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

June 2007

NAVY WORKING CAPITAL FUND

Management Action Needed to Improve Reliability of the Naval Air Warfare Center's Reported Carryover Amounts

GAO

Accountability * Integrity * Reliability

GAO-07-643

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GAO Accountability·Integrity·Reliability

Highlights

Highlights of GAO-07-643, a report to the Subcommittee on Defense, Committee on Appropriations, House of Representatives

Why GAO Did This Study

According to the Department of Defense's (DOD) fiscal year 2007 budget estimates, working capital fund activity groups (depot maintenance, ordnance, and research and development) will have about $6 billion of funded work that will be carried over from fiscal year 2007 into fiscal year 2008. The congressional defense committees recognize that these groups need some carryover to ensure a smooth work flow from one fiscal year to the next. However, the committees have previously raised concern that the amount of carryover may be more than is needed. GAO was asked to determine if (1) the Naval Air Warfare Center's (NAWC) reported actual carryover was reliable for fiscal years 2003 through 2006 and (2) NAWC was utilizing the required triannual review process to improve the reliability of its carryover information and underlying financial data.

What GAO Recommends

GAO makes six recommendations to DOD that are aimed at improving the reliability of carryover information and the effectiveness of the triannual review process. DOD concurred with all of GAO's recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-07-643.

To view the full product, including the scope and methodology, click on the link above. For more information, contact McCoy Williams at (202) 512-9095 or williamsm1@gao.gov.

What GAO Found

GAO's analysis of NAWC reports determined that NAWC's reported carryover information was not reliable. Since DOD changed its carryover policy in December 2002, NAWC reports showed that while under the ceiling for fiscal year 2006, it exceeded its carryover ceiling by tens of millions of dollars from fiscal year 2003 through fiscal year 2005, as shown in the following table. To the extent that carryover is too high, Congress can redirect the customers' funds for other priorities.

NAWC's Reported Carryover Amounts Over/Under Ceiling

Dollars in millions

	Fiscal year 2003	Fiscal year 2004	Fiscal year 2005	Fiscal year 2006
Carryover amount	$1,146	$1,109	$1,046	$1,007
Carryover ceiling	1,129	1,052	994	1,034
Amount over or under ceiling	Over $16	Over $57	Over $51	Under $28

Source: Navy reports.

Note: Figures may not add due to rounding.

GAO's analysis of accounting information on customer orders and discussions with NAWC officials determined that its fiscal year 2003 and 2004 carryover information was unreliable due to (1) NAWC converting to a new accounting system in fiscal year 2003 and (2) NAWC not performing reviews of obligations, including the required DOD triannual reviews. To better manage carryover and improve the reliability of carryover information, starting in fiscal year 2005, NAWC (1) issued guidance on the acceptance of orders at year end and (2) began reviewing orders to correct its old financial records. While the reliability of carryover information improved in fiscal years 2005 and 2006, GAO determined that problems still exist. For example, GAO found that funds on some customer orders totaling $19.5 million were deobligated at fiscal year end and then reobligated at the beginning of the next fiscal year on these same orders. This artificially lowered reported NAWC carryover at fiscal year end.

Further, even though DOD's 1996 guidance required NAWC as well as other activities to conduct triannual reviews of its financial information, NAWC did not perform these reviews until fiscal year 2006. If implemented properly, these reviews would improve the reliability of reported carryover information and the underlying financial data. In addition, as of September 2006, the two NAWC divisions were still not fully complying with several of the 16 specific DOD tasks required as part of the triannual reviews. For example, because the two divisions were not always effectively reviewing some obligations, especially dormant obligations (obligations over 120 days old), their reported actual carryover was overstated. Also, effective triannual reviews would help NAWC validate its financial records before it implements a new system that is scheduled to be installed in October 2007.

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United States Government Accountability Office
Washington, DC 20548

June 26, 2007

The Honorable John P. Murtha
Chairman
The Honorable C.W. Bill Young
Ranking Minority Member
Subcommittee on Defense
Committee on Appropriations
House of Representatives

According to the Department of Defense's (DOD) fiscal year 2007 budget estimates, working capital fund activity groups (depot maintenance, ordnance, and research and development) will have about $6 billion of funded work that will be carried over from fiscal year 2007 into fiscal year 2008.[1] The congressional defense committees recognize that these activity groups need some carryover to ensure a smooth flow of work during the transition from one fiscal year to the next. However, past congressional defense committee reports raised concerns that the level of carryover may be more than is needed. Excessive amounts of carryover financed with customer appropriations are subject to reductions by DOD and the congressional defense committees during the budget review process. To the extent that carryover is too high, Congress may redirect the funds gained from such reductions to pay for other priority initiatives.

In May 2001, we reported[2] that DOD did not have a sound analytical basis for its 3-month carryover standard, which it established in 1996. In December 2002, DOD revised its carryover policy to eliminate the 3-month across-the-board standard for allowable carryover. Under the new policy, the allowable amount of carryover (known as the carryover ceiling) is to

[1] The carryover amount includes both work for which obligations have been made by requesting organizations but that has not yet started and the cost to complete work that has been started.

[2] GAO, *Defense Working Capital Fund: Improvements Needed for Managing the Backlog of Funded Work*, GAO-01-559 (Washington, D.C.: May 30, 2001).

be based on the outlay rate[3] of the customers' appropriations financing the work. This means that in determining allowable carryover, the first year outlay rate of the customers' appropriations financing the work is used for new orders received in the current year (first year of the work order). However, we reported[4] in June 2006 that the military services have not consistently implemented DOD's revised policy in calculating carryover. Instead, the military services used different methodologies for calculating reported actual and allowable amounts of carryover since DOD changed its carryover policy in December 2002. We also reported that the Naval Air Warfare Center (NAWC) exceeded the carryover ceiling for fiscal years 2003, 2004, and 2005 by millions of dollars each year.

As requested by and agreed to with your office, this report assesses carryover related to NAWC. The objectives of this assignment were to determine if (1) NAWC's reported actual carryover was reliable for fiscal years 2003 through 2006 and (2) NAWC was utilizing the required triannual review process to improve the reliability of its carryover information and underlying financial data. Our review was performed from July 2006 through April 2007 in accordance with U.S. generally accepted government auditing standards. The carryover data used in this report were obtained from official Navy budget and accounting documents. To assess the reliability of the data, we (1) reviewed and analyzed the information used to calculate reported actual carryover, (2) analyzed the NAWC aircraft and weapons divisions' fiscal years 2003 through 2006 financial statements, (3) interviewed officials knowledgeable about the carryover data, (4) reviewed NAWC's implementation of the required DOD triannual review process, and (5) reviewed selected orders to determine if the orders were adequately supported by documentation. Further details on our scope and methodology can be found in appendix I. We requested comments on a draft of this report from the Secretary of Defense or his designee. Written comments from the Under Secretary of Defense (Comptroller) are reprinted in appendix III.

[3] The amount of allowable carryover using the outlay rate follows. For example, customers order $100 of work, which is financed with a specific appropriation. If the outlay rate for this appropriation at the appropriation level is 60 percent, then this would result in the working capital fund activity group being allowed to carry over $40 ($100 - $60 [$100 x 60 percent] = $40).

[4] GAO, *Defense Working Capital Fund: Military Services Did Not Calculate and Report Carryover Amounts Correctly,* GAO-06-530 (Washington, D.C.: June 27, 2006).

Results in Brief

Our analysis of accounting data that provide information on customer orders and discussions with NAWC officials determined that the reported carryover information was not reliable for fiscal years 2003 and 2004 as a result of (1) NAWC's conversion to a new accounting system in fiscal year 2003 and (2) the divisions not performing reviews of obligations, including the required DOD triannual reviews. Reliable carryover information is essential for DOD and congressional defense committees during the budget review process since they may redirect excessive carryover amounts to pay for other priority initiatives. For fiscal years 2003, 2004, and 2005, NAWC reports showed that it exceeded its carryover ceiling by $16.3 million, $57.2 million, and $51.7 million, respectively. During this 3-year period, our analysis of Navy reports showed that NAWC had carryover amounts of $1.1 billion, $1.1 billion, and $1.0 billion, respectively, which represented over one-third of NAWC's annual workload. However, both the NAWC aircraft and weapons divisions' comptrollers did not certify to the accuracy of financial information reported in their fiscal year 2003 financial statements. To better manage carryover, improve the reliability of reported carryover information, and avoid exceeding the carryover ceiling, beginning in fiscal year 2005 and continuing into fiscal year 2006, NAWC (1) issued guidance on the acceptance of orders at fiscal year end and (2) began reviewing orders to correct old financial records and reduce carryover. For fiscal year 2006, NAWC reported that its actual carryover was below the carryover ceiling. While the reliability of carryover information improved in fiscal years 2005 and 2006, we determined that some data reliability problems still exist. For example, we found that funds on some customer orders totaling $19.5 million were deobligated at the end of the fiscal year end and then reobligated at the beginning of the next fiscal year on these same orders. This artificially lowered carryover at the end of the fiscal year.

Furthermore, NAWC did not perform the triannual reviews of its financial information until fiscal year 2006, even though DOD guidance has been in place for about 10 years requiring NAWC and all other fund holders[5] to conduct these reviews of their financial data (outstanding commitments, obligations, and accrued expenditures). If implemented properly, these reviews would likely have improved the reliability of reported carryover information and related underlying financial data. DOD established its triannual review requirement in 1996 in order to improve the timeliness

[5] The fund holder is the organization on whose accounting records a commitment, obligation, and/or accrued expenditure is recorded.

and accuracy of its financial data. According to NAWC officials at the aircraft and weapons divisions, these reviews were not done prior to 2006 because they received guidance from the Naval Air Systems Command that stated NAWC was not required to conduct the triannual reviews. Further, as of September 2006, the two divisions were still not fully complying with several of the 16 specific DOD tasks that they were required to accomplish as part of the triannual reviews. Because the two divisions did not always effectively review some obligations, particularly dormant obligations (obligations over 120 days old), (1) their reported actual carryover was overstated and (2) they sometimes returned unneeded funds to customers after the funds had expired. Furthermore, if effectively implemented, the triannual reviews could help NAWC validate or correct any errors in its financial records before it implements a new system that is scheduled to be installed in October 2007.

