

GAO

Report to the Chairman, Subcommittee
on Government Management, Finance,
and Accountability, Committee on
Government Reform, House of
Representatives

April 2005

CAPITAL FINANCING

Potential Benefits of Capital Acquisition Funds Can Be Achieved through Simpler Means



G A O

Accountability ★ Integrity ★ Reliability

GAO
Accountability • Integrity • Reliability

Highlights

Highlights of [GAO-05-249](#), a report to the Chairman, Subcommittee on Government Management, Finance, and Accountability, Committee on Government Reform, House of Representatives

Why GAO Did This Study

CAFs have been discussed as a new mechanism for financing federal capital assets. As envisioned, CAFs would have two goals. First, CAFs would potentially improve decision making by reflecting the annual cost for the use of capital in program budgets. Second, they would help ameliorate at the subunit level the effect of large increases in budget authority for capital projects (i.e., spikes), without forfeiting congressional controls requiring the full cost of capital assets to be provided up-front. Through discussions with budget experts and by working with two case studies, the Departments of Agriculture and of the Interior, we are able to describe in this report (1) how CAFs would likely operate, (2) the potential benefits and difficulties of CAFs, including alternative mechanisms for obtaining the benefits, and (3) several issues to weigh when considering implementation of CAFs.

CAPITAL FINANCING

Potential Benefits of Capital Acquisition Funds Can Be Achieved through Simpler Means

What GAO Found

Capital acquisition funds (CAF) have been suggested as department-level funds that would use appropriated up-front borrowing authority to buy new departmental subunit assets. These subunits would then pay the CAF a mortgage payment sufficient to cover the principal and interest payment on the Treasury loan. The CAF would use those receipts only to repay Treasury and not to finance new assets. If existing capital assets were transferred to the CAF, subunits would pay an annual capital usage charge to the CAF.

CAFs might achieve the goals intended, but these goals can be achieved through simpler means. Alternative mechanisms, such as asset management systems, cost accounting systems, and working capital funds may achieve the goal of allocating annual capital costs and improving decision making for capital assets. Our case study agencies generally did not indicate problems with budget authority spikes. They budget in useful segments, use accumulated no-year authority, or finance capital assets using working capital funds. Many concerns about CAFs were raised, including the long-term feasibility of making fixed annual mortgage payments and the added complexity CAFs would create.

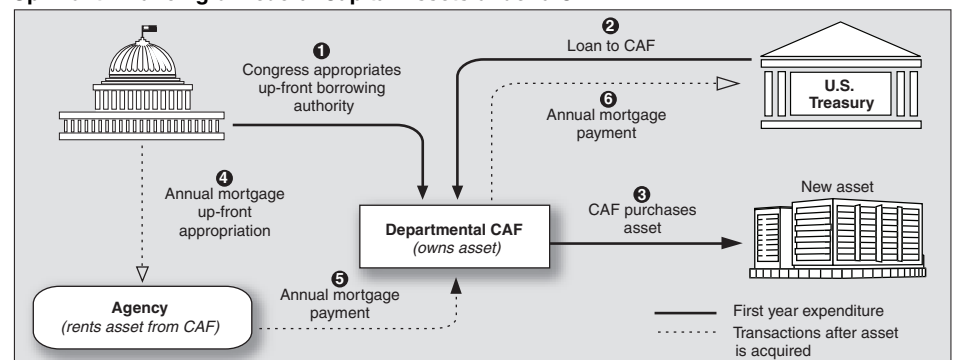
Implementation would raise a number of issues. If CAFs were applied only to new assets going forward, all programs would not reflect the full annual cost of capital for decades. Yet the difficulties of including existing capital are numerous. Even if these issues were tackled, there is little assurance that CAFs alone would create new incentives for programs to reassess their use of capital since CAF payments would not affect the deficit.

Implementation issues could overwhelm the potential benefits of a CAF. More importantly, current efforts under way in agencies would reflect asset costs as part of program costs without introducing the difficulties of a CAF. As long as alternative efforts uphold the principle of up-front funding, CAFs do not seem to be worth the implementation challenges they would create. Except for OMB, agencies generally agreed with our conclusions.

www.gao.gov/cgi-bin/getrpt?GAO-05-249.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Susan J. Irving at (202) 512-9142 or irvings@gao.gov.

Up-Front Financing of Federal Capital Assets under a CAF



Source: GAO.

Contents

Letter		1
	Results in Brief	2
	Background	8
	Scope and Methodology	10
	CAF Operations Would Create a New Financing System and New Oversight Responsibilities	12
	CAF Benefits Can Be Achieved through Alternative Means Without the Added Budget Complexity	17
	Several Issues to Weigh When Considering Implementation of CAFs	32
	Conclusion	40
	Agency Comments and Our Response	41

Appendixes		
	Appendix I: Comments from the Department of the Treasury	44
	Appendix II: Comments from the Department of the Interior	47

Figures		
	Figure 1: Up-Front Financing of Federal Capital Assets before and after Establishing CAFs: New Asset Obtained in Year 1	3
	Figure 2: NPS Asset Management Plan	19
	Figure 3: Illustration of Budget Spikes and Potential Smoothing Effects of a CAF at ARS	24

Abbreviations

ABC	activity-based costing
APHIS	Animal and Plant Health Inspection Service
ARS	Agricultural Research Service
BA	budget authority
BLM	Bureau of Land Management
BPA	Bonneville Power Administration
CAF	capital acquisition fund
CBO	Congressional Budget Office
CPAIS	Corporate Property Automated Information System
DOD	U.S. Department of Defense
DOI	U.S. Department of the Interior
FASAB	Federal Accounting Standards Advisory Board
FBF	Federal Buildings Fund
FMS	Financial Management Service
FS	Forest Service
FTS	Federal Technology Service
GSA	General Services Administration
INFRA	Infrastructure
IT	information technology
NASA	National Aeronautics and Space Administration
NPS	National Park Service
NRC	National Research Council
OMB	Office of Management and Budget
PBS	Public Buildings Service
USDA	U.S. Department of Agriculture
WCF	working capital fund

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



United States Government Accountability Office
Washington, D.C. 20548

April 8, 2005

The Honorable Todd Russell Platts
Chairman
Subcommittee on Government Management,
Finance, and Accountability
Committee on Government Reform
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we explore the concept of capital acquisition funds (CAF) as a possible way to reflect the annual cost for the use of capital in program budgets while still maintaining up-front congressional control over budgetary resources. To fully understand how these funds would work in the federal government, we agreed to (1) describe how CAFs might work as a financing approach for federal agencies' capital investment, (2) examine the potential benefits and difficulties of instituting and using CAFs, and (3) identify any issues that Congress might consider before instituting CAFs.

Since CAFs do not currently exist, we developed an in-depth understanding of the CAF mechanism through a review of written CAF proposals and interviews with budget experts at the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO). We then presented a detailed description of CAFs to officials at the Departments of Agriculture (USDA) and of the Interior (DOI) and some of their agencies. We obtained their insights and opinions on the applicability of the mechanism at their agencies and on how CAFs might compare to their current practices for financing capital assets. We also spoke with Department of the Treasury (Treasury) and General Services Administration (GSA) officials and congressional staff to gain their perspective on CAFs. Our work was conducted in Washington, D.C., from May 2004 through January 2005 in accordance with generally accepted government auditing standards. We obtained comments on a draft of this report from OMB, Treasury, GSA, DOI, and USDA. Written comments from Treasury and DOI are reproduced in appendix I and II. We have incorporated technical comments as appropriate throughout the report.

Results in Brief

In recent years, various interested parties¹ have reported on the different ways that federal agencies can improve planning, budgeting, and decision making for capital assets. One common recommendation has been to consider the creation of new capital asset financing mechanisms, CAFs. The theory behind this recommendation is that CAFs would both help improve decision making by allocating capital costs to subunits² of departments on an annual basis and also help alleviate, at the subunit level, the large, year-to-year increases in budget authority (BA)³ (referred to in this report as “spikes”) that sometimes occur with up-front financing of capital assets without changing the requirement for up-front funding at the department level.

CAFs would operate at the department level and would to some extent complicate the current process for financing federal capital assets. Instead of providing departmental subunits with up-front appropriations to directly purchase capital assets, Congress would appropriate up-front borrowing authority to the departmental CAF for the full cost of an asset.⁴ The CAF then would borrow from the Treasury’s general fund to acquire the asset. The subunit would receive the asset and make a “mortgage payment”⁵ to the CAF. This mortgage payment would then be forwarded to Treasury as repayment for the borrowed funds; it would not be used to finance new assets. If existing capital assets were transferred to the CAF, the CAF

¹These interested parties include the President’s Commission on Capital Budgeting, OMB, CBO, GAO, and others referenced throughout this report.

²Throughout this report we use the term “subunit” to mean any agency, bureau, or program that falls under the jurisdiction of a department-level entity. For example, the Agricultural Research Service would be a subunit within USDA. We sometimes use the word agency in place of the term subunit.

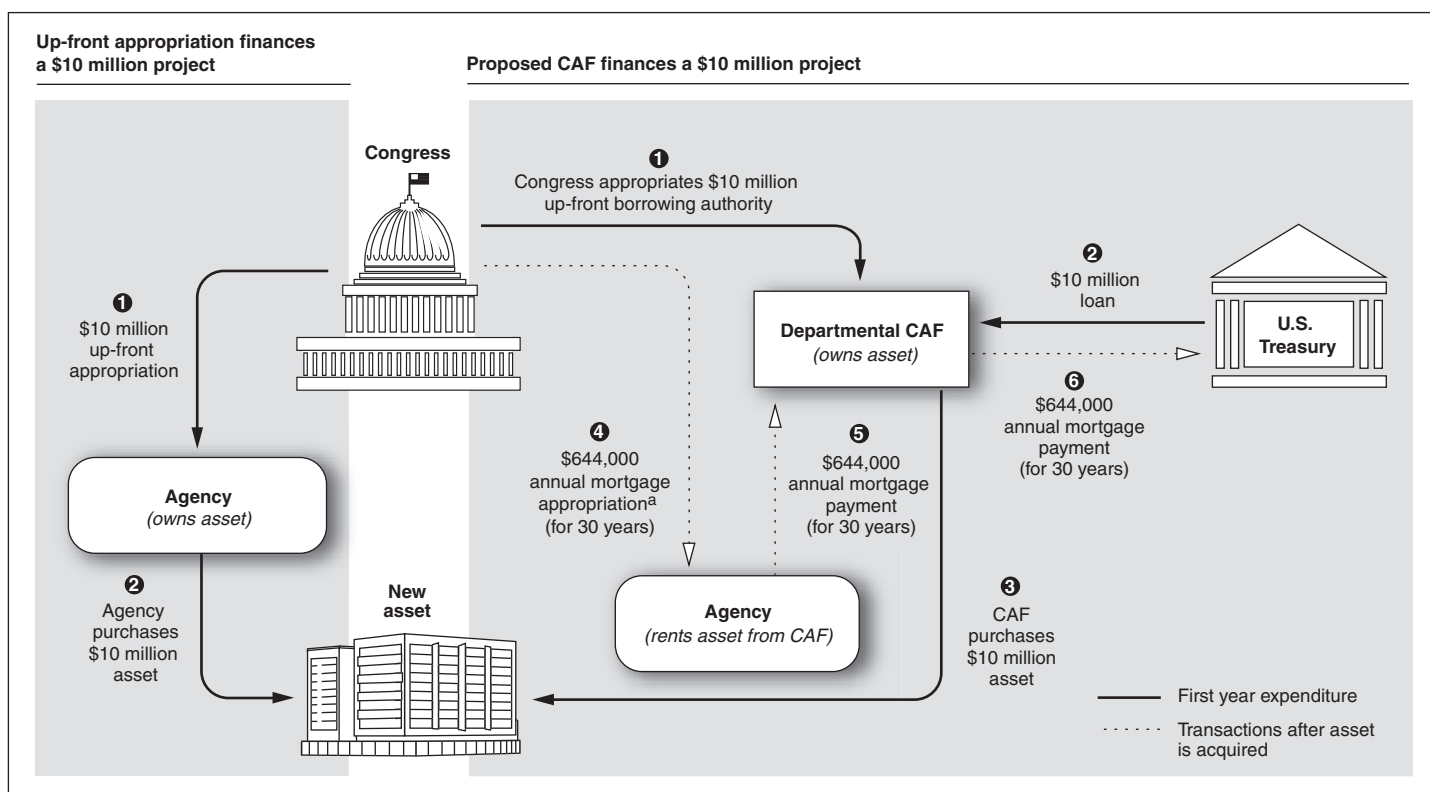
³Budget authority is authority provided by law to enter into financial obligations that will result in immediate or future outlays involving federal government funds. An appropriation act is the most common means of providing budget authority. The basic forms of budget authority include (1) appropriations, (2) borrowing authority, (3) contract authority, and (4) authority to obligate and expend offsetting receipts and collections.

