

# Inspector General

United States  
Department of Defense



DoD Can Improve Its Accounting for Residual Value  
From the Sale of U.S. Facilities in Europe

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## Acronyms and Abbreviations

|            |  |
|------------|--|
| DFAS       | Defense Finance and Accounting Service                                   |
| DoD FMR    | DoD Financial Management Regulation                                      |
| DOMFIRA    | Defense Oversees Military Facility Investment<br>Recovery Account        |
| DMOMS      | Deutsche Mark Occupation Mandatory Support                               |
| DUSD(I&E)  | Deputy Under Secretary of Defense for Installations<br>and Environment   |
| IG         | Inspector General  |
| IMCOM-E    | U.S. Army Installation Management Command–Europe                         |
| OMB        | Office of Management and Budget  |
| PIK        | Payment-In-Kind  |
| U.K. MOD   | United Kingdom Ministry of Defence                                       |
| USAFE      | United States Air Forces Europe  |
| USAREUR    | United States Army Europe  |
| USD(C)/CFO | Under Secretary of Defense (Comptroller)/Chief Financial<br>Officer, DoD |
| USEUCOM    | U.S. European Command  |



**INSPECTOR GENERAL**  
**DEPARTMENT OF DEFENSE**  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500

May 4, 2012

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/  
CHIEF FINANCIAL OFFICER, DOD  
DEPUTY UNDER SECRETARY OF DEFENSE FOR  
INSTALLATIONS AND ENVIRONMENT  
COMMANDER, U.S. EUROPEAN COMMAND

SUBJECT: DoD Can Improve Its Accounting for Residual Value From the Sale of U.S.  
Facilities in Europe (Report No. DODIG-2012-082)

We are providing this report for your information and use. DoD has closed since 2004, or anticipates closing by 2015, 138 sites for which it has invested \$1.8 billion. DoD organizations did not maintain adequate controls over \$8 million of unused monetary and nonmonetary proceeds. Also, they did not always perform and document analyses to support the negotiated \$19.4 million settlement amounts for seven installation closures. Further, lessons can be learned from the return of DoD housing units in the United Kingdom for which DoD may not recover a fair and equitable share of its \$20.3 million investment. We considered management comments on a draft of this report in preparing the final report.

The Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD; Deputy Under Secretary of Defense for Installations and Environment; and Commander, U.S. European Command, comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, we do not require any additional comments.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-8905 (DSN 664-8905).

A handwritten signature in cursive script, reading "Amy J. Frontz", is positioned above the typed name.

Amy J. Frontz, CPA  
Principal Assistant Inspector General  
for Auditing





# Results in Brief: DoD Can Improve Its Accounting for Residual Value From the Sale of U.S. Facilities in Europe

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## What We Did

We evaluated whether DoD personnel properly accounted for residual value transactions for facilities returned to host nations in Europe.

## What We Found

Although DoD organizations used residual value settlement proceeds appropriately, they did not maintain adequate controls over \$8 million of unused monetary and nonmonetary proceeds. DoD personnel did not provide adequate oversight and monitor and review \$7.6 million of unused monetary proceeds. DoD organizations should use the monetary proceeds to offset facility expenses. During the audit, the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD (USD[C]/CFO), personnel began researching the unused monetary proceeds and planned to complete the actions and clean up the remaining balances. The Army also corrected a \$0.4 million overstatement of its nonmonetary proceed balance.

Army and Air Force personnel did not always perform and document analyses to support the negotiated settlement amounts for seven installation closures. As a result, they were unable to show that the resulting \$19.4 million in compensation represented an adequate return on DoD's investment in those installations. This occurred because of inadequate DoD policy.

Lessons can also be learned from the return of the West Ruislip housing units in the United Kingdom, which may improve future returns. In this instance, several factors contributed to the current situation in which DoD may not recover a fair and equitable share of its \$20.3 million investment in housing.

DoD and host nation governments had already finalized the residual value settlements this audit reviewed and thus cannot change them. DoD needs to improve its processes for the benefit of future residual value negotiations. DoD has closed since 2004, or anticipates closing by 2015, 138 sites, with a U.S. investment totaling at least \$1.8 billion. These closures will require residual value settlements.

## What We Recommend

USD(C)/CFO should provide results of the review of unused monetary proceeds. In addition, the Deputy Under Secretary of Defense for Installations and Environment (DUSD[I&E]) and the Commander, U.S. European Command (USEUCOM), should revise DoD policy to require greater analysis and documentation to support residual value settlements. Finally, the Commander, USEUCOM, should assign responsibility for pursuing residual value for the West Ruislip housing units and require greater coordination between the Military Departments for future residual value agreements with host nations.

## Management Comments and Our Response

The USD(C)/CFO, DUSD(I&E), and the Commander, USEUCOM, comments were fully responsive to all recommendations. Please see the recommendations table on the back of this page. See the Finding sections for a summary of management comments, and see the Management Comments section for the full text.



## Recommendations Table

| Management  | Recommendations<br>Requiring Comment | No Additional Comments<br>Required |
|---|--------------------------------------|------------------------------------|
| Under Secretary of Defense<br>(Comptroller)/Chief Financial<br>Officer, DoD | None                                 | A                                  |
| Deputy Under Secretary of<br>Defense for Installations and<br>Environment   | None                                 | B                                  |
| Commander, U.S. European<br>Command   | None                                 | B, C.1, C.2, C.3                   |

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# Introduction

## Audit Objectives

The overall objective was to determine whether DoD personnel properly accounted for residual value transactions for facilities returned to host nations. Specifically, we determined whether DoD personnel properly submitted residual value claims for returned facilities, obtained monetary or nonmonetary consideration, and properly accounted for the use of residual value amounts. Testing the residual value settlement process involved evaluating a nonstatistical sample of 12 Army and Air Force facility closures at different stages of the residual value settlement process over the last 10 years. (See Appendix A for our scope and methodology and prior coverage of the residual value settlements from facility closures. See Appendix B for details on the residual value process.)

## Background on Facilities Returned to Host Nations

Public Law 101-510, “The National Defense Authorization Act for FY 1991,” Section 2921, “Closure of Foreign Military Installations,” as amended, specifies that the Secretary of Defense should ensure that the United States receives consideration equal to the fair market value of the improvements it made to facilities that will be returned to host countries. The determination of the fair market value of the improvements returned to host countries in whole or in part should be handled on a facility-by-facility basis.<sup>1</sup>

## Residual Value

To the maximum extent possible, DoD personnel should recover residual value for the U.S. investment in improvements made to facilities returned to host nations. Residual value is the negotiated monetary or nonmonetary compensation host nations provide to DoD following the return of DoD-funded facilities or other capital improvements to the host nation. Since 1991, European host nations have provided DoD \$1.1 billion in compensation for returned facilities. The majority of this compensation, \$921.8 million (85.5 percent), related to facilities returned to the Federal Republic of Germany (Germany). An additional amount of \$44.1 million (4.1 percent) related to facilities returned in the United Kingdom (U.K.).

*Residual value is typically based on the fair market value of the properties regardless of what was paid to build them. Therefore, there is often a difference between the U.S. investment in returned facilities and the amount of compensation received.*

Residual value is typically based on the fair market value of the properties regardless of what was paid to build them. Therefore, there is often a difference between the U.S. investment in returned facilities and the amount of compensation received. This difference may result when no parties are interested in using the improvements, especially when the

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<sup>1</sup> Improvements can include new construction of facilities and all additions, improvements, modifications, or renovations made to existing facilities or to real property. Fair market value of the improvements is defined to be “the value of improvements ... on the basis of their highest use.”

improvements are highly military in nature, which decreases or even eliminates any fair market value for the improvements. Typically, DoD personnel complete a residual value settlement agreement with host nation counterparts within 4 to 8 years after returning the facility. This allows sufficient time for the host nation to sell or find a use for returned facilities. The actual compensation provided to the United States varies depending on the specific host nation and can be affected by international agreements, environmental effects, economic conditions, and the potential reuse of the property.

Host nations can provide residual value in the form of monetary or nonmonetary compensation. Public Law 101-510 established a special U.S. Treasury account, known as the Department of Defense Overseas Military Facility Investment Recovery Account (DOMFIRA), to be used for depositing monetary compensation. Of the \$1.1 billion in total residual value from 1991 to 2011, host nations have provided only \$150.9 million (14 percent) as monetary compensation deposited into DOMFIRA.

Subsequent amendments to Public Law 101-510 included the option for DoD to recover

*Of the \$1.1 billion in total residual value compensation, host nations have provided \$925.4 million (86 percent) as PIK.*

nonmonetary payment-in-kind (PIK) in lieu of monetary compensation. PIK is compensation host nations provide to DoD in the form of construction, repair, and base support projects. PIK compensation has since become standard practice with some host nations, such that all residual value settlement agreements completed after 1997 with either Germany or the U.K. were settled for PIK. Of the \$1.1 billion in total residual value compensation, host

nations have provided \$925.4 million (86 percent) as PIK.<sup>2</sup> Table 1 shows the distribution of monetary and nonmonetary residual value settlements from 1991 to 2011.

**Table 1. Monetary and Nonmonetary Residual Value Settlements**

| Years        | Monetary Settlements |                  | Nonmonetary Settlements |                  |
|--------------|----------------------|------------------|-------------------------|------------------|
|              | Quantity             | Value (millions) | Quantity                | Value (millions) |
| 1991-1995    | 7                    | \$45.6           | 1                       | \$0.9            |
| 1996-2001    | 9                    | 98.0             | 11                      | 871.3            |
| 2002-2011    | 3                    | 7.2              | 11                      | 53.2             |
| <b>Total</b> | <b>19</b>            | <b>\$150.9*</b>  | <b>23</b>               | <b>\$925.4</b>   |

\*Difference between the three sets of years and the total row is a result of rounding.

<sup>2</sup> Host nations provided \$437.9 million of PIK as a credit for the United States to use toward funding military construction projects of its choosing. An additional amount of \$487.5 million was provided as a separate type of PIK compensation used to fund specific projects related to the relocation of capabilities from Rhein-Main Air Base to Ramstein and Spangdahlem Air Bases.

## ***Residual Value Process and Roles and Responsibilities***

The process for determining the residual value of a military facility that the United States has returned to a host nation varies by country.<sup>3</sup> DoD personnel negotiate and conclude settlement agreements with host nation representatives in accordance with applicable U.S. law and international agreements to ensure that the United States receives the maximum amount possible when recovering residual value compensation. Various DoD organizations have specific roles and responsibilities in the residual value process.

DUSD(I&E) is responsible for providing oversight of the residual value process by implementing DoD policy and providing more guidance as necessary. Additional responsibilities include providing policy advice and assistance on environmental matters, residual value, and PIK actions. DUSD(I&E) is also responsible for reviewing proposals on the recovery of residual value, including PIK, obtaining coordination from other DoD officials, and preparing correspondence to the Office of Management and Budget (OMB) and congressional committees.

USEUCOM is responsible within Europe for reviewing and screening DoD Component proposals for residual value and PIK actions and forwarding recommendations for action to DUSD(I&E). Additional responsibilities include developing guidance and policy for implementing DoD policy on the residual value process and providing oversight and assistance for the negotiation and implementation of residual value and PIK actions.

