December 09, 2005

Financial Management

Puget Sound Naval Shipyard Mission-funded Prototype (D-2006-037)

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Acronyms

COMPACFLT	Commander, U.S. Pacific Fleet
DON	Department of the Navy
DUSD (L&MR)	Deputy Under Secretary of Defense for Logistics and Material Readiness
GAO	Government Accountability Office
NAS	Naval Audit Service
NAVSEA	Naval Sea Systems Command
OUSD (AT&L)	Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics
OUSD (Comptroller)/CFO	Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer
PBD	Program Budget Decision
WARR	Workload and Resource Report
WCF	Working Capital Fund

INSPECTOR GENERAL
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December 9, 2005

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION, TECHNOLOGY, AND LOGISTICS
UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER
NAVAL INSPECTOR GENERAL

SUBJECT: Report on Puget Sound Naval Shipyard Mission-funded Prototype (Report No. D-2006-037)

We are providing this report for review and comment. The Deputy Comptroller for Program and Budget, Office of the Secretary of Defense (Comptroller)/Chief Financial Officer (OUSD [Comptroller]/CFO) requested that we conduct this audit. The Under Secretary of Defense for Acquisition, Technology, and Logistics and the OUSD (Comptroller)/CFO did not respond to the draft report; however, we considered the comments received from the Navy.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Department of Navy comments were partially responsive. As a result of management comments, we revised recommendation A.2. to add the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller), Office of Budget as an addressee to provide comments on the final report. We request that the Under Secretary of Defense for Acquisition, Technology, and Logistics; the OUSD (Comptroller)/CFO; and the Navy provide comments by January 9, 2006.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to Audclev@dodig.mil. 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. Questions should be directed to Mr. Raymond D. Kidd at (703) 325-5515 or Mr. Kenneth B. VanHove at (216) 706-0074 extension 245. See Appendix F for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

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Department of Defense Office of Inspector General

Report No. D-2006-037 **December 9, 2005**
(Project No. D2005-D000FC-0116.000)

Puget Sound Naval Shipyard Mission-funded Prototype

Executive Summary

Who Should Read This Report and Why? DoD program officials involved in budget execution, operations, and reporting of consolidated Naval ship maintenance activities should read this report. The report discusses the need for a more focused study of the effects of the Puget Sound Naval Shipyard transition from a Navy Working Capital Fund activity to a mission-funded activity.

Background. In FY 1998, the Department of the Navy (DON) consolidated the management, operations, and funding of the Pearl Harbor Naval Shipyard and the Naval Intermediate Maintenance Facility (Pearl Harbor) in Hawaii. Upon completion of the Pearl Harbor pilot, the Department of the Navy proposed to transition the other remaining public shipyards to mission funding. However, Program Budget Decision (PBD) 700C, "Navy Amended Budget Estimates Submission," January 7, 2003, allowed the DON to implement a 2-year prototype at only one additional shipyard, integrating intermediate maintenance and depot-level activities and financing operations with mission funding. On May 15, 2003, the DON officially merged all facilities and functions of the Puget Sound Naval Shipyard in Bremerton, Washington, and the Naval Intermediate Maintenance Facility, Pacific Northwest to create Puget Sound Naval Shipyard and Integrated Maintenance Facility (Puget Sound) for the 2-year prototype, which began in FY 2004.

The Deputy Comptroller for Program and Budget in the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer requested that we review the Puget Sound Naval Shipyard mission-funded prototype. The Deputy Comptroller expressed concerns that financing the public shipyards outside of the working capital fund would be premature without an adequate evaluation of the Puget Sound Naval Shipyard mission-funded prototype because this is a significant change for the Department's management of industrial fund activities. The working capital fund generally operates using private sector management techniques and the total shipyard maintenance costs are fully funded before beginning work on a ship, thus providing total cost visibility. Mission-funded activities, on the other hand, use fiscal year appropriated resources to perform shipyard maintenance.

Results. The DON cannot support the decision to transition other shipyards and intermediate maintenance facilities to mission funding based on the Puget Sound mission-funded prototype. The established metrics and goals used to track results of the transition for the Puget Sound prototype were unreliable. Additionally, the metrics and goals focused on the consolidation of the shipyard and intermediate maintenance facility but did not address the impacts of mission funding. Also, the consolidated activities did not routinely accumulate financial information as they had done when financed as a working capital fund activity, and developed different methods to manage the consolidated activities' operations. In addition, business practices were not followed.

Finally, Puget Sound's information technology systems do not fully support operations. As a result, we are unable to determine the effectiveness of the transition of Puget Sound to mission funding. The Under Secretary of Defense (Comptroller)/Chief Financial Officer should continue the Puget Sound mission-funded prototype and not transition the remaining public shipyards to mission-funding until meaningful metrics and goals are established and measured to evaluate the Puget Sound transition. Further, before transitioning other shipyards to mission funding, standard business practices and policies must be developed to help the shipyards accurately measure cost, meet financial reporting requirements, and report reliable financial information (finding A).

Other problems with reporting exist at the consolidated activities. DON officials did not fully comply with guidance from the Deputy Under Secretary of Defense for Logistics and Material Readiness concerning depot-level maintenance reporting. The guidance required the use of FY 2004 actual depot-level maintenance obligation data, but allowed the use of algorithms or estimation methods to determine the portion of depot-level maintenance and repair services established in contractor support contracts. The Fleet Readiness Division used an algorithm instead of available FY 2004 data and used the algorithm to report depot-level maintenance other than contractor support contracts. As a result, naval shipyard depot-level maintenance information included in reports to Congress may not be reliable. The Deputy Chief of Naval Operations (Logistics), Fleet Readiness Division needs to use actual obligation data for the FY 2005 and future reports to determine the amount of depot-level maintenance performed at the naval shipyards (finding B). See the Finding sections of the report for the detailed recommendations.

Management Comments and Audit Response. We issued the draft report on July 19, 2005. The Office of the Assistant Secretary of the Navy (Financial Management and Comptroller) commented on the draft of this report for the DON. The DON disagreed with the conclusion that the DON cannot support the decision to transition the shipyards and intermediate maintenance facilities to mission funding. The management comments received were partially responsive. We do not agree that the DON can support its decision to transition the consolidated activities to mission funding. Representations made by management regarding the effectiveness of mission funding were not substantiated. As a result of management comments, we revised recommendation A.2. to add the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller), Office of Budget as an addressee to provide comments on the final report on this recommendation.

We did not receive comments for recommendations A.1. and A.2. from the Under Secretary of Defense (Comptroller)/Chief Financial Officer or for Recommendation A.2. from the Under Secretary of Defense for Acquisition, Technology, and Logistics. We also did not receive comments for recommendation B.1. from the Deputy Chief of Naval Operations (Logistics), Fleet Readiness Division. We request the Under Secretary of Defense for Acquisition, Technology, and Logistics; the Under Secretary of Defense (Comptroller)/Chief Financial Officer; the Assistant Secretary of the Navy (Financial Management and Comptroller), Office of Budget; Commander, U.S. Pacific Fleet; Commander, Naval Sea Systems Command; and the Deputy Chief of Naval Operations (Logistics), Fleet Readiness Division provide comments on the final report by January 9, 2006. See the Finding sections of the report for a discussion of management comments and Appendix D for the complete text of the comments.

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Background

On January 12, 2005, the Deputy Comptroller for Program and Budget in the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer (OUSD [Comptroller]/CFO) requested that the DoD Office of Inspector General review the Puget Sound Naval Shipyard and Intermediate Maintenance Facility (Puget Sound) mission-funded prototype. The Deputy Comptroller expressed concerns that moving the public shipyards out of the working capital fund (WCF) without an adequate evaluation of the Puget Sound mission-funded prototype is premature because this is a significant change for the Department's management of industrial fund activities.[1] The OUSD (Comptroller)/CFO directed the Department of the Navy (DON) to continue the mission-funded prototype program at Puget Sound and keep the remaining shipyards in the WCF until an independent assessment is conducted.

Working Capital Fund and Mission Funding Structures. The WCF is a revolving fund financial structure used to provide necessary goods and services on a "break even" basis for the Armed Forces. The WCF generally operates using private sector management techniques and the total shipyard maintenance costs are fully funded before beginning work, thus providing total cost visibility. Organizations financed through the WCF derive their income from work they perform. Therefore, the funding is available to finance their continuing operations without fiscal year limitations. An organization must meet four criteria to be financed using the WCF:

- identifiable outputs,
- identifiable organizations that require the products or services,
- an approved accounting system, and
- evaluation of the advantages and disadvantages of establishing a buyer-seller relationship.