⁴Authority to borrow is a type of budget authority and thus is subject to congressional control. It refers to the statutory authority that permits a federal agency to incur obligations and make payments to liquidate obligations out of borrowed monies. This does not include the Treasury’s authority to borrow from the public or other sources under 31 U.S.C. 31. It can be provided in appropriations acts, authorization acts, or in permanent law.

⁵Throughout this report we use the term “mortgage payment” to mean an amount equal to the interest and amortization on an acquired capital asset.

would impute an annual capital usage charge on those assets to using agencies. The CAF would collect these charges on existing capital and forward them to Treasury; they could not be used for future projects. See figure 1 for an example of the current capital financing process compared to the process under a CAF mechanism.

Figure 1: Up-Front Financing of Federal Capital Assets before and after Establishing CAFs: New Asset Obtained in Year 1



Source: GAO.

^aThis example assumes the asset is acquired at the beginning of the fiscal year and rented for the entire year. The mortgage payment equals approximately \$644,000, assuming a \$10 million loan for 30 years at a 5 percent interest rate with monthly payments.

This new system for financing assets would increase management and oversight responsibilities for Treasury, departments with CAFs, OMB, and CBO. Treasury would have to set up CAF accounts and manage and report on the borrowing authority and mortgage payments; it would consider charging an administrative fee to cover the costs of these new responsibilities. Departments would have to account for the transactions between the CAF, Treasury, and the subunits, and perform oversight responsibilities. OMB would have to issue guidelines to determine the types of assets to include in the CAF and the method for calculating a capital usage charge for existing capital. OMB and Congress would have oversight responsibilities, which would need to be spelled out. In addition, OMB and CBO would have to determine the scoring of both the initial up-front borrowing authority and the subsequent appropriations for the annual mortgage payments. Although on a gross basis the BA would be appropriated twice, the payments are purely intragovernmental and offset one another so no adjustments would be needed to any appropriation subcommittee allocations⁶ for new assets. If existing capital assets are included in a CAF, the scoring of annual capital usage charges would have to be determined.

CAFs might improve decision making by allocating capital costs to programs. This could be part of a broader effort to include full costs in program budgets as a way of facilitating comparison across programs. CAFs might also ameliorate the spikes in BA for subunits that are sometimes said to inhibit capital acquisition. However, we found that agencies are implementing or using alternative mechanisms to address these challenges. For example, some agencies are developing and beginning to use asset management systems that should allow them to evaluate and record the condition of existing assets, estimate the funding required to sustain capital assets over time, and prioritize maintenance and improvements.⁷ Other agencies are using full cost information from accounting systems to aid in budget decisions, although more progress is

⁶In this report, subcommittee allocations refer to the distribution by the House and Senate appropriations committees of total new BA and outlays to the 13 appropriations subcommittees as required by the Congressional Budget and Impoundment Control Act of 1974. This allocation limits the total budget authority and outlays available for all accounts under the subcommittees' jurisdiction.

⁷We describe some of the asset management systems in this report and in GAO, *Budget Issues: Agency Implementation of Capital Planning Principles Is Mixed*, [GAO-04-138](#) (Washington, D.C.: Jan. 16, 2004). However, it was beyond the scope of both these reports to evaluate the effectiveness of the systems described.

needed before their cost accounting systems can fully inform decision making, including capital planning and budgeting.

Regarding spikes in BA, the case study subunits we spoke with generally did not consider them to be an impediment to acquiring needed capital. They explained that spikes are sometimes created by the changing priorities and funding decisions of Congress rather than agency budget requests. In other cases, agencies avoid spikes by funding capital in useful segments or using no-year authorities.⁸ Both of these approaches allow an agency to spread the total cost of an asset over time by either completing a project in phases or accumulating numerous years of funding in no-year accounts until the total amount of up-front BA has been appropriated. In addition, agency working capital funds (WCF)⁹ and the Federal Buildings Fund (FBF)¹⁰ at GSA are being used to finance some capital assets. By using these funds, which charge a rent payment or user fee, capital costs are allocated to programs and spikes in BA are averted.

In addition to describing alternative methods for achieving CAF goals, many of those we spoke with voiced concerns about CAFs. Case study agency and Treasury officials raised questions about the long-term feasibility of making fixed annual mortgage payments, especially in times of constrained budgets. Some subunits and congressional appropriations staff were concerned about shifting more control over capital assets from the subunit to the department level. In general, almost all agency officials, congressional staff, and budget experts that we interviewed concluded that CAFs sounded complicated and many questioned whether the challenges that CAFs are designed to address were problematic enough to warrant

⁸No-year authority refers to budget authority that remains available for obligation for an indefinite period of time, usually until the objectives for which the authority was made available are attained.

⁹A working capital fund is a revolving fund that operates as an accounting entity. The assets are capitalized and all income is in the form of offsetting collections derived from the funds' operations and available in their entirety to finance the funds' continuing cycle of operations without fiscal year limitation.

¹⁰The FBF is a governmentwide revolving fund established in 1972 and is the principal funding mechanism for the Public Buildings Service (PBS). Within GSA, PBS leases office space to federal customer agencies. PBS collects rent from federal tenants, which is deposited into the FBF. Congress exercises control over the FBF through the appropriations process that sets annual limits on how much of the fund can be expended for various activities. In addition, Congress may appropriate additional amounts for the FBF.

their adoption; especially given the additional budget complexities CAFs create.

We identified several other pertinent issues to weigh when considering the implementation of CAFs. Perhaps the most difficult issue to tackle would be the implementation of an annual capital usage charge on existing capital assets. The argument in favor of these charges is that they would allow programs to show the full annual cost of capital in their budgets and in doing so establish a level playing field for federal capital investment to allow for comparisons across programs. The annual capital usage charge also might influence agency managers to dispose of excess capital assets. If existing capital is not included, it would be decades before all programs showed the full annual cost of capital in their budgets, and programs purchasing new capital would appear more expensive than those using existing capital. However, there is no agreement on the need for such a charge or how it would be computed.

Beyond that, although cost allocation efforts may increase the transparency of total program costs, it is not clear that CAFs would really create incentives for managers to make better decisions about new or existing capital assets, especially if annual mortgage payments and capital usage charges are automatically included in subunit appropriations. For existing capital assets, mission responsibilities, legal requirements for federal property sales, and financial costs would likely constrain an agency's ability to dispose of surplus assets. If implemented, CAFs would create a whole new set of circumstances that would need to be addressed if an asset (which would be owned by the CAF) is sold or transferred—how would a “sale price” be determined between federal agencies, how would the full repayment of CAF debts be ensured, and how would the agencies' budgets be adjusted? Finally, even if guidelines indicate that most capital assets should be included in the CAF, it is likely that some capital assets would continue to be funded through currently existing mechanisms such as WCFs, FBF, and the Federal Technology Service's (FTS) Information Technology (IT) Fund.¹¹

¹¹The IT fund is a full-cost recovery revolving fund that provides federal agencies with IT products and services. FTS recovers both the costs of products and services and the costs of their delivery through the IT Fund. The IT Fund was authorized by the Paperwork Reduction Reauthorization Act of 1986 as included in section 821(a)(1) of Public Law 99-500 and 99-691; 40 U.S.C. 322.

In the past, we saw some merit in the broad concept behind CAFs¹² and agreed that CAFs should be explored as a financing mechanism. After having done an in-depth examination of the specifics and after discussing the perspectives of others who would be involved in implementing CAFs, we now see that implementation challenges are significant and that agencies have adopted other mechanisms to address challenges CAFs were designed to address. It is clear that in a mechanical sense CAFs could operate as intended, albeit by increasing the complexity of capital asset financing. However, we found there is little assurance that this increased complexity will better achieve what is already being accomplished through the alternative mechanisms discussed in this report. Without stronger justification and a clear plan for handling the potential difficulties raised in this report, CAFs would absorb the time and energy of those involved in budgeting for capital without commensurate benefit.

We obtained comments on a draft of this report from OMB, Treasury, GSA and our case study agencies—USDA and DOI. Treasury, GSA, USDA and DOI generally agreed with the report. Treasury, USDA, DOI and OMB provided technical comments, which have been incorporated as appropriate. OMB provided oral comments and agreed with our description of the mechanics of CAFs and concurred that spikes in BA for capital assets could be alleviated through other means. OMB also recognized the problems with CAFs that are highlighted in this report, including those related to existing capital, and agreed that the complications of designing and operating CAFs might outweigh the benefits. However, they disagreed with our description of the goals of CAFs because they view CAFs as part of a broader effort to have program budgets reflect full annual costs in order to change incentives for decision makers. They do not believe alternative mechanisms achieve that goal.

We recognize that if the sole or primary purpose of a CAF is to embed costs in the program budgets, then the alternatives discussed in this report do not achieve that purpose. However we believe, as highlighted in the *Report of the President's Commission to Study Capital Budgeting*, that the primary goal of CAFs is to improve decision making for capital. Asset management and cost accounting systems, when fully implemented, provide invaluable information that will assist decision makers in

¹²GAO, *Accrual Budgeting: Experiences of Other Nations and Implications for the United States*, [GAO/AIMD-00-57](#) (Washington, D.C.: Feb. 18, 2000).

determining how much and what types of capital are needed. While this information may not necessarily be reflected in program budgets, it is available to aid in budget and program decision making. The fact that many of these systems are in relatively early stages of development also increases our concern about CAFs. In a recent report, we noted the belief among some agency officials, congressional appropriations committee staff, and budget experts that improving underlying financial and performance information should be a prerequisite to efforts to restructure program budgets.¹³ We argue this would also be true for CAFs, since without adequate measures of program costs and an ability to identify capital priorities, a new financing mechanism would do nothing to address the basic challenges of determining how much and what types of capital are needed. Moreover, we are not convinced that CAFs and the annual mortgage payments they would require would change incentives for program managers or other decision makers, especially if annual mortgage payments and capital usage charges are automatically included in subunit appropriations. In conclusion, we remain of the view that the operational challenges of CAFs outweigh the benefits and that alternative mechanisms described in this report can more simply promote improved decision making.

Background

The federal government acquires a wide variety of capital assets for its own use including land, structures, equipment, vehicles, and information technology. Large sums of taxpayer funds are spent on these assets, and their performance affects how well agencies achieve their missions. To directly acquire an asset, agencies generally are required to have full up-front BA for the total asset cost—usually a sizable amount.¹⁴ This requirement allows Congress to recognize the full budgetary impact of capital spending at the time a commitment is made; however, it also means that the full cost of an asset must be absorbed in the annual budget of an

¹³GAO, *Performance Budgeting: Efforts to Restructure Budgets to Better Align Resources with Performance*, [GAO-05-117SP](#) (Washington, D.C.: February 2005), 15.

¹⁴While complying with up-front funding, agencies may choose to structure capital purchases into a series of useful segments. A useful segment of a capital project is a component that either (1) provides information that allows the agency to plan the capital project, develop the design, and assess the benefits, costs, and risks before proceeding to full acquisition (or canceling the acquisition) or (2) results in a useful asset for which the benefits exceed the costs even if no further funding is appropriated.

agency or program, despite the fact that benefits may accrue over many years. This up-front funding requirement has presented two challenges for capital planning and budgeting at the federal level.

One challenge is how to permit “full cost” analysis and to promote more effective capital planning and budgeting by allocating capital costs on an annual basis to programs that use capital. Allocating capital costs over the assets’ useful lives ensures that the full annual cost of resources a program uses is considered when evaluating the program’s effectiveness. It can make program managers more aware of on-going capital costs, thus promoting more effective decision making for capital. It may also contribute to equalizing comparisons across different programs or different approaches to achieving similar goals.

A second challenge is how to address the possible bias against the acquisition of necessary capital assets that may be created by spikes (large, temporary, year-to-year increases in BA), which can make capital assets seem prohibitively expensive in an era of resource constraints. GAO has reported in the past that agencies view up-front funding as an impediment to capital acquisition because of the resulting spike in BA.¹⁵ CAFs have been suggested as a capital asset financing approach that would benefit federal departments and their subunits by addressing both of these challenges. CAFs would be department-level funds that use annually appropriated authority to borrow from the Treasury to purchase federally-owned assets¹⁶ needed by subunits of the department. These subunits would then pay the CAF a mortgage payment sufficient to cover the principal and interest payment on the Treasury loan. The CAF would use those receipts only to repay Treasury and not to finance new assets.