The responsibilities of U.S. Army Installation Management Command–Europe (IMCOM-E) and U.S. Air Force Europe (USAFE) include conducting negotiations and related residual value matters and maintaining complete records of residual value actions for Army and Air Force installations, respectively, within Europe. USEUCOM assigns IMCOM-E and USAFE specific areas to conduct residual value matters within Europe. Additional IMCOM-E and USAFE responsibilities include informing USEUCOM of significant developments or problems arising in connection with negotiations or other related matters and also providing USEUCOM with advance copies of significant communications pertaining to negotiations and the recoupment of residual value.

## ***Future DoD Facility Returns and Potential Settlements***

On June 23, 2010, the Assistant Secretary of Defense (Public Affairs) announced Facility Closure Round 56, in which DoD would return 23 U.S. Army Europe (USAREUR) sites to Germany between 2010 and 2015. DoD scheduled these site closures in Germany in conjunction with a USAREUR force structure change. The closures were to consolidate personnel onto other DoD bases and return the closed USAREUR facilities in Mannheim, Heidelberg, and Wiesbaden, Germany, to the German government.

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<sup>3</sup> See Appendix B for additional details on the overall residual value process, including the specific processes within Germany and the U.K.

Overall, DoD has closed since 2004,<sup>4</sup> or anticipates closing by 2015, 138 sites, which are listed by IMCOM-E and USAFE with a U.S. investment totaling at least \$1.8 billion.<sup>5</sup> These closures will require residual value settlements.

## **Review of Internal Controls Over the Residual Value Settlement Process and Unused Proceeds**

Internal control weaknesses existed with the accounting for unused residual value proceeds and the residual value negotiation process as defined by DoD Instruction 5010.40, “Managers’ Internal Control Program (MICP) Procedures,” July 29, 2010. DoD personnel did not provide adequate oversight and review and monitor unused residual value balances to ensure the timely use of the funds (see Finding A). DoD and USEUCOM policy did not require specific documentation and analyses to adequately support the results of residual value negotiations (see Finding B). DoD organizations did not properly coordinate a residual value agreement with the U.K. (see Finding C). We will provide a copy of the report to the senior official responsible for internal controls in USD(C)/CFO, DUSD(I&E), and USEUCOM.

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<sup>4</sup> This includes one site returned in 2001, which was excluded from an earlier settlement.

<sup>5</sup> This capital investment figure includes adjustments for inflation and depreciation because that is how the IMCOM-E tracks capital investment. This value is also dependent on a currency conversion rate based upon when the data were received, not when the investments were actually made, because that level of detail for all 138 sites was not available.

# Finding A. DoD Accounting for Unused Residual Value Proceeds Needs Improvement

DoD organizations generally maintained adequate controls over expended residual value settlement proceeds and spent the funds for their intended purposes. However, DoD organizations did not provide adequate oversight and review and monitor \$7.6 million of unused monetary and \$0.4 million of unused nonmonetary residual value settlement proceeds. This occurred because monetary proceeds deposited into DOMFIRA are no-year funds that do not expire and DoD policy on DOMFIRA funds did not address monitoring unused funds. For nonmonetary residual values, tracking methods between responsible parties differed, proceeds were not accurately divided, and rounding errors contributed to misstatement of amounts. As a result, \$7.3 million<sup>6</sup> of unused DOMFIRA funds sat dormant instead of being used by DoD organizations for facility maintenance, repair, and environmental remediation at DoD military installations. In addition, IMCOM-E and USAFE overstated PIK settlement proceeds due from the German government by \$0.4 million.

As a result of this audit, USD(C)/CFO initiated actions to research the unused funds and planned to complete those actions and reconcile the remaining DOMFIRA balances. In addition, IMCOM-E and USAFE took action to correct a \$0.4 million overstatement of PIK settlement proceeds due from the German government.

## DoD Organizations Generally Maintained Adequate Controls Over Expended Settlement Proceeds

The Military Departments generally maintained adequate controls over the expended residual value settlement proceeds and spent the funds for their intended purposes. We analyzed DOMFIRA expenditures over the last 5 years and a nonstatistical sample of 9 PIK construction projects from the last 10 years.<sup>7</sup> Adequate documentation existed to support that the funds were properly used for military construction or facility maintenance in accordance with public law.

## Monetary Proceeds Deposited Into DOMFIRA

USD(C)/CFO maintains overall control over the DOMFIRA funds at the DoD level and, upon request, releases funds to the Military Departments. DoD maintains DOMFIRA

*Because DOMFIRA funds do not expire, there is an increased risk that they may sit dormant for an extended period of time.*

funds in Treasury account 97X5193, with subaccounts for the owning DoD organizations. Funds deposited into DOMFIRA are no-year funds; that is, they do not expire and remain available for obligation for an indefinite period of time. Because DOMFIRA funds do

<sup>6</sup> This consists of the \$7.6 million total unused Army, Navy and DoD DOMFIRA funds shown in Table 2 less a \$0.3 million erroneous Navy balance that DFAS corrected.

<sup>7</sup> See Appendix A for additional details on the methodology used to review the expended funds.

not expire, there is an increased risk that they may sit dormant for an extended period of time. In contrast, other appropriations, such as Operation and Maintenance, are only available for obligation for a period of time as specified in the law, which is generally 1 year, and must be expended within 5 years. The funds can be used to pay for facility maintenance, repair, and environmental restoration at military installations within the United States or for facility maintenance, repair, or compliance with applicable environmental laws at military installations outside the United States that are expected to be occupied by the Armed Forces for a long period.

The procedures for depositing, accounting, and releasing DOMFIRA funds are addressed in the DoD Regulation 7000.14-R, “DoD Financial Management Regulation” (DoD FMR), Volume 2B, Chapter 8, “Facilities Sustainment and Restoration/Modernization.” The DoD FMR specifies that once funds are deposited into DOMFIRA, the Military Departments request release of their funds by submitting a memorandum to USD(C)/CFO. The funds get released into a Military Department’s subaccount through a funding authorization document. While the DoD FMR addresses procedures for depositing, accounting, and releasing DOMFIRA funds, it does not address oversight of the unused DOMFIRA funds.

Once USD(C)/CFO releases the funds to the Military Departments, DoD policy requires the responsible fundholders to monitor them. Specifically, DoD FMR, Volume 3, Chapter 8, “Standards for Recording and Reviewing Commitments and Obligations,” defines an obligation as dormant if no obligations, adjustments, disbursements, or withdrawals occur within 120 days. The regulation requires fundholders to review all unliquidated obligations once every 4 months and initiate actions to resolve unliquidated obligations as appropriate. The fundholders are responsible because they initiate actions that result in commitments and obligations and, therefore, are in the best position to determine the accuracy and the status of such transactions.

Of the \$150.9 million in residual value payments received from European host nations and deposited into the DOMFIRA account, \$143.7 million (95.2 percent) occurred between 1992 and 1998. The last two deposits into any Military Department DOMFIRA account occurred in 2005 and 2007, when the Air Force received \$5.2 million from the Netherlands and Belgium. The significant decrease in DOMFIRA deposits resulted from a shift from monetary to nonmonetary compensation that occurred between 1995 and 1997. As of June 30, 2011, the DOMFIRA balance was \$10.5 million. Because of the ongoing corrective actions and the unlikelihood of additional deposits, we are not making any recommendations to improve controls over DOMFIRA.

## **Accounting for and Managing Unused DOMFIRA Funds**

DoD organizations did not maintain adequate controls over unused monetary proceeds deposited into DOMFIRA; that is, \$7.6 million of the \$10.5 million in remaining DOMFIRA balances as of June 30, 2011.

## ***Unused DOMFIRA Funds***

As a result of this audit, the USD(C)/CFO funds distribution manager attempted a reconciliation of the \$10.5 million DOMFIRA balance as of June 30, 2011, to determine which Military Departments had funds remaining. Ultimately, the funds distribution manager obtained a Standard Form 133 (SF-133), “Report on Budget Execution and Budgetary Resources,” from the Defense Finance and Accounting Service (DFAS) for account 97X5193 and all subaccounts.<sup>8</sup> The SF-133 report showed two significant balances, the unobligated balance and the obligated balance unpaid.

- The unobligated balance represents the difference between the total appropriation availability and the total obligations.
- The obligated balance unpaid, also referred to as the unliquidated obligation balance, represents the amount of obligations that have not been liquidated by payments.

We categorized as unused all remaining unobligated and obligated funds that DoD organizations had not expended. Table 2 shows the status of unused DOMFIRA funds by DoD organization, as shown on the June 30, 2011, SF-133 report.

**Table 2. Status of Unused DOMFIRA Funds as of June 30, 2011 (millions)**

| <b>Organization*</b> | <b>Unobligated Balance</b> | <b>Obligated Unpaid</b> | <b>Unobligated and Obligated Unpaid</b> |
|----------------------|----------------------------|-------------------------|---|
| Army                 | \$4.9                      | \$0.1                   | \$5.0                                   |
| Air Force            | 2.3                        | 0.6                     | 2.9                                     |
| Navy                 | 0.3                        | 1.2                     | 1.5                                     |
| DoD                  | 0.8                        | 0.3                     | 1.1                                     |
| <b>Total</b>         | <b>\$8.3</b>               | <b>\$2.2</b>            | <b>\$10.5</b>                           |

\* This column identifies the summary-level organization, but individual components may hold the funds. For example, USAREUR held Army funds and USAFE held Air Force funds.

## ***Monitoring and Reviewing Unused DOMFIRA Funds***

USD(C)/CFO and Military Department personnel did not provide adequate oversight and monitor and review \$7.6 million of unused Army, Navy, and DoD DOMFIRA funds. There were no indications that the Air Force improperly accounted for its DOMFIRA funds, as it was spending the available funds on a building renovation at Ramstein Air Base, Germany.

The Army reported the largest DOMFIRA unobligated balance of \$4.9 million. IMCOM-E and USD(C)/CFO provided information showing that the last Army deposit into DOMFIRA occurred in 1997 and the last release of funds to the Army occurred in

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<sup>8</sup> The SF-133 report shows the status of budgetary resources and related financial data and is used for reviewing apportionments, managing the rate of incurring obligations and outlays, and as a basis for initiating requests for reapportionments and transfers.



2002. In addition, transaction data on DOMFIRA disbursements showed that the last Army disbursement occurred in 2008.

In response to a request for details on the unused funds, USAREUR provided only limited information to show that in January 2010, it had followed up on some outstanding funds provided to the U.S. Army Corps of Engineers on a military interdepartmental purchase request from 1997. In March 2010, the U.S. Army Corps of Engineers returned to USAREUR \$824,135 of unobligated funds, and in June 2010, returned \$43,594 that was deobligated from a 1997 contract. As to details on the remaining \$4,037,067 unused balance, USAREUR was unable to provide any information on the contracts or projects for which it intended to use the funds or why it held the funds for so long. USAREUR explained that it had limited records on DOMFIRA because of changes in the European force structure and force reduction. In the absence of specific details, USAREUR could not show that it had adequately monitored the funds and reviewed them in a timely manner. In August 2011, USAREUR initiated action to return the entire balance to USD(C)/CFO. The Army subsequently informed USD(C)/CFO that it was reviewing potential uses for the funds through its Assistant Chief of Staff for Installation Management. In January 2012, USD(C)/CFO provided a detailed list of projects in Germany that the Army intended to fund using its \$4.9 million of unobligated DOMFIRA funds.

