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# NAVAL POSTGRADUATE SCHOOL

Monterey, California



## THESIS

PRACTICAL COMPTROLLERSHIP COURSE

by

John Robert Backus

March 1987

Thesis Co-advisors:

James R. Duke

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Practical Comptrollership Textbook

by

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Submitted in partial fulfillment of the  
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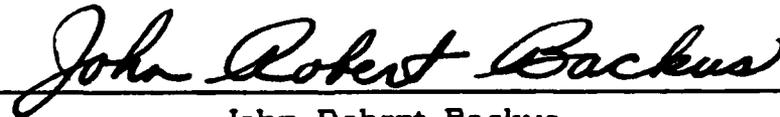
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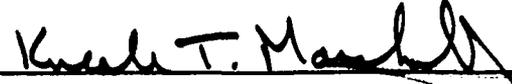
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## ABSTRACT

Legal and regulatory changes have made the 1981 edition of the Practical Comptrollership Course (PCC) Textbook obsolete. A new PCC Textbook was drafted under the hypothesis that it could be rewritten to improve the future performance of the military comptroller better than the 1981 edition. The hypothesis was tested by having a comptroller, a senior officer, an accounting professional, and several auditors compare the new PCC Textbook with the 1981 version, and their paradigms for comptrollership to determine if the new PCC Textbook might prepare comptrollers better. Research revealed that some characteristics of the new PCC Textbook were more likely to improve future comptrollership. Further, the research revealed differences in expectations between the accounting professional and the senior officer. Suggestions for improved research methods and salient topics for further research are offered. The new PCC Textbook is appended to the thesis.

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## I. INTRODUCTION

The purpose of this thesis is to evaluate a newly written Practical Comptrollership Course (PCC) Textbook, Appendix A. Research has been conducted to test whether Appendix A would improve the future performance of comptrollers better than the earlier Textbook. The PCC Textbook was evaluated by a practicing comptroller, an accounting professor, two auditors, and a senior officer. If these representatives determined that the new PCC Textbook was better, it would be considered approved for use.

Assuming the new PCC Textbook was, on the whole, considered better, the researcher hoped to identify specific chapters requiring further improvement. A secondary research question, then, was to identify chapters which could still be improved. These chapters are expected to be useful and interesting areas for research.

Aside from validating a new PCC Textbook, this research should yield insight into differing expectations of comptrollership. The evaluators are expected to focus on different aspects of comptrollership. This research identifies diverse opinions among professors, auditors, commanding officers, and comptrollers. The diversity, however, is not explained. These variations should suggest further research into both financial management and management behavior.

## A. BACKGROUND

The new PCC Textbook is intended for use in teaching two courses. As the title indicates, one is the *Practical Comptrollership Course*, offered at the Naval Postgraduate School. Students attending this course represent all Navy and Marine Corps claimants. A few students are new to the field of comptrollership. Many students, however, have significant financial management experience before attending the course.

The other course is *Financial Management in the Armed Forces* (MN 4154) offered to students at the Postgraduate School. Students in this course are a mix of Management and Computer Systems Management students. Some have financial experience ashore, some have financial experience afloat, and some have no financial experience.

The earlier textbook contains a large amount of useful information. Some parts, nonetheless, have become technically obsolete as a result of recently enacted Federal laws. Experienced students frequently identified errors and obsolete requirements which eroded course credibility. Moreover, the instructor and students felt that the earlier textbook did not sufficiently emphasize the managerial aspects of comptrollership.

## B. RESEARCH OBJECTIVE

The research objective was to determine if the new PCC Textbook is more likely to improve the performance of future comptrollers. The literature implies that while the comptroller is

an accountant, his accounting duties will absorb only a small part of his time. According to the literature, he should spend more time interpreting data (Jackson, 1949, pg. 23), communicating his findings to managers (Anderson *et al*, 1973, pg. 8), and influencing organizational decisions (Sathe, 1982, pg. 16). The new PCC Textbook attempts to emphasize the managerial functions. The research objective was to determine if experts in the field agree that these managerial tasks are more important than accounting skills, and if the new PCC Textbook communicates that emphasis adequately. This objective was then condensed to determining if the new PCC Textbook presented the material in a way that would result in students changing and improving the effectiveness of their work.

#### C. RESEARCH QUESTION

The logical research question was: Is it possible to rewrite the PCC Textbook so that it is more likely to improve the performance of future comptrollers? A subsidiary question is to identify chapters of the new PCC Textbook which still require improvement.

#### D. SCOPE, LIMITATIONS, AND ASSUMPTIONS

This study is comprised of opinions of a comptroller and those in the comptroller's immediate environment. The data collected will represent each person's opinion as refracted through the new PCC Textbook.

This effort should validate the new PCC Textbook. Because of the small samples involved, however, drawing further generalities

was not appropriate. With such small samples, individual biases will influence the results. Moreover, the sample includes personnel representing an educational activity. Although several evaluators have aviation, submarine, and headquarters staff experience, the sample does not include representatives currently assigned to supply support commands, the submarine force, the surface force, nor industrial facilities. Regardless of these sampling deficiencies, the results do suggest areas for further research.

A crucial assumption made in preparing the new PCC Textbook is that the student has at least some training or experience in financial management or accounting. That may include classroom training in accounting or several years' experience in a Comptroller Department. Given this assumption, the PCC Textbook does not include detailed accounting instruction. In any case, it is not plausible to believe that one could teach accounting in a two week course. The evaluators must assume that the prospective student is able to understand at least the principles of accounting.

#### E. SUMMARY OF FINDINGS

The evaluators found some aspects of the new PCC Textbook to be an improvement over the previously used Textbook. The research method, however, was time-consuming and proved to be clumsy because it required much work from the evaluator if he was not already familiar with the 1981 PCC Textbook. As a result, the researcher accepted open-ended comments from two evaluators. Another evaluator felt very strongly that it was

inappropriate to evaluate the PCC Textbook against the same standard for both the *Practical Comptrollership Course* and *Financial Management in the Armed Forces*. He requested and was granted permission to submit two evaluations. Thus, four evaluators submitted five standard responses. Two evaluators submitted only free-form comments.

Four of five evaluations reported the new PCC Textbook to be improved in readability and in presenting an appropriate level of material. Three of five evaluations reported that the new PCC Textbook developed comptroller skills and contributed to improving future comptrollership better than the earlier edition. Two evaluators found Chapter IVB, Budget Execution, to be a "good" chapter.

On the other hand, three of five evaluations reported that the new PCC Textbook did not define comptrollership better, nor present more useful material. One evaluator felt that the text required more practical examples. Another evaluator found that Chapter IV, Internal Control, required expansion.

In summary, the new PCC Textbook is recommended for use in teaching *Financial Management in the Armed Forces*. It may not be appropriate for teaching the *Practical Comptrollership Course* because the new PCC Textbook relies heavily on a background body of work developed in the the postgraduate financial management curriculum.

## F. ORGANIZATION OF STUDY

Chapter II includes the background and literature review. Chapter III discusses the research method and the rationale for selecting the proxy measures of effectiveness by which the new PCC Textbook was evaluated. The data is reported in Chapter IV. In Chapter V the data is analyzed. In Chapter VI, the data is evaluated and summarized. Finally, areas for additional research are recommended.

## II. BACKGROUND AND LITERATURE REVIEW

### A. BACKGROUND

#### 1. Management Viewpoint

As noted in the introduction, the purpose of this thesis is to evaluate a PCC Textbook which presents a different viewpoint from the earlier version of the textbook. The previous textbook focused on the job's technical nature. It encompassed the practical skills and procedures without addressing the managerial element as an integral part of the job.

Chester Barnard's ideas of the executive's "essential functions" fit the comptroller very closely. "The essential functions are, first, to provide the system of communications; second, to promote the securing of essential efforts; and third, to formulate and define purpose." (Barnard, 1968, pg. 217). The comptroller must manage an accounting system which *communicates* business results to other managers. He must *secure* cooperation and "essential efforts" by managing informally. In budgeting, the comptroller helps his peers turn *ethereal* plans into a reasonable pragmatic budget, thereby, *defining purpose*.

The comptroller is a department head in military organizations. He is responsible for the command's accounting system, but he has no specific authority to force other department heads to cooperate. The comptroller must exert leadership without a formal authority position. His leadership must result from his

knowledge and skills. He must understand human nature to accomplish his objectives. "The mark of success for the controller is when other executives seek him out for guidance and counselling." (Wilson, 1973, pg. 24).

## 2. Etymology

In case there exists any confusion between the words *comptroller* and *controller*, a brief etymology is provided. The word *comptroller* came to the English language through a translation error in the middle ages. The correct translation, *controller* came into the language at about the same time. The terms *comptroller* and *controller* mean the same thing and will be used interchangeably.

Traditional organizations tend to use the word *comptroller*. Hence, the U.S. Government has a Comptroller General and a Comptroller of the Currency. The Armed Services have staff and command comptrollers. International Telephone and Telegraph (ITT) describes its senior divisional financial executives as *comptrollers*. On the other hand, General Electric and Sears use the term *controller*. Quotations and references throughout this thesis will use the term used by the original author.

## B. LITERATURE REVIEW

### 1. Functional Definition

The first step in preparing the new PCC Textbook was to develop a functional definition from the literature. The literature described comptrollership in many ways, yet one could discern a

consistency among the definitions. The definitions seemed to describe two functions. In every case, accounting was the first function. The second function revolved around the term "interpreter." Unlike an accountant, who collects figures and hands them back to management, the comptroller is expected to increase the figures' meaning and usefulness to management.

Bradshaw and Hull emphasize the comptroller's ability to interpret and give meaning to his findings. They concluded from their study:

The accountant who has armed himself with the management viewpoint participates in management for three reasons:

- It is difficult to disentangle the orderly presentation of figure data on a problem from an analysis of the problem.
- The controller uncovers problems because he is in a position to read the pulse of business; sometimes asking the question is tantamount to answering it.
- The controller who provides the top executive with the facts and figures necessary to decision making is in a position to join in forming the overall judgement and final decisions. (Bradshaw and Hull, 1949, pg. 9).

Similarly, another writer takes the controller beyond the world of ledgers and accounts:

[the comptroller] is expected to extend his accounting function to its management applications. Essential to the proper fulfillment of the controllership function is an attitude of mind that energizes and vitalizes the financial data by applying it to future company objectives. It is a forward looking concept--a trained analytical approach that brings balance to the management planning and control system. (Wilson, 1973, pg. 13).

In recent empirical research, Sathe has found that comptrollers do not involve themselves enough in the interpretive

decision making function. "The research findings on the controller's involvement in decision making are thus similar-- controllers are less actively involved in the process than both they and other managers would like." (Sathe, 1982, pg. 12).

In summary, the comptroller can be described as the organization's senior accountant and interpreter of financial data. Organizations value the comptroller's thoughtful interpretation. "It is a serious mistake for the controller not to get involved in the day to day issues and problems of the operating functions or units." (Wilson, 1973, pg. 23).

## 2. Organizational Position

The Navy Comptroller Manual requires that "the comptroller . . . report directly to the activity commander." Reporting at this level puts the comptroller on a par with operating department heads. Wilson agrees with this executive level placement. "To accomplish the task effectively, the controller must have a peer relationship to all other major functional executives." (Wilson, 1973, pg. 20).

The comptroller must have sufficient organizational stature to be able to influence or stop "bad" decisions.

. . . a controller actively involved with management in business decision making has an opportunity to put an early stop to ill-conceived, ill-advised, or illegal courses of action being contemplated, that is, *before the fact or anticipatory control* [Sathe's emphasis]. (Sathe, 1982, pg. 19)

The NAVCOMPT Manual, nevertheless, requires line management to make and enforce operating decisions. "The

comptroller's activities will have an impact on the organization only when implemented by management authority." (NAVCOMPT Manual 012201(2)). That is, the comptroller must work through the commanding officer or other department heads to carry out his activities. Concurrently, however, Wilson recommends that the controller " . . . follow-up his studies and interpretations. The controller cannot force action, but he can usually secure it by keeping important matters before the executive until satisfactory action is taken." (Wilson, 1973, pg. 24).

The comptroller has no authority over personnel outside of his own relatively small department. He is, however, in a unique organizational position. He is the only department head who can routinely observe *every* part of the business. The observant comptroller is exposed to materials management, manufacturing, marketing, sales, and distribution. ". . . He or she is virtually the only person familiar with all the working parts of the company." (Business Week, 1977, pg. 86). This unique perspective enables the comptroller to balance priorities and recommend trade offs that will probably be optimal for the entire organization.

Peter Drucker explains that range of authority is not the only criteria for management. He asserts: "Management is authority for contribution. Function rather than power has to be the distinctive criteria and the organizing principle." (Drucker, 1974, pg. 394). As the primary planning and budget officer, the comptroller's responsibilities result in a significant contribution to the organization's success.

### C. SUMMARY

The literature views the comptroller as one who records, interprets, and communicates data for management. In many cases the comptroller is responsible for budget execution. Yet while the comptroller bears responsibility, he has no specific authority for making management concede to his plans. Although he derives his formal authority from the commanding officer, he can not afford the loss of cooperation that would result from "forcing" line managers to comply. The comptroller must therefore, manage informally. He must communicate, influence, and convince line managers to comply with budget guidelines. He must build and maintain the credibility he needs to get things done. The new PCC Textbook attempts to emphasize the importance of these functions and skills to comptrollership.

### III. RESEARCH METHOD

The comptroller's environment was evaluated systematically to determine who should evaluate the new PCC Textbook. The evaluation criteria were then selected on the basis of the course's purpose. The intent of the research was to compare two books. It was expected, though, that each evaluator would also compare the book against an internal paradigm, developed from his financial management experience. The new PCC Textbook would be validated against the older version and against expert knowledge of comptrollership.

#### A. EVALUATOR SELECTION

A systematic analysis of the comptroller's environment yielded the candidate groups for evaluating the new PCC Textbook. A practicing comptroller was selected because he is nearest to the problem. He should know what he needs to know to do the job. More importantly, he would know what his previous training lacked.

Commanding officers represent management's viewpoint. The commanding officer (CO) is ultimately responsible for operating his organization. The comptroller deals with the subject where CO's often have the least experience. The CO is nevertheless, subject to severe censure if his comptroller fails to manage spending. The comptroller will probably be ineffective if the CO does not support

him. Thus the CO and the comptroller share a special symbiotic relationship. From this relationship, the CO should thus understand what makes a "good" comptroller.

Unfortunately, getting a CO to expend the time necessary to review the new PCC textbook was not possible. A senior line officer with some financial experience and with daily exposure to a commanding officer's viewpoint was chosen as a surrogate.

The auditor or internal management analyst represents a critical influence on the comptroller's success. Often the auditor is a professional accountant. In doing his job, the auditor has generally observed and evaluated a wide range of performance. He has observed the results of "good" and "bad" comptrollership. He should recognize the criteria for good performance.

The accounting professional was represented by a professor. The professors at the Naval Postgraduate School have studied the influences of accounting and information on organizations. Many have researched managerial accounting problems in depth. This experiential base is qualification for him to evaluate a textbook on comptrollership. Further, the professor has a sense of the pedagogy necessary to prepare a textbook. He should offer cogent comments on both the textbook's style and content.

A sample of students evaluated the textbook to comment on the format and readability. The students were recognized not to be experts on comptrollership, but were felt to have some knowledge of what textbook form helps them prepare for a class.

## B. DATA COLLECTED

The evaluation form collected data about the evaluator, and collected his opinions on the new PCC Textbook. The demographic data requested that the evaluator identify his position in the organization. That is, he labeled himself as a:

- Practicing Comptroller,
- Commanding officer,
- Auditor or management analyst,
- Accounting Professional (professor, instructor, CPA),
- Student, or
- Other.

The second demographic question asked if the evaluator had attended either of the courses which used the earlier textbook. It seemed reasonable that having completed the course might bias the evaluation.

A simple scale was used to rate critical attributes of the new PCC Textbook. Evaluators were asked to rate the new PCC Textbook as "much inferior" to the earlier version, "inferior," "the same," "better," or "much better" than the earlier version. The scale was a bar with five dividing marks; no numerical value was attached to the scale.

Finally, the evaluators were asked to make free form comments on the new PCC Textbook, focusing on areas needing improvement, or for which an inappropriate perspective was offered.

### C. EVALUATION CRITERIA

The book was evaluated on a total of six characteristics: two pedagogical and four professional characteristics. The pedagogical characteristics were:

- Ease of reading. The first pedagogical characteristic was ease of reading. One must be able to read a book to learn from it. The book was rated for the student's ability to absorb the material.
- Skill developing The second pedagogical characteristic was skill-development. The course is a practical course. An objective was to teach skills which the student can use immediately. "Managers are action-focused; . . . Unless they can put into action right away the things they have considered and reconsidered, the course will not 'take.'" (Drucker, 1974, pg. 423).

The four professional characteristics related to specific material content. The course needed to:

- Define comptrollership. One must develop a functional definition of comptrollership. Most students realize that a comptroller is a financial officer. However, one must differentiate between comptrollership and accounting responsibilities.
- Include useful material. The evaluators had to judge how useful the textbook material would be to new comptrollers.
- Include the appropriate level of material. The material must be appropriate for a broad spectrum of students, while providing more than trivial information.
- Improve future quality/effectiveness of Navy Comptrollers. Obviously, the purpose of any training course is to enable those who complete the course to perform better on the job.

#### D. SUMMARY

The research objective was to compare two textbooks. Appropriate evaluators were selected systematically from players who influence and are influenced by the comptroller's performance. The new PCC Textbook was rated on the basis of two pedagogical factors and four areas critical to comptrollership. The rating was recorded on an ordinal scale to reveal whether the evaluator felt the new textbook was "inferior," the "same," or "better" than the previous version.

#### IV. DATA

The data resulting from this research is summarized in Table 1. Four of the six evaluators provided comparative ratings. There are five evaluations because one evaluator felt that the new PCC Textbook should be evaluated against one standard for the *Practical Comptrollership Course*, and against another standard for *Financial Management in the Armed Forces*. Two evaluators felt unable to provide comparative comments due to the time required to read both books. Since statistical analysis was not critical to evaluating the results, each of these variations was deemed acceptable.

Detailed data are available in Appendix C for those interested in responses sorted by demographic group. The senior officer, as a proxy for the CO, and the accounting professional, chose to provide free form comments. One of the management analysts chose not to forecast the effectiveness of the new PCC Textbook. The comments provided by evaluators are quoted when needed in Chapters V and VI. Brief evaluator biographies are provided in Appendix D to summarize the experiential base of the evaluators.

TABLE 1. DISTRIBUTION OF FINDINGS

	NC*	A<<B	A<B	A = B	A>B	A>>B
READABILITY	2	0	0	1	2	2
SKILL DEVELOPING	2	0	1	1	2	1
DEFINING COMPTROLLERSHIP	2	0	1	2	1	1
USEFUL MATERIAL	2	0	2	1	0	2
LEVEL OF MATERIAL	2	0	1	0	3	1
CONTRIBUTION TO IMPROVING FUTURE COMPTROLLERSHIP	3	0	0	1	1	2

---

\*No comment provided. This column represents evaluators who did not feel capable of comparing the two textbooks due to brief exposure to the earlier textbook.

## V. ANALYSIS

The new PCC Textbook is considered to be an improvement over the earlier edition. A plurality of evaluators expressed the opinion that the new PCC was better than the earlier edition in four of the six areas evaluated.

### A. STRUCTURED RESPONSES

In four of the five cases, the new PCC Textbook was evaluated as more readable, and as containing a more appropriate level of material. In three of the five cases, the new PCC Textbook was rated as better at skill developing, and as contributing better to improving future comptrollership.

Three of five evaluations rated the new PCC Textbook as equal to or worse than the earlier edition in usefulness of material and in defining comptrollership.

### B. FREE FORM RESPONSES

Evaluators A and E chose to provide only free form comments regarding the new PCC Textbook, as reviewing both the old and the new book would be too time consuming.

#### 1. Evaluator A

Evaluator A expected the new PCC Textbook to contain more "practical" information. He expected the course to include more information for the "guy who has no financial experience."

Consistent with his expectation, he felt the text should have been longer, and should have included more practical examples.

Evaluator A questioned the inclusion of Chapter III E, addressing auditing, in the comptrollership course. This could represent a perception that auditing is only a tool for imposing external control rather a management tool for achieving organizational objectives.

Evaluator A felt Chapter IV B, Budget Planning, placed too much responsibility on the comptroller. Chapter IV B suggested that the comptroller ensure department heads understand the CO's desires. Evaluator A felt it was "the CO's responsibility (not comptroller's) to ensure all dept [*sic*] heads understand his desires." Evaluator A found Chapter IV C, Budget Execution, to be a good description of the budget execution process.

Evaluator A indicated that a weakness he has observed is the comptroller's inability to present issues to the CO, either in written or oral presentation. He felt that the textbook should address the process of analyzing an issue and presenting it to the CO.

## 2. Evaluator B

Evaluator B questioned the rationale of teaching two courses from one book. He felt that the new PCC Textbook was "necessary but not sufficient" for teaching each course. He felt that *Practical Comptrollership Course* and *Financial Management in the Armed Forces* were sufficiently different that an addendum

or appendix should be prepared to meet the needs of each student group.

Evaluator B defined comptrollership as the "capacity for designing the bridge to span the gap between the place that accounting systems leave off, and real deeds begin." He felt that the accounting systems and command missions are not dynamic. In this relatively stable environment, the comptroller

must be able to communicate the effects of things that do change in [language that does not change] so that important decisions, even small ones, can be reliably made on PRACTICAL grounds.

To paraphrase, evaluator B suggested that the comptroller must design the means to interpret the neutral data coming from the Authorized Accounting Activity, turning the data into forms more usable by the line manager.

### 3. Evaluator C

Evaluator C closely represented the population from which PCC students are selected. As a GS-11 employee, she is a prime candidate for comptrollership training. She reported that the technical chapters, Chapters IV, V, and VI were "on the whole better organized and more clearly explained than in the [existing] PCC course. I tend to prefer more schematics and charts."

She felt that better analysis of the student population, focusing specifically on the students' needs might result in a further improved textbook. Having spent much time working with both the earlier version and the new PCC Textbook recently, she

reported: "Both the old and new PCC Textbooks have brought me up to speed."

4. Evaluator D

Evaluator D reported that he felt the new PCC textbook covered the required material very well. As a comptroller for three years, with previous financial training, he thought that the text was "by far the clearest financial text" he has read. He felt that Chapter V, Administration, was particularly good.

5. Evaluator E

Evaluator E also acknowledged the complication of teaching two diverse student bodies with the same textbook. Nevertheless, he felt the new PCC Textbook was a "nice piece of work" and "flowed very well from chapter to chapter." He indicated that the level of the material seemed to be right for the beginning comptroller. He stated that the new PCC Textbook presented an appropriate attitude for the Navy comptroller. In his experience, the military, in general, did not vest the comptroller with sufficient authority to perform the task assigned.

6. Evaluator F

Evaluator F reported that the new PCC Textbook was much better than the previous textbook. "The material is presented in a logical pattern with easy flow from chapter/section to chapter/section which the previous text lacked."

In his review he stated that "the detail is at a level that does not insult the intelligence of the knowledgeable student yet provides enough detail and sources of additional information for the

uninformed student." He was also pleased that the text did not "smell of typical Naval writings."

### C. SUMMARY

The responses to the new PCC Textbook are enthusiastic, yet not overwhelming. The book is perceived as an improvement over the earlier textbook. To some of the evaluators, nevertheless, the new PCC Textbook lacks in depth what it has gained in improved readability. Chapter VI will try to define this weakness, and suggest alternatives for continued improvement of the textbook.

## VI. EVALUATION AND SUMMARY

This chapter evaluates the research method, and evaluates and summarizes the findings. The research method is criticized as being a poor method for acquiring data from people who are otherwise occupied with full time jobs. Areas requiring additional work will be discussed in the middle section. The evaluators found the new PCC Textbook to be an improvement compared with the earlier edition. Nevertheless, some evaluators were not satisfied with the depth of the new PCC Textbook, apparently expecting the *Practical Comptrollership Course* to provide complete training, from the basic accounting skills to the broad vision required of a command level staff officer. The free form comments opened several areas for additional research which will be discussed in the last section of the chapter.

### A. RESEARCH METHOD EVALUATION

The research method used was cumbersome. Several evaluators were familiar with the earlier textbook and were able to compare the textbooks easily. For those who were not familiar with the earlier textbook, however, reviewing two textbooks was time consuming. It was far too time consuming for flag or commanding officers. Gathering data from those organization members who direct and evaluate comptrollers requires a more

time sensitive method. Surveys or structured interviews might provide data around which a textbook could be designed.

Moreover, comptrollership tends to be holistic rather than linear. The comptroller's accounting and clerical staff is interested in the detailed lists of reporting requirements. The comptroller, on the other hand, must be able to view and assimilate the operation of the whole organization. As asserted by evaluator B, the comptroller should be concerned with integrating his data accumulation process as unobtrusively as possible into the organization. Paraphrasing evaluator B again, it is logical then that one should try to teach principles rather than providing information lists for the comptroller to learn.

A better research method then might be to record critical incidents of comptroller success and failure from those people who dominate the comptroller's environment (Stoner, 1982, pg. 545). Collecting the incidents requires only a short time commitment from each data source. The researcher can then assemble the findings into short case studies supporting the technical material the comptroller must understand. In evaluating the case studies, the prospective comptroller should develop an appropriate view of what comptrollership is about. The new comptroller should then be more likely to perform better in the operating environment.

#### B. EVALUATION OF THE NEW PCC TEXTBOOK

The new PCC Textbook is evaluated as being more likely to improve future comptrollership. The evaluations showed the new

PCC Textbook to be slightly better than the earlier edition. In evaluating the new PCC Textbook, however, the evaluators were constrained by considering only the textbook, unsupported by the remainder of the course material. Obviously, the influence of the course is a function of the textbook, the lesson plans, lectures, handouts, and practical exercises. Other things equal, the new PCC Textbook is more likely to improve comptrollership.

### C. AREAS OF THE NEW PCC TEXTBOOK NEEDING IMPROVEMENT

#### 1. Policy Analysis and Presentation Skills

Evaluator A indicated that a weakness he has observed is the comptroller's inability to present issues to the CO, either in written or oral form. He felt that the textbook should address issue and policy analysis, and presentation of an issue to the CO.

His position is correct. Part of the course work, however, does implicitly cover this critical aspect of comptrollership. In the PCC, students work as teams on several practical exercises dealing with Budget Planning and Budget Execution problems. The students must make decisions and then present the results of their work to instructors simulating COs and NAVCOMPT Budget Analysts.

Graduate students in *Financial Management in the Armed Forces* also do case studies. Further, graduate students are required to complete *Managerial Communication* (MN 3333) and *Introduction to Systems Acquisition and Project Management* (MN 3105) both of which require practical, formal oral and written

presentations. Perhaps the skill should be covered in the new PCC Textbook, but it seemed to be covered adequately elsewhere.

