

GAO

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

April 1986

INDUSTRIAL FUNDS

Recent DOD Reporting Changes Should Facilitate Congressional Oversight



**National Security and International
Affairs Division****B-220255**

April 11, 1986

The Honorable Joseph P. Addabbo
Chairman, Subcommittee on Defense
Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

In House Report 97-943 on the fiscal year 1983 Department of Defense (DOD) appropriation bill, the House Committee on Appropriations expressed concern that inherent flexibility in the financing techniques for working-capital funds was being used to remove congressional oversight and control over some appropriated funds. Accordingly, the Committee asked us to begin a series of studies of working-capital funds¹ in DOD. After discussions with your office, which modified the request, we reviewed DOD's industrial funds to gather information on DOD and military service operation of the funds, and to assess the adequacy of information DOD provides the Congress for its use in overseeing industrial fund operations.

DOD's industrial funds are modeled after businesslike operations, except they are intended to operate on a break-even basis. Although DOD's five industrial funds have operated near break-even for fiscal years 1981-1985, some subdivisions (activity groups) of the funds have had large profits or losses. Before 1985, DOD reported to the Congress the results of industrial fund operations at the fund level. As a result, the large profits and losses incurred by activity groups were not readily apparent to the Congress.

In 1985, DOD expanded its industrial fund reporting to include the results of operations at the activity group level. With this expanded information, we believe the Congress will be in a position to better monitor the funds' operations.

**Operation of Industrial
Funds**

The Congress, in 1949, amended the National Security Act of 1947 (10 U.S.C. 2208) to authorize the establishment of industrial funds. The Congress expected that use of the funds would introduce the incentives of private industry and commerce to DOD's industrial activities. DOD uses the funds to finance a variety of activities, such as maintenance depots,

¹There are two types of working-capital funds—industrial funds and stock funds.

shipyards, and ordnance stations, that perform functions of an industrial or commercial nature. Industrially funded activities perform services for or provide goods to customers who reimburse the activities with appropriated funds for the costs incurred. Reimbursement enables industrial funds to maintain a level of working capital needed to continue operations. DOD's industrial funds are designed to (1) provide an effective means for financing, budgeting, accounting for, and controlling costs of producing certain goods and services and (2) create a contractual (buyer-seller) relationship between industrial type activities and customers to provide management advantages and incentives for economy and efficiency.

DOD has established five funds—one for each of the services and one for DOD agencies. These funds are further broken down into activity groups—commands or activities that carry out similar functions. Through the activity groups, the services can carry out a variety of activities under one fund.

DOD obligated about \$24.6 billion, \$25.0 billion, and \$25.1 billion through its industrial fund activities in fiscal years 1983-1985, respectively. The \$25.1 billion in fiscal year 1985 represented about 9 percent of DOD's \$289 billion budget for that year. The Navy, the largest user of the funds, accounted for over \$13.8 billion of the \$25.1 billion obligated through the funds in fiscal year 1985.

During fiscal years 1981-1985, the five funds had cumulative revenues and profits of about \$111.9 billion and \$438.1 million, respectively.

Reporting Results of Operations to the Congress

Before 1985, DOD's reports to the Congress on industrial funds highlighted results of operations at the fund level, but showed no information on the results of operations of activity groups within the funds. The reports thus showed what the profit or loss was for each of the five funds, but did not show the profit or loss for each individual activity group within the funds. For example, within the Navy Industrial Fund, one activity group—the Military Sealift Command—had profits of \$419.0 million in fiscal year 1984 and another activity group—the Naval Air Rework Facilities—had a loss of \$109.2 million for that year.

DOD's rate-setting policy provides for the funds to break even at the activity group level by basing rates on costs and returning profits and recovering losses through adjusting rates charged to customers in subsequent years. As indicated, DOD's projections have not been so precise as

to break even each year at the activity group level. Each fund has a separate cash account and the balances have been sufficient to sustain operations of the funds over time, notwithstanding the varying annual results at the activity group level within each of the funds.

