November 27, 2002

Financial Management

Financial Reporting of Deferred Maintenance Information on Air Force Weapons Systems for FY 2002

(D-2003-030)

Office of the Inspector General of the Department of Defense

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Acronyms

ACC	Air Combat Command
ALC	Air Logistics Center
ANG	Air National Guard
FASAB	Federal Accounting Standards Advisory Board
FMR	Financial Management Regulation
OMB	Office of Management and Budget
O&M	Operation and Maintenance
PP&E	Property, Plant, and Equipment
RSI	Required Supplementary Information
SFFAS	Statement of Federal Financial Accounting Standards

INSPECTOR GENERAL
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November 27, 2002

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER
DEPUTY UNDER SECRETARY OF DEFENSE FOR LOGISTICS AND MATERIEL READINESS
DEPUTY CHIEF OF STAFF OF THE AIR FORCE, INSTALLATIONS AND LOGISTICS

SUBJECT: Report on Financial Reporting of Deferred Maintenance Information on Air Force Weapons Systems for FY 2002 (Report No. D-2003-030)

We are providing this report for review and comment. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Office of the Under Secretary of Defense and Air Force comments were partially responsive. We request comments from the Under Secretary of Defense (Comptroller)/Chief Financial Officer on Recommendation B.2. and additional comments from the Office of the Under Secretary of Defense for Logistics and Materiel Readiness on Recommendation B.2. and from the Air Force Assistant Deputy Chief of Staff, Installations and Logistics on Recommendations A.1., A.2., and B.1. by January 27, 2003.

If possible, please provide management comments in electronic format (Adobe Acrobat file only). Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. For additional information on this report, please contact Mr. James L. Kornides at (614) 751-1400 ex 211 or Mr. Stuart D. Dunnett at (614) 751-1400 ex 214. See Appendix B for the report distribution. The team members are listed inside the back cover.

for David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General of the Department of Defense

Report No. D-2003-030 **November 27, 2002**
(Project No. D2001FJ-0156.001)

Financial Reporting of Deferred Maintenance Information on Air Force Weapons Systems for FY 2002

Executive Summary

Who Should Read This Report and Why? DoD personnel responsible for compiling and reporting deferred maintenance information and users of deferred maintenance information should read this report. The report discusses how to comply with deferred maintenance reporting requirements.

Background. The Federal Accounting Standards Advisory Board (FASAB) requires Federal entities to provide supplemental information on deferred maintenance as part of the entities' financial statements. The FASAB defines deferred maintenance as maintenance that was not performed when it should have been or was scheduled and delayed until a future period. The Air Force reported $167.5 million of deferred maintenance on aircraft, software, engines, and various other national defense property, plant, and equipment commodities at the beginning of FY 2002.

We primarily focused on the records used to compile the reported deferred maintenance estimate and did not include a detailed review of possible deferred maintenance at contractor or field level maintenance facilities.

Results. The Air Force did not accurately report deferred maintenance. Improved compilation procedures were needed for about $190.7 million in deferred maintenance information. Additionally, the Air Force only collected information on maintenance actions funded by the Operation and Maintenance appropriation. It did not identify whether any deferred maintenance was associated with the $3.3 billion of maintenance annually funded by other appropriations.

The Air Force was not planning to change its procedures for FY 2002 reporting. For improvements to be made, the Air Force should develop more comprehensive procedures for collecting deferred maintenance information. Otherwise, the Air Force will not be able to provide a reliable estimate of deferred maintenance on national defense property, plant, and equipment in FY 2002 (finding A).

The Air Force method of presenting deferred maintenance on national defense property, plant, and equipment needed improvement. DoD should require the Air Force to report major asset classes in accordance with Federal regulations and the Air Force needs to develop a narrative that includes all the elements required by Federal accounting standards to improve deferred maintenance reporting. Unless improvements are made,

enough information will not be presented to allow users and readers to understand the significance of deferred maintenance estimates or to make informed decisions on the condition of Air Force national defense property, plant, and equipment (finding B). We also reviewed the Management Control Program as it relates to Air Force procedures for reporting deferred maintenance. (See the Finding sections of the report for the detailed recommendations.)

Management Comments and Audit Response. The Air Force Deputy Chief of Staff for Installations and Logistics generally concurred with the intent of the recommendations. However, she nonconcurred that the Air Force deferred maintenance estimate should include only unfunded requirements deferred in that fiscal year. She also nonconcurred that significant maintenance delays at the depots, validated requirements that are deleted, or expected changes in depot billing rates should be incorporated in the deferred maintenance estimate. We believe that these changes are necessary because valid amounts of deferred maintenance were not included, and this inclusion would improve the accuracy of Air Force deferred maintenance amounts and would ensure compliance with FASAB requirements. The Deputy Under Secretary of Defense for Logistics and Materiel Readiness concurred with the intent of the recommendation to present deferred maintenance for all material asset classes but did not believe that a change to the Financial Management Regulation was necessary. We believe that a change to the Financial Management Regulation is necessary to ensure that the Air Force complies with Federal accounting policies, which require separate identification of material categories of accounting information. We request that the Air Force Deputy Chief of Staff for Installations and Logistics, the Under Secretary of Defense (Comptroller)/Chief Financial Officer, and the Deputy Under Secretary of Defense for Logistics and Materiel Readiness provide comments by January 27, 2003. See the Findings section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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Background

This is one in a series of planned reports that discusses the financial reporting of deferred maintenance on weapon systems for FY 2002. The audit was performed in support of Public Law 101-576, "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, "Federal Financial Management Act of 1994," October 13, 1994.

The Financial Accounting Standards Advisory Board (FASAB) defines generally accepted accounting principles for the Federal Government. FASAB defines maintenance as the act of keeping fixed assets in acceptable condition. This includes all activities needed to preserve the asset so that it continues to provide acceptable services and achieves its expected life. However, maintenance excludes activities aimed at expanding the capacity of the asset or otherwise upgrading it to serve needs different from, or significantly greater than, those originally intended.

Statement of Federal Financial Accounting Standard (SFFAS) No. 6, "Accounting for Property, Plant and Equipment (PP&E)," June 1996, as amended by SFFAS No. 14, "Amendments to Deferred Maintenance Reporting," April 1999, defines deferred maintenance as maintenance that was not performed when it should have been performed or when it was scheduled to be performed and which, therefore, is put off or delayed for a future period.

In June 1996, FASAB required entities to disclose deferred maintenance in the financial statements. Deferred maintenance was required to be shown as a line item on the Statement of Net Cost with a footnote reference in lieu of a dollar amount. FASAB concluded that deferred maintenance did not meet the definition of a liability because it could not be sufficiently measured. In April 1999, FASAB changed the requirements for financial statement reporting of deferred maintenance from a footnote disclosure to the Required Supplemental Information (RSI) section. This was done to allow management maximum flexibility in reporting deferred maintenance.

In SFFAS No. 6 and SFFAS No. 14, FASAB observed that maintenance is often underfunded and the consequences of underfunding maintenance are often not immediately reported. The consequences include increased safety hazards, higher costs in the future, and inefficient operations. Therefore, reporting deferred maintenance estimates in the financial statements is intended to provide reliable information on the condition of national defense PP&E. It also shows DoD managers and Congress the cost of correcting national defense PP&E deficiencies.

