United States Government Accountability Office

GAO

Report to Congressional Committees

May 2005

DEFENSE MANAGEMENT

Processes to Estimate and Track Equipment Reconstitution Costs Can Be Improved

GAO-05-293

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GAO Accountability·Integrity·Reliability

Highlights

Highlights of GAO-05-293, a report to congressional committees

Why GAO Did This Study

The high pace of military operations in Iraq and elsewhere has generated a multibillion dollar equipment maintenance requirement that must be addressed after units return home. Upon returning from deployments, active, reserve, and National Guard units reconstitute, or restore, their equipment to a condition that enables them to conduct training and prepare for future deployments. The Department of Defense (DOD) uses a two-phased process to develop equipment reconstitution supplemental budget estimates. GAO reviewed this process for the fiscal year 2004 supplemental budget to determine (1) the extent to which the process produced reliable estimates of reconstitution requirements in the fiscal year 2004 supplemental budget, and (2) whether DOD is accurately tracking and reporting reconstitution costs.

What GAO Recommends

GAO is making several recommendations to correct weaknesses identified in DOD's equipment reconstitution cost estimating and tracking processes. In commenting on a draft of this report, DOD concurred or partially concurred with five recommendations and did not concur with the other recommendation.

www.gao.gov/cgi-bin/getrpt?GAO-05-293.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William M. Solis at (202) 512-8365 or solisw@gao.gov.

What GAO Found

DOD's two-phased process to develop its fiscal year 2004 equipment reconstitution cost estimates contained weaknesses that produced errors, which may result in misstatements of future-year reconstitution cost requirements. The model DOD used to estimate costs in the first phase of the process generated unreliable estimates due to two main reasons. First, the model can overstate aircraft and ship reconstitution costs because these costs are covered in two different sections of the model. As a result, the model's estimate for Air Force aircraft reconstitution was overstated by over $1 billion. Second, there is uncertainty over what maintenance requirements the model covered. The Office of the Secretary of Defense (OSD) and the services developed their requirements with the understanding that the model did not calculate all maintenance requirements. GAO learned that the model may duplicate some requirements that the services manually calculated and included in their cost estimates. Consequently, DOD cannot have confidence that its equipment reconstitution budget estimate is reliable. There are also reconstitution estimating and guidance problems associated with the second phase of the process, where the services may develop alternative estimates outside of the model. For instance, the Army failed to consider funding in its baseline budget that would be available for equipment reconstitution. In another instance, the services included requirements in their reconstitution estimates that appear to go beyond equipment reconstitution as established by OSD's guidance. Nonetheless, GAO found an accumulation of unfulfilled equipment reconstitution requirements, because OSD guidance excluded the services from requesting funds for projected battle and other expected losses. The effect of losses not recognized in OSD's supplemental budget requirements have not yet been quantified and may be significant. GAO believes these problems are creating a backlog of equipment reconstitution requirements that will eventually need to be addressed in future budgets.

DOD has not accurately tracked and reported its equipment reconstitution cost because the services are unable to segregate equipment reconstitution from other maintenance requirements as required. As a result, DOD cannot accurately report the cost of equipment reconstitution and, consequently, the total cost of the global war on terror. The Air Force does not break out its equipment reconstitution obligations from other global war-on-terrorism obligations in a DOD monthly cost report because it does not have a mechanism that can track the amounts obligated on equipment reconstitution and delineate such obligations from routine maintenance. Further, Army- and Navy-reported equipment reconstitution obligations are likely overstated in the monthly report because they include other maintenance costs—such as those related to equipment used in training exercises—that do not fall within DOD's description of equipment reconstitution.

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United States Government Accountability Office
Washington, D.C. 20548

May 5, 2005

Congressional Committees

The high pace of military operations in Iraq and elsewhere has generated a multibillion dollar equipment maintenance requirement that must be addressed after units return home. Upon returning from Iraq and other global war-on-terrorism deployments, units reconstitute—that is, restore—their equipment to a condition that enables them to conduct training exercises, achieve required readiness levels, and prepare for future deployments. While the Department of Defense (DOD) has not formally defined equipment reconstitution, its financial regulation describes reconstitution costs as including costs to clean, inspect, maintain, replace, and restore equipment to the required condition at the conclusion of the contingency operation or unit deployment. Furthermore, the department has issued additional specific guidance as to what costs should be included as reconstitution. Reconstitution is performed at each level of maintenance—organizational, intermediate, and depot—depending on the condition of returning equipment and the capacity available at each maintenance level.[1] The department's equipment reconstitution maintenance requirement is based on the amount of repairs that need to be performed at all maintenance levels. As the global war on terrorism continues, the department will be generating additional equipment reconstitution requirements, which will have to be estimated for inclusion in future baseline or supplemental budgets.[2]

The department has a two-phased process in place to estimate the incremental costs[3] of supporting contingency operations, which includes the determination of equipment reconstitution requirements. During the

[1] Organizational maintenance normally consists of inspecting, servicing, lubricating, adjusting, and replacing parts. Intermediate maintenance includes calibration, and the repair or replacement of damaged and unserviceable parts. Depot maintenance is performed on equipment requiring major overhaul or a complete rebuild of parts.

[2] Fiscal years 2004 and 2005 global war-on-terrorism equipment reconstitution requirements are included in the supplemental budget requests.

[3] The term incremental costs means those directly attributable costs that would not have been incurred if it were not for the operation. Sections 230406 and 230902 of Department of Defense Financial Management Regulations 7000.14R, volume 12, chapter 23, Contingency Operations (February 2001) provide additional information on incremental costs. We further note that DOD's financial systems only capture total obligations and the services use various management information systems to identify incremental obligations and to estimate costs.

first phase, the Office of the Secretary of Defense (OSD) comptroller and the services use an OSD model, developed by the Institute for Defense Analyses (IDA), called the contingency operations support tool (COST),[4] which covers much of what is needed to conduct contingency operations, as well as some aspects of equipment reconstitution. Each service and OSD input information into the model regarding the period of deployment for units and equipment that will need reconstitution. The model generates an estimated funding requirement. During the second phase, the services may accept or reject the COST model's estimates and provide alternative estimates they developed outside the model. When the services propose an estimate other than that derived from the COST model, they meet with the OSD comptroller and provide support for their estimate and, in conjunction with the comptroller, determine the requirement to be submitted. The services also provide estimates for some requirements that are not covered by the model—such as depot-level maintenance and procurement for replacement equipment. OSD then reviews these estimates and, in conjunction with the services, determines a final estimate for inclusion in OSD's supplemental budget submission. However, when differences occur, the OSD comptroller has the final say in what equipment reconstitution requirement will be submitted in the supplemental budget.

This report focuses on DOD's planning, budgeting, and tracking and reporting for equipment reconstitution for military units that have returned from Iraq and other global war-on-terrorism operations. The objectives of this report are to examine the extent to which (1) the process DOD used to develop its fiscal year 2004 supplemental budget equipment reconstitution requirements produced reliable estimates and (2) the department is accurately tracking and reporting equipment reconstitution obligations. We performed our work on the basis of the authority of the Comptroller General[5] and are reporting the results to you because of your oversight roles.

We examined OSD's and the services' processes for developing their fiscal year 2004 equipment reconstitution requirements and collected data related to OSD and service equipment reconstitution requirements. We held discussions at service headquarters and also visited Army and Marine

[4] IDA is a federally funded research and development center that OSD used to develop, maintain, and modify its COST model.