We are making six recommendations to DOD to (1) reiterate guidance to NAWC that would prohibit it from deobligating reimbursable customer orders at fiscal year end and reobligating them in the next fiscal year, an action that artificially reduces carryover balances that are ultimately reported to Congress; and (2) improve the effectiveness of the triannual review process. DOD concurred with the six recommendations and identified corrective actions it is taking to address them. While we appreciate DOD's efforts, we are concerned with (1) the timing of the corrective action for one of the recommendations and (2) the completeness of DOD's planned actions related to the one recommendation with which it "concurred with comment." First, with regard to DOD's plans to complete its reviews and validations of dormant obligations and accrued expenditures by September 2008, we continue to believe that these reviews and validations should be completed prior to the planned implementation of a new accounting system, currently scheduled for October 2007. Second, in concurring with our recommendation for a clarification of the DOD Financial Management Regulation (FMR) guidance on the triannual reviews, DOD commented the FMR is clear as currently written but it would issue a letter directing the Navy to comply with the FMR. As noted in our draft report, we identified varying interpretations of the FMR guidance among the Navy officials we interviewed. Thus, while we continue to believe that a revision to the FMR would be the most efficient means to resolve this issue, a letter such as that proposed in DOD's response could suffice as long as it includes clarification of the FMR guidance, particularly with regard to the dollar thresholds for required reviews.

Background

A working capital fund relies on sales revenue rather than direct appropriations to finance its continuing operations. A working capital fund is intended to (1) generate sufficient resources to cover the full costs of its operations and (2) operate on a break-even basis over time—that is, neither make a gain nor incur a loss. Customers use appropriated funds to finance orders placed with the working capital fund. According to the Navy's fiscal year 2007 budget, the Navy Working Capital Fund will earn about $23.4 billion in revenue during fiscal year 2007. The Navy Working Capital Fund consists of the following five major activity groups: supply management, depot maintenance, transportation, base support, and research and development. The Navy's research and development working capital fund activity group is Navy's largest activity group in terms of expected revenue with $10.1 billion in fiscal year 2007. The activity group includes the following subactivity groups: (1) the Naval Surface Warfare Center, (2) the Space and Naval Warfare Systems Centers, (3) the Naval Undersea Warfare Center, (4) the Naval Research Laboratory, and (5) the Naval Air Warfare Center.

The Naval Air Warfare Center consists of two divisions: (1) the aircraft division, which is located at Lakehurst, New Jersey, and Patuxent River, Maryland; and (2) the weapons division, which is located at China Lake, California, and Point Mugu, California. NAWC employs about 10,300 civilian and military personnel and is expected to have revenues of almost $3 billion in fiscal year 2007. The mission of NAWC's aircraft division is to operate the Navy's principal research, development, test, and evaluation; engineering; and fleet support activity for naval aircraft engines, avionics, and aircraft support systems, and ships, shore, air operations. The mission of NAWC's weapons division is to operate as the Navy's full-spectrum research, development, test, and evaluation in-service engineering center for air warfare weapons systems (except antisubmarine warfare systems), missiles and missile subsystems, aircraft weapons integration, and assigned airborne electronic warfare systems. The weapons division also operates one of the Navy's major range and test facility bases comprising a complex of air, land, and sea test ranges.

What Is Carryover and Why Is It Important?

Carryover is the dollar value of work that has been ordered and funded (obligated) by customers but not completed by working capital fund activities at the end of the fiscal year. Carryover consists of both the unfinished portion of work started but not completed, as well as requested work that has not yet begun. Some carryover is necessary at fiscal year end if working capital funds are to operate efficiently and effectively. For example, if customers do not receive new appropriations at the beginning of the fiscal year, carryover is necessary to ensure that the working capital fund activities have enough work to ensure a smooth transition between fiscal years. Too little carryover could result in some personnel not having work to perform at the beginning of the fiscal year. On the other hand, too much carryover could result in an activity group receiving funds from customers in one fiscal year but not performing the work until well into the next fiscal year or subsequent years. By optimizing the amount of carryover, DOD can use its resources in the most effective manner and minimize the "banking" of funds for work and programs to be performed in subsequent years.

Decision makers, including the Office of the Under Secretary of Defense (Comptroller) and congressional defense committees, use reported carryover information to make decisions concerning whether working capital fund activities, such as NAWC, have too much carryover. If NAWC has too much carryover, the decision makers may reduce the customers' budgets and use these resources for other purposes. For example, during its review of the fiscal year 2003 budget, the Office of the Under Secretary of Defense (Comptroller) determined that the Navy research and development activities' carryover had been steadily increasing from about $2.2 billion in fiscal year 1997 to about $3.4 billion in fiscal year 2003. Since a significant portion of the carryover was related to work that was to be contracted out, the Office of the Under Secretary of Defense (Comptroller) reduced the customer funding by $161.1 million, because these efforts could be funded in fiscal year 2004 with no impact on performance.

DOD Revised Its Carryover Policy

In 1996, DOD established a 3-month carryover standard for working capital fund activities. In May 2001, we reported[6] that DOD did not have a basis for its carryover standard and recommended that DOD determine the appropriate carryover standard for depot maintenance, ordnance, and research and development activity groups. According to Office of the Under Secretary of Defense (Comptroller) officials, DOD provided verbal guidance concerning its new carryover policy for working capital fund activities in December 2002. Subsequently, DOD included its revised carryover policy in its DOD Financial Management Regulation 7000.14-R, Volume 2B, Chapter 9, dated June 2004, which eliminated the 3-month standard for allowable carryover. Under the new policy, the allowable

[6] GAO, *Defense Working Capital Fund: Improvements Needed for Managing the Backlog of Funded Work*, GAO-01-559 (Washington, D.C.: May 30, 2001).

amount of carryover is to be based on the outlay rate[7] of the customers' appropriations financing the work. This meant that in determining allowable carryover, the first year outlay rate of the customers' appropriations financing the work would be used for new orders received in the current year (first year of the work order). According to the DOD regulation, this new metric allows for an analytical-based approach that holds working capital fund activities to the same standard as general fund execution and allows for more meaningful budget execution analysis.

To calculate the reported actual carryover for the Navy research and development activity group that includes NAWC, the Navy uses the summary-level formula shown below.

Balance of customer orders beginning of year
Plus: New orders received
Equals: Total available orders
Less: Revenue
Less: Work-in-process
Equals: Carryover

In accordance with DOD policy, the following orders and related work are excluded from this calculation: (1) nonfederal orders, (2) non-DOD orders, (3) foreign military sales, (4) work related to base realignment and closure, and (5) major range and test facility base work. The reported actual carryover is then compared to the amount of allowable carryover using the above-mentioned outlay rate method to determine if the reported actual amount was over or under the allowable amount.

DOD Established Triannual Review Requirement in 1996

The May 1996 memorandum from the Under Secretary of Defense (Comptroller) that established DOD's triannual review requirement noted that the timely review of commitments and obligations to ensure the accuracy and timeliness of financial transactions is a vital phase of financial management. To illustrate the point, the Under Secretary stated that the accurate recording of commitments and obligations (1) forms the basis for formal financial reports issued by the department and (2)

[7] The amount of allowable carryover using the outlay rate follows. For example, customers order $100 of work, which is financed with a specific appropriation. If the outlay rate for this appropriation at the appropriation level is 60 percent, then this would result in the working capital fund activity group being allowed to carry over $40 ($100 - $60 [$100 x 60 percent] = $40).

provides information for management to make informed decisions regarding resource allocation.

Carryover-related budget decisions are examples of resource allocation decisions that require reliable obligation data. This is because there is a direct link between the (1) carryover data that working capital fund activities report to Congress and DOD decision makers and (2) obligation data contained in the accounting records of working capital fund activities and their customers. Specifically,

- when working capital fund activities, such as NAWC, accept customer orders, obligations are created in the customers' accounting records, and the activities become the "fund holders"; and
- as work is performed and customers are billed, both the unliquidated obligation balances in the customers' accounting records and the working capital fund activities' reported carryover balances are reduced.

DOD included the triannual review requirements in its Financial Management Regulation. DOD Financial Management Regulation 7000.14-R, Volume 3, Chapter 8, requires fund holders, such as NAWC, to provide written confirmation that they have completed 16 specific tasks[8] during their reviews. For example, the regulation requires fund holders to confirm, among other things, that they have (1) traced the obligations and commitments that are recorded in their accounting systems back to source documentation and (2) conducted adequate follow-up on all dormant obligations and commitments over 120 days old to determine if they are still valid.[9] Additionally, the regulation requires fund holders to (1) identify the problems that were noted during their reviews; (2) advise management of whether, and to what extent, adjustments or corrections were taken to remedy noted problems; (3) summarize, by type, the actions or corrections remaining to be taken; (4) indicate when such actions/corrections are expected to be completed; and (5) identify the actions that have been

[8] In June 2006, the Navy added 2 additional tasks, resulting in Navy activities being required to perform 18 specific tasks in their triannual reviews and to certify that they have completed them.

[9] All obligations and commitment balances are required to be reviewed at least annually in order to substantiate year-end certification requirements. However, for those balances that are greater than a certain amount, these transactions are required to be reviewed during each of the 4-month periods ending January 31, May 31, and September 30 of each fiscal year (e.g., for customer-order-related obligations and commitments, the amount is $50,000).

taken to preclude identified problems from recurring in the future. Thus, if properly implemented by the department, triannual reviews can provide a systematic process that can help fund holders not only improve the reliability of their financial data but also identify and correct the underlying causes of data problems.

NAWC Implemented a New System in Fiscal Year 2003 and Plans to Implement a Different System in October 2007

In 1998, the Navy established four separate Enterprise Resource Planning (ERP) pilot programs to address the need for business operations reform within the Navy. We reported[10] in September 2005 that (1) the Navy invested approximately $1 billion in its four pilot ERP efforts, without marked improvements in its day-to-day operations; (2) the lack of a coordinated effort among the pilots led to a duplication of efforts in implementing many business functions and resulted in ERP solutions that carry out similar functions in different ways from one another; and (3) the pilots resulted in four more stovepiped systems that did not enhance DOD's overall efficiency and resulted in $1 billion being largely wasted.