Because of congressional concern over the lack of information on industrial fund operations, DOD expanded its report to the Congress. In February 1985, DOD issued a report to the Congress, Department of Defense Industrial Fund Overview FY 1986, which provided a detailed account of its industrial fund operations, and included results of operations for individual activity groups. The revised report provides more detailed information to the Congress—results of operations of individual activity groups—for carrying out its oversight responsibilities regarding industrial funds. For example, knowledge of an activity group operating at a loss could raise oversight questions on matters such as the appropriateness of rates charged to customers or changes in workload.

Additional details about our work are in the appendixes.

Conclusions

Your committee expressed concern that inherent flexibility in the financing techniques for working-capital funds was being used to remove congressional oversight and control over some appropriated funds. Although DOD's industrial funds have operated near break-even, inherent flexibility in the working-capital fund concept allows the services to have varying operating results at the activity group level. Before 1985, DOD's reports to the Congress did not disclose this information. Therefore, the opportunity for congressional oversight over these funds was weakened.

However, in expanding its industrial fund report to the Congress in 1985, DOD disclosed information such as revenue, cost of goods sold, and net operating results (profits/losses) at the activity group level. With such information on the performance of specific activity groups, the Congress should be better able to monitor the funds' performance. This includes increased visibility over such items as revenue, costs, profits, losses, and rates charged customers for individual activity groups. Through this increased visibility, the Congress will be able to strengthen its oversight over how appropriated funds are ultimately used by industrial funds.

Agency Comments and Our Evaluation

DOD concurred with a draft of this report by letter dated February 28, 1986 (see app. II). However, it took exception with our statement that "one activity group's profits are used to offset another group's losses." DOD stated that although industrial fund rates are established so that each activity group breaks even, it is inevitable that projected rates will result in profits or losses. DOD said that activity group's profits and losses appeared to offset each other because this information was not reported to the Congress. However, the profits and losses were identified and maintained within each activity group.

We agree with DOD that in projecting rates to be charged customers, variances resulting in profits and losses will occur. We also recognize that no formal transfers of funds were made among activity groups. Our report emphasizes the prior lack of visibility of profit and loss by activity groups within an industrial fund and is not intended to question the accountability of each of the activity groups. Our report was clarified to eliminate the inference that there were direct offsets between activity groups.

We are sending copies of this report to the Director, Office of Management and Budget; Chairmen, Senate Committee on Governmental Affairs, House Committee on Government Operations, the House and Senate Committees on Appropriations, and on the Armed Services; and to the Secretaries of Defense, the Army, Navy, and Air Force.

Sincerely yours,



Frank C. Conahan
Director

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Abbreviations

ACP	Asset Capitalization Program
DOD	Department of Defense
MSC	Military Sealift Command
NARF	Naval Air Rework Facility

Improved Congressional Oversight of Industrial Funds Results From More Detailed DOD Reporting

DOD uses industrial funds to finance various activities, such as maintenance depots, shipyards, and ordnance stations, that perform functions of an industrial or commercial nature. Operating as "businesses," industrially funded activities perform services for or provide goods to customers, who reimburse the activities with appropriated monies for the costs incurred. Reimbursement enables the industrial fund to maintain the level of working capital it needs to continue its operations. In fiscal year 1985, DOD obligated about \$25.1 billion through its industrial fund activities, which represented about 9 percent of its \$289 billion budget.

Congressional Authorization and Objectives for Industrial Funds

During the mid 1940s, the Hoover Commission, while studying abuses in government operations, found that the military budget and appropriation processes were highly inefficient, uncoordinated, and confusing. Examples of problems that existed during this time include:

- Programs were funded from numerous appropriations managed or administered by scattered, unrelated organizations having various degrees of responsibility.
- Some activities had multiple sources of funding.
- Few activities had actual cost-accounting systems and efforts to relate production costs to end products were usually inaccurate and unreliable.
- Since management did not know the cost of a job, it concentrated on obtaining funds to support programs' existing staff years, equipment, utilities, and so forth.
- Industrial activities provided work free to DOD "customers" who were seldom restrained by financial considerations.

To correct such conditions, the Congress, in 1949, amended the National Security Act of 1947 (10 U.S.C. 2208) to authorize the establishment of industrial funds under the working-capital fund¹ concept. In establishing the funds, the Congress intended to introduce the discipline and incentives of private industry and commerce to DOD's industrial activities. The funds are modeled after businesslike operations, except they operate on a break-even basis. The Congress expected that:

- Businesslike cost-accounting would be used to (1) focus attention on the cost of performing a job, (2) simplify budgeting, and (3) provide cost information for management control.