[5] 31 U.S.C. 717.

Corps units in the process of reconstituting equipment to review the equipment reconstitution planning process at these levels, observe implementation of these plans, and collect actual reconstitution costs. We reviewed reported reconstitution costs for Army equipment and determined that the reliability of these data was sufficient for our purposes. We performed our work from September 2003 through March 2005 in accordance with generally accepted government auditing standards. The scope and methodology section contains more detailed information about the work we performed.

Results in Brief

The two-phased process DOD used to develop its fiscal year 2004 equipment reconstitution cost estimates contained weaknesses that produced errors, which, if not corrected, may result in misstatements of future-year reconstitution cost requirements. Specifically, we observed problems in both phases of the process, as follows.

- The COST model, which the department used during the first phase of the process, generated unreliable estimates due to two main reasons. First, the COST model contains an error that can result in a duplication of reconstitution cost estimates. OSD and IDA officials were unaware that the model's equipment reconstitution cost section duplicated reconstitution costs that were already covered by the operating cost section of the model. For example, the COST model estimate for Air Force aircraft reconstitution was overstated by $1.2 billion because the department did not take into account that these costs were already entered into the model as operating costs. Duplication of cost elements causes an overstatement of cost estimates and may result in DOD receiving more funds than are necessary to cover reconstitution costs. Second, there is uncertainty over what maintenance requirements the model covered. OSD and the services developed their equipment reconstitution requirements with the understanding that the COST model calculated organizational- and intermediate-level maintenance only, and thus calculated their depot-level maintenance requirements outside of the model during the second phase of the process. However, we later learned that, according to IDA officials, the model may include some depot-level maintenance, which could have resulted in the model duplicating the depot-level maintenance requirements calculated outside the model. This confusion occurred because the OSD comptroller's office apparently did not clearly identify what maintenance requirements are to be calculated by the model. Furthermore, neither OSD nor IDA was able to provide us with any

written guidance regarding what maintenance requirements should be covered in the model's equipment reconstitution section. Without clearly identifying what maintenance requirements OSD expected the COST model to estimate and clearly communicating this information to IDA, IDA officials were not able to ensure that the COST model generates accurate and complete reconstitution maintenance cost estimates, and does not duplicate maintenance costs calculated outside of the model. Consequently, the department cannot have confidence in the equipment reconstitution budget estimate generated by the model.

- We also found reconstitution estimating and guidance problems during the second phase of the process. These problems involve the services developing requirements not calculated by the COST model and modifying COST model estimates. In one instance, the Army did not consider baseline peacetime operation and maintenance funding when calculating its equipment reconstitution requirements outside of the COST model. This was because the Army does not have a step in its supplemental estimating process to offset estimates with the baseline budget, as required by the department.[6] Not recognizing and adjusting for normal operating budgets overstates the funding requirement and could, if not addressed, result in the Army overstating funding requirements for equipment reconstitution in the future. Moreover, the services included costs in their reconstitution estimates calculated outside the COST model that appear not to be equipment reconstitution as established by OSD's supplemental budget preparation guidance. For example, while OSD guidance specifically directed the services to request funds needed to restore forces to the same operational level as prior to deployment, and to limit requests to those costs already incurred as a direct result of operations in support of the global war on terrorism, the Navy and the Air Force included unfunded fiscal year 2004 depot maintenance requirements in their supplemental funding cost estimates that did not arise from Operation Iraqi Freedom and other global war-on-terrorism operations. This occurred due to a lack of clear guidance on how the services should calculate their reconstitution costs, and according to Navy and Air Force officials, they wanted all of their equipment in the best condition possible to fight the global war on

[6] OSD fiscal year 2004 supplemental budget preparation guidance instructed the services to offset costs from the baseline budget that will not be incurred (e.g., peacetime training- and maintenance-related activities that will not occur since units will be deployed in support of the global war on terrorism) when calculating their incremental costs.

terrorism. Including these unfunded peacetime requirements may overstate the estimated cost of reconstituting equipment involved in operations in Iraq and Afghanistan. Nonetheless, we found an accumulation of unfulfilled equipment reconstitution requirements because OSD guidance limited the services to requesting funding for replacement of known battle losses only. In preparing the fiscal year 2004 supplemental budget, the services were not permitted to request funds for projected battle losses and other expected losses. The effect of losses not recognized in OSD's supplemental budget calculations has not yet been quantified and may be significant.

DOD is unable to accurately track and report its equipment reconstitution cost because the services are unable to segregate equipment reconstitution from other maintenance requirements, as required. In an effort to meet congressional requests for information on global war-on-terrorism obligations[7] and provide the OSD comptroller with a means to assess variance between obligations and the budget, Defense Finance and Accounting Service (DFAS) produces a monthly report to track these obligations. The DFAS report on funds obligated in support of the war includes a category for tracking equipment reconstitution obligations. However, the data in the report are not reliable for determining accurately how much money each service is obligating on equipment reconstitution. For example, the Air Force does not break out its equipment reconstitution obligations from other global war-on-terrorism obligations in the DFAS report in accordance with DOD guidance, because it does not have a mechanism in its accounting system that can track the amounts specifically obligated for equipment reconstitution. Thus, the Air Force is reporting zero dollars in the DFAS report's equipment reconstitution category. Additionally, Army and Navy equipment reconstitution obligations may also be inaccurate in the DFAS report, because the services' accounting codes for equipment reconstitution are capturing global war-on-terrorism and other obligations that were not incurred exclusively for equipment reconstitution. Consequently, Army- and Navy-reported equipment reconstitution obligations are likely overstated because they include other maintenance costs—such as those related to equipment used in training exercises—that are not consistent with DOD's guidance relating to

[7] Obligations are incurred through actions such as orders placed, contracts awarded, services received, or similar transactions made by federal agencies during a given period that will require payments during the same or a future period. See Department of Defense Financial Management Regulations, 7000.14-R, vol. 1, Definitions, page xvii.

reporting reconstitution obligations for equipment used in support of the global war on terrorism. As a result, DOD cannot accurately report the cost of equipment reconstitution and, consequently, the total cost of the global war on terrorism.

We are making recommendations that correct weaknesses we identified in DOD's process for estimating and tracking equipment reconstitution costs. In concurring or partially concurring on our recommendations DOD indicated that it was taking steps to eliminate the duplication of maintenance requirements in its COST model, would consider including a factor to reflect maintenance washout trends in future supplemental budget requests, and has revised its financial management regulation to improve the reporting of equipment reconstitution obligations. However, we believe that further improvements, such as providing instructions in the DOD financial management regulation regarding how to avoid duplication of maintenance requirements in DOD's COST model, are needed to meet the intent of our recommendations. In not concurring with our recommendation that the Army establish a step to offset its equipment reconstitution estimate with its baseline budget, department officials said that their process for developing the supplemental budget already includes a process for excluding costs for equipment maintenance funded in the baseline budget. However, we believe that the Army's, and the other services', supplemental budget-estimating processes also need to have such assurances built in. DOD's comments and our evaluation of them are discussed on page 25.

