

GAO

Report to the Chairman and Ranking
Minority Member, Subcommittee on
Defense, Committee on Appropriations
U.S. Senate

May 1998

DOD CONSULTING
SERVICES

Erroneous Accounting
and Reporting of Costs



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United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-277895

May 18, 1998

The Honorable Ted Stevens
Chairman
The Honorable Daniel K. Inouye
Ranking Minority Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

Long-standing congressional concerns exist regarding the accuracy and reliability of costs reported by the Department of Defense (DOD) for consulting services, also known as advisory and assistance services. In an earlier report, we noted that while the President's budget had reported DOD expenditures of \$3 billion for these services, we had identified \$12 billion of DOD expenditures that could be advisory and assistance services.¹ This report responds to your request for additional information on DOD's underreporting of advisory and assistance services costs and whether costs for these services may be included in a miscellaneous budget category. You also asked that we provide you a summary of previous audit reports and studies on DOD's reporting of these costs.

Background

Congress enacted legislation requiring that the Office of Management and Budget (OMB) establish a separate object class for reporting actual and planned obligations for advisory and assistance services.^{2, 3} Congress mandated that the separate advisory and assistance services object class include three categories of services: (1) management and professional support services; (2) studies, analyses, and evaluations; and (3) engineering and technical services.⁴ To implement this congressional mandate, OMB established object class 25.1 and included definitions for each of the three categories. As seen in figure 1, there are also other object classes for reporting service contracts' costs, including object classes for

¹Defense Advisory and Assistance Service Contracts (GAO/NSIAD 97-166R, June 13, 1997).

²The object classification structure is one of several ways to present financial data in budgetary presentations and is used to report obligations for each government account according to the nature of the services or articles acquired.

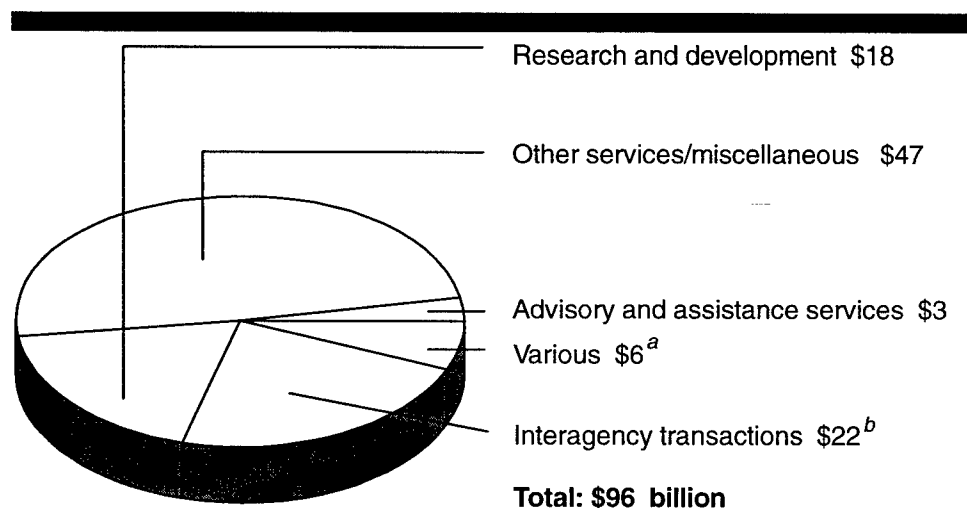
³In 1992, section 512 of P.L. 102-394 directed that OMB create a new object class for reporting actual and planned obligations for advisory and assistance services. This provision was to become effective beginning in fiscal year 1994. In 1994, the Federal Acquisition Streamlining Act (FASA), section 2454, put into law the three categories to be included in the advisory and assistance services object class and also included three exemptions.

⁴31 U.S.C. 1105 (g).

research and development contracts and interagency transactions. OMB retained object class 25.2 for other or miscellaneous services. OMB describes other services as those services that are not otherwise classified.

In fiscal year 1996, DOD reported a total of \$96 billion in contractual services (object class series 25), including \$47 billion for miscellaneous contract services (object class 25.2) and about \$3 billion for advisory and assistance services (object class 25.1).