A mission-funded activity receives an operating budget that provides the total appropriated funding for the fiscal year without identification of the specific work to be accomplished. Therefore, mission-funded shipyards use appropriated funds for a specific fiscal year to perform depot-level maintenance. The DON believes that mission funding will improve readiness because the workforce can be reassigned as needed without requiring full funding of maintenance. DON representatives stated that cost information is as visible for organizations using mission funding as it is for organizations funded by the WCF, and that performance accountability is maintained or improved under mission funding.

[1] An industrial fund activity was historically an activity such as a Navy shipyard that provided industrial and commercial goods and services, such as depot maintenance.

Shipyard and Intermediate Activity Consolidation History. In 1994, the Chief of Naval Operations decided to regionalize maintenance to:

- create workforce flexibility,
- reduce maintenance infrastructure through sharing or consolidating intermediate and depot-level facilities, and
- integrate maintenance and supply.

A key element of the Regional Maintenance Plan is the consolidation of separate intermediate and depot-level maintenance facilities in a region.[2] In FY 1998, the DON implemented a pilot project consolidating the management, operations, and funding of the Pearl Harbor Naval Shipyard and the Naval Intermediate Maintenance Facility (Pearl Harbor) in Hawaii. The pilot project used a single financial structure and selected mission funding rather than the WCF. To implement the pilot project, the DON and the Office of the Secretary of Defense developed a test plan with metrics to measure the performance. A DON report to Congress indicated that the Pearl Harbor pilot project was a success, and proposed the transition of the other remaining public shipyards to mission funding. However, the Government Accountability Office (GAO) expressed concerns that the pilot project did not provide adequate cost visibility and accountability over ship maintenance.

Puget Sound History. In PBD 700C, "Navy Amended Budget Estimates Submission," January 7, 2003, the DON received approval from the OUSD (Comptroller)/CFO to implement a 2-year prototype at one shipyard on a mission-funded basis with integrated intermediate maintenance and depot-level activities. Puget Sound was the site chosen. The Pearl Harbor pilot project served as the model for the Puget Sound mission-funded prototype and for all future consolidated shipyard and intermediate activities.

The DON, the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics (OUSD [AT&L]), and the OUSD (Comptroller)/CFO were directed to evaluate the results of the Puget Sound prototype prior to final decisions on the FY 2006 President's budget. To evaluate the prototype, the DON, OUSD (AT&L), and OUSD (Comptroller)/CFO were to work together to develop metrics and goals to provide total cost visibility and performance accountability under mission funding, and the metrics were to be reported quarterly. The DON established four reporting mechanisms to address cost visibility and performance accountability concerns of the prototype:

- the virtual 1307 report,[3]
- the ship availability schedule report,

[2] Intermediate facilities perform maintenance beyond the capability or capacity of a ship's crew consisting of short but time-critical projects. The scope of maintenance performed at depot-level facilities is described in finding B.

[3] The virtual 1307 was developed based on a WCF document, Accounting Report (m) 1307, used to report the total cost involved with operating the shipyard.

- the post availability quality report, and
- the customer appraisal of quality report.

On May 15, 2003, the DON officially merged all facilities and functions of the Puget Sound Naval Shipyard in Bremerton, Washington, and the Naval Intermediate Maintenance Facility, Pacific Northwest to create the 2-year prototype that began in FY 2004. At the time of our site visit in April 2005, Puget Sound had completed two mission-funded projects since the consolidation and transition to mission funding.

Puget Sound Operations. Puget Sound is a single regional maintenance organization with a single integrated workforce operated by the Commander, Naval Sea Systems Command (NAVSEA) and under the claimancy of the Commander, U.S. Pacific Fleet (COMPACFLT). NAVSEA oversees the management and operation of Puget Sound, exercises complete technical and engineering authority, funds centrally managed program technical support, and develops instructions defining processes and business practices. The COMPACFLT is responsible for programming and budgeting resources and, as such, matches resources to requirements and determines workload, priorities, and schedules.

Objectives

Our overall audit objective was to evaluate the Puget Sound mission-funded prototype. Specifically, we evaluated the metrics and goals, the development of the shipyard rate, and the effect on Congressional reporting. See Appendix A for a discussion of the scope. See Appendix B for prior coverage related to the objectives. Appendix C is the OUSD (Comptroller)/CFO letter requesting the audit.

Management Control Program Review

DoD Directive 5010.38, “Management Control Program,” August 26, 1996, and DoD Instruction 5010.40, “Management Control 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 the Review of the Management Control Program. We did not review the DON system of management controls. However, during the course of the audit, we identified internal control weaknesses involving the transition of the shipyards to mission funding and shipyard depot-level maintenance reporting. See findings A and B for more details on this review.

A. Evaluation of the Puget Sound Naval Shipyard Mission-funded Prototype

The DON cannot support its decision to transition the shipyards and intermediate maintenance facilities to mission funding because it did not properly plan for their transition. As a result, we are unable to determine the effectiveness of the transition of Puget Sound to mission funding.

Puget Sound Mission-Funded Prototype

The DON decision to transition shipyards and intermediate maintenance facilities to mission funding is not supported because the established metrics and goals used to track results of the transition for the Puget Sound prototype were unreliable. Additionally, the metrics and goals focused on the consolidation of the shipyard and intermediate maintenance facility but did not address the impacts of mission funding. Also, the consolidated activities did not routinely accumulate financial information as they had done when financed as a WCF activity, and developed different methods to manage the consolidated activities' operations. In addition, business practices were not followed. Finally, Puget Sound's information technology systems do not fully support operations. Until the DON can measure and demonstrate the impact of mission funding on the consolidated activities, and establish the required policies and procedures for them, it should extend the Puget Sound mission-funded prototype and not transition the remaining shipyards to mission funding.

Metrics and Goals Reliability. The established metrics and goals reported for Puget Sound were not reliable. Specifically, the Puget Sound cost visibility and performance accountability metrics were inconsistently prepared in FY 2004. The DON could not provide documentation to fully support most of the costs reported on the quarterly FY 2004 virtual 1307 reports. For example, Puget Sound representatives were inconsistent in using methodologies to calculate the Contracts line item on the virtual 1307 report. They used one methodology to calculate the first and third quarter Contracts amount and a different methodology to calculate the second and fourth quarter Contracts amount. Puget Sound representatives also could not support reported costs for the Salaries and Wages-Civilian line item because the shipyard financial information system does not maintain historical information when new information is entered into the system. Furthermore, Puget Sound could not support costs associated with base operations because it does not track these costs. The Commander, Naval Installations is responsible for funding base support costs and provides the cost data to the shipyard. However, Puget Sound representatives stated that some of the activity's base support costs are not included because they cannot distinguish these costs from those of the entire installation.

Puget Sound representatives also inconsistently reported amounts within the performance accountability metrics. For example, on the FY 2004 quarterly post availability quality reports, Puget Sound reported maintenance deficiencies in the quarter that the maintenance deficiency occurred; however, they did not consistently allocate the deficiencies based on this methodology. In the first quarter of FY 2005, NAVSEA required Puget Sound to modify their original methodology and report the maintenance deficiencies 90 days after ship maintenance was completed instead of in the quarter when the deficiency occurred. Puget Sound representatives indicated NAVSEA instructed them to shift the results reported in FY 2004 forward one quarter (from the original quarter in which the maintenance deficiencies were reported) because the maintenance deficiencies were reported incorrectly. However, the NAVSEA methodology did not correct the past inconsistent reporting of the maintenance deficiencies.

Consolidation of Activities and Impacts of Mission Funding. The mission-funded metrics and goals established for Puget Sound focus on the consolidation of the shipyard and intermediate maintenance facility rather than the transition of the consolidated activities to mission funding. The DON used the results of the metrics and goals, test plan, and lessons learned from the original pilot project that consolidated Pearl Harbor to transition Puget Sound to mission funding. However, the purpose of the Pearl Harbor metrics and goals and test plan was to evaluate the concept of consolidating the intermediate and depot-level maintenance activities. As such, the metrics were not valid for assessing the effect of the transition to mission funding.

DON representatives stated that mission funding is merely the funding structure that allows for the consolidation of the shipyard and intermediate maintenance facility; however, the DON presented several ways that mission funding impacted operations at the shipyard. According to DON, mission-funding provided flexibility to respond to changing maintenance requirements and priorities, improved use of workforce, and improved performance to budget. However, these impacts are not addressed or measured in the metrics and goals established for the Puget Sound prototype.