USD(C)/CFO and DFAS personnel conducted research on the unused \$1.5 million Navy DOMFIRA balance. The USD(C)/CFO funds distribution manager stated that the last distribution of DOMFIRA funds to the Navy occurred in 2002, and transaction data on DOMFIRA disbursements showed that the Navy has not disbursed funds since 2006. As a result of this audit, DFAS found that \$323,794 of the \$330,716 Navy unobligated balance was erroneous and resulted from a journal voucher that DFAS personnel improperly processed in February 2008. DFAS reversed the voucher in December 2011, leaving an unobligated Navy balance of \$6,922. Initial research DFAS performed on the nearly \$1.2 million obligated unpaid balance indicated that a portion of it could also be erroneous. The research was ongoing at the time of this report.

The USD(C)/CFO funds distribution manager was unable to provide details on the \$1.1 million unused DoD DOMFIRA funds and agreed to conduct research to determine to whom the funds belonged and whether or not a valid requirement still existed for them. USD(C)/CFO requested assistance from DFAS, and the research was ongoing at the time of this report.

## **Accounting for Unused Nonmonetary PIK Proceeds in Germany**

IMCOM-E and USAFE personnel did not adequately account for unused PIK proceeds that Germany held. Specifically, IMCOM-E and USAFE based their tracking of PIK funding due from Germany on a total entitlement which was \$0.4 million more than the amount Germany actually agreed to provide.

For PIK proceeds associated with settlements of returned Army and Air Force facilities in Germany, each Service maintains its own tracking method for the funds. IMCOM-E maintains the Army PIK tracking method and USAFE maintains the Air Force PIK tracking method. These tracking methods consist of manual ledgers and spreadsheets, not formal information systems. In Germany, all U.S. facility construction is jointly managed by a U.S. military contracting office and a German contracting office. These two offices jointly solicit and award a contract and in the case of a project funded through PIK, the German government pays the invoices from German bank accounts once both contracting offices approve them.

In 1995, the United States and Germany entered into the first residual value settlement using PIK. The United States and Germany have since entered into a total of 18 agreements entitling the United States to PIK compensation totaling \$393.8 million.<sup>9</sup> In 2008, Germany advanced the U.S. Army an additional \$59.9 million in PIK funding to be offset against future residual value settlements.<sup>10</sup> In total, Germany has agreed to provide up to \$453.6 million<sup>11</sup> in PIK funding, and in June 2011, USAFE and IMCOM-E reported total remaining PIK proceeds of \$11.4 million.

The PIK overstatement occurred for two reasons. IMCOM-E and USAFE PIK tracking methods differed on how the proceeds of joint settlements were divided between them. Between 1995 and 2000, IMCOM-E and USAFE entered into joint settlements with Germany for sites that DoD returned between FY 1991 and FY 1996. IMCOM-E and USAFE then divided the settlement proceeds, and each tracked its own portion of the funds.<sup>12</sup> However, IMCOM-E and USAFE did not divide the proceeds accurately, resulting in the double-counting and overstatement of approximately \$0.5 million in PIK proceeds.

Additionally, IMCOM-E repeatedly rounded the amounts, resulting in a net understatement of PIK funding by about \$0.1 million. The IMCOM-E PIK tracking method lists what IMCOM-E believes the Army is entitled to from each settlement, rounded to either the nearest 10,000 or 100,000 euros. The tracking method then adds the settlement amounts together and then further rounds this total down to the nearest 100,000 euros. These two levels of rounding resulted in errors of approximately \$0.5 million. We netted out the instances where the rounding created understatements and overstatements of the Army's PIK entitlements, and the rounding issues resulted in a \$0.1 million understatement of PIK funding the Army is due from Germany. Overall, the \$0.5 million overstatement combined with the \$0.1 million understatement resulted in a net \$0.4 million overstatement of PIK proceeds.

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<sup>9</sup> This excludes the \$447.5 million Germany provided for specific projects related to the relocation of facilities from Rhein-Main Air Base to Ramstein and Spangdahlem Air Bases.

<sup>10</sup> See the Other Matters of Interest section at the end of this Finding section for details on this PIK advance.

<sup>11</sup> Difference between total PIK funding value (\$453.6 million) and the sum of the PIK settlement (\$393.8 million) and PIK advance (\$59.9 million) values occurs due to rounding.

<sup>12</sup> Although IMCOM-E currently maintains the tracking system, when some of the settlements were signed and divided, USAREUR was managing the PIK for the Army.

## **DoD Should Be Using Dormant DOMFIRA Funds**

USD(C)/CFO and the Military Departments should use the dormant DOMFIRA funds for facility maintenance, repair, and environmental remediation at DoD military installations. In January 2011, USD(C)/CFO provided a detailed list of projects in Germany that the Army intended to fund using its remaining \$4.9 million of DOMFIRA funds. In addition, \$2.3 million of unused Navy and DoD funds were under review and could be potentially returned and used.

## **Conclusion**

DOMFIRA activity has slowed down significantly over the past decade, and few, if any, deposits into the account are expected in the future. Of the \$150.9 million in monetary payments, \$143.7 million (95.2 percent) occurred before 1999, and a significant decrease in monetary payments resulted from a shift from monetary to nonmonetary PIK compensation that occurred between 1995 and 1997. Nonmonetary PIK compensation has since become standard practice with some host nations, such that all residual value settlement agreements completed after 1997 with either Germany or the U.K. were settled for nonmonetary PIK.

In addition, the inadequate accounting for monetary residual value proceeds we identified in this audit primarily involved unused Army and Navy DOMFIRA funds that USD(C)/CFO distributed to them in 2002. A lack of documentation made it difficult to determine the specific organizations and individuals who did not monitor and review the funds in accordance with DoD policy.

In support of this audit, USD(C)/CFO initiated actions to review the remaining DOMFIRA balances. Considering all of these circumstances, we are not recommending any additional controls over the DOMFIRA funds.

## **Management Has Initiated Corrective Actions to Resolve Unused DOMFIRA and PIK Balances**

As a result of this audit, USD(C)/CFO initiated corrective actions to review the unused DOMFIRA balances. In addition, DFAS corrected a portion of the erroneous unused Navy balances and was conducting additional research on the remaining Navy balances. Also as a result of this audit, IMCOM-E and USAFE real estate personnel met in October 2011 to resolve the overstatement of PIK funding due from Germany. IMCOM-E tentatively reduced its PIK balance in its tracking method by \$0.4 million, pending ongoing reconciliation efforts with the German government. This will resolve the double-counting of joint settlements and rounding issues.

We do not expect overstatements to recur because IMCOM-E and USAFE were no longer settling residual value claims jointly. As a result, we are not recommending any further action on these issues.

## **Other Matters of Interest: 2008 Germany PIK Advance**

IMCOM-E requested a PIK advance from the German government based on anticipated residual value compensation for future installation returns within Germany. In August 2008, German officials agreed to make approximately \$59.9 million available to IMCOM-E as advanced PIK, to be offset by future facilities that IMCOM-E returns to Germany. At the time of the audit, IMCOM-E had spent all but \$7.2 million of the advanced PIK and had not concluded a settlement with Germany since receiving the advance.

Public Law 101-510, as amended, does not specifically require DoD personnel to notify either Congress or OMB of any advanced PIK amount associated with anticipated residual value compensation from future facility returns. DoD personnel are only required to notify Congress before entering into residual value negotiations involving the U.S. acceptance of PIK and also before concluding a settlement agreement for the U.S. acceptance of PIK. In addition, DoD personnel are only required to notify OMB before concluding a settlement agreement with U.S. capital investments at the returned facility in excess of \$10 million. Accordingly, DoD personnel did not make any notifications upon receiving the advanced PIK. DUSD(I&E) and USEUCOM personnel explained that because the advanced PIK was not associated with a negotiated settlement agreement, they were not required to notify Congress or OMB.

In its final DoD Annual Residual Value Report to Congress in 2006, DoD reported that Germany was no longer advancing PIK because the facility returns had slowed down significantly. However, Germany subsequently advanced \$59.9 million of PIK in 2008.

We are discussing the 2008 PIK advance in this audit report as an “other matter of interest” because DoD no longer provides Annual Residual Value Reports to Congress. Congress may expect DoD to use anticipated PIK compensation obtained from future facility closures to fund military construction or facility improvement projects at the time of, or after, the settlements. However, Germany has already provided compensation through advanced PIK, and IMCOM-E has already used a majority of the PIK compensation on existing military construction or facility improvement projects. Before it will receive additional PIK compensation from Germany, DoD has to liquidate the \$59.9 million PIK advance through future facility closures.

## **Recommendation, Management Comments, and Our Response**

**A. We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, provide DoD IG with the results of the review of unused monetary proceeds remaining in the DoD Overseas Military Facilities Investment Recovery Account.**

### ***USD(C)/CFO Comments***

The Deputy Comptroller, responding for the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, agreed with the recommendation and agreed

to provide DoD IG with the results of the review of unused monetary proceeds remaining in the DoD Overseas Military Facilities Investment Recovery Account within 90 days of the date of this report. The Deputy Comptroller also stated that his office established an execution plan to obligate \$6 million of the remaining \$6.8 million unobligated balance by September 30, 2012. In addition, he stated that his office plans to revise the DoD FMR by June 30, 2012, to address oversight of unobligated balances.

### ***Our Response***

The comments from the Deputy Comptroller were responsive, and the planned actions met the intent of the recommendations.

## **Finding B. Residual Value Settlements Lacked Transparency**

IMCOM-E and USAFE personnel did not sufficiently document residual value settlements for seven installation<sup>13</sup> closures. Specifically, personnel did not always perform and document the following analyses to support the negotiated settlement amounts:

- evaluation of host nation residual value claims, including the use of independent assessments of the fair market value of the installation;
- review of the calculation methodology used to determine the values for the land and capital improvements; and
- assessment of the reasonableness of the offsetting environmental remediation costs.

This occurred because DoD and USEUCOM policy did not require specific documentation and analyses that negotiators would need to complete and maintain to improve and provide support for residual value negotiations. As a result, IMCOM-E and USAFE personnel were unable to show that negotiations for the seven installation closures, resulting in \$19.4 million in nonmonetary compensation, represented an adequate return on DoD's investment in those facilities.

Although DoD has finalized the completed settlements and thus cannot change them, improvements to the residual value settlement process could benefit future negotiations. By having more detailed and accurate information, DoD negotiators would be in a stronger bargaining position when they enter into future residual value negotiations. Specifically, there are 138 sites, with a U.S. investment totaling at least \$1.8 billion, that DoD has either closed or anticipates closing by 2015 that will require residual value settlements.

### **Residual Value Settlements Reviewed**

We reviewed the negotiated residual value amounts for seven installation closures that resulted in nonmonetary compensation totaling \$19.4 million. The U.S. capital investment in these installations totaled \$249 million. As part of the residual value process, the host nation sells or finds a use for the installations. Negotiations result in a settlement amount that is affected by the allocation of the value of land, capital improvements, and environmental costs. The seven installation closures included six in Germany and one in the U.K. IMCOM-E was responsible for three closures and USAFE was responsible for four closures. See Table 3 for details on the seven facility closures.

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<sup>13</sup> An installation is a grouping of facilities, located in the same vicinity, that support particular DoD functions.