¹Working-capital funds are established by law to carry out a cycle of business-type operations. A fund's income is in the form of receipts from the sale of goods or services primarily to other federal components. The receipts are used to finance a continuing cycle of operations.

- Management, given greater freedom from the appropriations cycle, through the working-capital fund concept, could adjust to workload demands to increase efficiency and reduce costs.
- Industrial funds would result in buyer-seller relationships between customers and producers. Customers, forced to pay for services rendered, would be motivated to order only necessities and pay only the minimum price. Producers, financially dependent upon obtaining orders and matching costs with reimbursements, would be motivated to improve cost estimates and controls, and to identify and correct inefficiency and waste.

Congressional Concern Over Industrial Fund Operations

Although one of its goals in authorizing industrial funds was to make DOD's industrial activities relatively free of the appropriations cycle, the Congress has become increasingly concerned about the extent to which this flexibility has made its oversight role difficult and its control too indirect. In House Report 97-943 on DOD's fiscal year 1983 appropriation bill, the House Committee on Appropriations expressed concern that the flexibility of working-capital funds was being used to remove congressional scrutiny over 25 percent of DOD's appropriated funds. Consequently, the Committee asked us to begin a series of studies of working-capital funds in DOD to address five major issues:

- The use of working-capital funds to extend the life of appropriations.
- The use of such monies to fund multibillion-dollar programs without specific congressional approval.
- The degree to which the Congress can accurately assess the proposed operation of working-capital funds if it only reviews customer appropriations.
- The degree to which programs under working-capital funds, proposed in the annual budget, are actually executed.
- The adequacy of existing congressional controls over such funds during the authorization and appropriation process.

The Committee reaffirmed its concern during hearings on DOD's fiscal year 1984 appropriations when it noted that because of the way industrial funds are structured, the Committee or the Congress cannot directly affect a change in the execution of an industrial fund program as it does with appropriated fund accounts.

This report is the third in a series of reports addressing industrial fund issues of concern to the Committee. We have issued reports entitled Improper Use of Industrial Funds by Defense Extended the Life of

Appropriations Which Otherwise Would Have Expired (GAO/AFMD-84-34, June 5, 1984), which discussed the use of working-capital fund to extend the life of appropriations; and Improved Analysis Needed to Evaluate DOD's Proposed Long-Term Leases of Capital Equipment (GAO/PLRD-83-84, June 28, 1983), which discussed the use of working-capital funds to finance multibillion-dollar programs without specific congressional approval.

Objectives, Scope, and Methodology

We met with your office to discuss plans and to establish priorities for the requested work on industrial funds. We agreed that our specific objectives were to (1) develop information on DOD and military service operation of industrial funds and (2) assess the adequacy of information DOD provides the Congress for its use in overseeing industrial fund operations.

We reviewed the legislation authorizing industrial funds and subsequent changes to it, as well as DOD and service policies and procedures for the establishment, operation, and management of such funds. We also reviewed records and interviewed officials at DOD and service headquarters regarding budgets, workload, cash management, billing rates, and management oversight. Because the Navy Industrial Fund accounted for more than half of the activities operating under DOD's industrial funds and accounted for the largest share of DOD's industrial fund revenue (\$14.1 billion of \$25 billion in fiscal year 1984), our emphasis was on evaluating the Navy's management of its fund. However, our review also included the Army and the Air Force.

We visited the activities (see app. III) of activity groups (commands or activities that carry out similar functions such as the Army's Depot System Command or the Navy's shipyards) drawn from three of DOD's five industrial funds. These activities were selected because of the groups' large amounts of revenues and profits or losses for fiscal year 1983.

At selected group headquarters and individual activities, we identified current practices for preparing budgets, establishing billing rates, managing cash, and reporting operational results. Since four of these groups had about 40 percent of fiscal year 1984 revenues of all DOD industrial funds and had shown large profits or losses during fiscal years 1982-1984, we interviewed agency officials and reviewed their records to identify the causes and effects. We did not verify the amounts reported for receipts, costs, profits, or losses.