Figure 1: DOD's Other Contractual Services: Object Class Series 25 Fiscal Year 1996 Obligations (dollars in billions)



^aIncludes various other categories such as operation and maintenance of facilities and equipment and medical care.

^bPurchases from government accounts.

Source: Federal Budget, fiscal year 1998.

To implement these special reporting requirements, DOD developed enhanced management and oversight guidance for advisory and assistance services. For example, DOD's directive for acquiring and managing such services requires the appointment of a DOD advisory and assistance services director to provide (1) coordination with other DOD functional areas and (2) guidance for the identification, acquisition, management, and use of these services. In addition, the head of each DOD component is to designate its own advisory and assistance services director responsible for

ensuring proper identification, accounting, and reporting of these services. Furthermore, each proposed contract action for these services must undergo close scrutiny and be planned and justified by senior officials.⁵ To implement DOD's guidance, each service has issued detailed regulations to manage and control these services.

Results in Brief

DOD's directives and instructions require increased scrutiny of advisory and assistance services and affirm the need for enhanced management and oversight of these services. Despite DOD's guidance to properly identify and report advisory and assistance services costs, our analysis of selected contract actions shows that costs for these services are being reported as miscellaneous contract services. A limited analysis of costs included in the Army's miscellaneous budget category showed that some advisory and assistance costs were erroneously shown as miscellaneous costs. Army officials agreed that these costs should have been recorded as advisory and assistance services costs. The Navy's and the Air Force's accounting systems did not have the capability of generating information on contracts included in the miscellaneous budget category. However, discussions with Navy officials and prior Air Force audits indicate similar underreporting concerns. DOD officials also indicated that there is a tendency to report costs for these services in the miscellaneous category to avoid the closer scrutiny and spending limitations on contract services identified as advisory and assistance services.

DOD-wide problems with the management of advisory and assistance services, including accurate identification and reporting of costs, have been documented since 1985.⁶ Despite congressional action requiring detailed reporting of advisory and assistance services costs,⁷ problems continue. Officials in the DOD Comptroller's office stated that there is no incentive for accurate reporting of advisory and assistance services costs due to past congressional funding cuts in this area.

⁵The DOD directive requires that each component maintain an advisory and assistance services management plan that includes a summary of planned actions and dollars for each of the three categories.

⁶Appendix I provides information on selected previous audits of DOD advisory and assistance services.

⁷31 U.S.C. 1105 (g).

Advisory and Assistance Costs Are Erroneously Included in Miscellaneous Budget Category

Advisory and assistance services costs are being included in a miscellaneous budget category, but there was insufficient descriptive information in the Army, the Navy, and the Air Force accounting systems for us to determine the full amount of advisory and assistance services costs reported as miscellaneous costs. Such a determination could only be made by reviewing each individual contract file. The Army's accounting system uses codes to classify the types of services acquired, but this system, as used, provides only limited information. For example, in fiscal year 1996, the Army Materiel Command (AMC) reported \$1.1 billion in miscellaneous services and \$130.5 million in advisory and assistance services, but little descriptive information on the \$1.1 billion in miscellaneous services was provided (see app. II). At our request, AMC identified specific contract actions associated with the costs included in the miscellaneous category. As a result, we were able to review selected AMC contract actions. This review showed that obligations for advisory and assistance services were being reported as miscellaneous contract services, thereby avoiding the scrutiny and administrative controls associated with advisory and assistance services. We could not make an accurate and reliable estimate of the total advisory and assistance services included in the \$47 billion reported as miscellaneous services, in part, because DOD's accounting system provided little descriptive information on miscellaneous services.

Our review of 21 contract actions at AMC revealed that 16 were erroneously classified as other or miscellaneous services when a more appropriate classification code should have been selected. The misclassified contract actions totaled \$12.3 million, of which approximately \$11.6 million was erroneously identified and coded as other or miscellaneous services instead of advisory and assistance services. These miscellaneous services included advisory and assistance services, such as technical assistance to develop market strategies and to support engineering and business planning functions. We asked AMC personnel to reassess the coding of these contract actions and, after careful review, the officials agreed with our findings. Appendix II provides more detailed information on the Army's contract file review.