## 2. Internal Controls (Chapter IVD)

Evaluator B felt the Internal Controls chapter required additional depth. His point of contention is that the chapter simply quotes the rules without emphasizing the importance of internal controls as a way of performing the whole job. He felt strongly that the coverage given would result in the construction of artificial and ineffective internal control systems which could not be integrated into the daily work of managers.

Chapter IVD is an excellent example of a chapter which can be researched and rewritten using the critical incident method. Internal control as conceptualized by the Navy has come of age in the mid-eighties. Navy personnel are just beginning to understand how to implement internal controls effectively. A thorough study of effective and ineffective application would be valuable to new comptrollers.

## 3. Increased Depth of Accounting Coverage

The issue of increasing the accounting detail to accommodate the comptroller who has no accounting or financial management experience is a critical consideration in organizing either course. Notwithstanding the need for the comptroller to be a technically competent accountant, the PCC is not the place to try to instruct the principles of accounting for a senior officer. One must differentiate between the accounting skills the clerical

accountant needs, and the managerial/accounting/communicating skills the executive level comptroller requires.

As noted in the introduction, the new PCC Textbook assumes technical familiarity. If senior officers unfamiliar with accounting are detailed to comptroller billets, a course similar to the Defense Systems Management College *Project Management Course* should be developed to provide three to six months of the in-depth technical financial management and accounting training needed. One cannot provide such training in two weeks in a class with the diversity of the *Practical Comptrollership Course*.

#### D. RESEARCH RECOMMENDATIONS

##### 1. What Are The Student Populations Like?

One finding suggested further research into the propriety of using the same textbook for two different courses. Evaluator C felt that the differences between the two courses were significant and that using the same text was inappropriate. It would be useful to evaluate systematically the differences between the courses' constituents. One might survey major claimants, COs, and comptrollers, and correlate the source of their comptrollers' training with the needs reported by their sponsors. If a substantial difference between training and comptroller utilization is found, a new textbook, or appendices to the new PCC Textbook could be prepared to meet the needs of the diverse groups. If graduates of each course are detailed and managed differently, there should perhaps be two separate curricula. If the populations

are merged and detailed to the same jobs, there is little point in differentiating between the two groups.

## 2. How Much Authority Should the Comptroller Have?

The researcher found an interesting split between the military and academic evaluators. Evaluator A felt that suggesting that the comptroller communicate the CO's intentions to the department heads was too much responsibility for the comptroller. Evaluator E, professor of management, felt that the military did not invest the comptroller with sufficient authority to execute plans for the CO. He felt that the comptroller should be given more responsibility and authority for budget planning and execution. One might develop interesting research topics in evaluating what COs expect of comptrollers or investigating how much authority COs invest in their comptrollers.

## E. SUMMARY

The new PCC Textbook is evaluated to be more likely to improve the quality of future comptrollership than the earlier textbook. The new PCC Textbook can still be improved by expanding the coverage of Chapter IVD to explain better the nature of the Navy Internal Control Program. The new PCC Textbook can be further improved by discussing the importance of issue and policy analysis in the comptroller's job.

## APPENDIX A

### PRACTICAL COMPTROLLERSHIP COURSE

#### I. INTRODUCTION

The purpose of this textbook is to instruct Navy and Marine Corps officers and civil servants in the managerial and accounting skills needed to be effective comptrollers. The comptroller (or controller) is the chief accounting official of a business enterprise or institution. In the military context, he is a headquarters or command senior financial officer.

Because of the situations under which the course is offered, this purpose is difficult to fulfill. The text is used for two courses which are taught differently. The Practical Comptrollership Course (PCC) is a short course for classes of General Schedule employees and military officers. It is conducted on a full time basis for nine days; roughly 70 hours of class time. The PCC has no academic prerequisites.

Financial Management in the Armed Forces (MN 4154) is for full time graduate students for whom a Public Policy course is a prerequisite. The course is taught over a twelve-week quarter at a rate of four hours per week; roughly 50 hours of class time.

The student backgrounds in both courses are diverse. NAVCOMPT intentionally mixes Practical Comptrollership students to encourage lively, meaningful discussion. Part of the learning

experience is to discuss real situations with people working for other commands and claimants.

Postgraduate students are mixed by default. Classes consist of Navy and Marine Corps line officers, Navy Supply, Civil Engineer, and Medical Service Corps officers. Some students have extensive financial experience afloat; others have financial experience ashore; others have little or no financial experience.

#### A. COURSE CONTENT

The course and textbook are structured to accommodate as many students as possible. Chapter I develops a simple model for understanding how the comptroller can view himself in the context of the Navy.

Chapter II addresses the comptroller and his immediate command environment to provide a common language and basis for discussing comptrollership. Chapter II also reinforces the idea that the comptroller is both an accounting professional and a manager. Finally, NAVCOMPT expectations for comptroller behavior are summarized.

Chapter III explains the key organizations and people who make high level budgetary decisions. Although it seems remote to the field comptroller, the Washington arena indicates military financial management's direction from year to year. The audit organization is included in this chapter to reinforce its pervasive influence from the halls of Congress to remote field commands.

Chapters IV, V, VI, and VII are the technical accounting chapters, discussing Resource Management System accounting, civilian compensation and Interservice Support Agreements, Plant Property accounting, and working capital funds, respectively.

Chapter VIII discusses how NAVCOMPT is trying to direct the future of Navy financial management. The *Strategic Financial Management Master Plan* is the vehicle for this effort.

The author has adopted a management perspective, focusing on skills and information appropriate for an executive level manager. The text intentionally includes neither manuals nor instructions. The comptroller needs to read and become familiar with them, but he can do that on his own time. Given the propensity for change in recent years, it makes more sense to discuss procedures in general terms, and provide references. Thus, for specific technical questions, students are encouraged to seek the latest revision of the appropriate manual.

#### B. LEARNING OBJECTIVES

- To provide a common language for prospective comptrollers and financial managers.
- To explain the practical management work of the comptroller.
- To explain the practical accounting work of the comptroller.
- To expose students to case studies and exercises that approximate "real world" situations.

## C. A SYSTEMS VIEWPOINT

One way of understanding the comptroller's organizational responsibility is to study the business adaptation of systems theory. In systems theory, an organism exists in, and must adapt itself to a dynamic environment. Using built-in regulating mechanisms, the organism monitors critical, or control variables.

### 1. Cybernetics

In nature, the regulating mechanisms are the brain and the nervous system. For example, when an animal's feet feel cold, the nervous system transmits a message to the brain. The brain responds by moving the animal to safety. When control variables move outside preset limits, the regulating mechanism "tells" the system that it must do something, else it may be harmed by the environmental disturbance.

A commonly used analogy is to substitute a mechanical device for the organism. Instead of a nervous system, the device contains sensing devices and mechanical operators. The comparative study of automatic control systems formed by the nervous system and brain, and by electro-mechanical communication systems is called cybernetics.

### 2. "Open" Systems

Generalizing further, an organization can be substituted for the organism. Organization members act as the nervous system and brain to create a control network. A key assumption in this analogy is the concept of the "open" system. The open system posits that the organization needs to interact with its surroundings.

When the environment changes, the organization must adapt in order to survive.

#### D. THE COMPTROLLER IN A SYSTEM

The literature and NAVCOMPT emphasize this "open" model for comptrollership. In a 1985 article, Alleman (1985, pg. 30) asserts: "A comptroller must acquire a working knowledge of his company and an understanding of the business environment in which his organization operates." Wilson (1973, pg. 25) states that one qualification for comptrollership is to have "... a general understanding of the business ...." Jackson (1949, pg. 49) describes the comptroller as "... a good steel man, or oil man, or automobile manufacturer, depending on the industry or business it is his duty to serve."

NAVCOMPT understands comptrollership similarly. NAVCOMPT requires that the comptroller have "... knowledge of the operations carried on in a specific kind of naval program, such as shipbuilding or aircraft." Thus it is appropriate to define the comptroller in terms of a cybernetic system.

##### 1. Feedback systems

Figure 1 is a model of a cybernetic system.\* The information passed from the control variable to the regulatory mechanism is called feedback. Feedback is inexpensive because one

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\*Based on lectures delivered by Adjunct Professor Shahid Ansari, while teaching Financial Management Control Systems, MN 4161, Winter 1986, at the Naval Postgraduate School.

must simply collect data. No interpretation is necessary. The data itself has no risk because it is historical.

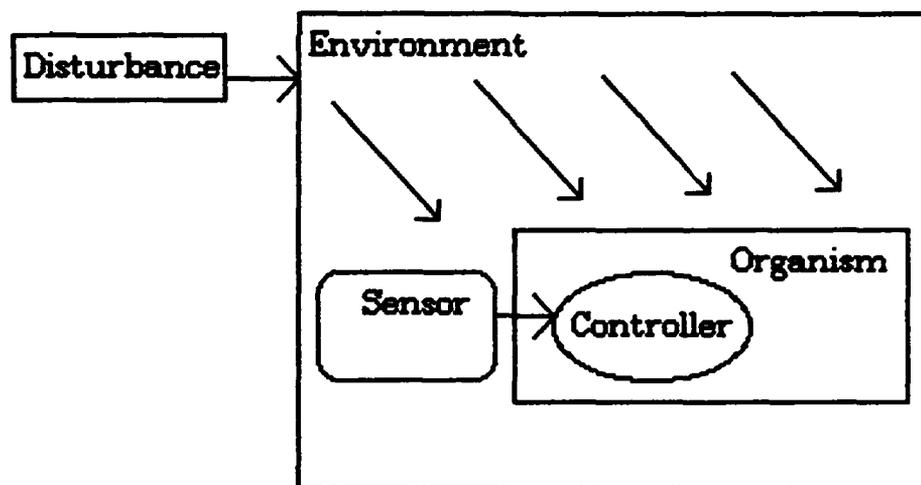


Figure 1. Cybernetic model with feedback loop

An example of a feedback loop is an officer reporting that he has failed an inspection after he has failed it. The inspection team (disturbance) acted on his command (organism), reporting something unsatisfactory. The sensor (the officer) noted that a control variable was out of standard, and provided the status (feedback) to the commanding officer (the controller) who must act to preserve the command in its environment.

This operating style will probably not be satisfactory to most commanding officers. Leaders/managers are supposed to operate systems, not respond to system failings.

## 2. Feedforward Systems

Figure 2 improves the cybernetic model. The action here is called feedforward. Although a clumsy word, it describes a

system in which certain disturbances are anticipated. The comptroller analyzes variables that predict environmental disturbances. One must decide which variables accurately forecast environmental conditions, and which environmental conditions may lead the business or organization to failure or to a compromising position.

Developing feedforward loops is expensive and time consuming. A cost-benefit analysis is appropriate to verify that the benefit received from the feedforward sensor is worth the increased cost of acquiring the information.

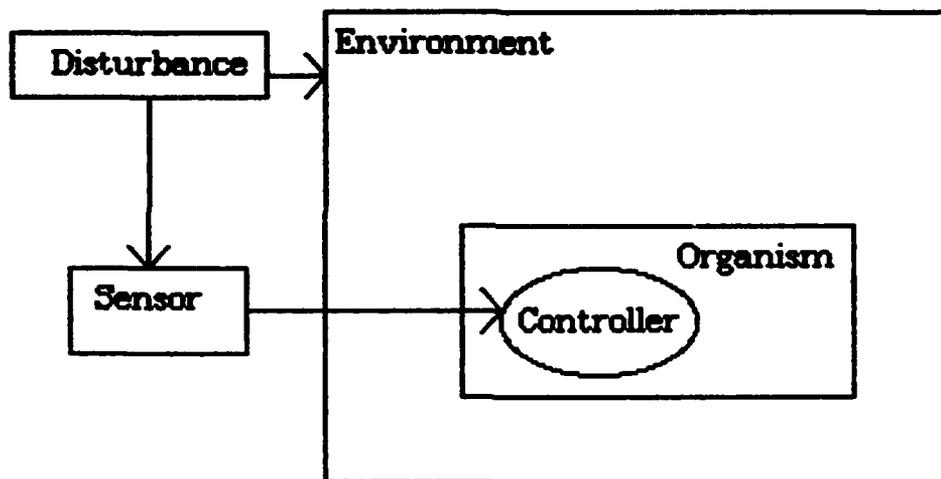


Figure 2. Cybernetic model with feedforward loop

For example, an air station comptroller (the sensor) observes and analyzes how fast the station is spending money (control variable) during budget execution. Since neither the commanding officer nor the comptroller desire to overspend the budget, the benefit of this observation far exceeds the cost. In the

second quarter, she predicts that the station will have obligated its entire year's budget by the end of the third quarter (possible disturbance).

She advises her commanding officer (provides feedforward) that the station must act to prevent overspending its budget. The commanding officer directs the comptroller to request increased obligation authority, and directs the department heads to decrease the spending rate. This anticipatory action should prevent the station from spending its limited resources too quickly.

#### E. SUMMARY

This chapter suggests one of many management approaches that a comptroller may adopt. If one assumes that the organization exists in an "open" system, the organization must respond to its environment. The comptroller must record and analyze relevant variables, searching for trends and changes in trends. Through this analysis, the comptroller anticipates changes and advises line management to plan for the forthcoming changes. Thus the organization survives by being sensitive to its surroundings.

The comptroller must be familiar with the economic nature of his business or organization in order to perform this analysis. He must communicate with line management and understand the critical cause and effect relationships that reveal business and organizational vulnerabilities.

Chapter I is somewhat theoretical; nevertheless understanding the ideas explained can increase the comptroller's awareness of what really makes his organization work. Chapter II expands on the comptroller's position in the organization.

## II. THE COMPTROLLER AND HIS ORGANIZATION

This chapter describes the ways in which a comptroller can fit into an organization. Broadly speaking, the comptroller is described as an accountant, as a manager, and as an industry expert. Each author uses his own favorite descriptor. One common theme, however, is that the managerial accountant, or comptroller, must reconcile his need to be independent with his need to be involved in the organizational decision-making process.

### A. FUNCTIONAL DEFINITION

The comptroller plays several roles in an organization. The literature describes these roles in various terms. Bradshaw and Hull (1949, pg. 13-15) refer to the comptroller as a "production manager" for accountants and as a "coordinating agent." Anderson *et al* (1973, pg. 27) typify the comptroller's purposes as providing (1) traditional accounting and reporting, and (2) management information services. Wilson (1973, pg. 25) asserts that the comptroller must be a technical accountant, a manager (one who understands planning, organizing, and controlling), and an industry expert.

The NAVCOMPT manual states that Navy comptrollers should perform three functions similar to Wilson and Campbell's interpretation. As a technical accountant, he "must be delegated authority to formulate principles and policy, and to prescribe procedures for . . . budgeting, accounting, fiscal progress and

statistical reporting, and internal control." He must manage his own Comptroller Department. He shall be an "industry expert." The comptroller's accounting knowledge shall be "coupled with experience in and knowledge of the operations carried on in a specific kind of naval program, such as shipbuilding or aircraft."

## B. FIELD RESEARCH

Vijay Sathe performed empirical research on comptrollership in a 1982 study. He analyzed comptrollership in 24 businesses, each with more than \$300 million in revenues, in ten U.S. industries (Sathe, 1982, pg. 4). He found that comptrollers could emphasize either the financial reporting and internal control aspects of the job, or the management service responsibility.

### 1. Financial Reporting and Control

Sathe found that if the comptroller (and organization) emphasized financial reporting and internal control, then the comptroller was likely to be independent. Because he views projects retrospectively, he is often required to say "no." In terms of the cybernetic models discussed in Chapter I, the comptroller is always in a feedback loop. He must react to questionable situations, rather than guiding the discussion to an acceptable outcome. The comptroller is perceived as bellicose or contrary.

This model fits military needs poorly. The comptroller will enjoy some independence, but he will often be surprised. It is in his management services role that the comptroller can find out what is happening before it happens. Neither the commanding

officer nor the comptroller can afford to be surprised. The comptroller must support the organization. In order to deal effectively with the many rules and regulations constraining federal agencies, the commanding officer must encourage his comptroller to be involved in the decision making processes.

## 2. Management Services

If the comptroller emphasizes management services, he is likely to be considered "part of the team," but he may lose some independence. To the organization's benefit, he is involved in the decision making process. In this feedforward position, he may offer alternatives during the discussion and decision making process, "showing management what it can do and how to do it." (Poindexter, 1969, pg. 37).

In this role, the comptroller participates in decision making and offers alternatives early in the process rather than allowing managers to pursue impossible or illegal options. The disadvantage of this model is that line managers may perceive the comptroller is stifling their creativity by offering alternative solutions.

This model is inappropriate for the military comptroller as well. Federal regulations and the *Federal Manager's Financial Integrity Act* require that the commanding officer, line managers, and the comptroller monitor and control spending closely. Fiscal and accounting creativity cannot be tolerated in the public sector. The comptroller cannot lose his independence.

control. To do this, the comptroller must "remain actively involved in . . . [organizational] decisions while retaining objectivity and independence from . . . management." (Sathe, 1982, pg. 133). "... The comptroller must be objective and independent of management when necessary, while at the same time remaining part of and performing a vital role on the management team" (Alleman, 1985, pg. 30).

Sathe acknowledges that one risk is "... stifling management creativity and initiative." (Sathe, 1982, pg. 133). If the comptroller uses good communication skills and understands the objectives of the larger organization, such problems should be minimal.

### C. OTHER DIMENSIONS

One can consolidate the technical aspects of these roles into two categories: accounting, and interpreting and forecasting.

#### 1. Accounting Role

The comptroller's accounting role is manifest. He must maintain accurate records of the organization's business transactions. He must budget, submit financial reports, manage property, maintain internal financial control, and perform internal financial auditing.

Financial reporting supports organizational credibility. In the private sector, financial reporting is important for acquiring and maintaining credibility with investors and lenders. In the military, accurate reporting assures organizational accountability, and feeds decision-making models above the organization. Data or

tabulated facts alone, however, are normally not sufficient for management decision-making.

For decision-making, data must be summarized, analyzed, and put into perspective. It must be converted into information. For this conversion process to work, the comptroller must know what information the line manager needs to guide his decisions. The comptroller must be able to interpret data. As Bradshaw and Hull stated,

the accountant operates a cost accounting system which provides monthly profit and loss statements, interim inventory valuations, product and departmental costs. The controller uses his cost accounting experience, particularly analyses of variances from standard, to point up problem areas and to ask discerning questions (Bradshaw and Hull, 1949, pg.6).

## 2. Interpreting and Forecasting

The NAVCOMPT Manual states that the comptroller is responsible "for interpreting program and cost data, and for acting as a technical advisor on the financial aspects of operations reflecting past management decisions or current problems." Here the comptroller "brings figures to bear where and when they will do the most good--within the management process and before the decision is made." (Bradshaw and Hull, 1949, pg.7).

In "bringing figures to bear" on an issue or decision, the comptroller has assumed a new dimension. He must be more than an accountant to make reasonable business judgements. "... The comptroller and his department must be competent to function over a fairly wide field." (Jackson, 1949, pg. 49).

"To be able to suggest a course of action, the controller must know the company. Indeed, the key to his influence is how well he keeps on top of every area of operations . . ." (Poindexter, 1969, pg. 39). He must leave the accounting office and familiarize himself with the organization and its environment in order to interpret usefully the company's history.

The comptroller who can make reasonable forecasts has learned the business. He has developed implicit or explicit models of the organization and its environment. He can collect data prospectively, organizing "... basic information needed to face up to future controversies as and when they arise." (Anderson *et al*, 1973, pg 98).

A forecast or prediction based on a logically conceived cause and effect relationship is useful to the manager. A properly estimated forecast includes a measure of variability which allows the manager to assess the estimate's quality. A forecast allows the line manager to plan his work, and it allows the comptroller to help the line manager develop a budget. The forecast, nonetheless, can be sound only if it is based on data which are accurately recorded. In building financial models, "garbage in yields garbage out."

#### D. THE COMPTROLLER DEPARTMENT

The Comptroller Department complements the comptroller's responsibilities. The department will consist of either three or four divisions depending on the source of electronic data processing services.

## 1. Budget Division

The Budget Division bears responsibility for the entire budget process. It provides planning guidance and requests budget estimates from departments. The division reviews and clarifies budget justification and assembles the budget request package. It may negotiate with the command's immediate superior in order to arrive at budget estimates. The budget division follows up on the spending plan, analyzes variances from planned expenditures, and recommends corrective action to the comptroller.

## 2. Accounting and Disbursing Division

Accounting and Disbursing Division handles the mechanics of recording debits and credits. It records and reports actual payments made. Accounting includes:

- Timekeeping;
- Payroll;
- Costs and reports;
- Inventory Accounting; and
- Plant Property Accounting.

Disbursing includes tasks such as:

- Maintaining military and civilian pay records;
- Certifying and processing public vouchers;
- Maintaining fiscal records, and rendering fiscal returns;
- Issuing savings bonds.

### 3. Progress Reports and Statistics

This division performs financial analysis and reporting functions, supporting the comptroller's interpretive and forecasting needs.

### 4. Data Processing

Data processing is a service division that operates computer systems to support the other three divisions. In many areas, this service function is provided by the Navy Regional Automatic Data Processing Center (NARDAC).

The NAVCOMPT Manual addresses an Internal Review section which responds directly to the comptroller to conduct special studies and audits. SECNAV Instruction 7510.8B moves the function under the commanding officer, to support the command management control system.

## E. SUMMARY

The comptroller is a staff officer embedded in an organization. He is an accountant and a manager at the same time. To execute his fiscal responsibilities, he must sometimes act independently. At other times, he must be part of the management team. As a manager, he will bring figures to bear on managerial problems. To do this, the comptroller must know something about the business. He must be an advertising person, an oil person, or an aviator, or a submariner, as appropriate, to help line managers make good decisions.

### III. THE BIG PICTURE

Federal financial management is highly centralized. Recent allegations of wasteful, mismanaged military spending have increased Congress' desire to scrutinize budget plans and to audit budget execution. This chapter examines five aspects of centralized financial management that affect the plans and activities of field comptrollers.

The Planning, Programming, and Budgeting System (PPBS) is the Department of Defense (DoD) and Department of the Navy (DoN) resource allocation tool. Budget calls and parts of the Resource Management System (RMS) interface directly with the PPBS. Thus, understanding PPBS will help the comptroller in prioritizing his requirements and negotiating his budget.

Congress examines the budget created by PPBS and makes political decisions in approving the final Congressional Budget which provides money for federal operations. The tone and results of Congressional actions provide the knowledgeable, alert comptroller a great deal of insight into how to plan for forthcoming budget years.

Once the budget and related appropriations are approved, the money must be apportioned over the year and allocated down the chain of command. Budget holders are legally responsible for this money. The section entitled "Funds Flow to the Cost Center" will

broaden the comptroller's understanding of financial organization relationships, and the legal constraints on spending.

Facilities Planning is included in this chapter because it is a centrally managed, visible portion of the budget. Although the public works officer manages base facilities, the commanding officer and comptroller retain responsibility for executing the budget according to plan. Thus, the comptroller must be familiar with the definitions and limitations of military construction, minor construction, and maintenance of real property.

The audit organization is highly centralized. The General Accounting Office has set government audit standards in its landmark "Yellow book." The Naval Audit Service performs Navy internal audits according to its Audit Manual For Management which invokes the "Yellow Book's" standards.

This chapter attempts to broaden the Comptroller's vision to include external, but influential organizations. Recalling the environmental model in the first chapter, one may see the topics in this chapter as potential environmental disturbances. By being alert to them, the comptroller can increase the likelihood of his organization flourishing through improved planning.

#### A. PLANNING, PROGRAMMING, AND BUDGETING SYSTEM

The Planning, Programming, and Budgeting System (PPBS) was designed in theory by the Rand Corporation in the late 50's. Rand analysts concluded that the input budget used at the time did not allow adequate analysis to make the complex choices

necessary to select from competing alternative weapons systems. Robert McNamara implemented PPBS in the 60's while he managed DoD.

PPBS has been analyzed and criticized by many influential players in the public policy arena. Despite the criticism, however, only evolutionary changes have been made to date. The system apparently does what DoD leadership desires it to do.

1. Learning objectives.

- To understand the organization of the Office of the Comptroller of the Navy.
- To understand the nature of Congressional appropriations.
- To be able to distinguish input and output budgeting from each other.
- To be able to explain the basic life cycle of PPBS.
- To recognize the key players in the PPBS process.
- To recognize and describe the key documents in the PPBS process.

2. Organization of the Office of the Comptroller of the Navy

To understand PPBS, one must first understand how the Office of the Comptroller of the Navy (NAVCOMPT) is organized. The structure of the Navy Comptroller's office is unique among the service comptrollers. The Army and Air Force comptrollers are military officers reporting to their respective chiefs of staff. To accommodate the existence of the Navy and Marine Corps under one service secretary, the Navy Comptroller is an Executive Service (civilian) employee who reports to the Undersecretary of

the Navy. NAVCOMPT allocates Navy and Marine Corps money through the CNO and CMC, respectively.

### 3. Director of Budget and Reports

The Office of the Comptroller is organized as shown in Figure 3 and is discussed below.

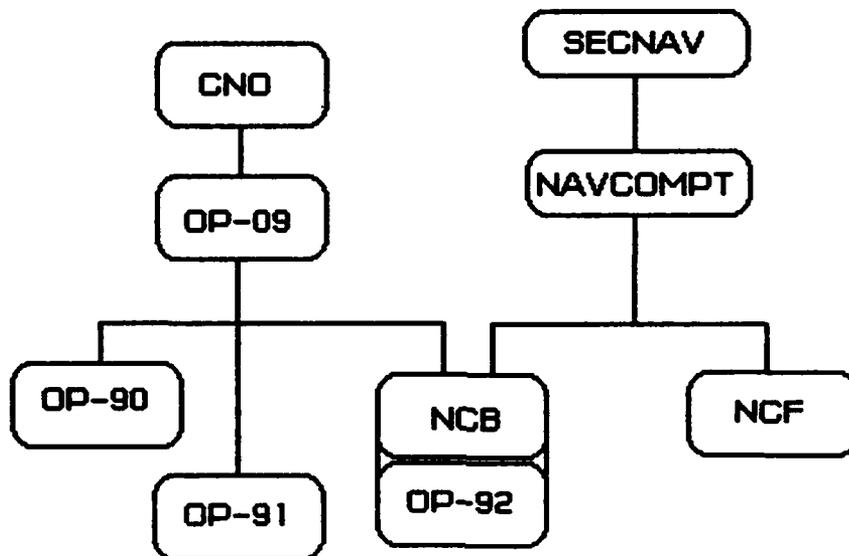


Figure 3. Navy Headquarters Financial Organization

The Director of Budget and Reports (NCB) prepares and administers the DoN Budget for the Secretary of the Navy. NCB is "double-hatted," responding also to the CNO as OP-92, Director of the Fiscal Management Division. NCB consists of seven functionally oriented groups:

- Appropriations Committee Liaison Office (NCBL). NCBL maintains liaison with the House and Senate Appropriation Committees, coordinates all matters relating to DoN participation in Appropriation Committee hearings, and advises the Director of Budget and Reports and appropriate division directors on the status of pending legislation.