Management Reports and Financial Data Accumulation. The DON claimed that the consolidated activities exhibited the same cost visibility as when they were funded under the WCF. However, NAVSEA and the consolidated activities took more than 3 weeks to provide financial information similar to that available in WCF routine reports. We requested the total amount of funds received and used from all shipyard customers for a fiscal year, which had been routinely reported by both Pearl Harbor and Puget Sound when they were funded under the WCF. Puget Sound, because it had transitioned to mission funding more recently—in FY 2004—was able, although with extensive effort, to provide the amount of funding received in FY 2004 and the amount of funding that carried over into FY 2005. However, Pearl Harbor could only determine the amount of funds received in FY 2004. NAVSEA representatives stated extensive time and effort would be required for Pearl Harbor to determine funding amounts carried over from previous years or carried over to the following fiscal year because Pearl Harbor no longer accumulated the information in the same format under mission funding.

Cost information also was not collected to determine the total cost—including all associated overhead costs—required to establish an overhead rate to charge non-DoD customers for maintenance performed. The rate Puget Sound charged to non-DoD customers only included direct labor and direct material costs, excluding overhead costs. The omission occurred because COMPACFLT is responsible for funding all overhead costs under mission funding. Puget Sound representatives indicated that under mission funding, the consolidated activity no longer routinely accumulates costs necessary to compute an overhead rate. However, Public Law 90-629, "Arms Export Control Act," Section 21, "Sales from Stocks," as amended October 6, 2000; the Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," July 31, 1995; and the DoD Financial Management Regulation, Volume 11a, Chapter 1, "General Reimbursement Procedures and Supporting Documentation," March 1997, require the DoD to charge the full cost of services—including overhead—provided to other Federal agencies, private parties, and foreign military sales.[4]

The DON also had not established standard operating guidance to monitor operations at the consolidated activities. In the absence of standard operating guidance, the consolidated activities have established activity-specific methods to monitor operations. For example, Pearl Harbor established a report that compares the Workload and Resource Report (WARR)[5] to the Shipyard Maintenance Capabilities Plan Model (the model)[6] to identify and explain deviations between budgeted workload and actual workload. This information was used by shipyard management as a basis for decisions regarding workload priorities and to compare budgeted performance to actual performance projected out for the remainder of the fiscal year. However, the process of comparing the WARR to the model has not yet been adopted for use at Puget Sound.

Business Practices at the Consolidated Activities. The DON is not in compliance with established business practices for reimbursable work performed at the consolidated activities. Memoranda of Agreement between COMPACFLT and NAVSEA, "Consolidation of Puget Sound Naval Shipyard and Naval Intermediate Maintenance Facility, Pacific Northwest," May 5, 2003, and "Integration of Pearl Harbor Naval Shipyard and Naval Intermediate Maintenance Facility, Pearl Harbor," November 26, 1997, require work that is not COMPACFLT funded (for example, some alterations; inactivations; Shipbuilding

[4] Statement of Federal Financial Accounting Standard No.4 defines full cost as the sum of (1) the cost of the resources consumed by the responsible segment that directly or indirectly contributes to the output, and (2) the cost of identifiable supporting services provided by other responsible segments within the reporting entity, and by other reporting entities. The full cost of a responsible segment's output is the total amount of resources used to produce the output, which includes direct and indirect costs that contribute to the output regardless of funding sources.

[5] The WARR provides a tool for forecasting resource needs, employment, training, and workforce assignments commensurate with workload over a 72 month period. The WARR is used by the consolidated activities for hiring or release plans for the workforce, to identify corporate workforce to workload imbalances, and for advanced planning of resources.

[6] The model's main function is to program dollars for ship maintenance to assist in the preparation of the DON ship maintenance budget. The model is used for three main purposes: workforce planning, budgeting total labor costs, and budgeting total material costs.

and Conversion, Navy-funded availabilities;[7] and some planning functions) are to be reimbursably funded and can continue to be funded using a project order. However, Engineered Refueling Overhaul[8] projects, which are Shipbuilding and Conversion, Navy-funded availabilities, are incrementally funded using Economy Act orders since the transition to mission funding. The Engineered Refueling Overhaul projects were historically funded by NAVSEA, using project orders that required full funding at the time the order was placed. Puget Sound representatives indicated that this change in practice was not documented, and they have not received written guidance from the DON documenting this change.

Information Technology Manual Workarounds. The information technology systems available at Puget Sound do not fully support the consolidated activity's operations. After the consolidation, Puget Sound was required to maintain two accounting information systems to manage the operations of the activities. Therefore, there is considerable manual effort required to assemble information for reports and data calls for the consolidated activity. For example, multiple databases from the Puget Sound shipyard cost information system had to be maintained and manual interfaces had to be established to reflect the combined activity's projects, as well as to break out the cost-reimbursable projects versus mission-funded projects on the WARR. Additionally, for projects that spanned multiple fiscal years, Puget Sound personnel had to manually extract data from multiple databases and add them together to determine the total cost of a project. In addition, the shipyard had to implement new end-of-year procedures to enable the appropriated funds to be de-obligated at the end of the current year and identified for re-entry into the next year's database to be re-obligated. These issues were not encountered until the transition to mission funding at Puget Sound because the reimbursable workload at Pearl Harbor was not substantial.

Planning of the Puget Sound Naval Shipyard Mission-funded Prototype

The condition that the DON cannot support the decision to transition the shipyards and intermediate maintenance facilities to mission funding occurred because the DON did not properly plan the transition of the shipyards and intermediate maintenance facilities to mission funding.

Metrics and Goals Policies and Procedures. The DON did not establish standard policies or procedures for reporting mission-funded metrics and goals. Specifically, the DON did not establish any standard policies or procedures for

[7] The Shipbuilding and Conversion, Navy appropriation finances the construction of new ships and conversion of existing ships, including all hull, mechanical and electrical equipment, electronics, guns, torpedo and missile launching systems, and communications systems.

[8] The term engineered refueling overhaul availability describes or identifies differences in fundamental planning and execution among overhaul availabilities of different nuclear powered ship classes during which the reactor is also refueled. An overhaul is a major availability usually exceeding 6-months duration for the accomplishment of maintenance and modernization.

the preparation of the mission-funded metrics and goals or the capture of documentation to support reported amounts. Standard policies and procedures would provide reliability of the quarterly mission-funded metrics and goals by eliminating inconsistencies and unsupported costs.

Transition of Puget Sound to Mission Funding. The DON did not properly plan for the transition of Puget Sound to mission funding because it relied on the planning for the Pearl Harbor pilot program. The DON stated it was not necessary to establish a new test plan or other planning documentation because it was not required, it would create a financial burden, and the lessons learned from Pearl Harbor could be used at Puget Sound. However, the DON did not have any evaluation factors in place to adequately measure the transition to mission funding. The DON, OUSD (Comptroller)/CFO, and OUSD (AT&L) should jointly establish new metrics and goals that evaluate the impacts of mission funding on the consolidated activity in order to provide a mechanism for evaluating productivity and performance.

Operational and Financial Reporting Guidance. The DON did not develop new guidance or update existing guidance related to operational and financial reporting requirements for the consolidated activities prior to the transition to mission funding. COMPACFLT and NAVSEA did not issue an instruction in accordance with the May 5, 2003, Puget Sound Memorandum of Agreement that defined processes and business practices required for the operations of the consolidated activity. This lack of guidance created confusion within the DON regarding what guidance to follow at the consolidated activities. For example, a Puget Sound representative indicated they used the DoD Financial Management Regulation; NAVSEA Instruction 7670.1, "Navy Industrial Fund Financial Management Systems and Procedures Manual;" and the Navy Comptroller Manual. NAVSEA indicated that only the DoD Financial Management Regulation was used and did not provide the NAVSEA instruction for our review. However, on April 21, 2005, 8 years after the consolidation of the first naval shipyard and intermediate maintenance facility, NAVSEA requested that the consolidated activities provide comments on NAVSEA Instruction 7670.1, Chapter 4, Section 2, "Uniform Costing Policies and Procedures for Naval Shipyards" to reflect the changes since the transition of the shipyards to mission funding.

The DON representatives stated that there was no change in cost visibility at the consolidated activities after transitioning to mission funding. However, the activity was no longer required to report cost in accordance with WCF procedures. The Navy did not identify the requirement to collect financial information at the consolidated activities to report the full cost of operations. The DON attempted to establish the virtual 1307 as a reporting requirement to capture the full cost of the consolidated activities after transitioning to mission funding. However, OUSD (AT&L), OUSD (Comptroller)/CFO, NAVSEA, Puget Sound, and Pearl Harbor representatives said they did not use the virtual 1307 report because either it did not provide the necessary information required for management of the activity or the information was not reliable. The consolidated activity representatives indicated that the lack of guidance led to an excessive amount of time spent working on ad hoc reports and data calls, and information requirements were evolving as decision makers identified what data they needed.

The DON did not identify the requirement to routinely accumulate financial information to support the consolidated activity's operations and decision making. Specifically, the DON had not identified the requirement to collect cost information at the consolidated activity to comply with Statement of Federal Financial Accounting Standard No. 4. For example, the DON did not routinely accumulate the total funding received and used during each fiscal year to identify the total amount of resources required for operation of the consolidated activity. In addition, the DON did not routinely accumulate cost data required to establish rates to charge non-DoD reimbursable customers of the consolidated activity.