Background

In preparation for the initiation of Operation Iraqi Freedom (OIF), the United States deployed four Army divisions and their supporting reserve component units, a Marine Expeditionary Force, and a significant portion of the Navy's and Air Force's combat power to southwest Asia. The Army's Third Infantry Division (mechanized) and its supporting reserve component units were primarily equipped with Army-prepositioned assets—consisting of over 17,000 pieces of rolling stock[8] and almost 6,000 standard 20-foot shipping containers of supplies—drawn from prepositioned equipment sites located in southwest Asia and offloaded from Army prepositioned ships. The 1st Marine Expeditionary Force was also primarily equipped with prepositioned assets offloaded from Marine

[8] Rolling stock includes items such as tanks, trucks, and trailers.

Corps prepositioned ships. By the height of the combat portion of OIF, the United States had deployed a significant portion of its combat power to southwest Asia. For example, during fiscal year 2003, the Army deployed four divisions and numerous supporting active, reserve, and national guard units which participated in the combat phase of OIF. As a result, the Army estimated that these units, with assistance from other Army maintenance activities, would have to reconstitute over 53,000 pieces of rolling stock[9] when the units redeployed to their home stations.

In Iraq and Afghanistan, the U.S. military—especially the Army and Marine Corps—are operating at a pace well in excess of their normal peacetime level, which is driven by units' training requirements. This not only greatly increases the day-to-day operational maintenance requirements, including spare parts demands, of deployed Army and Marine Corps units, but also generates a large post-operational maintenance requirement that must be addressed when the units redeploy to their home station. Upon redeployment, the units need to bring their equipment at least back up to fully mission-capable status[10] in order for the units to be able to train on their equipment and achieve their readiness levels and be prepared for future deployments. In addition, before leaving Iraq, redeploying units turned in a large amount of prepositioned equipment that must undergo maintenance and repair before the equipment can be reissued to units deploying to or already in southwest Asia in support of OIF, or returned to prepositioned equipment stock for future use. Figure 1 shows some prepositioned equipment stored in Kuwait awaiting repair.

[9] This figure includes prepositioned rolling stock that has remained in Iraq in support of ongoing operations.

[10] Fully mission capable means an item can "move, shoot and communicate", and has no outstanding safety issues.

Figure 1: Army Prepositioned Equipment Awaiting Maintenance at Camp Arifjan

Source: GAO.

Army and Marine Corps units returning from deployments related to the global war on terrorism have equipment that has been heavily used and is in various degrees of disrepair. Upon returning to home station, the units' equipment is inspected to determine what maintenance is needed to bring the equipment back to the condition needed to allow the unit to conduct mission-essential training and be prepared for future deployments. The services use myriad repair and maintenance sources to assist units in reconstituting their equipment. At military installations, various maintenance personnel—including military personnel within units, installation personnel (including contractors) who support day-to-day maintenance operations, contractors who have been hired to augment the units' and installations' day-to-day workforces, and contractors who have been hired to increase an installation's maintenance capacity—are all working in concert to reconstitute the units' equipment in a timely manner so that the units will be ready to again deploy. In addition, military depots and contractors are using their vast maintenance and repair capabilities to help in the equipment reconstitution effort.

To fund the global war on terrorism in fiscal year 2003, Congress provided DOD with $62 billion in the fiscal year supplemental appropriation, primarily funding operations in Iraq.[11] While most of this funding was used to cover the costs of combat operations, the DFAS monthly terrorist report[12] indicate that about $3.8 billion in funds were obligated for equipment reconstitution in fiscal year 2003.

The fiscal year 2004 global war-on-terrorism supplemental budget included a significantly larger amount for equipment reconstitution than the previous supplemental budget. DOD requested $65.6 billion for executing the global war on terrorism in its fiscal year 2004 global war on terrorism supplemental budget request, which Congress funded at $64.3 billion.[13] In the budget-building process that was used for developing its fiscal year 2004 global war-on-terrorism supplemental budget request, the department included $5.9 billion for equipment reconstitution. (See table 1.)

Table 1: Fiscal Year 2004 Reconstitution Requirements Identified by Services and Requested in Supplemental

Dollars in billions

	Service requested			OSD supplemental request		
Service	**Unit level**	**Depot level**	**Total**	**Unit level**	**Depot level**	**Total**
Army	$3.64	$1.47	**$5.11**	$1.85	$1.22	**$3.07**
Navy	0.00	0.78[a]	**0.78**	0.00	0.78[a]	**0.78**
Air Force	1.30	0.98	**2.28**	1.30	0.72	**2.02**
Marine Corps	0.17	0.26	**0.43**	0.00	0.07	**0.07**
Total	**$5.11**	**$3.49**	**$8.60**	**$3.15**	**$2.79**	**$5.94**

Source: Unaudited DOD data.

[a]Includes ship intermediate maintenance.

[11] Emergency Wartime Supplemental Appropriations Act for Fiscal Year 2003, Pub. L. 108-11 (Apr. 16, 2003).

[12] The DFAS monthly terrorist report tracks the amount of funds the services are obligating on the global war on terrorism by various categories, including equipment reconstitution.

[13] Emergency Supplement Appropriation Act for Defense and for the Reconstruction of Iraq and Afghanistan Fiscal Year 2004, Pub. L. 108-106 (Nov. 6, 2003).

For the fiscal year 2004 supplemental budget process, table 1 shows the requirements the services developed and what OSD ultimately included in its supplemental budget submission to Congress. The requirements are broken down between unit-level and depot-level requirements. Unit-level maintenance, which consists of organizational- and intermediate-level maintenance, includes maintenance performed by military units in motor pools and maintenance support units, and by DOD civilians and contractor personnel at installation maintenance organizations. Depot-level maintenance includes maintenance performed by DOD civilian employees and DOD contractors at military depots or private facilities. The fiscal year 2004 supplemental defense appropriation does not delineate the amounts appropriated for unit- and depot-level equipment reconstitution.

DOD's Equipment Reconstitution Estimating Process Contained Weaknesses That Produced Errors

The two-phased process DOD used to develop its fiscal year 2004 supplemental budget equipment reconstitution requirements contained weaknesses that produced errors that may result in misstatements of future-year budget estimates if not corrected. We observed two problems with the COST model associated with the first phase of DOD's process that have generated unreliable estimates. First, the COST model can overstate reconstitution costs related to aircraft and ship costs because these costs are covered in both the operations and reconstitution sections of the model. Second, there is uncertainty in DOD over the maintenance requirements covered by the model. We also noted problems with the second phase of DOD's process. In one instance, the Army did not consider funding in its baseline peacetime operation and maintenance budget that would be available for equipment reconstitution. The Army also significantly overestimated the organizational- and intermediate-level maintenance costs to reconstitute individual equipment items. In another instance, the services included requirements in their reconstitution estimates that appear to be inconsistent with equipment reconstitution activities established by OSD's supplemental budget preparation guidance. Also, OSD guidance only allowed the services to request funding to replace known battle losses—excluding projected battle losses and other expected losses—in preparing their fiscal year 2004 supplemental budget submissions.

Duplication of Cost Requirements Overstates Reconstitution Estimate

The model that OSD and the services used in the first phase of the process to calculate reconstitution requirements for fiscal year 2004 resulted in an overstatement of about $1.2 billion. This is because the COST model

contains an error that can result in a duplication of reconstitution cost requirements. The equipment reconstitution section of the COST model provides funding for aircraft and ship reconstitution that is already funded through the operations section of the model.