Air Force FY 2001 Deferred Maintenance Amounts. For FY 2001, the Air Force reported that it obligated $5.5 billion of depot maintenance. It compiled a deferred maintenance estimate of $167.5 million in the RSI portion of the Air Force general fund Financial Statement. The major classes of assets Air Force reported are "Aircraft" and "Other." The Other class is broken down into software, engines, other major end items, and various other commodities.

DoD Policy. The Financial Management Regulation (FMR) implements SFFAS No. 6 and requires the Military Departments to report deferred maintenance on national defense PP&E using the "unfunded" column of the Op-30 "Depot Maintenance Program Summary," as the basis for reporting deferred maintenance. The Op-30 is a budgetary exhibit that is submitted as part of the President's Budget to report depot maintenance programs funded through the Military Departments' operation and maintenance (O&M) funds. DoD policy allows the Departments to supplement the Op-30 unfunded amounts with any material deferred maintenance amounts not normally included in the Op-30 budget exhibit.

The Air Force, Air Force Reserve, and the Air National Guard (ANG) all use the "unfunded" column of the Op-30 to report deferred maintenance as required by the FMR. To prepare the Op-30, each Air Logistics Center (ALC) compiles a brochure for various maintenance categories such as aircraft and engines. The brochure contains every depot-level maintenance task required in the upcoming fiscal year, the rationale for the task, and the hours assigned to each task. During the Logistics Support Review, the Air Force validates the maintenance task and assigns a dollar amount to all expected depot maintenance during the year.

Objectives

The overall objective of the audit was to determine whether the Military Departments consistently and accurately compiled deferred maintenance information on weapons systems for financial statement reporting. We determined whether the Air Force procedures for compiling and presenting deferred maintenance information were adequate. We also assessed compliance with applicable laws and regulations. See Appendix A for a discussion of the audit scope and methodology and a review of the management control program.

A. Collecting Deferred Maintenance Information

The Air Force did not accurately report deferred maintenance. Improved compilation procedures were needed for about $190.7 million in deferred maintenance information. The prior year estimate of deferred maintenance included $66.4 million of deferred maintenance that was not supported by adequate documentation; contained $52.8 million of deferred maintenance that should not have been included; did not include $71.5 million of deferred maintenance that should have been included; and did not account for the future cost of completing deferred maintenance requirements. Additionally, the Air Force only collected information on maintenance actions funded by the O&M appropriation. It did not determine whether any deferred maintenance was associated with the $3.3 billion of maintenance annually funded by other appropriations. These conditions existed because the Air Force did not adequately implement the DoD policy for collecting deferred maintenance information or comply with financial statement reporting guidance. The Air Force was not planning to change its procedures for FY 2002 reporting. Unless the procedures are improved, the Air Force will not be able to provide a reliable estimate of deferred maintenance on national defense PP&E in FY 2002.

Air Force Policy for Reporting Deferred Maintenance

The Air Force used the Op-30 budget exhibit to report deferred maintenance in FY 2001 and planned to do so again in FY 2002. At the beginning of the fiscal year, the Air Force developed the Op-30 total budget requirements (dollar amounts) based on scheduled and forecasted maintenance requirements. Scheduled maintenance requirements are based on a designated number of months since the prior depot maintenance. For each asset that has a scheduled maintenance cycle, the asset is required to be inducted in a specified timeframe In contrast, forecasted maintenance is for all weapon systems that do not have a scheduled maintenance cycle. These requirements are not associated with any tail or serial number and are beginning of the year estimates based on historical data and other factors.

Representatives from the major commands, the ANG, the Air Force Reserves, the Air Logistic Centers, Air Force Headquarters, and the Air Force Materiel Command Headquarters validated the requirements. After the requirements were validated, the Air Force determined the level of funding for each weapon system by commodity.

At the end of the fiscal year, the Air Force may adjust the Op-30 total budget requirements (dollar amounts) based on additions and deletions of maintenance requirements, and for various other reasons including price increases, retirement of systems, and the difference between the actual and the forecasted maintenance.

The Air Force then reports the amount of funding that has been obligated for maintenance as "funded" and the remaining requirements become the "unfunded" requirements.

Maintaining Adequate Supporting Documentation

The Air Force used the Op-30, a budgetary document, as the sole basis for reporting deferred maintenance. However, the budgetary information Air Force used was not supported by adequate documentation. Specifically, Air Force did not reconcile the summary-level unfunded budget requirements (dollar amounts) used for reporting deferred maintenance with specific weapon system budget requirements.

Office of Management and Budget (OMB) Bulletin 01-09, "Form and Content of Agency Financial Statements," requires that reporting entities ensure that underlying records fully support the financial information presented. For $66.4 million of the deferred maintenance the Air Force reported, the Air Force could not provide accurate supporting information. The Air Force could not provide supporting documentation for the Air Combat Command (ACC) portion, $51.6 million, or the $14.8 million it reported in ANG deferred maintenance.

Accuracy of Air Combat Command supporting data. The Air Force was unable to provide details to support the large amounts of deferred ACC maintenance because it used a budget document to collect the data. The budget document was not designed to track requirements throughout the year. The Air Force maintained summary information supporting the deferred ACC maintenance amounts totaling $51.6 million, but the amounts were not reconcilable to the detailed supporting documentation that ACC provided.

According to ACC personnel, the amounts used for FY 2001 financial reporting were estimates developed in late August 2001. The information was based on actual unfunded budget data (dollar amounts) through August 2001 and estimates of remaining funding needed for the year.

The total difference at the commodity level between the financial statement estimate of deferred maintenance and actual data was $26,857,000.

ACC personnel could not provide an explanation for the differences in each commodity. Specifically, the differences between the reported deferred maintenance estimate of $51.6 million and the summary-level ACC data at the commodity level were not reconcilable to any detailed supporting documentation. The Air Force needed to establish a link between the two different sets of unfunded budget requirements. Table 1 shows the total difference between the FY 2001 estimated balance for the deferred maintenance and the amounts supported in documentation provided by ACC.

Table 1. Differences Between Air Force Estimates and ACC Documentation
(in thousands)

Commodity	ACC Data	FY 2001 Estimate	Difference
Software	$21,393	$36,034	$14,641
Aircraft	18,899	15,453	3,446
Missiles	117	0	117
Engines	4,600	100	4,500
OMEI[1]	0	14	14
Non MSD[2]	3,411	0	3,411
ABS[3]	0	0	0
Storage	728	0	728
Total	**$49,148**	**$51,601**	**$26,857**

1. Other Major End Items
2. Non-Materiel Support Division
3. Area Base Support

Availability of Air National Guard supporting data. The Air Force was also unable to provide support for about $14.8 million of deferred maintenance that it estimated for the ANG. Specifically, the ANG could not provide adequate supporting documentation for $9.4 million of deferred maintenance related to Other Major End Items, $3.6 million of deferred maintenance claimed in the area of non-Materiel Support Division, and $1.8 million of deferred maintenance in Area Base Support.

Overstatement of Deferred Maintenance

In addition to not adequately supporting the deferred maintenance data, the Air Force overstated the amount of the deferred maintenance requirements by $52.8 million. For systems we reviewed, the deferred maintenance estimate should not have included $23.1 million of future requirements and $29.7 million of contingency and forecasted unfunded requirements.