One of these pilots was managed by the Naval Air Systems Command and called SIGMA. SIGMA was to improve program management including linkage among contract management, financial management, and workforce management. Prior to fiscal year 2003, NAWC used the Defense Industrial Financial Management System to account for its funds. In January 2003, NAWC began to implement SIGMA and completed implementation of this new system in March 2003. As discussed later in this report, NAWC encountered significant difficulties implementing SIGMA, which affected the reliability of the financial information for fiscal years 2003 and 2004. The Navy now plans to implement one overall ERP system, referred to as Navy ERP, and discontinue using the four ERP systems. This overall ERP system is planned to be implemented at NAWC in October 2007.

[10] GAO, *DOD Business Systems Modernization: Navy ERP Adherence to Best Business Practices Critical to Avoid Past Failures*, GAO-05-858 (Washington, D.C.: Sept. 29, 2005).

NAWC's Reported Actual Carryover Information Was Unreliable

Our analysis of accounting data that provide information on customer orders and discussions with NAWC officials determined that the reported carryover information was not reliable for fiscal years 2003 and 2004 as a result of (1) NAWC's conversion to a new accounting system in fiscal year 2003 and (2) the divisions not performing reviews of obligations including the required DOD triannual reviews—as discussed later in this report. Reliable carryover information is essential for DOD and congressional defense committees during the budget review process since they may redirect excessive carryover amounts to pay for other priority initiatives. Both the NAWC aircraft and weapons divisions' comptrollers did not certify to the accuracy of financial information reported in their respective fiscal year 2003 financial statements. To try to better manage carryover, improve the reliability of the carryover information, and avoid exceeding the ceiling, beginning in fiscal year 2005 and continuing into fiscal year 2006, NAWC (1) issued guidance on the acceptance of orders at year end and (2) started to review orders to correct its old financial records and reduce carryover. While the reliability of carryover information improved in fiscal years 2005 and 2006, we determined that data reliability problems still exist. For example, we found that funds on some customer orders totaling $19.5 million were deobligated at the end of the fiscal year and then reobligated at the beginning of the next fiscal year on these same orders. This artificially lowered carryover at the end of the fiscal year.

NAWC Reports Showed that It Exceeded Its Carryover Ceiling from Fiscal Year 2003 through Fiscal Year 2005

Since DOD changed its carryover policy in December 2002, NAWC exceeded its carryover ceiling by tens of millions of dollars from fiscal year 2003 through fiscal year 2005. During this 3-year period, Navy reports showed that NAWC had carryover amounts of $1.1 billion, $1.1 billion, and $1.0 billion, respectively, which represented over one-third of NAWC's annual workload. Table 1 shows the dollar amount of the carryover ceiling, the dollar amount of the Navy-reported actual carryover for NAWC, and the dollar amount of carryover that was over or under the ceiling for fiscal years 2003 through 2006.

Table 1: Dollar Amount of Reported Actual Carryover, Carryover Ceiling, and the Amount of Carryover that is Over or Under the Ceiling

Dollars in millions

	Fiscal year 2003	Fiscal year 2004	Fiscal year 2005	Fiscal year 2006
Carryover amount	$1,146	$1,109	$1,046	$1,007
Carryover ceiling	1,129	1,052	994	1,034
Amount over or under ceiling	Over $16	Over $57	Over $51	Under $28

Source: Navy reports.

Note: Figures may not add due to rounding.

Implementation of New System Affected Reliability of Carryover Information

NAWC reports showed that it exceeded the carryover ceiling in fiscal year 2003 by $16.3 million. NAWC reports showed that the weapons division exceeded the ceiling by $31 million, while the aircraft division was $14.7 million under the ceiling. NAWC aircraft and weapons division officials stated that their fiscal year 2003 carryover information was unreliable as a result of NAWC's conversion to SIGMA in fiscal year 2003. According to NAWC aircraft and weapons division officials, immediately after the conversion to SIGMA between January and March 2003, NAWC personnel began experiencing problems with the reliability of the data. This resulted from the lack of subject matter expertise and user training on the new system, and system configuration problems between the previous system, called the Defense Industrial Financial Management System, and SIGMA. Further, due to the system not operating for approximately 3 months and system-related problems, NAWC experienced significant backlogs in processing financial documents during fiscal year 2003. For example, NAWC weapons division officials noted that their personnel spent the first 2 months of fiscal year 2004 processing fiscal year 2003 customer bills. Due to the delays in processing billing transactions, NAWC's work-in-process balances at the end of fiscal year 2003 (a key component in the carryover calculation) were about 10 times (aircraft) and 8 times (weapons) higher than its fiscal year 2002 reported amount. As a result of these system problems, both the NAWC aircraft and weapons divisions' comptrollers would not certify to the accuracy of financial information reported in their fiscal year 2003 financial statements.

For fiscal year 2004, the aircraft and weapons divisions reported that their carryover exceeded the ceiling by $35.7 million and $21.5 million, respectively, for a total of $57.2 million. According to NAWC aircraft and weapons division officials, several data fixes were made to SIGMA in fiscal year 2004 that improved its processing times and data integrity issues. However, some data reliability problems continued to exist. The NAWC aircraft and weapons divisions' comptrollers noted problems with the reliability of some of their financial information presented in the fiscal year 2004 financial statements. In fiscal year 2004, NAWC aircraft and weapons division officials stated that, at the request of the Naval Air Systems Command Comptroller, a team of consultants and analysts conducted a review of SIGMA's processes to address its multitude of data integrity issues and its inability to provide accurate financial statements. The team developed a detailed plan of action and milestones to fix these problems with timelines that extended into fiscal year 2006. Further, for most of fiscal year 2003 and 2004, NAWC aircraft and weapons division officials stated that SIGMA lacked carryover management reports that would allow NAWC program managers to monitor the status of each order (funding document) and make informed decisions to control its carryover. In the executive summary to the NAWC aircraft division's fiscal year 2004 financial statements, the division reported that the implementation of SIGMA resulted in the nonavailability of specific carryover reports necessary for managing carryover at the program level. NAWC aircraft and weapons division officials stated that while the reports became available late in fiscal year 2004, they were of limited utility because of continuing data integrity issues and NAWC's inability to review and validate both aged and current financial records.

NAWC Took Steps to Better Manage Carryover and Improve the Reliability of Carryover Information

Beginning in fiscal year 2005 and continuing into fiscal year 2006, NAWC issued guidance on the acceptance of orders at fiscal year end in an attempt to better manage carryover and avoid exceeding its carryover ceiling for the third straight year. Specifically, in an August 2005 memorandum that contained fiscal year 2005 NAWC carryover guidance, NAWC estimated that its year-end carryover balance would be $95 million over its authorized level. The memorandum placed strict controls over acceptance of year-end orders including (1) the rejection of noncritical new orders, (2) the acceptance of requests for reversion of funds back to customers, and (3) before the NAWC accepts any critical workload that would result in additional unexpended carryover, the division must obtain approval from the NAWC aircraft division or weapons division commander and offset the outstanding carryover amounts by reversions of funds to the customer of an equal or greater amount. Further, the NAWC comptrollers were directed to provide program managers with a list of projects or tasks that had 25 percent or less of authorized funding executed as a potential source for reversion or offsets. Finally, the NAWC weapons division provided its business financial management community with tools to give them the capability to better manage carryover. For example, one tool provided the business financial managers (BFM)[11] with the capability to compare planned carryover data to actual carryover data for individual orders and at the summary level on a weekly basis to determine if actual carryover may exceed the carryover ceiling at year end. If actual carryover may exceed the ceiling at year end, the weapons division can use the tool to identify problems—such as a significant delay in a major program's start date—and begin working on solutions to mitigate them. Even with these stronger management controls over new orders and the increased efforts to validate old accounts, NAWC's reports showed that it still exceeded the carryover ceiling in fiscal year 2005 by $51.7 million. The aircraft division exceeded the ceiling by $52.4 million while the weapons division was under the ceiling by $0.7 million.

For fiscal year 2006, NAWC's reported actual carryover amount was below the carryover ceiling for the first time since DOD revised its carryover policy in December 2002. The aircraft and weapons divisions were under the ceiling by about $10 million and $18 million, respectively. NAWC officials informed us that they continued to emphasize the management of carryover during fiscal year 2006 by reviewing orders and issuing additional guidance. Key elements of this guidance include the following.

- The aircraft division issued additional carryover guidance in September 2006 to reiterate several requirements cited in fiscal year 2005. Furthermore, an aircraft division official noted that the increased focus resulting from the prior GAO report recommending that the research and development subactivity groups report their carryover balances separately in the Navy's annual budget encouraged NAWC management to more closely monitor and manage its carryover.

- The weapons division issued carryover guidance in August 2006, which continued to stress the reviews of customers' orders that are financed with appropriations that are canceling or expiring. The guidance states that such reviews would (1) improve the quality of the year-end carryover and (2) validate the records, which is an essential task for accomplishing a smooth financial conversion to the new Navy ERP system planned for October 2007. The guidance further provided that funds accepted during the remainder of the fourth quarter should not negatively impact the

[11] BFMs are responsible for pre- and postcontract functions and contract management, including resource management, manpower management, and material management.

division's carryover position. Otherwise, the division should notify the customer that the order cannot be accepted and renegotiate, if possible, the amount of the order that can be accomplished using the DOD carryover guidance on outlay rates.

Furthermore, starting primarily in fiscal year 2005, the aircraft and weapons divisions began reviewing certain types of orders to validate old financial records and reduce carryover. According to NAWC aircraft and weapons division officials, most of these reviews were not done in fiscal years 2003 and 2004 because of NAWC's conversion to SIGMA and the problems, mentioned earlier, it encountered with implementing the system and the reliability of the data in the system. Some of the reviews performed by the aircraft or weapons divisions include (1) reviews of funding documents (orders) citing appropriations that are canceling[12] at the end of each fiscal year (such reviews have been done since the 1990s), (2) reviews of funding documents citing accounts that were to expire at the end of the fiscal year (these reviews started in fiscal year 2005), and (3) a fiscal year 2006 review of unused funds with work completion dates of September 30, 2005, and before. According to NAWC officials, these reviews resulted in correcting millions of dollars in unsupported or unneeded funds on orders, and greatly improved the reliability of the financial data. For example, according to a NAWC aircraft division official, as of August 2005, this division had 14,353 orders that were still open on its books when it converted to SIGMA in fiscal year 2003. As a result of the aircraft division's review of these orders from August 2005 through November 2006, this number was reduced to 7,053 open orders—a reduction of about 50 percent—and $10 million of unneeded funds were removed from its books.