**Table 3. Details on the Seven Installation Closures Reviewed**

| <b>Installation</b>   | <b>Responsible DoD Component</b> | <b>Location</b> | <b>Capital Investment* (millions)</b> | <b>Residual Value (millions)</b> |
|---|----------------------------------|-----------------|---------------------------------------|----------------------------------|
| Bad Kreuznach Family Housing                                      | IMCOM-E                          | Germany         | \$26.41                               | \$3.46                           |
| Bitburg and Sembach Air Bases                                     | USAFE                            | Germany         | 138.50                                | 3.10                             |
| Frankfurt Contingency Hospital                                    | USAFE                            | Germany         | 50.78                                 | 5.57                             |
| Jever Air Base and Gut Husum Ammunition Storage                   | USAFE                            | Germany         | 2.75                                  | 2.00                             |
| Kreuznach Hospital  | IMCOM-E                          | Germany         | 11.53                                 | 0.04                             |
| Royal Air Force Chelveston and Molesworth-Brington Family Housing | USAFE                            | United Kingdom  | 5.33                                  | 4.59                             |
| Rose Barracks   | IMCOM-E                          | Germany         | 13.65                                 | 0.65                             |
| <b>Total</b>  |                                  |                 | <b>\$248.95</b>                       | <b>\$19.41</b>                   |

\* This is the original cost of the investments and does not include adjustments for inflation or depreciation.

## **Insufficient Documentation Exists to Assess the Adequacy of Residual Value Settlements**

IMCOM-E and USAFE personnel did not sufficiently document seven residual value settlements. IMCOM-E and USAFE personnel did not always perform and document analyses associated with the evaluation of host nation residual value claims. This included the use of independent appraisals, the review of calculation methodologies, and the assessment of offsetting environmental remediation costs.

### ***Evaluation of Host Nation Residual Value Claims, Including the Use of Independent Appraisals***

IMCOM-E and USAFE personnel did not always obtain documentation to support a host nation's claims in residual value negotiations. Specifically, IMCOM-E and USAFE personnel did not conduct or obtain independent appraisals or document the reasons why they did not perform appraisals to support the adequacy of the host nation's sales price. In addition, IMCOM-E and USAFE personnel did not consistently obtain contracts for the sale of installations, which should be available whenever a host nation sells a property.

An independent appraisal is an analysis of specific market data using industry-accepted methods to determine the most probable value a property should realize in a competitive and open market. IMCOM-E personnel acknowledged that their staff appraiser position was vacant and USAFE personnel stated that they did not have a staff appraiser. The



lack of independent appraisals makes it difficult for IMCOM-E and USAFE personnel to show that the settlement amounts represented an adequate return on DoD's investment in the returned installations. Obtaining this documentation would increase the transparency of the settlement process.

For example, the three IMCOM-E settlements were based on a bulk sale. An IMCOM-E negotiator's written summary showed that Germany sold the Bad Kreuznach installations for \$16 million. German officials originally offered \$1.8 million as compensation. The negotiator's summary explained that "intensive detailed negotiations" eventually increased the offer to \$4.4 million, which the United States accepted. There was no supporting documentation or description to justify either of the two offers; no appraisals of the buildings or the land value, no calculation supporting the value associated with Army-funded improvements, or even any details on the extent of the negotiations. So, although IMCOM-E personnel negotiated more compensation than originally offered, there was no justification to explain the final settlement and whether the amount was reasonable.

An independent appraisal may not always be necessary or cost-effective. Specifically, if the United States determines that installations do not have an economic or military reuse because their location or physical condition is not desirable on the open market, then an appraisal may not be necessary. For example, a site visit to the Kaiserslautern family housing in Germany supported USAFE's assessment that the installation did not have any economic or military reuse. The German government sold the Kaiserslautern family housing to a private investor, who subsequently had it demolished. In this instance, USAFE would not be entitled to any residual value compensation, and an independent appraisal would not have benefited the negotiations.

### ***Review of the Calculation Methodology Used to Determine the Value of the Land and Capital Improvements***

IMCOM-E and USAFE personnel did not always review the calculation methodology used to determine the value of the land and capital improvements based upon calculations agreed upon with the German government. Specifically, IMCOM-E and USAFE personnel did not document the calculation methodology determinations of the U.S.-funded facility improvement costs and offsetting land value and the German government and North Atlantic Treaty Organization improvement costs.

For example, USAFE personnel did not document the calculation methodology used to determine the percentage value of various U.S. improvements to German-funded hospital buildings when calculating the initial \$7.6 million residual value claim for the Frankfurt Contingency Hospital. Specifically, USAFE personnel only prepared a spreadsheet that listed the various improvements to the hospital buildings and the applied percentage value of the improvements without any support for the determination of the applied percentage values, which were less than the agreed-upon percentage amounts between the

United States and Germany.<sup>14</sup> USAFE personnel ultimately accepted a settlement totaling \$5.6 million. However, USAFE personnel did not sufficiently document the settlement by obtaining details supporting the applied percentage value of the improvements.

### ***Assessment of the Reasonableness of Offsetting Environmental Remediation Costs***

USAFE personnel did not always sufficiently document environmental remediation costs claimed by Germany. This includes verification of contracts or invoices for the remediation of environmental damages<sup>15</sup> if the German government completed remediation before the residual value settlement. For the one USAFE settlement with environmental remediation costs, USAFE personnel trusted the information the German government provided, without verifying the amounts to supporting contracts or invoices.

For example, USAFE personnel did not support \$1.9 million in environmental costs claimed by the German government to offset the residual value compensation for the Bitburg and Sembach Air Base closures. Specifically, of the \$1.9 million, USAFE personnel provided a handwritten ledger for \$1.6 million in environment costs, written in German, as support for the actual costs incurred. However, USAFE personnel did not provide sufficient evidence to support whether the German government actually incurred the \$1.6 million in environmental costs that it claimed.

### **Reasons for Inadequate Residual Value Settlement Information**

DoD and USEUCOM policy did not specify the required steps personnel should follow, the documentation they should prepare, and the time period for retaining the

*DoD and USEUCOM policy did not specify the required steps personnel should follow, the documentation they should prepare, and the time period for retaining the documentation.*

documentation. The lack of DoD and USEUCOM requirements leaves the level of analysis and documentation performed up to the discretion of the personnel managing the residual value settlement process. USEUCOM and IMCOM-E real estate personnel stated they became increasingly comfortable over time with the residual value negotiation process as relationships

developed with their host nation counterparts. As a result, they devoted less effort to justifying and documenting the final settlement amounts.

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<sup>14</sup> See Appendix B for additional details on the calculation methodology used to determine the values for the land and capital improvements.

<sup>15</sup> Per the North Atlantic Treaty Organization Status of Forces German Supplementary Agreement, the German government can offset any residual value amount made to U.S. forces with claims for environmental remediation costs.

## ***Current DoD Policy Lacks Specific Requirements***

DUSD(I&E) and USEUCOM personnel established policy for the residual value negotiation and settlement process through DoD Instruction 4165.69, “Realignment of DoD Sites Overseas,” April 6, 2005, and USEUCOM Instruction 4101.02, “Plans and Policy–Negotiation for the Recovery of Residual Value of U.S. Excess Facilities Located in Foreign Countries,” May 12, 2008. Specifically, the policies provide guidance for the return of U.S. facilities to host nation governments and also the negotiation for the recovery of residual value compensation. However, the policies do not explicitly specify the documentation that IMCOM-E and USAFE personnel should prepare and retain.

Although DoD Instruction 4165.69 and USEUCOM Instruction 4101.02 do address some residual value negotiation and reporting requirements, they do not detail the specific steps personnel should complete when negotiating a settlement. In addition, the policies do not address the actual forms and documentation personnel need to prepare when entering into negotiations, concluding settlements, and reporting residual value actions. Specifying the steps and documentation would provide consistency among DoD components and continuity during staff turnover.

These policies also do not address any retention period for maintaining the supporting documentation. Although policy

*DoD and USEUCOM policies need to address the residual value process in greater detail by specifying the documentation personnel should retain and for how long.*

requirements exist for real estate and contract documentation, DoD and USEUCOM policies need to address the residual value process in greater detail by specifying the types of documentation personnel should retain and for how long.

## ***Personnel Need to Devote More Effort to Documenting Settlements***

USEUCOM, IMCOM-E, and USAFE personnel stated they developed a trusting relationship with their host nation counterparts. In addition, IMCOM-E personnel stated they became increasingly comfortable with the settlement process. As a result, they devoted less effort to documenting and justifying the settlements. Documentation on residual value settlements completed in the early 1990s was more extensive than the documentation associated with more recent settlements.

Additionally, IMCOM-E personnel acknowledged that the negotiation process lasted such a long time that they were not always documenting events thoroughly. USAFE personnel also stated that they did not verify, but trusted the word of their host nation counterparts. IMCOM-E and USAFE personnel need to perform sufficient reviews to ensure residual value negotiations are adequately documented, sufficient audit trails exist, and appraisals are accurate.

## Impact of the Lack of Transparency on Residual Value Settlements

IMCOM-E and USAFE personnel were unable to show that residual value negotiations for the seven installation closures were sufficient and the \$19.4 million obtained in

*IMCOM-E and USAFE personnel were unable to show that residual value negotiations for the seven installation closures were sufficient and the \$19.4 million obtained in nonmonetary compensation represented an adequate return on DoD's investment in those facilities.*

nonmonetary compensation represented an adequate return on DoD's investment in those facilities. Although DoD has finalized the completed residual value settlements, and thus cannot change them, future settlements could benefit from improvements to the current processes. Specifically, the 138 sites with a U.S. investment totaling at least \$1.8 billion, which DoD has closed since 2004 or

anticipates closing by 2015, will require residual value settlements.

DoD needs to improve its policy on the residual value process because key DoD civilian real estate positions in foreign areas will eventually turn over, and replacement personnel will not have sufficient experience or guidance to properly negotiate and document residual value settlements. USEUCOM, IMCOM-E, and USAFE personnel stated that the turnover of DoD civilian real estate positions in foreign areas could occur sooner than expected because of a proposed change to the current DoD policy that limits DoD civilian positions in foreign areas to a 5-year tour, with the possibility of a single, 2-year extension. The current policy had allowed for exemptions for positions that require frequent contact with officials of the host nation and also detailed knowledge of the culture, morals, laws, customs, and government processes of the host nation. However, USEUCOM personnel indicated the final version of the draft policy will remove this exemption. Turnover of these key personnel, along with the current lack of detailed policy, may result in their replacements not being able to effectively handle future residual value settlements.

Additionally, by having more detailed and accurate information, DoD negotiators will be in a stronger bargaining position when they enter into residual value negotiations. Having analyses such as independent assessments of the fair market value of the returned installations helps negotiators ensure that proposed settlement amounts are adequate. By having specific policy detailing the steps personnel need to complete and the documentation they need to prepare and retain, DoD can help mitigate the knowledge drain resulting from the IMCOM-E and USAFE personnel turnover, strengthen DoD's position in future negotiations, and ensure that personnel sufficiently negotiate and document future settlements.

## USEUCOM Comments on the Finding and Our Response

### USEUCOM Comments

The USEUCOM Chief of Staff, responding for the Commander, USEUCOM, commented on the finding that DoD organizations did not always perform and document

analyses to support the \$19.4 million settlement amounts for seven installation closures. He stated that the negotiators' reports for each settlement provide the analyses documenting how they arrived at the settlement amounts. The Chief of Staff provided the negotiators' reports with his comments.

## ***Our Response***

We acknowledge that USAFE and IMCOM-E negotiators prepared reports for the seven settlements. However, we disagree that their reports provide sufficient analyses documenting how they arrived at the settlement amounts. As for the reports the Chief of Staff provided with his comments, we had previously obtained and reviewed all of them during the audit and considered them in preparing our draft report.