Future Requirements. The Air Force estimate of deferred maintenance should not have included at least $23.1 million of maintenance that is scheduled to be completed in future fiscal years. The Air Force funds maintenance that is scheduled to cross over fiscal years when the maintenance is scheduled to begin and the total maintenance requirements, regardless of when the work will be completed, are included in that year's Op-30. Therefore, because the Air Force calculated deferred maintenance from the Op-30 unfunded requirements, the entire amount of maintenance will be included as deferred maintenance, regardless of when the work will be completed. For example, the ANG reported

the entire unfunded amount for deferred maintenance on eight KC-135 aircraft instead of reporting only the portion of maintenance requirements that were actually deferred. As a result, the ANG overstated its estimate of deferred maintenance on the KC-135 by $23.1 million. The Air Force needed to defer only the portion of maintenance that should have been completed by year-end when compiling future deferred maintenance estimates.

Unfunded Requirements. The Air Force did not accurately calculate deferred maintenance amounts because material amounts of unfunded requirements were requirements that did not meet the FASAB definition of deferred maintenance. The Air Force reported about $29.7 million of deferred maintenance related to contingency and forecasted requirements. The Air Force should not have included these requirements when calculating the Air Force estimate of deferred maintenance.

Contingency and Aircraft Damage Requirements. Approximately $12.7 million of the $29.7 million of unfunded maintenance requirements that should not have been included as deferred maintenance were contingency and aircraft damage requirements. The Air Force based the estimated requirements on historical data at the beginning of the year for unanticipated damage maintenance on aircraft. However, the estimated contingency and aircraft damage requirements that did not occur in the fiscal year should not be included in the deferred maintenance estimate used for financial statement reporting for that fiscal year.

Forecasted Requirements. Approximately $17 million of the $29.7 million of unfunded maintenance requirements were for forecasted maintenance that was not needed during the year. In the "engine" commodity, the actual requirements did not match forecasted requirements at year-end. The Air Force included the difference ($17 million) for the engines in its deferred maintenance estimate. Based on information provided by the ANG, the $17 million represented the difference between the beginning estimate of forecasted requirements and the actual amount expended on maintenance. However, this reporting methodology did not meet the intent of the FASAB because the additional expected maintenance did not and will never materialize. The Air Force should exclude forecasted but unrealized requirements from future deferred maintenance estimates.

Understatement of Deferred Maintenance

For systems we reviewed, about $71.5 million in deferred maintenance that should have been part of the FY 2001 estimate was not included. Of the $71.5 million in understated deferred maintenance, $37.7 million was related to maintenance delays at the depots and $33.8 million resulted when current year requirements were deleted from the Op-30 due to lack of depot capacity.

Maintenance Delays. The Air Force did not accurately collect deferred maintenance information because its compilation procedures did not require an accounting for funded work that was simply behind schedule. Specifically, the

Op-30 is not designed to track deferred maintenance on funded requirements not satisfied by year's end.

Based on data received from the Air Force depot maintenance scheduling systems, we calculated that $24.9 million of maintenance was deferred on aircraft that were in depot maintenance status at the beginning of FY 2002. In addition, based on Air Force depot maintenance scheduling systems, we calculated that $12.8 million of maintenance was deferred for aircraft that were inducted for depot maintenance by the end of FY 2001 but for which work was scheduled to begin long before the actual induction date. Maintenance on these aircraft was not completed as originally scheduled.

The majority of the delays occurred in weapon systems that had significant work stoppages at the depot. For the systems we reviewed, such as the KC-135 Stratotanker, personnel stated that work was delayed for as much as three months although the aircraft had been inducted into the depot. Reporting these material deferred maintenance amounts will properly reflect the deferrals occurring at the depots and comply with the DoD FMR policy that requires disclosure of any material deferred maintenance not included in Op-30 amounts. The Air Force should augment the Op-30 deferred maintenance estimate with delays associated with scheduled work at the maintenance depots.

Deleted Requirements. The Air Force does not consistently and accurately calculate deferred maintenance because required maintenance can be deleted from the Op-30 data. Commands sometimes remove items from the list of impending maintenance tasks included in the Op-30 because of additions and deletions of maintenance requirements, and for various other reasons including price increases, retirement of systems, and the difference between the actual and the forecasted maintenance. Removing maintenance requirements from the Op-30 budget data understates deferred maintenance because all unfunded requirements will not be included in the year-end deferred maintenance estimate. Specifically, for FY 2001, the Air Force should have included an additional $33.8 million of deferred maintenance in the major asset class, "Aircraft."

The Op-30 funded and unfunded requirements are changed by the major commands throughout the year. However, no guidance exists that instructs the Air Force major commands to adjust year-end Op-30 budget data to comply with deferred maintenance reporting requirements.

We reviewed 17 Air Mobility Command KC-135 Stratotanker aircraft that required FY 2001 Program Depot Maintenance induction but were deferred until FY 2002 due to capacity problems at the depot. Based on Air Force depot maintenance schedules, we calculated that the 17 aircraft had deferred maintenance of $33.8 million. The Air Mobility Command determined that these aircraft were no longer valid Op-30 requirements and deleted them from the FY 2001 total. However, the requirements met FASAB reporting criteria for deferred maintenance and should have been included in the Air Force Financial Statements.

In summary, the Air Force has not implemented procedures to include deferred maintenance amounts for funded maintenance that subsequently becomes

deferred. It also has no process for including deleted requirements that meet the definition of deferred maintenance. To improve its compliance with FASAB and DoD policy, the Air Force deferred maintenance compilation process needed to include all material deferred maintenance requirements in its year-end estimate, including those requirements that are deleted from the Op-30 during the fiscal year. The Air Force should develop a policy to augment the year-end Op-30 data with validated requirements removed during the fiscal year that still meet the FASAB deferred maintenance definition.

Reporting Cost to Complete Deferred Maintenance

The Air Force did not have a process in place to account for material differences between the Op-30 unfunded requirements and the true cost to complete the deferred maintenance.

The Air Force used current-year dollar amounts taken from the Op-30 unfunded portion to report deferred maintenance. However, the Air Force should report an updated estimate of the cost to complete the deferred requirements, not what the cost would have been to perform the maintenance had it been completed on schedule. At the time of the audit, the Air Force had not established procedures to adjust Op-30 amounts to account for known depot rate changes. Material misstatements in the Air Force deferred maintenance estimate could occur without cost estimate adjustments to Op-30 data to account for depot rate changes.

Information provided by personnel in the Office of the Assistant Secretary of the Air Force (Logistics) indicated that the Air Force increased programmed depot maintenance rates by 4 percent between FY 2001 and FY 2002. However, some depot maintenance rates increased substantially more than the 4 percent average. For example, in FY 2001, the KC-135 Stratotanker aircraft depot maintenance rates increased by approximately $2.1 million dollars per aircraft ($3.8 million to $5.9 million), a 55 percent increase in cost. Although the Air Force did not receive the official FY 2002 rate until December 2001, the preliminary rate increases were available in September 2001. When the following year rates are available before the end of the current fiscal year, adjustments to the deferred maintenance estimate are possible and should be performed. The Air Force did not do this.