All services support their aircraft through a flying-hour program that covers costs associated with operating aircraft, such as petroleum, oil and lubricants, consumables (supplies), and spare parts. As a result, all organizational- and intermediate-level maintenance and repair requirements are met through the flying-hour program.[14] Since the operations section of the COST model already includes flying-hour program funding, the inclusion of an equation for aircraft reconstitution in the equipment reconstitution section of the model is redundant. Air Force officials told us that due to their flying-hour program, additional funding specifically addressing organizational- and intermediate-level reconstitution of aircraft was not needed. However, the Air Force's fiscal year 2004 supplemental budget request included about $1.2 billion in the equipment reconstitution section for aircraft maintenance that was also covered by the operations section of the COST model. According to Air Force officials, they were unaware that the equipment reconstitution section duplicated the aircraft maintenance costs that are covered in the operations section of the COST model. In contrast, the Navy removed funding that the COST model's equipment reconstitution section provided for aircraft organizational- and intermediate-level maintenance.

The equipment reconstitution section of the COST model also duplicates organizational-level ship reconstitution that is already covered in the operations section of the model. However, the Navy treated this potential duplication in the same manner as it treated the flying-hour program duplication. Recognizing that this maintenance was already covered in the COST model's operations section, the Navy only included intermediate-level ship maintenance, and aircraft and ship depot-level maintenance in the equipment reconstitution section of its requirements calculation.

The different ways that the Air Force and Navy treated aircraft reconstitution demonstrate how this potential redundancy is a weakness in the structure of OSD's COST model. In discussing these redundancies in the model with OSD comptroller officials, they told us that OSD and IDA

[14] Depot-level aircraft maintenance and repair requirements are funded through a process separate from the flying-hour program.

officials were unaware of this potential duplication. This lack of awareness was demonstrated when OSD comptroller officials did not identify and correct the Air Force's duplication described previously. Air Force finance officials told us that they have taken steps when preparing their fiscal year 2005 supplemental budget to prevent this duplication from occurring again. We observed that the fiscal year 2005 supplemental budget did not repeat this duplication.

DOD Had Uncertainty Over Which Maintenance Requirements Were Covered by Its COST Model

There was uncertainty within the department regarding which maintenance requirements were covered in the COST model. OSD and the services developed their equipment reconstitution requirements with the understanding that the COST model calculated organizational- and intermediate-level maintenance only, and they thus calculated their depot-level maintenance requirements outside of the model during the second phase of the process. However, we later learned that the model may have calculated some depot-level maintenance requirements, which could have resulted in the model duplicating the depot-level maintenance requirements calculated outside the model.

We held a series of discussions with officials from OSD—the owners of the model—and IDA—the developers of the model—to determine what types of maintenance requirements are included in the equipment reconstitution section of the model. Both OSD and IDA officials provided us with different descriptions of what was included in the model. In addition, these officials were unable to produce any written guidance that OSD provided IDA regarding what maintenance requirements the model's equipment reconstitution section should cover. They stated that this was determined so long ago that the paper trail no longer exists and that in all probability the guidance was transmitted either verbally or via e-mail, or both.

For example, in our initial meeting with OSD comptroller officials to determine how OSD and the services developed their equipment reconstitution estimates for the fiscal year 2004 supplemental budget, we were told that the equipment reconstitution section of the COST model included organizational- and intermediate-level maintenance requirements and excluded depot-level maintenance requirements. Officials from each of the services corroborated this viewpoint and stated that they understood the equipment reconstitution section of the COST model to include organizational- and intermediate-level maintenance requirements and exclude depot-level requirements. Army, Navy, Air Force, and Marine

Corps finance officials also told us that they developed depot-level maintenance estimates separate from the COST model.

Next, we met with IDA officials to better understand what levels of reconstitution maintenance were included in the equipment reconstitution section of the COST model. The IDA officials said that the model included organizational- and intermediate-levels of maintenance, and could include some depot-level maintenance. However, IDA could not provide us with the documentation to support this assertion and we were therefore unable to determine whether model calculations included or excluded depot-level maintenance.

We shared IDA's comments about the levels of maintenance covered in the model with OSD comptroller officials in a follow-up meeting. At this point, they told us that its COST model was intended to provide organizational-level maintenance costs only, which represents a small portion of the total equipment reconstitution requirement.[15] However, based on our analysis of the COST model, we concluded that intermediate-level requirements are indeed included in the COST model equations. In the end, OSD comptroller officials stated that they are now taking steps to clear up confusion regarding the requirements for each type of maintenance and repair.

As described previously, OSD comptroller officials did not clearly establish and communicate to IDA what levels of maintenance they expected the COST model to estimate. Without clearly identifying what levels of maintenance OSD expected in the COST model and subsequently clearly communicate this information to IDA, IDA officials are not able to ensure that the COST model generates accurate and complete organizational and intermediate maintenance cost estimates, and does not duplicate depot maintenance costs calculated outside of the model. Consequently, the department cannot have confidence in its equipment reconstitution budget estimate.

[15] OSD's supplemental request was split 53 percent for organizational- and intermediate-level maintenance and 47 percent for depot-level maintenance. OSD comptroller officials were not able to delineate organizational- and intermediate-level maintenance.

Army's Equipment Reconstitution Estimate Did Not Consider Baseline Peacetime Budget

The Army did not consider funding in its baseline peacetime operation and maintenance budget that would be available for equipment reconstitution when developing its own estimate outside of the COST model. As a result, the Army overestimated its equipment reconstitution requirements.

The Army used the COST model as a starting point for determining its equipment reconstitution requirements for fiscal year 2004. However, Army officials concluded that the $1.9 billion calculated by the model was inadequate. As a result, the Army developed its own methodology for calculating equipment reconstitution requirements and estimated $3.0 billion would be needed for organizational- and intermediate-level repair and maintenance, which was about $1 billion higher than the OSD COST model estimate.

Our analysis of the Army's methodology for calculating equipment reconstitution requirements revealed a major weakness in the Army estimate. The Army's process for estimating its equipment reconstitution requirements did not include steps to offset total requirements with baseline funding.[16] Consequently, we estimate that the Army's equipment reconstitution estimate may have been overstated by between $299 million to $497 million.

OSD's guidance to the services for developing the supplemental budget specifies that the services were to offset funds already contained in their baseline budgets—peacetime maintenance costs that would not be incurred because the unit was deployed in support of the global war on terrorism—when estimating a contingency operation's cost. Not recognizing and adjusting for normal operating budgets overstates the funding requirement and could result in the Army overstating funding requirements for equipment reconstitution in the future if not addressed. According to Army officials, this oversight occurred because the Army did not establish a specific step in its supplemental estimating process to offset the Army's estimate with baseline budget funds.

[16] We have previously reported that contingency costs were being overstated because they were not adjusted to reflect baseline budget offsets. See GAO, *Contingency Operations: DOD's Reported Costs Contain Significant Inaccuracies*, NSIAD-96-115 (Washington, D.C.: May 17, 1996).