For example, on page 15 of this report, we specifically cite the lack of sufficiency associated with the negotiators' summary report on the settlement for the Bad Kreuznach installations. In this instance, the report lacked:

- supporting documentation or descriptions to justify either of the two offers;
- appraisals of the buildings or the land value;
- calculations supporting the value associated with Army-funded improvements; and
- details on the extent of the negotiations.

So, although IMCOM-E personnel negotiated more compensation than the host nation originally offered, there was no justification to explain the final settlement and whether the amount was reasonable.

As part of his comments, the Chief of Staff provided the same negotiators' report that IMCOM-E provided during the audit, but he did not include any additional supporting documentation. We had similar concerns with the six additional negotiators' reports that we previously reviewed and that the Chief of Staff provided to us again without any additional supporting documentation.

The negotiators' reports are a good starting point for negotiators to document the residual value settlement process and the agreed-upon settlement amounts. However, they need to include additional supporting information to allow for an independent party that was not present at the negotiations to determine the adequacy of the settlement amounts.

As discussed below, the Assistant DUSD(I&E) and the USEUCOM Chief of Staff agreed to update their respective policies to require that future residual value settlement negotiations analyze and document how the negotiators determined the residual value settlement amount. These analyses and documentation, if properly prepared and retained, will supplement the negotiators' reports and provide more sufficient support for residual value settlement amounts.

## **Recommendation, Management Comments, and Our Response**

**B. We recommend that the Deputy Under Secretary of Defense for Installations and Environment and the Commander, U.S. European Command, revise DoD Instruction 4165.69 and U.S. European Command Instruction 4101.02, respectively, to require that future residual value settlement negotiations analyze and document how the residual value settlement amount was determined, to include at a minimum:**

- **results of an independent appraisal of the facility's value or the reasons why it was deemed not worth performing one;**
- **analysis of any agreed-upon calculation methodology used to determine the values for the land and capital improvements;**
- **evaluation of any environmental remediation being claimed for reasonableness, if there is an offsetting effect on the residual value received; and**
- **description of specific documents that should be maintained supporting residual value settlements and how long these documents should be maintained.**

### ***DUSD(I&E) Comments***

The Assistant Deputy Under Secretary of Defense for Installations and Environment, responding for the Deputy Under Secretary of Defense for Installations and Environment, agreed with the recommendation and stated that his office would issue guidance directing implementation of the additional requirements this year and would incorporate the guidance into DoD Instruction 4165.69, "Realignment of DoD Sites Overseas."

### ***USEUCOM Comments***

The USEUCOM Chief of Staff, responding for the Commander, USEUCOM, neither agreed nor disagreed with the recommendation. He stated that USEUCOM planned to revise USEUCOM Instruction 4101.02 in summer 2012 to include details on how negotiators determine the residual value settlement amounts, including the four items stated in Recommendation B.

In addition, he provided specific comments on the preparation of a formal appraisal report on properties the United States turns over to host nations. He stated that appraisals would only be practical if sufficient funding existed to complete the appraisal and if the terms of the pertinent Status of Forces Agreement or agreements allowed for their use during negotiations. Further, he stated that U.S. appraisals would be appropriate when the German government retained a property for its own reuse.

The Chief of Staff stated that ongoing operational requirements took priority over appraisal work and that he expected the staff available to perform appraisal work in the future would be scarce. He further stated that since the “net proceeds of sale, if any” clause, in the NATO German Status of Forces Agreement, Supplementary Agreement Protocol of Signature, Article 52, was the basis for residual value agreements in Germany, obtaining an additional U.S. appraisal was often an unnecessary step that would have no impact on the residual value negotiation.

### ***Our Response***

The comments from the Assistant DUSD(I&E) and USEUCOM Chief of Staff were responsive, and the planned actions met the intent of the recommendations.



## **Finding C. Lessons Can Be Learned From the Turnover of U.S. Navy Housing Facilities to the United Kingdom in 2007**

The U.S. Navy turned over 63 newly renovated family housing units at West Ruislip to the U.K. Ministry of Defence (U.K. MOD) in September 2007 and has yet to receive any residual value compensation. Many lessons can be learned from the following factors that contributed to this situation.

- The Navy purchased housing units in 1994 but was unable to reach an agreement then with the U.K. on how residual value would be handled upon return of the property.
- USAFE signed an arrangement with the U.K. in 2006, specifying how residual value would be handled for returned U.S. housing facilities. However, USAFE did not coordinate the agreement with USEUCOM or the Navy to protect the Navy's investment.
- The Navy requested assistance from USEUCOM and also made numerous unsuccessful attempts to negotiate residual value, but the U.K. cited its arrangement with USAFE, which did not require any residual value compensation until U.K. sold the housing units on the open market.
- The Navy eventually gave up pursuing residual value and issued a memorandum to USAFE in September 2009 to transfer followup responsibility. However, USAFE did not accept responsibility, and neither USAFE nor the Navy followed up on the issue until we brought it to their attention during this audit.

At the time of this audit, U.K. MOD personnel occupied the West Ruislip housing units, and DoD could only receive residual value based on a percentage of the sales price when and if the U.K. MOD sold them. The residual value could be up to 50 percent of the sales price, but could also be nothing if the site was demolished for redevelopment. Therefore, the Navy may never recover a fair and equitable share of the \$20.3 million<sup>16</sup> it invested to purchase and renovate the 63 housing units.

### **Purchase, Renovation, and Turnover of West Ruislip Housing Units**

#### ***Purchase of West Ruislip Housing***

In the early 1980s, U.K. MOD leased approximately eight acres at West Ruislip for a nominal amount to a financial trust for a term of 125 years for Navy family housing. Per

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<sup>16</sup> The \$20.3 million equals the \$11.4 million purchase of housing units in 1994 and the \$8.9 million renovation costs completed in 2005.

that agreement, the trust funded construction of 81 housing units on the property and subleased the land and housing to the Navy for a term of 10 years, with 15 additional 1-year options. The trust also granted a purchase option for the 125-year lease. In 1993, the Navy studied the cost of exercising 1-year lease options through 2009 versus the cost of purchasing the housing and the lease through 2110. It determined that purchasing the housing and the lease was the more cost-effective alternative for obtaining housing for Navy personnel in the London area. West Ruislip is 10 miles northwest of London and benefits from excellent transportation links and is within walking distance of the West Ruislip railway station.

During negotiations for the purchase of the West Ruislip housing in 1994, the U.K. MOD Secretariat, Air Staff, and a Navy real estate contracting officer drafted a “side agreement” that addressed how the Navy would recover residual value in the event that it returned the housing to the U.K. MOD. The proposed side agreement stipulated that upon return, the U.K. MOD would sell the property and the United States would be entitled to 100 percent of sale proceeds attributable to the value of housing, minus the value of the land and any costs of the sale. For unknown reasons, the parties did not finalize the proposed side agreement.

The proposed agreement occurred 17 years before this audit, and the responsible Navy real estate contracting officer has since retired. Current Navy real estate officials did not participate in the 1994 negotiation and could not explain why the Navy and U.K. MOD never executed the proposed agreement. In June 1994, on the Navy’s behalf and expense, the U.K. MOD purchased the housing and the lease for \$11.4 million, and the Navy also paid all associated legal costs.

### ***Renovations and Turnover of West Ruislip Housing***

The Navy completely renovated all of the West Ruislip housing units before turning them over in September 2007. In October 2000, the Navy requested \$8.7 million from the FY 2003 Military Construction budget to perform whole-house renovations. The project identified improvements, repairs, and site work for the officer and enlisted homes built in the early 1980s that had not received any major repairs or improvements since construction. Without the renovations, the housing would become unsuitable for occupancy within 4 to 6 years. Specifically, windows and doors were in poor condition, electrical systems needed to be updated, and flooring and wood trim were heavily painted and needed replacement. Navy real estate officials stated that completion of the final renovations occurred in October 2005, at a total cost of approximately \$8.9 million,<sup>17</sup> and resulted in 63 two-story townhomes because some smaller units were combined. Navy real estate officials also stated that U.S. personnel never occupied many of the renovated units.

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<sup>17</sup> Navy personnel provided summary-level cost data, but were unable to locate the actual contract files for the renovations.

Navy real estate personnel visited the housing units and took pictures in March 2007. As Figure 1 indicates, the housing was in excellent, like-new condition upon return. On March 30, 2007, the Assistant Secretary of Defense for Public Affairs announced that the United States would cease operations at West Ruislip<sup>18</sup> and in September 2007, the Navy turned over the housing units to the U.K. MOD.

**Figure 1. Renovated Housing Units at West Ruislip, March 2007**



## **2006 USAFE–U.K. MOD Arrangement Lacked Coordination With DoD**

USAFE personnel stated that agreements established before 2006 between the United States and the U.K. provided for residual value for family housing returned to the U.K. In 2006, USAFE formalized an arrangement titled, “Memorandum of Arrangement Concerning the Settlement of Residual Value Claims for US-Funded Housing and former US-occupied MOD Family Quarters Returned to MOD and Sold after 31 December 1999.” The arrangement covers all U.S.-funded housing and all former U.S.-occupied MOD family quarters that have been improved with U.S. investments. The arrangement

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<sup>18</sup> Navy documentation shows that the closure decision was initially considered in June 2005, which was around the time that the renovations were nearing completion.

more precisely details the determination of residual value payments, including the following:

- 50 percent of the net proceeds of sales for U.S.-funded housing built on the U.K. MOD's land;
- 10 percent of the net proceeds of sales of sites sold to demolish U.S.-funded housing for redevelopment with use of existing utility services;
- 18.75 percent of proven U.S. expenditures on improvements to MOD housing made within 10 years of sale; and
- no payment for U.S.-funded housing or improvements to MOD housing demolished to allow redevelopment of the site.

The arrangement also provides, "The U.K. will, if possible, arrange for the sale of properties eligible for residual value payments when they become surplus to requirements and are made available for disposal, in accordance with current Her Majesty Treasury guidelines."

The arrangement was signed by the U.S. Air Force Director of Installations and Mission Support and a U.K. MOD official and became effective November 2, 2006.<sup>19</sup> USAFE officials stated that they did not formally coordinate the arrangement with Navy officials in accordance with USEUCOM policy. In addition, a USEUCOM official stated that USEUCOM had no contact with USAFE or U.K. MOD officials in negotiations that led to the arrangement.

At the time the arrangement was signed, Navy and USAFE both had residual value responsibilities in the U.K. USEUCOM Directive 62-3, "Real Estate and Utilities: Real Estate Operations," April 2004, specified that USEUCOM would assign one component as the real estate Lead Service with overall responsibility for real estate operations in a specific geographic area for all DoD components and agencies. The Lead Service was responsible for coordinating with other Service components and establishing real estate working arrangements.

The directive designated Navy Europe as the Lead Service for Navy activities within the London area, which included the West Ruislip housing. The directive designated USAFE as the Lead Service for the U.K., excluding Navy activities in the London area. USEUCOM Instruction 4101.01<sup>20</sup> replaced USEUCOM Directive 62-3 in 2008 and designated USAFE as the Lead Service for all the U.K.

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<sup>19</sup> The Air Force Director of Installations and Mission Support who signed the arrangement on behalf of the United States retired in January 2008.

<sup>20</sup> USEUCOM Instruction 4101.01, "Real Estate and Utilities: Real Estate Operations," November 2008.