- Budget Evaluation Group (NCBG). NCBG prepares the DoN budget guidance, and controls and coordinates budget submission. This group also reviews and recommends action on Departmental budget issues.
- Operations Division (NCB-1). NCB-1 reviews, recommends, and revises estimates for active and reserve personnel, operations and maintenance appropriations, replenishment spares, revolving, and other Navy and Marine Corps funds.
- Investment and Development Division (NCB-2). NCB-2 reviews, recommends, and revises estimates for procurement, research and development, and construction appropriations.
- Financial Control Division (NCB-3). NCB-3 administers financial control systems and procedures for apportioning and allocating funds, and the reprogramming process.
- Budget and Management Policy and Procedures Division (NCB-5). This office develops, coordinates, and issues budget and funding policy and procedures, appraises financial systems, and develops and administers audit management procedures.
- Civilian Manpower Division (NCB-6). NCB-6 reviews, recommends, and revises civilian personnel levels for inclusion in the budget, justifies these levels to OSD/OMB and Congress, and allocates end strength authorizations to DoN major manpower claimants.

The Assistant Comptroller, Financial Management Systems/Commander, Navy Accounting and Finance Center (NCF) is responsible for ascertaining that all Navy and Marine Corps accounting support systems meet the Comptroller General's Standards.

#### 4. Navy Department Structure and Procedures

The Chief of Naval Operations (CNO) receives his financial guidance from the SECDEF in the form of Program Decision

Memoranda (PDM). The PDM tells each service secretary and chief what force levels, manpower, and cost he may expect to be authorized over the Five-Year Defense Program (FYDP).

The CNO relies on The Director of Navy Program Planning (OP-09) to assess, develop, and control the Navy's FYDP database. OP-09 consists of three subordinate offices.

- General Planning and Programming Division (OP-90) develops programs which are to be executed two to seven years in the future. OP-90 issues POM guidance, defends the POM, and appraises resource sponsor proposals for new or revised programs.
- Program Resource Appraisal Division (OP-91) does long range planning. Using operations research techniques, this division assess programs and develops long range financial plans.
- Fiscal Management Division (OP-92) acts as NCB. Among other things, OP-92:
  - Develops, reviews, and executes the Navy budget.
  - Translates program requirements into appropriation requirements.
  - Reports the results of execution to the DoD comptroller.
  - Requests allocations from NAVCOMPT.
  - Justifies the budget request to the DoD comptroller.

##### 5. Marine Corps Procedures

Headquarters, Marine Corps develops and justifies program requirements for the Marine Corps. The deputy chiefs of staff are responsible for budget matters within their respective warfare or supporting areas.

Fiscal Division (MC-FD) manages all Marine Corps appropriations during all phases of the budget process. Fiscal Division compiles, submits, and justifies estimates for the five Marine Corps appropriations. Fiscal Division receives its funding allocation from NAVCOMPT.

The Office of the Comptroller of the Navy, through the CNO and CMC accumulates the background data needed to justify and protect the Navy and Marine Corps budgets.

DoD and the Congress view the budget from different perspectives. Congress enacts appropriations which provides funds for quantities of inputs. DoD writes its budget in terms of program output.

The next subsection will define appropriations. Input and output budgeting will be clarified thereafter.

#### 6. Appropriation Characteristics

A federal appropriation has three characteristics:

- Purpose.
- Duration.
- Level of funding.

##### a. Purpose.

The appropriation purpose may be either expense or investment. Expense appropriations fund year to year operations. O&MN and MPN appropriations are examples of expense appropriations.

Investment appropriations are analogous to capital budgets. The items funded are expected to last more than one

year. Shipbuilding and Conversion, Navy (SCN) and Military Construction, Navy (MCN) are examples of investment appropriations.

b. Duration

Duration indicates how long appropriated money will be available for obligation. Appropriations are either annual or multiyear. Expense appropriations are generally annual. Congress expects the money to be spent in the year appropriated. If the appropriation has a positive balance after the duration plus two years, it lapses into the successor or "M" account. If it has a negative balance, Congress must pass a "deficiency appropriation" to make the balance positive so that it can lapse.

Figure 4 displays the life cycle of an annual or one-year appropriation. The appropriation expires on 30 September 19A2. After expiration, no new obligations may be lodged. Funds may be expended, nonetheless, to pay for previously entered appropriations.

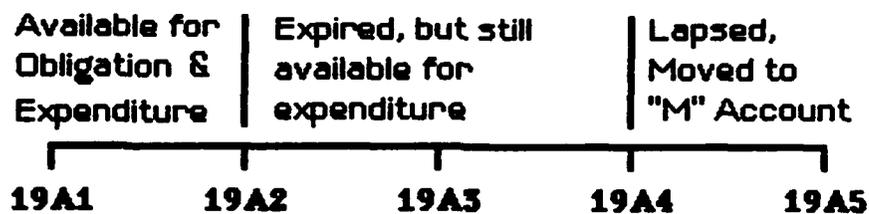


Figure 4. Annual Appropriation

The two-year appropriation shown in Figure 5 lapses on 30 September 19A5, assuming that it has a positive balance.

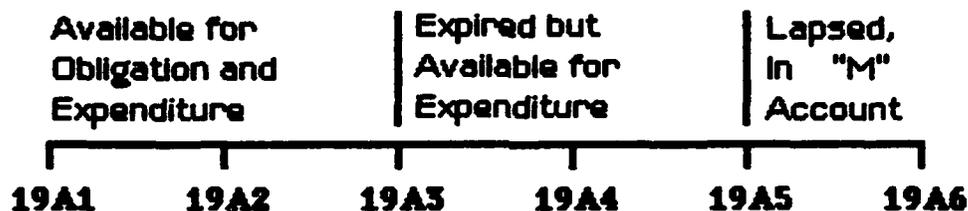


Figure 5. Multiple Year Appropriation

c. Level of funding.

The third characteristic of an appropriation is the level of funding. Fully funded means that the life-cycle costs are funded at the beginning of the program. This refers to investment programs, where the entire cost of a building or ship may be budgeted. The amount to be spent this year is included in the budget authority figure, while the amount authorized for future spending is part of total obligational authority.

An incrementally funded program is funded "exactly" as required to operate each year. Because of the program's nature, repeated funding is assured. Military pay, and operations and maintenance appropriations are expected to be refinanced each year without controversy and are thus funded incrementally.

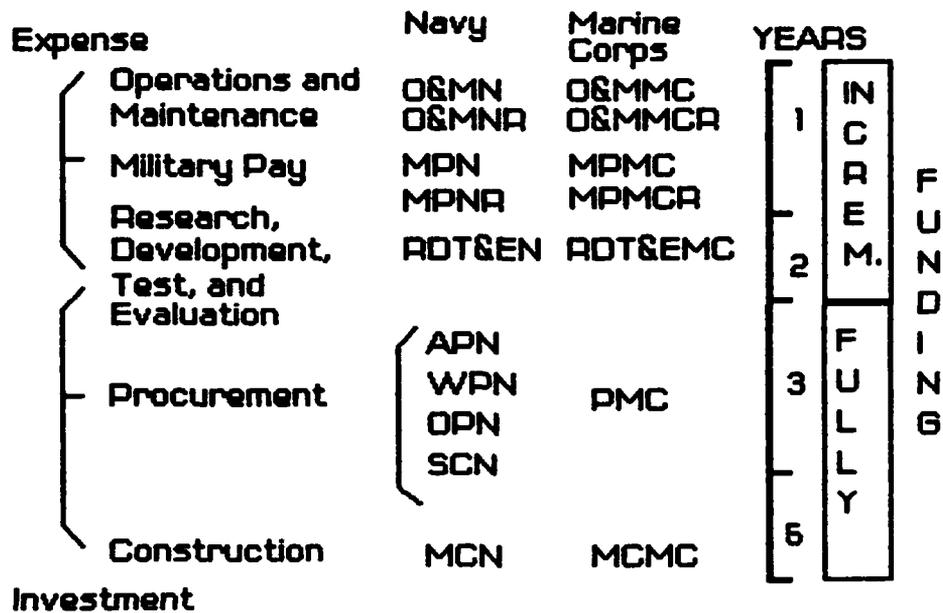


Figure 6. Appropriation inventory

The abbreviated appropriations titles listed in Figure 6 are spelled out in Table 1. In cases where the appropriation may be written for either the Navy or Marine Corps, the N or MC is omitted. Navy or Marine Corps specific appropriations are identified parenthetically.

TABLE 1. NAVY APPROPRIATION TITLES

<u>Abbreviation</u>	<u>Full title</u>
O&M	Operations and Maintenance
MP	Military Pay
RPN	Reserve Pay
RDT&E	Research, Development, Test and Evaluation
APN	Aircraft Procurement (Navy only)
WPN	Weapons Procurement (Navy only)
SCN	Shipbuilding/Conversion (Navy only)
PMC	Procurement (Marine Corps only)
MCN	Military Construction

Moreover, appropriations may be classified according to the reason for enactment. A "regular" appropriation is the

normal annual, or multiyear appropriation providing funds to an agency or program. A "supplemental" appropriation is passed during the fiscal year to provide additional dollars to fund contingent requirements. Finally, a "deficiency" appropriation is passed to infuse dollars into an appropriation to make its balance positive, so that it may lapse to the successor account.

#### 7. Input versus output budgeting

The input budget is the historical method of government budgeting. Input costs are assumed to be proportional to their output value, and thus are used to decide what should be procured. Congress uses an input structure in considering federal appropriations.

In the fifties, DoD budgets were based on the estimated input costs of operating each department for the next year. Each headquarters command formulated its budget and submitted it through the chain of command to Congress. As long as the total budget did not exceed the presidential limit, no cuts were made in either the DoD or Bureau of the Budget. Each bureau defended its own budget before Congress. Coordination was weak and no budget strategy existed. Each bureau tried to get the largest possible percentage of the Federal Budget.

The Rand Corporation reasoned that budgeting could be improved by focusing on the program, or output of the budget, rather than on the input. One can understand this in the context of cost accounting where all input must somehow be related to the output or product.

When Robert McNamara was appointed Secretary of Defense, he brought Rand Corporation personnel into DoD to implement PPBS. His avowed purpose was to improve the quality of the thought process behind budgeting, and thereby improve the quality of defense acquired with the budget dollar. A by-product has been to centralize the DoD budget process. Decisions are no longer made by the functional heads. Only the Secretary of Defense sits high enough in the organization to determine the relative value of major programs in order to make trade-offs.

DoD uses the ten broad categories listed in Table 2 to describe its results or outputs.

TABLE 2. PROGRAM CATEGORIES

<u>Program</u>	<u>Output</u>
1.....	Strategic Forces
2.....	General Purpose Forces
3.....	Intelligence and Communication
4.....	Airlift and Sealift
5.....	General and Reserve Forces
6.....	Research and Development
7.....	Central Supply and Maintenance
8.....	Training, Medical, and other General Personnel Activities
9.....	Administration and Associated Activities
10.....	Support of Other Nations

Programs 1, 2, 4, and 5 are considered force related. Programs 3, 6, 7, 8, 9, and 10 are considered support programs.

One must be able to move back and forth between the Congressional input budget and the DoD program budget. The process of translating from one budget form into another is called the crosswalk (Wildavsky, 1984, pg. 284).

The program element is the basic building block of the FYDP and the common unit on which the crosswalk is based. A program element normally consists of hardware, manpower, and costs. Examples are: cruisers, PE #24291N; Trident, PE #11228N; and depot maintenance, PE #72007N. The first digit reveals the program element. The *DoD Program Structure Codes and Definitions Handbook* (DoD 7045.7) defines the characteristics of the middle four digits. The last letter indicates the service. The three examples are all Navy programs. Army and Air Force Programs are indicated by "A" and "F," respectively. (DoN *RDT&E Management Guide*, 1985, pp.3-1, 3-2).

The program element has several dimensions. Sorting program elements by the first character which indicates the major program yields the DoD program budget. Using other dimensions which are embedded in the four digit code, they can be sorted into an input budget or they can be sorted for material management purposes.

#### 8. PPBS

With this background, understanding PPBS is possible. PPBS is a structure for allocating resources while considering the perceived threats. The output of PPBS is the current year budget and an updated Five-Year Defense Plan. PPBS is executed in the three phases that comprise the title: planning, programming, and budgeting.

a. Planning.

In this phase, the Joint Chiefs of Staff, in consultation with the unified and specified commanders-in-chief, evaluate the environment and attempt to predict the nature and size of the threat(s) to the United States. The resultant fiscally unconstrained *Joint Strategic Planning Document (JSPD)* lists the forces and manpower necessary to counter those threats.

The *JSPD* has been criticized because it is not fiscally constrained. It is possible to conceive that the perceived threat might outweigh the resources the country is willing to commit to defense. The JCS should probably consider all threats and plan for what would be required to defend against them, even if it is not politically possible to fund that maximum force level.

The Secretary of Defense reviews the *JSPD* and prepares a document called the *Defense Guidance*. The *Defense Guidance* is a broad statement of national military strategy based on fiscal constraints provided by the President. It provides expected fiscal ceilings to be used in preparing the FYDP. The issue of the *Defense Guidance* marks the start of the Programming phases. Each service attempts to convert broad spectrum strategies into specific acquisition and force programs to counter the threats identified in the planning phase.

The *Program Objective Memorandum (POM)* is the critical communication from the service secretary to the Secretary of Defense, describing how the service intends to fill a specific mission need in the FYDP. The *POM* is expressed in terms of:

- Force structure,
- Manpower and material, and
- Estimated cost.

Requests for changes to previously approved FYDP are also submitted through the *POM*. The summary of the new and revised programs yield an updated FYDP.

c. Budgeting

The Department of the Navy *Budget Guidance Manual* (NAVCOMPT Instruction 7102.2) provides detailed guidance to budget submitting organizations for preparing and submitting budget requests, preparing requests for reconsideration in response to budget adjustments made by higher authority, and executing the DoN budget. DoN has divided the budget process into four phases.

The first phase is submission of the budget to NAVCOMPT and DoN Budget Review. Given Departmental policy and budgetary guidance, each office submits a budget to NAVCOMPT stating its objectives and priorities for resource use.

After an initial review and mark-up by the cognizant budget analyst, NAVCOMPT hearings are held to review program details and to obtain additional information on programs for which initial justification was insufficient. The analyst will often provide written questions before the hearing to allow the submitting office an opportunity to prepare for discussion.

As stated in the *Budget Guidance Manual*, the purpose of the review is to assure a "balance of program profiles"

considering resources expected to be available. To overcome the tendency for cost-estimators to over estimate resource requirements, NAVCOMPT analysts have tended to adopt the "Nemfakos Assumption"<sup>\*</sup> which states that most estimates can be reduced. Many players in the budgetary game have some hidden strategy to get the money needed (Anthony and Herzlinger, 1980, pp.344-353). The Nemfakos Assumption automatically challenges those hidden agendas.

The basis for this assumption is probably valid. The estimator's hedges against program risk and cost overrun are considered "capricious repricing" by the budget reviewer. More importantly, an "unbiased" reviewer in the Office of the Secretary of Defense may challenge the repricing. This challenge can result in the loss of credibility, programs, and dollars. At OSD and OMB, such losses are nearly impossible to recover.

The message is clear. One must:

- Submit budget proposals that comply with policy and guidance provided;
- Justify changes;
- Consider the activity's ability to execute the budget;
- Consider industry's ability to support execution.

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<sup>\*</sup>Refers to a downward bias often observed in DoN, named after Charles Nemfakos. The assumption attempts to remove the "protective blanket" surrounding the program manager's budget estimates by requiring justification of true need.

After a budget submission is "marked," the submitting activity has the opportunity to ask the analyst to reconsider his judgement. The request for reconsideration is called a "reclama." The *Budget Guidance Manual* addresses the procedures. Reclamas must normally be returned to the analyst within three work days after distribution of the mark-up.

In submitting the reclama, the challenging activity must provide additional information to support the request. The reclama must challenge the rationale of the mark-up. Reiterating that the program is "critical to achieving the command mission" will not result in getting the desired money. One must provide new information that NAVCOMPT can use to support its arguments in the OSD/OMB review.

The second phase is the submission of the budget to the OSD and OMB. This review is similar to the DoN Review. The joint OSD/OMB review transforms the budget into the SECDEF's budget and the President's Budget.

The third phase is submission of the President's Budget to Congress. The fourth phase is Congressional action leading to enactment of the appropriation. The third and fourth phases will be discussed in the subsection entitled Congressional Budget Process.

#### 9. Summary

This section has briefly covered covered the Planning, Programming, and Budgeting System. PPBS is the Navy's resource allocation tool. The JCS and the Unified and Specified Commanders begin the PPBS process by analyzing and describing

the perceived threat(s) in the *Joint Strategic Planning Document*. Each service secretary evaluates the *JSPD* and submits *POM* to suggest ways in which his service can meet missions identified in the *JSPD*. The Secretary of Defense approves the *POM* with *Program Decision Memoranda (PDM)*. Navy PPBS is executed by the Director of Navy Program Planning. The output of the PPBS process is a FYDP and the current year budget.

## B. THE CONGRESSIONAL BUDGET PROCESS

The comptroller is the staff expert on all financial and budgetary matters. He or she must understand how Congressional actions may influence the command's budget execution.

This section examines the Congressional processes providing Federal money. It focuses on the needs of the Practical Comptrollership student and the graduate student who has not taken a public policy course. It is a review for those who have completed a public policy course.

### 1. Learning objectives

- To be able to describe the intent and impact of the Congressional Budget and Impoundment Control Act of 1974(P.L. 93-344).
- To be able to describe the intent and potential impact of the Balanced Budget and Emergency Deficit Control Act of 1985(P.L. 99-177)
- To be able to describe the budgeting process, from submission of the President's Budget in January until appropriation enactment.

- To recognize the key players in the budget process, including OMB, the President, and the Congressional Armed Services, Appropriations, and Budget committees.

## 2. Two Key Laws Influencing the Process

As discussed in the previous segment, the DoD budget is negotiated, balanced, reconciled, consolidated, and submitted to OMB by late December or early January. Once approved, the DoD budget becomes part of the President's Budget Proposal. Through 1986, the President's Budget was submitted within fifteen days of Congress reconvening in January, usually with the President's State of the Union Address.

### a. Congressional Budget and Impoundment Control Act

The Congressional Budget and Impoundment Control Act of 1974 implemented radical procedural and structural changes in the process. The Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman Act) implemented a series of actions aimed specifically at balancing the Federal Budget by 1991.

The Congressional Budget and Impoundment Control Act of 1974 was intended to correct six problems that reduced Congressional budgetary effectiveness. The problems were:

- Congress did not have enough time to enact appropriations before the beginning of the fiscal year.
- Congress had no mechanism to set spending priorities.
- Congress had no mechanism to set economic policy.
- Congress could not obtain objective information on budget matters.

- Congress had no way to impose spending discipline on its committees.
- Congress had no procedures for overcoming presidential impoundments. (Collendar, 1985, pg 14).

The Act implemented nine provisions to correct these problems.

- The Congressional Budget Office (CBO) was established to provide unbiased, professional estimates of budgetary impact. CBO performs research to support congressional decisions.
- The fiscal year was changed to allow Congress more time to deliberate and act on the budget. The change was accomplished by creating a transition fiscal year from 1 July to 30 September 1976, fiscal year 7T. Fiscal year 77 started on 1 October 1976 and ended on 30 September 1977.
- The House and Senate Budget Committees were established. Before this act, the taxing committees and the spending committees worked independently. No one in Congress was able to compare what was being spent with what was being collected to fund the spending. The Budget Committees, with the advice of the Congressional Budget Office, would be able to balance spending and taxation.
- The act required two "concurrent resolutions." The first concurrent resolution was
  - to establish targets for the aggregate levels of budget authority, outlays, revenues, and deficit or surplus, the appropriate level of public debt, and an estimate of the budget authority and outlays for each of the nineteen budget functions (Collendar, 1985, pg 150).

The second concurrent resolution was intended to revise and update the first. Neither resolution required presidential approval.

- Authorization estimates had to be submitted six months earlier.
- The President was required to submit a five year budget estimate rather than just a one year estimate.
- The President was required to submit a "current services" budget. This was a projection of what each program would cost if no policy changes were invoked.
- A standard Federal system for recording budget and program data and information was mandated.
- The President's ability to impound, or refuse to release money to be spent was restricted. President Nixon had forbidden the OMB from apportioning money to a benefiting agency several times. To prevent this from happening again, Congress imposed strict reporting requirements on presidential deferrals (spending delays) and rescissions (permanent reductions in spending authority). A deferral is considered approved if Congress does not act. If, however, Congress does not approve a rescission within 45 legislative days, the rescission is considered disapproved and the president is obliged to release the money. The Comptroller General is required to file civil action against the president if he refuses to release duly authorized appropriations.

The Congressional Budget and Impoundment Control Act was procedural and organizational. It attempted to provide a new framework and mechanism for the budget process.

b. Balanced Budget and Emergency Deficit Control Act

The Balanced Budget and Emergency Deficit Control Act (Gramm-Rudman Act) does not change the framework installed by the earlier act. Rather, the new act tries to force

the budget process to achieve balanced budgets within the existing Congressional structure.

The significant actions in Gramm-Rudman are (1) establishing fixed deficit targets to be achieved between 1986 and 1991; and (2) invoking an automatic reduction tool called sequestration to achieve the deficit targets if the President and Congress do not meet them (Collendar, 1986, pg.15).

The deficit targets are consecutively lower deficits to be achieved by some combination of tax increase and spending decreases between 1986 and 1991. The deficit targets are recapped below (in billions of dollars):

Fiscal <u>1986</u>	Fiscal <u>1987</u>	Fiscal <u>1988</u>	Fiscal <u>1989</u>	Fiscal <u>1990</u>	Fiscal <u>1991</u>
171.9	144	108	72	36	0

The President must propose a budget which meets these targets. He may recommend any combination of cuts or tax increases that he desires to meet the target. Thereafter, Congress must meet these targets exactly in fiscal years 1986 and 1991. Congress has allowed itself a variance of \$10 billion for the years in between.

The Gramm-Rudman Act accelerates the timetable for Congressional action. This is probably trivial, since Congress has achieved its self-imposed budget schedule only once since 1975. The Act also requires Congress to pass one Concurrent Resolution rather than two. This is also trivial because Congress has historically acted under one resolution.

Stanley Collendar provides an excellent analysis each year of the Congressional budget process (Collendar, 1986, pp.13-23). Part of the timetable, incorporating Gramm-Rudman changes, is shown below:

25 February	Committees submit their non-binding "view and estimates" to respective budget committees.
1 April	Senate Budget Committee reports Congressional budget resolution to Senate.
15 June	Congress completes action on fiscal year reconciliation bill.
30 June	House cannot begin Independence Day recess unless it has passed all (13) annual appropriations for the coming year.

The student should review current Congressional actions in the news. No matter how the rules are written, one must look to see what Congress is doing today. In the FY87 budget cycle, for instance, Congress consolidated all thirteen appropriations into one omnibus act in late October. The act nominally complies with Gramm-Rudman requirements. This delayed action, however, emasculated the sequestration feature of Gramm-Rudman, because there were no appropriation acts to evaluate in August and September, as required under the law.

With the background of these two pieces of legislation, one can understand the actions and players in the process.

### 3. Congressional Action

Once the DoD budget proposal is presented to Congress, three committees act on it: the House Armed Services Committee,

the House Appropriations Committee, and the House Budget Committee. By tradition, new legislation generally originates in the House. The Senate process is similar.

Recommendations for new defense programs must be considered by the House Armed Services committee. As the authorizing committee, the House Armed Services Committee conducts hearings and investigates the proposed program. If the program is found to have merit, the authorizing committee prepares the substantive legislation needed to create the program.

The authorizing legislation provides a maximum force structure and composition allowed to accomplish the mission. The bill may include a sunset clause, which either ends the program, or requires that new legislation be enacted at some future date to continue the program. Although the authorizing legislation often includes a dollar limitation or ceiling, it does not allow any money to be spent. Once the program is authorized, it must be examined by the relevant Appropriations Committee to determine what level of budget authority will be allowed.

The House Appropriations Committee must review and act first on existing programs. In deliberating over an existing program, Congress practices incremental budgeting. The rationale behind incremental budgeting is that Congress has neither the time nor the staff to review every dollar in the nearly \$600 billion budget over which the President and the Congress may hold some control. Congress must trust previous decisions and committee work. Base figures, the prior year's budget levels, are accepted as

given. Thus, Congress weighs changes (increases) to previously budgeted amounts in comparison to the "base" in order to make budgetary decisions.\*

As a final step in each house of Congress, the Senate or House Budget Committee examines each appropriation. The Budget Committee considers the fiscal policy impact of the spending and tries to balance its impact with other legislation.

The Budget Committee is supposed to perform a reconciliation, wherein the appropriations from each committee are compared with expected revenues and with desired fiscal policy. If the amounts appropriated will exceed the "acceptable deficit," the Budget Committee is supposed to instruct the Appropriation Committee to reduce the appropriation act.

The full Senate and full House almost never generate the same legislation. Thus, a conference committee must usually meet to negotiate the legislation between the Upper and Lower House. The conference committee will report out a joint act which must then be acted upon again by the full Senate and full House. It is this approved joint legislation which is presented to the President for his approval or veto.

#### 4. Impact on the field comptroller

The field comptroller is impacted strongly by the failure of Congress to pass a budget. Several times in recent years, civilian employees have been sent home on furlough, which is a day of

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\*See Wildavsky, Chapter 6, for additional discussion and comparison of budgeting styles.

leave without pay. Technically, benefits and pay cannot accrue when there is no budget. No one can take leave, because it too, is a form of compensation.

Congress has used the "continuing resolution" as a means for keeping government operating while it deliberates. The continuing resolution "allows a Federal agency or department to continue spending funds when its regular appropriation is not passed on time" (Collendar, 1986, pg.45). While operating under this stopgap legislation, an agency may spend money at the level authorized in the previous year's budget, for previously authorized and funded programs. New programs, however, cannot be started until an appropriation act (of some kind) is approved. This delay puts pressure on field activities in executing budgets. Often, new starts require major contracting to get off the ground. Allowing for the Congressional delay, and the time lag in apportioning and allocating money, a program which was intended to be executed in twelve months may be compressed to less than six months. This tends to reflect badly on the program sponsor in the next budget review cycle. Followup on previous program execution is a major consideration in the review process.