[12]An appropriation enacted for a fixed period of time is available for incurring and recording new obligations during such fixed period of time after which the appropriation account expires. The expired appropriation account remains available for the period of 5 years to record adjustments to obligations properly incurred prior to its expiration and to liquidate such obligations. At the end of the 5-year expired account period, the appropriation balance is canceled and the account is closed. Once closed, the expired appropriation account ceases to be available to adjust or liquidate obligations.

31 U.S.C. §§ 1552(a), 1553(a), 1553(b) (1). For further discussion see GAO, *Principles of Federal Appropriations Law*, vol. 1, 3rd ed., GAO-04-261SP, pp. 5-71 through 5-75 (Washington, D.C.: January 2004) and *Principles of Federal Appropriations Law: Annual Update of Third Edition*, GAO-06-534SP, pp. 5-3 and 5-4 (Washington, D.C.: April 2006).

Some Customer Orders Were Reduced at Year End, which Artificially Lowered Carryover

While we are encouraged by NAWC's actions to review and validate its financial records and better manage its carryover, we identified some cases where NAWC deobligated millions of dollars of funds at fiscal year end on orders for work it still planned to perform. NAWC then reobligated funds at the beginning of the next fiscal year to perform the work. This action artificially lowered NAWC's actual year-end carryover balances in fiscal years 2004 and 2005 that were reported to DOD and congressional decision makers. We analyzed fiscal years 2004 and 2005 year-end orders where amendments or adjustments were made to deobligate funds on these orders at the end of the fiscal year. We found a total of $19.5 million was deobligated at the end of fiscal year 2004 or 2005 and reobligated at the beginning of the next fiscal year. These actions had the effect of reducing carryover even though the requirement for the funds still remained at the time the funds were returned to their customers. We reported[13] on a similar problem in fiscal year 2003 on our review of the Space and Naval Warfare Systems Command. The following examples illustrate the orders that were deobligated at the end of fiscal year 2004 or 2005, which had the effect of reducing reported carryover even though the requirement for the funds still remained but the work could not be completed by the end of the fiscal year.

- Aircraft division officials stated that they did not know why adjustments totaling $10.5 million on 14 orders were made to deobligate customer funds at the end of fiscal year 2004 or 2005 and why the funds were reobligated at the beginning of the next fiscal year on these same orders. They said that lack of documentation, turnover of personnel, and difficulties implementing SIGMA hindered their ability to determine why these year-end adjustments were made. For example, from December 1, 2003, to September 23, 2004, the NAWC aircraft division accepted a work order and related amendments from the Naval Air Systems Command totaling approximately $2.1 million for engineering support for the CH-53E helicopter program. Accounting records showed that $404,435 was deobligated in September 2004—at the end of the fiscal year—and that this same amount was reobligated 1 month later in October 2004—at the beginning of the next fiscal year. According to an aircraft division official, "no documentation for reason of the deobligation has been located."

[13] GAO, *Navy Working Capital Fund: Backlog of Funded Work at the Space and Naval Warfare Systems Command Was Consistently Understated*, GAO-03-668 (Washington, D.C.: July 1, 2003).

- In April 2005, the NAWC weapons division accepted two orders from the U.S. Army Space and Missile Defense Command totaling $5.5 million for range instrumentation services and missile flight safety support for two separate tests of the Missile Defense Agency Target Intercontinental Ballistic Missiles. The tests were originally scheduled to be completed in fiscal year 2005, but were delayed into fiscal year 2006 due to weather and instrumentation problems. Due to program delays and expenditure rates that were 25 percent or less of authorized funding on the orders, NAWC identified these orders as potential funds that could be returned to the customer. According to a BFM, the NAWC weapons division needed to have these funds "off the books" to relieve the carryover problem. The NAWC weapons division's comptroller officials stated that the return of funds to customers is appropriate when mission support requirements slip from one fiscal year to the next and the tasking to be accomplished is severable, as in this case. On September 23, 2005, the U.S. Army Space and Missile Defense Command issued an amendment to each order deobligating a total of $4.85 million. Approximately 1 month later, the command issued amendments on the orders returning the $4.85 million—the exact amount that was deobligated in September 2005. The two tests were performed in fiscal year 2006.

- In January 2005, the NAWC aircraft division accepted an order from the Naval Air Systems Command totaling $100,000 for the research and development of a low-cost, automated fiber optic cable. In September 2005—8 months later—the Naval Air Systems Command issued an amendment to the order deobligating the entire amount. In October 2005—approximately 1 month later—the command issued another amendment to the order returning funds to the program totaling $110,000. Work on the order began in November 2005 and was completed in September 2006. According to a BFM, delays in completing work in fiscal years 2003 and 2004 on other jobs delayed the start of fiscal year 2005 work. NAWC aircraft division accounting officials said, and we agree, that work should have been started within a reasonable amount of time after accepting the order in January 2005—within 90 days. Otherwise, the funds should have been deobligated when the delays caused the work to commence beyond a reasonable amount of time as specified in the DOD financial management regulation.

NAWC Did Not Perform the Required Triannual Reviews Until Fiscal Year 2006

NAWC did not perform the triannual reviews of its financial information until fiscal year 2006, even though DOD guidance had long required NAWC and all other fund holders[14] to conduct these reviews of their financial data (outstanding commitments, obligations, and accrued expenditures). These reviews would likely have improved the reliability of carryover information and the underlying financial data. DOD established its triannual review requirement in 1996 in order to improve the timeliness and accuracy of its financial data. However, the aircraft and weapons divisions did not conduct their first reviews until January 2006—about 10 years later. Further, as of September 2006, the two divisions were still not fully complying with several of the 16 specific DOD tasks that they were required to accomplish during their reviews. Because the two divisions did not always effectively review some obligations, particularly dormant obligations (i.e., those over 120 days old), (1) their reported actual carryover was overstated and (2) they sometimes returned unneeded funds to customers after the funds had expired. Further details on dormant obligations and accrued expenditures are included in appendix II. Furthermore, if effectively implemented, the triannual reviews could help NAWC validate its financial records before it implements a new system that is scheduled to be installed in October 2007.

NAWC Did Not Properly Implement DOD's Triannual Review Guidance

NAWC did not properly implement DOD's triannual review guidance cited in DOD Financial Management Regulation 7000.14-R, Volume 3, Chapter 8. Specifically, (1) NAWC did not perform the required triannual reviews prior to fiscal year 2006 although these reviews were required in a May 1996 memorandum from the Under Secretary of Defense (Comptroller) and in the November 2000 DOD Financial Management Regulation and (2) NAWC did not review all obligations at least once during fiscal year 2006 as required by the November 2000 DOD regulation. In addition, the November 2000 DOD regulation (triannual guidance) on the dollar threshold for reviewing obligations was unclear.

NAWC Did Not Perform Required Triannual Reviews Prior to Fiscal Year 2006

Prior to fiscal year 2006, NAWC did not perform triannual reviews, even though these reviews were required by the DOD Financial Management Regulation. According to NAWC officials at the aircraft and weapons divisions, these reviews were not done because they received e-mail guidance from the Naval Air Systems Command that stated the NAWC

[14] The fund holder is the organization on whose accounting records a commitment, obligation, and/or accrued expenditure is recorded.

divisions were not required to submit the triannual review confirmation report because this requirement was only for general funds. In October 2005, the Naval Air Systems Command provided guidance to the NAWC aircraft and weapons divisions that they were now required to perform the triannual reviews and complete the confirmation statements. Officials from the NAWC aircraft and weapons divisions stated that the first time they completed a triannual review and confirmation statement was for the period ending January 31, 2006.

NAWC Did Not Review All Obligations in Fiscal Year 2006 as Required by DOD Regulation

Although the DOD regulation requires that all obligations be reviewed at least annually in order to substantiate year-end triannual review requirements, the NAWC aircraft and weapons divisions only reviewed obligations, including dormant obligations, over a certain dollar threshold—$50,000 or $200,000. The weapons division did not review all the obligations because guidance received from the Naval Air Systems Command dated June 2, 2006, and September 28, 2006, and guidance issued by NAWC weapons divisions dated September 29, 2006, did not require a review of all of them. Officials from Naval Air Systems Command and the NAWC weapons division informed us that they did not require the review of all obligations at least once a year because they did not realize that the DOD regulation required such a review. NAWC aircraft division officials told us that although the DOD regulation required such reviews, they did not have the time or resources to perform the reviews. If effectively implemented, the triannual reviews could help NAWC validate its financial records before it implements a new system that is scheduled to be installed in October 2007.

DOD Triannual Review Guidance on Dollar Threshold for Reviewing Obligations Is Unclear

We also found that DOD's triannual review guidance regarding the dollar threshold for reviewing outstanding obligations was unclear. The DOD Financial Management Regulation 7000.14-R, Volume 3, Chapter 8, guidance states that during the January and May reviews, obligations of (1) $200,000 or more for investment appropriations (e.g., procurement and the capital budget of the working capital funds) should be reviewed and (2) $50,000 or more for operating appropriations (e.g., operation and maintenance funds and the operating portion of the working capital funds) should be reviewed. However, the Naval Air Systems Command and the NAWC weapons division interpreted the guidance to mean that customer orders—which are the operating portion of the working capital fund—financed with investment funds fell into the $200,000 threshold category for review purposes, rather than the $50,000 category. The NAWC weapons division conducted its triannual reviews accordingly. In discussing this issue with accounting and budgeting officials from the Office of the Under Secretary of Defense (Comptroller), they stated that customer orders received by working capital fund activities are part of the operating portion of the working capital fund regardless of the appropriation financing the order. Thus, the January and May triannual reviews should have included all obligations over $50,000.

NAWC Continues to Refine Its Triannual Review Process

Our review of the process that the NAWC aircraft and weapons divisions used to conduct their triannual reviews identified several areas that need improvements. The aircraft and weapons divisions developed their own separate processes for performing the triannual reviews. For fiscal year 2006, the weapons division used a decentralized process that relied on both the accounting department and the BFMs to conduct its reviews, while the aircraft division used a centralized process that relied on the accounting department to conduct its reviews. During our review, we identified problems with the two divisions' triannual reviews of obligation and accrued expenditure balances. Based on the results of our review and discussions with NAWC officials, the aircraft and weapons divisions issued written guidance on performing the triannual reviews and are now including the BFMs in the process. If the process is implemented properly, the aircraft and weapons divisions' decision to include the BFMs in its triannual review process should result in better reviews and more reliable financial information, including carryover information, in the future.

