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September 30, 1997

Ms. Alice C. Maroni
Acting Under Secretary of Defense (Comptroller)

The Honorable R. Noel Longuemare
Acting Under Secretary of Defense (Acquisition and Technology)

Subject: Financial Management: DOD Needs to Expedite Plans to Implement Deferred Maintenance Accounting Standard

Recent laws[1] have enhanced the legislative requirements to provide policymakers and agency program managers with more reliable financial information to formulate budgets, manage government programs, and help make difficult policy choices. Because informed decision-making is made more difficult by incomplete and unreliable information on the cost and consequences of government programs and activities, these laws have made implementation of new accounting standards and audited federal financial statements a priority. New federal financial accounting standards have been adopted to enhance federal financial statements by showing the financial results of government agencies' entire operations and providing relevant information on agencies' financial status–information that has never before been required in this form. This letter discusses one such requirement for information related to deferred maintenance on mission assets.[2]

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[1]The Chief Financial Officers Act (CFO) of 1990, the Government Management Reform Act (GMRA) of 1994, and the Federal Financial Management Improvement Act of 1996.

[2]Statement of Federal Financial Accounting Standard (SFFAS) No. 6, Accounting for Property, Plant, and Equipment, dated November 30, 1995, defines federal mission property, plant, and equipment as possessing certain characteristics related to (1) its use, such as having no expected nongovernmental uses, and (2) its useful life, such as a very high risk of being destroyed in use or premature obsolescence.

Beginning with fiscal year 1998, federal accounting standards require agencies to disclose in their financial statements the amount of deferred maintenance related to property, plant, and equipment, including mission assets. For the Department of Defense (DOD), mission assets such as submarines, ships, aircraft, and combat vehicles are a major category of property, plant, and equipment. For fiscal year 1996, DOD reported over $590 billion in this asset category. Accurate reporting of deferred maintenance is important for key decisionmakers such as the Congress and DOD, including military service managers. Further, deferred maintenance applicable to mission assets, if reliably quantified and reported, can be an important performance indicator of mission asset condition (a key readiness factor), as well as an indicator of the proper functioning of maintenance and supply lines. While the existence of deferred maintenance may also indicate a need for additional resources for maintenance, such resources may already be available within the current funding of the services.

The purpose of this letter is to report on the status of DOD's efforts to develop agencywide policies to address the deferred maintenance standard for mission assets and to emphasize the importance of developing timely DOD-wide guidance. This is the first in a series of reviews that will address DOD's implementation of the deferred maintenance standard, including separate reports on issues related to Army and Navy.

RESULTS IN BRIEF

The development of DOD policy and implementing guidance for deferred maintenance is essential to ensure consistent reporting among the services and to facilitate the preparation of accurate DOD-wide financial statements, particularly since the new accounting standard provides extensive management flexibility in implementing the disclosure requirement. During our ongoing work on identifying and disclosing deferred maintenance on mission assets, both Army and Navy officials stated that they were reluctant to develop procedures to implement the required accounting standard until DOD issues overall policy guidance.

Accounting policy officials within the Office of the Under Secretary of Defense, Comptroller (OUSD(C)), stated that they plan to issue DOD-wide policy guidance in the DOD Financial Management Regulation after OUSD(C) and the Under Secretary of Defense (Acquisition and Technology) review the results of a study by a nonprofit organization. This study is expected to identify and evaluate alternative reporting approaches. The officials then plan to provide financial management and logistic policy guidance as appropriate for deferred maintenance. OUSD (Acquisition and Technology) maintenance policy staff

plan to award the task order for this study in October 1997 and expect the results in 6 to 9 months. However, under this time frame, the military services may not have the DOD-wide guidance in time to develop service-specific policies and procedures for collecting deferred maintenance data for the fiscal year 1998 financial statements.

SCOPE AND METHODOLOGY

To assess progress made in implementing the requirements to disclose mission assets and associated deferred maintenance, we reviewed regulations and pertinent documentation at DOD headquarters and various organizational levels within DOD and the Departments of the Army and Navy and interviewed responsible officials. Our work focused on Army and Navy because they account for most of the major classes of mission assets found throughout DOD.

We conducted our review from May 1997 through September 1997 in accordance with generally accepted government auditing standards. This work was part of our broader reviews of factors that DOD, Army, and Navy need to address in developing deferred maintenance policy and guidance. We requested comments on a draft of this report from the Secretary of Defense or his designee. The Acting Under Secretary of Defense (Comptroller) provided us with written comments, which are discussed in the "Agency Comments and Our Evaluation" section and are reprinted in enclosure I.