¹⁵GAO, *Budget Issues: Budgeting for Capital*, [GAO/AIMD-97-5](#) (Washington, D.C.: Nov. 12, 1996); *Budget Issues: Alternative Approaches to Finance Federal Capital*, [GAO-03-1011](#) (Washington, D.C.: Aug. 21, 2003); and *Capital Financing: Partnerships and Energy Savings Performance Contracts Raise Budgeting and Monitoring Concerns*, [GAO-05-55](#) (Washington, D.C.: Dec. 16, 2004).

¹⁶It would not be appropriate or useful to include in the CAF grants to states or localities for what, in other contexts, may be deemed to be capital expenditures, such as those for highways. The grant itself is the program; highways and other federally assisted capital assets are not owned by the federal government and are not being used by the federal government in its own operations, so there are no federal programs to which the cost of using this capital should be allocated for budget decision making.

The CAF concept was formally proposed in the February 1999 *Report of the President's Commission to Study Capital Budgeting*¹⁷ as a mechanism that would help improve the process by which annual budget decisions are made by promoting better planning and budgeting of capital expenditures for federally owned facilities. The report states that by ensuring that individual programs are charged the true cost of using capital assets, the CAF encourages managers to make more efficient use of those assets. The Commission report also argues that CAFs could help smooth out the spikes in BA experienced by subunits with capital project requests. By aggregating all up-front BA for capital requests at the department level, subunit budgets would reflect only an annual payment for capital. Since the Commission report, CBO, GAO, and the National Research Council (NRC) have all agreed that CAFs should be explored as a capital financing mechanism.¹⁸

CAFs were also discussed in the President's *Fiscal Year 2004 Budget* issued in February 2003.¹⁹ The section on "Budget and Performance Integration" briefly described the concept and reports that draft legislation creating CAFs has been developed, discussed with agencies, and improved. It said that CAFs would be one way to show the uniform annual cost for the use of capital without changing the requirement for up-front appropriations. At this time, OMB's interest in CAFs appears to have waned. CAFs were not mentioned in the President's Budget in either fiscal year 2005 or 2006 and the CAF legislation described has not been introduced.

Scope and Methodology

To address our objectives, we reviewed the available literature describing the CAF concept. We also interviewed budget experts at OMB and CBO to gain a more thorough understanding of how CAFs would operate and discuss issues involved with their implementation. This permitted us to describe a theoretical CAF with some operational detail. Additionally, we

¹⁷The President's Commission to Study Capital Budgeting, *Report of the President's Commission to Study Capital Budgeting* (Washington, D.C.: February 1999).

¹⁸CBO, *The Budgetary Treatment of Leases and Public/Private Ventures* (Washington, D.C.: February 2003); [GAO/AIMD-00-57](#); NRC, *Investments in Federal Facilities: Asset Management Strategies for the 21st Century* (Washington, D.C.: The National Academies Press, 2004).

¹⁹OMB, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2004* (Washington, D.C.: 2003), 13.

sought the views of the many parties that would be affected if CAFs were established. Since agency and congressional officials were generally unaware of the CAF concept, we developed a brief summary describing the general mechanics of a CAF and shared that summary prior to interviews in order to generate discussion.

To get the department perspective, we chose USDA and DOI as case studies. Both of these departments have substantial and varied capital needs.²⁰ Capital assets acquired by USDA and DOI include land, buildings, research equipment, laboratories, quarantine facilities, dams, bridges, parklands, roads, trails, vehicles, aircraft, and information technology (hardware and software). In addition, each department has multiple subunits that use capital assets to achieve their missions—important for examining the question of subunit spikes. We interviewed officials at the department and subunit levels to gather their opinions and insights on the operation, benefits, and difficulties of CAFs. Specifically within USDA we spoke with officials in the Animal and Plant Health Inspection Service (APHIS), the Agricultural Research Service (ARS), and the Forest Service (FS). Within DOI, we spoke with officials in the National Park Service (NPS) and the Bureau of Land Management (BLM). During these discussions, agency officials also compared CAFs (as described in our summary) with current practices used for planning, budgeting, and acquisition of capital assets.

Since congressional approval would be necessary for the creation and operation of CAFs, we spoke with staff on the House and Senate Budget Committees, the House and Senate Appropriations Subcommittees on the Interior, and the House Appropriations Subcommittee on Agriculture²¹ to get their opinions on the proposed CAF mechanism. We also interviewed officials at Treasury, which would be responsible for managing the borrowing authority. In addition, we spoke with officials at GSA to discuss how a CAF might affect the FBF, used by some federal agencies to acquire

²⁰We used character class data from OMB's MAX system to identify departments with substantial capital budget authority over the last 12 years. These character classes include Construction and Rehabilitation (1312 and 1314), Major Equipment (1322 and 1324), and Purchases and Sales of Land and Structures (1340). Major equipment includes capital purchases of information technology but excludes the support services related to information technology purchases. MAX is the computer system used to collect and process information needed to prepare the President's Budget.

²¹We were unable to meet with staff from the Senate Appropriations Subcommittee on Agriculture.

federal office space and the FTS, used by some federal agencies to acquire IT.

Finally, we reviewed agency documents including asset management plans, accounting system descriptions, capitalization policies, and working capital fund information. We also examined our prior work, financial accounting standards, and various legal and budgetary sources specifically related to federal property management.

We recognize that our findings on agency perspective, which are based on interviews with five subunits within two departments, may not be applicable to all agencies within the federal government. However, we were struck by the consistency in department and subunit reaction to the concept, especially when followed by comparable reactions from congressional officials. Our work was conducted in Washington, D.C., from May 2004 through January 2005 in accordance with generally accepted government auditing standards.

CAF Operations Would Create a New Financing System and New Oversight Responsibilities

Implementing CAFs would change the current process for financing new federal capital projects. In addition, if all existing capital assets of a department and its subunits were transferred to the CAF, the CAF would impute an annual capital usage charge on those assets to using agencies. This additional complication could be avoided if CAFs were limited to new assets. However, this would mean it would be decades before all programs showed the full annual cost of capital in their budgets.

Although in many respects CAFs are accounting devices to record financial transactions, their creation would create new management and oversight responsibilities for many federal entities. Treasury would have primary responsibility for administering the borrowing authority. Both Treasury and those departments with CAFs would be required to keep track of the many CAF transactions. The management and oversight responsibilities of the departments would need to be clearly spelled out in order for CAFs to operate effectively. OMB would likely have to issue guidelines on operation specifics and OMB and the congressional appropriations committee staff would have to review the CAFs to ensure they were operating properly. OMB and CBO would score (estimate) the CAFs' and subunits' BA—both the initial authority to borrow and the subsequent appropriations used for repayment. The scoring of the annual capital usage charges, if CAFs were applied to existing capital, has not yet been developed.

CAFs Would Be Positioned at the Department Level and Create a More Complex Process for Financing Capital

Although CAFs do not currently exist, we can describe how they would likely operate based on written proposals and our discussions with budget experts. CAFs would be established at the department level as separate accounts that would receive up-front authority to borrow (provided in appropriation acts) on a project-by-project basis, for the construction and acquisition of large capital projects for all of the subunits within a department. For those departments with subunits split between two appropriation subcommittees, it is likely that two CAFs would be necessary. For example, DOI receives appropriations through two subcommittees: the Energy and Water Development Subcommittee, which is responsible for Bureau of Reclamation (Reclamation) programs; and the Interior and Related Agencies Subcommittee, which is responsible for all other Interior programs. CBO, OMB, and agency officials we spoke with generally believed that having a CAF that crossed subcommittee jurisdictions would create many problems, thus it would likely be necessary for departments to have a separate CAF for each subcommittee with which they work. Using the example above, DOI would have one CAF for Reclamation and a second for the remaining subunits within DOI. Alternatively, CAFs could be situated at the appropriation subcommittee level rather than the department level, with each of the 13 subcommittees appropriating to their respective CAF for the agencies under their jurisdiction.²² Some congressional officials did not seem to think that this would be the most effective arrangement and raised the point that increased resources might be needed at the subcommittee level to manage CAF transactions. In addition, OMB argued that CAFs should be located at the department level because the department is the focus of accountability for planning and managing programs and capital assets, as well as for budget execution and financial reporting.

The CAF would receive appropriations for the full cost of an asset (or useful segment of an asset) in the form of borrowing authority. Like all BA, the borrowing authority for each CAF-financed project would specify the purpose, amount, and duration of the authority. Unless the asset is to be available for use in the same fiscal year, the subunit itself would receive no appropriations. The CAF would use its authority to borrow from the Treasury's general fund to acquire the asset for the subunit. When the asset became usable, the subunit would begin to pay the CAF an amount equal to

²²The President's Commission to Study Capital Budgeting, *Report of the President's Commission*, 33 and NRC, *Investments in Federal Facilities*, 82.

a mortgage payment consisting of interest and principle. These equal annual payments would consist of the principal amortized over the useful life of the asset and include interest charges at a rate determined by Treasury (based on the average interest rate on marketable Treasury securities of comparable maturity). The CAF would use these mortgage payments to repay Treasury for the funds borrowed plus interest. Unlike a revolving fund, the mortgage payments collected by the CAF would be used only to repay Treasury and could not be used to finance new assets.

For each project funded through the CAF, the subunit's annual budget request would need to include the annual mortgage payment in each year, for the useful life of the asset (or until the asset was sold or transferred). The subunit would need annual appropriations for these payments, along with its other operating expenses. On the basis of our discussions, we conclude that the appropriations from which the payments are made would be discretionary as opposed to mandatory. They would not be provided as a line item for mortgage payments to the CAF, but would be part of the subunit's total appropriation. While the subunit would be required to make the annual payment, there would be no guarantee that Congress would include the additional amounts to cover the payment in the subunit's appropriation.

At some point, the mortgage on an asset would be "paid off." However, if annual capital usage charges on existing capital were established, payments would continue, although the amount of the payments would depend on the method used to calculate the charges for existing capital. Any imputed charges collected by the CAF would be transferred to the general fund of Treasury and not be available to finance new assets. Later in this report we discuss in more detail the idea of imputing a capital usage charge on existing capital.

Treasury Would Oversee Borrowing Authority Used to Acquire Capital Assets

Treasury is responsible for administering and managing borrowing authority. Treasury officials explained that within the department, the Financial Management Service (FMS) would have responsibility for setting up the accounts to correspond with each CAF created. Before a CAF could actually borrow from Treasury, an agreement would have to be signed establishing the interest rate and repayment schedule. Treasury officials recommended that OMB establish guidelines to specify the useful life of capital assets so departments would abide by an appropriate amortization schedule and not attempt to lower payments by lengthening the asset's

useful life. The standards issued by the Federal Accounting Standards Advisory Board (FASAB) on how to account for property, equipment, and internal-use software could be useful in developing these guidelines.²³ According to Treasury officials, FMS would also be responsible for preparing the warrants, an official document that establishes the amount of monies authorized to be withdrawn from the central accounts maintained by Treasury, and would report annually on account activity. The Bureau of Public Debt would have the most day-to-day interaction with the CAF. It would be responsible for transferring the borrowed funds to the department and for receiving payments. Although Treasury officials did not think it would be an unmanageable task, they said that tracking individual transactions could become complicated, depending on the level of detailed reporting required, and would certainly require additional staff time. To cover these costs, they would want to charge an administrative fee, as they do for trust funds.

CAFs Would Add Complications to Oversight and Scoring

A CAF is an additional layer of administration that could complicate program management rather than streamline it. At the department level, the chief financial officer would likely be responsible for the financial operation of the CAF. Department heads would need to specify duties for those with capital asset management and oversight responsibilities according to the unique needs of the department. Oversight functions would include accounting for all the transactions between the CAF and Treasury as well as between the CAF and the subunits. In addition, the managerial relationship between the CAF and individual subunits would have to be worked out. OMB would also likely have new responsibilities. For example, OMB would probably have to develop guidelines on issues such as (1) the types of assets to include in the CAF, (2) the amortization schedule for various types of assets, (3) the method for calculating a capital usage charge on existing capital (along with CBO and Congress), and (4) the relationship between a CAF and FBF.²⁴ Indeed, the NRC report argued that oversight and management of CAFs should actually reside at OMB. Although OMB officials provided no details, they agreed that they would have some responsibility for reviewing CAFs, as would congressional committees.

²³Statement of Federal Financial Accounting Standards, No. 6, *Accounting for Property, Plant and Equipment* and No. 10, *Accounting for Internal Use Software*.