NAWC Weapons Division Improved Its Decentralized Review Process throughout 2006

The NAWC weapons division accomplished its triannual reviews on a decentralized basis. During the first step of the process, the Office of the Comptroller for the NAWC weapons division, which has overall responsibility for the reviews, developed computer lists that contain information on the division's outstanding commitments, obligations, and accrued expenditures. The Comptroller's office then placed these lists on the Business Financial Management Community shared server so that the BFMs could access the data and conduct their triannual reviews. When the BFMs finished their reviews, the competency[15] heads certified that their reviews had been completed and then forwarded their certifications to the Comptroller's office. On the basis of the technical department's certifications, the Comptroller then certified that the division has completed its review.

[15] Competencies represent different departments aligned to perform specific functions such as engineering, contracting, and financial management. Throughout the rest of this report, we will refer to the competencies as technical departments.

We found problems with the weapons division's implementation of the triannual review process. The NAWC weapons division performed its first triannual review for the period ending January 31, 2006. The review was performed on a limited basis by the Comptroller's office since no formal triannual review procedures had been developed by the weapons division. For the second triannual review performed for the period ending May 31, 2006, the Comptroller's office modified its process to place primary responsibility for reviewing its division's commitments, obligations, and accrued expenditures on the BFMs within the division's technical departments. NAWC weapons division officials stated that the BFMs had information that was not immediately available to the Comptroller's office on whether work was performed on its orders. Consequently, they were in the best position to determine whether outstanding obligations and accrued expenditures were valid and whether the funds were still needed to perform the work.

While the May 2006 process was better than the one used for the weapons division's January 2006 review, our analysis and discussions with technical department and Comptroller's office officials found that (1) no written procedures had been developed by the weapons division, (2) not all BFMs that were responsible for reviewing the transactions participated in the training offered by the Comptroller's office, (3) the Comptroller's office did not specifically identify which transactions the technical departments were required to review, (4) the weapons division did not have a standard methodology for reporting the results of its technical departments' reviews to the Comptroller's office in order to ensure that all required transactions were certified, (5) not all BFMs that reviewed transactions were maintaining documentation for 24 months on their reviews as required by the DOD Financial Management Regulation, and (6) the division did not have a procedure in place to ensure the technical departments were performing the triannual reviews properly. For example, many of the technical departments' BFMs that we interviewed stated that the lists provided by the Comptroller's office contained hundreds of commitment, obligation, and accrued expenditure transactions for review, but the lists did not contain enough information to identify the specific transactions that the BFMs were responsible for reviewing. As a result, some BFMs did not perform the May 2006 triannual review at all because they could not identify the transactions that they were responsible for reviewing. Further, several of the BFMs that did perform reviews stated that they did not report their results to the Comptroller's office because a clearly defined procedure for reporting the results did not exist.

In August 2006, we met with weapons division officials to discuss the division's triannual review process. Based on those discussions, we pointed out internal control weaknesses we identified in the May 2006 process. The officials agreed that the weapons division's triannual review process could be improved and the division needed to document its triannual review procedures. Shortly after our meeting, the division established a team to develop guidance on its triannual review procedures. The team decided to use a phased approach to achieve compliance with the DOD triannual review regulation. On September 29, 2006, the weapons division issued interim guidance containing the triannual review procedures for reporting on the period ending September 30, 2006. The weapons division made a number of improvements to the May 2006 process. The weapons division (1) modified the process to clearly identify which technical departments were responsible for the transactions, (2) directed the department heads who were responsible for the transactions assigned to their departments to certify that these transactions were reviewed, and (3) established a procedure for reporting results to the Comptroller's office.

Our discussions with several weapons division technical departments' BFMs found that these officials thought the September 2006 triannual review process was a significant improvement over the May 2006 review process because the computer lists provided by the Comptroller's office contained sufficient information to identify the technical department and BFM responsible for reviewing the September 2006 transactions. Further, the interim guidance contained clear instructions for reporting their results to the Comptroller's office through their technical department managers. Our analysis showed that while the guidance for the September 2006 triannual reviews was an improvement, the guidance (1) did not comply with all the requirements of the DOD Financial Management Regulation to review all outstanding commitments, obligations, and accrued expenditures at least once annually; (2) did not require training for all the technical departments' BFMs involved in the review; (3) did not require all BFMs that were responsible for performing triannual reviews to maintain documentation for 24 months on their reviews; and (4) did not establish a procedure for ensuring that the technical departments are completing their reviews in compliance with the September 2006 interim guidance.

On December 21, 2006—about 3 months later—the NAWC weapons division issued additional guidance containing instructions for performing all future triannual reviews beginning with the review period ending January 31, 2007. The guidance stated that the triannual reviews are a critical factor in the NAWC weapons division efforts to eliminate problem disbursements, reduce potential violations of the Anti-Deficiency Act, and improve obligation and expenditure rates. The guidance requires all commitments and obligations to be reviewed at least annually in compliance with the DOD Financial Management Regulation and requires the technical departments' BFMs to attend mandatory annual triannual review training. While the new guidance addresses many of our concerns, it still does not establish procedures for ensuring that the technical departments are completing their reviews in compliance with the new guidance. Without these procedures, the Comptroller's office does not have a sound basis for providing written confirmation that the NAWC weapons division's transactions are complete and accurate.

NAWC Aircraft Division Did Not Generally Involve BFMs in Its Triannual Reviews

Unlike the weapons division, the NAWC aircraft division accomplished its triannual reviews on a centralized basis within the accounting department and the BFMs were generally not included in the process. During the first step of the aircraft division process, the accounting department generated computer lists that contained information on the division's outstanding commitments, obligations, and accrued expenditures. The accounting department then forwarded these lists to the various team leaders within the accounting department to conduct the needed research to ensure that the outstanding obligations, accruals, or commitments are still valid. For example, the accounting department reconciled the disbursements recorded in SIGMA to the disbursements recorded in the DOD payment system called the Mechanization of Contract Administration Services (MOCAS). In performing the triannual reviews, the accounting department involved the BFMs on an as-needed basis. When the accounting department team leaders finished their reviews, they sent the completed lists back to the cost accounting supervisor, who then coordinated with the accounting officer to certify that the reviews were completed and forwarded these certifications to the Comptroller's office. On the basis of these certifications, the Comptroller certified that the division had completed its review and the transactions reviewed were accurate.

NAWC aircraft division did not complete its first triannual review until January 2006. Our analysis and discussions with NAWC aircraft division officials determined that the aircraft division had not (1) developed and implemented written procedures for performing the triannual reviews and (2) developed or provided training to the BFMs on how to conduct the triannual reviews since they have not been specifically involved in performing these reviews. The accounting officer stated that they were unable to review all outstanding obligations, as required by the DOD regulation at least annually, due to time and resource constraints.

In addition to the triannual reviews, the accounting officer stated that the aircraft division accounting department reviews commitments, obligations, and accrued expenditures as part of its routine operations. Specifically, the accounting department is to take the following actions.

- Identify outstanding orders funded with appropriations that are canceling at the end of the fiscal year and perform detailed analyses to resolve these transactions in order to get them off the books prior to the end of the fiscal year.

- Forward information to the budget department, which coordinates with the BFMs to review outstanding commitments over 90 days old on a monthly basis and respond back to the accounting department as to whether the commitments on the list are valid or invalid.

- Perform research on outstanding accrued expenditures. The first accrued expenditure data file was produced as of the end of fiscal year 2005. According to a NAWC aircraft division official, throughout fiscal year 2006, the accrued expenditure information improved. The aircraft division now compares the information in this file to information received from MOCAS. The accounting department had not provided the accrued expenditure file to the BFMs for review prior to January 2007. However, beginning in January 2007, the Comptroller's office began generating files that identified which accrued expenditure records belonged to which BFMs. In addition, one of the data elements identifies the person in the accounting department who performed the initial research and what research had been performed to date to alleviate the duplication of efforts between accounting and BFM personnel. This will enable the accounting department to begin using the BFMs in researching the accrued expenditures.

Even though the procedures provide for some BFM involvement, our review of 21 dormant obligations involving 17 different BFMs disclosed that they had not reviewed the specific transactions in our sample prior to our visit. This is an indication that the aircraft division's routine reviews of obligations were not always effective. Additionally, our analyses identified that the aircraft division's current process did not provide an adequate review of its obligations and accrued expenditures. We found that:

- As of September 30, 2006, $43 million (or 23 percent) of the NAWC aircraft division's obligations were over 120 days old and $20 million (or 11 percent) were over 1 year old. The accounting officer stated that they were unable to review all the obligations as required by the DOD regulation at least annually, due to time and resource constraints. Accordingly, this item was not certified on the September 30, 2006, triannual review confirmation checklist.

- As of June 30, 2006, $70 million (or 62 percent) of the NAWC aircraft division's accrued expenditures were over 120 days old and $35 million (or 31 percent) were over 1 year old. The accounting officer stated that accrued expenditures were only reviewed within the accounting department and that they had not developed policies or procedures for reviewing the accrued expenditures.

In February 2007, NAWC aircraft division officials stated that they were developing a new draft instruction for conducting their triannual reviews. These officials added that they started with the December 2006 NAWC weapons division guidance and are revising it to better reflect the aircraft division's operations. A month later, on March 20, 2007, the NAWC aircraft division issued written procedures that (1) require the division to review all outstanding obligations and accrued expenditures at least annually in order to substantiate the year-end certification process, (2) clearly delineate the responsibilities of the individuals performing the review, (3) require the BFMs to participate in performing the triannual reviews, (4) clearly describe the process for reporting the triannual review results to the division's Comptroller office, and (5) require the division to maintain all documentation related to the transactions reviewed for a period of 24 months following the review to ensure that independent organizations, such as the Office of Inspector General, can verify that the reviews were accomplished as required. While we agree with the aircraft division's issuance of written triannual review procedures that increase the involvement of the BFMs in the triannual review process, we note that the division had not yet developed and implemented training that provides detailed instructions to the BFMs on performing the triannual reviews. Although this may require a short-term increase in resources to provide this training, the long-term benefit will be a more complete review of obligations, commitments, and accrued expenditures. This, in turn, should improve the reliability of the aircraft division's financial information, including carryover.