We reviewed and assessed the adequacy and type of information DOD has provided the Congress in the past for its use in overseeing industrial fund operations. We also reviewed the type of information DOD and its services use to manage industrial fund activities. Further, we discussed with representatives of your office the type of industrial fund information they received and its adequacy for purposes of congressional oversight.

Our field work was performed from September 1984 through March 1985. Our review was made in accordance with generally accepted government audit standards.

Organization and Operation of DOD Industrial Funds

Under the authority of the 1949 legislation, the Secretary of Defense has established five funds—one for each of the four services, and one for DOD agencies. The five funds are further broken down into activity groups. Through the activity groups, the services can carry out a variety of activities under one fund. For example, the Air Force provides for equipment maintenance, real property maintenance, airlift services, and laundry and dry cleaning services with its industrial fund. The types of activities carried out through industrial funds change over time. For example, in fiscal year 1984, the Navy began operating its Regional Data Automation Centers as industrial fund activities, and in fiscal year 1986, the Army reverted to use of appropriated funds for its research and development activities. A detailed listing of activity groups, the number of activities, and the fiscal year 1985 revenues for the five funds are in table I.1.

**Appendix I
Improved Congressional Oversight of
Industrial Funds Results From More Detailed
DOD Reporting**

**Table I.1: DOD Industrial Fund Activity
Groups, Number of Activities, and
Fiscal Year 1985 Revenues**

Dollars in billions		
Activity group	Number of activities	Revenues
Army Industrial Fund:		
Depot System Command	16	\$1.9
Armament, Munitions and Chemical Command	6	0.5
Research and Development Activity Group	4	0.4
Missile Command	1	0.5
Military Traffic Management Command	5	0.3
Total		\$3.7^a
Navy Industrial Fund:		
Naval Shipyards	8	\$4.1
Military Sealift Command	24	1.8
Chief of Naval Research Laboratories	7	2.5
Naval Air Rework Facilities	6	1.9
Naval Ordnance Facilities	10	1.5
Public Works Centers	8	1.1
Naval Air Laboratories	3	0.7
Publications and Printing Service	^b	0.2
Aeronautical Engineering Centers	2	0.4
Navy Regional Data Automation Centers	9	0.2
Navy Research Laboratories	2	0.5
Total		\$14.8^a
Marine Corps Industrial Fund:		
	2	\$0.1
Total		\$0.1
Air Force Industrial Fund:		
Depot Maintenance Industrial Fund	8	\$4.1
Airlift Service Industrial Fund	1	2.3
San Antonio Real Property Maintenance Activity	1	0.2
Laundry and Dry Cleaning Service	9	^c
Total		\$6.6
Defense Industrial Fund:		
Clothing and Textile Center	1	^c
Communications Service Industrial Fund	4	1.0
Automated Data Processing Equipment Fund	1	^d
Total		\$1.0

^aTotals do not add due to rounding.

^bThis activity group has numerous offices, branches, and plants located worldwide.

^cLess than \$50,000,000.

^dThis activity group was established to purchase automated data processing equipment for various DOD activities. It has no revenue.

Industrial funds receive initial working capital at the time they are established. Initial working capital is provided either through a direct appropriation or a transfer of resources from existing appropriations or other working-capital funds. The industrial funds consist of fund balances with the Treasury— accounts receivable, inventories of materials, supplies, work in process, and all other assets pertaining to or acquired in the operations of activities.

The five funds are separate entities, in that each has a cash account with the Treasury. According to a DOD Comptroller official, a fund's cash is available to pay for expenses associated with orders placed with any of the activity groups within the fund.

Before an activity can be financed as an industrial fund, the Assistant Secretary of Defense (Comptroller) must approve a charter for the activity. The charter governs its operations and includes information such as

- justification of estimated working-capital requirements;
- detailed requirements for fund balances; and
- information concerning the expected volume of business, by type and character, and the source of reimbursements by customer agency and appropriation, or other source.

Charter amendments, including cancellations, are also subject to approval by the DOD Comptroller.

Management Responsibility

The Secretary of Defense has delegated administration and management of industrial funds to the Secretaries of the military departments and the Directors of DOD agencies responsible for the activities financed with industrial funds. These departments and agencies, in turn, have delegated the responsibility for managing industrial fund operations to their activity groups. For example, the Department of the Navy has assigned to the Naval Sea Systems Command the responsibility for the eight shipyards under the Command's administrative control. Authority to incur obligations and costs for each activity is vested in the local activity (an individual shipyard), under the direction and supervision of the Sea Systems Command.