Sequestration will affect the comptroller as well. Previously submitted and approved command budgets will be reduced to achieve the reduced outlays required by sequestration. The target for most cuts will be annual expense appropriations. The O&MN appropriation which funds most civilian personnel, and most shore based and shipboard maintenance is always a promising

target for reducing outlays. Large acquisition and building programs, which are investment appropriations, are protected from cuts by contractual obligations. Congress cannot legally renege on a fixed price multi-year contract for airplanes or a ship.

The field comptroller must develop, with the commanding officer, a strategy for achieving the required reductions. He must have a good relationship with key people in the financial chain of command so that he gets good information as soon as it is available. He must rely on his negotiating and communicating skills to find ways for his fellow department heads to achieve their objectives, while at the same time meeting the cuts directed by his command's financial sponsor.

Despite Congress' and the Navy's best efforts, not every desirable and necessary program can be funded under an appropriation. Some requirements develop during execution and require immediate action. Congress allows programs to be funded through changes within and between appropriations, as explained in the next section.

#### 5. Changing amounts made available in appropriations

Federal agencies may change the amount of money available in an appropriation using either of two legal avenues. The Congressionally imposed limitations and reporting requirements for both methods are cited in Table 3.

**TABLE 3. CONGRESSIONAL OVERSIGHT REQUIREMENTS FOR OTHER THAN CONSTRUCTION REPROGRAMMING BY TYPE OF APPROPRIATION**

	<b>Congressional Restriction or threshold</b>	<b>requirement</b>
<b>ALL APPROPRIATIONS</b>	<b>Any item or activity--</b>	
	previously denied by Congress.	None allowed
	previously reduced by, or of special interest to Congress.	Prior Approval
	that will result in significant follow on cost.	Notification*
	involving the use of general transfer authority	Prior approval
<b>MILITARY PERSONNEL</b>	<b>\$10 million or more per budget activity</b>	Notification
<b>OPERATIONS AND MAINTENANCE</b>	<b>\$5 million or more per budget activity</b>	Notification
<b>PROCUREMENT</b>	<b>\$10 million or more per approved line item</b>	Notification
	<b>\$2 million or more per new line item</b>	Notification
	<b>Less than \$2 million per new line item</b>	Advance notification <sup>†</sup>
	<b>Increase in procurement quantity of aircraft, missile, tracked combat vehicle, or other weapon system subject to authorization legislation</b>	Prior approval
	<b>Application of funds to fiscal year program prior to current fiscal year</b>	Not allowed
<b>RDTE</b>	<b>\$4 million or more per approved program element</b>	Notification
	<b>\$2 million or more per new program element</b>	Notification
	<b>Estimated at \$10 million or more in 3-year period per new program element</b>	Notification

\* Notification requires 15-day waiting period.

† Advance notification justifies item and give rationale for fund source. Does not require waiting period.

SOURCE: Part IV. Department of the Army Budget Directive

The first method is reprogramming, or moving money within an appropriation. Although an agency must notify Congress that it is reprogramming funds, in most cases, Congress can be notified after the fact. The second method is a transfer which moves money between appropriations. Congress must always approve transfers before the money is moved.

#### 6. Summary

This chapter has examined the Congressional Budget Process, the method by which Congress appropriates money to fund government operations. Two recent laws by which Congress attempts to govern itself have been outlined. The purposes and responsibilities of the House and Senate Appropriation Committees, the House and Senate Armed Services Committees, and the House and Senate Budget Committees have been discussed briefly. The rules governing transfer and reprogramming funds were provided.

Money is now available to the president to run the government. The next section will cover how the money gets from the OMB to the operating Navy.

#### C. FUNDS FLOW TO THE COST CENTER

After discussing how DoD arrives at its portion of the budget estimate, and how the Congress deliberates on and validates the estimate, the next step is to study how the funds move from the Congressional Appropriation Act to the Cost Center or using activity.

## 1. Learning objectives

- To understand how funds move from Congress to the Cost Center.
- To understand the following terms as they relate to Navy budgeting: apportionment, allocation, and suballocation.
- To know the legal and administrative restrictions on expenditures and obligations.
- To understand the concepts of fences, ceilings, and floors.

## 2. Funds flow

After the appropriation is passed by the Congress and signed by the president, the Secretary of the Treasury prepares a warrant which formally advises SECDEF and SECNAV how much money is available to be spent. The warrant cites any Congressionally imposed fences, ceilings, or floors placed in the appropriation language (explained below). The warrant is countersigned by the Comptroller General to certify that the Treasury Secretary interpreted the limitations correctly. A certified copy of the warrant is provided to NAVCOMPT.

The warrant is the Navy's legal guideline for spending money, but it does not authorize the Navy to spend. That authorization comes from OMB, acting for the president, in the form of an apportionment. OMB generally apportions money quarterly, in accordance with the President's fiscal policy guidance. The apportionment is received by NAVCOMPT (for SECNAV). The comptroller then allocates funds to "responsible

offices," such as the CNO, the CMC, and the Assistant Secretary of the Navy for Research.

The responsible offices then suballocate the money to the fleet commanders in chief, hardware commands, and research agencies. For example, the Commander in Chief Atlantic Fleet suballocates money to Commander Submarine Force Atlantic Fleet.

### 3. Legal Limitations

All agencies holding budgets are subject to both civil and criminal punishment under Title 31, United States Code Amended, for overspending their budgets. Operating Target holders are administratively responsible, but not legally liable for keeping their budgets "in the black."

Previously known subsections 3676 and 3679, the relevant subsections are now 1341(a), 1342, and 1512, Title 31, United State Code, Amended. The crucial references are quoted below.

#### §1341 LIMITATIONS ON EXPENDING AND OBLIGATING AMOUNTS

"(A)(1) AN OFFICER OR EMPLOYEE OF THE UNITED STATES GOVERNMENT OR OF THE DISTRICT OF COLUMBIA MAY NOT —

(A) MAKE OR AUTHORIZE AN EXPENDITURE OR OBLIGATION EXCEEDING AN AMOUNT AVAILABLE IN AN APPROPRIATION OR FUND FOR THE EXPENDITURE OR OBLIGATION; OR

(B) INVOLVE EITHER GOVERNMENT IN A CONTRACT OR OBLIGATION FOR THE PAYMENT OF MONEY BEFORE AN APPROPRIATION IS MADE UNLESS AUTHORIZED BY LAW.

#### §1342. LIMITATION ON VOLUNTARY SERVICES.

"AN OFFICER OR EMPLOYEE OF THE UNITED STATES GOVERNMENT OR OF THE DISTRICT OF COLUMBIA GOVERNMENT MAY NOT ACCEPT VOLUNTARY SERVICES FOR EITHER GOVERNMENT OR EMPLOY PERSONAL SERVICES EXCEEDING THAT AUTHORIZED BY LAW EXCEPT FOR EMERGENCIES INVOLVING THE SAFETY OF HUMAN LIFE OR THE PROTECTION OF PROPERTY...

**§1350. CRIMINAL PENALTY.**

"AN OFFICER OR EMPLOYEE OF THE UNITED STATES GOVERNMENT OR OF THE DISTRICT OF COLUMBIA GOVERNMENT KNOWINGLY AND WILLFULLY VIOLATING SECTION 1341(A) OR 1342 OF THIS TITLE SHALL BE FINED NOT MORE THAN \$5000, IMPRISONED FOR NOT MORE THAN TWO YEARS, OR BOTH.

**§1517. PROHIBITED OBLIGATIONS AND EXPENDITURES.**

"(A) AN OFFICER OR EMPLOYEE OF THE UNITED STATES GOVERNMENT OR OF THE DISTRICT OF COLUMBIA GOVERNMENT MAY NOT MAKE OR AUTHORIZE AN EXPENDITURE OR OBLIGATION EXCEEDING —

(1) AN APPORTIONMENT; . . .

**§1519. CRIMINAL PENALTY.**

"AN OFFICER OR EMPLOYEE OF THE UNITED STATES GOVERNMENT OR OF THE DISTRICT OF COLUMBIA GOVERNMENT KNOWINGLY AND WILLFULLY VIOLATING SECTION 1517 OF THIS TITLE SHALL BE FINED NOT MORE THAN \$5000, IMPRISONED FOR NOT MORE THAN TWO YEARS, OR BOTH.

Subsections 1341(a) and 1342 forbid obligating more dollars than are authorized by an appropriation. This includes spending money for purposes other than cited in the appropriation. Funding research and development for a new weapons system with O&MN dollars violates subsection 1341(a) because RDT&E dollars are intended for that purpose. Buying a \$25,000 metal press using O&MN violates subsection 1341(a), because the equipment is correctly purchased using OPN dollars.

Subsection 1517(a) forbids an agency from obligating more money than is apportioned to it. Operations and maintenance is apportioned quarterly. If COMNAVSURFLANT is apportioned \$10 million in the first quarter and allows its ships and stations to obligate \$11 million, it has violated subsection 1517(a), even if the

money was scheduled to apportioned in the following quarter of the same fiscal year.

#### 4. Congressional "Language"

At times, Congress inserts a limit, or fence, on spending in the language or wording of an appropriation. A fence requires that an agency spend a certain proportion of an appropriation to achieve a specific purpose or objective. A fence stipulating an upper limit on spending is called a ceiling. A fence that establishes a lower limit is called a floor. For example, Congress has recently required that over 50% of the ships' O&MN budget for each fleet be expended on repair parts. Shore stations routinely receive floors requiring that some given percentage be spent on Maintenance of Real Property (MRP). Ceilings are often provided on O&MN funds that may be expended to support Non-Appropriated Fund activities.

#### 5. Summary

This section has covered the movement of funds from Congress to the Cost Center, or spending activity. Of interest as the money moves down the chain of command is the transfer of legal liability. Nearly all holders must comply with Subsection 1341(a), Title 31 USCA. Only operating target (OPTAR) holders, deploying shore commands and afloat commands, avoid this legal responsibility.

The next section looks at facilities planning. Visible and audited from Washington down to the Cost Center, facilities planning is covered as part of the "big picture."

## D. FACILITIES PLANNING

The term "facilities planning" encompasses building, maintaining, repairing, and ultimately destroying "real property facilities." The staff Public Works Officer is the local facilities planning expert. Yet, because of the large dollar amounts budgeted and expended for facilities, the comptroller must be involved in the planning process. To contribute, the comptroller must speak the language.

### 1. Learning Objectives

- To be aware of the sensitive environment in which facilities planning occurs.
- To differentiate among construction, minor construction, repair, and maintenance.
- To be aware of limitations on command funding of facilities projects.

### 2. Background

Facilities planning involves the entire organization. The user department discovers a problem and requests repair work. The public works department evaluates the requirement and estimates the cost. The comptroller identifies funds to perform the work. The commanding officer decides if the project is important enough to supersede other work competing for the same funds.

The *Facilities Planning Manual* (OPNAVINST 11010.20E) consolidates all policies and procedures for maintaining, repairing, and constructing facilities. A major problem in administering

construction projects is the similarity of the various categories of work. As noted in the *Manual*:

Several recent Congressional committee reports have highlighted abuses in the interpretation of the authority for accomplishing minor construction with operations and maintenance funds. There is no question that this high level concern will continue and that the administration of facilities projects at all levels will be audited frequently. (OPNAVINST 11010.20E).

Demolishing a building or structure is an example of work which may fall into either of two categories, depending on circumstances. If a facility is to be demolished incident to replacing it with another facility, the demolition should be funded as a construction project. On the other hand, should a building be demolished simply because it is no longer useful or safe, the demolition should be funded as a repair.

In this process, one can see potential for circumvention. How far ahead may one foresee the replacement construction? Has the law been violated if a building is demolished in 1985 using repair funds and the command decides to build a new facility on the vacant lot in 1986? The resolution to this dilemma will be found by opening communication with the local Naval Audit Service (NAS) Representative. Circumvention will probably be found if the new facility has been in the budget since before the building was demolished. On the other hand, if funding for the new facility is part of a subsequent budget request, no fault is likely to be found. Generally, the comptroller should seek help

from his NAS Representative if he is uncertain how an action could be interpreted.

The effective comptroller, consistent with the philosophy explained in Chapter II, will participate in and guide the planning process. He will help the Public Works Officer execute the command plan while protecting the commanding officer from violating Subsection 1341(a), title 31 USCA. The comptroller must communicate continuously with the Public Works Officer. The Public Works Officer is the facilities planning expert. The comptroller, however, is the command budget advocate and must remain involved in all command activities.

Understanding the following basic concepts will increase the likelihood that the comptroller will be knowledgeable, and thus effective.

### 3. Basic Concepts

The Military Construction Appropriation (MCN) is centralized and tightly controlled. Congress holds extensive hearings and analyzes all parts of this five-year, fully funded, investment appropriation. In addition to approving major projects in the appropriation language, Congress requires that expenditures over certain thresholds be reported to a subcommittee.

The long lead time required for this approval cycle has encouraged commands to try innovative ways to circumvent the rules. Incrementation is an example of an illegal action. Dividing a facilities project into smaller, "legal" chunks to be performed in less visible bites constitutes incrementation. By reducing visibility,

a large project can perhaps be accomplished more quickly than by waiting for the "normal" appropriation approval. Incrementation is illegal, and is easy to discover considering the detailed records kept on facilities. As noted in the Facilities Project Manual, audit and oversight will continue. Such circumvention violates subsection 1341(a) of title 31, USCA.

An activity, in the context of facilities planning, is a unit of the Naval establishment, of distinct identity, established ashore under a commanding officer or officer-in-charge. A support agency is a command or officer responsible for providing financial resources to an activity.

A real property facility is a separate and individual building, structure, or other real property improvement.

Construction is the erection, installation, or assembly of a new real property facility; the addition, expansion, extension, alteration, conversion, or replacement of an existing real property facility; or the relocation of a real property facility.

Conversion is a major structural revision of a real property facility that changes the purpose for which the facility was designed or used. Two elements are necessary for conversion: (a) a major structural revision and (b) a change in functional purpose. A conversion project may also include repair or maintenance which may be funded separately as such.

Addition, extension, and expansion each constitute a physical increase to a real property facility that adds to the overall

dimensions of the facility. Moreover, increasing the capacity of a utility plant by adding a generator constitutes an expansion.

An alteration is the work required to adjust interior arrangements, on base locations, or other physical characteristics of the existing real property facility so that it may be more effectively used for its intended purpose. Additions, expansions, and extensions are not alterations.

Construction incident to repairs is that for which good engineering practice dictates simultaneous repair. The intent of the integrated undertaking must be restoring the real property to such condition that it may be used for its designed purpose and must be separately identified in the cost estimate for proper funding.

A minor construction project is a single undertaking at a military installation that includes all construction necessary to produce a complete and usable improvement to an existing facility, and has an approved cost less than or equal to the amount specified by law as the maximum amount for a minor military construction project.

#### 4. Repair versus Maintenance

It is difficult to differentiate between maintenance and repair. Generally, maintenance does not require the replacement of constituent components. Further, maintenance is done to prevent or correct wear and tear to prevent or delay replacement.

Repair is the act of restoring a real property facility to such condition that it may be used for its designed purpose by

overhaul, reprocessing, or replacing constituent parts that have been worn by the elements or use.

Maintenance is the recurring, day-to-day, periodic or scheduled work required to preserve or restore a real property facility to such condition that it may be used for its designed purpose. Maintenance includes work accomplished to prevent damage that would otherwise be more expensive to restore.

Maintenance is divided into broad categories of specific maintenance and continual maintenance. Specific maintenance is preventive maintenance generally performed under a job order. The work is normally cyclic. Examples are exterior and interior painting of buildings and resealing joints in concrete pavement.

Continual maintenance is preventive, recurring work to maintain the facility. This type of work is very repetitive on a portion of a facility. Examples are railroad track maintenance, pier maintenance, and preventive maintenance on electrical and mechanical equipment.

#### 5. Funding Limitations

Congress has imposed fiscal limits on the commanding officer's authority to approve facilities projects. The commanding officer's authority is summarized in Table 4. Table 4 also specifies who has authority to approve larger projects. Obviously, Congress can change the limits at any time.

TABLE 4. LIMITS AT A REGULAR SHORE ACTIVITY

Category of Work	Cost limits	Submission	Approval Authority	Funds Source
Continual Maintenance	None	None	C.O.	Note 1
Specific Maintenance and Repair	0-75,000	None	C.O.	Note 1
	75,001-200,000	M.C.	M.C.	M.C.
Repair costing > 200,000 and over 50% of replacement value	Over 200,000	NAVFAC	ASN(S & L)	M.C.
Minor Construction	0-25,000	None	C.O.	Note 1
	25,001-200,000	M.C.	M.C.	M.C.
	200,001-500,000	CNO	CNO	CNO(MILCON)
	500,001-1,000,000	ASN(S & L)	ASN(S & L)	CNO(MILCON)

Note 1: Activity operating funds, Expense operating budget

M.C. is the Major Claimant.

## 6. Summary

This section is not intended to make the comptroller a facilities planning expert. Nonetheless, it should have highlighted the need for the comptroller to understand (1) the importance of facilities planning, (2) some of the lexicon of facilities, and (3) why he must involve himself in the planning process. Moreover, the comptroller must work closely with the Public Works Officer to

stay abreast of his needs. Both must work to achieve a mutually beneficial situation.

## E. THE AUDIT

An audit is a method for achieving control of an organization. Audit and inspection pervade DoD and DoN. In its most general sense, an audit determines if the auditee is meeting the standards provided by an authoritative organization.

Auditors seem to be everywhere, looking at everything. As a military officer or federal official, one must learn to cope with and benefit from audits. The audit can be a learning experience. If used properly, the actions resulting from audit findings can improve a command's operation.

### 1. Learning Objectives

- To understand the nature of internal audit.
- To understand the audit organizations influencing the DoD and DoN.
- To be familiar with the organization of the Naval Audit Service (NAS).
- To distinguish among financial and compliance audits; economy, efficiency, and effectiveness audits; and program audits.
- To be able to discuss management actions resulting from an audit.

### 2. Audit Theory

Auditing is a systematic process of gathering evidence to determine if an organization is meeting predetermined objectives,

and then reporting those findings to someone else. The predetermined objectives are the areas being evaluated. The selection of objectives indicates the scope or breadth of the audit.

An audit of a command's imprest or petty cash fund can exemplify narrow and broad scope audits. On one hand, the auditor might examine only the cash and the records in the safe. From this narrow scope audit, he may determine that the imprest fund is managed properly. A broader scope audit would require that the auditor examine the safe's contents, then follow all documents back to the originating officer to verify that he or she did, in fact, approve the purchase. The auditor might also ask to see the merchandise to verify that the division purchased what it said it intended to purchase.

a. Supervisory Audit

There are two broad categories of audits. The more basic is the supervisory audit. It is conducted by the supervisor to determine that the employee is performing as he or she is supposed to. Verbal feedback is given immediately.

b. Third-Party Audit

The third-party audit is performed by someone outside of the direct line of authority. An aviation electronics technician conducting a quality assurance check on a job performed by another shop is a third-party auditor. The keys to the effective third-party audit are:

- That the person performing the audit be technically qualified. A yeoman would not be qualified to perform a quality assurance check on a jet engine.

- That the person be independent and unbiased. If a sailor must audit his boss, then rely on him for liberty, the auditor is not independent and will probably render a biased opinion.
- That either a verbal or written report be made. If no one else knows of the deficiency, it will probably not be corrected.
- That line management be accountable for following up on the report and for completing the job. The auditor can only make recommendations. Line management must validate the findings and correct them. If the quality assurance petty officer finds a problem and helps to correct it, he has lost his independence. He can no longer judge the work, because it is now his work.

### 3. Internal audit

Defining internal audit depends on where one stands. The NAS is an internal audit agency for DoN, but it is an external audit agency for Naval Shipyard Mare Island.

From a management perspective, internal audit is a tool that the organization uses for finding and correcting operating problems before an auditor from outside the organization finds them. Internal audits expand and centralize control. An internal audit supplements the supervisory audit by providing additional sets of independent but knowledgeable eyes and ears to evaluate performance and results, and to train employees.

### 4. Audit agencies

This section will discuss the major audit agencies that influence the DoD.

#### a. General Accounting Office (GAO).

GAO is the Congressional auditing arm, headed by the Comptroller General. Its *"Standards of Audit of Governmental*

*Organizations, Programs, Activities, and Functions*, "otherwise known as the "Yellow Book," has greatly influenced both government and civilian auditing. The Yellow Book, first published in 1972 and revised in 1981, outlines the procedures for "expanded scope" auditing. Rather than simply attesting to the accuracy of financial records and reports, expanded scope auditing tries to evaluate the appropriateness of what an agency does. Then the expanded scope auditor considers how well the agency does what Congress intended it to do.

b. Naval Audit Service (NAS).

The NAS, the Navy's internal audit force, is headed by the Auditor General of the Navy, a Senior Executive Service (SES) member. The Auditor General reports to the Under Secretary of the Navy. The DoN *Audit Manual for Management* (SECNAV Instruction 7510.7) summarizes the NAS mission and guides commands in preparing for audits and responding to audit findings.

Headquartered in Falls Church, Virginia, the NAS has regional offices in Camden, New Jersey; Washington, D.C.; Norfolk, Virginia; and San Diego, California. The regional offices are commanded by three Navy captains and a Marine Corps colonel. The NAS has representatives at Naval Shipyards, Supply Centers, and Air Rework Facilities to perform continual on site audits. In addition to auditing, NAS Management Consulting Directorates provide managerial assistance which can recommend solutions to client problems.

c. Defense Contract Audit Agency (DCAA).

As the only DoD agency authorized to audit contractors, DCAA examines and evaluates the records and operations of defense contractors. Although DCAA audits no DoD agencies, its director reports directly to the SECDEF. DCAA evaluates contractors' compliance with the Cost Accounting Standards.

d. Inspectors General

Military services have had inspectors general for decades. The Inspector General Act of 1978, nevertheless, formalized their existence and made their duties consistent across all agencies. Inspectors general perform essentially the same duties as the audit services. As stated in the legislation, the inspector general is intended to "increase economy and efficiency in the Executive Branch of the Government."

According to Congressman L. H. Fountain, the principal author of the Act, the agency inspector general will:

- Conduct and supervise audits and investigations relating to the programs and operations of his or her agency.
- Provide leadership and coordination and recommend policies for other activities designed to promote economy and efficiency and to prevent and detect fraud and abuse in such programs and operations.
- Keep their agency heads and the Congress informed about the administrative problems and deficiencies and the necessity for and progress of corrective action.

e. Department of Defense Inspector General (DoD/IG).

A 1982 amendment to the Inspector General Act of 1978 changed the Defense Audit Service to the DoD Inspector General, which reports to the Secretary of Defense. DoD/IG audits the office of the SECDEF, the Organization of the JCS, and all Defense agencies. It performs interservice audits, as well as quick response and special interest audits for SECDEF.

5. GAO Audits

GAO performs some financial and compliance audits, such as audits of the Senate Barber Shop and the House Beauty Salon. More often, however, GAO executes expanded scope audits. Expanded scope audits are typically performed on a one time basis to provide information for Congress. Each audit is designed and tailored to provide information needed for a congressional committee to reach a decision.

a. Financial and Compliance Audits

Financial and compliance audits focus on the internal financial control system and how well the agency records and reports its financial transactions. The compliance part of the audit evaluates how well the agency follows the rules imposed on it. Audit findings are reported in terms of whether the financial reports accurately reflect the agency's condition.

Questions typically asked during a financial audit include: Do reports accurately reflect the facts? Has the organization and the people in it followed externally and internally imposed rules?

b. Economy and Efficiency Audits

Economy and efficiency audits evaluate how well the agency uses the resources it is given to achieve its mission and objectives. In this type of audit, the auditor broadens his perspective and looks at, for example, job planning, material waste in shops, and administrative time waste in service lines. Audit findings are generally recommendations to improve the efficiency of the organization.

Questions that typify an economy and efficiency audit are: Are the resources provided used efficiently? Is the organization producing the expected results?

c. Program Results Audits

Program results audits evaluate an agency's effectiveness. The auditor is trying to determine if the results of the program are what was desired. For example, a program audit of unemployment offices should attempt to determine whether the offices are actually finding unemployed people jobs.

Questions typical of a program results audit are: Is this the best way to meet the stated objective? Are the objectives worth achieving? Are the results achieved at the lowest possible cost?

6. Naval Audit Service (NAS)

The NAS defines its audits differently. According to the DoN *Audit Manual for Management*, the NAS performs eight types of audits.

- Activity audits are performed on a three to five year cycle. The auditors use audit programs or guidelines to examine "significant functional areas." Previous findings, audit findings elsewhere in the Navy, and Congressional interest are variables that drive selection of "significant" areas.
- Multilocation audits investigate specific functions. In 1985, for example, the NAS performed audits of health care functions, and of supply departments, focusing on spare parts. These two audits were part of DoD-wide multilocation audit.
- Commercial Activity Reviews are performed to comply with OMB Circular A-76 and SECNAV Instruction 4860.44. After the DoN activity has done its in-house cost estimate, the NAS must certify the estimates if they exceed certain thresholds.
- Project Management Reviews are similar to the GAO Program Results Audit. The objective is to determine that a program or project is accomplishing what it is supposed to accomplish.
- Systems Reviews evaluate operational and developmental automated systems. The objective is to determine if the new system complies with the standards imposed by the Comptroller General, DoD, and DoN.
- Morale, Welfare, and Recreation (MWR) Activity Audits are done to evaluate how well local MWR audit boards perform. The MWR review is normally done when the Activity Audit is performed. Marine Corps MWR activities are audited by Marine Corps Nonappropriated Fund Instrumentalities' auditors.
- Unannounced Disbursing Audits are surprise audits. The audit team counts the cash that the disbursing officer holds in his safe and evaluates the effectiveness of the commanding officer's verification program. A comprehensive review is not conducted unless the commanding officer's verification program is ineffective. A comprehensive disbursing review is performed during the Activity Audit.
- Command Request Audits are performed when a commanding officer determines that he needs one. Reports from command

request audits are normally not distributed as other audit reports are.

## 7. Audit approach

The audit approach is the method used to prepare for, conduct, and complete the audit. The NAS approach, described below, is a good general approach for auditing.

- The pre-audit survey is an orientation that gives the audit team a sense of the people and the organization. The auditors normally brief the commanding officer and department heads on the audit scope and objectives about a month before the audit.
- The on-site audit is the accumulation of evidence necessary for the auditors to reach a conclusion about the organization. The Naval Audit Service uses detailed checklists, or audit guides, to ensure that the auditors review and evaluate at least a spectrum of the possible areas.
- A draft report is provided to the command when the on-site portion is completed. Feedback should be continual (daily meetings are ideal) to inform the command of findings. A draft report is provided with the stipulation that the command must respond within thirty days.
- Management response. The command must respond to each finding. The possible responses are: (1) concur--corrective action completed; (2) concur--corrective action not yet completed, but target date established; or (3) nonconcur--to be resolved.
- Publish report. The report is then published and distributed to the chain of command.
- Resolution. Management must thereafter act to resolve remaining uncorrected findings.