We found that the Navy's accounting system does not have the capability to generate information on the types of services included in the miscellaneous category and on contracts associated with that category. Also, each naval command maintains a different accounting and classification system for such costs. In a March 1996 report, we noted that although the Navy's finance and accounting system used expense element

codes to record transactions, a large number of the transactions analyzed did not have expense element codes or the recorded codes were invalid.⁸ Furthermore, our interviews with officials at two major naval commands revealed that different management interpretations of advisory and assistance services definitions could result in underreporting of costs for such services. For example, in the Naval Sea Systems Command (NAVSEA), the Comptroller's office uses a management approach to identify and report advisory and assistance services that, in our view, is inconsistent with OMB's definitions. Officials told us that definitions for advisory and assistance services contracts are read in the context of potential management concerns. Thus, services for engineering and technical support would be identified as advisory and assistance services only when the nature of the task raises management concerns. One such concern would be placing the contractor in a situation where there is a perceived "risk" of influencing government decision-making.

We requested information from the Air Force Comptroller's office on the types of services included in the miscellaneous category, but we were informed that this information could only be obtained with extensive base level research into each individual contract. We, therefore, did not conduct any additional work at the Air Force. However, as discussed later, several recent Air Force Audit Agency reports have discussed problems with accurate identification and reporting of advisory and assistance services costs.

Underreporting of Advisory and Assistance Services Costs Is a Long-Standing Concern

There are long-standing concerns about DOD's accuracy, reliability, and underreporting of costs associated with advisory and assistance services. Since 1985, over 30 reports have identified problems with DOD's management and reporting of these services, including (1) inadequate accounting systems to identify advisory and assistance services expenditures, (2) inaccurate reporting of advisory and assistance services expenditures, (3) improper justification of advisory and assistance services contracts, and (4) improper use or administration of advisory and assistance services contracts. For example, the DOD Inspector General has issued several reports outlining difficulties with accurate reporting of advisory and assistance services expenditures. One report estimated that \$4 billion to \$9 billion in advisory and assistance services costs was

⁸CFO Act Financial Audits: Increased Attention Must be Given to Preparing Navy's Financial Reports (GAO/AIMD-96-7, Mar. 27, 1996). In February 1997, the Navy started to implement the OMB object class system in its Standard Accounting and Reporting System. Prior to that date, each command used different codes and there was no way to associate accounting data with object classification data.

underreported in fiscal year 1987.⁹ This underreporting was attributed, in part, to unclear terminology. Other reasons included difficulties with the finance and accounting systems; lack of consistency in identifying, recording, and reporting advisory and assistance services costs; and opportunities for flexible interpretation of definitions. Air Force, Army, and Navy organizations have also performed various audits. For example, the Air Force Audit Agency has issued nine audit reports since 1991 dealing with advisory and assistance services contracting issues, including inaccurate reporting of costs for such services. One recent Air Force Audit Agency report identified weaknesses in the Air Force's accounting systems that limited the collection of advisory and assistance services costs at laboratory and test centers.¹⁰ (See app. I for a list of these reports and related findings.)

Governmentwide reports on advisory and assistance services were issued by the President's Council on Integrity and Efficiency and OMB's Office of Federal Procurement Policy. For example, one of these reports summarized the results of audits made by 21 Inspectors General to fulfill the requirement for an annual evaluation of the progress made in establishing effective management controls and improving the accuracy and completeness of advisory and assistance services data in the Federal Procurement Data System.¹¹ The report stated that the management and oversight of advisory and assistance services were long-standing problems and that improvements were needed in the accuracy and completeness of reporting of advisory and assistance services.

DOD Cites Disincentives to Accurate Cost Reporting

DOD's directives and regulations require increased scrutiny of advisory and assistance services and affirm the need for enhanced management and oversight, yet problems continue. In part, DOD officials attribute this situation to remaining ambiguities on how to interpret advisory and assistance services definitions.¹² DOD officials believe that problems with inaccurate identification of advisory and assistance services continue because the enhanced scrutiny and management controls have, in effect,

⁹Audit Report, Office of the Inspector General, Department of Defense: DOD Reporting and Controls for Contracted Support Services, Report No. 95-295, Aug. 21, 1995.