Air Force Non-O&M Funds

Deferred maintenance estimates obtained using Op-30 data are incomplete because the Air Force did not have a process in place to quantify deferred maintenance on non-O&M funded requirements. The Op-30 includes only maintenance requirements funded by Air Force general O&M funds. The Air Force funds an additional $3.3 billion in depot maintenance from other Air Force appropriations such as research, development, testing and evaluation; procurement; and working capital funds. Any deferred maintenance on those requirements is not included in Op-30 unfunded amounts. As a result, aircraft and software maintenance funded by the U.S. Transportation Command, software modifications, and some software maintenance were excluded from the Op-30

total requirements and were not included in the unfunded requirements used to compile the deferred maintenance estimates.

For example, we determined that $18.5 million of deferred maintenance for Air Force-owned C-5 aircraft was not included in the Air Force FY 2000 deferred maintenance estimate. The maintenance was not funded by Air Force O&M appropriations and therefore would not be included in Op-30 budget data. Additionally, any deferred maintenance related to non-O&M funded software will not be included in Op-30.

According to the Air Force FY 2003 budget estimate, the depot maintenance budget for FY 2002 is about $5.9 billion. The Air Force allocated about $2.6 billion of Air Force general fund O&M funding for depot maintenance. However, the Air Force did not have a process in place to quantify deferred maintenance at year-end on maintenance funded by appropriations other than O&M. Funding for depot maintenance and other actions in FY 2002 totaled $3.3 billion.

To improve the completeness and accuracy of the Air Force deferred maintenance estimate, the Air Force should implement procedures to quantify deferred maintenance that will be associated with the Air Force appropriations other than O&M.

Intent of Deferred Maintenance Reporting Criteria

Until the Air Force procedures for estimating deferred maintenance are improved, the Air Force will not be able to provide a reliable estimate of the total maintenance delays and deficiencies on Air Force national defense PP&E. Improvements are needed to prevent continuing problems for FY 2002 and beyond.

In SFFAS No. 6, FASAB concludes that by reporting deferred maintenance, the entity would provide reliable information on the condition of the PP&E and estimates of the cost to correct deficiencies. In addition, due in part to concerns over the deteriorating condition of Government-owned PP&E, FASAB requires Federal agencies to report deferred maintenance.

The Air Force deferred maintenance data collection procedures resulted in inaccurate and incomplete deferred maintenance amounts and amounts that cannot be fully supported by maintenance records. As a result, the current Air Force process for capturing deferred maintenance information does not meet the requirements of FASAB.

Modifying Op-30 Information. The Air Force should modify the Op-30 budget information to account for the inconsistencies that prevent an accurate estimate of deferred maintenance. Specifically, Op-30 amounts should be adjusted to exclude unrealized contingency and forecasted amounts, to include data on maintenance delays at the depots, to reflect changes in depot billing rates, and to include any non-O&M funded deferred maintenance. Additionally, the Air Force should include validated requirements that are deleted during the fiscal year in the annual

deferred maintenance estimate. The Op-30 budget document was not designed to estimate deferred maintenance for financial reporting purposes and does not capture all material amounts of deferred maintenance. Therefore, the inconsistencies and inaccuracies that result from using Op-30 data for financial reporting purposes are likely to result in misstatements of future Air Force estimates of deferred maintenance information. The Air Force should improve its procedures to compile annual deferred maintenance amounts to prevent similar problems in the future.

Obtaining Future Estimates of Deferred Maintenance. Additional sources of Air Force deferred maintenance data were available to augment the Op-30 budget exhibit. Specifically, we were provided maintenance records from the Program Depot Maintenance Scheduling System maintained at the ALC level that used estimates of the amount of work that should have been completed on aircraft in the depot at year-end. The ALCs also provided a list of all requested aircraft by tail number that had passed the Program Depot Maintenance cycle at year-end, along with estimated future costs to perform the required maintenance, regardless of the funding source or budgetary changes.

Using sources of deferred maintenance data that are available outside the Op-30 compilation process would improve deferred maintenance reporting. Additional sources of data existed that were verifiable, supported by detail-level documentation, and based on actual requirements. Including this information would have provided a more accurate picture of deferred maintenance than Op-30 data alone. The Air Force should revise the process to compile their deferred maintenance estimate to report more accurate deferred maintenance information when budgetary information does not completely reflect the true amount of Air Force deferred maintenance on national defense PP&E.

Recommendations, Management Comments, and Audit Response

A. We recommend that the Air Force Deputy Chief of Staff, Installations and Logistics:

1. Develop additional procedures for collecting deferred maintenance information that are reconcilable with detailed year-end execution data. Additionally, the information needs to be expanded beyond amounts reported in the Op-30 budget report. Specifically, the amounts should:

a. Include only the portion of maintenance related to the unfunded requirements deferred in that fiscal year,

Management Comments. The Air Force Assistant Deputy Chief of Staff, Installations and Logistics, nonconcurred and stated that the Air Force does not view rescheduling depot-level workload within a fiscal year as deferred maintenance. In addition, the Assistant Deputy believed that reporting all deferred maintenance is not economically viable in view of the expected benefits.

Audit Response. The Assistant Deputy's comments were not responsive. We agree that maintenance delays that occur within a fiscal year but are completed by the end of the fiscal year do not constitute deferred maintenance. We do not address these instances of maintenance delays in the report. However, the Air Force should not report deferred maintenance for requirements that were not scheduled to be completed by the financial statement date. In one example, this weakness resulted in an overstatement of reported deferred maintenance for the KC-135 aircraft. In addition, significant delays and work stoppages at the depots can materially understate reported deferred maintenance estimates. Material misstatements in deferred maintenance amounts occurred when rescheduling was not properly recognized. We believe collection and inclusion of this information is easily attainable and economically viable. Depot-level maintenance records already show this type of information and when used in conjunction with Op-30 data, the accuracy of unfunded requirements data (deferred maintenance information) will be improved. Both the records and the Op-30 data are readily available. We request that the Assistant Deputy reconsider her comments and provide comments to the final report.

b. Exclude contingency and forecasted amounts,

Management Comments. The Air Force Assistant Deputy Chief of Staff, Installations and Logistics, concurred and will reissue guidance to exclude contingency requirements in the Logistic Support Review exhibits.

c. Include maintenance delays at the depots,

Management Comments. The Air Force Assistant Deputy Chief of Staff, Installations and Logistics, nonconcurred. She stated that the Air Force does not view maintenance delays within a fiscal year as deferred maintenance. In addition, she does not believe collecting this information would be cost-effective.

Audit Response. The Assistant Deputy's comments were partially responsive. We agree that maintenance delays that occur within a fiscal year but are completed by the end of the fiscal year do not constitute deferred maintenance. We do not address these instances of maintenance delays in the report. However, we did observe instances of work stoppages at the depot that were routine and maintenance delays crossed fiscal years. In these instances, the maintenance delays at the depots should be reported as deferred maintenance. The reporting of the delays will improve the accuracy of deferred maintenance amounts. Additionally, collecting information on maintenance delays can be performed at little additional cost because scheduling information is already available at the depots. We request that the Assistant Deputy reconsider her comments and provide comments to the final report.

d. Include deleted validated requirements that still meet the FASAB deferred maintenance definition, and

Management Comments. The Air Force, Assistant Deputy Chief of Staff, Installations and Logistics, nonconcurred. The Air Force believes that maintenance requirements are estimates and the lack of induction does not necessarily equate to deferred maintenance.