How Industrial Funds Operate

Industrial fund activities may furnish services to other government activities, agencies of state and local governments, foreign governments, government personnel, and others outside DOD when authorized by law. Customers, most commonly DOD organizations financed with appropriated funds, place orders with the industrial fund activity. On the basis of these orders, the activity uses its working capital to finance the cost of performing the work, which is done either in-house or contracted out. Orders accepted by the activity specifically state whether reimbursement to the fund is based on predetermined prices or on actual costs. Reimbursement is usually made on a progress-payment basis. These payments are used to finance continuing operations, much as sales receipts are used by a commercial enterprise.

The ability of the industrial funds to continue operating is limited by the resources available to them. These resources consist of cash and customer orders for certain types of work, such as production, and do not expire at the end of a fiscal period. This contrasts with the operation of appropriated fund activities that receive obligational authority through the congressional appropriation process for a particular fiscal year and for a specified amount.

The following example illustrates how the funds operate. The overhaul and maintenance of major Navy vessels is primarily performed by industrially-funded Navy shipyards and funded by annual appropriations to the organization responsible for the vessels (e.g., Commander, Naval Surface Force, U.S. Atlantic Fleet). This organization or "customer" then contracts with one of the Navy shipyards to have the needed work accomplished at a predetermined price. Upon commencement of work, the shipyard initially finances the cost of labor, material, and overhead from its working capital. As these costs begin to accumulate, the shipyard will periodically bill the customer in accordance with the agreed price. The payments from the customer replenish the shipyard's working capital so that the cycle can continue.

Basis for Reimbursement

DOD customers of an industrial fund activity reimburse the activity on the basis of rates and prices determined annually, in accordance with DOD Regulation 7410.4R. According to this regulation, such rates are established to

- recover estimated operating expenses to be incurred by the fund for the applicable fiscal year;

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- return profits or recover losses from previous years, as applicable, at the activity group level;
- provide sufficient working capital for acquisition of fixed assets, as approved by the Assistant Secretary of Defense (Comptroller); and
- realize other factors, as designated by the Assistant Secretary of Defense (Comptroller).

In determining rates and prices, the industrial funds are directed to minimize overall gains or losses at the activity group level. In other words, accumulated operating results theoretically will reach zero at the end of the year for which the rates and prices are established. The rates and prices charged to DOD customers do not include charges for certain items such as military personnel services (including retirement), and civilian personnel retirement.

Unless changes are specifically approved by the Assistant Secretary of Defense (Comptroller), the rates or prices are held stable for the entire fiscal year. This stabilization protects customers from unforeseen inflation, as well as other cost uncertainties. Thus, purchases can be planned with greater confidence and programs carried out within budgetary limits. The industrial activities, in turn, are provided a more dependable projection of workload, enabling them to adjust resource expenditures to workload demand.

Measuring Industrial Fund Operations

Industrial funds assess the net effect of operations in terms of profits and losses. An excess of revenues over costs for the year will generate a profit; an excess of costs over revenues will result in a loss. For fiscal years 1981-1985, DOD's industrial funds had revenues of about \$111.9 billion and profits of about \$438.1 million. Table I.2 is a comparison of the industrial funds' revenues and profits.

Table I.2: Comparison of Revenue to Profits of DOD Industrial Funds for Fiscal Years 1981-1985

Dollars in millions			
Industrial fund	Revenue	Profit	Profit as a percentage of revenue
Army	\$15,556.8	\$49.3	.3
Navy	64,807.7	207.3	.3
Marine Corps	424.0	18.4	4.3
Air Force	26,980.0	54.1	.2
Defense	4,170.5	109.0	2.6
Totals	\$111,939.0	\$438.1	

**Financing Capital
 Equipment Purchases**

The Asset Capitalization Program (ACP) was initiated in fiscal year 1983 to provide for the purchase of industrial fund equipment with money received from customers, rather than with appropriated funds. Under ACP, equipment costs are initially financed by the industrial fund activity receiving the equipment. These costs are subsequently recovered over the life of the equipment by including depreciation expenses in the rate charged to the fund's customers.