¹⁰Air Force Audit Agency Report of Audit: Laboratory and Test Center Advisory and Assistance Services, Project 96064034, Aug. 28, 1997.

¹¹President's Council on Integrity and Efficiency: Summary Report on Audits of Contracted Advisory and Assistance Services Conducted During FY 1989 in Compliance with United States Code, Title 31, Jan. 1990.

¹²Varying interpretations of what constitutes advisory and assistance services was the matter at issue in the bid protest resolved in the Matter of: Nations Inc., B-272455, 96-2 CPD 170, Nov. 5, 1996.

become a disincentive to accurately identifying these services, particularly when alternatives exist. For example, while a contract identified as advisory and assistance services has to undergo substantial management and administrative oversight, contracts identified as "other services" do not require such scrutiny.

DOD officials also suggested that congressional funding cuts for advisory and assistance services are the most powerful disincentive to accurately identifying and reporting these costs. DOD officials pointed out that in fiscal year 1998 the defense appropriations act reduced advisory and assistance services funding by \$300 million and that in the previous year Congress reduced advisory and assistance services funding by \$102.3 million.¹³

Agency Comments

In commenting on our draft report, DOD had no overall objections to its content but did offer some additional perspectives. DOD's comments are contained in appendix III. DOD stated that given its increased emphasis on competition of noninherently governmental functions for potential outsourcing to private industry, advisory and assistance services will likely increase markedly over the next few years. However, DOD sees little reason to continue to report expenditures for these services in a separate budget account. The issues raised in our report as well as the continued interest of several congressional committees led us to an opposite perspective than that reached by DOD and we do not endorse the elimination of a separate budget account for these expenditures. DOD suggested that we expand the historical background leading to the 1994 FASA requirement for a separate object class. We have annotated the report to provide an additional legal citation.

We agree with DOD's comment that until 1997 the Navy's accounting system did not generate OMB object class information and the draft report provided that information. We do not agree with DOD's view that NAVSEA reports advisory and assistance services in a manner consistent with OMB's object class definitions. As stated in our draft report, NAVSEA officials' views are that a consideration of management risk determines the nature of (and subsequent accounting for) advisory and assistance services. We find nothing in the specific language of either 31 U.S.C. 1105(g) or the OMB circular's object class 25.1 descriptions of what are and are not advisory and assistance services that supports NAVSEA's position. Management risk

¹³Public Law 105-56, section 8041, 111 Stat. 1230 and Public Law 104-208, section 8037, 110 Stat. 3009-96.

is undoubtedly a significant consideration in contract management. In the arena of accounting, however, it introduces a subjective factor that compromises the attempt to capture the costs associated with defined categories of advisory and assistance services.

Scope and Methodology

To analyze DOD obligations for contractual services in general, we analyzed OMB data for fiscal year 1996.¹⁴ To obtain information on what types of services are being reported as other services (object class 25.2), we contacted each of the military services to determine what information was available in their databases. Data were not available from the Navy's and Air Force's accounting systems, but limited data were available from the Army's finance and accounting system regarding obligations reported as other services. Thus, we visited AMC and analyzed available data from the finance and accounting system¹⁵ and reviewed contract actions at one of its subordinate commands, the Army Research Laboratory in Adelphi, Maryland. At the laboratory, we judgmentally selected 21 contract actions to review that were classified as other services. As part of our methodology, we asked laboratory personnel to review 16 actions that we thought were not correctly classified as other services. After a careful review of the contracts by both budget and procurement personnel, the officials concluded that in each case there were alternatives to the "other" category that more appropriately described the nature and type of services purchased. Eleven of the 16 contract actions should have been classified as advisory and assistance services instead of other services.

To determine the reasons for underreporting of advisory and assistance services, we identified and reviewed selected prior audit reports by the DOD Inspector General, the Air Force Audit Agency, and the Army Audit Agency, the Center for Naval Analysis, the President's Council on Integrity and Efficiency, and OMB's Office of Federal Procurement Policy. We also met with DOD, Army, Navy, Air Force, and Defense Logistics Agency officials with responsibility for managing and reporting advisory and assistance services. We contacted OMB officials regarding the advisory and assistance services budget exhibit to Congress and object class reporting.