Army Overestimated Organizational and Intermediate Maintenance Costs for Numerous Equipment Items

In the process of reviewing the Army's methodology for calculating equipment reconstitution requirements, we also found that the Army overestimated organizational- and intermediate-level maintenance costs for numerous equipment items. A comparison of the actual fiscal year 2004 equipment reconstitution obligations reported by the Army with the Army's equipment reconstitution cost estimate showed that organizational- and intermediate-level repair costs for individual equipment items were significantly overestimated. Specifically, we collected actual cost data on 38 types of equipment included in the Army's estimate and determined that the actual costs for reconstituting the items were lower than the Army's estimates for 34 of the 38 items. (See table 2.) The Army was unable to provide us with adequate support for its estimates because it did not retain supporting documentation. Consequently, we were not able to determine the reasons for differences between estimated costs and reported equipment reconstitution obligations.

Table 2: Comparison of Army's Estimated Reconstitution Cost to Actual Cost for 38 Selected Items for Fiscal Year 2004

Item	Estimated reconstitution cost per item	Average actual reconstitution cost per item [a]	Actual as percent of estimate
M119 howitzer	$50,000	$1,869	4%
M1101	12,931	1,312	10%
M88A1	140,000	14,587	10%
M969	30,000	4,528	15%
M1A1	120,000	18,213	15%
M916 (10T tractor)	44,000	8,560	19%
M1078 (FMTV)	33,000	6,508	20%
M35A3	33,000	6,780	21%
Compressor	9,000	2,013	22%
M9 ACE	60,000	14,136	24%
M113A3 (FOV)	46,000	11,391	25%
MKT	9,000	2,594	29%
M113A2 (FOV)	46,000	13,738	30%
M871	17,000	5,319	31%
M978 2.5K tankers	38,000	11,932	31%
M992 FAASV	50,000	15,940	32%
M1083 (LMTV)	25,000	8,830	35%

(Continued From Previous Page)

Item	Estimated reconstitution cost per item	Average actual reconstitution cost per item [a]	Actual as percent of estimate
AVLB	96,000	34,917	36%
Generator sets	5,565	2,024	36%
D7	25,000	9,527	38%
MICLIC	6,000	2,327	39%
M915 (8T tractor)	25,000	9,914	40%
M2A2/M3A3	77,000	31,266	41%
M109A6 Paladin	55,000	24,064	44%
M1076 (PLS trailer)	15,000	6,851	46%
M872	22,000	10,740	49%
PLS truck	39,000	19,477	50%
ATLAS forklift	15,000	7,552	50%
M984 HEMTT wrecker	39,000	19,868	51%
M977 10T cargo truck	38,000	23,880	63%
M149	3,777	2,435	64%
FLU-419	35,000	24,629	70%
M101	2,288	1,612	70%
4K forklift	9,000	8,363	93%
M105	2,288	2,654	116%
PLS racks	1,200	1,783	149%
M1061	1,200	1,973	164%
M200A1 trailer	1,200	2,390	199%

Sources: U.S. Army and GAO analysis.

[a]Represents incremental cost comprised of direct labor and material costs and does not include any indirect cost allocation.

Alternative Service Estimates Included Equipment Maintenance That May Exceed OSD's Reconstitution Guidance

The services included costs in their reconstitution estimates calculated outside the COST model that appear not to be equipment reconstitution as established by OSD's guidance. In one case, the Navy and the Air Force included unfunded fiscal year 2004 depot-level maintenance requirements in their supplemental funding cost estimates that did not arise from OIF and other operations related to the global war on terrorism.

The Navy and Air Force used unfunded peacetime depot maintenance requirements as the basis for the depot-level maintenance portion of their fiscal year 2004 supplemental equipment reconstitution requests. The Navy requested funding for unfunded ship overhauls, and according to Atlantic

fleet officials, unfunded ship overhauls occur every year. These officials also stated that the Navy typically finds the funding needed to perform unfunded overhauls somewhere in its baseline budget or will delay the overhauls until the following year. In addition, the Air Force's fiscal year 2004 supplemental request for depot-level equipment reconstitution consisted of funding engine and airframe overhauls that were not funded in its fiscal year 2004 baseline budget.

These requirements may not fall within the description of equipment reconstitution as established in OSD's guidance, which directed the services to request funds needed to restore forces to the same operational level as prior to deployment and to limit requests to those costs already incurred as a direct result of operations in support of the war on terrorism. However, the DOD guidance also instructed the services to prepare their supplemental budget estimates around the DOD Financial Management Regulation, Chapter 23 Contingency Cost Breakdown Structure, which provides a broader description of reconstitution costs. Taken as a whole, the DOD supplemental budget preparation guidance is unclear on what the services could and could not include in their budget submissions. In addition, Air Force and Navy officials said that funding for these requirements was needed to prepare their forces to be fully ready to fight the global war on terrorism. However, including these unfunded depot maintenance peacetime requirements may overstate the estimated cost of reconstituting equipment involved in operations in Iraq and Afghanistan.

OSD Guidance Excluded Estimates of Potential Equipment Losses During the Budgeting Process

In preparing the fiscal year 2004 global war-on-terrorism supplemental budget, OSD only allowed the services to request funding to replace known battle losses and excluded projected battle losses and other expected losses. Such expected losses include equipment that would be considered beyond economic repair, such as crash-damaged vehicles and maintenance washouts.[17] However, the replacement of these excluded items ultimately will need to be funded in future budgets to ensure that the Army and Marine Corps have an adequate amount of equipment needed to meet future challenges.

[17] Maintenance washouts are equipment that has been deemed too expensive to repair when compared to the cost to replace the equipment item, and is removed from the active inventory.

Figure 2: Bradley Fighting Vehicle—Example of Projected Equipment Item Damage

Source: GAO.

The equipment replacement needs being quantified by the services for inclusion in the fiscal year 2005 global war-on-terrorism supplemental budget will incorporate some of the expenses excluded by OSD guidance in the fiscal year 2004 supplemental budget request. However, as of December 2004, the magnitude of this requirement is unknown.

Using the Army's equipment reconstitution requirements analysis, we estimated that the fiscal year 2004 equipment replacement requirement due to maintenance washouts ranged from $259 million to $562 million.[18] Recognizing that not all OIF equipment losses were covered in the fiscal year 2004 supplemental, the Army has included some unknown battle losses, crash losses, and maintenance washouts in its Tactical Wheeled Vehicle Study. The Army engaged this study to identify shortfalls in its tactical wheeled vehicle fleets and also included transformation and underfunded requirements in past baseline budgets. This study will identify multiyear procurement requirements and, according to Army resource officials, it is hoped the Army will have these requirements funded

[18] This estimate is based on the Army's ability to locate excess carcasses that could be remanufactured at its intermediate-level maintenance facilities and depots. If carcasses are unavailable or maintenance capacity is unavailable due to operational and reconstitution requirements, the funding needed will be higher because the requirement will have to be met with procurement of new equipment.

through future baseline and supplemental budgets. As of March 2005, the study has not been issued and the Army has been unable to provide us with an estimate of the procurement funding requirements, including the amount directly related to OIF equipment reconstitution requirements.

Furthermore, the Army's and Marine Corp's reconstitution requirements for prepositioned equipment still being used in Iraq will also increase because the anticipated battle and crash losses and maintenance washouts will also continue to increase the longer the equipment remains in use. Until OSD allows the services to consider anticipated operational equipment losses and maintenance washouts in their supplemental budgeting process, equipment reconstitution requirements generated during the current fiscal year will inevitably be pushed out for funding in upcoming years. Not doing so could also have an impact on the ability of the services to quickly reconstitute equipment in the current fiscal year.