²⁴All of these issues are discussed in more detail in other sections of this report.

As they do for all appropriation actions, CBO and OMB would score the CAF and subunit BA—both the initial authority to borrow and the subsequent appropriations used for repayment. Although the net amounts of BA and outlays for capital acquisitions would not change, the type of BA would. Currently, annual appropriations, which allow program managers to incur obligations and make outlays with no additional steps, are provided for most capital acquisitions. A CAF, however, would be appropriated up-front borrowing authority. On a gross basis, the BA would have to be appropriated twice, once as up-front borrowing authority and incrementally over time through appropriations for the annual mortgage payment. Since the annual mortgage payment is purely intragovernmental, the subunit's BA and outlays are offset by receipts in the CAF, so the total BA and outlays are not double-counted. Therefore, appropriation subcommittee allocations would not need to be adjusted if a CAF were used for new assets.

The initial borrowing authority would be equal to the asset cost and would be scored up front in the CAF budget. When the annual mortgage payments begin, the amount provided in the subunit's budget would equal the mortgage payment and would be scored as discretionary BA. The mortgage payment would then be transferred to the CAF and, as a receipt, be considered mandatory BA. However, according to OMB, it would be treated as a discretionary offset for scoring purposes.²⁵ The payment and receipt would completely offset each other within the appropriation subcommittees' totals and in the BA and outlay totals for the federal budget as a whole.

When the CAF repays Treasury using the mortgage receipts, scoring would follow the current guidelines for debt repayment transactions. The mortgage receipt would be considered mandatory BA and be used to repay Treasury; however, the portion of the mortgage payment that corresponds to the amortization of the asset cost would be deducted from the BA (and outlay) totals. When collections are used for debt repayment, they are unavailable for new obligations, and therefore are not BA. If they were counted, the BA and outlay totals would be overstated over the life of the loan. According to OMB, the remaining mandatory BA would be obligated and outlaid for interest payments to an intragovernmental receipt account in Treasury, but would not be scored. At this time, the scoring of

²⁵According to OMB officials, this treatment of budget authority can be used for certain transactions.

annual capital usage charges on existing capital assets has not been determined.

CAF Benefits Can Be Achieved through Alternative Means Without the Added Budget Complexity

CAFs have been proposed as a way to address two challenges that arise from the full up-front funding requirement for capital projects. The first challenge is to facilitate program performance evaluation and promote more effective capital planning and budgeting by allocating capital costs on an annual basis to those programs using the capital. By having annual cost information, managers can better plan and budget for future asset maintenance and replacement. During our interviews, we learned that asset management and cost accounting systems are currently being implemented that could be used to address this problem. These systems are designed to provide the information necessary for improved priority setting and better decision making, although we found that many agencies are still working to fully implement and use these systems. The second challenge—managing periodic spikes in BA caused by capital asset needs—if considered a problem at all, is managed by our case study agencies through existing entities and practices, such as the use of WCFs. Consequently, CAFs appear to offer few benefits over and above those provided by other mechanisms being put into place or in use. In addition, officials at the department and subunit level and key congressional staff we spoke with have a number of concerns about adopting CAFs as an alternative financing method. Most of those we spoke with said CAFs sounded like a complicated mechanism to achieve benefits that can be achieved in simpler ways and some worried that implementation of CAFs could distract from current efforts to improve capital decision making.

Allocating Annual Capital Costs and Improving Decision Making for Capital Assets May Be Achieved through Existing Initiatives

Officials we interviewed reacted to our presentation of the CAF mechanism by describing current agency initiatives and existing mechanisms that they believe can better achieve the ultimate goal of improving budgeting and decision making for capital. We found that some agencies currently make use of asset management plans to collect, track, and analyze cost information and to assist management in budget decisions and priority setting. Accounting systems that report full costs are also being developed that will include the cost of capital assets in total program costs and will provide a tool for agency managers to make better decisions and use capital more efficiently. Once fully implemented, these methods will provide agencies with the ability to assign costs at the program level and link those costs to a desired result. The information provided should lead

The Departments of the Interior
and Agriculture Are
Implementing Asset Management
Systems to Make Informed
Decisions on Capital Investment

agencies to consider whether they will continue to need the current quantities and types of fixed assets they own to meet future program needs.

As we have reported in previous work, leading organizations gather and track information that helps them identify the gap between what they have and what they need to fulfill their goals and objectives.²⁶ Routinely assessing the condition of assets and facilities allows managers and their decision makers to evaluate the capabilities of current assets, plan for future asset replacements, and calculate the cost of deferred maintenance. We found that asset management systems are being developed and implemented at some agencies as a mechanism to aid in the identification of asset holdings and prioritization of maintenance and improvements.

For example, we reported in 2004 that NPS, within DOI, is currently implementing an asset management process.²⁷ If it operates as planned, the agency will, for the first time, have a reliable inventory of its assets, a process for reporting on the condition of those assets, and a systemwide methodology for estimating deferred maintenance costs. The system requires each park to enter all of its assets and information on its condition into a centralized database for the entire park system and to conduct annual condition assessments and regular comprehensive assessments. This new process will not be fully implemented until fiscal year 2006 or 2007, and will require years of sustained commitment by NPS and other stakeholders.

²⁶GAO, *Executive Guide: Leading Practices in Capital Decision-Making*, [GAO/AIMD-99-32](#) (Washington, D.C.: December 1998).

²⁷[GAO-04-138](#). In this report we also found that three of four case study agencies—NPS, the Department of Veterans Affairs, and the National Oceanic and Atmospheric Administration—lacked current asset condition data.

Figure 2: NPS Asset Management Plan

Department officials provided us a prototype of an asset management plan for the Grand Canyon National Park. The objective is to establish the total cost of ownership of the Grand Canyon's asset inventory and to provide a tool to aid managers in budget decisions, priority setting, and communication. It focuses on four key questions about the following:

- What inventory NPS owns in the park.
 - The condition of assets.
 - Current replacement values.
 - What operations and resources are required to properly sustain the asset inventory.
- Information on the park's inventory is gathered from condition assessments, operations and maintenance budgets, staff experience, and industry standard sources.^a This information helps clarify asset maintenance and operations requirements, which are then compared to agency budget data to determine if funding levels are adequate to sustain the capital over time. In addition, managers use a facility condition index plotted against an asset priority index^b to restore assets in priority order and identify assets for disposal.

Source: DOI.

^aIndustry standard sources refer to the facility condition index, which is considered to be a leading metric for assessing asset conditions. It is calculated by dividing the total project requirements by the replacement value of the asset.

^bThe asset priority index is a score that park leadership assigns and is reflective of the asset's relevance to carrying out the park mission.

According to NPS documents, this approach and the information captured in the asset management plan provides Grand Canyon National Park managers with the knowledge and specifics to make informed capital investment decisions and to develop sound business cases for funding requests. The appropriators for NPS that we spoke with agreed that the additional funding they have provided for condition assessments and asset management has improved planning and decision making at NPS. Department officials told us that these types of asset management plans would eventually be completed for all capital-holding subunits within DOI. The completion of this management system is especially important for DOI because much of its mission is the upkeep and improvement of its capital for use by the public.

FS, whose capital includes numerous trails, roads, and recreation facilities, has implemented and is continuing to enhance its asset management system referred to as Infrastructure (INFRA). INFRA has been in production since 1998 and served as the agency's primary inventory reporting and portfolio management tool for all owned real property until May 2004. FS officials said that they have used INFRA to assist management in prioritizing backlogs of maintenance and renovations. According to these officials, INFRA allows for the transfer of FS asset

inventory data directly into USDA's asset inventory system known as the Corporate Property Automated Information System (CPAIS). CPAIS, which agency officials said was modeled after INFRA and further enhanced to include leased property and GSA assignments, was implemented in May 2004 and maintains data elements necessary to track and manage owned property, leased property, GSA assignments, and interagency agreements. The system will provide the department and its subunits with the capability to increase asset utilization and cost management and to analyze and reduce maintenance expenses. The primary users of the system are those subunits with considerable capital needs, according to agency officials. ARS's capital is mostly high-priced laboratories, specific scientific equipment, and research facilities, and officials are confident that CPAIS will provide the information needed to ensure accountability over its real property. ARS also has its own facilities division made up of contractors and engineers that are equipped with the experience and expertise to manage and oversee their specialized capital projects. APHIS officials said they are in the process of doing facility condition assessments and hope to use the information in order to better align its mission with its strategic plan.

The need for asset management systems to aid agency officials in making informed decisions was underscored in our report designating federal real property as a new high-risk area in 2003. The report highlighted the fact that in general, key decision makers lack reliable and useful data on real property assets.²⁸ In February 2004, the President issued an Executive Order for Federal Real Property Asset Management. The order requires designated agencies to have a real property officer and to implement an asset management planning process. Its purpose is to promote the efficient and economical use of America's real property assets and to assure management accountability for implementing federal real property management reforms.

²⁸GAO, *High-Risk Series: Federal Real Property*, [GAO-03-122](#) (Washington, D.C.: January 2003).

Some Agencies Are Beginning to Use Full Cost Information to Make Budget Decisions, Although Much Work Needs to Be Done

We found that some agencies are currently implementing cost accounting methods, such as activity-based costing (ABC), to help determine the full cost of a product or service, including the annual cost of capital, and using that information to make budgeting decisions.²⁹ For example, BLM has implemented a management framework that integrates ABC and performance information. We have previously reported that BLM's model fully distributes costs and can readily identify, among other things, (1) the full costs of each of its activities and (2) what it costs to pursue each of its strategic goals. The system provides detailed information that facilitates external reporting and can be used for internal purposes, such as developing budgets and analyzing the unit costs of activities and outputs.³⁰ Integrating cost and performance information into one system helped BLM become a finalist for the President's Quality Award in 2002 in the "performance and budget integration" category. The bureau was recognized for implementing a disciplined approach that allows it to align resources, outputs, and organizational goals, and can lead to insights to reengineer work processes as necessary. Among the results of its ABC efforts, BLM has reported increased efficiency and success in completing deferred maintenance and infrastructure improvement projects. BLM was at the forefront of this cost management effort, which began in 1997 and has now been adopted departmentwide as part of DOI's vision of effective program management.

In another report, we described how the National Aeronautics and Space Administration (NASA) is beginning to use accounting information to help make decisions about capital assets.³¹ NASA's "Full Cost" Initiative involves changes to accounting, budgeting, and management to enhance cost-effective mission performance by providing complete cost information for more fully informed decision making and management. The accounting changes allow NASA to show the full cost of related projects and supporting activities while the "full cost" budgeting uses budget restructuring to better align resources with its strategic plan. The accounting and budgeting portions of the initiative support the

²⁹Statement of Federal Financial Accounting Standards, No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, recommends that federal entities report the full costs of outputs in general-purpose financial reports.

³⁰GAO, *Bureau of Reclamation: Opportunities Exist to Improve Managerial Cost Information and Cost Recovery*, [GAO-02-973](#) (Washington, D.C.: Sept. 20, 2002).

³¹[GAO-05-117SP](#).

management decision-making process by providing not only better information, but also incentives to make decisions on the most efficient use of resources. For example, NASA officials credited “full cost” budgeting with helping to identify underutilized facilities, such as service pools—the infrastructure capabilities that support multiple programs and projects. NASA’s service pools include wind tunnels, information technology, and fabrication services. If programs do not cover a service pool’s costs, NASA officials said that it raises questions about whether that capability is needed. NASA officials also explained that when program managers are responsible for paying service pool costs associated with their program, program managers have an incentive to consider their use and whether lower cost alternatives exist. As a result, NASA officials said “full cost” budgeting provides officials and program managers a greater incentive to improve the management of these institutional assets. Although accounting changes alone are not sufficient to improve decision making and management, it is clear from discussions with NASA officials and agency documentation that the move to full costing is a critical piece of the initiative.