ACCOUNTING STANDARD ALLOWS MANAGEMENT FLEXIBILITY

Statement of Federal Financial Accounting Standards (SFFAS) No. 6, Accounting for Property, Plant, and Equipment, issued on November 30, 1995, requires the disclosure of deferred maintenance in agencies' financial statements for the fiscal year beginning October 1, 1997. SFFAS No. 6 defines deferred maintenance as "maintenance that was not performed when it should have been or was scheduled to be and which, therefore, is put off or delayed for a future period." It includes preventive maintenance and normal repairs, but excludes modifications or upgrades that are intended to expand the capacity of an asset. The deferred maintenance standard applies to all property, plant, and equipment, including mission assets that will be reported on the supplementary stewardship report.[3] Federal mission assets specifically include weapons

[3]Statement of Federal Financial Accounting Standards No. 8, Supplementary Stewardship Reporting, requires the reporting of federal mission property, plant, and equipment on the supplementary stewardship report.

systems, such as fighter/attack aircraft, submarines, and tracked combat vehicles.

SFFAS No. 6 recognizes that there are many variables in estimating deferred maintenance amounts. For example, the standard acknowledges that determining the condition of the asset–condition rating–is a management function because different conditions might be considered acceptable by different entities or for different items of property, plant, and equipment held by the same entity. Amounts disclosed for deferred maintenance may be measured using condition assessment surveys[4] or life-cycle cost forecasts.[5] Therefore, SFFAS No. 6 provides flexibility for agencies' management to (1) determine the level of service and condition of the asset that are acceptable, (2) disclose deferred maintenance by major classes of assets, and (3) establish methods to estimate and report any material amounts of deferred maintenance.

SFFAS No. 6 also has an optional disclosure for stratification between critical and noncritical amounts of maintenance needed to return each major class of asset to its acceptable operating condition. If management elects to disclose critical and noncritical amounts, the disclosure must include management's definition of these categories.

PROPOSED TIMING OF DOD'S ACCOUNTING AND LOGISTICS POLICY AND GUIDANCE WILL NOT ENSURE CONSISTENT AND TIMELY DISCLOSURE

As of September 30, 1997, DOD accounting policy and implementing guidance for the disclosure of deferred maintenance had not been developed. Officials from both Office of the Secretary of Defense (OSD) offices responsible for developing implementation guidance for SFFAS No. 6–accounting policy and maintenance policy–acknowledged the need for DOD policy guidance to ensure consistent disclosure of deferred maintenance by the military services. The

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[4]Condition assessment surveys are periodic inspections of property, plant, and equipment to determine their current condition and the estimated cost to correct any deficiencies.

[5]Life-cycle costing is an acquisition or procurement technique which considers operating, maintenance, and other costs in addition to the acquisition cost of assets. Since it results in a forecast of maintenance expense, these forecasts may serve as a basis against which to compare actual maintenance expense and estimate deferred maintenance.

officials stated that about a year ago the two offices started discussing how the deferred maintenance definition should be applied to DOD's mission assets.

Issuance of implementing policy guidance is particularly important for disclosing deferred maintenance because operational and financial Army, Navy, and DOD officials have varied positions regarding what constitutes deferred maintenance. Consistent application of criteria for identifying and reporting deferred maintenance is especially important in the case of similar or even identical classes of assets held by two or more services. For example, DOD-wide policy and guidance would help ensure that all services use the same methodology in developing estimates of deferred maintenance for aircraft, a weapon system common to all three services.

During our review, OUSD(C) accounting policy officials advised us that they planned to publish policy guidance in electronic form by October 1, 1997. They recognized that the military services must have guidance available at the beginning of the fiscal year to establish their own policies, develop implementation plans, and ensure that appropriate processes are in place to collect the needed data to properly disclose deferred maintenance at year-end. According to OUSD(C) officials, the planned DOD-wide policy would consist of reiterating the federal financial accounting standards related to deferred maintenance in DOD's Financial Management Regulation without further guidance at that time. However, after we received DOD's official comments, the Deputy CFO advised us on September 30, 1997, that DOD now plans to await the results of the LMI study, as discussed below, before issuing DOD-wide guidance.

OUSD (Acquisition and Technology) maintenance policy officials recently requested fiscal year 1998 funds to engage a nonprofit organization, the Logistics Management Institute (LMI), to identify and evaluate alternative reporting approaches for deferred maintenance, recommend the best solution from the Chief Financial Officer (CFO) and maintenance community perspective, and recommend the necessary policy and reporting protocols. DOD maintenance policy personnel expect to award a task order to LMI in October 1997, with an estimated 6-month to 9-month completion date. An OUSD(C) official stated that once the information is obtained from LMI, policy updates can easily be communicated because DOD's Financial Management Regulation is available electronically to all DOD staff.