DOD Not Accurately Reporting Equipment Reconstitution Costs

DOD has not accurately tracked and reported its equipment reconstitution costs because the services are unable to segregate equipment reconstitution from other maintenance requirements, as required. In part to provide Congress with information on global war-on-terrorism costs and provide the OSD comptroller with a means to assess variance between obligations and the budget, DFAS compiles a monthly report to track these obligations. The DFAS report on funds obligated in support of the war includes a category for tracking equipment reconstitution obligations and the guidance associated with this report describes what reconstitution costs can include. Our analysis of the DFAS report showed that 1) the Air Force is not separately reporting equipment reconstitution obligations because it does not have a mechanism within its current accounting system to track them, 2) the Army is including unit reconstitution obligations that are above and beyond equipment reconstitution and other maintenance costs, and 3) the Navy is unable to segregate regular maintenance from reconstitution maintenance for ship overhauls. As a result, the equipment reconstitution obligations are being inconsistently reported by the services and the report data are not reliable for accurately determining how much the services are actually obligating for the reconstitution of equipment returning from deployments in support of the global war on terrorism. Table 3 lists the fiscal year 2004 obligations reported by the services in DFAS's report as of the end of September 2004 for reconstitution.

Table 3: Reconstitution Obligations Reported by Services in DFAS Terrorist Cost Report, as of the End of September 2004

Dollars in thousands	
Service	**Obligations reported**
Army	$3,704,622
Navy	791,532
Air Force	0
Marine Corps	229,280
Special Operations	54,206
Total	**$ 4,779,640**

Source: DOD.

DOD reports the costs of the global war on terrorism largely in accordance with the cost breakdown structure found in its financial management regulation.[19] This internal DOD guidance describes equipment reconstitution costs as including the cost to clean, inspect, maintain, replace, and restore equipment to the required condition at the conclusion of the contingency operation or unit deployment. This guidance, which includes a specific cost category for equipment reconstitution along with specific budget guidance issued by the OSD comptroller's office that addresses incremental costs of the global war on terrorism, calls for the services to report equipment reconstitution costs separately from other incremental costs.[20] Despite this guidance, the Air Force is not separately reporting equipment reconstitution obligations to DFAS for inclusion in its monthly terrorism cost report owing to the way the Air Force accounting system was designed. Air Force officials told us that the Air Force's accounting system currently has no way to delineate equipment

[19] DOD Financial Management Regulation 7000.14-R, vol. 12, ch. 23, sec. 230406, Contingency Operations (2001).

[20] Although not pointed out to us by the OSD comptroller office or Air Force officials, we noted during the course of our review two provisions of volume 12, chapter 23 of DOD's financial regulation that could be viewed as being inconsistent with this requirement. These provisions suggest that the services need not separately report reconstitution obligations if 1) to do so would require them to establish a cost accounting system solely for the purpose of determining costs of contingency operations, or 2) they could not separately identify the additive costs for equipment overall and maintenance attributable to the contingency. This apparent inconsistency could further confuse service budget and accounting officials as to the extent they should specifically report reconstitution costs apart from other incremental costs.

reconstitution obligations from other global war-on-terrorism obligations for DFAS reporting purposes. Specifically, the Air Force does not have a mechanism nor has it established codes that can track the dollar amounts obligated on equipment reconstitution in fiscal years 2003 and 2004, which the guidance does not require. The Air Force's accounting system has two types of codes for classifying expenses: (1) element of expense investment codes, which are used for tracking obligations by commodities (such as supplies, travel, and civilian pay); and (2) emergency and special program codes, which are used to collect costs incurred during an emergency or a special program (such as the global war on terrorism). Neither of these codes, individually or in combination, equates to equipment reconstitution. Instead, equipment reconstitution obligations are spread throughout other categories in the DFAS terrorist cost report, as appropriate, for the type of obligations incurred. Thus equipment reconstitution obligations are reported in the operations category of DFAS's report, not the reconstitution category of the DFAS report, and are mixed with other global war-on-terrorism obligations that are tracked by other cost categories in the DFAS report. According to OSD comptroller officials, having the ability to track actual global war-on-terrorism obligations is important in that it allows them insight into the accuracy of the supplemental budget that was generated, in part, from the COST model.

Army and Navy equipment reconstitution obligations may also be inaccurate in the DFAS report. The Army and Navy track their equipment reconstitution obligations through the use of certain codes available in their account encoding structure and may overstate reported equipment reconstitution obligations, because these codes are accumulating global war-on-terrorism and other obligations that were not exclusively for equipment reconstitution.

During our review, we found that the Army is including obligations not directly related to equipment reconstitution requirements arising from global war-on-terrorism deployments. For example, units reconstituting after returning from Iraq may be including maintenance obligations generated during training exercises. Army officials stated that these units are being ordered to rapidly prepare for subsequent deployments, which includes reconstituting equipment and engaging in training exercises among various other tasks. According to Army officials, training exercises can require the use of equipment that has not yet been fully reconstituted and the exercises generate additional maintenance requirements not related to global war-on-terrorism equipment reconstitution. However, these training-related maintenance requirements are not readily separable

from the equipment reconstitution requirements, and are therefore being included as part of the Army's reported reconstitution obligations. In addition, some reconstitution obligations do not readily align with the cost categories in the DFAS report and are thus included in existing categories, such as equipment reconstitution. For example, Army budget officials told us that when units return home from a deployment they incur reconstitution expenses unrelated to their equipment. These expenses include training needed to reestablish a unit's ability to perform its mission and personnel expenses related to the movement of soldiers in and out of the unit that occur after an extensive deployment. The officials told us that these obligations are being included in the equipment reconstitution section because this was the best place to account for them. As a result, the Army's equipment reconstitution amounts are likely overstated.

The Navy's reported reconstitution obligations include some maintenance costs that did not appear to completely result directly from global war-on-terrorism deployments. Portions of the Navy's reported obligations for equipment reconstitution include major ship repairs and overhauls, called "availabilities", which are accomplished at specified time intervals independent of the ship's use during the global war on terrorism. The specific maintenance tasks performed during an availability depend on the type of ship, the type of repair or overhaul being conducted, and the ship's condition. According to Navy officials, they report all of the obligations incurred in conjunction with an availability funded by the fiscal year 2004 supplemental budget as equipment reconstitution regardless of whether the obligations are due to conditions that existed prior to a global war-on-terrorism deployment or to peacetime maintenance conducted during all availabilities. The Navy reports all of these obligations as equipment reconstitution, because it does not have a process to capture what obligations for an availability are driven by the higher level of operations generated by global war-on-terrorism deployments versus baseline requirements generated by a ship during deployments not related to the global war on terrorism. While all of the maintenance tasks associated with availabilities that are funded by supplemental money are needed to effectively maintain the condition of Navy ships, not all of the maintenance performed during the availabilities resulted from the ships being deployed in support of the global war on terrorism. Thus, some of the Navy's reported obligations do not appear to fit DOD's criteria for equipment reconstitution costs that should be reported as an incremental cost of the global war on terrorism.