Some agencies still need to make more progress before their cost accounting can more fully inform their decision making, including decisions on capital planning and budgeting. In a 2003 report looking at the financial management systems of 19 federal departments, we found that although departments are required to produce information on the full cost of programs and projects, some of the information is not detailed enough to allow them to evaluate programs and activities on their full costs and merits.³² For example, the Department of Defense (DOD) does not have the systems and processes in place to capture the required cost information from the hundreds of millions of transactions it processes each year. Lacking complete and accurate overall life-cycle cost information for weapons systems impairs DOD’s and congressional decision makers’ ability to make fully informed decisions about which weapons, or how many, to buy. DOD has acknowledged that the lack of a cost accounting system is its largest impediment to controlling and managing weapon systems costs. Our report states that departments are experimenting with methods of accumulating and assigning costs to obtain the managerial cost information needed to enhance programs, improve processes, establish fees, develop budgets, prepare financial reports, make competitive sourcing decisions,

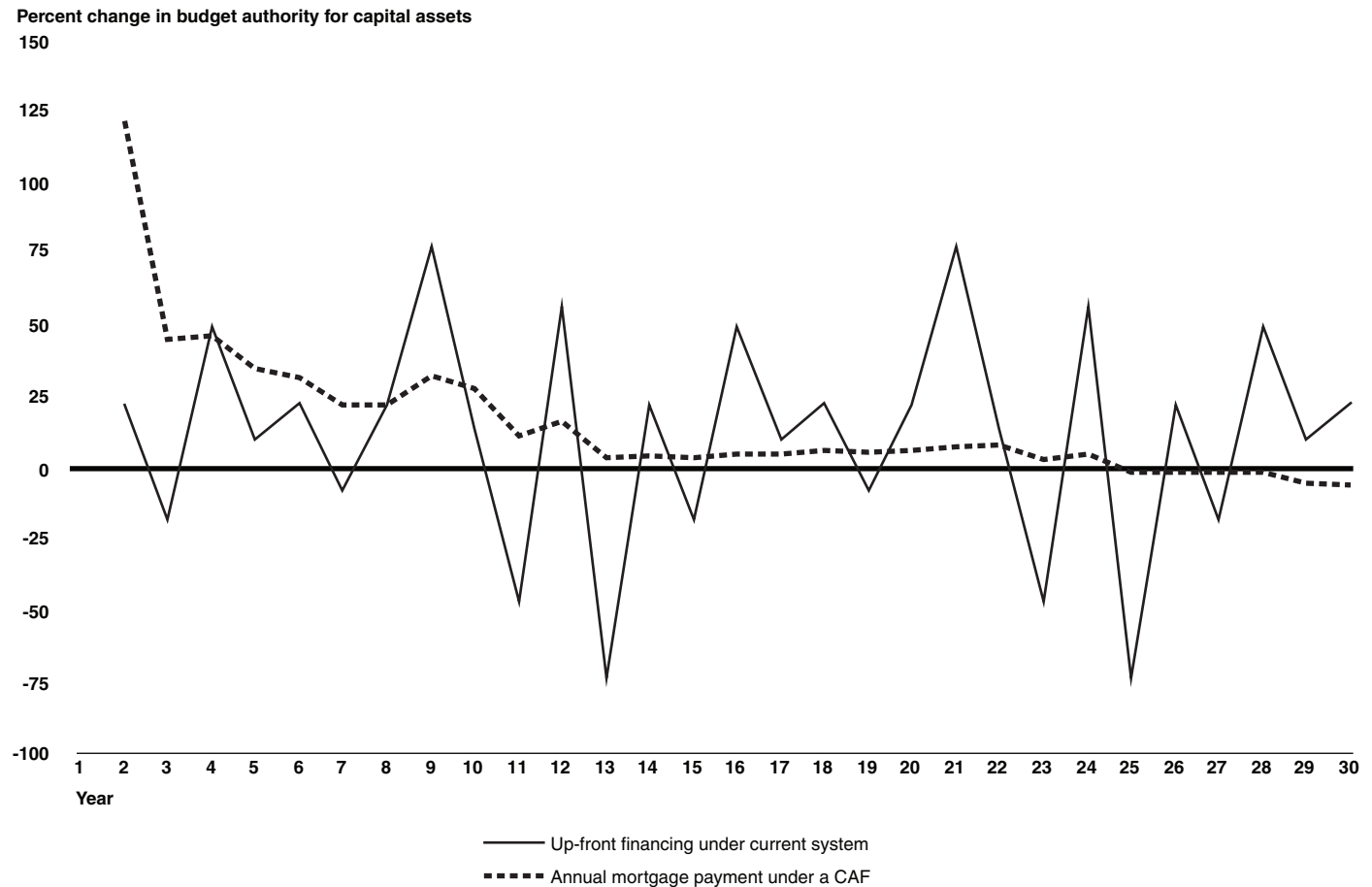
³²GAO, *Financial Management: Sustained Efforts Needed to Achieve FFMA Accountability*, [GAO-03-1062](#) (Washington, D.C.: Sept. 30, 2003).

and report on performance. As departments implement and upgrade their financial management systems, opportunities exist for developing cost management information as an integral part of the systems to provide important information that is timely, reliable, and useful.

CAFs Might Smooth Budget Spikes, but Benefit May Be Minor

The President's Commission to Study Capital Budgeting and NRC have suggested that a CAF might help ameliorate the spikes in agency budgets that often result from large periodic capital requests by smoothing capital costs over time and across subunits. Our analysis of recent trends in BA for capital acquisitions clearly shows the presence of spikes at the subunit level. See figure 3 for an illustration of budget spikes and potential smoothing effects of a CAF at ARS.

Figure 3: Illustration of Budget Spikes and Potential Smoothing Effects of a CAF at ARS



Source: GAO analysis of OMB MAX data.

Note: In this figure, the first 12 years of data are based on actual BA for capital assets for fiscal years 1994 through 2005. To simulate a long-term trend, we replicate this data for years 13 through 30. A 20-year repayment term is used to calculate the annual mortgage payment, which does not include an interest charge. We obtained BA data for capital assets from OMB's MAX database as described in the Scope and Methodology section.

However, these spikes did not appear to be a major concern to the case study subunits we spoke with nor did they consider them a barrier in meeting capital needs. Given current practices for financing capital assets, it seems that some program managers and Congress have found ways to cope with spikes in the absence of CAFs. As a result, the benefit of smoothing costs with a CAF would be minimal.

Some Spikes May Be Created by Congressional Funding Decisions

Our prior work indicates that some agencies have complained that large spikes in their budget hinder their ability to acquire the needed funding to complete capital projects³³ and reveals that some agencies have turned to alternative financing mechanisms, such as incremental funding, operating leases, and public-private partnerships, that allow them to obtain assets without full, up-front BA.³⁴ A few agency officials we spoke with said that because of the up-front funding requirement, they have sometimes opted for operating leases instead of capital leases or constructing buildings. Operating leases are generally more expensive than construction, purchase, or capital leases for long-term needs but do not have to be funded up front. Nevertheless, the agencies we spoke with reported that spikes are often created by the changing priorities of Congress and its willingness to provide up-front funding for favored capital projects. For example, ARS officials reported that appropriators have increased the agency's budget in a given year to fund a new or expanded facility that the subcommittee considered a priority. Historically, the appropriations subcommittee for ARS (and all USDA agencies except FS) has been active in initiating capital projects and following through with the up-front funding necessary to build or acquire assets. From ARS's perspective, budget spikes are not problematic because of the perceived ease in obtaining needed funds. DOI also reported that some of its subunits have received "waves" of funding for capital projects largely dependent upon the priorities of Congress and the President. Within DOI, BLM officials agreed that budget spikes were mostly a result of congressional add-ons. On the other hand, NPS reported that most of its capital projects are just not large enough to cause a noticeable budget spike.

Staff from the congressional budget committee suggested that deliberations during the appropriations process result in some smoothing at the subcommittee level. The smoothing effects may not be apparent to agencies when they review their individual budgets, but they are evident from a governmentwide perspective. Historical analysis shows that federal nondefense capital spending has remained relatively constant over the past 30 years.³⁵

³³[GAO/AIMD-97-5](#).

³⁴GAO, *Budget Issues: Incremental Funding of Capital Assets*, [GAO-01-432R](#) (Washington, D.C.: Feb. 26, 2001) and [GAO-03-1011](#).

³⁵OMB, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2005* (Washington, D.C.: 2004), Table 9.3, 160-161.

Spikes Are Being Managed by Funding Useful Segments or Using No-Year Authority

When spikes might be a problem, the departments and subunits we spoke with have been able to manage them by dividing projects into useful segments and accumulating funds with no-year authority. USDA and FS reported that they have broken capital projects into useful segments and requested the funding accordingly to minimize dramatic fluctuations in capital costs. For example, USDA is currently renovating its headquarters in Washington, D.C., and is using funds the department receives every other year to finance the overhaul of one discrete section of the building at a time. APHIS and BLM have also broken up large projects by funding the survey and design phases in the first year and requesting funds for construction in subsequent years. In addition, ARS and APHIS have authorities that allow them to accumulate a specified amount or percentage of unobligated funds until the amount is sufficient to cover the full up-front costs of the desired asset. For example, ARS is building an animal health center in Iowa, which costs an estimated \$460 million. ARS received \$124 million in fiscal year 2004 towards the project and can accumulate that money in its no-year account until the total amount to cover the costs is collected. In its efforts to consolidate field offices, APHIS officials told us they were granted authority to convert \$2 million in unobligated balances into no-year money each year for 3 years. The \$6 million it was able to accumulate allowed it to fund the consolidation with up-front funding. The bureau hopes to expand this authority to apply to other capital, including helicopters and airplanes.

WCFs and FBF Can Be Used Both to Finance Capital Assets Without Spikes and to Allocate Capital Costs

WCFs, a type of revolving fund,³⁶ are a mechanism that can be used both to spread the cost of capital acquisition over time and to incorporate capital costs into operating budgets. As reported previously,³⁷ we found that WCFs can be effective for agencies with relatively small, ongoing capital needs because the WCFs, through user charges, spread the cost of capital over time in order to build reserves for acquiring new or replacement assets. Also, WCFs help to ensure that capital costs are allocated to programs that use capital by promoting full cost accounting. Since WCFs are designed to be self-financing, the user charges must be sufficient to recoup the full cost of operations and include charges, such as depreciation, to help fund capital replacement.

³⁶Revolving funds are accounts authorized to be credited with collections that are earmarked to finance a continuing cycle of business-type operations without fiscal year limitation.

³⁷GAO-97-5.

Some we spoke with use WCFs to finance capital assets such as IT initiatives and equipment. For example, USDA's WCF provided funds to the National Finance Center, one of its activity centers, to purchase and implement a financial system. Department officials explained that after the system became operational, the Finance Center charged the 28 user entities a depreciation expense to recoup the costs of purchasing the system so it could repay the WCF. In another example, the FS's WCF purchases radio equipment, aircraft, IT, and other motor-driven equipment. The equipment is rented out to administrative entities within the agency, such as the National Forests and Research Experiment Stations, and to outside agencies for a charge that recoups the costs of operation, maintenance, and depreciation. The user charge is adjusted to include sufficient funds to replace the equipment. Agency officials would like to expand the WCF beyond just equipment and establish a facilities maintenance fund. Through this fund, they would apply a standard charge per square foot plus a replacement cost component. The charges would be used for ongoing maintenance and replacement and they believe would help influence line officers to reexamine capital needs. BLM's WCF functions similar to that of the FS's WCF. BLM's WCF purchases vehicles, then charges fees to users of the vehicles and uses the revenue to buy replacement vehicles. In both of these examples, the WCF is designed to accumulate the funds to absorb the up-front costs of the capital while the user entities incur the annual costs of using the capital.

This mechanism operates similarly to a CAF, but with more flexibility in the funding requirements. First, since WCFs are revolving funds, they allow agencies to purchase new capital without a specific congressional appropriation whereas a CAF would require a new appropriation to purchase new capital. Second, WCFs are not subject to fiscal year limitations (they have no-year authority) while CAFs would have project-by-project borrowing authority specified in appropriation acts. Third, WCFs reflect annual capital costs through a depreciation charge whereas CAFs would reflect this cost through an annual mortgage payment of principal and interest.³⁸ Hence, both would reflect the annual cost of capital in the subunits' budgets.

³⁸OMB noted that these two costs are not identical since CAF mortgage payments would reflect an interest cost whereas WCFs do not reflect an interest cost. However, besides depreciation, some WCFs are able to charge additional amounts for future asset replacement.

To obtain federal office space, many agencies lease from and make rental payments to GSA, which deposits those funds into the FBF. Although leasing is recognized as being more expensive in the long run than ownership, some agencies lease because it does not require as much up-front funding as ownership (i.e., to avoid spikes). Although a CAF is conceptualized to reduce the amount of up-front funding needed by subunits when acquiring capital assets (while still requiring up-front funding at the department level), it is not clear that having a CAF would encourage subunits to build rather than lease office space. Two agency officials we spoke with said that they would likely continue leasing and one commented that if planning outright ownership, it would be easier to deal with obtaining the traditional up-front funding than worry about the annual mortgage payments required by a CAF. Through their charges, both WCFs and FBF spread the cost of capital over time and ensure that capital costs are properly allocated to the user programs.