- Follow-up. The NAS keeps the status of all audit findings in a database. The Navy Inspector General monitors compliance with findings.

The GAO approach is very similar to the NAS approach. The major difference is that most GAO audits are custom made, requiring more research in the pre-audit phase and thus more time.

A key point in both the NAS and GAO approaches is the iterative handling of audit findings. The initial findings are written, presented to the supervisor, and discussed. Draft findings are later presented to the department head and commanding officer and discussed again. Finally, the commanding officer is provided a formal report and must respond formally in writing to the NAS.

#### 8. Summary.

This chapter has discussed the audit as a management tool. Internal audit is a tool for increasing efficiency and effectiveness, for reducing the risk of error or embarrassment, and for certifying that the organization is financially sound. To benefit from audit, one must not be so concerned with "taking hits" as with improving the organization.

This completes the "Big Picture." The five preceding sections have provided an overview of how the services plan budgets in PPBS, how Congress deliberates on and enacts appropriations providing funds, and how the appropriated money finds its way to the cost center. It was discussed how facilities

planning and audit are functions which bridge Congress with individual cost centers.

The purpose of this section is to convince the comptroller that he is in a large environment, a great part of which influences his job. Attending to that external world can help the comptroller do his job better.

The next chapter returns to the more parochial world of the comptroller, where the focus shifts downward to command level activities.

#### IV. LOCAL PROCEDURES

This chapter will cover the detailed subsystems with which the comptroller must be familiar to survive in his organization. Because of accounting support system and mission diversity, it will be necessary to distill procedures for many subsystems into a few pages. Again, the assumption is that prospective comptrollers have some understanding of accounting systems, and will study as necessary to learn the accounting details. More nebulous, but equally important are the abilities to keep all the Comptroller Department personnel working in the same direction, and to build credibility with the CO, fellow department heads, and the financial sponsor's staff.

This chapter will discuss the Resource Management System, Budget Planning, Budget Execution, and Internal Control. The purpose is to develop a conceptual understanding of how the systems fit together, so the comptroller can ask intelligent questions about potential system vulnerabilities.

##### A. RESOURCE MANAGEMENT SYSTEM ACCOUNTING

The Resource Management System is the formal system by which the Navy budgets and manages Operations and Maintenance, and Research Development, Test, and Evaluation appropriations. It is the structure within which local shore based planning and budgeting decisions are made.

Financial management can be broken into three categories of activities:

- In planning and programming, missions are determined, and the means to accomplish the missions are chosen. These activities are generally accomplished in headquarters commands.
- In budgeting, dollar estimates are attached to the hardware and personnel needed to carry out the missions conceived. Budgeting is an iterative process performed by headquarters commands with some input from decentralized field units.
- In execution, the money that was budgeted is spent. The decentralized field activities execute a large percentage of operating budgets without any feedback from headquarters.

Before the implementation of RMS in 1967, these three activities were not linked together. As a result, the Navy Department, in Washington, was unable to compare its plan with the executed budget. RMS established a uniform chart of accounts and instituted centralized reporting that provided feedback on budget execution to headquarters.

Like PPBS, RMS is an integrated command budgeting system, focusing on a command's output. Command funding is consolidated, increasing the commanding officer's ability to control accomplishment of the command's mission. In the lexicon of RMS, the command is called the responsibility center.

This section will describe RMS accounting and some of its key financial and management reports.

## 1. Learning Objectives

- To understand RMS terminology, including activity and subactivity groups; functional and subfunctional categories; cost account codes; and expense elements.
- To understand the RMS accounting subsystems.
- To be familiar with some RMS reports.

## 2. The Resource Management System

RMS was instituted to change emphasis from obligations to expenses, and to account for military labor. It provided command-level, rather than department-level visibility of funds. It attempted to impose the discipline of accrual accounting on the O&MN account. Operating costs were to be reported up the chain of command to NAVCOMPT.

RMS is, among other things, a cost accounting system. As it was originally conceived, military labor was to be moved from the MPN appropriation into the O&MN appropriation. The operating budget holders would then assume responsibility for budgeting and compensating sailors. The Congressionally approved plan, however, left military personnel funding in MPN.

For years military personnel charges were accumulated for statistical purposes only. Shore commands, however, often ordered military personnel to report only forty hours a week, regardless of hours actually worked or time spent on watch. Thus the statistical data was of little value to anyone.

NAVCOMPT cancelled the monthly report as of 31 March 1986. He cancelled the associated military personnel expense

general ledgers as of 1 October 1986. An account entitled "General Expenses-Military Personnel" has been retained for recording military personnel expenses as they are sometimes reimbursable. (Puhala, 1986, pg. 20).

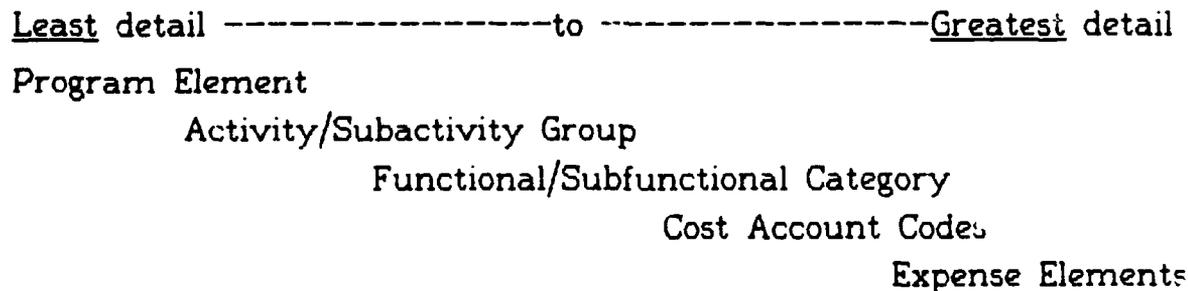
### 3. Uniform Chart of Accounts

A cost accounting system requires the creation of a uniform chart of accounts in order to classify and record expenses (Matz and Usry, 1984, pg. 16). The uniform account structure increases the probability that reported information will be useful to managers. It creates the potential for a sound linkage between budget planning and execution. One may analyze the planned and actual expenditures to determine variances. Standard accounts allow managers to follow program costs from planning through execution.

The uniform account structure is linked to the basic programs, or mission areas, in the FYDP. Thus, it is the basis for responsibility centers to report operating expenses.

### 4. RMS Coding

RMS segregates accounts at five levels of detail. The field comptroller is interested in these categories in order of increasing detail.



a. Program Element

The Program Element is the lowest level of detail. It is a one-digit code consistent with the PPBS program numbers. Thus most commands have only one assigned.

b. Activity Group(AG)/Subactivity Group(SAG)

Activity group/subactivity group is the next level of detail. It identifies the broad area for which money is spent. For example, station operations is assigned AG F3; maintenance of real property is assigned AG FA.

c. Functional/Subfunctional Category Code (F/SFC)

Functional/subfunctional category code is a two character code. It accumulates expenses by function. Examples are:

Mission operations.....	A1
Supply operations.....	E1
Administration.....	D1

The letter "Z" in the second position indicates that the function is reimbursable. A reimbursable mission operations account is identified by "AZ."

d. Cost Account Codes (CAC)

Cost account codes are the basic building blocks of the budget. They describe the functional/subfunctional category in greater detail. CACs measure resource input in terms of cost and man-hours, and measure output in terms of work units produced. CACs can be valuable in estimating budgets. If the line manager can estimate production rates or activity levels, the comptroller

can use CAC information to forecast the cost for given output levels.

CACs are described in the NAVCOMPT Manual (Volume 2). For example, the NAVCOMPT Manual defines CAC 2153:

CAC 2153 Waterfront Container Operations (Waterfront Container)--includes the loading and unloading of empty and loaded containers onto and from vessels; operations of marshalling yards incident to receiving, temporary storage, and release of containers, including arranging for the movement of loaded containers received to ultimate consignees and return of empty containers to the marshalling yard or vessels; and direct supervision of the foregoing operations.

Work Unit: Number of loaded containers handled.

Definition: Reusable metal or wooden containers containing one or more shipment units and measuring 8' x 8' x 20' or larger in size.

Point of Count: Upon completion of the loading or unloading of loaded containers onto or from carriers. Work unit count will exclude empty containers and CONEX loaded onto or from carriers.

e. Expense Element

The expense element is the most detailed level of accounting, recording the type of resource consumed. For example:

Expense Elements

<u>Code</u>	<u>Description</u>
U	Civilian Personnel
M	Utilities and rents
Y	Printing and reproduction
T	Supplies
W	Equipment

Table 3 demonstrates the numerical relationships between these different levels of detail. The matrix represents the finances of a small activity. The activity's missions are training, and supporting its training mission.

The activity accumulates data in four cost account codes: food service, general supply, instructional staff, and counselling. The cost account codes indicate both the type of service and the type of resource providing the service. The responsibility center, for example, will spend \$6000 on civilian personnel (expense element U) for counselling.

By expense element, the command plans to spend \$17000 on civilian personnel (EE U) for the entire command.

TABLE 3. RELATIONSHIP AMONG THE FOUR MAJOR RMS ACCOUNT CATEGORIES

Expense Elements		U	M	T	W	Total
AG/SAG	F3(Base Ops)	17000	2000	3000	8000	30000
E1		3000	1000	2300	2700	9000
	Food Service	2000	800	1000	200	4000
	General Supply	1000	200	1300	2500	5000
A1		14000	1000	700	5300	21000
	Teaching Staff	8000	500	200	300	9000
	Counselling	6000	500	500	5000	12000

The budget can be viewed as \$30,000 by AG/SAG reflecting that the money is to be spent for base operations. Or it may be viewed as \$30,000, categorized by F/SFC reflecting the functions to be performed in consuming the inputs to accomplish the purpose. It may also be viewed as \$30,000 by cost account code, indicating specifically the amount and types of costs incurred and actions performed. Lastly, it may be viewed by expense element to indicate the amount and types of resources consumed.

5. Accounting within RMS

RMS is composed of three subsystems:

- The obligational subsystem,
- The accrual subsystem, and
- The cost accounting subsystem.

The relationship between these subsystems is shown in Figure 7. The characteristics of each subsystem are explained further in subsequent paragraphs.

<p style="text-align: center;"><b>Obligational Subsystem</b></p> <ul style="list-style-type: none"> <li>• Available</li> <li>• Commitments</li> <li>• Obligations</li> <li>• Expenditures</li> </ul>	<p style="text-align: center;"><b>Accrual Subsystem</b></p> <ul style="list-style-type: none"> <li>• Expenses (Consumed on receipt)</li> <li>• Undelivered orders</li> </ul>
<p><b>Cost Accounting Subsystem</b></p> <ul style="list-style-type: none"> <li>• Location...Cost Centers...Local management codes</li> <li>• Purpose    AG/SAG    F/SFC    CAC    EE</li> </ul>	

Figure 7. RMS Accounting Subsystems

a. Obligational Subsystem

The obligational subsystem is similar to checkbook accounting. Recording an obligation is like writing a check. The check writer reduces his checkbook balance, but the money remains in his checking account until the check officially clears the bank. Then the bank records the transaction.

Under obligational accounting, the amount of money available is reduced when a requisition is submitted, or when a contracting center is requested to undertake a contracting effort. Even though funds are not transferred between appropriations or disbursed to a contractor, the money is considered to be spent.

Obligational accounting focuses on the command's financial responsibilities under subsection 1341(a), Title 31 USCA. Recording obligations tries to ensure that the responsibility center does not overspend its budget.

b. Accrual Accounting

Accrual accounting matches the timing of an expense, with consumption of the resource. It is possible that goods and services ordered in this fiscal year might be expensed in the next fiscal year. Accrual accounting is a managerial tool. It should tell the manager what resource level was actually required to support operations in the fiscal year.

Obviously, the balances reported in the obligational subsystem will differ from the balances reported in the accrual subsystem. The "bridge" between the two accounts is called "undelivered orders." New obligations increase the undelivered

orders account. Material or services received in RMS decrease undelivered orders, and increase the appropriate RMS expense account. RMS will thus contain two subaccounts: unfilled obligations and undelivered orders. Each subaccount is made of two components. One component is common to each, and one is distinctive.

The common account is outstanding goods and services which have neither been received nor paid for. The distinctive section of the obligational accounting subsystem is material received but not paid for. The distinctive section of the accrual subsystem is material paid for but not yet received.

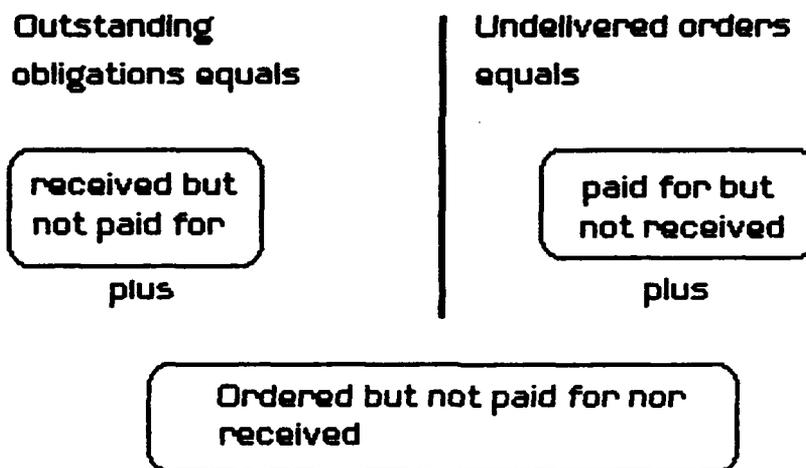


Figure 8. Outstanding Obligations Versus Undelivered Orders

c. Cost Accounting

Cost accounting is the third subsystem of RMS. Cost accounting assigns costs to specific cost objects. The cost accounting subsystem tells management who spent money and for

what purpose. By coding transactions according to AG/SAG, F/SFC, CAC, and EE, costs are assigned to mission areas and cost centers.

#### 6. Official Accountants

RMS responsibility centers maintain memorandum or unofficial accounting records. The official records are kept by the Financial Information Processing Centers (FIPC), previously known as Authorization Accounting Activities (AAA). The FIPC/AAA is a nearby supply center, regional finance center, or fleet accounting and disbursing center. The FIPC/AAA:

- records the data provided by the responsibility center,
- provides financial and management reports to the responsibility center, and
- submits financial reports to the claimant or subclaimant.

##### a. Financial Database

Financial reports are created from a financial database built from transaction data which the responsibility center provides. Transaction data is recorded in a job order number. A sample is provided in Figure 9.

The length of this job order number makes key punch errors common. To reduce the chance of error, commands and FIPC/AAA have established abbreviated codes which are expanded when loaded to the database.

The database should also include the responsibility center's budget plan. Many FIPC/AAA's require that commands submit a copy of the final approved NAVCOMPT Form 2168 or 2179-1 at the start of the fiscal year. Putting the plan into the database allows the computer based accounting support system to

provide an analysis of variances, saving time each month when the reports are received.

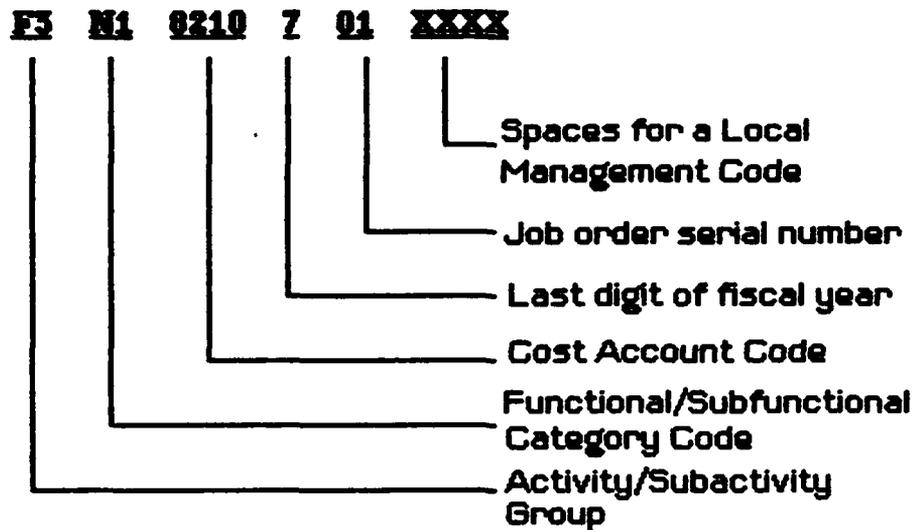


Figure 9. Sample Job Order Number

Alluding to the checkbook analogy, the FIPC/AAA database suffers the same problems as a checkbook. Whether or not the writer records the check properly, it will still clear the bank. The checking account can be overdrawn. Failing to record an obligation in the financial system has the same impact. The supply system will ultimately charge the careless user's account. Like the careless check writer's bank, the FIPC/AAA will reduce the command's available balance.

Other errors can delay loading a document to the database. The document can be keypunched or transcribed incorrectly. Or the requisition number can be coded incorrectly by any of the supply activities handling the document.

Despite the best efforts of all involved, errors happen. Good communications and relations with the FIPC/AAA can reduce the impact of errors. With good relations, the FIPC/AAA is more likely to call the comptroller to advise of a significant error rather than sending a scathing message without warning.

#### 7. Budget/RMS/Management Reports

The FIPC or AAA is responsible for processing financial data and preparing financial information for the responsibility center and the claimant. RMS, like any management information system, can generate more reports than a manager can read in a month.

RMS was designed as a fiduciary system. Many reports therefore are fund control reports which provide little management information. To fill this void, local activities devised a panoply of reports. This variation obviously made it difficult for claimants to compare data among activities served by different AAA's.

In 1977, the Uniform Management Reports (UMR) were instituted. The UMRs consolidated and sorted data from the original RMS reports. The output displayed information in managerially useful formats. Loading the initial budget plan into the database allowed preparation of variance reports in various dimensions.

##### a. Input Documents

The Operating Budget/Expense Report (NAVCOMPT 2168) is a basic tool in RMS accounting. The responsibility center

provides its annual budget plan to the FIPC/AAA on the N/C 2168. The AAA reports funds status to the responsibility center as well.

The Activity Budget/Appportionment Submission (NAVCOMPT 2179-1) is a multi-purpose accounting form. Organized as a spreadsheet, the N/C 2179-1 is submitted to the claimant with the N/C 2168 requesting quarterly apportionment. The N/C 2179-1 is used by comptrollers as a budgetary worksheet.

The Resource Authorization (NAVCOMPT 2168-1) is the claimant's response to an activity's budget request. The claimant projects the year's quarterly grants at the fiscal year start. The claimant will also advise the command of fences on spending. A new authorization is prepared each quarter, as well as when any changes are authorized. Each authorization is serial controlled.

b. RMS and Funds Control Reports

The Operating Budget/Expense Report (N/C 2168) is also used to report expenses to the responsibility center. The report can be prepared for individual cost centers or for the entire command. Expenses are reported in order of activity/subactivity group, functional/subfunctional category, and cost account codes. The report includes no obligational data.

The Trial Balance report (NAVCOMPT 2199) is prepared and submitted to the responsibility center and to the claimant. The report is prepared using the RMS Uniform Chart of Accounts. The trial balance is a snapshot report, showing the status of all direct and reimbursable accounts. The trial balance

report simulates double entry accounting by recording obligational authority received as an asset account. Obligations and expenditures are recorded as liabilities. The objective for fiscal year end is for assets to equal liabilities to equal zero. Although reporting and posting delays make this unlikely, it is the conceptual goal.

Unlike traditional balance sheets, only obligational authority and reimbursables are held as assets. Plant and equipment are not entered. This report contains information from the obligational and accrual subsystems. It has no cost accounting data.

The funds control reports are working-level reports. Information included is authorization, annual obligation plan for labor, and for material and other. "Obligation as percentage of plan" is displayed. The funds control reports are available in three formats.

The Detail Transaction Report lists all transactions. It is the most detailed accounting report available. It is not a management report. This report is crucial for correcting errors and for verifying that all transactions have been posted to the AAA's official records.

The Responsibility Center Report is a flexible summary report providing cost center managers with detail on each cost center's performance.

The Commanding Officer's Summary is a one-page report providing command wide authorization, obligation, and obligation rate information.

c. Uniform Management Reports

UMR-A provides information on production, civilian labor, gross adjusted obligations, staffing, undelivered orders, and prior year expense. It also measures performance or variance and productivity rates between periods. The report can be used to identify trends in production, expenses, and backlogs.

UMR-B provides roughly the same information as the UMR-A. The scope of UMR-B, however is reduced for use by a smaller activity.

UMR-C is a financial control report. It provides year-to-date expenses, undelivered orders, and gross adjusted obligations. UMR-C displays variances, monitors expenses and obligations by targets, and tracks total obligations for those authorizations with legal limitations.

UMR-D combines the N/C 2168 and 2169, providing expense, work unit, and labor hours and dollars by Cost Account Code and by activity/subactivity group. The report is useful for financial management control, performance measurement, and for monitoring expense and obligation rates.

8. Summary

RMS was established to change the accounting emphasis from obligational to accrual accounting. In so doing, RMS consolidated budgeting under the commanding officer. Much like

program budgeting at DoD level, RMS tries to look at the mission output rather than input costs. RMS provides a variety of multiple purpose reports. It provides financial reports, funds control reports, and management reports.

## B. BUDGET PLANNING

The Navy engages in two different levels of budget planning. As discussed in Chapter III, the Navy plans for the long run general threat. It programs to decide how it will meet those threats over the next five years. It budgets at the DoN level to help DoD and OMB prepare the President's Budget for the upcoming fiscal year.

The Navy supplements this "top down" process with an iterative, "bottom up" cycle. Given his mission, the commanding officer is responsible to his superior for estimating the resources required to accomplish his assigned mission. DoN assembles all these field inputs and uses the information to support the budget proposal in Congress.

### 1. Learning objectives

- To differentiate between a "budget call" and a "budget request."
- To understand how the budget request submitted by the activity fits into the Navy wide budget cycle.
- To suggest three strategies for eliciting budget needs from fellow department heads.

## 2. The Budget Process

According to the DoN Programming Manual, a budget is "a planned program for a fiscal period in terms of estimated costs, obligations, and expenditures, and sources of funds for financing, including reimbursements anticipated, and other resources to be applied."

The budget is thus an activity's plan stated in financial terms. Although the comptroller must be intimately and continuously involved in budget formulation, both the comptroller and line managers must recognize that the budget is a policy statement. Only line managers should set policy (Anthony and Herzlinger, 1980, pg. 20; Anderson and Schmidt, 1983, pg. 311). Thus, line management must be deeply involved in budgeting.

The comptroller must communicate proficiently during budget formulation. He must ensure that he understands the commanding officer's strategy for the command. The comptroller must be sure that all department heads understand the commanding officer's desires as well. As budgeteer, the comptroller must often mediate conflicts between competing departments, while supporting the commanding officer's plan.

## 3. The Budget Call

The budget call officially starts the budget formulation process. The call is usually received in February or March, with a short turnaround time. The effective field comptroller will anticipate the call by generating interest in the budget in

December or January. Starting early should reduce the stress and perhaps allow better decision-making.

The comptroller should call or visit his claimant's comptroller to discuss the budget informally. Often the claimant, through his informal discussions with NAVCOMPT, can provide a good estimate of whether or not to expect budget growth. This informal guidance is useful in preparing the internal budget call.

The comptroller should routinely discuss budget matters with the commanding officer, particularly if the CO visits the claimant periodically. Often a timely word from a well-armed CO to his boss can assure that funds are provided for a badly needed program.

The formal budget call may come in a notice, by letter, or by message. It normally includes planning guidelines, anticipated fences, civilian personnel information, and control numbers. The call will include a mandatory due date. Most claimants mandate forms or formats for response in a budget instruction.

The budget call will request estimates for three fiscal years: the prior year, the apportionment year, and the budget year. These titles reflect where the budget is with respect to Congress when the budget call is received.

The prior year budget was enacted in Congress last year. It is the budget in execution when the call is received. The claimant is looking for an update on execution, including unfunded requirements or excess funds to be applied to other requirements.

The claimant uses this information when trying to justify his request for additional funds in the mid-year review.

At the field level, a key issue in requesting additional funds is whether the money can actually be spent. It does no good to get new money in the mid-year if the command cannot obligate because the procurement division has a five month backlog (unless the funds are part of a plan to reduce the backlog).

The apportionment year is the upcoming fiscal year beginning 1 October. It is the budget that is before Congress. DoN and DoD use the apportionment year estimates from the field to request dollars from OMB for the next fiscal year.

The budget year represents the year which DoN is negotiating and approving. The budget year estimate is where the comptroller should propose new programs and requirements, if the command is able to see the need early enough to do so.

If the comptroller has received his budget call in February of 1988, FY 1988 is the prior year (the budget in execution), FY 1989 is the apportionment year (the budget before Congress), and FY 1990 is the budget year (the budget in DoN).

Once the comptroller has received some informal guidance, he should arm his budget division with the facts it needs to prepare the command budget guidance. As discussed in Chapter II, the Budget Division is the focal point of budget development and execution.

Since other department heads are typically not financial experts, the internal budget call should be clearly written and free

of budgetary jargon. An ambitious comptroller might offer training on how to complete the forms. At minimum, a name should be provided as a point of contact to help the departments. Ideally, the local guidance should be prepared by the comptroller, but signed by the commanding officer.

#### 4. Budget Development Strategies

The comptroller's method for requesting budget information from the command is limited only by his imagination. The key point is to remember to ask. One must recognize that a budget call asks maintenance and operational personnel to estimate what they will have to fix, or how many exercises they will fly. Operating and maintenance personnel will often hesitate to estimate what will happen next year. Nevertheless, they are best suited to *make such forecasts.*

One method is to ask the other department heads how much money each will need. This is good in theory, but most department heads do not have a financial crystal ball. Budgeting frustrates line managers, and this method increases the frustration factor. As a ship's engineer once said "You tell me what's going to break next year, and I'll tell you what it'll cost to fix it."

An alternative method is to provide each department head with his current budget status, and his department's expenditure figures for the past two or three years. Given this information, he is asked to anticipate how changes in activity might increase or decrease his need for funds. By guiding the thought process, the

comptroller helps the line manager judge whether he will need more or less money in terms that the line officer can understand.

Another possible method is to provide a "control number," or baseline figure, which will support the same operating level as the current year budget. Considering last year's requirement, the department head is asked to estimate cost increases, and to submit and justify new and previously unfunded requirements.

The comptroller must assemble all the data provided by the department heads into a budget spreadsheet, normally a NAVCOMPT form 2179-1, but with the expanded availability of microcomputers, perhaps an electronic spreadsheet. He must gather any information he has on reimbursables and estimate obligational authority that the command will receive from other commands. He must study the data and develop recommendations to work around budgetary short-falls. He must play "devil's advocate" with increases caused by program changes in order to clarify and strengthen justifications. He will probably need additional justification from some department heads.