Audit Response. The Air Force comments were not responsive. We agree that there are certain instances when the lack of induction does not constitute deferred maintenance, such as projections based on flying hours. We do not address these instances in this recommendation. However, the Air Force deleted depot maintenance requirements that were based on engineering requirements that met the FASAB definition of deferred maintenance. Those requirements should have been reported as deferred maintenance. Required maintenance that is based on an established interval of time should be included in the financial statements as deferred maintenance if it is still planned to be completed in the future. This type of deferred maintenance information was available to augment Op-30 budget data. We request that the Assistant Deputy reconsider her comments and provide comments to final report.

e. Reflect changes in depot billing rates.

Management Comments. The Air Force Assistant Deputy Chief of Staff, Installations and Logistics, nonconcurred. The Assistant Deputy stated that the purpose of deferred maintenance financial information is to provide a year-end value for the reporting period.

Audit Response. The Air Force comments were not responsive. The deferred maintenance estimate should show the resources that will be required to perform the needed maintenance in the future. Therefore, reporting an estimate of what it would have cost to complete the deferred maintenance in the past is not forward-looking and can be inaccurate. Instances can occur in which maintenance costs increase to a level that warrants changes to the deferred maintenance reporting process. We request that the Assistant Deputy reconsider her comments and provide comments to the final report.

2. Include non-operation and maintenance appropriations that fund maintenance when determining the amount of deferred maintenance that the Air Force will report in the financial statement.

Management Comments. The Air Force Assistant Deputy Chief of Staff, Installations and Logistics, partially concurred. The Assistant Deputy stated that the Air Force will track depot maintenance for Air National Guard; the Air Force Reserve; and Research, Development, Test, and Evaluation.

Audit Response. The Assistant Deputy's comments were partially responsive. The Air Force already provided deferred maintenance information for the Air National Guard and the Air Force Reserve. Compiling deferred maintenance data for Research, Development, Test, and Evaluation maintenance actions is another step toward providing more accurate deferred maintenance estimates. However, the Air Force should confirm whether material amounts of deferred maintenance exist for the other appropriations that fund maintenance on Air Force-owned National Defense property, plant, and equipment such as the U.S. Transportation Working Capital Fund, which funds some programmed depot maintenance. We request that the Assistant Deputy reconsider her comments and provide comments to the final report.

B. Presenting Deferred Maintenance Information

The Air Force procedures for presenting deferred maintenance on national defense PP&E needed improvement. The Air Force did not:

- identify each major asset class,
- adequately report the method of measuring deferred maintenance,
- provide a definition of acceptable condition, and
- disclose the asset condition as required by the OMB and FASAB.

Improvement was needed because the FMR did not permit the Air Force to present other information in accordance with OMB requirements and because the Air Force had not implemented other FMR requirements. Unless improvements are made, information will not be presented to allow users and readers to understand the significance of deferred maintenance estimates or to make informed decisions about the condition of Air Force national defense PP&E.

Deferred Maintenance Criteria and Policy

FASAB Presentation Criteria. The FASAB recognizes that each entity is unique and allows management flexibility in reporting deferred maintenance amounts. Therefore, to ensure that readers understand the deferred maintenance amounts that are reported, SFFAS No. 6 and No. 14 require management to present supplemental narrative information along with the deferred maintenance amounts. Some examples of required information include: each major asset class, the method of measuring deferred maintenance, the definition of acceptable condition, and asset condition.

DoD Policy. DoD provides deferred maintenance reporting policy in the FMR, DoD Regulation 7000.14, volume 4, "Accounting Policy and Procedures," chapter 6, "Property, Plant and Equipment," August 2000; and volume 6B, "Form and Content of the DoD Audited Financial Statements," chapter 12, "Required Supplementary Information (RSI)," November 2001.

Air Force Procedures. The Air Force Office of Financial Management developed implementing procedures for the FMR policy on deferred maintenance for the FY 2000 financial statements. The presentation procedures were not reissued for FY 2001. However, the presentation of Air Force deferred maintenance estimates was very similar for both fiscal years.

Compliance with OMB and FASAB Reporting Requirements

The Air Force procedures for presenting deferred maintenance on national defense PP&E needed improvement to comply with OMB and FASAB requirements. OMB and FASAB require narrative information in the RSI section of the financial statements to enable the reader to understand the condition of the PP&E in relation to necessary maintenance. However, the Air Force RSI data do not provide enough information to present the condition of Air Force national defense PP&E. Specifically, the Air Force procedures do not result in deferred maintenance reporting information that:

- properly identifies the major asset classes as required by OMB,
- reports the method of measuring deferred maintenance for each major asset class as required by FASAB,
- provides a description of requirements or standards for acceptable condition for each major asset class as required by FASAB, and
- discloses the asset condition for each major asset class as required by FASAB.

Additional deferred maintenance information in these categories would improve the presentation of deferred maintenance by making the information more understandable and meaningful for users.

Proper Identification of Major Classes of Assets. The Air Force procedures for presenting deferred maintenance information needed improvement to properly identify the major asset classes. Specifically, Air Force use of the "Other" category for reporting $107.9 million (64.4 percent) of the deferred maintenance did not comply with OMB reporting guidance. Table 2 includes the major asset classes and estimated deferred maintenance the Air Force reported at the end of FY 2001.

Table 2. Deferred Maintenance Presentation Methodology

Major Asset Class	Amount (in Millions)	Percent of Total Amount Reported
Aircraft	$59.6	35.6
Other*	107.9	64.4
Total	**$167.5**	**100.0**

*Consists of software; engines; other major end items; non-materiel support division; area, base, and manufacturing support; and storage

The OMB Bulletin 01-09, "Form and Content of Agency Financial Statements," September 25, 2001, prohibits entities from using the "Other" category for any balance of a material amount or for an aggregate material amount. Those balances that are material are required to be separately reported and designated by name.

The Air Force did not present the major asset classes in accordance with OMB requirements because the FMR directs the Military Departments to consolidate and report all Op-30 budget exhibit commodities, except aircraft and missiles, as "Other" deferred maintenance. This policy limits the amount of asset classes that can be presented in the RSI and conflicts with the intent of SFFAS No. 6 and No. 14.

OMB states that the entity should consider materiality as the basis when determining the major asset classes. Table 3 shows a breakdown of the "Other" category as provided by the Air Force. The "Other" category reported by the Air Force included material balances of deferred maintenance for engines, software, and other major end items. Therefore, those items should have been reported as individual asset classes. Only non-materiel support division; area, base, and manufacturing support; and storage commodities were not material individually or aggregately and were acceptable entries in the "Other" category.