Whether the U.K. MOD would have accepted additional terms that would have protected the Navy's investment is not certain. Also, the fact that the arrangement was signed nearly 5 years before this audit made it difficult to determine all the factors that led to its outcome. However, the agreed-upon terms in the arrangement were not favorable to the Navy's investments in West Ruislip and differed from the terms that the Navy proposed in its 1994 draft side agreement. Most significantly, the 2006 arrangement only requires that the U.K. MOD sell the property when it becomes surplus to their needs, whereas the unexecuted Navy draft side agreement required sale at turnover. USEUCOM needs to ensure that future residual value agreements with European host nations are formally coordinated with all U.S. Military Departments that have facilities in the host nation.

## **Navy's Unsuccessful Attempts to Negotiate Residual Value**

Navy real estate personnel began the residual value negotiation process with the U.K. MOD in March 2007 and continued until September 2009. In June 2007, the Navy issued a memorandum to USEUCOM requesting assistance in pursuing residual value for its investments in the West Ruislip family housing it planned to return to the U.K. The Navy memorandum specifically stated that USAFE officials did not coordinate before finalizing the 2006 arrangement with the U.K. MOD. The negotiations included Navy personnel traveling to the U.K. in March 2007 and meeting with U.K. MOD officials and touring the housing facilities. U.K. MOD officials stated throughout the process that because the housing was not planned for sale on the open market, there was no need for immediate negotiations.

The Commander, Navy Region Europe, stated that the 2006 arrangement did not specifically address the U.K. MOD's retaining and using the housing for its own use instead of selling it on the open market and entering into residual value negotiations. U.K. MOD officials disagreed and reiterated that the trigger point for negotiating residual value was the disposal of houses on the open market. Further, they stated that they negotiated the arrangement over a number of years with USAFE officials on behalf of the U.S. Government and they expected that concerns over circumstances before disposal on the open market would have been raised and discussed before its completion.

Both Navy and U.K. MOD personnel performed several assessments to value the West Ruislip site before and after renovations. Defense Estates, the U.K. MOD's housing assistance arm, performed a rent assessment based on comparables for the housing units at West Ruislip in October 2003, before renovations. To obtain a reasonable estimate of the value of the housing after the renovations, Naval Facilities Europe real estate officials performed an additional estimate of the housing and lease value in September 2007. At the Navy's request, the District Valuer, London, performed a final market value analysis in May 2008 of individual properties before and after the Navy's renovations as well as the potential development value of the West Ruislip site.

Table 4 identifies the results of the property value assessments performed for the West Ruislip family housing units between 2003 and 2008.

**Table 4. West Ruislip Property Value Assessments**

| <b>Assessment</b>                                  | <b>Annual Rent of All Units</b> | <b>Value of Property</b>  |
|--|---------------------------------|---|
| October 2003 U.K. MOD (pre-renovations)            | \$1.4 million                   | \$12.4-\$19.8 million*  |
| September 2007 Navy (post-renovations)             | \$2.2 million                   | \$19.3-\$30.9 million   |
| May 2008 London District Valuer (pre-renovations)  | Not evaluated                   | \$48.5 million for land and buildings<br>\$25.5 million for land only** |
| May 2008 London District Valuer (post-renovations) | Not evaluated                   | \$51.9 million for land and buildings<br>\$25.5 million for land only** |

\* This assessment did not include a value for the land. The methodology from the September 2007 assessment to use rental amounts to value a property was copied to determine this value.

\*\* Assessment includes value of land sold for redevelopment purposes. Existing housing would be demolished and removed.

In 2009, after more than 2 years of discussions, U.K. MOD officials continued to state that they would not enter into residual value negotiations until they sold the housing units on the open market. As a last-ditch effort in January 2009, Navy real estate personnel attempted to obtain a token amount of rent of \$475 per month per unit to be credited toward the final settlement value once U.K. MOD sold the units. The token rent only represented 23 percent of the market rental value of the housing as assessed in 2007. Naval Facilities Engineering Command officials recognized that the U.K. MOD would obtain value because it was planning to house its own military personnel indefinitely in the houses. Again, the U.K. MOD response in March 2009 stated that the 2006 arrangement specifically stated that residual value would not be negotiated until the U.K. sold the units on the open market. By contrast, U.S. residual value agreements with Germany entitle the United States to residual value based on German reuse of the property in cases where the property is not sold.

## **Navy Attempted to Transfer Followup Responsibility to USAFE**

In September 2009, the Navy issued a memorandum to USAFE to transfer responsibility for discussions for West Ruislip housing. Navy officials stated that they did everything they could, but were unable to obtain any consideration, and they suggested that USAFE might be able to move negotiations forward. During a March 2011 meeting for this audit, USAFE and USEUCOM officials stated that they had not conducted followup and did not know the sales status or whether U.K. MOD personnel still occupied the housing units.

When questioned why USAFE had not performed followup on residual value negotiations, USAFE and USEUCOM officials stated that USEUCOM guidance specifies that the discharge of real estate responsibilities from one Service component to another must be mutually agreed to by both parties. USEUCOM officials also stated that USAFE and Navy personnel did not mutually consent to transfer responsibility for residual value

negotiations, and therefore, neither party performed followup. USEUCOM

*USEUCOM officials stated that USAFE and Navy personnel did not mutually consent to transfer responsibility for residual value negotiations, and therefore, neither party performed followup.*

Instruction 4101.01 states that USEUCOM is responsible for making decisions when unresolved matters exist, and USEUCOM never decided who had followup responsibility. USEUCOM needs to officially assign responsibility for following up on the sales status of the West Ruislip housing facilities and for conducting residual value negotiations.

## **Navy May Never Recoup Its \$20.3 Million Investment**

At the time of this audit, U.K. MOD personnel occupied the housing units, and DoD could only receive residual value based on a percentage of the sales price when and if the U.K. MOD sold them. This could be up to 50 percent, but could also be nothing if the site was completely demolished for redevelopment. Therefore, the Navy might never recover a fair and equitable share of the \$20.3 million invested to purchase and renovate the 63 housing units.

Because it continues to use this like-new housing that the Navy turned over in September 2007 for its military personnel, the U.K. MOD has certainly benefited from the Navy's investment. However, the Navy is only entitled to residual value after the property is sold, and the U.K. MOD does not have to sell the property until it determines that the housing units are surplus. Because of these stipulations, when and if the U.K. MOD will sell the property and how much it may have diminished from its like-new condition at turnover are unclear.

When and if the property is sold, the Navy's entitlement to residual value depends on how the sale is structured. The U.K. MOD has repeatedly indicated that it expects the property to be sold eventually for redevelopment, entitling the Navy to nothing. The property assessment in 2008 shows that the property is far more valuable to sell with the housing units reused (\$51.9 million) than it is for redevelopment (\$25.5 million). Either type of sale results in a similar amount for the U.K. MOD, while resulting in significantly different amounts for the Navy. Based on the 2008 property assessment, the Navy could be entitled to up to \$26 million less its share of selling expenses if the houses were sold for reuse, but the Navy could be entitled to nothing if they were sold for complete redevelopment.

Selling the property for demolition and redevelopment is not in line with the U.K. MOD's stated position that it is "trying to approach this whole deal in the interest of both the Navy and the U.K. MOD, striking a reasonable balance of costs and benefits." This certainly does not balance the \$20.3 million in costs the Navy incurred to purchase and renovate the property with the benefits the U.K. MOD receives in housing for its personnel from 2007 until it sells the property. At a minimum, when negotiating residual value, USEUCOM needs to calculate and retain the estimated benefit that the U.K. MOD receives from the free housing at West Ruislip from September 2007 through the sale of the property.



## **Recommendations, Management Comments, and Our Response**

### **C. We recommend that the Commander, U.S. European Command:**

**1. Officially assign responsibility for following up on the sales status of the West Ruislip housing facilities and for conducting residual value negotiations.**

**2. Calculate and retain the estimated benefit that the U.K. Ministry of Defence receives from the free housing at West Ruislip from September 2007 through the sale of the property for use in negotiating residual value.**

**3. Require that future residual value agreements with host nations be formally coordinated with all U.S. Military Departments that have facilities in the host nation that would be affected by the proposed agreement.**

### ***USEUCOM Comments***

The USEUCOM Chief of Staff neither agreed nor disagreed with the recommendations. He stated that USEUCOM issued a task order on March 26, 2012, to USAFE to accomplish Recommendations C.1 through C.3. He further stated that the next revision of USEUCOM Instruction 4101.02, "Residual Value," to be accomplished in summer 2012, would require that future residual value agreements with host nations be formally coordinated with all U.S. Military Departments that have facilities in the host nation that would be affected by the proposed agreement.

### ***Our Response***

The comments from the USEUCOM Chief of Staff were responsive, and the planned actions met the intent of the recommendations. We also reviewed the task order that USEUCOM issued to USAFE on March 26, 2012, and determined that it met the intent of our recommendations.

## **Appendix A. Audit Scope and Methodology**

We conducted this performance audit from March 2011 through February 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

### **Testing Methodology**

#### ***Controls Over Monetary and Nonmonetary Residual Value Settlement Proceeds***

Testing the usage of funds from monetary settlements involved the evaluation of all Military Department expenditures from DOMFIRA within the last 5 years. We obtained transaction records and supporting documentation for those records from DFAS. We evaluated those transactions to ensure that they were properly supported and that the use of the funds was allowable under Public Law 101-510, as amended, and as specified in DoD FMR, volume 2B, chapter 8.

DoD document retention requirements and minimal DOMFIRA disbursement activity in recent years limited our review of expended DOMFIRA funds. Specifically, the DoD FMR, Volume 5, Chapter 21, requires that DoD organizations only maintain vouchers and other supporting documentation for disbursements for 6 years and 3 months. While the Air Force has consistently expended DOMFIRA funds over the past 5 years, the last Army DOMFIRA disbursement occurred in 2008, and the Navy has not made a DOMFIRA disbursement since 2006.

Testing the usage of funds from nonmonetary settlements involved a nonstatistical sample of projects that used PIK funding. We evaluated nine of the 30 Army and Air Force projects, which were in different stages of construction over the last 10 years. We evaluated documentation to ensure that the projects were valid and properly approved and that the documentation of the contracting procedures, such as modifications and invoice approvals, was sufficient.

Testing the controls over unused monetary settlement proceeds involved examining unliquidated obligations and unobligated funds in the DOMFIRA account according to the June 30, 2011, SF-133, "Report on Budget Execution and Budgetary Resources." Testing the controls over unused nonmonetary settlement proceeds involved reconciling IMCOM-E and USAFE tracking methods to settlement agreements.

#### ***Residual Value Settlement Process***

Testing the residual value settlement process involved evaluating a nonstatistical sample of 12 Army and Air Force facility closures at different stages of the residual value settlement process over the last 10 years. This included seven facilities that were both closed and settled and another five facilities that were closed but not yet settled. We

chose these sites from a population of 160 Army and Air Force sites in Europe that closed during the last 10 years.

We focused on facilities that we judged to have a higher chance of reutilization on the open market, such as family housing and hospitals. We focused primarily on installation returns in Germany because the majority of the residual value obtained from installation closures came from Germany and future returns were scheduled for Germany. We also included installation returns in the U.K. because there were significant recent and ongoing settlement agreements. (For more information on the residual value process in Germany and the U.K., see Appendix B.)