Once he feels he understands the budget, the comptroller should review it carefully with the CO. The CO may decide to reduce, change, or eliminate certain programs. He may request additional data from department heads, or he may direct a department head to reconsider his estimates. The CO may also seek additional guidance from his superior if a mission area will suffer due to externally imposed budgetary limitations.

## 5. The Budget Request

When the CO is satisfied that the budget reflects his intentions for the command, the comptroller must prepare the budget request letter. The Budget Section, headed by the comptroller, prepares the budget request. The comptroller must carefully examine the budget request to assure himself that it answers the claimant's call exactly.

Nothing destroys credibility with the claimant faster and more assuredly than failing to comply with his budget call. Making arithmetic errors, using the wrong forms, or omitting justification when it is specifically required are failures to comply with the budget call. The comptroller must take the time to verify that the request is correct before submitting it for the CO's signature.

## 6. Summary

In the budget planning phase, a manager decides what to do and estimates the cost of doing it. Budget planning is important in non-profit organizations and public agencies, because they are generally resource constrained (Anthony and Herzlinger, 1980, pp. 328-330). They must survive on a fixed budget. The objective function of the organization should be to maximize service provided to its clientele subject to its fixed budget.

Budget planning must be a two-way communication exercise. The commanding officer provides his plan or framework for action to the organization. The organization responds with ways to accomplish the plan with the resources available.

Although the method for requesting budget estimates is not important, it is crucial that the comptroller elicit budget estimates from other department heads. As the final step in the planning process, the commanding officer selects the methods he prefers for achieving his plan given the alternatives offered by his staff.

The next section will address budget execution, focusing on how a manager carries out his mission while attending to budgetary constraints.

### C. BUDGET EXECUTION

The Navy's historical attitude towards budgeting is summed up in the Budget Guidance Manual (NAVCOMPTINST 7102.2A).

Chapter IV, entitled "Budget Execution," states **"This section will be included at a later date."** Fortunately, the Navy's attitude seems to be changing. OPNAV Instruction 7000.29, *Duties and Responsibilities of Financial Execution Officers*, was published in 1984 to guide financial decision making in program management. Although the Budget Guidance Manual does not yet have a chapter on execution, execution of previous budgets is a key factor in the NAVCOMPT budget review process.

#### 1. Learning objectives

- To understand how emphasis on budget execution has developed.
- To develop a framework for controlling budget execution, for identifying opportunities and problems, and for acting on those opportunities to the best advantage of the budgeted activity.
- To understand some of the players and factors to consider in executing a budget successfully.

## 2. Background

The DoD budget grew by some \$72 billion between 1980 and 1982. In April 1982, the GAO reviewed defense increases to evaluate how well DoD has managed the increased obligational authority. A key finding was that "because budget execution was not defined as a formal part of the original PPBS, it receives minimal attention. Execution is primarily the responsibility of field personnel in DoD and the services." (U.S. GAO, 1982, pg. 57).

The next substantial ripple occurred in May 1985 when Defense Secretary Weinberger offered to reapply \$4 billion from fiscal years 1984 and 1985 to fiscal year 1986 rather than taking a budget cut. Senators Mark Hatfield (R, ORE) and Alfonse D'Amato (R, NY) and Representative Les Aspin (D, WIS) asked GAO to investigate.

GAO reported that "during the 1980's, DoD requested budget authority based on inflated estimates of inflation and has been unable to use appropriated funds at the rates estimated when the funds were requested and appropriated." GAO estimated that DoD has benefitted from over \$36.8 billion dollars in "inflation dividends" between 1982 and 1985. Probably more damning than the inflation dividend was DoD's inability to explain what had happened to the money. The implication was that DoD accounting systems do not really account for resources. GAO concluded that "DoD needs to improve and integrate its budget and financial management systems." (U.S. GAO, Sep. 3, 1985, pp 1-7).

NAVCOMPT has planned to meet this requirement through the Strategic Financial Management Master Plan (see Chapter VIII) which will update and integrate all Navy accounting support systems. In the short run, however, NAVCOMPT has adopted a detailed budget review process (see previous section).

Under the "Nemfakos Assumption," NAVCOMPT analysts seek out and eliminate, through the review process, "capricious repricing." The assumption is that program managers will try to hedge their budget estimates by adding unjustified and unexplained "safety factors." The rationale is that if NAVCOMPT does not find these increases, either OSD, OMB, or Congress will, at great cost to the whole Navy budget.

Moreover, a key issue is executability: if the money is granted can the activity spend it? For large acquisition programs, the review will consider such issues as industry's ability to accept the contracts and deliver the material. For smaller budgets,

NAVCOMPT will ensure that funds are budgeted for the year in which they are required. . . accepted obligation and expenditure rates have been established for each appropriation. . . Extremely low obligation rates tend to reflect "forward funding," or funding in advance of annual requirements, while unusually high obligations may reflect a funding shortfall. (NAVCOMPTINST 7102.2, pg 1-31).

### 3. Factors Affecting Execution

Budget execution would be simple if cost estimates exhibited no variability. Unfortunately, actual job cost seldom matches the estimate. For example, employee salaries and wage rates, and employee mix will vary, changing total employee cost.

Changes in national and international markets increase or decrease material and commodity prices. Oil prices have dropped precipitously since 1982 as OPEC nations increased production to gain a larger share of a depressed market. Computer prices have fallen as technology thieves manufacture and market cheap "ciones." The prices of platinum and other strategic metals will increase as economic sanctions against South Africa take effect.

One can seldom forecast such changes. Nevertheless, a comptroller can note them and try to anticipate their budgetary impacts. For example, a drop in energy prices frees up money for a northern air station, by making it cheaper to heat buildings in winter. A passive comptroller could wait for his claimant to recoup the money. The active comptroller would be standing on the claimant's doorstep explaining how he will reapply the newly available resources to meet unfunded, mission-oriented needs.

The comptroller must be flexible and multi-dimensional in executing the budget. He must have a "feel" for whether each department head will spend out his budget. He must understand the constraints imposed on other department heads, and do his best to help the department head work through or around these constraints. He must assist and train department heads in the financial penalties levied on a command for failing to execute as planned.

COMNAVAILANT, for example, requires that ships obligate 95% of the cumulative OPTAR grant in each of the first three quarters of the fiscal year. In the last quarter, the ship must

obligate 99% of its grant. If the ship fails to achieve the 99% target in the final quarter, AIRLANT reduces the ship's subsequent first quarter grant by the shortfall amount. AIRLANT assumes if the ship asked for the money, but did not spend it, the money was not needed.

#### 4. Key Players

Each command has different missions. The department heads assigned have different personalities. The comptroller must develop a strong rapport with all department heads. Since several will be responsible for executing large portions of the command plan, the comptroller must get to know them and encourage a free flow of information.

The Public Works Officer (PWO) is generally a big spender, with seemingly endless requirements for funds. The Comptroller must work with the PWO to stay abreast of potential delays in maintenance or repair that could change the way the command budget is executed.

The Civilian Personnel Officer can offer invaluable advice regarding personnel costs. He or she can assist in controlling outlays by the way that vacant billets are filled. He can assist in deciding if a RIF will, in fact, result in reducing outlays.

The Supply Officer enters requisitions and obligations into the command database. He may enter contracts for the Government. The Supply Department may certify vouchers or invoices for payment. Each of the Supply Officer's activities

influences station accounts. The Comptroller and the Supply Officer must have a good working relationship.

#### 5. Midyear Review

The mid-year review could occur sometime between January and June. The claimant will compare actual obligation and expenses with plan to evaluate how well the responsibility center is executing its budget. If funds are made available through Congressional action, the major claimant may review unfunded requirements and release funds. The funds may be made available at any time before the end of the year.

For large unfunded requirements, the comptroller should keep documentary proof that the unfunded requirement was filled. GAO periodically follows up on these expenditures to prevent allegations that funds are spent on short term, unsubstantiated requirements.

#### 6. Comptroller Actions

Besides keeping informed and advising line management, what else can a comptroller do to control execution? First, he must keep the issue of budget and execution before the line managers. In order to do so the comptroller should prepare and distribute some type of funds status report. Line graphs displaying planned versus actual expenditures are clear and usable. Of particular interest are accounts which have mandatory floors or ceilings.

At a minimum, the CO and XO should see all the reports, and each department head should see his own. When it appears

that a department head is off target, the comptroller should investigate. In the most embarrassing case, the problem could be in the comptroller shop. Or it may be a problem in contracting or in defining a requirement. In any case, the comptroller must be aware of delays. If the delay will prevent the department from spending its money as planned, then the comptroller may need to recommend reprogramming.

The comptroller should understand any ADP systems that lodge obligations in his accounting system. He should follow up with Personnel Department on liquidating travel claims. He should be aware of contracting backlogs that may prevent or delay fund obligation. He must encourage the Supply Officer to validate (and, if appropriate, cancel) aged requisitions. The comptroller must be aware of Interservice Support Agreements (see Chapter V), particularly for cross services which generate reimbursable billing for civilian personnel.

#### 7. End of Fiscal Year

Closing out the end of the fiscal year is the comptroller's most challenging task. As 30 September nears, the comptroller must find some positive way to assure that the command closes out on target. If resources available are less than projected requirements, the command must do something. Essentially, the command must decide to either ask for more money, or reduce its requirements for funds.

As noted above, claimants have very stringent standards for end of year balances. Considering the chain through which

money flows, and the many "contingency funds" preserved along the way, large amounts of money could be found unobligated if claimants did not require obligation.

If the comptroller can specify how often his budget reports are processed, he should request that his reports be processed more often as the quarter ends. If he is responsible for remote or isolated activities, he must arrange to get time cards and financial data in time to complete processing.

To assure positive control, the comptroller may pull all funds back into his office. He can then approve obligations on a case basis, referring high value obligations to the CO for approval. Department heads, however, might well complain that this method punishes those who are economical and awards a premium to those who spend too fast.

Alternatively, the comptroller might set short range obligation goals, allowing departments to budget and spend over increasingly shorter time horizons. As the departments achieve those goals on schedule, they are advanced money for the next target. The department head retains control of his budget. The comptroller is assured that the money is obligated. This method involves more clerical work, but it does not penalize low obligation rates or reward high obligation rates.

The command must establish cut-off dates for obligation. The CO and the comptroller must make a philosophical decision on what command target to set. Holding one percent of \$50,000,000 is a large reserve. Obviously, the claimant's target must be met,

but how much money is one willing to put on hold? The answer can be found only by assessing the risk that the accounting system is providing valid information, and by deciding how much risk the CO is willing to accept.

#### 8. Summary

The comptroller cannot afford to be passive in budget execution. As headquarters level interest increases, so must the comptroller's skill. He must adopt a command-wide perspective based on a firm understanding of the command mission. He must communicate with other department heads, providing information on the consequences of their spending habits. He must anticipate problems, generate alternative solutions, and sell those solutions to the appropriate players.

#### D. INTERNAL CONTROL

Notwithstanding recent Congressional action and OMB guidance, internal control is a traditional accounting concept. In the broader picture, "control" is what managers do. "Control deals with expectations, that is with the future . . . Control is normative and concerned with what ought to be." (Drucker, 1974, pg. 494). Thus, internal control deals with ensuring that an accounting system is recording data as it should.

For government purposes, internal control is defined in the Federal Manager's Financial Integrity Act of 1982 and by OMB Circular A-123. GAO defines internal control as:

The plan of an organization and all the coordinate methods and measures adopted to safeguard assets, check the accuracy and

reliability of accounting data, promote operational efficiency and encourage adherence to prescribed managerial policies.

### 1. Learning Objectives

- To understand the Federal Managers' Financial Integrity Act requirements for internal control.
- To be familiar with requirements imposed by OMB Circular A-123.
- To understand GAO's standards for internal control.
- To understand the concept of the vulnerability assessment.

### 2. Legal Aspects of Internal Control

Internal control must involve all levels and all functional areas of management. It is not restricted to financial and supply personnel. Line managers must also be involved.

*The Federal Manager's Financial Integrity Act of 1982* required the following steps for implementation:

- The Comptroller General shall prescribe standards for internal control.
- OMB shall establish guidelines for the evaluation of internal controls.
- Agency heads will annually prepare a statement to the President and Congress regarding adequacy of internal controls.

### 3. Internal Control Standards

GAO promulgated *Standards For Internal Controls In The Federal Government* in 1983. The *Standards* emphasize that management is responsible for implementing and following up on internal controls. The objectives of internal control are to provide management with reasonable assurance that:

- Obligations and costs are in compliance with law.
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation.
- Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over assets.

In most Navy organizations, internal control is "pasted" on top of other reporting and control systems. The *Standards* encourage the manager to integrate internal controls into his organization. The *Standards* are divided into three subgroups which are outlined below.

General standards

- Reasonable assurance
- Supportive attitude
- Competent personnel
- Control objectives
- Control techniques

Specific standards

- Documentation
- Recording of transactions and events
- Execution of transactions and events
- Separation of duties
- Supervision
- Access to and accountability for resources

Audit resolution standard

- Prompt resolution of audit findings

4. OMB Circular A-123

OMB Circular A-123 promulgated specific agency actions.

Under circular A-123:

- Agency heads will be responsible for establishing and maintaining systems of internal controls.
- Agency heads will issue an internal control directive.
- Senior audit official will determine if the circular is implemented.
- Vulnerability assessments will be conducted at least every four years.
- Internal control review shall be conducted on an ongoing basis.
- Internal control responsibilities will be included in performance appraisals. (Must be a critical element for civilian supervisory personnel)

#### 5. The Vulnerability Assessment

The vulnerability assessment is the critical aspect of the formal internal control program. To be effective, assessments must be done by functional specialists who are close to the area being assessed. The assessment is an environmental analysis to determine where the organization might be susceptible to

- loss or unauthorized use of resources,
- errors in reports or records,
- illegal or unethical acts, or
- adverse or unfavorable public information.

When a program or function is assessed to be vulnerable, a Management Control Review (MCR) is held to discuss methods for reducing risk. This is a MANAGEMENT responsibility. One sure way of emasculating the Internal Control Program is to delegate the MCR to the new staff ensign. Admittedly, the MCR may not

be appropriate in every situation. When it is used, however, top management must be involved.

#### 6. Summary

The Internal Control Program is a high visibility issue. Auditors are obliged to comment on the organization and effectiveness of the command program. The command must assign responsibility and follow up on execution. Line managers must perform assessments and must be involved in MCRs.

To simplify the assessment process, one should segment the organization logically. For example, it may make sense for an air station to assess the Supply Department's Aviation Support Division and the Aviation Intermediate Maintenance Department together, since their environments are similar.

The command must exhibit high level interest in Management Control Reviews. Results of the assessments and MCR process must be reported to the activity Immediate Superior in Command in accordance with his instructions.

## V. ADMINISTRATION

The comptroller must deal with two important administrative matters. He is deeply involved in payroll administration, crucial to morale. Additionally, the comptroller must be able to calculate, or to audit calculation of the wage and salary accelerator\* to recover full salary costs. Proper wage and salary distribution is essential for correctly billing Interservice Support Agreements (ISSA) or reimbursable OPTARs. Payroll and ISSAs are covered below.

### A. PAYROLL ACCOUNTING

Civilian compensation is a major component of budget estimates. At a typical Navy command, civilian compensation can amount to between 70 and 80 percent of the Operations and Maintenance, Navy (O&MN) budget. Civilian payroll must be understood and controlled closely to execute the budget according to the command plan.

Payroll is also the largest part of Interservice and Intraservice Support Agreement (reimbursable OPTAR) billings. Because of this close relationship, civilian compensation will be addressed with reimbursable OPTARs.

#### 1. Learning Objectives

- To be able to discuss the different structures for compensating civilian personnel.

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\*See section VB for explanation of accelerator.

- To be able to calculate the acceleration rates used for billing reimbursable work.
- To understand how "reduction in force" effects budget execution.

## 2. Background

Federal employees are managed in two large pools: General Schedule and Federal Wage System employees. Some employees, such as doctors and professors, are "excepted" and are hired on special scales to reflect the competitive market conditions for their skills. This section will discuss General Schedule and Federal Wage Service.

### a. General Schedule

General schedule employees are salaried, "white collar" workers. The jobs are professional, managerial, or clerical, rated from GS-1 to GS-15, and GM-13 to GM-15. Non-career employees, previously GS-16 to GS-18, were redesignated Senior Executive Service (ES grades 1 to 6) by the Civil Service Reform Act of 1979. Salary levels are set nationally by the President and Congress. All employees receive the same pay for the same work. Except for the non-career SES employees, General Schedule employees are hired competitively, based on merit.

### b. Federal Wage Service

Federal Wage Service(FWS), or "blue collar," employees earn an hourly wage. These employees include painters, laborers, truck drivers, and warehousemen. Employees are hired according to their experience in their specific fields.

Wages are set on scales from WG-1 to WG-15, with steps in each grade. A non-skilled laborer might be assigned as WG-1. A skilled craftsman such as a patternmaker might be assigned as WG-14. To allow for further differentiation, scales are set for Wage Leaders (WL) and Wage Supervisors (WS).

The wage scale is based on a survey of local industrial employers. The largest federal employer in the region conducts the survey. A two-person labor-management team records the wage levels paid to similar industrial employees in the region. The results are forwarded to the agency's Wage Fixing Authority in Washington, D.C. The regional wage scale is computed and returned to the region.

### 3. Accounting for Payroll

One must account for civilian payroll in two dimensions.

#### a. Timekeeping

One must first account for the hours each employee works in order to compute his pay and entitlements. This process is called timekeeping. The timecard, or clockcard, is the source document for this accounting subsystem. Each employee fills out a biweekly timecard, recording his straight time, overtime, and holiday time. The supervisor signs the timecard certifying its accuracy. The timecard is processed, yielding a paycheck for the employee, and leave, earnings, and withholding reports.

#### b. Cost Accounting

One must also record the purpose for which the labor charge was incurred. Cost accounting data is accumulated on the

labor distribution card. Each station has job order numbers representing functions, or cost objectives to which labor can be distributed. For example, a station may have job orders for routine work, training, and labor union matters.

Some stations have only one dual-purpose card. Others have separate timekeeping and labor distribution cards. In either case, the supervisor must ensure that the same number of hours is reported for each account.

#### 4. Payday

Although people have many motivations for working, one of the most consistent is to be paid. It is imperative that each employee receive a check (or bank deposit notice) for the right amount every pay period. The comptroller must have control systems in place to protect the employees he pays, and himself, from fraud and theft.

The payroll staff must have positive control over each check from the time it is prepared until it is delivered to the correct employee. As soon as the checks are received by the comptroller department, they should be matched against the payroll list. The checks should be sorted by work center and labeled.

Checks should be turned over only to the properly authorized courier. The courier should identify himself, match the checks he accepts, and sign for custody. Each employee should initial a payroll list on receiving his check to protect the courier's integrity.

## 5. Acceleration Rates

When entering Interservice Support Agreements, the host activity must plan to recover the full cost of civilian expenses incurred to support another activity. Paid leave and fringe benefits are funded from O&MN money. Thus activities leasing services to other activities must recover funds to pay those costs.

Non-industrial activities can be reimbursed only for direct material and direct labor costs. Direct labor cost includes employee payroll and fringe benefits. Under a traditional cost accounting system, fringe benefit costs are recovered through overhead. Since non-industrial activities are not authorized to accumulate and charge overhead, fringe benefit costs must be recovered through the acceleration rate.

The acceleration rate has two components. One component compensates for reduced working hours due to annual and medical leave. The other component recovers the cost of fringe benefits. Figure 10 is a conceptual model showing how the acceleration principle applies the full employment costs to the employee's productive hours.

The computations are simple. Leave acceleration equals the leave taken divided by the total hours worked during the year. Fringe acceleration equals the fringe costs divided by the productive hours, all divided by the hourly salary.

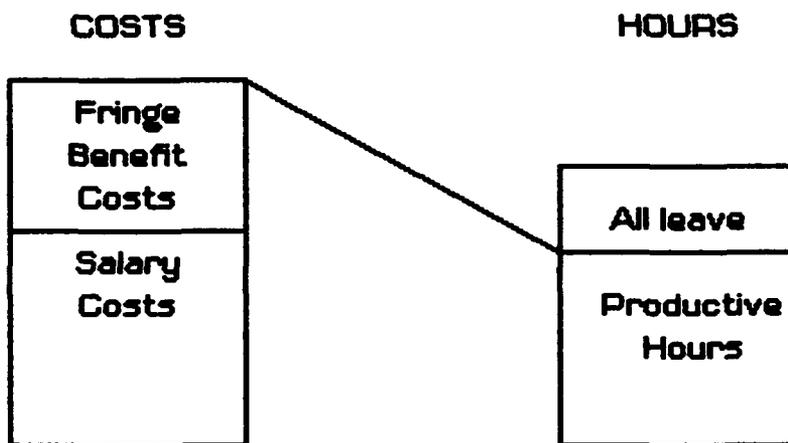


Figure 10. Model of Acceleration Principle

A single acceleration factor is calculated using the equation below:

Given:

Annual Salary = S  
Fringe Benefits = F

Normal Hours = H  
Leave Hours = L

$$\left[ \frac{\frac{S + F}{H - L} - \frac{S}{H}}{\frac{S}{H}} \right] \times 100 = \text{Acceleration Rate}$$

The first factor,  $\{(S + F) \div (H - L)\}$ , represents the employee's effective pay rate. The second factor,  $(S \div H)$ , represents the average hourly salary based on 2,080 hours, a standard civilian pay year.

**Example.**

Annual salary = \$30,160  
Fringe benefits = 3,120  
Working hours = 2,080 hours  
Employee leave = 160 hours

The hourly pay rate is  $\$30,160 \div 2,080 = \$14.50$

The productive pay rate is

$$(30,160 + 3,120) \div (2,080 - 160) = 17.33\dots$$

The component accelerators are:

Fringe Accelerator

$$\{(\$3,120 \div 1,920) \div 14.50\} \times 100 = 11.21\%$$

Leave Accelerator

$$(160 \div 1,920) \times 100 = 8.33\dots\%$$

The total acceleration factor is

$$\{(17.33 - 14.50) \div 14.50\} \times 100 \approx 19.54$$

**6. Management Considerations**

Acceleration rates are estimated before the fact. This may lead to over or under application of accelerated reimbursable revenues. The comptroller must monitor execution closely to assure that leave taken is less than or very close to leave planned. If leave taken exceeds leave planned, the command will charge less than actual costs for the reimbursable work. Examples of meeting the plan exactly, overestimating leave, and underestimating leave are shown in subsequent paragraphs.

a. Taking Leave as Planned

The employee works 1920 hours and takes 160 hours of leave as planned. The result is no variance.

		Costs Charged to job	Actual Amount Paid	Variance Acceleration versus actual
Salary	1920 x 14.50	27840	27840	
Leave	160 x 14.50		2320	
Lv acceleration	27840 x 8.33%	2320		0
Fringe			3120	
Fr acceleration	27840 x 11.21%	<u>3120</u>	<u>        </u>	<u>0</u>
		33280	33280	0

b. Taking Less Leave Than Planned

The employee works 2,080 hours and takes no leave. In this case the station "earns" additional income. More obligational authority than planned is available in the current fiscal year. The apparent gain, however, is borrowed from the future as the command must take up a contingent liability for the earned but unused leave.

		Costs Charged to job	Actual Amount Paid	Variance Acceleration versus actual
Salary	2080 x 14.50	30160	30160	
Leave	None		0	
Lv acceleration	30160 x 8.33%	2510		2510
Fringe			3120	
Fr acceleration	30160 x 11.21%	<u>3380</u>	<u>        </u>	<u>260</u>
		36050	33280	2770

c. Taking More Leave Than Planned

The employee works 1680 hours and takes 400 hours of leave, which is more than was planned. The command does not recover full cost for the time allocated to the job.

		Costs Charged <u>to job</u>	Actual Amount <u>Paid</u>	Variance Acceleration <u>versus actual</u>
Salary	1680 x 14.50	24360	24360	
Leave	400 x 14.50		5800	
Lv acceleration	24360 x 8.33%	2030		(3770)
Fringe			3120	
Fr acceleration	24360 x 11.21%	<u>2730</u>	<u>        </u>	<u>(390)</u>
		29120	33280	(4160)

## 7. Reduction-in-Force

Reductions-in-force (RIF) are undesirable, painful evolutions. Unless they are mandated by external authority, one is wise to avoid them. Before considering them as a method of achieving budget reductions, the comptroller should consult with the Civilian Personnel Officer to evaluate the effect.

Aside from reducing budget outlays, RIFs may be directed to achieve three other objectives. First, the command may be ordered to reduce its workforce to achieve end strength limitations. Second, a RIF may be necessary to accommodate a reduced mission. Finally, a RIF may be necessary as part of a reorganization.

If one is considering a RIF to reduce budgetary outlays, one must simultaneously consider four personnel entitlements which may offset the savings to be realized. The short run costs of these entitlements will probably exceed the cost reductions achieved. The RIF should be considered only where it is likely that the reductions will be permanent.

### a. Relocation Allowances

Some personnel are entitled to relocation allowances if they are required to move. The allowances are paid by the

releasing command. Thus the benefit of paying fewer employees may be offset by these outlays. The cost of moving may equal up to two month's pay.

b. Lump-sum Leave

Personnel who are retired early, or are forced to leave government service are often entitled to payment for up to thirty days of "lump-sum leave." Considering that most budgets estimate an average leave figure, the fiscal impact of paying RIF'ed personnel for leave can offset the RIF savings.

c. "Saved Pay"

RIF'ed personnel often move into new, lower grade jobs by virtue of their seniority. These personnel, however, are in many cases eligible for the saved pay provision. An employee can continue employment in a GS-7 job, but will receive pay and benefits befitting her previous GS-9 grade for two years. Again, the "benefit" of the RIF is offset.

d. Severance Pay

Career employees may be eligible to receive up to one year's salary in severance pay which is funded by the command's O&MN budget. The budgetary impact of paying several year's worth of salaries as severance pay is obvious.

8. Merit or Personnel Awards

Cash awards for excellent performance may be authorized under the Merit Pay system. The comptroller must work with the Commanding Officer and the Civilian Personnel Officer to develop policy and estimate budgetary effect of these awards.

Department heads should be requested to estimate personnel awards as part of the internal budget call.

9. Leave Without Pay

When personnel use leave without pay the budget accumulates unused dollars. Employees may be granted leave without pay to attend schools which will benefit the command, while recovering from accident or injury not covered by sick leave, or while awaiting disability retirement. The comptroller may reprogram the accumulated benefit of leave without pay as he and the commanding officer chose.

10. Summary

The comptroller bears much responsibility for civilian personnel management through his administration of the payroll. He must, however, seek assistance from the staff expert, the Civilian Personnel Officer. The comptroller must be aware of how changing rates of reimbursable work influence budget execution through the acceleration rate.