Table 3. Proper Deferred Maintenance Reporting for "Other" Commodities

Commodity	Amount (in millions)	Percent of Total Amounts Reported
Engines	$21.9	13.1
Software	57.9	34.6
Other Major End Items	19.3	11.5
Non-Material Support Division	6.1	3.6
Area Base and Manufacturing Support	2.4	1.2
Storage	0.3	0.2
Total	**$107.9**	**64.4**

Reporting the Method of Measuring Deferred Maintenance. The Air Force procedures for presenting deferred maintenance information needed to include the method of measuring deferred maintenance for each major asset class. FASAB defines two acceptable methods of measuring deferred maintenance in SFFAS No. 6: the condition assessment survey method and the life-cycle costing method. Condition assessment surveys are periodic inspections to determine the current condition of an asset and estimate the cost to correct any deficiencies. The life-cycle costing method considers operations, maintenance, and other costs in addition to the acquisition cost of the assets. These forecasted maintenance expenses serve as a basis for comparing actual expenses and estimating deferred maintenance. FASAB also allows entities to use other methods similar to the two defined.

In its disclosures of deferred maintenance estimates, the Air Force reported that the deferred maintenance figures were estimated amounts from future years amended budget estimate submissions. However, this only informs the reader what report the information was taken from and does not adequately describe the method of measuring deferred maintenance. The Air Force needed to include a description of the methodology and decisions that resulted in maintenance requirements being deferred to future accounting periods. For example, deferred maintenance can result from a lack of depot capacity, lack of spare parts, additional unexpected requirements, or delays in contracting for required maintenance.

The Air Force did not report the method of measuring deferred maintenance as required by FASAB because the Air Force did not adequately implement the FMR. Specifically, volume 4, chapter 6; and volume 6B, chapter 12 of the FMR require entities to include a narrative statement to explain the method used to value the deferred maintenance amounts. The Air Force should provide additional guidance on the two types of measurement FASAB defines to ensure that the method of measurement will be accurately reported.

Description of Requirements or Standards for Acceptable Condition. The Air Force deferred maintenance implementing procedures needed improvement to provide a description of the requirements or standards of acceptable condition for each major class of asset. FASAB requires disclosure of the standards for acceptable condition used to compile the deferred maintenance estimates.

Different definitions of acceptable condition for Air Force assets can result in different amounts of reported deferred maintenance. For example, instead of using unfunded requirements, the Air Force could calculate deferred maintenance primarily based on a percentage of mission capability or future maintenance requirements to keep assets at an Air Force standard of average remaining useful life. Until the Air Force defines what constitutes acceptable condition for each asset class, estimates of deferred maintenance will not comply with FASAB requirements or accurately reflect deferred maintenance information.

The Air Force did not provide a definition of acceptable condition because the Air Force did not implement the FMR. Specifically, volume 4, chapter 6; and volume 6B, chapter 12 of the FMR require entities to include a narrative statement that describes the requirements and standards for acceptable operating condition for every major asset class. Therefore, the Air Force should provide additional guidance detailing what constitutes acceptable condition. The Air Force may consider relating acceptable condition to fully mission capable or partially mission capable status and provide a method of calculating deferred maintenance based on mission capability information.

Disclosure of Asset Condition. The Air Force deferred maintenance presentation procedures need improvement to disclose the asset condition for each major class of asset, as required by FASAB. Asset condition can include averages of standardized condition rating codes; percentage of assets above, at, or below acceptable condition; or narrative information. Condition information would provide more depth and perspective to the reported deferred maintenance amounts.

The Air Force did not disclose the asset condition because the Air Force did not implement the FMR policy. Specifically, volume 4, chapter 6 of the FMR requires entities to provide information on the condition of the assets, either in narrative form or through the use of descriptive statistics. However, volume 6B, chapter 12, does not include this requirement or refer the reader to volume 4, chapter 6. The Air Force procedures for presenting deferred maintenance information should include volume 4, chapter 6 requirements.

Understanding Air Force Deferred Maintenance Information

The intent of SFFAS No. 6 and No. 14 is to require entities to provide meaningful deferred maintenance information on the condition of the national defense PP&E and provide estimates of the costs to correct any deficiencies. This information may be useful to DoD managers, the Congress and other interested parties. When significant portions of the required information are omitted, the usefulness of the data is reduced. This information, in conjunction with other types of maintenance and readiness indicators, is helpful in understanding where maintenance funds would be most effective, the differences in budget and financial reporting requirements, and the condition of national defense PP&E in relation to a defined level of acceptable operating condition.

Recommendations, Management Comments, and Audit Response

Redirected Recommendation. As a result of management comments to the draft report, we redirected draft Recommendation B.1. to the Assistant Deputy Chief of Staff of the Air Force, Installations and Logistics. In addition, we redirected draft Recommendation B.2. to the Under Secretary of Defense (Comptroller)/Chief Financial Officer.

B.1. We recommend that the Assistant Deputy Chief of Staff of the Air Force, Installations and Logistics, include a narrative in the deferred maintenance amounts in the financial statement that describes the method of measuring deferred maintenance, the requirements or standards for acceptable condition, and the condition of assets, expressed as a narrative or as descriptive statistics, as required by federal accounting requirements.

Management Comments. The Air Force Assistant Deputy Chief of Staff, Installations and Logistics, nonconcurred. The Assistant Deputy stated that in accordance with Under Secretary of Defense, Accounting and Policy Directorate memorandum, "Reporting of National Defense Property, Plant, and Equipment Quantity and Condition Information in the FY 2001 Financial Statements," dated November 5, 2001, the Air Force will not report quantity and condition information in the DoD financial statements. The policy memorandum states that the Office of the Secretary of Defense has determined that reporting quantity and condition of national defense property, plant, and equipment information would be an inappropriate disclosure of sensitive information.

Audit Response. The Assistant Deputy's comments were partially responsive. We support the DoD policy regarding the disclosure of sensitive information to

readers of the financial statements. However, this policy does not preclude the Air Force from providing narrative information that describes the methodology used to compile deferred maintenance information for each commodity. Additionally, it does not prevent the Air Force from defining acceptable condition. We believe that defining acceptable condition for national defense property, plant, and equipment is necessary to clarify how deferred maintenance on assets is being measured and improves the usefulness, understandability, and acceptance of Air Force deferred maintenance information. We believe that this type of deferred maintenance narrative information can be worded such that sensitive information is not provided to readers of the financial statements. We request that the Assistant Deputy reconsider her comments and provide additional comments to the final report.

B.2. We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer, in conjunction with the Deputy Under Secretary of Defense for Logistics and Materiel Readiness, revise Financial Management Regulation volume 6B, chapter 12, to allow the Air Force to present all material categories of deferred maintenance as major asset classes in accordance with federal accounting requirements.

Management Comments. The Office of the Deputy Under Secretary of Defense for Logistics and Materiel Readiness concurred with the intent of the recommendation and stated that the Services can report subcategories at their discretion. The Office of the Under Secretary response stated that a change to the Financial Management Regulation was not necessary.

Audit Response. The Office of the Deputy Under Secretary of Defense for Logistics and Materiel Readiness comments were not responsive. Action is needed to revise Financial Management Regulation, volume 6B, chapter 12, to ensure that the approach used to present deferred maintenance by the Air Force identifies material categories of deferred maintenance separately. The revision is needed to ensure that the Air Force does not consolidate all commodities except aircraft and missiles into the "other" category. This would ensure compliance with the intent of Federal accounting policies. We request that the Office of the Deputy Under Secretary of Defense for Logistics and Materiel Readiness reconsider their comments and provide comments to the final report.