Conclusions

As the services, especially the Army and Marine Corps, continue to conduct operations related to the global war on terrorism at the current high pace, they will continue to generate equipment reconstitution requirements. OSD and the services will continue to use the department's two-phased process to develop estimates of these maintenance requirements so they can be funded through supplemental and baseline budgets. However, DOD and the services cannot be assured that its global war-on-terrorism supplemental budget requirements are as reliable and complete as possible until the OSD comptroller:

- revises its contingency model to ensure that costs covered by the model's operating tempo cost elements are not duplicated by costs in the model's reconstitution cost elements;
- clearly establishes what equipment reconstitution maintenance requirements should be covered by the COST model and communicates this information to IDA to ensure that the model calculations reflect only these maintenance costs;
- clarifies its guidance to the services on what types of maintenance requirements should and should not be included as equipment reconstitution when developing the supplemental budget; and
- ensures that all anticipated equipment reconstitution requirements, such as operational losses and maintenance washouts, are considered when developing supplemental budget requests.

Overestimating these requirements could result in a misapplication of funds, while underestimating them could require the services to draw funds from baseline programs or result in the inability of the services to fully reconstitute their equipment. Improving DOD's process for estimating equipment reconstitution maintenance and equipment replacement requirements will aid the services in reducing the risks they face in executing the equipment reconstitution program and help maintain a military that is able to meet the nation's needs.

With global war-on-terrorism operations continuing at a high pace, the Army will be generating additional equipment reconstitution requirements that will be funded through future supplemental budgets. Although OSD did not use the Army's fiscal year 2004 equipment reconstitution estimate for the fiscal year 2004 supplemental request, that does not preclude OSD

from using future Army estimates. Consequently, it is important that the Army appropriately offset its equipment reconstitution estimate with baseline peacetime funding, which it did not do for its fiscal year 2004 estimate. Until the Army establishes a step in its supplemental estimating process to offset the estimate with the baseline budget, its calculation of equipment reconstitution requirements for future supplemental budgets will continue to be overstated. Further, if OSD uses the Army-calculated equipment reconstitution estimate and does not adjust the estimate for baseline funding, the Army's equipment reconstitution requirements could be overfunded, which could limit the funding available for other requirements, thus potentially increasing risks in other areas.

Inconsistencies between how the services are reporting equipment reconstitution obligations in the DFAS global war-on-terrorism cost report mean that equipment reconstitution and other related cost categories are being inaccurately reported. Until DOD develops comprehensive and consistent methods for tracking and reporting equipment reconstitution obligations—including (1) developing a mechanism within the Air Force for identifying, accumulating, and reporting its equipment reconstitution obligations; and (2) refining the Navy and Army processes for identifying obligations that are incurred exclusively for equipment reconstitution—the usefulness of the DFAS report will remain limited. Improving the accuracy and completeness of the report will result in a DFAS cost report that will be more useful to OSD and Congress in their oversight of global war-on-terrorism obligations.

Recommendations for Executive Action

To correct the weaknesses we identified in the equipment reconstitution cost estimating process the department used when developing its fiscal year 2004 supplemental budget request, we recommend that the Secretary of Defense take the following five actions:

- Direct the OSD comptroller to revise its COST model to ensure that costs covered by the model's operating tempo cost elements are not duplicated by costs in the model's reconstitution cost elements;

- Direct the OSD comptroller to clearly establish what equipment maintenance requirements should be covered by the COST model and communicate this information to IDA to ensure that the model calculations reflect only these maintenance costs;

- Direct the Secretary of the Army to establish a step in its supplemental estimating process to offset the estimate with the baseline budget to improve future contingency funding estimates;

- Direct the OSD comptroller to clarify its supplemental budget guidance to the services on what types of maintenance requirements should and should not be included as equipment reconstitution when developing the supplemental budget; and

- Direct the OSD comptroller to ensure that all potential equipment reconstitution requirements are considered when developing supplemental budget requests by allowing the services to include anticipated equipment losses—both operational losses and maintenance washouts—in their supplemental budgeting process.

To ensure that Congress has a clear insight into the cost of equipment reconstitution, we also recommend that the Secretary of Defense direct the services, in conjunction with DFAS, to develop comprehensive and consistent methods for tracking and reporting equipment reconstitution obligations. This includes (1) developing a mechanism within the Air Force for identifying, accumulating, and reporting its equipment reconstitution obligations; and (2) refining the Navy and Army processes for identifying obligations that are incurred for equipment reconstitution.

Agency Comments and Our Evaluation

The OSD Comptroller, Director for Operations and Personnel provided oral comments on a draft of this report for DOD and concurred with two of our six recommendations, partially concurred with three recommendations, and did not concur with the other recommendation.

In concurring with our recommendation that OSD clarify its supplemental budget guidance to the services on what types of maintenance requirements should and should not be included as equipment reconstitution when developing the supplemental budget, the OSD director stated that improvements are made to each iteration of the guidance. We confirmed that the guidance provided to the services for the fiscal year 2005 supplemental budget was much more detailed and comprehensive than the guidance provided for developing the fiscal years 2003 and 2004 supplemental budgets.

In concurring with our recommendation that the services, in conjunction with DFAS, develop comprehensive and consistent methods for tracking

and reporting equipment reconstitution obligations, the OSD director stated that they have already revised their financial management regulation to improve reporting of equipment reconstitution. However, until additional actions are taken, such as improving the services' financial systems' ability to track obligations, our recommendation will not be fully implemented.

In partially concurring with our recommendation regarding the duplication of maintenance costs in the COST model, the OSD director stated that they have made revisions to DOD's financial management regulations to ensure that the cost of equipment maintenance is not being duplicated in different COST model sections. However, as currently written, the revised section does not have any instructions on avoiding duplicating maintenance requirements calculated by the model's operations section; instead it simply divides reconstitution into four subcategories of maintenance. Until further changes are made, the intent of our recommendation will not have been met.

In partially concurring with our recommendation that the OSD comptroller clearly establish what equipment reconstitution maintenance requirements should be covered by the COST model, the OSD director stated that IDA, the model's operator, periodically receives specific guidance from the comptroller's office on the criteria and elements of costs to be included in the model's calculations. However, as we reported, neither OSD comptroller nor IDA officials were able to provide us with examples of this guidance when requested. The OSD director also told us that they have taken action to ensure that the model calculates costs in accordance with the DOD Financial Management Regulation and that they issue guidance to the services on what costs will be covered by the model. Although Volume 12, Chapter 23, Section 3.5 of the financial management regulation has been revised to delineate equipment reconstitution into four categories—organizational-, intermediate-, and depot-level maintenance; and contractor logistics support—the section does not state which of these categories are covered by the COST model. In addition, while OSD guidance to the services for developing the fiscal year 2005 supplemental budget stated that intermediate- and depot-level maintenance would be calculated outside the model, the guidance provided for developing the fiscal years 2003 and 2004 supplemental budgets only specified that depot-level maintenance would be calculated outside the model. Until changes are made establishing what maintenance requirements are in the COST model and clearly communicating this to IDA, the intent of our recommendation will not have been met.