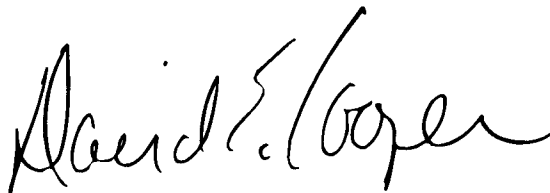
¹⁴As part of their annual budget submissions to OMB, departments and agencies are required to report actual and planned obligations. OMB collects and processes this information through the MAX budget system, which is used to prepare the President's annual budget request. We extracted and accumulated DOD data and aggregated these data into object class 25 series subcategories. We did not verify the data submitted by DOD to OMB.

¹⁵The data provided by the Army and AMC were extracted from the defense finance and accounting system, which uses four-digit identification codes to identify the resources being used. The first and second positions are usually related to an OMB object classification. We did not verify the data submitted by the Army and AMC.

We discussed underreporting issues with DOD's advisory and assistance services director and explored options for improving advisory and assistance services cost reporting with DOD's Assistant Deputy Comptroller and other officials. We conducted our review from June 1997 to March 1998 in accordance with generally accepted government audit standards.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Subcommittee on National Security, House Committee on Appropriations, and to the House Committee on National Security and the Senate Committee on Armed Services; the Director, Office of Management and Budget; and the Secretary of Defense. We will also provide copies to others on request.

Please contact me at (202) 512-4841 or Ralph Dawn, Assistant Director, if you or your staffs have any questions concerning this report. Other contributors to this report were Gretchen Bornhop, M. Cristina Gobin, and Benjamin Mannen.

A handwritten signature in black ink, reading "David E. Cooper". The signature is fluid and cursive, with the first name "David" being the most prominent.

David E. Cooper
Associate Director, Defense Acquisitions Issues

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Abbreviations

AMC	Army Material Command
DOD	Department of Defense
FASA	Federal Acquisition and Streamlining Act
NAVSEA	Naval Sea Systems Command
OMB	Office of Management and Budget

Selected Reports About Advisory and Assistance Services Management and Reporting Problems

Date	Report title	Selected findings
10/31/97	<u>Inspectors General: Concerns About Advisory and Assistance Service Contracts (GAO/T-OSI/ AIMD-98-28)</u>	Improper use of other than full and open competition
08/28/97	<u>Report of Audit, Laboratory and Test Center Advisory and Assistance Services (Air Force Audit Agency Project 96064034)</u>	(1) Inadequate accounting systems to identify advisory and assistance services expenditures (2) Inaccurate reporting of advisory and assistance services
06/13/97	<u>Defense Advisory and Assistance Service Contracts (GAO/NSIAD-97-166R)</u>	Inaccurate reporting of advisory and assistance services
11/26/96	<u>Management Advisory Services, Research, Development, Test and Evaluation Manpower Review, Kirtland AFB NM (Air Force Audit Agency Project 96411026)</u>	Inaccurate reporting of advisory and assistance services
03/19/96	<u>Project Manager Core Support Contracts (Army Audit Agency Report AA 96-140)</u>	(1) Improper justification of advisory and assistance services contracts (2) Improper use of other than full and open competition
01/05/96	<u>Acquisition Management Staffing at the Ballistic Missile Defense Organization (DOD Inspector General Report 96-056)</u>	Improper use of or administration of advisory and assistance services contracts
08/21/95	<u>DOD Reporting and Controls for Contracted Support Services (DOD Inspector General Report 95-295)</u>	(1) Improper justification of advisory and assistance services contracts (2) Inaccurate reporting of advisory and assistance services
04/03/95	<u>Pricing Orders for Contracted Advisory and Assistance Services, Space and Missile Systems Center, Los Angeles AFB, CA (Air Force Audit Agency Project 41295013)</u>	Improper use or administration of advisory and assistance services contracts
12/30/94	<u>Cost-Effectiveness of Contracting for Services (DOD Inspector General Report 95-063)</u>	Improper justification of advisory and assistance services contracts
12/16/94	<u>Pricing Orders for Contracted Advisory and Assistance Services (CAAS), Aeronautical Systems Center (ASC), Wright-Patterson AFB, OH (Air Force Audit Agency Report 44595014)</u>	Improper use or administration of advisory and assistance services contracts
06/09/94	<u>Cost-Effectiveness of Contracted Advisory and Assistance Services at Space and Missile Systems Center (Air Force Audit Agency Project 94064002)</u>	Improper justification of advisory and assistance services contracts
05/27/94	<u>Procurement of Support Services by the Air Force Electronic Systems Center, Hanscom Air Force Base, Massachusetts (DOD Inspector General Report 94-112)</u>	(1) Improper justification of advisory and assistance services contracts (2) Inaccurate reporting of advisory and assistance services
04/08/94	<u>"Super" Scientific, Engineering, and Technical Assistance Contracts at the Ballistic Missile Defense Organization (DOD Inspector General Report 94-077)</u>	Improper justification of advisory and assistance services contracts
03/10/94	<u>Government Contractors: Measuring Costs of Service Contractors Versus Federal Employees (GAO/GGD-94-95)</u>	Improved guidance needed