Appendix A. Scope and Methodology

The Air Force reported a deferred maintenance amount of $167.5 million in the Required Supplementary Information section of the general fund financial statements at the end of FY 2001. We obtained the Op-30 "Depot Maintenance Program Summary" budgetary documents that were used to compile the deferred maintenance information for the prior two years. We obtained the maintenance funding summaries from the Air Force major commands, which were compiled into the Op-30 data. We visited the three Air Logistics Centers (located at Tinker Air Force Base, Warner Robins Air Force Base, and Hill Air Force Base) to obtain depot-level supporting documentation for outstanding deferred maintenance amounts. We obtained September 30, 2001, airframe maintenance scheduling information on the C-5, KC-135, F-15, C-141, B-1, and C-130 weapon systems from the Programmed Depot Maintenance Scheduling System maintained at the various Air Logistics Centers. We obtained unfunded maintenance requirements information from the Air Combat Command, the Air Mobility Command, the Air National Guard, and the Air Force Space Program major commands. We attempted to reconcile deferred maintenance amounts with unfunded requirements obtained from the major commands.

FASAB and the DoD FMR provide the reporting requirements for deferred maintenance. We met with FASAB representatives familiar with deferred maintenance reporting requirements to discuss the intent of the Standards. We reviewed the compilation and presentation of deferred maintenance for compliance with FASAB and DoD policy.

The Air Force does not accumulate deferred maintenance for some contractor-performed maintenance or for field-level operations. Therefore, the audit primarily focused on reviewing the records used to compile the reported deferred maintenance estimate, and the audit did not include a detailed review of contractor or field-level maintenance facilities. In addition, we did not attempt to perform a comprehensive review of potential deferred maintenance on national defense PP&E maintenance funded through non-O&M appropriations.

We performed this audit from July 2001 through May 2002 in accordance with generally accepted Government auditing standards.

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the Department of Defense. This report provides coverage of the Defense Financial Management high-risk area.

Computer-Processed Data. We used summary requirements, budget, and financial system computer data that supported the DoD Planning, Programming, and Budgeting System. We also used computer-processed data from the Air Force Programmed Depot Maintenance Scheduling System and the Core Automated Maintenance System. We relied on the computer-processed data without performing tests of system general and application controls to confirm the reliability of the data. We did not establish the reliability of the data because it

would have required audit resources that are not available. However, not establishing the reliability of the computer-processed data will not materially affect the results of our audit.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We reviewed the Air Force management's self-evaluation of the process to compile and present deferred maintenance information in the Required Supplementary Information section of the general fund financial statements.

Adequacy of Management Controls. We identified material management control weaknesses for the Air Force, as defined in DoD Instruction 5010.40. Air Force management controls were not adequate to ensure that all material amounts of deferred maintenance information were consistently and accurately compiled or presented in accordance with DoD policy and FASAB standards. Recommendations A.1., A.2., B.1., and B.2., if implemented, will correct the weaknesses. A copy of the report will be provided to the senior official within the Air Force responsible for management controls.

Adequacy of Management's Self Evaluation. Management's self-evaluation was not adequate. The Air Force Office of Financial Management identified preparation of a deferred maintenance estimate as an assessable unit. However, in its evaluation, the Air Force Office of Financial Management did not identify the material management control weaknesses because the evaluation covered a much smaller area.

Prior Coverage

Unrestricted General Accounting Office reports can be accessed on the Internet at http://www.gao.gov. Unrestricted Logistics Management Institute reports can be searched on the Internet at http://www.lmi.org/reports.html and may be ordered by emailing library@lmi.org.

General Accounting Office

GAO Report No. GAO/AIMD 98-42, "Deferred Maintenance Reporting, Challenges to Implementation," January 30, 1998

GAO Report No. GAO/AIMD-98-25, "Financial Management: Issues to Be Considered by DoD in Developing Guidance for Disclosing Deferred Maintenance on Aircraft," December 30, 1997

Logistic Management Institute

LMI Report No. LMI, LG007T1, "Enhancements to Deferred Maintenance Reporting for National Defense Property, Plant, and Equipment," June 2001

LMI Report No. LMI, LG709T1, "Disclosure of Deferred Maintenance on National Defense Property, Plant, and Equipment," November 1998

LMI Report No. LMI, PL308LN2, "Depot Maintenance Unfunded Deferred Requirements," August 1994

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
  Deputy Under Secretary of Defense for Logistics and Materiel Readiness
Under Secretary of Defense (Comptroller)/Chief Financial Officer
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force
Deputy Chief of Staff, Installations and Logistics

Non-Defense Federal Organizations and Individuals

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

Deputy Under Secretary of Defense for Logistics, and Materiel Readiness

Final Report Reference

Final Report Reference

DEPUTY UNDER SECRETARY OF DEFENSE FOR
LOGISTICS AND MATERIEL READINESS
3500 DEFENSE PENTAGON
WASHINGTON, DC 20301-3500

NOV 0 4 2002

MEMORANDUM FOR THE INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE

THROUGH: DIRECTOR ACQUISITION RESOURCES ANALYSIS 11/04/02

SUBJECT: Report on Financial Reporting of Deferred Maintenance Information on Air Force Weapon Systems for FY 2002 (Project No. D2001FJ-0156.001)

You requested we review and comment on the attached draft audit report on Air Force reporting of deferred maintenance information on weapon systems for fiscal year 2002. Our comment on the Under Secretary of Defense (Acquisition, Technology & Logistics) recommendation follows.

DoDIG Recommendation:

B.2. We recommend that the Under Secretary of Defense, Acquisition, Technology, and Logistics revise Financial Management Regulation volume 6B, chapter 12 to allow the Air Force to present all material categories of deferred maintenance as major asset classes in accordance with federal accounting requirements.

Redirected

OSD Response:

Concur with the intent of the recommendation. The objective intended in this recommendation can be attained several ways. In addition to adding categories to the Financial Management Regulation, the Services can report subcategories at their discretion. This would not require a change to the Financial Management Regulation.

for Diane K. Morales

Attachment:
As stated

Department of the Air Force Comments

DEPARTMENT OF THE AIR FORCE
HEADQUARTERS UNITED STATES AIR FORCE
WASHINGTON DC

31 OCT 2002

MEMORANDUM FOR ASSISTANT INPECTOR GENERAL FOR AUDITING
OFFICE OF THE INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

FROM: HQ USAF/IL
1030 Air Force Pentagon
Washington, DC 20330-1030

SUBJECT: Draft Department of Defense Inspector General (DoD IG) Audit Report: "Reporting Deferred Maintenance Information on Air Force Weapon Systems for FY 2002"

Thank you for the opportunity to review and provide input to your draft report on the reporting of deferred maintenance. We concur with the overall intent on the DoD IG's recommendations, but provide detailed comments in the attachment.

The Air Force remains committed to a strong depot maintenance program as well as complying with applicable directives. My action officers are Lt Col David Brown, AF/ILPY, (703) 697-1853 and Mr. Wade Wolfe, AF/ILPY, (703) 697-9365.