We are encouraged by the collaborative and concurrent efforts of the accounting policy and maintenance policy officials to develop meaningful financial data that will be useful to both financial and program managers--a goal of the recent laws to improve government performance and accountability.

However, the timing of OUSD(C)'s planned guidance may be problematic since the overall results of the contract on which the guidance is to be based will not be available until April 1998 at the earliest–assuming the study begins on October 1, 1997, and is completed within 6 months. Additional time would then be needed for OUSD(C) staff to review the study results and develop specific policies and procedures. Without accelerating the planned study completion date, the military services may not have the guidance in time to develop service-specific policies and procedures for collecting deferred maintenance data for the fiscal year 1998 financial statements. The military services have emphasized that they need the OUSD(C) guidance as soon as possible to ensure that they have enough time to meet the deferred maintenance reporting requirements for fiscal year 1998. We believe that such guidance needs to be issued no later than March 1998 in order to allow the services time to take appropriate action and accumulate the necessary data to ensure consistent DOD-wide implementation for fiscal year 1998.

For example, Army officials stated that they needed timely OUSD(C) guidance to ensure that they have the necessary procedures in place to accumulate the needed data. In particular, Army officials were concerned that although they have previously reported deferred maintenance at the depot level for budgetary purposes, they were not certain whether these reports would be consistent with OUSD(C) deferred maintenance policy guidance. Further, they were also concerned that they did not have procedures or systems in place to quantify deferred maintenance at the unit level. Because of the lead time necessary to support disclosure of unit-level deferred maintenance, Army officials preferred to know at the start of the fiscal year whether this would be required.

Similarly, Navy officials stated that they would prefer to have specific OUSD(C) guidance as close to the beginning of the fiscal year as possible so that fleet comptrollers can determine how the needed information will be derived. Navy officials told us that they intend to obtain the data needed to disclose deferred maintenance by relying on "data calls" in which financial management personnel send out a request to all appropriate locations for the information. Navy officials stated that at the latest, OUSD(C) guidance must be received by July 1998 to give them enough time to issue the data calls.

CONCLUSIONS

DOD-wide policy on identifying and disclosing deferred maintenance is necessary to ensure consistent application of the accounting standards across the military services. This is especially important because of the flexibility provided by the standards and the various opinions among service officials as to what constitutes deferred maintenance. The recent coordination effort between

OUSD (C) accounting policy and OUSD (Acquisition and Technology) maintenance policy staffs to issue a task order for the Logistics Management Institute to help develop deferred maintenance policy is a positive step. However, as indicated by Army and Navy officials, OUSD(C) implementing guidance is needed as close to the start of fiscal year 1998 as possible to ensure that the services have enough time to implement service-specific policies and procedures and derive the needed data for the fiscal year-end.

RECOMMENDATIONS

We recommend that you

- ensure that DOD-wide policy is in place as soon as possible so that DOD can comply with the fiscal year 1998 effective date of the deferred maintenance standard;

- establish milestones for key actions in the policy development process to help ensure issuance of the policy no later than March 1998; and

- modify the proposed study with the Logistics Management Institute to accelerate completion of the deliverables to help achieve the March time frame.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on a draft of this report (see enclosure I), the Department of Defense generally concurred with the report and the intent of our recommendations.

We recommended that milestones be established for key actions in the policy development process to help ensure issuance of the DOD-wide implementing policy for the deferred maintenance standard no later than March 1998. In response to our recommendation that DOD accelerate completion of the LMI study results to achieve the March time frame for issuing implementing guidance, DOD stated that the Office of the Assistant Under Secretary of Defense (Maintenance Policy, Programs and Resources) will investigate the feasibility of expediting the completion date of the LMI study to March 1998.

In order to be fully responsive to our recommendations, DOD will soon need to establish several additional important interim milestone dates. While DOD responded that it has established key milestones, the only milestone established is the September 30, 1998, date for publishing DOD guidance on form and content of financial statements for fiscal year 1998. DOD has not yet

established milestones for key actions (such as reviewing study results, drafting implementing guidance, and coordinating with the military services), as intended by our recommendation, to ensure that it has time to incorporate the results of the LMI study into implementing policy and to publish that policy no later than March 1998. As emphasized in our report, we believe it is important, especially in light of the varied opinions of DOD officials on what constitutes deferred maintenance, that the policy guidance be expanded beyond a reiteration of the standard to address its specific application in DOD to help ensure consistent disclosure of deferred maintenance by the military services. Clearly, for DOD to have sufficient time to use those results to develop its policy, coordinate with the military services, and publish the policy within this time frame, the results must be available before March.