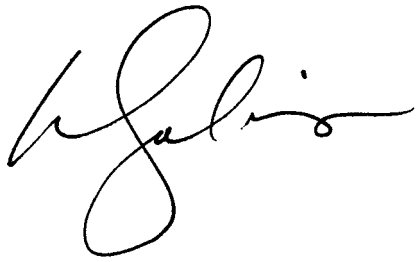
The OSD director did not concur with our recommendation that the Secretary of the Army be directed to establish a step in its supplemental budget process for estimating equipment reconstitution requirements to offset the estimate with baseline funding. The OSD director said that the process for developing the supplemental budget already includes a process for excluding costs for equipment maintenance funded in the baseline budget. As stated in this report, we acknowledge that OSD's COST model equations for equipment reconstitution contain a factor for reducing the reconstitution requirements by taking baseline funding into account. We also acknowledge that OSD's process for building the supplemental budget has controls in place to help ensure that only incremental costs are included in the supplemental budget. However, we believe that the services' supplemental budget estimating processes also need to have such assurances built in. We made our recommendation to address the fiscal year 2004 equipment reconstitution requirement that the Army developed separate from the COST model during what we have described in this report as the second phase of DOD's process for building the supplemental budget. When developing this requirement, the Army did not take into account available baseline funding, because it did not have a step in its supplemental budget estimating process to offset the estimate with baseline funding. If the OSD comptroller had used this Army-generated requirement in its fiscal year 2004 supplemental budget, the potential exists that OSD comptroller officials might miss the Army's failure to adjust this requirement for baseline funding. Importantly, the very safeguards that the OSD comptroller stated it has in place failed to offset the $1.2 billion duplication of aircraft maintenance requirements that the Air Force included in its fiscal year 2004 supplemental budget requirement. Taking action on our recommendation would provide the Army with the necessary safeguards to submit accurate budget estimates and avoid the potential that future supplemental budgets could provide more than incremental funding to the Army. Therefore, we continue to believe our recommendation has merit.

In partially concurring with our recommendation that the services be allowed to include equipment losses in their supplemental budget requirements, the OSD director stated that they typically address these potential future costs through subsequent budget requests or through reprogramming efforts. The OSD director also told us that it is conceivable that some factor reflecting maintenance washout trends could be considered in future supplemental budget requests. If this action is taken, it should satisfy the intent of our recommendation. As we stated in our report, until OSD allows the services to consider anticipated operational

equipment losses and maintenance washouts in their supplemental budgeting process, equipment reconstitution requirements generated during the current fiscal year will inevitably be pushed out for funding in upcoming years. Not doing so could also have an impact on the ability of the services to quickly reconstitute equipment in the current fiscal year.

We are sending copies of this report to other appropriate congressional committees, the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, the Secretary of the Air Force, the Commandant of the Marine Corps, and the Director, Office of Management and Budget. We will also make copies available to others upon request. In addition the report will be available at no charge on GAO's Web site at http://www.gao.gov.

If you or your staff have any questions on the matters discussed in this letter, please contact me at (202) 512-8412 or solisw@gao.gov or my assistant director, Julia Denman, at (202) 512-4290 or denmanj@gao.gov. Other major contributors to this letter were John Strong, Bob Malpass, Andy Marek, Robert Wild, Dave Mayfield, and Charles Perdue.



William M. Solis
Director, Defense Capabilities
and Management

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The Honorable Jerry Lewis,
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The Honorable John Murtha
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Subcommittee on Defense
Committee on Appropriations
House of Representatives

Scope and Methodology

To determine if the process DOD used to develop its fiscal year 2004 supplemental budget equipment reconstitution requirements was accurate, we met with officials from the OSD Under Secretary of Defense (Comptroller); Assistant Secretary of the Army, Financial Management and Comptroller; Assistant Secretary of the Navy, Financial Management and Comptroller; Assistant Secretary of the Air Force, Financial Management and Comptroller; Headquarters U.S. Marine Corps Programs and Resources Department, and U.S. Marine Corps Deputy Commandant Installations and Logistics. We also collected and reviewed OSD and service equipment reconstitution guidance to develop an understanding of the processes the department used to develop its fiscal year 2004 equipment reconstitution requirements. As part of this effort we also met with officials from OSD Under Secretary of Defense (Comptroller); Headquarters U.S. Army Deputy Chief of Staff G-4; Headquarters U.S. Navy Deputy Chief of Naval Operations (Logistics); Headquarters U.S. Air Force Deputy Chief of Staff Installation and Logistics; and Headquarters U.S. Marine Corps Programs and Resources Department to identify the methodologies used by OSD and each of the services for determining equipment reconstitution requirements and collected related documentation. To gain further insight into the accuracy of the process the Army used to develop its equipment reconstitution requirement, we met with officials at and collected data from the Army Materiel Systems Analysis Activity; Forts Bragg, Campbell, Dix, Hood, Riley, and Stewart; and Camps Arifjan and Doha, Kuwait. We collected actual equipment reconstitution cost data from these activities and compared them to the data the Army used in developing its equipment reconstitution requirement. To determine the reliability of the actual reconstitution costs for Army equipment, we discussed and observed the equipment reconstitution data collection process at four of the Army bases we visited where we observed a consistent process for collecting and entering equipment reconstitution data into the Army's database. We also visited the AMSAA team that was managing and summarizing the Army's equipment reconstitution data collection effort to determine that the personnel collecting the data and managing the data collection effort were performing quality reviews to ensure completeness and accuracy. Additionally, the AMSAA management team had the Army commands review the data collected at their installations prior to passing the data to higher commands. Based on this assessment, we concluded that the data collection effort was sufficiently comprehensive and reliable to provide data for this engagement. We also collected and analyzed data the services use in developing their reconstitution requirements, which were submitted to OSD. Further, we collected and analyzed data OSD used to develop the department's overall equipment reconstitution requirement that was

included in the fiscal year 2004 global war-on-terrorism supplemental budget request. To gain further insight into how OSD developed the equipment reconstitution requirement, we met with IDA officials to develop an understanding of how OSD's COST model calculates this requirement. We limited our examination of the COST model to the section that calculates equipment reconstitution requirements, which consists of only 4 of the 188 equations that comprise the COST model. To understand the extent to which equipment reconstitution requirements generated during fiscal year 2004 will have to be funded in upcoming budgets we met with and obtained guidance issued by the OSD Under Secretary of Defense (Comptroller) regarding how the services' equipment reconstitution requirements were restricted. To quantify the effect of these limitations we collected Army data on potential equipment losses and estimated their possible impact on future budgets. To assess the equipment reconstitution requirement inputs provided to the services by their component commands and units we met with officials of and collected data at Army Forces Command, Naval Air Systems Command, U.S. Atlantic Fleet, Air Combat Command, and U.S. Marine Corps Logistics Command. Using the information and analysis described here we assessed the reasonableness and completeness of the department's equipment reconstitution requirements.

To determine how accurately and completely the department is tracking and reporting equipment reconstitution costs we met with officials of and collected documentation from the Assistant Secretary of the Army, Financial Management and Comptroller; Assistant Secretary of the Navy, Financial Management and Comptroller; Assistant Secretary of the Air Force, Financial Management and Comptroller; and Headquarters U.S. Marine Corps Programs and Resources Department. We reviewed the structure of how the services are accumulating and reporting obligations associated with their equipment reconstitution efforts. We compared and contrasted what type of obligations each service considered as equipment reconstitution for inclusion in the Defense Financial Accounting Service's report that is tracking fiscal year 2004 global war-on-terrorism obligations. We discussed the inconsistencies between the services noted during our review with the service officials listed above to determine the reasons for the inconsistent manner in which equipment reconstitution obligations were reported.

We performed our work from September 2003 through March 2005 in accordance with generally accepted government auditing standards.

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