(continued)

**Appendix I
Selected Reports About Advisory and
Assistance Services Management and
Reporting Problems**

Date	Report title	Selected findings
01/27/94	<u>Price Reasonableness of Contracted Advisory and Assistance Services, Space and Missile Systems Center, Los Angeles AFB, CA (Air Force Audit Agency Report 41294006)</u>	Improper justification of advisory and assistance services contracts
1/94	<u>Summary Report of Agencies' Service Contracting Practices (OMB, Office of Federal Procurement Policy)</u>	Improved guidance needed
08/17/92	<u>Selected Service Contracts at Wright-Paterson Air Force Base (DOD Inspector General Report 92-128)</u>	Improper justification of advisory and assistance services contracts
08/07/92	<u>Review of Contracting for Advisory and Assistance Services (CAAS), Warner Robins Air Logistics Center, Robins AFB, GA (Air Force Audit Agency Report 91425101)</u>	(1) Improper use of other than full and open competition (2) Inaccurate reporting of advisory and assistance services
06/04/92	<u>Contracting for Advisory and Assistance Services (Air Force Audit Agency Project 91064041)</u>	(1) Improper justification of advisory and assistance services contracts (2) Inaccurate reporting of advisory and assistance services
12/16/91	<u>Contracting for Advisory and Assistance Services, Aeronautical Systems Division (ASD), Wright-Paterson AFB, OH (Air Force Audit Agency Report 91445053)</u>	(1) Inaccurate reporting of advisory and assistance services (2) Improper use or administration of advisory and assistance services contracts
10/30/91	<u>Consulting Services (DOD Inspector General Report 92-010)</u>	Inaccurate reporting of advisory and assistance services
08/22/91	<u>Consulting Services Contracts for Operational Test and Evaluation (DOD Inspector General Report 91-115)</u>	Improper justification of advisory and assistance services contracts
05/08/91	<u>Consulting Services: Contract Obligations for Fiscal Years 1987, 1988, and 1989 (GAO/GGD-91-62FS)</u>	Inaccurate reporting of advisory and assistance services
02/01/91	<u>Contracted Advisory and Assistance Services Contracts (DOD Inspector General Report 91-041)</u>	(1) Improper justification of advisory and assistance services contracts (2) Inaccurate reporting of advisory and assistance services
08/20/90	<u>Consulting Services: Role and Use in Acquiring Three Weapon Systems (GAO/NSIAD-90-119)</u>	Inaccurate reporting of advisory and assistance services
1/90	<u>Summary Report on Audits of Contracted Advisory and Assistance Services Conducted During FY 1989 in Compliance with United State Code, Title 31 (President's Council on Integrity and Efficiency)</u>	Inaccurate reporting of advisory and assistance services
06/07/89	<u>Use of Consulting Services in Defense Acquisition (GAO/T-NSIAD-89-36)</u>	Inaccurate reporting of advisory and assistance services
9/88	<u>Report on the Government's Use of Contracted Advisory and Assistance Services (OMB, Office of Federal Procurement Policy)</u>	(1) Inaccurate reporting of advisory and assistance services (2) Inadequate definition of advisory and assistance services
9/88	<u>Summary Report on Contracted Advisory and Assistance Services (President's Council on Integrity and Efficiency)</u>	(1) Improper justification of advisory and assistance services contracts (2) Inaccurate reporting of advisory and assistance services