Business Practices at the Consolidated Activities. The DON had not updated or changed its Memorandum of Agreement to reflect the change in business practice to fund the Engineered Refueling Overhaul projects incrementally, using Economy Act orders rather than fully funded project orders. Guidance indicates that the consolidated activity can continue to reimbursably fund work that is not COMPACFLT funded with the use of a project order. However, according to Pearl Harbor and Puget Sound representatives, the consolidated activities use incrementally funded Economy Act orders for the Engineered Refueling Overhaul projects. The DON indicated that this change in business practice was required because project orders could no longer be used at the consolidated activities, and Economy Act orders provided the customer with better cost control. The audit team could find no written policy to support DON using incremental funding for the Engineered Refueling Overhaul projects or to substantiate the claims of better cost control.

Information Technology Systems. The DON did not address information technology issues at Puget Sound prior to the consolidated activity's transition to mission funding. After Puget Sound transitioned to mission funding, information technology issues arose that had not been encountered at Pearl Harbor. At Pearl Harbor, a new module of the Advanced Industrial Management system was created, the Advanced Industrial Management-Express, in order to accommodate mission funding and the functionalities at both the intermediate and depot-level maintenance facilities. A Pearl Harbor representative stated that the DON planned to use this system at future consolidated shipyard activities despite comments made in the Pearl Harbor Regional Maintenance Pilot – Lessons Learned report, June 9, 2000. The report stated:

> Although the current [accounting information system] suite in use for the Pilot is performing adequately, it is not user friendly and it should not be assumed or concluded that this suite can be exported for use in other regions. Such things as differences in operational processes, differing product lines, differing legacy systems, and customization of "standard" systems make it necessary to take each region's needs and requirements into consideration in the development of [accounting information system] merger and transition plans. However, this does not preclude [accounting information system] standardization or uniformity among regions --- the point to be made is that the current Pilot suite does not provide full functionality for all regions and it is not a fully integrated software solution.

The DON did not incorporate this lesson learned into the planning for the Puget Sound prototype and realized after the Puget Sound transition that Advanced Industrial Management-Express would not work at Puget Sound because of differing product lines and information requirements. Puget Sound continues to use two information systems and incur the costs—approximately $2.2 million to date—associated with necessary system changes and interfaces.

Operating Efficiency of Puget Sound

As a result, we are unable to determine the effectiveness of the transition of Puget Sound to mission funding. In the past, the WCF has been the funding structure at industrial activities, which include the naval shipyards, and all of the regulations and policies associated with those activities were WCF-related. Because the DON did not set measurable goals and adequately define cost requirements, the merits or the drawbacks of mission funding at an industrial activity cannot be validated and the reliability of the data produced under this structure is in question. While it appears that there are some benefits to mission funding, such as the flexibility to move the workforce between the naval shipyard and maintenance activities, the audit team could not substantiate these claims. Defining requirements and establishing new metrics and goals associated with the transition to mission funding will help the DON, OUSD (Comptroller)/CFO, OUSD (AT&L), and the consolidated shipyards measure the success of the Puget Sound mission-funded prototype and better manage the day-to-day operations of a mission-funded activity.

Management Comments on the Finding and Audit Response

DON Comments. The DON disagreed that the DON cannot support the decision to transition the shipyards and intermediate maintenance facilities to mission funding. The DON stated that the report was flawed because it suggested that the effectiveness of the financing methodology will determine the success of the DON ship maintenance program. However, the DON indicated that funding methodologies facilitate efficiency and effectiveness and add neutral value to operating efficiency. The DON also stated the report incorrectly opined that the purpose of the goals and metrics was to evaluate the effect of the transition to mission funding. Rather, the DON stated that the objective of the goals and metrics was to demonstrate that the DON could retain total cost visibility and performance accountability under mission funding, as required by PBD 700C. The DON indicated that the experience at Pearl Harbor and Puget Sound had demonstrated the ability to manage an integrated depot under mission funding. As the Fleets move to consolidate waterfront support, mission funding was considered to be an important element in achieving an effective, efficient, and agile organic ship repair capability. The DON position remained that the One Shipyard concept required the use of one financial system in order to facilitate standardization, transparency, and the development of consistent metrics.

Audit Response. As part of the request from the OUSD (Comptroller)/CFO office, we were tasked to look at the change from the working capital fund to mission funding at the shipyards, as well as the existing goals and metrics based on PBD 700C. Therefore, we did not base our decision solely on the intent of PBD 700C. We agree that PBD 700C stated that the DON, OUSD (Comptroller)/CFO, and USD (AT&L) develop criteria for the pilot that retain total cost visibility and performance accountability under mission funding. Our determination that the DON cannot support the decision to transition the shipyards and intermediate maintenance facilities to mission funding was based on the following issues discussed in the report.

- The DON did not establish standard policies or procedures for reporting mission-funded metrics and goals.

- Both the Pearl Harbor pilot and the Puget Sound prototype metrics and goals have been focused on the consolidation of the activities without determining the effectiveness of mission funding.

- The DON did not develop new guidance or update existing guidance related to operational and financial reporting requirements for the mission-funded consolidated activities.

As stated in the report, the DON consistently claims that the same cost visibility is maintained within the mission-funded shipyard activities. However, mission-funded shipyard activities cannot replicate financial reports that were produced for working capital funded shipyard activities. Additionally, the DON has continually claimed that mission funding is the more effective funding methodology. When asked to substantiate this claim of improved effectiveness, the DON was unable to demonstrate that mission funding was more effective. The Navy needs to develop metrics that evaluate the effectiveness of the activities' transition to mission funding before it transitions the remaining shipyard activities.

Recommendations, Management Comments, and Audit Response

Revised Recommendations. As a result of management comments, recommendation A.2. has been revised to add the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller), Office of Budget as a responder to the recommendation. The revision was the result of management comments on the draft of this report.

A.1. We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer continue the Puget Sound Naval Shipyard mission-funded prototype and do not transfer the remaining public shipyards from the Working Capital Fund until recommendations A.2. through A.4. are implemented.

OUSD (Comptroller)/CFO Comments. The OUSD (Comptroller)/CFO did not provide comments on the draft of this report. We request that the OUSD (Comptroller)/CFO provide comments in response to the final report.

Unsolicited DON Comments. The DON stated that the prototype has been a success and mission funding should remain permanent. The DON indicated that full implementation of the transition should proceed and the DON will remain committed to resolving issues after the permanent transition.

Audit Response. Although not required to comment, the DON commented on this recommendation. We believe that the decision to transition the remaining shipyards remains premature. The DON has not collected the information necessary to determine the success of the transition. Additionally, if the remaining shipyards are allowed to transition prior to resolving the identified issues, the issues may be compounded and may result in more problems in the long term.

A.2. We recommend that the Under Secretary of Defense for Acquisition, Technology, and Logistics; Under Secretary of Defense (Comptroller)/Chief Financial Officer; Under Secretary of the Navy (Financial Management and Comptroller), Office of Budget; and the Deputy Chief of Naval Operations (Logistics), Fleet Readiness Division jointly establish metrics and goals and baseline these metrics to evaluate the Puget Sound Naval Shipyard and Intermediate Maintenance Facility transition to mission funding.

OUSD (AT&L) Comments. The OUSD (AT&L) did not provide comments on the draft of this report. We request that the OUSD (AT&L) provide comments in response to the final report.

OUSD (Comptroller)/CFO Comments. The OUSD (Comptroller)/CFO did not provide comments on the draft of this report. We request that the OUSD (Comptroller)/CFO provide comments in response to the final report.

DON Comments. The DON nonconcurred and stated that the existing goals and metrics, established with representatives from OUSD (AT&L) and OUSD (Comptroller)/CFO staffs, comply with PBD 700C. Regardless, the DON agreed to continue to discuss goals and metrics that better demonstrate cost visibility and performance accountability. The DON requested that the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller), Office of Budget be required to respond to this recommendation.

Audit Response. The DON comments were not responsive to the recommendation. As stated earlier in the report, both the Pearl Harbor pilot and the Puget Sound prototype metrics and goals have focused on the consolidation of the activities without determining the effectiveness of mission funding. The DON needs to know the effectiveness of mission funding as compared with working capital fund financing prior to transitioning the remaining shipyards. An addressee was added to the recommendation based on management’s request. We request that the DON reconsider its position on the recommendation and provide comments on the final report.

A.3. We recommend that the Commander, Naval Sea Systems Command establish policies and procedures for mission-funded metrics and goals to ensure information is consistently collected and reported and supporting documentation is maintained to fully support reported results.