**Agency Officials,
Congressional Staff and
Other Key Players Have
Numerous Concerns About
CAFs**

Agency officials, congressional staff, and other key players raised numerous concerns about CAFs. For example, department and subunit officials are concerned that there is no guarantee or assurance that the annual mortgage payments to be collected by the CAF will be adequately funded in annual subunit appropriations. In addition, some subunits and appropriators are reluctant to shift more control for capital planning and budgeting to the department level. Congressional staff also raised concerns about the feasibility of the congressional mind shift that would be required to fund capital through a mechanism such as a CAF, especially if a charge on existing capital is included, and questioned the value that a CAF would really add to agency planning and budget decision making that could not be obtained through other means. CBO and GSA were also apprehensive and cautious about the usefulness of the CAF concept when operating details were described in full. Most budget experts and agency officials we spoke with agreed that the complexities involved in operating a CAF would likely outweigh the possible benefits. A few worried that CAFs might even divert attention from the current initiatives under way to improve asset management and full costing.

**Concerns over Receipt of Annual
Mortgage Payment**

Treasury, which would assume responsibility for collecting debt repayments, was concerned that there would be no guarantee that future appropriations would finance the mortgage payments, nor would there be any enforcement mechanism by which Treasury could enforce repayment. Treasury officials feared that over time other types of spending would take

priority over debt repayment. They based their concerns on the record of some other programs that have struggled to repay debt or for which debt has been “forgiven” or otherwise excused. For example, the Black Lung Disability Trust Fund, which provides disability benefits and medical services to eligible workers in the coal mining industry, has growing debt and will never become solvent under current conditions.³⁹ Although Black Lung Disability Fund revenues are now sufficient to cover current benefits, they do not cover either repayment of the over \$8 billion owed the Treasury or interest on that debt. Another example is the Bonneville Power Administration (BPA), which is a federal electric power marketing agency in the Pacific Northwest with authority to borrow from Treasury on a permanent, indefinite basis in amounts not exceeding \$4.45 billion at any time. BPA finances its operations with power revenues and the loans from Treasury, and has authority to reduce its debt using “fish credits.” This crediting mechanism, authorized by Congress in 1980, allows BPA to reduce its payments to Treasury by an amount equal to mitigation measures⁴⁰ funded on behalf of nonpower purposes, such as fish mitigation efforts in the Columbia and Snake River systems. BPA took this credit for the first time in 1995 and has taken it every year since that time. The annual credit allowed varies, but has ranged between about \$25 million and \$583 million, including the use in 2001 and 2003 of about \$325 million total unused “fish credits” that had accumulated since 1980.

Some officials at the department and subunit level also raised concerns about the long-run feasibility of fulfilling their mortgage payments over the entire repayment period given that the payments are made from their annual appropriations, which they expect to become increasingly constrained. The mortgage payments would be relatively uncontrollable items within an agency’s budget, to the detriment of other, more controllable items, such as personnel costs. Because the mortgage costs would not change unless the asset is sold, managers would have less flexibility in making budgeting decisions within stagnant or possibly declining annual budgets that occur in times of fiscal restraint. BLM officials said this type of fixed obligation, which could consume an increasing share of its budget, could hinder its ability to address emergency needs that arise during the year. For example, they cited a case in which the

³⁹The debt resulted from advances originally obtained to cover benefit payments that coal taxes, the primary source of fund revenues, could not provide.

⁴⁰BPA is required by law to mitigate the impacts to fish and wildlife to the extent they are affected by the construction and operation of the Federal Columbia River Power System.

agency reprogrammed resources to deal with a landslide that occurred on the Oregon coast in late 2003. BLM delayed other projects in order to redirect funds for the removal and stabilization of the landslide and to reopen Galice Creek Road, which is a major artery for public access, recreation, and commercial activity such as timbering, as well as BLM and FS administration. BLM officials questioned whether the fixed payment to the CAF would constrain their ability to make adjustments such as this. Many agency officials were skeptical of the idea that they could fulfill annual mortgage payments to a CAF without squeezing program operations and some said they would rather deal with the up-front funding requirement than have to worry about annual mortgage payments.

The alternative to force-fitting a mortgage payment within agencies' annual appropriations is to adjust agency budgets with an automatic add-on equal to agencies' mortgage payments. While this would relieve budget pressures at the agency level, it would probably not provide incentives or influence managers to improve capital asset management and decision making.

Concerns About Shifting More Control over Capital Assets to the Department Level

Under the CAF concept, requests for capital projects would come from the department level and the CAF would own all capital assets. This would shift more control of capital planning and decision making from the subunit to the department level. Some agencies and one appropriation subcommittee staffer said they would not favor this shift. Several agencies feel that they have the expertise and experience to better assess their own capital needs, which are often mission specific. For example, ARS's capital consists of mostly scientific equipment, laboratories, and research facilities designed for conducting agricultural research in various climates. In fact, the agency has its own facilities division consisting of contractors and engineers who are involved in the management and oversight of capital projects. Similarly, APHIS's facilities are mission specific. BLM's use of activity-based costing allows it to assign capital costs to the program level and track those costs to desired outputs. Consequently, the bureau has a more intimate understanding of its capital needs and how capital contributes to carrying out its mission. One agency raised the point that departmental management might force bureaus to share facilities or later decide to use an asset for purposes other than those originally intended. While some of these departmental decisions might be beneficial, some agencies were skeptical of departmental decision making.

Concerns over Problems Not
Addressed, Additional
Complexity, and Limited Benefits

The officials we interviewed stated that there are important problems in capital budgeting that CAFs do not address. Before the smoothing effects of a CAF can be realized in the out years, the department must still receive full up-front funding to begin new capital projects or acquire new assets. And as noted above, some agency officials stated that the annual mortgage payments may be even more of a dilemma than the up-front funding requirement. Since a CAF assumes up-front funding, some agencies may still seek to use some of the alternative financing mechanisms that they already use, such as operating leases or enhanced-use leases, to meet capital needs without first having to secure sufficient appropriations to cover the full cost of the asset.⁴¹ As currently envisioned, CAFs would probably not help improve capital planning concerns, such as the need for improved budgeting and management of asset life-cycle costs. According to the NRC report,⁴² operation and maintenance costs are typically 60 to 85 percent of the total life-cycle costs of a facility while design and construction typically account for only 5 to 10 percent of those costs.⁴³ For example, agencies must properly determine the funds needed for increasing staff in new and expanded facilities in order to avoid staffing shortages.

Almost everyone we spoke with agreed that CAFs sounded complicated and many questioned whether the challenges in budgeting for capital that CAFs were designed to address were great enough to warrant CAFs as a solution. Congressional budget committee and appropriations subcommittee staff agreed that CAFs might be beneficial in theory but were probably not worth the additional budget complexity they would create. Budget committee staff considered the proposed benefits of a CAF to be abstract and uncertain coupled with a sizeable likelihood for repayment problems in the out years. In addition, they saw no obvious dilemma prompting the need for CAFs. While this capital financing approach may be appealing in theory since it promotes strategic planning and broadened, forward-looking perspectives, budget practitioners cautioned the adoption of an approach involving such layers of complexity in the absence of a clearly stated, agreed-upon problem that the new approach is expected to address. Further, they saw a need for agencies to

⁴¹For a thorough discussion of alternative financing approaches, see [GAO-03-1011](#).

⁴²NRC, *Investments in Federal Facilities*, 27.

⁴³Land acquisition, programming, conceptual planning, renewal or revitalization, and disposal account for the remaining 5 to 35 percent.

complete their implementation of capital asset management and cost accounting systems, which can help achieve some of the same benefits that CAFs were meant to achieve. A good asset management system including inventories and asset condition would likely be a necessary precursor to successfully implementing CAFs. All of these factors weaken the case for CAFs as an improved approach to current capital financing practices.

Several Issues to Weigh When Considering Implementation of CAFs

While in theory CAFs could be implemented at most agencies, there are several complex issues that Congress would need to consider before adopting such a mechanism. For example, proposals to apply CAFs to existing capital would require the development of a formula to calculate an annual capital usage charge, which is likely to be a difficult and contentious undertaking. Key players including OMB, CBO, and Congress would need to work together to develop an agreed-upon method to estimate an appropriate capital usage charge for various types of assets. And even if the full cost of programs, including the cost of existing capital, was more accurately reflected in the budget through the use of CAFs, incentives to cut capital costs may not materialize except in times of severe budget cuts. Even then, managers' abilities to eliminate unneeded capital assets would probably be limited given mission responsibilities and legal requirements that dictate the disposal of surplus federal property. To remedy this, additional funding or agency flexibilities would be needed, as would provisions to ensure debt repayment if CAF-financed assets were transferred or sold. Additionally, it is likely that some capital projects for federal office space, IT, and land would continue to be financed outside of the CAF through mechanisms such as the FBF, WCFs, or the GSA IT Fund.

Imputing an Annual Capital Charge on Existing Capital May Offer Benefits but Would Be Difficult and Contentious

There are arguments that the CAF concept be applied to existing capital assets as well as new capital assets to ensure that the full costs of all programs are reflected in the budget. OMB points out that if CAFs were not applied to all capital, it would be many decades before programs reflected full annual costs and before the cost of alternative inputs could be compared. Developing an annual capital usage charge for existing assets would establish a level playing field for federal capital investment and allow for comparisons across programs. In addition, this new charge could influence agency managers to get rid of excess capital assets.

Accomplishing these goals would require developing a standard method of computing an appropriate annual capital usage charge. Subunits would pay

these charges to the department's CAF using appropriated funds, which would then be transferred to Treasury's general fund. In other words, agencies would receive appropriations to pay for the use of capital assets they already own and would not retain any of the funds to maintain or replace assets. Imputing such a charge on existing capital is likely to be difficult and very contentious given questions about how to estimate the charge and the fact that the assets were already funded.

Before imputing an annual capital usage charge, key players, including OMB and Congress, would need to agree on some type of standard formula to estimate the charge. Three possible approaches to compute annual capital usage charges would be to (1) use historical cost for the asset by applying a charge as though the original cost had been financed by borrowing from Treasury, (2) use market rental rates, or (3) devise a calculation incorporating asset replacement cost, depreciation rates, and interest rates. There are arguments for and against each of these options. For example, while using historical cost would make the charge congruent with accounting data; the charge would not reflect the current cost of using capital and so might be less meaningful for evaluating costs. Although using market rates would theoretically be the right measure for comparing the cost of using resources for federal versus private purposes, the fact that many government assets fill unique purposes means there is not a measure of market value for them. For example, some agencies occupy historic buildings, such as the Old Executive Office Building, for which a comparable market-based value would be difficult to determine. The third approach might be considered an agreeable middle ground, but applying depreciation rates poses problems since they are largely arbitrary. Agreement on whether to apply Treasury or market interest rates would be necessary.

Some agency officials and congressional staff suggested that any charges on existing capital should reflect the life-cycle costs of maintaining assets and, similar to a WCF, receipts collected should be made available for future maintenance and renovation costs. We have reported that repair and maintenance backlogs in federal facilities are significant and that the challenges of addressing facility deterioration are prevalent at major real property-holding agencies.⁴⁴ However, research and discussions on CAF

⁴⁴[GAO-03-122](#), 15.

design indicate that CAF receipts could only go to Treasury and not for future projects. Officials were also skeptical about how to accurately charge for highly specialized capital. For example, ARS has more than 100 laboratories located in various regions of the country, as well as abroad, which are designed to carry out mission responsibilities ranging from the study of crop production to human nutrition to animal disease control. The highly technical and diverse nature of its objectives requires capital assets that are suitable for varied climates, soils, and other agricultural factors, which pose unique and difficult challenges in establishing capital usage charges that would be viewed as acceptable by agency officials.

If key players were able to agree on the method for calculating usage charges on existing capital assets, they would also have to examine the budgetary effects of such charges. Budget scorekeepers—OMB, CBO, and the budget committees—would need to develop additional scoring rules to clarify how the usage charges would be treated in the budget. Unlike charges on new capital, there is no corresponding debt to repay. As a result scorekeepers would have to specify how to score the usage charges as they are transferred from the CAF to Treasury. Although these charges would not change agency or government outlays or the deficit, they could require a permanent increase in agencies' total BA, which would require Congress to consider adjustments of appropriations subcommittee allocations.⁴⁵ Oversight would be especially important for these transactions since CAF collections would be greater than needed to repay Treasury loans, creating a temptation to use accruing balances for other purposes.