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This report contains recommendations to you. Within 60 days of the date of this letter, we would appreciate receiving your written statement on actions taken to address these recommendations.

We are sending copies of this letter to the Chairmen and Ranking Minority Members of the Senate Committee on Appropriations, the Senate Committee on Armed Services, the House Committee on National Security, the Senate Committee on Governmental Affairs, and the House Committee on Government Reform and Oversight. We are also sending copies to the Director of the Office of Management and Budget and the Secretary of Defense; the Assistant Secretaries for Financial Management for the Air Force, Army, and Navy; and the Acting Director, Defense Finance and Accounting Service. Copies will be made available to others upon request.

During our work on deferred maintenance at both the Army and Navy, we have collected information that may be useful to you in developing policies and procedures for identifying and disclosing deferred maintenance. We will be issuing reports on these issues but are also available to discuss this information with you at your convenience. Please contact me at (202) 512-9095 to arrange a meeting or if you or your staffs have any questions concerning this letter. Major contributors to this letter are listed in enclosure II.

Lisa G. Jacobson

Lisa G. Jacobson
Director, Defense Audits

Enclosures

COMMENTS FROM THE DEPARTMENT OF DEFENSE

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

COMPTROLLER

SEP 23 1997

Mr. Gene L. Dodaro
Assistant Comptroller General
Accounting and Information Management Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Dodaro:

This is the Department of Defense response to the General Accounting Office (GAO) draft report entitled, "FINANCIAL MANAGEMENT: DoD Needs to Expedite Plans to Implement Deferred Maintenance Accounting Standard," dated September 4, 1997 (GAO Code 918876/OSD Case 1458).

The Department generally concurs with the draft report. Enclosed is the Department's response to the report's recommendation.

The Department appreciates the opportunity to comment on the subject draft report.

Sincerely,

Alice C. Maroni
Acting Under Secretary of Defense
(Comptroller)

Enclosure

GAO DRAFT REPORT – DATED SEPTEMBER 4, 1997
OSD CASE 1458, GAO CODE 918876

"FINANCIAL MANAGEMENT: DoD NEEDS TO EXPEDITE PLANS TO IMPLEMENT DEFERRED MAINTENANCE ACCOUNTING STANDARD"

DEPARTMENT OF DEFENSE COMMENTS ON THE GAO RECOMMENDATION

Recommendation: The GAO recommended that the Under Secretary of Defense (Comptroller) and the Under Secretary of Defense (Acquisition and Technology), collaboratively,

- ensure that OSD policy is in place as soon as possible so that DoD can comply with the fiscal year 1998 effective date of the deferred maintenance standard;

- establish milestones for key actions in the policy development process to help ensure issuance of the policy no later than March 1998; and

- modify the proposed study with the Logistics Management Institute to accelerate completion of the deliverables to help achieve the March time frame. (p. 11/GAO Draft Report)

See comment 1.

DoD Response: Concur with the intent of the recommendation. The OUSD(C) already has established key milestones not only for publishing DoD-wide financial management policy in the "DoD Financial Management Regulation" (DoD 7000.14-R), including DoD's form and content guidance for the preparation of financial statements, but also updating that policy guidance, if required, upon a joint review of the LMI study initiated by the OADUSD(MPP&R). As correctly stated in the draft audit report, the OUSD(C) plans to publish DoD-wide financial management policy guidance for deferred maintenance in the DoD 7000.14-R. That policy guidance, as a minimum, is expected to include the federalwide accounting standard on deferred maintenance. Additionally, "DoD Guidance on Form and Content for CFO Financial" is expected to be published in the DoD 7000.14-R. The OADUSD(MPP&R) will investigate the feasibility of expediting the completion date of the LMI study to March 1998.

Enclosure to Letter – GAO
Draft Report – OSD Case 1458
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The following is GAO's comment on DOD's letter dated September 23, 1997.

GAO COMMENT

1. After we received DOD's official comments, the Deputy CFO advised us on September 30, 1997, that DOD now plans to await the results of the LMI study before issuing the DOD-wide guidance. Accordingly, we have revised the appropriate sections of the report.

MAJOR CONTRIBUTORS TO THIS LETTER

ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, WASHINGTON, D. C.

Cleggett Funkhouser

DALLAS FIELD OFFICE

Charnel Harlow
Seth Taylor

NORFOLK FIELD OFFICE

Rebecca Beale
Merle Courtney
Chris Rice
John Wren

(918876)

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