DON Comments. The DON concurred with the establishment of cascading metrics and the improvement of policies and procedures to ensure greater consistency and retention of supporting documentation.

Audit Response. The DON comments were partially responsive. The DON did not identify the proposed action(s) and completion date(s) related to the establishment of policies and procedures for the metrics and goals. We request the DON provide a plan of action with milestones in its comments on the final report for the establishment of metrics and improved procedures.

A.4. We recommend that the Commander, Naval Sea Systems Command and Commander, U.S. Pacific Fleet:

a. Jointly develop an instruction addressing the processes and business practices to be used at mission-funded shipyards.

b. Issue guidance to address routine financial reporting requirements and cost information accumulation requirements necessary for the operations of the consolidated activity.

c. Update existing reporting and cost guidance applicable to the consolidated activity to reflect changes since consolidating and transitioning the shipyards and intermediate maintenance facilities to mission funding.

d. Identify information technology system requirements for supporting the operations of all consolidated activities affected by the shipyard transition to mission funding in order to avoid costly manual workarounds and system bridges.

DON Comments. The DON nonconcurred with recommendations A.4.a., A.4.b., and A.4.c. because the issues presented were not unique to mission-funded activities but also applied to working capital funded activities. However, the DON indicated that they support improving top-down guidance, improving operating procedures, improving consistency of financial information, and ensuring compliance with fiscal policy. The DON concurred with recommendation A.4.d.

Audit Response. The DON comments were not responsive to recommendations A.4.a; A.4.b., and A.4.c. We agree that the same type of guidance and instructions are required for both mission-funded and working capital funded activities. The specific requirements addressed in the recommendations are specific to the mission-funded shipyards. The DON has not identified the cost and operational data required to be presented on a recurring basis to track the efficiency and effectiveness of the mission-funded shipyard, thereby lacking a means by which to measure performance. The DON consistently states that the same cost visibility is maintained within the mission-funded shipyard activities. However, mission-funded shipyard activities cannot replicate financial reports that were produced for working capital funded shipyard activities. We request that the DON reconsider its position on the recommendations and provide comments on the final report.

The DON response to recommendation A.4.d. was partially responsive. The DON agreed to address information technology system requirements. However, the DON did not identify the proposed action(s) and completion date(s). The need to properly plan and identify information system requirements prior to transitioning the remaining shipyard activities is crucial in order to avoid costly fixes and workarounds. We request the DON provide a plan of action with milestones in response to the final report for identifying information technology requirements.

Management Comments Required

In response to the final report, management is requested to provide additional comments on the recommendations. The comments should include elements marked with an X in Table 1.

Table 1. Management Comments Required

Recommendation	Organization	Concur/ Nonconcur	Proposed Action	Completion Date
A.1.	OUSD (Comptroller)/CFO	X	X	X
A.2.	USD(AT&L), OUSD (Comptroller)/CFO, DON	X	X	X
A.3.	DON		X	X
A.4.a., A.4.b., A.4.c.	DON	X	X	X
A.4.d.	DON		X	X

B. Internal Controls for Naval Shipyard Depot-Level Maintenance Reporting

DON officials did not fully comply with the Deputy Under Secretary of Defense for Logistics and Material Readiness (DUSD [L&MR]) guidance concerning depot-level maintenance reporting. This condition occurred because the Deputy Chief of Naval Operations (Logistics), Fleet Readiness Division (Fleet Readiness Division) used an algorithm to report depot-level maintenance when actual data was available. As a result, naval shipyard depot-level maintenance information included in maintenance reports to Congress may not be reliable.

Congressional Reporting Requirement

Section 2460, title 10, United States Code, January 6, 2003, (10 U.S.C. 2460) defines depot-level maintenance and repair to include material maintenance or repair requiring the overhaul, upgrading, or rebuilding of parts, assemblies, or subassemblies, and the testing and reclamation of equipment as necessary, regardless of the source of funds or the location at which the maintenance or repair is performed. Depot-level maintenance and repair does not include the procurement of major modifications or upgrades of weapon systems designed to improve program performance or the nuclear refueling of an aircraft carrier.

Section 2466, title 10, United States Code, January 6, 2003, (10 U.S.C. 2466) requires the DON to limit the amount of depot-level maintenance and repair workload performed by non-Federal Government personnel to no more than 50 percent of the total depot workload reported for the Department. Any funds that are not used for a contract are to be used for the performance of depot-level maintenance and repair workload by DoD employees. This requirement, known as the 50/50 report, includes reporting of depot-level maintenance performed at naval shipyards.

Public Law 108-375, section 321, "Simplification of Annual Reporting Requirements Concerning Funds Expended for Depot Maintenance and Repair Workloads," October 28, 2004, amended 10 U.S.C. 2466 to require one annual report from DoD containing the percentage of funds expended for depot-level maintenance during the preceding fiscal year and projected to be expended for the current and next fiscal year. In addition, the Comptroller General must submit a report that determines whether DoD complied with the 50 percent requirement for the preceding year and whether the expenditure projections for the current and future fiscal years are reasonable.

DoD Reporting Guidance

The Fleet Readiness Division did not fully comply with the DUSD (L&MR) memorandum, "Distribution of DoD Depot Maintenance Workloads," dated November 12, 2004. The DUSD (L&MR) memorandum implemented the DoD reporting requirements in accordance with 10 U.S.C. 2466. The memorandum requires the use of FY 2004 actual depot-level maintenance obligation data, but allows for the use of algorithms or estimation methods to determine the portion of depot-level maintenance and repair services established in contractor support contracts. However, each agency must maintain records that describe and explain any algorithms or estimation formulas used for depot-level maintenance reporting. The Fleet Readiness Division used an algorithm instead of available FY 2004 data and used it to estimate depot-level maintenance for work performed by DoD employees.

Documentation of DON Internal Policies and Procedures

The Fleet Readiness Division used an algorithm to report depot-level maintenance at the consolidated naval shipyard and intermediate maintenance facilities when actual data was available. After consolidating two naval shipyards and intermediate maintenance facilities, the Fleet Readiness Division directed the consolidated activities to use the Ship Maintenance Capability Plan Model (the model), or algorithm, to exclude the intermediate-level maintenance. The model calculates the percentage of depot-level maintenance based on a percentage of the total workload reported by the consolidated activity to determine the amount reported to Congress within the 50/50 report. However, according to a Fleet Readiness Division official, procedures for what information is included in the model and how the percentage is calculated for the 50/50 report is not documented.

According to Puget Sound and COMPACFLT representatives, actual data was available at Puget Sound to determine the amount of depot-level and intermediate-level maintenance performed during the fiscal year because separate systems were maintained at the shipyard and the intermediate maintenance facility after the consolidation. The Fleet Readiness Division was not aware that Puget Sound maintained actual depot-level maintenance data for use in the 50/50 report. We raised this issue with Fleet Readiness Division officials, who acknowledged it as a weakness and took corrective actions to discontinue the use of the algorithm when actual data is available. Therefore, we are making no recommendations concerning the use of algorithms at Puget Sound.

The Fleet Readiness Division used the algorithm to report depot-level maintenance at Pearl Harbor for the FY 2005 report to Congress. However, Pearl Harbor representatives stated that they also were able to provide actual data on depot-level maintenance performed at their facility. They can review each maintenance project customer order acceptance record to determine whether each project should be classified as intermediate or depot-level maintenance. The Fleet Readiness Division felt the data they received from Pearl Harbor using this methodology was not accurate and elected to instead use the algorithm to estimate the amount of total depot-level maintenance performed at the shipyard and intermediate maintenance facility. However, that use of the algorithm does not comply with the DUSD (L&MR) memorandum. The algorithm is to be used to determine the portion of depot-level maintenance and repair services established in contractor support contracts only when actual data is not available. In order to comply with the requirements set forth by the November 2004 DUSD (L&MR)

guidance, the Fleet Readiness Division should not use an algorithm to support the amount of depot-level maintenance performed by DoD employees, but should use actual obligation data.

Table 2. shows the FY 2004 total COMPACFLT-funded depot-level maintenance performed at Puget Sound and Pearl Harbor. The different calculations include the amounts reported by the consolidated activities to COMPACFLT, revisions to those amounts made by COMPACFLT based on DUSD (L&MR) and DON guidance, and the amounts included within the 50/50 report to Congress by the Fleet Readiness Division.

Table 2. Depot-Level Workload Reported for Pearl Harbor and Puget Sound for FY 2004

(dollars in thousands)

Shipyard	Shipyard Calculation	COMPACFLT Calculation	Report to Congress
Puget Sound	$326,768	$344,600	$411,200
Pearl Harbor	188,134	197,900	282,800

While we did not validate any of the amounts included in Table 2., the significant differences in total workload amounts indicate that what is reported to Congress may not be a precise measure of the amount of depot-level work performed at the consolidated activities. Both the GAO and the Naval Audit Service (NAS) are reviewing the accuracy of the information provided by the DON for the 50/50 report.