We evaluated the documentation from the closure as well as the documentation supporting a residual value settlement if the site had already been settled. Documentation of closures included transfer of the facilities documents, record of an inspection of the facilities, an exchange of information on any environmental conditions and a record of U.S. capital investments, which are all mentioned in DoD Instruction 4165.69. Documentation of settlements included the official signed settlements, negotiation minutes, and memoranda to notify OMB and Congress of the proposed settlements. We evaluated the documentation to determine whether the closure and settlement were properly documented.

### ***Turnover of U.S. Navy Housing Facilities to the United Kingdom in 2007***

Evaluating the return of West Ruislip family housing units in the U.K. involved interviewing personnel involved in the closure and attempted settlement process and reviewing documentation related to the history of the site, the closure and return of the site, and the attempts made to pursue a residual value settlement. The documentation reviewed included documents related to the initial construction and lease, purchase and remodeling, and closure and return of the housing units. We also reviewed documentation related to the drafting of the Navy's 1994 proposed side agreement and USAFE's 2006 memorandum of arrangement with the U.K. along with correspondence of the Navy's attempts to pursue a residual value settlement for the return of the West Ruislip housing units.

### **Currency Conversion**

During the audit, many of the records and transactions involved different currencies. For proper context, this report presents all figures as dollars. We used historic currency conversion rates at the time each event took place, to the degree that this could be determined.

### **Sites Contacted and Visited**

We contacted and visited several DoD organizations with responsibilities related to real estate closure and residual value settlement and international agreements. We also contacted and visited several DFAS centers responsible for maintaining the financial

transaction records. See Tables A-1 and A-2 for the specific organizations we contacted and visited.

**Table A-1. Organizations Visited**

| <b>Location</b>         | <b>Organization or Office</b>                 |
|-------------------------|---|
| Norfolk, Virginia       | Naval Facilities Engineering Command Atlantic |
| Stuttgart, Germany      | USEUCOM                                       |
| Heidelberg, Germany     | USAREUR                                       |
| Heidelberg, Germany     | IMCOM-E                                       |
| Wiesbaden, Germany      | U.S. Army Corps of Engineers Europe District  |
| Kaiserslautern, Germany | USAFE   |
| Columbus, Ohio          | DFAS  |

**Table A-2. Organizations Contacted**

| <b>Location</b>         | <b>Organization or Office</b>     |
|-------------------------|-----------------------------------|
| Arlington, Virginia     | USD(C)/CFO, DoD                   |
| Arlington, Virginia     | DoD Office of the General Counsel |
| Arlington, Virginia     | DUSD(I&E)                         |
| Naples, Italy           | U.S. Naval Forces Europe          |
| Cleveland, Ohio         | DFAS                              |
| Indianapolis, Indiana   | DFAS                              |
| Limestone, Maine        | DFAS                              |
| Rome, New York          | DFAS                              |
| Kaiserslautern, Germany | DFAS                              |

## **Use of Computer-Processed Data**

We relied on computer-processed transaction data from the DFAS Cash History On-Line Operator Search Engine, the Air Force General Accounting and Finance System-Rehost, and the Operational Data Store; a storage system for the Standard Army Finance Information Systems. We used the data to determine a sample of DOMFIRA transactions for our review and to determine the accuracy of the DOMFIRA balances. We determined data reliability by obtaining source documentation to support the system transactions. We determined that the DOMFIRA transaction data were sufficiently reliable to accomplish our audit objectives.

## **Use of Technical Assistance**

We did not use technical assistance in conducting this audit.

## **Prior Coverage of Residual Value Settlements for Facility Closures**

During the last 5 years, the Government Accountability Office (GAO) has issued two reports discussing residual value for facility closures in Europe. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>.

### **GAO**

GAO Report No. 10-745R, “Defense Planning: DoD Needs to Review the Costs and Benefits of Basing Alternatives for Army Forces in Europe,” September 13, 2010

GAO Report No. 08-1005, “Defense Infrastructure: Opportunity to Improve the Timeliness of Future Overseas Planning Reports and Factors Affecting the Master Planning Effort for the Military Buildup on Guam,” September 17, 2008

## **Appendix B. Residual Value Settlement Process**

The process for determining the residual value of a facility returned by the United States to a host nation varies by the specific country. In those instances where the United States is entitled to residual value compensation for its investments, the residual value compensation is typically based on the fair market value of the properties regardless of what was paid to build them.

### **Negotiating Residual Value Settlement Agreements**

IMCOM-E and USAFE personnel are responsible for conducting residual value negotiations based on policy guidance provided by the DUSD(I&E) and USEUCOM personnel. Specifically, in conducting negotiations, IMCOM-E and USAFE personnel should address, at a minimum:

- schedule for departure of personnel and removal of equipment,
- joint inspection of facilities,
- disposition of United States facilities to be retained at the site,
- exchange of information on environmental conditions,
- transfer of facilities,
- calculation of the current value of the facilities, and
- estimated residual value.

### **Concluding Residual Value Settlement Agreements**

At the conclusion of negotiations, IMCOM-E and USAFE personnel should prepare a settlement package that summarizes the agreed-upon residual value and includes, at a minimum:

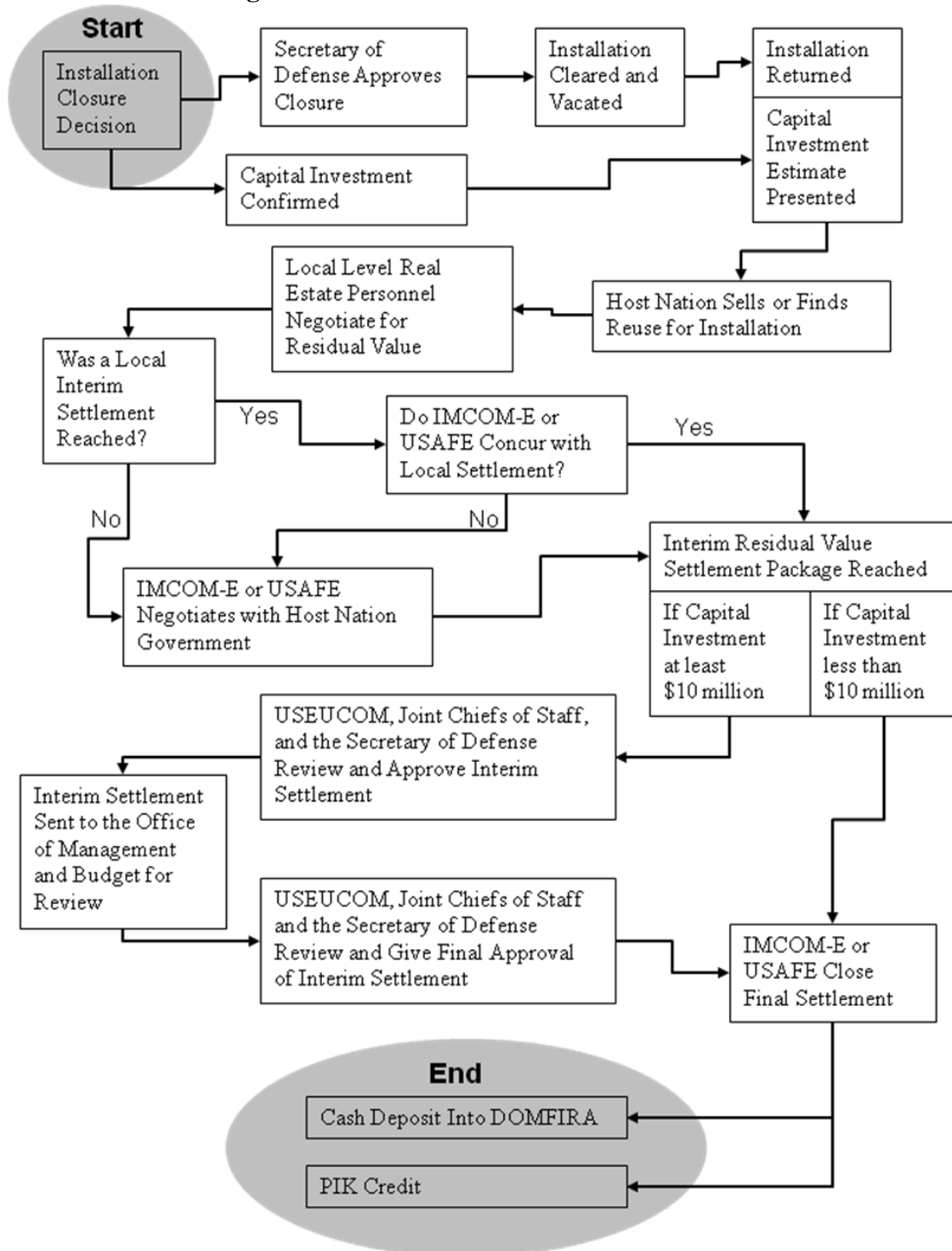
- date negotiations began and concluded;
- present-day value of U.S. investments;
- final negotiated residual value, including any PIK; and
- justification for any difference between the U.S. investment and the negotiated residual value.<sup>1</sup>

In addition, before IMCOM-E and USAFE personnel can conclude a settlement agreement, DUSD(I&E) personnel must notify OMB of the proposed settlement if the U.S. investment in the facility is greater than \$10 million. Details on the overall residual value settlement process are summarized in Figure B.

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<sup>1</sup> IMCOM-E and USAFE personnel provide the residual value settlement package to USEUCOM personnel, who then provide it to DUSD(I&E) personnel.

**Figure B. Residual Value Settlement Process**



## Residual Value Process for Germany

In Germany, the United States is entitled to residual value related to the return of any facility for which an economic or military reuse can be found.<sup>2</sup> The value of the reuse would typically be determined by the sale price of the facility on the open market, but in the case of a reuse by a German government entity, an appraisal of fair market value would be used. The value of the reuse, less any selling expenses, would be the base residual value. Once the base residual value was determined, an allocation would be performed, which would distribute the residual value to each of the buildings and to the land.

On the basis of this allocation, the allocated residual value for each building would be divided into different pools of money based on the parties that made investments in the building. There would be one pool for U.S.-funded investments, another for normal German-funded investments, possibly one for any North Atlantic Treaty Organization-funded investments, and finally, a pool related to a special set of funding called Deutsche Mark Occupation Mandatory Support (DMOMS).<sup>3</sup> By default, the residual value allocated to each building would be included in the pool of whatever source of funding built or constructed the building. However, if another source of funding made any of a certain list of specific improvements to the building, then those pools would receive a percentage of the building's allocated residual value, and the pool of the funding that originally constructed the building would receive the remainder. Examples of these investments include:

- new roof tiles with insulation (7 percent),
- new windows with insulation glass (5 percent),
- upgraded bathrooms (8 percent), and
- upgraded heating supply (7 percent).

Other factors can be taken into account in negotiations as needed, including reductions of the percentages for the building improvements if those improvements do not deserve the full percentage due to age or other factors. Once the residual value for all the facilities in a given settlement are allocated to the funding pools, any environmental remediation costs are reduced by the total of residual value allocated to the DMOMS pool. If there is any remaining environmental remediation cost, it is then offset against the residual value allocated to the U.S.-funded pool.

For example, the Drake School complex was returned to the German government in 1995. The Drake School specifically consisted of two buildings: building 536 was

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<sup>2</sup> Per the North Atlantic Treaty Organization Status of Forces German Supplementary Agreement, article 52.