The next section will discuss Interservice Support Agreements where the acceleration principle influences budgeting.

B. INTERSERVICE SUPPORT AGREEMENTS

The purpose of this section is to describe the framework under which DoD tries to reduce cost and outlays by exploiting the economies of scale. One method of cost reduction is to consolidate activities where possible to spread the costs of fixed, common facilities and functions. The framework for this activity is the Interservice Support Agreement.

The military services have always struggled to balance the need for redundancy (and the associated high cost) with the need for resource economy. It is costly and probably inefficient to provide personnel services as part of every aviation squadron. And yet for the squadron to deploy and operate effectively, and to handle its staff, it must have a personnel division. On the other hand, a stationary, non-deploying command in Norfolk can share personnel services with other non-deploying commands on Naval Operating Base, Norfolk.

#### 1. Learning Objectives

- To be familiar with the purposes of the Defense Retail Interservice Support Manual (DODINST 4000.19).
- To understand the mission of the Joint Interservice Resources Study Group (JIRSG).
- To understand the differences among "sole use," "joint use," and "common use" facilities.
- To be familiar with some management considerations in administering Interservice Support Agreements.
- Understand the comptroller's responsibility for the Interservice Support Agreement.

#### 2. Interservice Support Agreements

As stated in the introduction, DoD must balance the need for redundancy to support deployability with the need to minimize cost. DoD has attempted to increase government efficiency and to reduce cost by exploiting the economies of scale. That is, by consolidating activities to benefit from the specialization possible in a larger organization.

The vehicle for this effort is the Defense Retail Interservice Support (DRIS) Manual (DOD Instruction 4000.19). OSD has established an office to support DRIS implementation. The office conducts an annual study of ISSA's to identify potential savings by increasing overlap. The Defense Logistics Agency is assigned to oversee ISSA's.

Interservice Support is administered locally by the Joint Interservice Resource Study Group (JIRSG). The JIRSG is an *ad hoc* committee whose mission it is to review functions within its region, a fifty mile radius, for potential consolidation. A representative of the senior commander in the region chairs the study group. The group studies functions as requested by the OSD sponsor.

### 3. Mechanics

In the lexicon of DRIS, the "host" is the activity providing services. The "tenant" receives the benefits of the host's services. Three levels of service will be identified later. The key issue is whether the services provided are classified as billable "cross services."

An ISSA may be self-initiated or directed by the JIRSG. The ISSA is best approached informally. The responsible department head should contact his counterpart to determine if the potential host has capacity to provide the desired service. If capacity is available, the potential tenant should submit a proposal to be used as a "strawman."

The potential host may establish an interdepartmental study group to evaluate the tasking. The group must consider what type of support has been requested. It is critical to include all possible areas of interface in the planning stages.

The agreement will include three levels of support. Some facilities will be provided as "common use," some as "joint use," and some as "sole use." The host/tenant relationship incurs different liability levels for each designation.

a. Common Use Facilities

Common use facilities are services such as exchange and commissary privileges, base security, and civilian personnel activities for which the host is already funded, or is funded through a source other than appropriated funds. The host must continue to fund utilities and maintenance to support these facilities.

b. Joint Use Facilities

Joint use facilities shall be funded by the host unless one can clearly distinguish what facilities the tenant is using. For example, a tenant sharing a building may be billed for electrical power if the spaces occupied by the tenant are on a distinct electrical bus and separately metered. An engineering survey may be used to allocate costs if it is determined to be "acceptable." Otherwise, the host will bear the cost of utilities and will maintain the facilities.

c. Sole Use Facilities.

Utilities charges for sole use facilities will be billed directly to the tenant. Except for special equipment installations, the host must fund and maintain sole use facilities. If, for example, the tenant installs a mainframe computer system that requires special air conditioning, the tenant must fund installation and maintenance.

The DRIS Manual promulgates four criteria for billing a tenant for cross services.

- Charges must be significant, (i.e. greater than \$100 per quarter).
- The charges must be identifiable to the tenant.
- The charges must result from out-of-pocket expenses, or actual cash outlays.
- The costs must be developed without undue administrative difficulty.

The DRIS Manual acknowledges that both hosts and tenants may experience environmental changes. A host may discontinue a function. JIRSG may direct action which eliminates a function. If a host is going to change a common use facility to cross service, the host should give the tenants 12-15 months notice. If a function is to be eliminated, the tenant should be given six months notice to allow him to find an alternative source.

4. Documentation

NAVCOMPT Instruction 7000.43 prescribes a new series of forms for use in obligating Navy funds. Nonetheless, before

negotiating with other services, one must check to see what forms the potential host will require.

For Navy purposes, the host and tenant may deal in four forms. The basic form used to prepare the ISSA is the DD Form 1144, *Support Agreement*. The DD Form 1144 contains the terms of the agreement. The agreement itself must be renegotiated at least every six years.

The three NAVCOMPT forms were designed with many commonalities. They allow multiple lines of accounting data. The forms have instructions printed on the reverse. Data blocks on all the forms are intentionally similar.

The NAVCOMPT form 2275 is the *Order for Work and Services*. It funds work and services to be provided by another DoD activity. The NAVCOMPT form 2275 may not be used where an operating budget or allotment should be issued.

The NAVCOMPT form 2276 is the *Request for Contractual Procurement*. It is used to request one Navy activity to procure material or services from outside commercial sources for another activity. It is a specific and definite request for procurement of material, equipment, or services by contracts placed with commercial enterprises. One may invoke subsection 1341(a), Title 31, USCA on either NAVCOMPT form 2275 or 2276 through supplementary item 3 on the back of either form.

The NAVCOMPT form 2277 is the *Voucher for Disbursement or Collection*. This form is used for disbursing or collecting funds. It is intended for use as a Navy bill, cash

collection voucher, public voucher, voucher for transfers between appropriations or funds, schedule of voucher deductions, and as a voucher and schedule for correcting errors.

#### 5. Management considerations

Administering ISSAs requires a lot of management and communication skill for both the tenant and host. Developing the preliminary cost estimates requires much interdepartmental communication. For the comptroller's own protection, he or she must be involved in the estimating process.

Many agreements revolve around facilities and services. The public works officer is thus a key player in the cost estimating needed to negotiate the ISSA. Like budgeting, cost estimating requires people not typically involved in financial management to think in terms of numbers. The comptroller must involve himself and his staff to improve the quality of the results.

The host's comptroller must be aware of the volume of work accomplished on labor intensive jobs. Recall that man-hours are billed at an accelerated rate. Employees occupied at tasks to support the host "earn" no income. While working on the tenant's job order, each man-hour generates income at his or her pay rate times the acceleration rate. If the work is not monitored carefully, one may "earn" accelerated dollars faster than one can spend the earnings, resulting in unplanned end of fiscal year balances.

For the tenant's comptroller, converting from a self-performed task to a reimbursable task will result in a tremendous

cost increase. Often military jobs which result in no charge against the O&MN budget are "contracted" to another command under an interservice support agreement. Changing from free military labor to accelerated civilian pay rates may be traumatic to an activity budget. The tenant comptroller must be involved in planning for such conversions from the start to ensure that adequate funding is available at execution.

#### 6. Summary

The ISSA has grown from a need to optimize the use of military resources. Guided by The Defense Retail Interservice Support Manual, the *ad hoc*, regional Joint Interservice Resource Study Groups evaluate support functions for consolidation. The basis for an ISSA is the availability of excess capacity at non-deploying activities. Two or more activities then contract to use the same services, with one host billing the tenants for cross services. Comptrollers must be keenly aware of the long run budgetary impact of entering an ISSA as either a host or tenant.

Chapter VI shifts gears from managing money and personnel to managing material assets.

## VI. PLANT PROPERTY

The first five chapters have focused on planning and budgeting. The emphasis has been identifying and acquiring the resources to fund new or expanded requirements. This chapter focuses on a traditional comptroller responsibility: safeguarding the assets already acquired. The Navy labels this task Plant Property management.

This chapter is a comptroller's overview of plant property management, intended to make the reader familiar with the lexicon and the broad responsibilities that the comptroller bears. The NAVCOMPT Manual (Volume 3, Chapter 6) provides detailed guidance for managing plant property. For those managing plant property on a full-time basis, careful study of the NAVCOMPT Manual is mandatory.

### A. LEARNING OBJECTIVES

- To identify the four categories of Plant Property and the characteristics of each category.
- To understand the characteristics of the Other Procurement, Navy (OPN) appropriation.
- To recognize what Industrial Plant Equipment is and who manages its acquisition and disposition.
- To understand the inventory controls necessary for managing each property category.
- To understand the comptroller's regulatory responsibilities for managing plant property.

## B. PLANT PROPERTY AND CLASSES

### 1. Definition

A plant property item is defined as an investment item with expected useful life longer than two years and with acquisition and installation costs exceeding \$1,000. Plant property is generally found ashore, although Class IV industrial plant equipment is found on industrial ships, such as tenders, repair ships, and aircraft carriers. Medical and dental items are not considered plant property, but are centrally managed and are subject to stringent control by MEDCOM.

### 2. Property Classes

The Navy divides plant property into four categories:

#### a. Class I

This class includes land and water rights. The Naval Facilities Engineering Command identifies and manages these resources. In most cases, inventory requires the technical skills of a surveyor.

#### b. Class II

This class is comprised of improvements to Class I property. Buildings, roads, structures, sidewalks, piers, utilities, and conduits for utilities and telephones are examples of Class II property. These assets are controlled jointly by the comptroller and the local public works department. All items of class II property are identified by serial number.

c. Class III

This class includes a broad spectrum of general purpose equipment. Examples are passenger vehicles, trucks, trailers, dollies, railroad cars, dumpsters, tractors, forklifts, sewing machines, shredders, and typewriters. The criteria for a Class III item are:

- Cost must be greater than \$1000.
- Life of asset is expected to exceed 2 years.
- Asset is not be altered or consumed in the performance of work.
- Asset is not built into Class II property.
- Asset must be mission related.
- Must not be held in a supply inventory account.
- Must not be specifically excluded from plant property by NAVCOMPT.

Class III assets are controlled on records maintained by the comptroller. Assets are inventoried triennially, and on relief of the responsible department head. Because of the differing financial limitations between O&MN and OPN appropriations, it is possible that class III plant property may be procured from either an expense or an investment appropriation.

d. Class IV

Industrial Plant Equipment (IPE), defined as any item that cuts, abrades, bends, or otherwise reshapes or reforms materials, makes up Class IV. The Defense Industrial Plant Equipment Center (DIPEC) plans and budgets for, acquires, and retires Class IV plant property for all services. Because of the high

cost and long lead-time involved in procuring these assets, DIPEC closely controls all assets. For example, when a command replaces a lathe, the old asset is reported to DIPEC which then directs refurbishment of the equipment, if possible, and makes it available for redistribution to other DoD activities through a monthly report of excess IPE.

### C. CENTRALIZED BUDGETING AND MANAGEMENT

The comptroller must attend closely to the OPN and IPE budget cycles. Non-standard items costing more than \$5000 must be procured through the OPN appropriation.

OPN is a fully funded, three-year investment appropriation. Budget calls are generally received from the claimant early in the calendar year with responses due back on short notice. This appropriation is small and highly competitive. Acquiring funds for these assets requires careful planning and justification. One cannot count on approval of last-minute equipment requests.

Industrial Plant Equipment is also procured through the OPN appropriation. The IPE budget call may occur in a cycle different from the OPN cycle because DIPEC does the budgeting. In justifying command requests, the comptroller must be familiar with the IPE on board his command and of the standard lives estimated by DIPEC. The IPE budget clerk can find management information and policy guidance in the NAVCOMPT Manual. He should keep records of each request, and of each piece of IPE throughout its life-cycle.

The using work center should research and justify the OPN or IPE budget request. This work completed, the comptroller should then supervise the required cost analysis and prepare the smooth budget request. The comptroller shop must maintain continuity from year to year, as few work centers keep records of prior year requests. To maintain its resource base, a command must have an effective system for managing, maintaining, and replacing plant property.

#### D. RECORDSKEEPING

In addition to his budgeting duties, the comptroller is the official Plant Property recordskeeper. In performing this duty, the comptroller must assure that his clerical personnel have access to the offices and work centers where plant property is used to validate inventory results. Moreover, the comptroller must

- Establish and maintain official plant property accounting records.
- Prepare and submit plant property accounting returns.
- Coordinate and supervise the compiling of data when physical inventories are taken.
- Assure accuracy of the records by maintaining adequate internal controls.
- Assure that all plant property is identified and reported.

#### E. DEPRECIATION

Industrial-Commercial activities are required to depreciate plant property. The specific procedures are available in the

NAVCOMPT Manual, Volume 3, chapter 6, part c, but are not covered in this text.

## F. MINOR PROPERTY

All other material is designated Minor Property, and must be managed locally. These assets must be controlled on a local custody record by department head.

## G. MANAGEMENT ISSUES

### 1. Work in Progress

Plant property work-in-progress is a current management issue. Work-in-progress represents the value of disbursements made for plant property that vendors claim to have shipped or delivered to the benefitting activity. The account value is reduced when receipts are reported to the responsible Fleet Accounting and Disbursing Center on the NAVCOMPT form 167. Failure to reconcile actual receipts with payments can result in vendors being paid when they have not performed. The current emphasis on detecting contractor fraud demands that the comptroller pay close attention to such potentially sensitive areas.

### 2. Recurring Inspection Findings

Auditors have found some consistent deficiencies in Plant Property management. This listing in no way exhausts the ways that innovative clerks can try to work around a system. This list, however, should be a reasonable starting point in reviewing Plant Property management.

- Activities fail to record and safeguard expensive plant property. The proliferation of microcomputers, and subsequent conversion to personal use will increase the visibility of this issue.
- Activities fail to dispose of idle equipment, thus incurring unnecessary holding or maintenance charges.
- Class IV property is sometimes misclassified as Class III. This results in improper disposition, and wasting of valuable assets.
- Failing to report unused facilities may prevent other activities with valid requirements from benefitting from another activity's excess capacity.
- Computing depreciation charges incorrectly at Industrial-Commercial activities may result in improperly charging customers for work performed.
- In making "lease versus purchase" decisions, activities often fail to do economic analysis, or do the analysis improperly, resulting in improper decisions.

## H. SUMMARY

Managing plant property is one of the comptroller's more technical jobs. Generally, he will have one or several clerks performing this function. Rather than trying to emphasize the "formology" of plant property accounting, this chapter has defined categories and areas of vulnerability. Recent management issues include maintaining work-in-progress accounts correctly and calculating depreciation at Industrial-Commercial activities.

Chapter VII will continue with overviews of Navy working capital funds which are critical to the operation of many activities.

## VII. WORKING CAPITAL FUNDS

A working capital, or revolving fund is a method of financing work or inventory until it is ultimately paid for by the customer. "Working capital accounts . . . hold items in suspense so as to differentiate between the place of acquisition and consumption." (Anthony and Herzlinger, 1980, pg. 433). The working capital fund's benefit is that material can be available, or work on a job may begin before dollars are actually appropriated. Thus, DoN can buy material in economic quantity, at discount, and can hold it in inventory, anticipating a customer's need.

The DoD operates two categories of working capital funds: stock funds and industrial funds. In section A, stock funds will be explained. In section B, industrial funds will be outlined.

### A. THE NAVY STOCK FUND

The Navy Stock Fund is the oldest DoD fund. The Fund is a body of parts and dollars. Customer reimbursements and annual Congressional appropriations maintain the "corpus," or body of the fund. The Commander, Naval Supply Systems Command administers and manages the Navy Stock Fund. DoD Directive 7420.1, *Regulations Governing Stock Fund Operations* provides policy guidance to all services.

#### 1. Learning objectives.

- To understand the revolving fund concept, and the Navy Stock Fund in particular.

- To discuss aspects of the Navy Stock Fund which are important to field activity comptroller.

## 2. The Revolving Fund

As noted in the introduction, working capital funds exist to improve efficiency. Authorizing an agency to hold material in inventory reduces lead time for the end-user. Economies of making large buys can be exploited. An organization can try to minimize the impact of demand variability by carrying material as "safety stock."

Recognizing the need for "increased economy and efficiency," Congress, in 1949, amended the National Security Act of 1947 (10 USC 2208) authorizing the Secretary of Defense to establish working capital funds for financing supply inventories and for capitalizing industrial type activities.

Congress expected that:

- Businesslike cost-accounting would be used to (1) focus attention on the cost of doing the job, (2) simplify budgeting, and (3) provide cost information for management control.
- Management, given greater freedom from the appropriations cycle, through the working-capital fund concept, could adjust to workload demands to increase efficiency and reduce costs.
- Industrial funds would result in buyer-seller relationships between customers and producers. Customers, forced to pay for services rendered, would be motivated to order only necessities and pay only the minimum price. Producers, financially dependent upon obtaining orders and matching costs with reimbursements, would be motivated to improve cost estimates and controls, and to identify and correct inefficiency and waste. (U. S. GAO, April 1986, pp. 8-9).

Funds were intended to run on a businesslike basis, striving to break even. Rather than maximizing the distance between revenue and cost, working capital funds are to strive to make revenue and cost equal.

The stock fund consists of two large accounts: the Appropriated Purchases Account and the Navy Stock Account.

a. Appropriated Purchases Account (APA)

This account contains a relatively small number of very high cost assets which are procured through investment appropriations such as SCN, WPN, and OPN. Most items in this account are managed by a hardware command ( e.g., Naval Sea Systems Command or Naval Air Systems Command).

APA material is issued at no charge to the user. Statistical charges are processed, but no funds are required for the end-user to acquire these components. Control is exercised through a decentralized tracking system, relying (often unsuccessfully) on the user's good intentions to return the damaged carcass for repair. The carcass return rate has been very low because then user is not effectively motivated to complete the turn-in.

In 1981 the Navy transferred hundreds of non-aviation depot level reparable items from the APA to the Navy Stock Account. This transfer, or migration was executed for at least two reasons. The first was to reduce lead time for these assets by removing their acquisition from the POM cycle. Once they were placed in the Stock Fund, repair or replacement could

be financed through the Fund rather than through Congressional appropriation.

The second reason for the migration was to instill a firm financial motivation for the fleet to return assets for repair. Nominal repair charges are assessed on assets returned promptly for repair. Actual replacement charges are assessed only for new stock assets, or for ordering an asset for which the turn-in has been "lost." Loss of one high cost reparable asset can obligate a large percentage of a ship's OPTAR. Thus all hands are interested in processing turn-ins more promptly.

In 1985 the Navy continued this migration, moving almost all aviation reparables into the Navy Stock Account. This migration has a direct impact on air station comptrollers and supply officers. Most of the weapons replaceable assemblies and subassemblies were migrated. The result has been to increase the funds necessary to repair assemblies in the Aviation Intermediate Repair Departments. At implementation, aviation fleet maintenance OPTARs were expected to grow several times. The financial and material transactions needed to feed the centralized accounting system were also expected to receive much more attention because of the financial penalties imposed on poor material accountants.

b. Navy Stock Account (NSA)

Before the large migrations in 1981 and 1985, the Navy Stock Account contained mostly low cost consumable items.

With the addition of the reparable assets, the fund grew tremendously.

Maintaining the Financial Inventory Report (FIR) has become a major interest at air stations and industrial activities holding NSA material. The FIR summarizes monthly inventory transactions. The report starts with the opening balance, adds receipts, gains, and price adjustments, subtracts issues, transfers, and losses, finally yielding an ending balance. The FIR is divided by cognizance symbol, and represents all inventory in dollars.

The FIR must be reconciled each month to the transactions reported by other supply activities. The comptroller generally performs this reconciliation by processing and posting the unmatched expenditure and issue listings. Processing these transactions does not affect the station's budget. Because the FIR is widely distributed and analyzed, however, the quality of the report can enhance or reduce the station's financial reputation. Although most of the errors fall in the supply officer's baliwick, the title, **financial** inventory report will generally place responsibility for correcting the errors squarely in the comptroller's lap.

### 3. System Model

Revolving funds are supposed to be self-sufficient. To assure that full operating costs are recovered, the Stock Fund imposes a surcharge on material sold. The industrial funds are authorized to charge a predetermined overhead rate, with the

intent of recovering general and administrative expenses, as well as manufacturing costs.

The Navy Stock Fund was capitalized over 100 years ago with a corpus, or body of cash. With that cash, early managers bought material for inventory. Except for wartime injections to allow for the entire Stock Fund to grow, the fund was self-supporting until the early eighties. This longevity was achieved by recognizing that the fund would experience other charges and losses, which fund managers had to anticipate and recover.

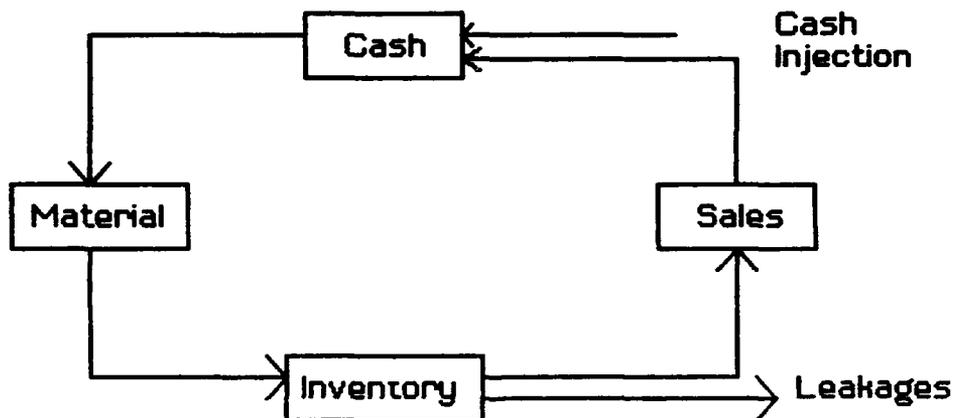


Figure 11. Stock Fund Cash Cycle

The cycle follows the business cycle very closely as shown in Figure 11. The fund starts with cash. The fund manager goes into the market and buys material to support the Navy. The material is stored in inventory until needed by a ship or squadron. When needed, the material is issued (or sold) to a ship, and "money" is transferred from the ship's operating funds to the Navy Stock Fund. This "money" transfer allows the fund manager to buy new material for the next requirement.

There are, unfortunately, system losses or leakages. Keeping an inventory results in holding charges. Warehousemen must be paid. Material may be received or issued, but the paperwork lost before the transaction is posted. Shelf lives expire. Material is stolen. Equipment may become obsolete. Cost accounting requires that transportation charges to the inventory be recorded as inventory (Matz and Usry, 1984, pp.236-250). Finally, price inflation may make replacement costs higher than original acquisition costs.

To minimize the need for injections, The Naval Supply Systems Command charges a standard surcharge for each class of material. Prices are set at the beginning of each fiscal year. The formula is:

$$\text{NSF Price} = (\text{LRP}) \times \text{surcharge}$$

Where LRP = last receipt price.

The last receipt price is the price paid when the material was last purchased. This surcharge, nonetheless, covers only part of the money required to keep the Stock Fund solvent. NAVSUP must request funds through an appropriation each year to compensate for other events which reduce Stock Fund resources. Deployment of new, technically advanced fleet equipment typically requires a broader range of more expensive components than the less sophisticated predecessor. Without additional funds, the Stock Fund could overextend itself trying to buy parts to support the new gear. Theoretically, the parts for the phased out equipment can be sold. Many times though, undocumented users appear.

Fund managers are hesitant to sell off (thereby recovering some of the cash invested in) the "obsolete" parts. Moreover, equipment is normally phased in, meaning that for several years, the Stock Fund must support two end-items simultaneously.

Adding new equipment adds requirements for additional prepositioned war reserve material. Filling this requirement means that additional funds must be budgeted for spare parts which are then unavailable to support daily operational needs.

Changes in stocking policy affect Stock Fund operations. Stock-funding aircraft carriers, for example, added 13 new stock points to the system in a period of 18 months. The capitalized carrier inventories added several hundred million dollars in material to the Stock Fund body. But because of fleet funding shortages in the years before capitalization, the carriers also brought tens of millions of dollars of unfilled allowances that immediately taxed Stock Funds assets. New dollars had to be infused into the Stock Fund to maintain it.

Injections also stabilize prices. Customers expect some price changes during inflationary periods. Price increases, however, do not occur evenly across all markets. Injections are used to offset these imbalances, and thus equalize price increases for all customers.

#### 4. Implications for the Comptroller

Drawing generalities for the comptroller is extremely difficult. Some activities have no Stock Fund material on board, and the comptroller will be little interested in the Stock Fund.

Other activities, such as master jet bases or a Naval Shipyards carry millions of dollars of Stock Fund material; the comptroller's interest will be much higher. Further complicating the issue, Stock Fund transactions are recorded in 28 different accounting support systems. Addressing all the possible combinations and activities is not possible. Rather, the author will discuss some accounting areas which can yield significant transaction errors if not closely monitored.

- Differences are changes in price or quantity that affect the amount billed to a command. The comptroller must be alert to differences and how they are processed. Differences can reduce the balance available for obligation. The comptroller must be sure that his clerks research and resolve differences. If they are ignored or improperly processed, the command risks overobligating, or violating subsection 1341(a), Title 31 USCA. Each accounting system has a different report title. For end-use OPTAR accounting, the Summary Filled Order and Expenditure Difference Listings and the Aged Unfilled Order Listing report differences. Under Special Accounting Class AV-207 the C and H Listing and the A and G Listing provide this crucial data.
- Receipt processing is a critical function from both a material management and financial perspective. The comptroller should be aware of who posts receipts and who corrects errors. Nothing ruins a day like discovering, several weeks after the fact, that an end-use receipt for one each was erroneously posted as 10,000 each at \$2,000. The error reduces funds available in the relevant end-use OPTAR, which can be traumatic. Most accounting systems generate "exception reports" which provide visibility to unusually large transactions. The comptroller should be aware of who processes exception data, and should be sure that the processor understands the need for prompt investigation (and correction) of large transactions.

- The comptroller must get to know his system. The comptroller who searches for the employee in either the Comptroller Department or the Supply Department who understands both financial and material transactions will be sorely disappointed. There is likely to be no one. The comptroller must develop a broad perspective on the material-financial interface and then motivate others to do the same. He should try to get both Supply Department and Financial personnel involved. The Supply Department generally incurs the obligations, and the financial people are forced to clean up the errors.

## 5. Summary

The Navy Stock Fund is an area of increasing concern for both the Supply Officer and the comptroller. The Supply Officer controls the material and posts the transactions, and the comptroller is involved in billing and maintaining the financial records. Managing the large inventory requires knowledge and cooperation from both departments.

### B. THE NAVY INDUSTRIAL FUND

Industrial funds are also working capital or revolving funds. Although they are not as old as Stock Funds, the legal pedigree is similar. Industrial funds were born in 1949 as an amendment to the National Security Act of 1947.