Reliability of Shipyard Data

As a result, internal and external depot-level maintenance reports prepared for Congress may not reliable. The quality of the data is essential because these reports are used to address Congressional concern for the amount of depot-level maintenance by non-Federal personnel within DoD, including the shipyards. The use of actual obligation data will comply with the guidance published by DUSD (L&MR) and assist the DON efforts to ensure data integrity and reliability.

Recommendation

B.1. We recommend that the Deputy Chief of Naval Operations (Logistics), Fleet Readiness Division use actual obligation data to determine the amount of depot-level maintenance performed by the naval shipyards and to report that data in the Distribution of DoD Depot Maintenance Workloads report for FY 2005 and future workload reports.

Management Comments Required

The Deputy Chief of Naval Operations (Logistics), Fleet Readiness Division did not comment on the draft of this report. We request that the Deputy Chief of Naval Operations (Logistics), Fleet Readiness Division provide comments on the final report.

Appendix A. Scope and Methodology

To review the Puget Sound mission-funded prototype, we evaluated the established metrics and goals, the development of shipyard rates, and the reporting of the Distribution of DoD Depot Maintenance Workloads report issued to Congress. Specifically, we met with representatives from the OUSD (AT&L), OUSD (Comptroller)/CFO, Assistant Secretary of the Navy (Financial Management and Budget), the Fleet Readiness Division, NAVSEA, COMPACFLT, Puget Sound, Pearl Harbor, Defense Finance and Accounting Service Cleveland, GAO, and NAS. We reviewed documentation dated from September 23, 1997, to April 21, 2005. We performed this audit from January 2005 through June 2005 in accordance with generally accepted government auditing standards. Our review did not include a review of the management control program because it was not a stated audit objective.

To accomplish the audit objectives, we reviewed the following:

- FY 2004 and first quarter FY 2005 quarterly metrics and goals and the related supporting documentation for the FY 2004 metrics and goals, Pearl Harbor Pilot Study, Pearl Harbor Regional Maintenance Pilot Report to Congress and Lessons Learned, and the GAO recommendations to Pearl Harbor. These documents were reviewed to evaluate the established Puget Sound mission-funded prototype metrics and goals.

- Applicable laws and regulations to include Statement of Federal Financial Accounting Standards No. 4; the Arms Export Control Act (Public Law 90-269); Department of Defense Financial Management Regulation Volume 11A, Chapter 1; Department of Defense Financial Management Regulation Volume 11A, Chapter 2; and NAVSEA Instruction 7670.1, Chapter 4, Section 2. Additionally, we reviewed project orders and work orders for different types of customers, Memoranda of Agreement between COMPACFLT and NAVSEA for the consolidation of the naval shipyards and intermediate maintenance facilities, the Concept of Operations for Integrating Intermediate and Depot Maintenance Activities, and various cost data and reports for Puget Sound provided by NAVSEA at our request. These documents were reviewed to determine the rate mission-funded shipyards are required to charge reimbursable customers.

- Depot-level maintenance documents including: applicable laws and regulations for reporting depot-level maintenance data, to include 10 U.S.C. sections 2460 and 2466; DoD Depot Maintenance Workload Distribution Reports; GAO reports that reviewed DoD Depot Maintenance Workload Distribution data; and documentation provided by the Fleet Readiness Division and Puget Sound relating to depot-level maintenance distribution data and processes. The audit team did not validate the amounts reported in the 50/50 report to Congress, but instead reviewed documentation to develop an understanding of how depot-level maintenance workload data are compiled for Puget Sound and how the transition to mission funding would affect the compilation and reporting process.

Use of Computer-Processed Data. We did not evaluate the general and application controls related to the accounting system, Standard Accounting and Reporting System-Field Level that processes data for the virtual 1307 report, or the Logistics Data System, COST, and Department of the Navy Industrial Budget Information System, which process data for shipyard costs. We did not evaluate the controls because the information was only used to develop an understanding of the processes in the areas of shipyard rate development and the establishment of metrics and goals. Therefore, the results of the audit were not affected by not evaluating the controls.

GAO High-Risk Area. The GAO has identified several high-risk areas in DoD. This report provides coverage of the DoD Financial Management high-risk area.

Appendix B. Prior Coverage

During the last 5 years, GAO and the NAS have issued 12 reports discussing the transition of Naval Shipyards to mission funding and depot-level reporting. Unrestricted GAO reports can be accessed over the internet at http://www.gao.gov. Unrestricted NAS reports can be accessed at http://www.hq.navy.mil/NavalAudit/.

GAO

GAO Report 04-871, "DEPOT MAINTENANCE: DOD Needs Plan to Ensure Compliance with Public and Private-Sector Funding Allocation," September 29, 2004

GAO Report 03-1023, "DEPOT MAINTENANCE: DOD's 50-50 Reporting Should Be Streamlined," September 15, 2003

GAO Report 03-16, "DEPOT MAINTENANCE: Change in Reporting Practices and Requirements Could Enhance Congressional Oversight," October 18, 2002

GAO Report 02-95, "DEPOT MAINTENANCE: Management Attention Required to Further Improve Workload Allocation Data," November 9, 2001

GAO Report 01-19, "DEPOT MAINTENANCE: Key Financial Issues for Consolidations at Pearl Harbor and Elsewhere Are Still Unresolved," January 22, 2001

GAO Report 00-193, "DEPOT MAINTENANCE: Action Needed to Avoid Exceeding Ceiling on Contract Workloads," August 24, 2000

GAO Report 00-69, "DEPOT MAINTENANCE: Future Year Estimates of Public and Private Workloads Are Likely to Change," March 1, 2000

Navy

NAS Report N2005-0010, "The Department of the Navy's Reporting of Depot Maintenance Workload Allocation Between Public and Private Sectors," November 16, 2004

NAS Report N2003-0082, "Reporting of Depot Maintenance Workload Allocation Between Public and Private Sectors," September 5, 2003

NAS Report N2003-0019, "Shipyard Management Information System," December 9, 2002

NAS Report N2001-0010, “Fiscal Year 2000 Naval Shipyard Financial Accounting Performed by Defense Finance and Accounting Service Norfolk,” February 6, 2001

NAS Report N2000-0035, “Allocation of Depot Maintenance Workload Between Public and Private Sectors,” August 10, 2000

Appendix C. OUSD (Comptroller)/CFO Request

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

COMPTROLLER

(Program/Budget)

JAN 12 2005

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DEPUTY INSPECTOR GENERAL FOR AUDITING)

SUBJECT: Request for Independent Management Review (Puget Sound Naval Shipyard Mission-funded Prototype)

The Navy received approval in Program Budget Decision (PBD) 700C, Navy Amended Budget Estimates Submission, dated January 7, 2003, to implement a 2-year pilot program test to mission fund the Puget Sound Naval Shipyard in FY 2004 and FY 2005. With just three quarters of FY 2004 data, the Navy proposed transferring its remaining public shipyards from the Navy Working Capital Fund (NWCF) beginning in FY 2006. Moving the public shipyards out of the NWCF without an adequate evaluation of the Puget Sound prototype is premature because this is a significant change for the Department's management of industrial depot activities. Recognizing there are pros and cons to both NWCF and mission funding for these activities, an independent assessment of Puget Sound to include shipyard rate building, metrics, effects on congressional reporting, and budgetary impacts would provide the Department a better basis for this decision.

In PBD 702, Navy Budget Issues, dated November 29, 2004, the USD Comptroller directed the Navy to keep the Portsmouth and Norfolk Naval Shipyards in the NWCF and continue the mission-funded prototype program at the Puget Sound Naval Shipyard pending an independent assessment (management review) from the DoD Inspector General (DoDIG) by June 30, 2005.

The Department has now finalized the budget decisions for FY 2006 and our respective staffs have already been sharing background information to implement this management review. Request the DoDIG take action to conduct the independent assessment of the Puget Sound Naval Shipyard mission-funded prototype as directed in PBD 702 so that the USD Comptroller, USD Acquisition, Technology, and Logistics, and Navy staffs will be able to evaluate the report prior to final decisions on the FY 2007 President's Budget. The OUSD (C) point of contact is Mr. Tom Meredith, Revolving Funds Directorate, (703) 614-5789, Thomas.Meredith@osd.mil.