<sup>3</sup> DMOMS funding was a specific grant of money provided by the German government to the occupying governments in the 1950s. Per the North Atlantic Treaty Organization Status of Forces German Supplementary Agreement, Article 52, the United States is not entitled to residual value for facilities constructed or improved with DMOMS funding, but may use any associated residual value to offset environmental remediation expenses.



completely U.S.-funded, and building 533 was German-funded with U.S.-funded improvements. Both buildings were sold, and after deducting selling costs, \$0.9 million was allocated to building 536, and \$3.5 million was allocated to building 533. As building 536 was completely U.S.-funded, the United States was entitled to the entire \$0.9 million as residual value compensation.

For building 533, the United States improved the roof (7 percent), windows (5 percent), bathrooms (8 percent), and heating (7 percent) and installed school equipment (4 percent) for a total of 31 percent worth of improvements. Therefore, the United States was entitled to 31 percent of the \$3.5 million allocated to building 533, which amounted to \$1.1 million in residual value compensation. In total, the United States was entitled to \$2 million as residual value compensation for the Drake School complex from the German government.<sup>4</sup>

## **Residual Value Process for the U.K.**

In the U.K., the United States is only entitled to residual value compensation related to the return and sale of family housing when family housing is returned.<sup>5</sup> The current agreement between the United States and U.K. states that the residual value compensation is determined based on the sale of the property. At the time of sale, the base residual value compensation is determined as the proceeds of the sale<sup>6</sup> less the selling expenses. The base residual value is then divided between the United States and U.K. as follows:

- For instances where the United States funded the family housing on the U.K. land:
  - where the housing is to be reused by the buyer, the United States receives 50 percent of the base residual value;
  - where the family housing is to be redeveloped by the buyer but the utility infrastructure is to be reused, the United States receives 10 percent of the base residual value; and
  - where the family housing and utility infrastructure is to be redeveloped, the United States receives nothing.
- For instances where the U.K. funded the family housing on its own land, but the United States made improvements to the housing:

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<sup>4</sup> We did not assess the reasonableness of the negotiated residual value settlement agreement for the Drake School complex.

<sup>5</sup> Per the “Memorandum of Arrangement Concerning the Settlement of Residual Value Claims for US-Funded Housing and former US-occupied MOD Family Quarters Returned to MOD and Sold after 31 December 1999” as of November 2, 2006.

<sup>6</sup> If the sale is a bulk sale including more than the returned U.S. family housing (which could include other premises or land), then this is the portion of the sale value attributable to the returned family housing.

- where the site is being reused, the United States receives 18.75 percent of the cost of the investments made within 10 years before the sale.
- where the site is being redeveloped, the United States receives nothing.

For example, as part of the Royal Air Force Chelveston and Royal Air Force Molesworth-Brington family housing return to the U.K. MOD, USAFE documentation indicated that the U.K. MOD sold 50 family housing units at Royal Air Force Chelveston and 42 family housing units at Royal Air Force Molesworth-Brington. As a result, USAFE received 50 percent of the net selling cost from the U.K. MOD, or \$4.6 million, from the U.K. MOD as residual value compensation for the Royal Air Force Chelveston and Royal Air Force Molesworth-Brington family housing.

# Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD Comments



COMPTROLLER

(Program/Budget)

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

APR - 3 2012

[REDACTED]  
Audit Program Director  
DoD Payments and Accounting Operations  
Inspector General  
Department of Defense  
4800 Mark Center Drive  
Alexandria, VA 22350-1500

Dear [REDACTED]:

This is the Office of the Under Secretary of Defense (Comptroller) response to the Department of Defense Inspector General (DoDIG) draft report "DoD Can Improve Its Accounting for Residual Value from the Sale of U.S. Facilities in Europe," dated February 27, 2012 (Project No. D2011-D000FR-0189.000).

We concur with the recommendation for the Office of the Under Secretary of Defense (Comptroller) to provide DoDIG with the results of the review of unused monetary proceeds remaining in the DoD Overseas Military Facility Investment Recovery Account (DOMFIRA). Based on the current status of the review, we plan to provide the results within 90 days from the date of issuance of the DoDIG report. The current DOMFIRA unobligated balance has been reduced by 18 percent to \$6.8 million, from the \$8.3 million unobligated balance (as of June 30, 2011) referenced in the report. Of the remaining unobligated balance, there is an execution plan for \$6.0 million to be obligated by September 30, 2012. Additionally, we plan to revise the DoD Financial Management Regulation by June 30, 2012, to address oversight of existing unobligated balances.

If you have any questions, please contact [REDACTED]  
[REDACTED]

Sincerely,

John Roth  
Deputy Comptroller

# Deputy Under Secretary of Defense for Installations and Environment Comments



ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

MAR 30 2012

MEMORANDUM FOR PROGRAM DIRECTOR, DOD PAYMENTS AND ACCOUNTING  
OPERATIONS, DoDIG

THROUGH: DIRECTOR, ACQUISITION RESOURCES AND ANALYSIS

SUBJECT: Draft Report Entitled "DoD Can Improve Its Accounting for Residual Value From the Sale of U.S. Facilities in Europe" (Project No. D2011-D000FR-0189.000)

As requested, I am providing the response to the recommendation for the Deputy Under Secretary of Defense for Installations and Environment contained in the subject draft report.

**Recommendation B:** We recommend that the Deputy Under Secretary of Defense for Installations and Environment revise DoD Instruction (DoDI) 4165.69 to require that future residual value settlement negotiations analyze and document how the residual value settlement amount was determined, to include at a minimum:

- results of an independent appraisal of the facility's value or the reasons why it was deemed not worth performing one;
- analysis of any agreed-upon calculation methodology used to determine the values for the land and capital improvements;
- evaluation of any environmental remediation being claimed for reasonableness, if there is an offsetting effect on the residual value received; and
- description of supporting residual value settlement documents that should be maintained and how long these documents should be maintained.

**Response:** Concur. Guidance directing implementation of the additional requirements will be issued this year, and will be incorporated into DoDI 4165.69, Realignment of DoD Sites Overseas, when it is updated.

Please contact [REDACTED] if additional information is required.

John Conger  
Assistant Deputy Under Secretary of Defense  
(Installations and Environment)

~~FOR OFFICIAL USE ONLY~~

# Commander, United States European Command Comments



HEADQUARTERS  
UNITED STATES EUROPEAN COMMAND  
Chief of Staff  
UNIT 30400  
APO AE 09131

ECCS

17 April 2012

MEMORANDUM FOR Inspector General, Department of Defense, 4800 Mark Center Drive,  
Alexandria, VA 22350-1500

SUBJECT: DODIG Draft Report: DOD Can Improve Its Accounting for Residual Value From the  
Sale of U.S. Facilities in Europe Project No. D2011/D000FR-0189.000

1. Reference memorandum, Inspector General, DOD, 27 Feb 12.
2. The attached response (Encl 1) clarifies that overseas international or bilateral agreements govern what U.S. capital investments can be recouped from a host nation and offers additional documentation (Encl 2) to support residual value negotiations. U.S. European Command's comments (Encl 3) on the draft DODIG report are provided for your consideration.
3. We appreciate the support provided by the visiting DODIG Team. Their professionalism and objective review of the residual value efforts for U.S. European Command and the service components will help to improve how residual value is recouped in our theater of operations. Please convey to them our sincere appreciation for their assistance.
4. Point of contact is [REDACTED]

3 Encls

1. Response to DODIG memo  
with recommendations
2. Negotiators' Reports
3. Review Comments in Track Changes  
on the Draft Report

A handwritten signature in black ink, appearing to read "Mark A. Barrett".

MARK A. BARRETT  
Major General, U.S. Air Force

DODIG Review of Draft Report: DoD Can Improve Its Accounting for Residual  
Value From the Sale of U.S. Facilities in Europe  
Project No. D2011-D000FR-0189.000

**Response to Memorandum and Recommendations:**

Reference is made to the DODIG Memorandum, 27 Feb 12, requesting comments to the Draft Report: DoD Can Improve Its Accounting for Residual Value From the Sale of U.S. Facilities in Europe, Project No. D2011-D000FR-0189.000. The following comments are provided to increase the accuracy of the report.

DODIG Memorandum, 27 Feb 12.

Clarification is made to the cover memorandum which stated:

"Also, they (DOD Organizations) did not always perform and document analyses to support the negotiated \$19.4 million settlement amounts for seven installation closures. Further, lessons can be learned from the return of DoD housing units in the United Kingdom for which DoD may not recover a fair and equitable share of its \$20.3 million investment."

Response 1: For the seven installations in the report, where \$19.4M settlement was made, there were analyses documenting how they derived their amounts, this information is provided Enclosure 2 - Negotiators Reports (provides a summary and detail reports).

The following are responses to the draft report Recommendations A-C:

Recommendation A

We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, provide DoD IG with the results of the review of unused monetary proceeds remaining in the DoD Overseas Military Facilities Investment Recovery Account.

Response 2: The OSD Comptroller will provide a separate response to Recommendation A.

Recommendation B

We recommend that the Deputy Under Secretary of Defense for Installations and Environment and the Commander, U.S. European Command, revise DoD Instruction 4165.69 and U.S. European Command Instruction 4101.02, respectively, to require that future residual value settlement negotiations analyze and document how the residual value settlement amount was determined, to include at a minimum:

1. results of an independent appraisal of the facility's value or the reasons why it was deemed not worth performing one;
2. analysis of any agreed-upon calculation methodology used to determine the values for the land and capital improvements;
3. evaluation of any environmental remediation being claimed for



- reasonableness, if there is an offsetting effect on the residual value received; and
4. description of specific documents that should be maintained supporting residual value settlements and how long these documents should be maintained.

Response 3: EUCOM plans to revise EUCOM Instruction 4101.02, Summer 2012, to include how the residual value settlement amount was determined including the 4 items stated above. Further, DUSD AT&L will provide a separate response regarding revision of the DODI 4165.69, to address the recommendations above.

Response 4: Regarding Recommendation B1, to include at a minimum results of an independent appraisal of a facility's value or the reasons why it was deemed not worth performing one: The recommendation concerning preparation of a formal appraisal report on properties turned over to host nations will only be practical if funding for the appraisal work can be identified, and if the terms of the pertinent Status of Force Agreement or agreements, other would enable the appraisal results to be used during negotiations. For example, US appraisals would be appropriate when the Federal Republic of Germany retains a property for their own re-use. Such appraisals will not be prioritized ahead of ongoing operational requirements, and staff to perform appraisal work are expected to be very scarce in future. Since the "net proceeds of sale, if any" clause, as stated in the NATO German Status of Forces Agreement, Supplementary Agreement Protocol of Signature, Article 52, is the basis for residual value agreements in the FRG, obtaining an additional US appraisal is often an unnecessary step that would have no impact on the residual value (RV) negotiation.

#### Recommendation C

C. We recommend that the Commander, U.S. European Command:

1. Officially assign responsibility for following up on the sales status of the West Ruislip housing facilities and for conducting residual value negotiations.
2. Calculate and retain the estimated benefit that the U.K. Ministry of Defence receives from the free housing at West Ruislip from September 2007 through the sale of the property for use in negotiating residual value.
3. Require that future residual value agreements with host nations be formally coordinated with all U.S. Military Departments that have facilities in the host nation that would be affected by the proposed agreement.

Response 5: EUCOM issued a task order on 26 Mar 12, to U.S. Air Forces Europe to accomplish Recommendation C, Items 1-3 above. Further, the next revision of ECI 4101.02, Residual Value, to be accomplished Summer 2012, will require future residual value agreements with host nations be formally coordinated with all U.S. Military Departments that have facilities in the host nation that would be affected by the proposed agreement.



# Inspector General Department of Defense