Similar questions about how to charge for and how to score capital usage charges for existing assets would eventually pertain to new capital funded through the CAF. Once an asset is fully "paid off" through the CAF, it is comparable to existing capital and would similarly incur an annual capital usage charge. Some might argue that payments should continue in the same amounts as before, while others may call for the calculation of a new capital usage charge for "paid off" assets based upon the formula used for capital that existed before the creation of CAFs. In any case, numerous decisions on capital usage charges for existing capital would need to be made prior to implementing CAFs.

⁴⁵ Although the scoring has not been determined, the subunit's payment to the CAF for existing assets would likely require budget authority since the payment is not for debt repayment.

Aside from the specifics of how to develop appropriate capital usage charges, most agency officials and congressional staff with whom we spoke were skeptical of the need for such a charge. Many said that the cost of maintaining capital assets—which is reflected in agency budgets—and depreciation expenses—which are reflected in agency accounting systems along with asset maintenance costs—sufficiently represent the cost of existing capital assets and help inform managers.⁴⁶ As discussed earlier, asset management systems and full cost accounting approaches are also beginning to provide the information managers need to make better decisions about the maintenance or disposal of existing assets and the need for new capital. Some congressional staff thought the mind shift required for Congress to agree to impute this new charge on existing capital assets would be even more difficult than that required for purchasing new capital using borrowing authority.

In the countries of New Zealand, Australia, and the United Kingdom, charges on existing capital are being used to encourage the efficient use of assets. These charges, similar to interest charges, are generally used to reflect the opportunity cost of capital invested. In New Zealand, departments are appropriated a capital charge based on their asset base at the beginning of the year; at the end of the year they must pay the government a capital charge based on their year-end asset base. If a department has a smaller asset base at the end of the year than the asset base for which the appropriation was made, the department is permitted to keep part of the appropriation made for the capital charge. This spurred the New Zealand Department of Education to sell a number of vacant sites that it had acquired in the 1960s but that were no longer needed. However, officials in New Zealand's Office of Controller and Auditor General were uncertain about the effectiveness of having a charge for capital in changing behavior significantly. In addition, some analysts in New Zealand expressed concern that capital charging could drive department executives to decisions that are rational in the short term but damaging in the long term. For example, an audit official suggested that a department might have an incentive to try to operate with obsolete and fully depreciated assets in order to avoid a higher capital charge.

⁴⁶OMB noted that neither the budget nor accounting systems reflect imputed interest costs and therefore do not reflect full economic costs.

Cost Allocation Efforts May Have Limited Effect on Agency Decision Making

Although one goal of CAFs is to ensure the allocation of full costs to programs in the budget and thereby encourage managers to make more informed decisions about capital assets, additional incentives to evaluate new or existing asset needs are unlikely to be created except during times of severe budget cuts or downsizing. For new assets funded through the CAF, the mortgage payments made out of the subunits appropriations would be equal to those received by the CAF and thus the payments would offset each other within the department budget and at the appropriations subcommittee level and would not affect the deficit. Although the information on total program costs might be made more transparent, it is not clear that this would create stronger incentives for more careful deliberation on future asset needs than having these costs shown through available methods such as cost accounting systems or the use of working capital funds.

A charge on existing assets might also have limited impact. If appropriation subcommittee allocations were simply raised to accommodate new capital usage charges, programs would appear more expensive but perhaps not differentially so. As with new assets, the capital charge on existing assets would not affect the deficit. As a result, incentives for rationalizing existing capital would not necessarily be created. Even during tight budget years, when mandatory CAF payments would squeeze operating budgets and be most likely to force trade-offs among capital assets, managers may be constrained by mission responsibilities, legal requirements, or the cost of disposing of assets. Consequently, agencies might have to argue for increased funding or case-by-case exemptions, which Congress has granted in the past.⁴⁷

Some agencies questioned the effectiveness of applying a charge to influence managers' decision making given the unique locations or types of assets required to accomplish mission goals. BLM officials said an annual capital usage charge would have a limited impact on their ability to dispose of capital assets because of its stewardship role over the nation's public lands. Similarly, ARS officials justified having locations dispersed all over the country because its research activities are diverse and require facilities in various climates and environments. As discussed, Congress also plays a role in determining where ARS will conduct its research. Likewise, many of

⁴⁷For example, Congress has provided FS and BLM with specific authorities to sell land in Los Angeles, California and near Las Vegas, Nevada. These authorities allowed the agencies to retain the sale proceeds and use them for new projects.

APHIS's capital assets are mission specific, including animal quarantine stations, sterile insect-rearing facilities, and laboratories, and typically do not have a comparable counterpart in the commercial sector. APHIS officials said this limits managers' abilities to sell or transfer assets because the land often must be converted to original condition, a costly undertaking. For some subunits we spoke with, destruction of certain assets, which also has an up-front cost, is the only viable option for eliminating unneeded assets. For example, NPS and FS have many facilities located on public land. If no longer needed, some of these facilities cannot be sold or transferred and would have to be demolished. According to FS officials, when they determine that an asset has exhausted its useful life and needs to be disposed of, the agency will incur the cost for removal and recover the salvage value.

Many agencies are subject to certain legal requirements that create disincentives for disposing of surplus property. In these cases, agencies would need additional funding or more flexibility to modify asset holdings if improved decision making were to be realized. For example, under the National Environmental Policy Act, agencies may need to assess the environmental impact of their decisions to dispose of property. In general, agencies are responsible for environmental cleanup of properties contaminated with hazardous substances prior to disposal, which can involve years of study and amount to considerable costs. Agencies that own properties with historic designations—which is common in the federal portfolio and certainly within the inventories of USDA and DOI—are required under the National Historic Preservation Act to ensure that historic preservation is factored into how the property is eventually used. The Stewart B. McKinney Homeless Assistance Act, as amended, sets forth a requirement that consideration be given to making surplus federal property, including buildings and land, available for use by states, local governments, and nonprofit agencies to assist homeless people.

If none of these restrictions apply and an agency is able to sell an asset, most cannot retain the proceeds from the sale of unneeded property even up to the cost of disposal. However, Congress has granted special authorities in some cases. For example, FS officials told us it owned a number of trails and roads on public lands that ran through the city of Los Angeles, California. When the city expanded, it was no longer feasible to maintain the roads and trails. As a result, the agency was granted authority

to sell the land and use the proceeds to build a new ranger station.⁴⁸ We have said that agencies be allowed to retain enough of the proceeds from an asset sale to recoup the cost of disposal, and that in some cases it may make sense to permit agencies to retain additional proceeds for reinvestment in real property where a need exists.⁴⁹

Issues Regarding Property Sales Would Further Complicate CAF Implementation

Provisions would also need to be established to ensure the full repayment of CAF debts in the event that an agency sells or transfers a capital asset before it reaches the end of its useful life (the repayment period). Two possible options would be to (1) transfer the outstanding debt to a new “owner” agency of the asset or (2) allow the “seller” agency to sell the asset and use the proceeds from the sale to repay the outstanding CAF debt. Both of these options would produce complications and issues to resolve. For example, transferring the asset would require all parties involved, including Treasury, to record adjustments to their CAF accounting systems and oblige subunits to adjust their budget requests accordingly. After the transfer, it is not clear whether the “seller” agency’s budget would be reduced by an amount equal to the asset’s mortgage payment. However, if that was done, it would lessen or eliminate the incentive for the “seller” agency to sell or transfer the asset. If the asset was sold instead of transferred, an appropriate “sale price” would need to be determined as well as the appropriate disposition of the sale proceeds. For example, if the asset was sold for an amount that is greater than the outstanding CAF debt, the Treasury general fund would receive full repayment on the asset plus excess revenue. On the other hand, if an asset was sold for an amount less than the outstanding debt, the CAF would default on the loan unless additional receipts for debt repayment were appropriated. Finally, some subunits may argue to refinance their mortgage if a lower Treasury interest rate became available and lower payments would result. Again, before CAFs are implemented, proposals on how to handle such circumstances would need to be addressed.

⁴⁸In fiscal year 2002, Congress granted FS additional authorities to sell or exchange excess buildings and other structures located on National Forest System lands and under the jurisdiction of FS. The agency was allowed to retain proceeds from the sales until the proceeds were expended for maintenance and rehabilitation activities within the FS region in which the building or structure was located. In fiscal year 2003, Congress extended this authority allowing for some of the sale proceeds to be used for construction of replacement facilities. Pub. L. No. 107-63, Sec. 329, 115 STAT. 471 (Nov. 5, 2001) and Pub. L. No. 108-7, Sec. 325, 117 STAT. 275-276 (Feb. 20, 2003).

⁴⁹[GAO-03-122](#), 41.

Some Capital Would Likely Continue to Be Obtained through Existing Means

The CAF's scope of coverage would need to be addressed by any CAF proposal. Capital assets are generally defined as land, structures, equipment and intellectual property (such as software) that are used by the federal government and have estimated useful lives of 2 years or more. However, departments have some discretion in defining capital. The Commission report suggested that OMB issue guidance on which capital items belong in the CAF to ensure uniform implementation of the CAF proposal. Alternatively, each department could use its current department guidelines and definitions to determine which capital to fund through the CAF. Whatever parameters are put in place, some capital assets would likely continue to be funded outside the CAF through existing mechanisms.

For example, for federal office space, the Commission and NRC reports state that agencies would generally continue to lease space from GSA and pay rent to FBF. FBF, a governmentwide revolving fund, is used to acquire office buildings and the space is then rented out to federal agencies. Most agencies are not allowed to lease their own office space unless GSA delegates its authority to do so to that agency, which GSA has done in the past. Under the CAF mechanism, if GSA were to delegate this authority, the CAF would lease the office space. The NRC report recommends that agencies should use their CAF for office space acquisition only if it could be done more effectively and efficiently than through GSA. GSA would negotiate the acquisition of space for multiple agencies that seek to collocate in a single facility.

Agencies also have the option to purchase IT through FTS and its IT Fund. For a fee, FTS provides expertise and assistance in acquiring and managing IT products. Those agencies that chose to use this service may argue for continuing to finance these projects outside of the CAF so that they are not paying a fee to FTS as well as interest on the borrowed funds. Some officials also questioned the effectiveness of using borrowing authority to finance IT purchases when their useful life is typically no more than 10 years and is often 5 years or less, thus indicating that officials may argue to fund some IT projects outside the CAF. Departments and subunits would also likely continue to rent certain capital assets from WCFs or to use their WCFs to purchase some capital. As discussed, WCFs rely on user charges to fund ongoing maintenance and replacement of capital assets and the collections are used by some departments and subunits to finance capital assets, such as vehicles and IT.

Land, such as wilderness areas, is also likely to remain outside the CAF. Land retains its value so concepts such as depreciation and amortization do

not apply to it. However, one subunit official stated that using borrowing authority to buy land might be beneficial if it meant that land could be purchased at a faster rate to obtain environmentally sensitive land before it is damaged.

Conclusion

There is little doubt that in the mechanical sense CAFs could work as a new system for financing capital assets. However, the implementation and operation of the CAF concept would be complicated. Managing the extra layer of responsibilities for CAF administration and oversight would require the devotion of resources within departments, subunits, and Treasury and to a lesser extent, OMB, CBO, and Congress. Accounting for CAF transactions would be complex and burdensome. The annual debt repayment would be a source of concern for Treasury and agency officials, especially as more assets were financed through the CAF and mortgage payments became a larger percentage of agency appropriations.

Beyond the complexities inherent in financing capital assets using borrowing authority is a list of difficult issues that would have to be resolved before benefits could be realized. The most difficult of these issues, applying a capital usage charge to existing capital, would also be the most important to address if annual capital costs were to be allocated to program budgets. If CAFs were applied only to new assets going forward, programs would not reflect the full annual cost of capital for decades and programs purchasing new capital would appear more expensive than those using existing capital. Even if this and other issues were tackled and improved information about capital costs was provided to managers, there is little assurance that CAFs alone would create incentives for programs to reassess their use of capital. Even in times of severe budget constraints, it is probable that managerial flexibility to adjust the amount of assets used by a program would continue to be limited by agency missions, legal restrictions, and limited funds for asset disposal. Given the execution complexities and implementation concerns, the ensuing question seems to be whether there are simpler methods that can be used to achieve the same benefits as CAFs.

We believe there is strong evidence that both benefits attributed to CAFs could be more easily obtained through existing mechanisms. Asset management and cost accounting systems, when fully implemented, will be important tools for promoting more effective planning and budgeting for capital. Cost accounting systems can provide the same information on capital costs as CAFs are intended to provide, while the information

provided by asset management systems could be even more crucial for helping managers with limited budgets prioritize capital asset maintenance and replacement. For existing capital, incentives to rationalize assets might be created if agencies were allowed to retain proceeds to recoup the cost of disposal, or in some cases, for reinvestment in real property. While some of our case study agencies did not view spikes as a problem, those that did felt they were managing them well through the use of WCFs, no-year authority, and acquiring assets through useful segments. In any case, spikes in spending for capital assets are likely to continue as congressional and presidential priorities change over time.