Conclusions

Reliable carryover information is essential for Congress and DOD to perform their oversight responsibilities, including reviewing and making well-informed decisions on DOD's budget. Moreover, by improving the reliability of the underlying data used to calculate carryover, NAWC's financial data, such as obligation and accrued expenditure balances, will also be more reliable. Management accountability at the divisions for the accuracy of reported carryover and the timely identification of unneeded funds will be a key factor in improving these data. This includes increased management attention to help assure that the divisions are effectively conducting their triannual reviews, including reviewing funded orders. Further, in light of NAWC's planned conversion to a new Navy accounting system in October 2007, it is especially important for NAWC to review and correct any errors in recorded obligations and accrued expenditures, particularly dormant ones. If not corrected prior to conversion, any such errors could cause additional resource-intensive research to fully resolve them and these problem transactions could potentially remain unresolved for years.

Recommendations for Executive Action

In order to improve the reliability of carryover information at NAWC, we are making the following six recommendations to the Secretary of Defense.

We recommend that the Secretary of Defense direct the Secretary of the Navy to take the following actions.

- Reiterate its guidance that clearly prohibits Navy working capital fund activities from deobligating reimbursable customer orders at fiscal year end and immediately reobligating them in the next fiscal year, a process that results in artificially reducing the carryover balances that are ultimately reported to Congress.

- Develop and implement procedures for the Naval Air Warfare Center's aircraft and weapons divisions to provide assurance that triannual reviews of obligation and accrued expenditure balances are performed in accordance with the DOD Financial Management Regulation.

- Develop and implement a required training course for BFMs that provides instructions on performing the triannual review requirements for the Naval Air Warfare Center's aircraft division.

- Require individuals, including BFMs responsible for performing the reviews at the Naval Air Warfare Center's aircraft division, to attend the training to ensure that they are aware of the triannual review requirements.

- Review and validate the accuracy of NAWC's aircraft and weapons divisions' reported outstanding obligations and accrued expenditures, especially those that have remained outstanding since the conversion to

SIGMA, prior to its conversion to a new accounting system in October 2007.

We recommend that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to clarify the triannual review guidance for the January and May reviews in the DOD Financial Management Regulation as it pertains to the dollar threshold for reviewing outstanding commitments and obligations for the capital budget and operating portion of the working capital fund.

Agency Comments and Our Evaluation

DOD provided written comments on a draft of this report. DOD concurred with our six recommendations and plans to complete actions on five of the six recommendations by the end of fiscal year 2007. We appreciate DOD's efforts and find them generally responsive to our recommendations. For example, DOD stated that it would complete the following actions.

- Direct the Navy to reiterate its policy on handling reimbursable customer orders in its fiscal year end closing guidance.
- Direct the Navy to develop and implement procedures that provide assurance that the required triannual reviews are properly performed.
- Direct the Navy to develop and implement a training course or courses for all Naval Air Warfare Center employees involved with the triannual reviews and require these employees, including the business financial managers, to attend the training.

However, we are concerned with the timing of the corrective action for one of the recommendations and also with the completeness of DOD's planned actions related to the one recommendation with which it "concurred with comment." Specifically, in its written comments, DOD stated that the Navy would emphasize reviewing and validating outstanding obligations and accrued expenditures that have remained outstanding since the conversion to SIGMA and estimated that this action would be completed by September 2008. As noted in our draft report, we believe that it is critical that such reviews and validations be completed prior to the planned conversion to a new accounting system in October 2007. While we appreciate that the Navy has already started these reviews, validating these transactions prior to the system conversion is a best practice that would help avoid some of the problems that were encountered when NAWC implemented its current accounting system in 2003.

Further, in response to our recommendation that the triannual review guidance in the FMR be clarified, DOD "concurred with comment" and stated that a letter would be issued directing the Navy to comply with the FMR concerning the dollar thresholds for performing the triannual review. DOD commented that the FMR was clear as currently written. As noted in our draft report, officials from the Naval Air Systems Command, the NAWC weapons division, and the NAWC aircraft division had varying interpretations of the FMR requirements. Thus, while we continue to believe that a revision to the FMR would be the most efficient means to resolve this issue, a letter such as that proposed in DOD's response could suffice as long as it includes clarification of the FMR guidance, particularly with regard to the dollar thresholds for reviewing outstanding commitments and obligations for the capital budget and operating portion of the working capital fund.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Armed Services; the Subcommittee on Readiness and Management Support, Senate Committee on Armed Services; the Subcommittee on Defense, Senate Committee on Appropriations; the House Committee on Armed Services; and the Subcommittee on Readiness, House Committee on Armed Services. We are also sending copies to the Secretary of Defense, the Secretary of the Navy, and other interested parties. Copies will be made available to others upon request.

Should you or your staff have any questions concerning this report, please contact McCoy Williams, Director, at (202) 512-9095 or williamsm1@gao.gov, or William M. Solis, Director, at (202) 512-8365 or solisw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IV.

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Appendix I: Scope and Methodology

To determine if the Naval Air Warfare Center's (NAWC) reported actual carryover was reliable for fiscal years 2003 through 2006, we obtained budget and accounting documents that provided information on reported actual carryover and the carryover ceiling for fiscal years 2003 through 2006. We analyzed the carryover information to determine if the NAWC aircraft or weapons divisions' reported actual carryover exceeded the ceiling for fiscal years 2003 through 2006. We (1) discussed with NAWC officials the reliability of the carryover information, (2) obtained and analyzed the NAWC aircraft and weapons divisions' financial statements for fiscal year 2003 through 2006 to determine if NAWC certified to the reliability of the information, and (3) discussed with NAWC officials actions they were taking to improve the reliability of the carryover information. We also reviewed year-end transactions that reduced the dollar amount of reported actual carryover. For these transactions, we obtained data on orders from August through December for 2004 and 2005. We identified orders that showed deobligated amounts in August or September and matched them to the same orders that showed obligated amounts in October through December. We analyzed the orders and any amendments to the orders and met with officials from the NAWC aircraft and weapons divisions to determine why these transactions occurred at the end of the fiscal year. We also discussed with NAWC aircraft division and weapons division officials actions they were taking or have taken to help ensure that the reported actual carryover amount stays below the ceiling.

To determine if NAWC was utilizing the required triannual review process to improve the reliability of its carryover information and underlying financial data, we reviewed the policies and procedures the Naval Air Systems Command and NAWC used to implement the Department of Defense's (DOD) triannual review guidance. Specifically, we (1) reviewed the DOD, Navy, Naval Air Systems Command, and NAWC triannual review guidance and discussed it with cognizant individuals; (2) requested the triannual review confirmation statements that NAWC submitted since fiscal year 2003, and discussed these statements with cognizant individuals; (3) discussed NAWC's triannual review procedures with cognizant individuals, including those who completed the reviews; and (4) reviewed documentation on the results of the review. We also reviewed obligations and accrued expenditures to identify problems and actions that could be taken to fix these problems if NAWC had performed the triannual reviews.

- We obtained data on the status of obligations related to carryover (contracts between NAWC and contractors) at the end of fiscal year 2006. From these data, we selected and analyzed 41 obligations that had outstanding carryover balances at the end of fiscal year 2006 to determine if the carryover balances accurately reflected the amount of work that remained to be performed. We selected obligations that were old (over 120 days) and did not have any recent financial activity (no activity for at least 1 year) since these obligations were more likely to have unneeded funds and because a review of these obligations was, therefore, more likely to identify problems with the triannual review procedures.

- We obtained data on accrued expenditures related to carryover at the end of fiscal year 2005 and June 2006. From these data, we selected and analyzed 17 accrued expenditures to determine if the accrued expenditure balances were correct. Accrued expenditures are critical in the computation of carryover since NAWC recognizes revenue and bills customers based on the accrued expenditures, which in turn, reduces its amount of carryover. We selected accrued expenditures that were over 1 year old and showed no financial activity for at least 1 year since these accrued expenditures were more likely to have unneeded funds and because a review of these orders was, therefore, more likely to identify problems with the triannual review procedures.

We performed our work at or obtained information from headquarters offices of the Under Secretary of Defense (Comptroller) and the Assistant Secretary of the Navy (Financial Management and Comptroller), Washington, D.C.; the Naval Air Systems Command, Patuxent River, Maryland; the Naval Air Warfare Center, Aircraft Division, Patuxent River, Maryland and Lakehurst, New Jersey; and the Naval Air Warfare Center, Weapons Division, China Lake and Point Mugu, California. To assess the reliability of the data used in this report, we (1) reviewed and analyzed the factors used in calculating carryover, (2) analyzed the NAWC aircraft and weapons divisions' fiscal years 2003 through 2006 financial statements, (3) analyzed the NAWC aircraft and weapons divisions' fiscal year 2006 triannual review confirmation statements, (4) interviewed NAWC officials knowledgeable about the carryover data, and (5) reviewed obligations and accrued expenditures to determine if they were adequately supported by documentation.

The carryover information in this report was obtained from official Navy budget and accounting documents. We conducted our work from July 2006 through April 2007 in accordance with U.S. generally accepted government auditing standards. We requested comments on a draft of this report from the Secretary of Defense or his designee. The Under Secretary of Defense (Comptroller) provided written comments, which are presented in the Agency Comments and Our Evaluation section of this report and are reprinted in appendix III.

Appendix II: Analysis of Dormant Obligations and Accrued Expenditures

Our analysis of the Naval Air Warfare Center (NAWC) aircraft and weapons divisions' fiscal year 2006 dormant obligations and accrued expenditures showed the two divisions had tens of millions of dollars of obligations and accrued expenditures that went unresolved for more than 1 year. For the transactions we reviewed, we determined that the two divisions did not perform adequate reviews on some of their dormant obligation and accrued expenditures. If the aircraft and weapons divisions had performed adequate triannual reviews as required, NAWC could have significantly improved the reliability of the carryover balances reported to the Department of Defense (DOD) and congressional defense committees.