As noted in the previous section, the revolving fund concept tries to motivate both the provider and consumer of the material and services to be economical. The customer is supposed to press the seller to provide adequate goods and services at the minimum cost. On the other hand, the seller is supposed to charge the buyer for the goods and services provided, motivating the buyer to

consider how badly he needs each job done to try to maximize economy.

1. Learning objectives

- To understand the industrial fund concept and to become familiar with the Navy Industrial Fund.
- To understand the advantages and disadvantages of service by an Industrial Fund activity.

2. DoD Organization

DoD agencies operate five industrial funds. Each service, and the DoD operates one. Because of service differences, each fund has its own character. All industrial funds are operated and managed in accordance with DoD Directive 7410.4, *Regulations Governing Industrial Fund Operations*.

The Navy Industrial Fund is the largest of these funds. Shipyards, air rework facilities, ordnance depots, some public works centers, and the Military Sealift Command all operate under the NIF. The Marine Corps Industrial Fund is the smallest. The MCIF finances equipment maintenance depots and technical engineering support.

Industrial funds use cost accounting procedures to hold assets in suspense until a job or repair action is completed. Resources consumed in manufacturing an item, or repairing an asset, are thus allocated to the final output, or cost object. Similarly, resource expenditure is matched (in time) with job completion.

The customer submits a job order or work request for the NIF activity to perform work. The NIF activity starts the job using cash and material held in the fund. Direct labor is paid from the NIF, but labor charges are accumulated in work-in-process. Direct material is issued from NIF inventories and charged to work-in-process. Production overhead and general and administrative overhead are added to the work-in-process account once a month and when the job is completed, based on a predetermined rate. The cost of each individual job order is thus accumulated in the accounting system.

When the job is completed, all costs are transferred from work-in-process to finished goods, and the customer is notified. Once the customer accepts the goods, the costs are moved to the cost of goods sold account. The funds received from the customer are placed in the NIF corpus and the cycle continues.

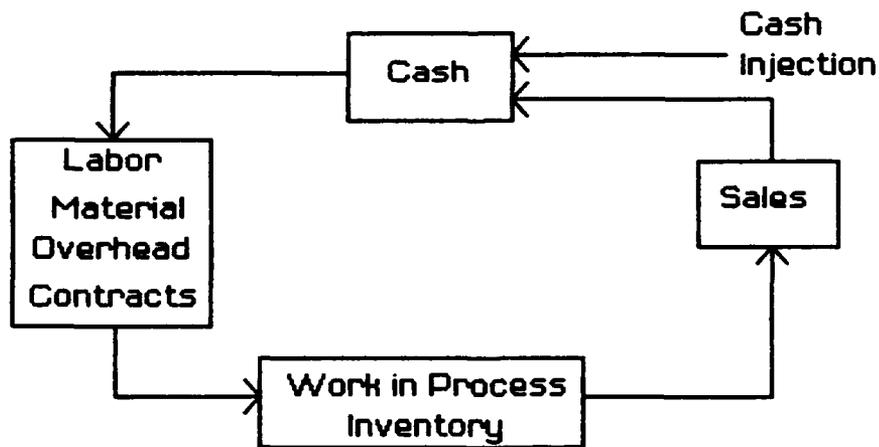


Figure 12. Industrial Fund Cash Flow Cycle

As one might expect, the NIF model is very much like the Navy Stock Fund cycle. One should note, however, that there is

no leakage in the NIF model. Due to cost accounting procedures all "leakage costs" are charged to overhead. The leakages must be explained at the end of the fiscal year as variances from planned overhead.

Despite this method of recovering losses, the NIF must still receive annual Congressional cash injections. The same phenomena that threaten the body of the Stock Fund threaten to consume the body of the NIF.

First, the NIF is susceptible to wage and price changes since a large percentage of the costs flowing through the system are labor costs. During inflationary periods, cash must be added to fund wage increases. Otherwise, the increased costs would be charged against overhead as variances, requiring changes in the stabilized rate structure.

Second, policy changes or NIF expansions normally require increased capital. Opening a new shop store at a shipyard requires capital to fund increased inventory levels. Adding a composite materials shop at an air rework facility requires additional manpower, tools, and equipment, all of which must be funded by outside funds, before actual production work begins.

NIF activities are generally individual commands. The commands are organized in activity groups under an Activity Group commander. NAVSEA, for example, is the Activity Group commander for shipyards; NAVAIR is the Activity Group commander for NARFs.

Activity Group commanders act as the claimant for all members of the activity group. The Activity Group commanders answer to the CNO and NAVCOMPT for administration and management of the Navy Industrial Fund. Navy and Marine Corps activity groups are displayed in Table 4.

Accounting policies for all Navy and Marine Corps industrial fund activities are promulgated in the Navy Comptroller's Manual, Volume V. In addition, NAVCOMPT publishes handbooks for each activity group in cooperation with the Activity Group commanders.

TABLE 4. NAVY AND MARINE CORPS  
ACTIVITY GROUPS

Marine Corps Industrial Funds.....	2
Naval Shipyards.....	8
Military Sealift Command.....	24
Chief of Naval Research Laboratories.....	7
Naval Air Rework Facilities.....	6
Public Works Centers.....	8
Naval Air Laboratories.....	3
Publications and Printing Service.....	*
Aeronautical Engineering Centers.....	2
Navy Regional Data Automation Centers.....	9
Navy Research Laboratories.....	2

### 3. Summary

This chapter paints pictures of the Stock Fund and Industrial Fund in very broad brush strokes. The Navy manuals governing these funds are several hundred pages long. One can

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\*Numerous activities and locations throughout the world.

not reasonably communicate the details of managing these funds in twenty pages as background for a two-hour lecture.

The comptroller assigned to an activity with a large Stock Fund or Industrial Fund investment on board must study and learn on his own. He must walk around and find the experts in receiving, issuing, and controlling both material and financial transactions.

The first seven chapters have looked backwards at the threats and actions taken in the financial management arena. The Navy's response to financial problems has been rather reactionary. There has always been time to solve the problem "later." The clamor to reduce the budget deficit, and the growth of legislation to affix fiscal responsibility have made a reactionary response inappropriate. In Chapter VIII, NAVCOMPT's attempt to get ahead of the problem through implementation of a Strategic Financial Management Master Plan will be examined.

## VIII. THE FUTURE OF FINANCIAL MANAGEMENT

As a result of the persistently high federal deficits, we have entered an era of budgetary constraint, and we are now confronted with many hard choices. However, we lack reliable systems to ensure that our decisions can be effectively implemented. (Bowsher, 1986, pg. 1).

Financial managers have received much visibility and guidance in recent years. As Mr. Bowsher said, deficits and the national debt continue to grow. Congress has attempted to stem the expenditure of funds through such radical actions as passing the Gramm-Rudman Act.

Recently enacted legislation, the *Federal Managers' Financial Integrity Act*, requires agency action to improve financial management systems. This Act is intended to provide the "reliable systems" of which Mr. Bowsher spoke. NAVCOMPT implemented this requirement through the DoN *Strategic Financial Management Master Plan*. (NAVCOMPT Instruction 7000.39).

A major issue facing NAVCOMPT is the proliferation of incompatible accounting support systems. Accumulating and using the data collected from so many dissimilar systems is difficult. The last section of this chapter examines several publications which provide current, official information which may help the comptroller be aware of recent financial management issues.

## A. LEARNING OBJECTIVES.

- To understand the goals and objectives of the *Strategic Financial Management Master Plan (SFMMP)*.
- To understand how the SFMMP may influence field comptrollers.
- To develop a sense of the Navy financial management system's complexity.
- To become familiar with sources of current financial information.

## B. THE PURPOSE OF THE MASTER PLAN

The Navy's financial management system has evolved in a variety of environments. As financial pressure developed on one or another groups of activities, a system was designed to accumulate management accounting information. The result has been uncontrolled development of accounting systems.

Consequently, system architectures, hardware, and software are often grossly incompatible.

Enactment of the *Federal Managers' Financial Integrity Act* requires that all Federal Agencies change their approaches to developing accounting systems. "The Act seeks to strengthen internal control and accounting systems in federal agencies to help detect and reduce fraud, waste, and abuse, and thereby improve government management." (U.S.GAO, Sept. 27, 1985, pg. 1).

Achieving this objective requires that the Navy change its style of controlling accounting support systems. The SFMMP is intended to lead the Navy to achieving this objective over the long run. It is a detailed document (over 300 pages) informing all

players of approved financial management programs, projects, and milestones. Moreover, any proposed system must be evaluated for compliance with the SFMMP. New systems must meet the following standards:

- Provide timely, accurate, useful and adequate data;
- Ensure responsiveness of the accounting process to mandated changes and specific requirements;
- Achieve efficient and economical financial systems;
- Ensure effective accountability and control of all funds, property, and other assets;
- Certify system compliance with GAO principles and standards and OMB principles under the Federal Managers' Financial Integrity Act;
- Obtain GAO approval of accounting systems. (NAVCOMPTINST 7000.39, pg. A-10).

#### C. SYSTEM DIVERSITY

Fulfilling these objectives is a challenging project. In a 1985 report, GAO credited the Navy for "correcting 27 material weaknesses reported in fiscal year 1983." (U.S.GAO, Sept. 27, 1985, pp. 6). The Navy was, nevertheless, faulted for its unwillingness to test systems. GAO does not assume that the correction is sufficient unless it is tested and proven.

As shown in Table 5, the Navy and Marine Corps operated 182 systems in 1984 (SFFMP). One major objective of the SFMMP is to reduce the number of systems to 66 by the end of 1990.

TABLE 5. EXISTING AND PLANNED ACCOUNTING SUPPORT SYSTEMS

<u>System</u>	<u>1984</u>	<u>End of 1990</u>
DON	5	5
Navy Agency	9	9
Navy Industrial Fund	28	9
Navy Stock Fund	24	9
Navy Trust Fund	6	6
Navy Civilian Pay	29	2
Navy Military Pay	8	8
Navy General Accounting	<u>57</u>	<u>15</u>
Navy Subtotal	166	61
Marine Corps Agency	3	1
Marine Corps Industrial Fund	1	1
Marine Corps Stock Fund	1	-
Marine Corps Civilian Pay	2	-
Marine Corps Military Pay	5	3
Marine Corps General Accounting	<u>4</u>	<u>-</u>
Marine Corps Subtotal	16	5
DON Total	182	66

#### D. IMPLEMENTATION

The first step in consolidating and redesigning Navy and Marine Corps accounting support systems has been to develop a systems inventory. As each system is identified, a System Manager is appointed. He will ensure that the system is established, maintained, reviewed, improved, and reported on as required by SECNAV policy.

The review and control process will be executed through two programs. The first is the System Manager/User (SM/U) Review Process. The second is the Consolidated Systems Evaluation (CSE) Program. The primary objective of each of these programs is to identify systems deficiencies. Given the number of systems the

Navy sponsors, it is likely that many commands (and thus, many field comptrollers) will experience SM/U and CSE reviews in the near future.

The System Manager conducts the SM/U Review in concert with the System Users. The review focuses on six areas:

- Technology
- System processes
- Recording/reporting transactions
- System integrity
- Efficiency and economy of operations
- Corrective action.

When the review is completed (successfully) the system manager signs a statement that the review has been completed.

The Consolidated System Evaluation is a more detailed review, conducted on both operational and developmental systems. The intent is to provide effective feedback on deficiencies to System Managers. The reported deficiencies are then used to update the SFMMP. The purpose of the CSE is to provide reasonable assurance that systems comply with:

- GAO, Treasury, OMB, and DoD accounting requirements and standards,
- Internal control requirements,
- Cash management requirements,
- ADP soundness,  
Functional soundness,
- User information needs, and
- SFMMP.

CSE will be conducted by multidiscipline teams of functional specialists, ADP specialists, and systems analysts. (Lewis, 1986, pp. 3-4).

#### E. UNIFORM CHART OF ACCOUNTS

Although there is a uniform chart of accounts in the RMS, the Navy has never used a Navy-wide Uniform Chart of Accounts. One initiative of the SFFMP has been to institutionalize a Navy Uniform Chart. As discussed in Chapter III, a chart of accounts is necessary for organizing and classifying accounting information.

Consistent with the top-down design of the SFFMP, the chart of accounts is scheduled for promulgation in 1987. By publishing so early, NAVCOMPT enables users to embed the chart in newly designed systems.

#### F. INTEGRATED DISBURSING AND ACCOUNTING AND FINANCIAL MANAGEMENT SYSTEM

The Navy has traditionally separated the duties of the disbursing officer and the comptroller. The disbursing officer is a Treasury agent. He prepares checks and makes payments to companies and people who provide material and services to the Government. He reports his transactions directly to the Treasury. The Treasury then consolidates and summarizes transactions, and reports them back to the claimants. On the other hand, the comptroller has financial responsibility for managing the funds within the organization.

This separation, and the resulting dual reporting systems and databases, results in a continuous discrepancy between the disbursing officer's expenditure accounting system and the comptroller's obligational accounting system. As disbursements are reported to the claimants, they are matched with reported obligations. Disbursements which cannot be matched are called undistributed disbursements.

Undistributed disbursements result from either delays in moving information from the paying activity to the AAA, or from errors in the appropriation data cited in the disbursing voucher supporting the payment. (Rogers, 1986, pg. 6).

Although this delay in matching disbursements is probably a minor nuisance at the field level, it is a large and continuing problem for NAVCOMPT. At current annual outlay rates, a three-week delay yields a four billion dollar disparity between the obligation and expenditure systems. NAVCOMPT must reconcile and explain this discrepancy in its reports to the GAO, the Treasury, and OMB. Obviously, making this monthly adjustment does not engender confidence in the Navy's accounting system.

The Integrated Disbursing and Accounting and Financial Management System (IDAFMS) has been designed to solve this problem. Comptrollers will see the effect of the IDAFMS systems as various new accounting systems are implemented over the next few years. The objective of IDAFMS is to

- Develop and implement an interim system;
- Consolidate disbursing and accounting into one activity;

- Consolidate accounting activities into Financial Information Processing Centers (FIPC);
- Develop and implement Standard Financial Management Systems; and
- Integrate FIPC databases via teleprocessing into one national database.

#### G. SOURCES OF CURRENT INFORMATION

Aside from message traffic, instructions, and notices, the comptroller has four resources for keeping current. The first is to develop working relationships with both the claimant's comptroller and with the AAA or FIPC staff. These people will often be aware of upcoming changes. By cultivating a good working relationship, the comptroller should be aware of changes on the horizon.

A second source is the *Financial Management Newsletter* (NAVSO P-3568). The *Newsletter* is a pragmatic periodical which is intended to provide timely information to field activities. It is a short publication. Even the busiest comptroller has a few minutes three times a year to read it.

The American Society of Military Comptrollers publishes a monthly magazine entitled *Military Comptrollership*. Although Army and Air Force officers and civilians tend to be the most prolific contributors, the magazine contains interesting, though slightly less pragmatic articles than those found in the *Financial Management Newsletter*.

The *Defense Management Journal* addresses broad topics of defense management, (e.g., acquisition and inventory topics.) Financial articles are sometimes published. In any case, reading

the magazine may help the comptroller understand many issues which may affect his fellow department heads.

#### H. SUMMARY

This chapter discusses the future of financial management, and advises the comptroller of ways to be alert to environmental changes. The Navy has summarized its plan for improving financial management systems in the SFMMP. The comptroller must be prepared to be involved in System Manager/User Reviews and Consolidated Systems Evaluations to determine if his accounting support system meets GAO, Treasury, and OMB standards.

## GLOSSARY

**Allocation:** the provision of funds from the Principal Administering Office to a Claimant.

**Appeal:** alternative term for reclama; usually used in communications with congressional committees.

**Apportionment:** distribution of appropriations (and other budgetary resources) by the director of OMB; usually by quarter or by project or activities

**Appropriation:** an act of Congress, authorizing an agency to incur obligations for specified purposes and to make payments out of the treasury.

**Authorization:** congressional legislation that sets up a federal program or agency for a specified period of time. Such legislation must be enacted before budget authority can be enacted. (see Sunset clause.)

**Budget authority:** budget authority that allows a federal agency to incur obligations before appropriations have been passed, or in excess of the amount of money in a revolving fund. Must be funded subsequently by an appropriation so that the commitments entered can be paid.

**Budget call:** a letter or message from a senior in the chain of command providing control numbers, personnel ceilings, and expected fences which must be used to prepare the ensuing budget request.

**Budget request:** a submission from a responsibility center to a major claimant providing estimates of the resources necessary to carry out the command's mission.

**Commitment:** an activity level administrative reservation of funds; a planning tool to ensure funds are available for desired projects.

**Concurrent resolution on the budget:** an act passed by both houses of Congress establishing the Congressional Budget for a given fiscal year.

**Continuing resolution:** congressional legislation providing budget authority for specific ongoing activities when the regular appropriation for those activities has not been enacted by the start of the fiscal year.

**Control numbers:** planning limits provided by a major claimant or a local comptroller to a subordinate activity or department, providing an estimate of the next year's resources.

**Current services budget:** a budget showing the estimated outlays and proposed appropriations necessary to continue existing programs without policy changes in the following fiscal year.

**Deficiency appropriation:** an act passed after a fiscal year has expired, to increase funds available so that the appropriation has a positive balance, and can lapse to the successor, or "M" account.

**Expenditure:** an outlay; expenditure of funds to fill an obligation.

**Expired funds:** budget authority which is no longer available for obligation but which may still be expended.

**Fences:** explicit limitations on funds use provided in the appropriation act by Congress.

**Fiscal Policy:** tax, spending, and borrowing policies intended to promote national economic growth, employment, inflation, and international balance of payments status.

**Five-year defense program (FYDP):** the official document which summarizes the SECDEF approved plans and programs for the Department of Defense. It is published at least once annually.

**Full funding:** providing the budget authority covering total program or project cost at the time it is first approved.

**Incremental funding:** providing budget authority for those obligations which are expected to be incurred in a given fiscal year.

**Input budgeting:** a budgetary method which focuses on the cost of the objects, or inputs.

**Internal audit:** determining that management controls, practices, and procedures at all levels are adequate in concept and effective in application and that they provide for adequate financial integrity and effective utilization of resources available.

**Lapsed funds:** budget authority which is no longer available for obligation or expenditure.

**Mark-up:** the process of modifying budget submissions and reducing, increasing, revising or eliminating items, and providing appropriate guidance resulting from the review process.

**Midyear review of the budget:** (1) A revision of the budget submitted to the Congress by the President by 15 July, incorporating the effects of newly enacted legislation, the latest information on the previous year's spending and revenues, and providing updated economic projections. (2) A locally conducted review to determine the adequacy of present funding levels, to update unfunded requirements to the next level in the financial chain-of-command, and to update the budget submission being prepared for delivery to Congress.

**Minor property:** personal property acquired for immediate use with unit cost of less than \$1000. Also Organic Property.

**Multiple-year appropriation:** an appropriation which is available for a specified number of years.

**No-year appropriation:** an appropriation which has no designated life, available continuously for obligation. Examples are the Navy Stock Fund, and the Navy Management Fund.

**Obligation:** a legal reservation of funds; establishes future requirement to expend funds.

**Office of Management and Budget (OMB):** the division of the Executive Office of the President which assists the President in discharging his budgetary and management responsibilities.

**Operating target (OPTAR):** an administrative rather than legal limitation on expenditures provided to an afloat operating unit or department ashore.

**Organic property:** USMC term for minor property.

**Plant property:** all Navy-owned real property.

**Planning, Programming and Budgeting System:** an integrated system for establishing, maintaining, and revising the FYDP and the DoD budget.

**President's Budget:** the proposal sent by the President to Congress in January each year; required by the Budget and Accounting Act of 1921, as amended.

**Program:** a set of activities directed toward a common purpose or objective, undertaken or proposed by an agency.

**Programming:** translating planned military force requirements into time-phased manpower and material resource requirements.

**Program budgeting:** a method of budgeting which attempts to relate the cost of inputs to the value of outputs.

**Program element:** basic building block of the FYDP; a description of a mission by identifying the organizational entities and resources needed to perform the assigned mission.

**Public debt:** the total of all direct borrowings of the U.S. Treasury, as opposed to borrowings of other federal agencies.

**Reclama:** a request for restoration of all or part of a reduction in a budget estimate made by a higher level review.

**Regular appropriation:** See appropriation.

**Reimbursable OPTAR:** funds provided by a tenant to a host command in return for the host's providing specified and mutually agreed services.

**Sequestration:** the automatic process of reducing Federal outlays, invoked through the Office Of Management and Budget and the General Accounting Office, when the Congress and the President are unable to enact appropriation acts that meet the Gramm-Rudman mandated deficit levels.

**Supplemental appropriation:** an act passed during the fiscal year to provide funds for unexpected contingent requirements.

**Sunset clause:** a provision in a law requiring either termination or automatic review at a preset date

**Transfer:** moving dollars from one appropriation into another; must be approved in advance by Congress.

**Unfunded requirements:** Projects or previously unidentified needs, such as pay raises or inspection deficiencies, for which funds have not yet been provided.

## APPENDIX B

### EVALUATION FORM

The purpose of the Practical Comptrollership Course is to prepare students to deal with the day-to-day responsibilities of the comptroller. Please answer the following questions:

1. Please identify your experience with comptrollership:

- a. Practicing Comptroller
- b. Commanding Officer
- c. Auditor or management analyst
- d. Accounting Professional (instructor)
- e. Student
- f. Other

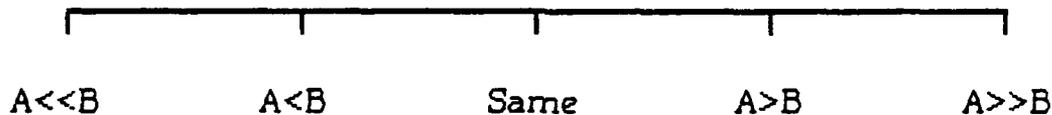
2. Have you completed either the Practical Comptrollership Course or Financial Management in the Armed Forces at the Naval Postgraduate School?

Yes \_\_\_\_\_

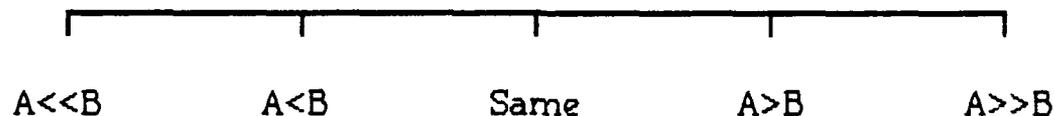
No \_\_\_\_\_

Please evaluate the new PCC Textbook (identified on the bars below as "A") comparing it with both the previous textbook (B) and your experience and expectations of comptrollership. Compare on the following qualities:

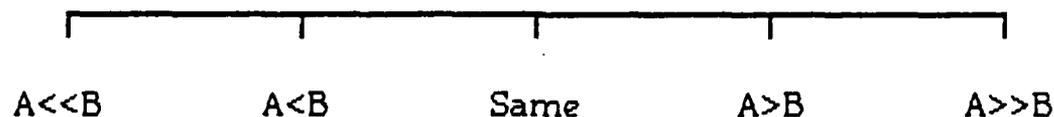
3. Readability.



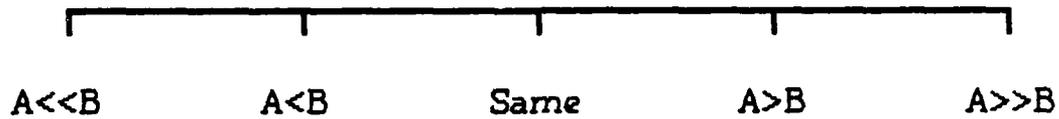
4. Skill Developing.



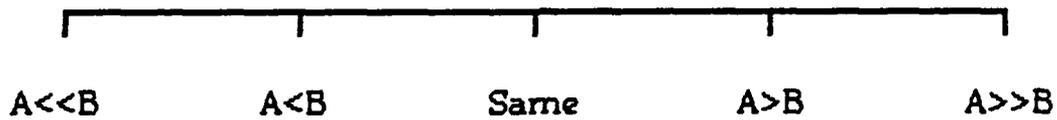
5. Defining comptrollership.



6. Usefulness of material



7. Level of material.



8. Contribution to improving future comptrollership.



9. Specify the chapters or subject areas where you would change the emphasis. (Use other side if you need more space.)

1.

2.

3.

APPENDIX C  
DETAILED DATA

A. MANAGEMENT ANALYSTS

	NC*	A<<B	A<B	A = B	A>B	A>>B
READABILITY	0	0	0	1	2	0
SKILL DEVELOPING	0	0	1	1	1	0
DEFINING COMPTROLLERSHIP	0	0	1	2	0	0
USEFUL MATERIAL	0	0	2	1	0	0
LEVEL OF MATERIAL	0	0	1	0	2	0
CONTRIBUTION TO IMPROVING FUTURE COMPTROLLERSHIP	1	0	0	1	1	0

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\*NC means no comment. Reflects evaluators who chose not to comment.

## B. PRACTICING COMPTROLLER

	NC	A<<B	A<B	A = B	A>B	A>>B
READABILITY	0	0	0	0	0	1
SKILL DEVELOPING	0	0	0	0	0	1
DEFINING COMPTROLLERSHIP	0	0	0	0	0	1
USEFUL MATERIAL	0	0	0	0	0	1
LEVEL OF MATERIAL	0	0	0	0	0	1
CONTRIBUTION TO IMPROVING FUTURE COMPTROLLERSHIP	0	0	0	0	0	1

## C. STUDENT

	NC	A<<B	A<B	A = B	A>B	A>>B
READABILITY	0	0	0	0	0	1
SKILL DEVELOPING	0	0	0	0	0	1
DEFINING COMPTROLLERSHIP	0	0	0	0	0	1
USEFUL MATERIAL	0	0	0	0	0	1
LEVEL OF MATERIAL	0	0	0	0	0	1
CONTRIBUTION TO IMPROVING FUTURE COMPTROLLERSHIP	0	0	0	0	0	1

## APPENDIX D

### EVALUATORS' BIOGRAPHIES

Evaluator A: Commander; Experience as Airwing Maintenance Officer, several years on a headquarters program management staff, executive assistant to a flag officer.

Evaluator B: Lieutenant Commander, Supply Corps; Submarine and submarine tender experience, contract administration, systems analyst in foreign military sales, management analyst and auditor.

Evaluator C: GS-11, 12 years government service, Operational auditor/management analyst; personnel management, accounting and comptrollership, operational auditor/management analyst.

Evaluator D: Lieutenant, Medical Service Corps; Medical Service Corps Financial Management training, comptroller ashore for three years, MSM Financial Management.

Evaluator E: Professor, Strategic and Financial Management; over twenty years at the Naval Postgraduate School, extensive exposure to financial and managerial issues.

Evaluator F: Lieutenant, Civil Engineer Corps; assistant resident-officer-in-charge-of-construction overseas, MSM Financial Management.

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