When described in detail to executive branch and congressional officials, we learned that the CAF proposal would likely have few proponents. Almost everyone we consulted concluded that implementation issues would overwhelm the potential benefits of a CAF. More importantly, current efforts under way in agencies would achieve the same goals as a CAF without introducing the difficulties. Given this, as long as alternative efforts uphold the principle of up-front funding, then a CAF mechanism does not seem to be worth the complexity and implementation challenges that it would create.

Agency Comments and Our Response

We obtained comments on a draft of this report from OMB, Treasury, GSA and our case study agencies—USDA and DOI. Treasury, GSA, USDA and DOI generally agreed with the report. Treasury, USDA, DOI and OMB provided technical comments, which have been incorporated as appropriate. OMB agreed with our description of the mechanics of CAFs and concurred that spikes in BA for capital assets could be alleviated through other means. OMB also acknowledged the problems with CAFs that are highlighted in this report, including those related to existing capital, and agreed that the complications of designing and operating CAFs might outweigh the benefits. However, they disagreed with our description of the primary goal of CAFs and therefore do not believe alternative mechanisms achieve the same goal.

OMB supports having program budgets reflect full annual budgetary costs in order to change incentives for decision makers. In addition to proposing to budget for accruing retirement benefit costs, OMB has suggested budgeting for accruing hazardous waste clean-up costs and budgeting for capital through CAFs. Budgeting for full annual budgetary costs should facilitate decision makers' ability to compare total resources used with results achieved across government programs. For capital, OMB has

suggested CAFs as a possible method to allocate and embed the cost of capital assets at the program budget level. OMB recognizes the usefulness of asset management and cost accounting systems regardless of whether CAFs are adopted. It is OMB's opinion that these tools do not ensure that the costs of capital are captured in individual program budgets and therefore do not affect incentives for decision makers in allocating resources among and within programs. We disagree on several points.

We recognize that if the sole or primary purpose of a CAF is to embed costs in the program budgets, then the alternatives discussed in this report do not achieve that purpose. However we believe, as highlighted in the *Report of the President's Commission to Study Capital Budgeting*, that the primary goal of CAFs is to improve decision making for capital. We are not convinced that CAFs and the annual mortgage payments they would require would achieve this more effectively than other mechanisms. We argue instead that the information provided by asset management and cost accounting systems, when fully implemented, could assist decision makers in efficiently allocating budgetary resources. While this information may not necessarily be reflected in program budgets, it is available to aid in budget and program decision making. The fact that many of these systems are in relatively early stages of development also increases our concern about CAFs. In a recent report, we noted the belief among some agency officials, congressional appropriations committee staff, and budget experts that improving underlying financial and performance information should be a prerequisite to efforts to restructure program budgets.⁵⁰ We argue this would also be true for CAFs, since without adequate measures of program costs and an ability to identify capital priorities, a new financing mechanism would do nothing to address the basic challenges of determining how much and what types of capital are needed.

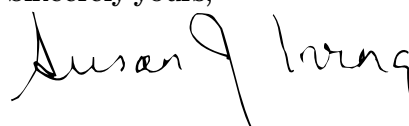
It is also unclear that CAFs would create new incentives as OMB argues. As we describe in the section titled "Cost Allocation Efforts May Have Limited Effect on Agency Decision Making," if the annual mortgage payments offset each other within the department budget and at the appropriations subcommittee level, the deficit would not be affected, and it is unlikely incentives would be changed. Even during tight budget years, when CAF payments would squeeze operating budgets, managers may be unable to change the amount of capital assets they use because of mission responsibilities, legal requirements, or the cost of disposing of assets.

⁵⁰GAO-05-117SP, 15.

We also recognize the value of linking resources to results in comparing programs; however, it is unclear that CAFs are necessary or would even work to accomplish this. Institutionalizing CAFs could permit program comparison, but fair evaluations would only be possible if existing capital were included. Therefore, the difficult issue of including existing capital would have to be addressed. Alternatively, we believe that cost accounting systems, when well developed within and across agencies, provide a similar opportunity for comparing programs. In conclusion, we remain of the view that the operational challenges of CAFs outweigh the benefits and that alternative mechanisms described in this report can more simply accomplish the goals of CAFs.

As we agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from its issuance date. At that time we will send copies of this report to the Director of the Office of Management and Budget, the Administrator of the General Services Administration, the Secretary of the Department of the Interior, the Secretary of the Department of Agriculture, and the Secretary of the Department of the Treasury. We will also make copies available to others upon request. This report will also be available at no charge on the GAO Web site at <http://www.gao.gov>. If you or your staff have any questions regarding the information in this report, please contact me at (202) 512-9142 or Christine Bonham at (202) 512-9576. Key contributors to this report were Jennifer A. Ashford, Leah Q. Nash, and Seema V. Dargar.

Sincerely yours,



Susan J. Irving
Director, Federal Budget Analysis
Strategic Issues

Comments from the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

MAR -2 2005

Ms. Susan J. Irving
Director, Federal Budget Analysis
Strategic Issues
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Irving:

The Department of the Treasury has received for comment a copy of the draft report entitled *Capital Financing: Potential Benefits of Capital Acquisition Funds Can Be Achieved through Simpler Means* (GAO-05-249). Our comments are as follows:

We are in general agreement with the conclusions contained in the report that implementing capital acquisition funds (CAF) to purchase capital assets would be challenging and complex, not only from an accounting and budget standpoint but also from increased management and oversight responsibilities for Treasury and other stakeholders.

We recommend that the discussion of Bonneville Power Administration's (BPA) "fish credits" be stricken from pp. 28-29 of the report for the following reasons:

1. In about 1980, Congress gave BPA the statutory authority to offset the dollar amount of the non-power portion of its statutorily required fish recovery efforts against its total annual payment to Treasury. These offset credits are commonly called "fish credits."
2. This statutory offset authority provides BPA with a means, outside of the normal budget/appropriations process, to reimburse BPA ratepayers, who pay for power produced by Federal Columbia River Power System, for the non-power-related portion of these fish recovery costs. The BPA ratepayers are, however, responsible for paying the power-related portion of these costs. This is the reason why Congress gave BPA in 1980 the statutory authority to use "fish credits." Congress did not give BPA this statutory authority in 1994 to help BPA solve its current financial difficulties, as is stated on pp. 28-29. This "fish credit" statutory authority actually predates the explosion in BPA's fish recovery costs that occurred in 1994 by about 14 years. It was given to BPA in 1980 as a means for BPA to avoid delays in the appropriations process.
3. From about 1980 until 1994, BPA used appropriations, and not the statutorily authorized "fish credits," to cover the power and the non-power-related portions of its required fish recovery costs because these costs were not very high then. However, in 1994, BPA began using "fish credits" on an annual basis, instead of seeking high annual appropriations, which were needed because its fish recovery costs had exploded due to changes to the Endangered Species Act,

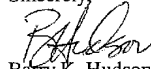
Appendix I
Comments from the Department of the
Treasury

-2-

among other things. In addition to the use of annual "fish credits" to reimburse its ratepayers for the non-power-related portion of its fish costs, BPA was also allowed, under certain OMB/Treasury prescribed conditions, to use up to about \$325 million in retroactive "fish credits" that had "accrued" from 1980 until 1993.

Thank you for the opportunity to respond to this draft GAO report. If you have any questions or wish to discuss these comments further, please contact me at (202) 622-0750

Sincerely,



Barry K. Hudson
Acting Chief Financial Officer

cc: Donald Hammond
Fiscal Assistant Secretary

Christine Bonham
Assistant Director, Federal Budget Analysis
Strategic Issues
U.S. Government Accountability Office

GAO's Comments

We believe that the discussion of BPA's use of "fish credits" is an appropriate example for the section on agencies' repayment of their borrowing from Treasury. Although these credits were provided by Congress, their use for offsetting payments on Treasury debt has been controversial and opposed by some members of Congress and other interested parties. However, we have made technical changes to the section based on Treasury's comments.

Comments from the Department of the Interior



United States Department of the Interior

OFFICE OF THE ASSISTANT SECRETARY
POLICY, MANAGEMENT AND BUDGET
Washington, DC 20240



FEB 23 2005

Ms. Susan J. Irving
Director, Federal Budget Analysis
Strategic Issues
U.S. Government Accountability Office
441 G. Street N.W.
Washington, D.C. 20548

Dear Ms. Irving:

Re: GAO Draft Report 05-249: Capital Financing, Potential Benefits of Capital Acquisition Funds Can Be Achieved Through Simpler Means

Thank you for the opportunity to comment on the above referenced draft report on Capital Financing.

The Department of the Interior agrees with the major conclusion of the report that the benefits attributed to Capital Acquisition Funds (CAFs) could be more easily obtained through existing mechanisms:

"Asset management and cost accounting systems, when fully implemented, will be important tools for promoting more effective planning and budgeting for capital. Cost accounting systems can provide the same information on capital costs as CAFs are intended to provide, while the information provided by asset management systems could be even more crucial for helping managers with limited budgets prioritize capital asset maintenance and replacement...."

We believe that Interior, through several initiatives, is already providing more effective planning and budgeting for capital.

- Interior has implemented a Capital Planning and Investment Control (CPIC) process that involves review of all capital asset projects valued at \$2.0 million or greater and fully considers the annual operating costs of proposed projects. This process is evolving to shift to life-cycle management, where the planning focus is on asset investments rather than just project formulation and project execution.
- Interior is in the process of implementing a robust, common, automated, off-the-shelf asset management system. Deployment began in 2002 in the National Park Service and was followed by the Bureau of Land Management, U.S. Geological Survey, Fish and Wildlife Service, the Bureau of Indian Affairs for its irrigation systems and safety of dams program, and the DOI National Business Center for the Interior Main and South buildings. The Bureau of Reclamation began using the same system in 1995 for its water facilities. The BIA continues to use the comprehensive facilities maintenance management system already in place, that provides the functionality and business process features that will provide information to manage BIA non-irrigation facilities over their entire useful life.

Appendix II
Comments from the Department of the
Interior

- Phased implementation of the Department's Financial and Business Management System (FBMS) has begun in three of eight Interior bureaus. This system will provide timely financial and business information, such as property inventories, and standardize DOI's business practices across all bureaus. The common, automated asset management system referenced in the paragraph above will be configured on a single platform and be linked to FBMS.

- Interior, in response to *Executive Order 13327 Federal Real Property Asset Management* issued in February 2004, has developed and submitted to the Office of Management and Budget (OMB) its initial agency-wide asset management plan. This plan institutionalizes a common framework government-wide for the life cycle management of assets.

The report also states that spikes in funding can be avoided by funding capital in useful segments and by using no-year authorities, but probably will continue with shifts in executive and legislative branch priorities. While Interior will not ultimately control the executive or legislative shifts in priorities with their attendant fluctuations in funding, it does use no-year budget accounts for construction activities; and bureaus phase projects into useful segments when budget targets will not permit full funding in one year.

We also note for your attention three technical changes that need to be made. First, in the paragraph at the top of page 12, the Bureau of Reclamation should replace the Bureau of Land Management in two places, as the named Interior bureau under the aegis of the Energy and Water Development Subcommittee. Second, in the first full paragraph on page 29, BLM officials believe that the report is addressing the National Park Service because BLM has no parks.

In conclusion, we believe that the complicated CAF funding mechanisms would probably produce little improvements in capital financing but would require many more staff in Interior, the Department of Treasury, OMB, and most likely in the legislative branch to administer it. Further, the complexity and complications of an annual mortgage for each capital asset would be difficult to explain to a field program manager and might reduce his/her feeling of ownership and control of the very assets the CAF concept is designed to improve.

Sincerely,



P. Lynn Scarlett
Assistant Secretary
Policy, Management and Budget

GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "Subscribe to Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000
TDD: (202) 512-2537
Fax: (202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Gloria Jarmon, Managing Director, JarmonG@gao.gov (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, D.C. 20548

Public Affairs

Paul Anderson, Managing Director, AndersonP1@gao.gov (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, D.C. 20548

**United States
Government Accountability Office
Washington, D.C. 20548-0001**

**Official Business
Penalty for Private Use \$300**

Address Service Requested

<p>Presorted Standard Postage & Fees Paid GAO Permit No. GI00</p>
--