John P. Roth
Deputy Comptroller (P/B)

cc: Department of Defense Inspector General (Assistant Inspector General, Defense Financial Auditing Service)

Final Report Reference

Appendix D. DON Comments on the Draft Report

THE ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON, DC 20350-1000

20 October 2005

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Review of Draft Report on Puget Sound Naval Shipyard Mission-Funded Prototype (Project No. D2005-D000FC-0116.000)

Reference: (a) OASN (FM&C) memo of 10 June 2005

Thank you for the opportunity to comment on the DRAFT report on the Puget Sound Naval Shipyard Mission-funded Prototype. As stated in reference (a), * we disagree with the report's conclusion that the Department of the Navy cannot support the decision to transition the shipyards and intermediate maintenance facilities to mission funding. Although not restated in their entirety here, the comments provided in reference (a) * still apply and should be considered prior to final publication of the report.

The current DRAFT report, while acknowledging our previous comments, states, "...Representations made by management regarding the effectiveness of mission funding were not substantiated. The Department of the Navy needs to know the effectiveness of mission funding as compared with working capital fund financing prior to transitioning the remaining shipyards." We believe these statements reflect not only a fundamental misunderstanding of the Department's rationale for the merger of intermediate and depot maintenance activities, but also mischaracterize the information and discussion exchanged during the review.

__Effectiveness of Mission Funding__: Operational effectiveness and fiscal solvency are key to the successful execution of every function performed in the Department, regardless of the financing source. Funding methodologies facilitate efficiency and effectiveness, but may not generate improved operational performance. Management practices do. We believe the report is flawed because it suggests that the effectiveness of the financing methodology will determine the success of the Navy's ship maintenance program. In fact, as in the private sector, financing mechanisms are value neutral to operating efficiency. Successful ship maintenance is a derivative of many factors, including sound operational decisions, flexible and responsive organizational structures, and good business and financial practices. When combined, these attributes optimize program management and produce positive results, regardless of the financing methodology employed. The Department's position continues to be that the primary advantage of mission funding the shipyards is that it best supports the Fleet Response Plan (FRP) by allowing Fleet Commanders as opposed to Fleet support activities to control priorities. This benefit is not always visible in an accounting report nor does it fit neatly into a metric that can be compared in "before and after" snapshots, as implied by the report. We believe this fundamental difference in management perspective must be recognized.

* Reference a. is in Appendix E.

SUBJECT: Review of Draft Report on Puget Sound Naval Shipyard Mission-Funded Prototype (Project No. D2005-D000FC-0116.000)

Metrics and Goals: Of equal concern are the report's conclusions about the metrics and goals established for the Puget Sound Mission-funded Prototype. The report incorrectly opines that the purpose was to evaluate the effect of the transition to mission funding.

The purpose of the prototype was not to evaluate the effectiveness of mission funding versus the working capital fund. Rather, the objective was to demonstrate that the Department of the Navy could retain total cost visibility and performance accountability under mission funding. This distinction is important. The objectives of the prototype criteria are clearly stated in Program Budget Decision (PBD) 700C, Navy Amended Budget Estimates Submission, of 7 January 2003. The existing metrics and goals comply with this direction.

Purpose of Mission Funding Ship Maintenance: The FRP requires agility in workforce management supported by effective financial systems. To achieve optimal success, the Fleet must be able to quickly and efficiently reallocate funding to ships that are required to surge and integrate the application of all available resources while properly accounting for resource use. Subsequent to an emergent surge and sortie, industrial resources will remain available. These organic resources should be effectively applied to reprioritized and necessary ship work. Mission funding supports full utilization of organic industrial capacity on a daily basis in a dynamic environment. The FRP requires a transformed and innovative approach to ship maintenance. Experience at Pearl Harbor and Puget Sound has demonstrated the ability to manage an integrated depot under mission funding. As the Fleets move to consolidate waterfront support, mission funding is considered to be an important element in achieving an effective, efficient, and agile organic ship repair capability. We believe the flexibility to assign resources combined with the cost visibility available in management information systems provides the most effective management framework to meet ship maintenance requirements.

Necessity for One Financial Process: The One Shipyard concept is critical to the overall success and efficiency of the Naval Shipyards. It is imperative that the Navy be able to manage the shipyards with one financial system to allow for standardization, transparency and development of comparable metrics. Additionally, as the Intermediate and Depot level work in the Regional Maintenance Centers begins to merge, it is important that those financial systems be the same. Under the One Shipyard model, personnel with critical skills and capabilities are shared across geographically dispersed locations to support the schedule to meet critical Fleet Readiness requirements. In FY 2005, this was demonstrated on several occasions with numerous availabilities (USS GEORGE WASHINGTON, USS JOHN F. KENNEDY decommissioning decision, and USS SAN FRANCISCO and USS HARTFORD). In each of these cases, the use of different financial systems was a hindrance to effective shipyard management. At this critical juncture, the Navy must move forward with one financial process for the shipyard maintenance community.

DoDIG Recommendations:

A.1. DoDIG recommends that the Under Secretary of Defense (Comptroller)/Chief Financial Officer continue the Puget Sound Naval Shipyard mission-funded prototype and not transfer the

Final Report
Reference

SUBJECT: Review of Draft Report on Puget Sound Naval Shipyard Mission-Funded Prototype
(Project No. D2005-D000FC-0116.000)

remaining public shipyards from the Working Capital Fund until recommendations A.2 through A.4 are implemented.

Response – A.1: We believe the Puget Sound Naval Shipyard mission-funded prototype has been a success and mission funding should be made permanent. The Chief of Naval Operations recently recommended to the Deputy Secretary of Defense that we move from further debate over this initiative and focus on achieving full implementation. We are committed to resolving remaining concerns and hope to achieve the benefits of this significant management initiative, consistent with Congressional direction on this issue.

A.2. DoDIG recommends that the Under Secretary of Defense for Acquisition, Technology, and Logistics; Under Secretary of Defense (Comptroller)/Chief Financial Officer; and the Deputy Chief of Naval Operations (Logistics), Fleet Readiness Division jointly establish metrics and goals and baseline these metrics to evaluate the Puget Sound Naval Shipyard and Intermediate Maintenance Facility transition to mission funding.

Response – A.2: We believe existing goals and metrics, established with representatives from the OUSD (AT&L) and OUSD(C) staffs, comply with PBD 700C direction. This issue notwithstanding, we agree to continued dialogue on metrics and goals that may better demonstrate the ability to retain total cost visibility and performance accountability.

Technical Correction: The Office of Budget was omitted from the list of participants for this recommendation. As the principal liaison for this study and a participant in much of the dialogue pertaining to mission funding issues (and associated financial implications), our participation in future discussions is necessary. Accordingly, the Office of the Assistant Secretary of the Navy (Financial Management & Comptroller), Office of Budget should be added as a participant to Recommendation A.2. Revised

A.3. DoDIG recommends that the Commander, Naval Sea Systems Command establish policies and procedures for mission-funded metrics and goals to ensure information is consistently collected and reported and supporting documentation is maintained to full support reported results.

Response - A.3: Concur with the establishment of cascading metrics and improvements to policies and procedures that will ensure greater consistency in reported data and retention of supporting documentation.

A.4. DoDIG recommends that the Commander, Naval Sea Systems Command and Commander, U.S. Pacific Fleet:

a. Jointly develop an instruction addressing the processes and business practices to be used at mission-funded shipyards.

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SUBJECT: Review of Draft Report on Puget Sound Naval Shipyard Mission-Funded Prototype (Project No. D2005-D000FC-0116.000)

b. Issue guidance to address routine financial reporting requirements and cost information accumulation requirements necessary for the operations of the consolidated activity.

c. Update existing reporting and cost guidance applicable to the consolidated activity to reflect changes since consolidating and transitioning the shipyards and intermediate maintenance facilities to mission funding.

d. Identify information technology (IT) system requirements for supporting the operations of all consolidated activities affected by the shipyard transition to mission funding in order to avoid costly manual workarounds and systems bridges.

Response – A.4: We support improvements in top-down guidance, strengthening internal operating procedures, improving the consistency of reported information, and ensuring compliance with fiscal policy. These positions are not unique to this situation and are equally applicable to mission-funded activities as well as those in the Navy Working Capital Fund. Lastly, we agree with the recommendation to identify information technology system requirements in order to avoid costly manual workarounds and systems bridges.

The OASN (FM&C) point of contact in this matter is Ms. Karen Waide (FMB-413) who can be reached at (703) 692-4832 or (karen.waide@navy.mil).

Richard Greco, Jr.

Richard Greco, Jr.

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Appendix E. DON Comments on the Discussion Draft of this Report

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON, D.C. 20350-1000

JUN 1 0 2005

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Review of Discussion DRAFT of a Proposed Report Project No. D2005-D000FC-0116 Puget Sound Naval Shipyard Mission-funded Prototype

We appreciate the opportunity to comment on the discussion draft report on the Puget Sound Naval Shipyard Mission-funded Prototype and look forward to providing additional written comments upon publication of the official draft report.