(continued)

Appendix I
Selected Reports About Advisory and
Assistance Services Management and
Reporting Problems

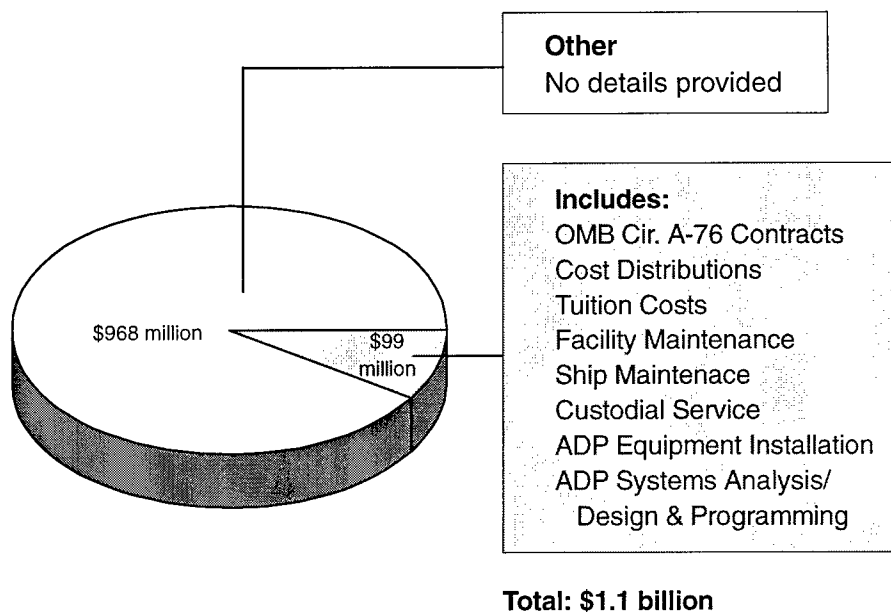
Date	Report title	Selected findings
11/22/85	<u>Support Services: Actions to Gain Management Control Over DOD's Contract Support Services (GAO/NSIAD-86-8)</u>	(1) Inaccurate reporting of advisory and assistance services (2) Inadequate accounting systems to identify advisory and assistance services expenditures
9/85	<u>The Problems of Budget Presentation and Recording of Contracted Advisory and Assistance Services (CAAS) (Center for Naval Analysis Report CRM 85-65)</u>	Inaccurate reporting of advisory and assistance services
9/85	<u>Proposed Solutions to the Definitional Problems of Contracted Advisory and Assistance Services (Center for Naval Analysis Report CRM 85-66)</u>	Inadequate definition of advisory and assistance services
8/85	<u>The General Problems of Contracted Advisory and Assistance Services (CAAS) (Center for Naval Analysis Report CRM 85-63)</u>	Inadequate definition of advisory and assistance services

Army Contract Files Review

Our review of data from the Army's finance and accounting database disclosed that the accounting system had assigned descriptive codes for less than half of the Army's fiscal year 1996 expenditures of \$11.6 billion reported as other, or miscellaneous, services (object class 25.2). However, about \$6 billion in expenditures had codes that provided no descriptive information.

To determine whether advisory and assistance services were reported as miscellaneous services, we examined expenditures data from the Army Materiel Command's (AMC) finance and accounting system that totaled \$1.1 billion in direct obligations for miscellaneous services.¹ As shown in figure II.1, the AMC's data contained little descriptive information on the \$1.1 billion.

**Figure II.1: Army Materiel Command:
Object Class 25.2 Fiscal Year 1996
Obligations (dollars in millions)**



Source: Army's Finance and Accounting System.

¹We used fiscal year 1996 data because fiscal year 1997 data were incomplete at the time of our review. The data provided by AMC were "execution" or actual obligation data that contained expenditures by major command, appropriation account, and element of resource. The data were not disaggregated to the contract or contract action level.