**Activity Groups'
 Losses Were Not
 Apparent in Prior
 Reports**

DOD's policy is that the gains and losses of the individual activity groups be minimized. A review of the Navy activity groups' results of operations for the past three fiscal years demonstrates that within the Navy Industrial Fund, some had profits and some had losses (see table I.3).

**Table I.3: Profits and Losses of Navy
 Industrial Fund Activity Groups for
 Fiscal Years 1983-1985**

Activity group	Fiscal year		
	1983	1984	1985
Naval Shipyards	\$-80.7	\$42.8	\$72.2
Military Sealift Command	146.8	419.0	-97.3
Chief of Naval Research (formerly Material) Laboratories	-1.6	46.6	-58.5
Naval Air Rework Facilities	-170.9	-109.2	188.0
Naval Ordnance Facilities	-14.7	9.9	-9.6
Public Works Centers	24.1	-5.6	-51.4
Naval Air Laboratories	-3.7	-1.3	2.6
Publications and Printing Service	-1.4	7.1	-4.5
Aeronautical Engineering Centers	-1.2	5.3	2.5
Navy Regional Data Automation Centers	—	6.2	-7.3
Navy Research Laboratories	-0.7	3.0	-5.1
Special projects	-3.4	—	—
Totals^a	\$-107.3	\$423.8	\$31.5

^aTotals do not add due to rounding.

For fiscal years 1981-1985, the NARFS had a cumulative net operating loss of about \$116 million. This amount included losses of \$170.9 million and \$109.2 million in fiscal years 1983 and 1984, respectively. According to officials at one NARF and at the Naval Air Logistics Command, a negative balance does not adversely affect the NARFS, because the central industrial fund account contains enough cash to continue its normal operations. According to Navy records, the NARFS had negative

cash balances of \$197 million in fiscal year 1983 and \$247 million in fiscal year 1984.

MSC, on the other hand, had profits of \$146.8 million and \$419.0 million in fiscal years 1983 and 1984, respectively. Because MSC's profits added cash to the overall Navy Fund, the Navy had enough resources at the fund level to sustain operations notwithstanding the NARFs' losses.

Based on the data reported to the Congress in DOD's annual reports prior to 1985, the results of the individual activity groups' operations were not apparent. For example, DOD's 1984 report only disclosed the Navy's aggregate loss of \$107.3 million—not the results of individual activity group operations.

A similar situation exists within the Air Force Industrial Fund. The profits and losses of two activities—the depot maintenance industrial fund, operated by the Air Force Logistics Command, and the airlift service industrial fund, operated by the Military Airlift Command—have generally compensated for one another within the Air Force Industrial Fund over the past four fiscal years (see table I.4).

Table I.4: Depot Maintenance and Airlift Service Industrial Funds' Profits and Losses

Dollars in millions					
Activity group	Fiscal year				
	1981	1982	1983	1984	1985
Depot Maintenance	\$1.7	\$-51.5	\$-110.1	\$54.6	\$14.1
Airlift Service	-1.9	58.4	110.6	-23.9	-14.4

Recent Changes in DOD Reporting Should Facilitate Congressional Oversight of Industrial Funds

Most government programs undergo an annual authorization and/or appropriations process during which various congressional committees closely examine the programs' recent operations and future plans. Industrial fund activities do not require annual appropriations. As a result, the Congress relies on information provided by DOD on the results of industrial fund operations to carry out its periodic oversight of the funds.

Past Reporting Provided Only Aggregate Data

The National Security Act of 1947, as amended in 1949, provides for the Secretary of Defense to report annually to the President and the Congress on the condition and operations of industrial funds. In response to

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this requirement, the Secretary annually submitted a report entitled Department of Defense Industrial Fund Estimates for Fiscal Year 19.

Until 1985, DOD's annual reports contained information summarizing data for the five industrial funds. The type of information reported included:

- Civilian personnel end strengths and workyears.
- Program and financing schedules.
- Balance sheets showing assets, liabilities, and equity account balances.
- Income statements.