Susan A O'Neal
SUSAN A. O'NEAL
Asst DCS/Installations & Logistics

Attachments:
1. Air Force Comments
2. OSD Ltr 5 Nov 01

Air Force Comments on the Draft DoD IG Report,
"Reporting Deferred Maintenance Information on Air Force Weapon Systems for FY 2002"

Finding 1A: "The Air Force did not accurately report deferred maintenance. Improved compilation procedures are needed for about $190.7M in deferred maintenance information. Additionally, the Air Force only collected information on maintenance actions funded by the O&M appropriation. The Air Force did not determine whether any of the $3.3B of maintenance annually funded by other appropriations was used to fund any deferred maintenance."

Recommendation A1: Develop additional procedures for collecting deferred maintenance information that is reconcilable with detailed year-end execution data. Additionally, the information needs expanded beyond amounts reported in the OP-30 budget report. Specifically, the amounts should:

a. Include only the portion of maintenance related to the unfunded requirements deferred in that fiscal year.
b. Exclude contingency and forecasted amounts.
c. Include maintenance delays at the depots.
d. Include deleted, validated requirements that still meet the FASAB deferred maintenance definition.
e. Reflect changes in depot billing rates.

Air Force Comment: We concur with excluding estimates for contingency amounts (item A.1.b). We will reissue guidance to exclude estimates of contingency requirements (i.e., aircraft battle damage repair) in Logistic Support Review (LSR) exhibits.

Deferred maintenance, as defined by the Air Force, is maintenance not accomplished when scheduled and ***is delayed to a future fiscal year***. The Air Force does not view rescheduling depot-level workload *within* a fiscal year as deferred maintenance. Therefore, we do not concur with items A.1.a. and A.1.c. These recommendations appear to offer limited new information for enhancing business management. Induction delays spanning one day, one week, or one month, have minimal financial impact providing the delay does not span fiscal years since dollars are concurrently obligated when inducting an item at the depot. We believe the OP-30 budget exhibit and the Fiscal Year Annual Financial Statements compiled by SAF/FMBMB already capture deferrals spanning fiscal years and represent an accurate assessment of true deferred maintenance. Under your definition, reporting all deferred maintenance – regardless of cause or length of time – requires both a level of manpower and collection systems that either are not available or are not economically viable when viewed with the expected benefits or return on investment for collecting and reporting such data.

Additionally, we do not concur with including deleted validated requirements that still meet the FASAB deferred maintenance definition (i.e., recommendation A.1.d). Maintenance requirements, particularly at the commodity level, are estimates and the absence of induction does not necessarily equate directly to a specific deferral under the terms of the current definition. For example, actuarial tables utilized to determine engine maintenance requirements

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rely on projected flying hours. In execution, the effort can change and subsequently effect the requirement. Because engines stay "on wing" longer does not necessarily constitute a deferral for cause. Finally, we do not concur with tracking changes in depot billing rates (i.e., recommendation A.1.e). The purpose of the financial statement is to provide an end of fiscal year value for the reporting period.

Recommendation A2: Include non-Operation and Maintenance (O&M) appropriations that fund maintenance when determining the amount of deferred maintenance that the Air Force will report in the financial statement.

Air Force Comment: We concur with recommendation A.2 to a limited extent. We will track depot maintenance for Air National Guard, Air Force Reserve, and Research, Development, Test, and Evaluation.

Finding 2: The Air Force procedures for presenting deferred maintenance on National Defense Plant, Property, and Equipment needed improvement. The Air Force did not:

- **Identify each major asset class**
- **Adequately report the method of measuring deferred maintenance**
- **Provide a definition of acceptable condition**
- **Disclose the asset condition as required by the Office of management and Budget and FASAB**

Redirected

Recommendation B.1: We recommend that the Assistant Secretary of the Air Force (Financial Management and Comptroller) include a narrative in the deferred maintenance amounts in the financial statement that describes the method of measuring deferred maintenance, the requirements or standards for acceptable condition of assets, and the condition of assets, expressed as a narrative or as descriptive statistics, as required by federal accounting requirements.

Air Force Comment: IAW Office of the Under Secretary of Defense, Accounting and Policy Directorate memorandum dated 5 Nov 2001, we will not report quantity and condition information in the DoD annual financial statements. Such disclosure could provide sensitive information on the status and capabilities of critical weapons systems and components to the general public or other nations.

Recommendation B.2: We recommend that the Assistant Secretary of Defense, Acquisition, Technology, and Logistics revise Financial Management regulation volume 6B, chapter 12 to allow the Air Force to present all material categories of deferred maintenance as major asset classes in accordance with federal accounting requirements.

Air Force Comment: Concur. The Air Force currently tracks deferred maintenance by commodity (i.e. aircraft, engines, software, missiles, etc). On the fiscal year 2001 report, "Other Weapon Systems" on the USAF Financial Statement included non-aircraft items such as engines, software, and missiles. HQ USAF/ILPY and SAF/FMBMB are working in concert on this year's submission to ensure proper format.

NOV 5 2001

COMPTROLLER

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

COVER BRIEF

TO: PRINCIPAL DEPUTY AND DEPUTY UNDER SECRETARY OF DEFENSE FOR MANAGEMENT REFORM

THRU: DEPUTY UNDER SECRETARY OF DEFENSE (FINANCIAL MANAGEMENT)
DEPUTY CHIEF FINANCIAL OFFICER NET 11/5/01

FROM: DIRECTOR, ACCOUNTING POLICY DIRECTORATE NOV 5 2001

SUBJECT: Reporting of National Defense Property, Plant and Equipment (ND PP&E) Quantity and Condition Information in the Fiscal Year (FY) 2001 Financial Statements

PURPOSE: To obtain your approval for not reporting quantity and condition in FY 2001.

DISCUSSION: During a meeting on Wednesday, October 7, you directed that the Department's response to the Federal Accounting Standards Advisory Board (FASAB) on the ND PP&E Exposure Draft indicate that the reporting of quantity and condition information in DoD annual financial statements would be an inappropriate disclosure of "sensitive" information.

As mentioned during that meeting, the Department has been reporting such information since FY 1998. The reporting of this information was in conformance with a proposed requirement in an earlier FASAB Exposure Draft, a proposal that the Board later rescinded. Since the FASAB continued to deliberate on a proposed standard for ND PP&E, and since the Department's systems did not have the information that would allow it to comply with the existing ND PP&E reporting requirements (i.e., historical or latest acquisition cost) and it would have cost millions of dollars to comply with what was only an interim standard, the previous Administration chose to continue to report quantity and condition information pending the establishment of a permanent standard.

Now that it has been determined that the reporting of quantity and condition information would be an inappropriate disclosure of "sensitive" information, this office recommends that the Department not report such information in its FY 2001 financial statements. If you concur, indicate your approval below for the Department to discontinue the reporting of ND PP&E quantity and condition information in its financial statements effective with the FY 2001 statements. Upon your approval, this office will notify the DoD Components that such information is not to be reported.

COORDINATION: OUSD(AT&L), OASD(C3I), and JCS concur that information on the quantity and condition of the Department's weapons systems is sensitive and should not be reported in the Department's financial statements.

RECOMMENDATION: That you approve the decision not to report quantity and condition information.

APPROVE: _____ Lawrence J. Lanzillotta NOV 6 2001

DISAPPROVE: _____

OTHER: _____

Prepared by: Schreier/ODCFO(AP)/ (703) 604-1881/October 17, 2001

Attachments

Team Members

The Defense Financial Auditing Service Directorate, Office of the Assistant Inspector General for Auditing of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

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