The Army Comptroller's Office and AMC both informed us that there was no way to associate reported expenditures with specific contracts without requesting such data from each subcommand. Accordingly, we requested such data from AMC for all of its major subcommands, which proved to be a labor intensive and slow process. The Army Research Laboratory was the first to provide contract data to conduct our analysis. For fiscal year 1996, the laboratory provided a list of contract actions, with a value of \$113.5 million, that had been classified as other, with no explanation or detail as to the type of expense.

Our review of contract actions at the laboratory disclosed that advisory and assistance services such as technical assistance to develop market strategies and engineering and business planning support were being misclassified in the other category. Of 21 contract actions reviewed, 16 actions, with a value of \$12.3 million, were misclassified as miscellaneous services. The misclassified actions included 11 actions, with a value of \$11.6 million, that should have been classified as advisory and assistance services. Laboratory budget and procurement personnel agreed that the actions should have been more appropriately described as advisory and assistance services.

Comments From the Department of Defense



ACQUISITION AND
TECHNOLOGY

DP/CPA

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

April 27, 1998

Mr. David E. Cooper
Associate Director, Defense Acquisition Issues
National Security and International Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Cooper,

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "DOD CONSULTING SERVICES: Erroneous Accounting and Reporting of Costs," dated March 26, 1998 (GAO Code 707273/OSD Case 1579). The Department has no overall objections to the content of the draft report, though I would like to suggest some additional perspectives on several issues. You have pointed out the difficulties surrounding the identification and reporting of advisory and assistance services, as well as the underlying reluctance to identify amounts that have become targets for substantial Congressional budget cutting. At the same time, Congress is considering legislation (the Fair Competition Act in the Senate - S.314 and the Competition in Commercial Activities Act in the House - H.R. 716) to create level playing fields in public-private competitions. The goal is to increase the contracting out of those functions that are not inherently governmental. Given the Department's increased emphasis on competition of non-inherently governmental functions for potential outsourcing to private industry, it is likely that advisory and assistance contracts will increase markedly over the next few years. If the intent of the Congress is to encourage such outsourcing, there seems little reason to continue to report expenditures for advisory and assistance services in a separate budget account.

The first paragraph of the BACKGROUND section can be clarified in the interest of precision. In Section 512 of Public Law 102-394 Congress directed initially that the Office of Management and Budget (OMB) create a new object class for reporting actual and planned obligations for "advisory and assistance services" for each Department and Agency in the annual budget submission. This was enacted in October of 1992, not in 1994, although it was effective beginning in FY 1994. This led to the initial creation of Object Class 25.1 by OMB and insertion of this Object Class into OMB Circular A-11. Congress defined "consulting services" to include: (1) management and professional



See page 7.

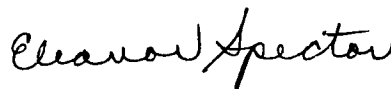
See page 1.

Appendix III
Comments From the Department of Defense

support services, (2) studies, analyses and evaluations, (3) engineering and technical services (excluding routine engineering services such as automated data processing and architect and engineering contracts), and (4) research and development. Working with OMB, DoD crafted a definition for this Object Class and the categories of services included within the Object Class. Based on discussions, three exemptions were created during the development of the Object Class. Section 2454 of the Federal Acquisition Streamlining Act (FASA) in 1994 put into the law the exemptions that OMB and OSD had already developed in response to the requirement of section 512 of Public Law 102-394.

With respect to the last paragraph on page 4, the STARS(HQ) accounting system does have the capability to segregate costs based on OMB object classes. Prior to FY 97, such records were not maintained. In the paragraph at the top of page 5, the draft report states that NAVSEA does not report advisory and assistance services in a manner consistent with OMB definitions. While the definitions in the SECNAV Instruction on this subject are not identical to the OMB Object Class definitions, they are consistent with the objectives sought by the OMB definitions, namely, to report on instances of engineering and technical support services that are not routine.

Thank you for the opportunity to comment on this draft report.



Eleanor R. Spector
Director of Defense Procurement

See page 1.

See pages 7-8.