The reported information covered a 3-year period—actual figures for the prior year, and estimates for the current and budget years. For example, in February 1984, the Secretary of Defense submitted a report containing actual amounts for fiscal year 1983 (the prior year) and estimates for fiscal year 1984 and 1985 (the current and budget years). The report's Revenue and Expense and Changes in Government Equity statement showed actual fiscal year 1983 net operating income or loss for the five funds and for the overall DOD industrial fund, as shown in table I.5.

The report did not reveal the results of operations for the individual activity groups. For example, although the Navy reported a net operating loss of \$107.3 million, the Congress was not provided information on NARF's \$170.9 million loss or MSC's \$146.8 million profit. Without such information, the Congress did not have a clear picture of how well the individual industrial fund activity groups were performing.

**Table I.5: Net Operating Income or Loss
for DOD Industrial Funds—Fiscal Year
1983**

Dollars in millions	
Industrial fund	Net operating income or (loss)
Army	\$-108.3
Navy	-107.3
Marine Corps	3.7
Air Force	13.3
Defense	16.7
Total	\$-181.9

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In addition, officials within DOD and the Army's Office of the Comptroller stated that the reporting format had serious shortcomings as a management tool, and that the report

- lacked an extensive set of financial statements, such as would be found in the yearly reports of similar commercial organizations,
- terminology was not consistent with commercial cost accounting terminology, and
- design was more suited to appropriated fund activities.

**Current DOD Report
Provides Improved
Management Data**

Because of increased congressional concern, in 1985 DOD greatly expanded its industrial fund report and issued Department of Defense Industrial Fund Overview FY 1986.

The report explained what operations DOD finances with industrial funds and how the funds operate. It also included overall statistics on the prior year's operations and future estimates, and information on revenues, costs of goods and services, and net operating results at the activity group level. DOD continued to use the revised format for its fiscal year 1987 report to the Congress. According to its Comptroller's office, DOD plans to continue including activity group level information in future reports to the Congress.

Agency Comments



COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

28 FEB 1986

Mr. Frank C. Conahan
Director, National Security and
International Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "Recent Changes In DoD Reporting Should Facilitate Congressional Oversight Of Industrial Funds," dated December 26, 1985 (GAO Code 390022, OSD Case 6904).

The Department concurs with the draft report, except for one point. The draft report states that "one activity group's profits are used to offset another group's losses." This is not actually the case, although the annual budget justifications have given that appearance.

Annual budget reviews are designed to allow each activity group to break even (i.e., realize neither a profit or loss) for the applicable fiscal year. Budgetary adjustments and associated industrial fund rate changes made as a result of the budget reviews are based on projections in excess of one year in advance of actual experience. It is inevitable that actual experience will vary from such projections and result in either profits or losses. Justification material previously provided to the Congress showed these net profits or losses only at the Service industrial fund level; thus profits and losses at different activity groups appeared to offset each other. The profits or losses, however, are actually identified and maintained within each activity group. The recent changes in budget justification material discussed in the GAO report should alleviate the appearance that profits and losses are transferred between activity groups.

The Department appreciates the efforts of the GAO in reviewing this important program.

Sincerely,

John R. Quast
Principal Deputy Assistant Secretary of Defense
(Comptroller)

Locations Visited

Department of Defense: Office of Assistant Secretary of Defense, Comptroller, Washington, D.C.

Department of the Army: Deputy Chief of Staff, Logistics, Washington, D.C.
Office of the Comptroller of the Army, Washington, D.C.
Depot System Command, Chambersburg, Pennsylvania
Letterkenny Army Depot, Chambersburg, Pennsylvania

Department of the Navy: Office of the Comptroller, Washington, D.C.
Military Sealift Command, Washington, D.C.
Naval Air Systems Command, Washington, D.C.
Naval Data Automation Command, Washington, D.C.
Naval Engineering Facilities Command, Alexandria, Virginia
Naval Material Command, Washington, D.C.
Naval Sea Systems Command, Washington, D.C.
Naval Aviation Logistics Center, Patuxent River, Maryland
Naval Air Rework Facility, Norfolk, Virginia
Navy Public Works Center, Norfolk, Virginia
Norfolk, Naval Shipyard, Portsmouth, Virginia

Department of the Air Force: Office of the Comptroller, Washington, D. C.
Air Force Logistics Command, Wright-Patterson Air Force Base, Dayton, Ohio
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