More Effective Reviews of Dormant Obligations Could Result in Better Use of Customer Funds and Reduce Reported Carryover

A key element of the triannual reviews is the requirement to follow up on all obligations that have been dormant for more than 120 days to determine if unused funds are still needed. The task is one of the 16 DOD triannual review requirements and is important because it will facilitate the (1) identification and recording of work performed on these orders, thereby reducing NAWC's reported carryover and, in turn, the likelihood of customers' budget cuts; and (2) identification and return of unneeded funds to customers so that the customers can reuse the funds for other purposes if they are returned before they expire. Furthermore, this task is especially important for NAWC as it is scheduled to convert to a new system—Navy Enterprise Resource Planning (ERP)—in October 2007, and reviewing and validating its records to help ensure they are accurate before converting to the new system would help ensure a smooth transition.

The task of validating obligations to determine if they are still needed is especially important for NAWC's aircraft and weapons divisions. NAWC's September 30, 2006, report on obligations related to carryover showed that $252 million was associated with orders received from customers. Our analysis of the obligation report showed that about $59 million of the $252 million, or 23 percent, was over 120 days old as of September 30, 2006, and $27 million of the $252 million, or about 11 percent, was over 1 year old.

As previously discussed, NAWC's aircraft and weapons divisions did not perform the required triannual reviews of obligations to determine their validity prior to fiscal year 2006. Even though the two divisions did not begin reviewing dormant obligations until fiscal year 2006, both divisions certified that adequate follow-up was conducted on all dormant obligations over 120 days old in the January and May 2006 reports. However, after we began our review, the two divisions did not provide written confirmation that adequate follow-up reviews of dormant obligations over 120 days old to determine if they were valid were conducted in their respective September 2006 reports.

To identify problems and actions that could be taken to fix these problems if the NAWC had performed the triannual reviews, we selected and reviewed 41 outstanding obligations totaling about $4.1 million that were more than 120 days old and had not had any recent financial activity (sometimes no activity for years). For the obligations we reviewed, we determined that the aircraft and weapons divisions did not perform adequate reviews on some of their obligations. In addition, obligations were overstated, which means that the year-end carryover for this work was also overstated by varying amounts for several years. In reviewing the 41 obligations, we found that 14 obligations totaling about $3 million were valid, and 27 obligations[1] totaling about $1.1 million overstated carryover. The following provides a breakout of the obligations that overstated carryover.

- Eight obligations totaling $467,786 were for work that had been performed but (1) no payments had been made to liquidate the obligations and (2) no accrued expenditures were recorded for the work that was performed.

- Eleven obligations totaling $273,628 had no work completed on them or NAWC was in the process of deobligating the funds.

- Ten obligations totaling $312,727 were for work that had been performed and paid for but (1) the payment had either not been correctly recorded or matched to the obligations in order to liquidate the obligations and (2) no accrued expenditures were recorded for the work performed.

The following are some examples of the problems we identified with the dormant obligations that we reviewed.

- In March 2004, the NAWC aircraft division obligated $172,552 for the inspection of flight test propellers. Since May 2004, no financial activity occurred for this obligation (such as payments made or accrued expenditures recorded for work performed). According to NAWC aircraft division officials, the accounting department reviewed this obligation prior to our visit and confirmed that this appeared to be a valid outstanding obligation since they had not received a bill for this work. As part of our review, we requested that the business financial manager (BFM) review

[1] Portions of two obligation amounts were included in two different categories.

the status of the dormant obligation. Further research performed by the BFM disclosed that while the work had been completed by July 15, 2004, the vendor had not submitted a bill. At the time we performed our work, the NAWC aircraft division was in the process of paying the contractor and liquidating the obligation. If the triannual review had been effectively performed, this problem could have been identified years earlier and NAWC could have reduced its year-end obligations and carryover by $172,552 for fiscal years 2004, 2005, and 2006.

- In February 2004, the NAWC aircraft division obligated $25,000 for ship installation drawings for an aircraft carrier. Since that time, no financial activity had occurred. Due to a schedule change regarding the availability of the aircraft carrier, the shipyard was unable to gain access to the ship in order to develop the technical drawings. Consequently, the NAWC aircraft division was unable to perform the work and use the funds. NAWC officials agreed that this obligation should have been closed out several years ago and the funds returned to the customer. According to these officials, they did not review this obligation as part of the division's triannual review because they lacked the time and resources to review all transactions below $50,000. As a result of not deobligating the funds from the records, the NAWC aircraft division overstated its reported year-end obligations and carryover by $25,000 for fiscal years 2004, 2005, and 2006.

- In fiscal year 2002, the NAWC weapons division obligated $30,000 for updating electronic software in EP-3 planes. As of September 2006, the weapons division's accounting records showed that $22,798 of the obligation remained on the accounting records. As part of our review of NAWC carryover, we requested that the BFM review the status of this dormant obligation. The BFM found that (1) the work was completed in 2002, (2) the contractor processed about $18,986 in invoices but only $7,305 in invoices were recorded as being paid, and (3) about $11,014 of the original $30,000 was not used by the contractor. The BFM agreed that the accounting records were in error and, as a result of our inquiry, NAWC weapons division officials are researching the invoice difference of $11,681 ($18,986 less $7,305) and plan to return the remaining unused amount of $11,014 to the customer. As a result of this failure to match invoices with the obligation and revert unused funds back to the customer in a timely manner, the NAWC weapons division overstated reported year-end obligations and carryover by $22,798 in fiscal years 2003, 2004, 2005, and 2006 while also precluding the customer from using some of these funds for some other purpose because the funds had expired.

More Effective Reviews of Dormant Accrued Expenditures Could Improve Reliability of Reported Carryover

At the conclusion of their triannual reviews, fund holders are required to provide written confirmation that they have conducted adequate research on all accrued expenditures[2] that are more than 120 days old to determine if they are valid. This task is important because

- large accrued expenditures balances in general, and large dormant accrued expenditure balances in particular, can indicate either serious accounting problems or ineffective procedures for developing accrued expenditure schedules; and

- accrued expenditures reduce reported carryover balances, and overly optimistic accrued expenditures can, therefore, cause reported carryover to be understated.

The task of validating accrued expenditures is especially important for the aircraft and weapons divisions because NAWC's report on accrued expenditures related to carryover showed that it had about $138 million of accrued expenditures as of June 30, 2006, that were associated with orders received from customers over the years. Accurately accounting for accrued expenditures is important from a carryover standpoint since NAWC recognizes revenue and bills customers based on accrued expenditures. The Office of the Under Secretary of Defense (Comptroller) has also recognized the importance of accrued expenditures in its review of Navy working capital fund activities. During its review of the Navy's working capital fund research and development fiscal year 2008 budget, the Comptroller's Office questioned the large amount of recorded accrued expenditures. As a result, the Office of the Under Secretary of Defense (Comptroller) reduced the Navy's working capital fund research and development fiscal year 2008 budget for three research and development subactivity groups, including NAWC, by $214.7 million.

Our analysis of NAWC's accrued expenditures report showed that about $85 million of the $138 million of accrued expenditures, or 62 percent, were over 120 days old as of June 30, 2006. Further, $45 million of the $138 million, or about one-third of the reported accrued expenditures, were over 1 year old. NAWC officials informed us that when NAWC

[2] According to DOD's Financial Management Regulation 7000.14-R, Volume 1, accrued expenditures represent the amount of paid and unpaid expenditures for (1) services performed by employees, contractors, etc.; (2) goods and tangible property received; and (3) items such as annuities and insurance claims for which no current service or performance is required.

implemented SIGMA in fiscal year 2003, the system did not produce an accrued expenditure report.[3] Since the new system did not produce a report, the NAWC aircraft division designed and developed its own accrued expenditure report. The first report was issued in September 2005—over 2 years after the implementation of the new system. As a result, comprehensive reviews of accrued expenditures were not performed for fiscal years 2003, 2004, and 2005. The two divisions began performing reviews of accrued expenditures during fiscal year 2006 but they did not have any written procedures for such reviews. The following summarizes the fiscal year 2006 results.

- The aircraft division provided written confirmation that adequate follow-up was conducted on all dormant accrued expenditures over 120 days old in its January, May, and September 2006 triannual review reports. Our analysis of the aircraft division's accrued expenditure report as of June 2006 showed that $70 million of the $113 million of the accrued expenditures—or 62 percent—were over 120 days old and about $35 million of the $113 million, or 31 percent, were over 1 year old.
- The weapons division provided written confirmation that adequate follow-up was performed in its January and May 2006 reports but it did not provide written confirmation that adequate follow-up reviews were done of dormant accrued expenditures over 120 days old in its September 2006 report. Our analysis of the weapons division's accrued expenditure report as of June 2006 showed that $14.7 million of the $24.5 million of the accrued expenditures—or 60 percent—were over 120 days old and $10.6 million of the $24.5 million, or 43 percent, were over 1 year old.

To identify problems and actions that could be taken to fix these problems if the NAWC had performed the triannual reviews, we selected and reviewed 17 accrued expenditures totaling about $4.4 million[4] that were over 1 year old as of June 30, 2006, and did not have any recent financial activity (sometimes no activity for years). Since accrued expenditures

[3] In our report entitled *DOD Business Systems Modernization: Navy ERP Adherence to Best Business Practices Critical to Avoid Past Failures*, GAO-05-858 (Washington, D.C.: Sept. 29, 2005), we reported that because the pilots were stovepiped, limited within the scope of their respective commands, and not interoperable, they did not transform the Navy's business operations. As a result, under the leadership of a central office, the Navy decided to start over and undertake the development and implementation of a single ERP system.

[4] The dollar amount for the four categories may not total due to rounding. Further, portions of three accrued expenditures are included in two categories.

represent the amount of paid and unpaid expenditures for services performed by employees or contractors, accrued expenditures that remain outstanding for long periods of time are an indication of a potential problem with the accuracy of recorded accrued expenditure data because the work should have already been performed and payment made. In most of the cases we reviewed, we determined that the aircraft and weapons divisions did not perform adequate reviews of their accrued expenditures. Specifically, we found that

- no work was performed on 10 accrued expenditures totaling about $2.2 million (about half the dollar amount reviewed);
- work was performed for 4 accrued expenditures totaling about $1 million and while the contractor had billed NAWC, the payment was not correctly recorded in the accounting system to liquidate the accrued expenditure;
- for 4 accrued expenditures totaling about $1 million, the accrued expenditures were so old that neither we nor NAWC officials could determine their status; and
- documentation for 2 accrued expenditures totaling about $100,000 showed they were correctly recorded.