Summary: The report concludes that the Department of the Navy (DON) cannot support the decision to transition the shipyards and intermediate maintenance facilities to mission funding because the DON did not properly plan for the transition. We disagree with this conclusion. The report incorrectly assumes that the "purpose of the metrics and goals was to evaluate the mission funded program and evaluate the transition from the working capital fund". The purpose of the metrics and goals, as approved in Program Budget Decision (PBD) 700C, Navy Amended Budget Estimates Submission, of 7 January 2003 was to enable the shipyard pilot to "retain total cost visibility and performance accountability under mission funding". We believe the existing metrics and goals comply with this direction and that all discussion in the draft report concerning metrics should be revised to be consistent with the PBD.

Background: The rationale for mission-funding shipyards has always been the operational need to size and shape maintenance infrastructure to meet maintenance needs of the Fleet. Planning began during the 1990s when it became apparent that ship maintenance organizational structures had not kept pace with the evolution in the size and shape of Navy forces. The solution, outlined in the Chief of Naval Operations Regional Maintenance Plan of March 1994, included integration of intermediate and depot (I&D) maintenance activities.

A consequence of the I&D merger was the need to assess the best financial methodology with which to operate the combined operation. The Navy concluded that mission funding provided the best mechanism to match workforce skills with workload priorities and meet fiduciary responsibilities. The first merger of intermediate and depot maintenance activities occurred at Pearl Harbor beginning in FY 1998. As noted above, our second opportunity came with publication of PBD 700C, when OSD approved another two-year NSY & IMF mission funded pilot.

Current Status: The Puget Sound mission-funded prototype reflects the cumulative lessons learned from more than seven years of merged operations, however we acknowledge that there are areas that can be improved. The Department is committed

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to improving top-down guidance, strengthening internal operating procedures, and ensuring compliance with fiscal policy.

Metrics and Goals Reliability: The report states the Department did not establish overall policies or procedures for the reporting of the mission funded metrics and goals, thereby creating inconsistencies in actual reporting and limiting the reliability of reported amounts.

Response: The Department did provide guidance for the financial transition of Puget Sound Naval Shipyard (PSNSY) from the Navy Working Capital Fund (NWCF) to mission funding and for preparing mission funded reporting requirements. This guidance is contained in the 5 May 2003 Memorandum of Agreement (MOA) between COMPACFLT and COMNAVSEA, subject: Consolidation of Puget Sound Naval Shipyard and Naval Intermediate Maintenance Facility, Pacific Northwest and in the 10 November 2003 OASN(FM&C) memorandum, subject: Mission Funded Naval Shipyard Metrics. Specifically, the MOA required that "financial accounting procedures shall be established to continue tracking and reporting to ensure the same level of cost visibility as existed under NWCF". However, the Department has no objection to developing more detailed guidance for the collection and reporting of future quarterly metric and performance goal data and for retaining the required supporting documentation.

Additionally, we acknowledge some reporting inconsistencies during FY 2004 due to the normal learning curve that is encountered during organizational transition. This is not an impediment to mission funding. By FY 2004 year-end, improved operating procedures were in place, thus yielding greater standardization and consistency in the information being reported.

With regard to the report's assertion that "PSNS & IMF representatives could not support reported costs for the "Salaries and Wages-Civilian" line item" included on the Virtual 1307 report, Navy representatives did provide the IG team with hard copy reports from the STARS-FL system to support the civilian labor information reported on the Virtual 1307. We believe that it isn't necessary to actually get online and access the STARS-FL system in order to validate the data in the virtual 1307 since this is beyond the scope of the assessment. However, we acknowledge that better on-line financial query capabilities could offer additional benefits for internal and external management and reporting purposes.

Concerning the criticism leveled at the reporting of maintenance deficiencies, we believe that the report is misleading because it neglects to acknowledge that the change in reporting methodology had zero impact on the real substance of the deficiency reports. The same number of deficiencies, including the individual hull level data, would have existed under either methodology.

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Consolidation of Activities and Impacts of Mission Funding: The report states that the Department did not properly plan for the transition of Puget Sound Naval Shipyard & Intermediate Maintenance Facility (PSNSY & IMF) because we relied on the planning for the Pearl Harbor Naval Shipyard (PHNSY) & IMF pilot. The report also states that the DON did not have any evaluation factors in place to adequately measure the transition from the NWCF to mission funding.

Response: PBD 700C approved the two-year NSY & IMF mission funded pilot and established the pilot's ground-rules. In accordance with PBD direction, the Department worked with the Under Secretary of Defense (Comptroller) and the Under Secretary of Defense (Acquisition, Technology, and Logistics) to develop criteria for the pilot that would retain total cost visibility and performance accountability. PBD 700C did not require further validation of the consolidated ship maintenance activity concept, nor did it require metrics to measure the transition from the NWCF to mission funding. The existing metrics, designed to demonstrate cost visibility and performance accountability, are in compliance with OSD direction. The current metrics are:

Ship Availability Schedule
Virtual 1307 Funding Profile
Guarantee Work Metric
Customer Satisfaction Metric

Management Reports and Financial Data Accumulation: The report states that cost information wasn't collected to establish an overhead rate to charge non-DoD customers for work performed by PSNSY & IMF. The report also states that the DON did not develop guidance or update existing guidance related to operational and financial reporting requirements for the consolidated activity prior to the transition to mission funding. This lack of guidance created confusion at the consolidated activities.

Response: The Department agrees with the need to review existing guidance to evaluate its applicability and adequacy at consolidated NSY & IMF activities. Where appropriate, we will establish standard operating procedures at consolidated maintenance activities. The Department also agrees to review on-going practices at both PSNSY & IMF and PHNSY & IMF to ensure compliance with public law and Department of Defense (DoD) financial policies. However, the issue of non-DoD customer rates is not relevant to the scope of the audit. DoN activities routinely provide services to non-DoD parties such as visiting vessels and aircraft of foreign nations in compliance with extant policy and statute. Mission funded shipyards can accomplish the same task. Our understanding of the annual volume of non-DoD customer work at PSNSY & IMF is that it accounts for approximately $5 million out of an annual base of over $1 billion, which appears to be a minor amount and beyond the scope of the assessment focus.

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Business Practices at the Consolidated Activities: The report states that the DoN has not updated the MOA to reflect the change in business practices to fund Engineering Refueling Overhaul (ERO) projects.

Response: The Department agrees to review current business practices. If a change to the MOA is warranted, it will be revised.

Information Technology Systems: The report states that the DON did not address information technology (IT) issues at PSNSY & IMF prior to the transition to mission funding, thereby generating considerable manual effort and work-arounds.

Response: The Department acknowledges the fact that current practice requires manual effort. However, this situation is not unique to the mission funding of PSNSY & IMF and is not due to the limitations of prior planning. These IT issues would occur under NWCF or mission funding. Had the PSNSY & IMF pilot been funded in the NWCF, there would still be similar kinds of IT related issues because such transition problems and work-arounds will arise anytime that two diverse organizations are merged. Moreover, Congressional limitations on IT investments, the pilot nature of the effort, and the DON's long-term goal to utilize Enterprise Resource Planning technical solutions restricted the level of IT investment we were willing or able to make in this particular instance.

Internal Controls for Naval Shipyard Depot Level Maintenance Reporting: The report states that the DON is not fully compliant with the DoD guidance concerning depot level maintenance reporting. This condition occurred because the Navy uses an algorithm to report depot level maintenance even when actual data is available.

Response: The Department's current practice is to use actual obligation data when available and to utilize an algorithm in only those instances when actual depot level obligations cannot be determined. In the latter case, an algorithm based on the ship maintenance model is used. Based on conversations with IG team members and internal Navy discussions, we believe the Navy's current practice and capabilities may have been mischaracterized during IG site visits. We regret any misunderstanding that resulted. The existing practice, internally developed within the DON, has been briefed to representatives from DUSD(L&MR) and to members of the House Armed Services Committee, both of whom expressed support for this approach. Additionally, DUSD(L&MR) depot level reporting guidance states, "Military Services shall issue guidance, as necessary concerning consolidation of depot and non-depot work at individual locations". It does not specifically prohibit the use of algorithms or models.

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Additionally, the statement that "prior to consolidation of the naval shipyard depot and intermediate maintenance activities, each shipyard reported actual depot-level maintenance data" is technically inaccurate. The source of such data was not and is not (for those shipyards currently in the NWCF) the shipyard. Rather, the Fleet, NAVSEA, and other customers are the sources of the depot maintenance information referred to in this section of the report.

If you have any questions concerning our comments, my point of contact in this matter is Ms. Karen Waide, who may be reached at 703-692-4832.

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Appendix F. Report Distribution

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