The following are examples of the problems we identified with the accrued expenditures that we reviewed including their impact on reported NAWC carryover balances.

- On July 7, 2003, the NAWC weapons division obligated $232,318 on a contract with Northrop Grumman Field Support Services to provide engineering services in support of the F-14 Weapons System Support Activity. On September 29, 2003, the weapons division recorded an accrued expenditure in its system totaling $201,651—the balance remaining unpaid to the contractor that was obligated in fiscal year 2003. As part of the weapons division's May 2006 triannual review, the BFM that had responsibility for this contract determined that the accrued expenditure recorded in fiscal year 2003 was unsupported. NAWC weapons division officials stated that the final invoice for this contract was processed on September 20, 2006. In October 2006, the administrative contracting officer issued an amendment to the contract that deobligated these funds which had expired. One month later, the weapons division reversed the accrued expenditure and returned the funds to its customer. As a result of the erroneous accrued expenditure, our analysis showed that the weapons division understated its carryover in fiscal years 2003, 2004, 2005, and 2006 by $201,651 and billed its customer for work that was not performed.

- As of March 2002, the NAWC aircraft division obligated $226,901 on an order with Northrop Grumman to provide engineering design data services. In fiscal year 2003, the contractor billed and received payment of $5,626, leaving a remaining balance of $221,275. Our analysis of the aircraft division's June 2006 accrued expenditure report indicated that the aircraft division recorded accrued expenditures in its accounting system for $221,275—the outstanding balance—over 3½ years ago. Although no further work was performed on this order, the accrued expenditure of $221,275 remained outstanding until August 2006. In August 2006, NAWC reversed the remaining accrued expenditure of $221,275 and deobligated the funds because the customer appropriation financing the order was canceling at the end of the fiscal year. By not performing the triannual reviews prior to fiscal year 2006 which would have identified this problem, the aircraft division recognized revenue and billed its customer $221,275 for work that was not performed and understated its carryover by this amount in fiscal years 2003, 2004, and 2005.

- In March 1996, the NAWC weapons division issued an order to the Electronic Proving Ground totaling $333,000 to provide funding for Global Positioning System test support. On September 18, 1996, the NAWC weapons division recorded an accrued expenditure for the full amount of the obligation in its financial management system. In February 1997, a payment totaling $123,195 was processed against these funds. The remaining accrued expenditure amount ($209,805) has been outstanding since it was recorded in 1996. These transactions were recorded in a financial management system that has been replaced twice. Many details associated with these transactions are no longer available. Because of the limited data available, we could not determine the validity of the accrued expenditure amount. However, if the weapons division had performed the triannual reviews as required by DOD regulation, the records may have been available to either reverse the outstanding accrued expenditure amount or liquidate the accrued expenditure amount against vendor payments.

- In July 2003, the NAWC aircraft division increased funding on a task order by $126,477 to provide software support services for the Navy's HE-2K aircraft tactical systems program. In July 2004, the NAWC aircraft division recorded an accrued expenditure in its accounting system totaling $126,477—the entire balance for the software support services to be performed. According to a BFM, the work for the software support services was never performed. In January 2006, an amendment to this task order decreased excess funds for the entire $126,477 that was previously obligated for the additional software support services. However, the NAWC aircraft division did not reverse the accrued expenditure until August 2006—about 2 years after it had recorded the accrued expenditure. As a result, we determined that the NAWC aircraft division recognized revenue and billed its customers $126,477 for work that was not performed and understated its carryover by this amount in fiscal years 2003, 2004, and 2005.

- Between March 1997 and April 1998, the NAWC weapons division issued an order and three amendments totaling $505,000 to the 46th test group at Holloman Air Force Base for work on the radar cross section of the QF-4E range targets. Between September 1997 and August 2001, the NAWC weapons division recorded accrued expenditure amounts totaling $505,000 in its financial management system—the full amount obligated on the order. In the late 1990s, Holloman Air Force Base and the Defense Finance and Accounting Service Denver paid the 46th test group the full amount obligated on the order. However, the NAWC weapons division records showed that only $151,074 was recorded in the financial management system as paid. Thus, an accrued expenditure totaling approximately $353,926 remains outstanding. If the NAWC weapons division had performed its triannual review as required by DOD regulation, the weapons division could have reduced its end of fiscal year outstanding accrued expenditures by $353,926 for fiscal years 2001 through 2006. NAWC weapons division officials stated that in this case, the carryover amount was accurately reported but the accrued expenditure amount was distorted by $353,926.

Appendix III: Comments from the Department of Defense

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

COMPTROLLER

JUN 1 2 2007

Mr. McCoy Williams
Director
Financial Management and Assurance
Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Williams:

This is the Department of Defense response to the Government Accountability Office draft report 07-643, "NAVY WORKING CAPITAL FUND: Management Action Needed to Improve Reliability of the Naval Air Warfare Center's Reported Carryover Amounts," dated April 26, 2007, (GAO Code 195095). We have received and reviewed the draft report. Specific comments on the draft report are enclosed.

The Department appreciates the GAO pointing out that the reliability of the Navy's Warfare Centers FY 2005 – FY 2006 carryover reporting has improved. Further improvement will result as these recommendations are implemented.

Sincerely,

Tina W. Jonas

Enclosure:
As stated

GAO DRAFT REPORT DATED APRIL 26, 2007
GAO-07-643 (GAO CODE 195095)

"NAVY WORKING CAPITAL FUND: MANAGEMENT ACTION NEEDED TO IMPROVE RELIABILITY OF THE NAVAL AIR WARFARE CENTER'S REPORTED CARRYOVER AMOUNTS"

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommends that the Secretary of Defense direct the Secretary of the Navy to reiterate its guidance that clearly prohibits Navy working capital fund activities from de-obligating reimbursable customer orders at fiscal year-end and immediately re-obligating them in the next fiscal year, a process that results in artificially reducing the carryover balances that are ultimately reported to Congress. (p. 35/GAO Draft Report)

DOD RESPONSE: Concur. The Department will direct the Secretary of the Navy to reiterate its guidance on handling reimbursable customer orders in its fiscal year end closing guidance. Although Navy's actions artificially reduced the FY 2006 carryover balances, there is no evidence to suggest that the Navy deliberately intended to underreport its carryover balance.
Estimated Completion Date: July 2007

RECOMMENDATION 2: The GAO recommends that the Secretary of Defense direct the Secretary of the Navy to develop and implement procedures for the Naval Air Warfare Center's aircraft and weapons divisions to provide assurance that the triannual reviews of obligation and accrued expenditure balances are performed in accordance with the DoD Financial Management Regulation. (p. 35/GAO Draft Report)

DOD RESPONSE: Concur. The Navy currently issues specific guidance to its Budget Submitting Offices directing the triannual reviews be performed in accordance with the Department's Financial Regulations. Beginning with the FY 2007 review, the Department will direct the Navy to develop and implement procedures that provide assurance that the required reviews are properly performed.
Estimated Completion Date: July 2007

RECOMMENDATION 3: The GAO recommends that the Secretary of Defense direct the Secretary of the Navy to develop and implement a required training course for business financial managers that provides instructions on performing the triannual review requirements for the Naval Air Warfare Center's aircraft division. (p. 35/GAO Draft Report)

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DOD RESPONSE: Concur. The Secretary of Defense will direct the Navy to develop and implement a required training course or courses for all Naval Air Warfare Center employees that are involved in the management, oversight and execution of the triannual review requirements.
Estimated Completion Date: July 2007

RECOMMENDATION 4: The GAO recommends that the Secretary of Defense direct the Secretary of the Navy to require individuals including business financial managers responsible for performing the reviews at the Naval Air Warfare Center's aircraft division to attend the training to ensure that they are aware of the triannual review requirements. (p. 18/GAO Draft Report)

DOD RESPONSE: Concur. The Secretary of Defense will direct the Navy to make its triannual review training course mandatory for all Naval Air Warfare Center employees that are involved in the management, oversight and execution of the triannual review requirements, including its business financial managers.
Estimated Completion Date: July 2007

RECOMMENDATION 5: The GAO recommends that the Secretary of Defense direct the Secretary of the Navy to review and validate the accuracy of Naval Air Warfare Center's aircraft and weapons divisions' reported outstanding obligations and accrued expenditures, especially those that have remained outstanding since the conversion to SIGMA, prior to its conversion to a new accounting system in October 2007. (p. 36/GAO Draft Report)

DOD RESPONSE: Concur. The Navy has already been directed to review and validate the accuracy of Naval Air Warfare Center's outstanding obligations and accrued expenditures, and report to the results to the Office of the Under Secretary of Defense (Comptroller). The first of these reviews took place in April 2007. The Department will direct the Navy to place special emphasis on those outstanding obligations and accrued expenditures that have remained outstanding since converting to the new accounting system.
Estimated Completion Date: September 2008

RECOMMENDATION 6: The GAO recommends that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to clarify the triannual review guidance for the January and May reviews in the DoD Financial Management Regulation (DoDFMR) as it pertains to the dollar threshold for reviewing outstanding commitments and obligations for the capital budget and operating portion of the working capital fund. (p. 36/GAO Draft Report)

DOD RESPONSE: Concur with comment. The Under Secretary of Defense (Comptroller) will issue a letter directing the Navy to comply with the DoDFMR. The DoDFMR is clear as currently written. The FMR provides guidance to the

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Defense Working Capital Fund (DWCF) fund holder as to the dollar threshold for performing the triannual review in January and May. The DWCF has two thresholds, one for operations and one for its capital program. Commitments and obligations in support of the DWCF capital program are segregated and the threshold is defined. For all other commitments and obligations, when a DWCF activity enters into an agreement, whether it is in support of a funded project or activity overhead, it is categorized as DWCF operations and that threshold applies. On the other hand, the fund holder for the general fund activities is responsible for validating their own commitments and obligations.

Estimated Completion Date: September 2007

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Appendix IV: GAO Contacts and Staff Acknowledgments

GAO Contacts

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Acknowledgments

Staff who made key contributions to this report were Richard Cambosos, Francine DelVecchio, Steve Donahue, Mary Jo LaCasse, Keith McDaniel, Greg Pugnetti, Chris Rice, and Hal Santarelli.

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