Audit Report

OFFICE OF THE INSPECTOR GENERAL

AIR FORCE MERGED ACCOUNT OBLIGATIONS

Report No. 94-139 June 17, 1994

Department of Defense

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Acronyms

ACRN	Accounting Classification Reference Number
AFB	Air Force Base
ALC	Air Logistics Center
CLIN	Contract Line Item Number
DAO	Defense Accounting Office
DFARS	Defense Federal Acquisition Regulation Supplement
DFAS	Defense Finance and Accounting Service
FAR	Federal Acquisition Regulation
GAO	General Accounting Office
IG	Inspector General
"M" Account	Merged Account
NULO	Negative Unliquidated Obligations
SMC	Space and Missile Systems Center
ULO	Unliquidated Obligation

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

June 17, 1994

MEMORANDUM FOR COMPTROLLER OF THE DEPARTMENT OF DEFENSE
ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Air Force Merged Account Obligations
(Report No. 94-139)

We are providing this audit report for your review and comments. The audit was made at the request of the Chairman, Senate Subcommittee on Defense, Committee on Appropriations. It discusses the validation of unliquidated obligations of selected appropriations in the Air Force merged "M" accounts and support for outstanding obligations, including support for funds that had been deobligated and reobligated.

Comments received from the Deputy Assistant Secretary of the Air Force (Budget) and the Deputy Director (Finance), Defense Finance and Accounting Service, on a draft of this report were considered in preparing this final report. No comments were received from the Comptroller of the Department of Defense.

DoD Directive 7650.3 requires that audit recommendations be resolved promptly. Therefore, we request that the Comptroller of the Department of Defense provide comments on the unresolved recommendation by August 16, 1994.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. F. Jay Lane, Program Director, at (703) 693-0430 (DSN 223-0430) or Mr. Carl F. Zielke, Project Manager, at (703) 693-0453 (DSN 693-0453). Copies of this report will be distributed to the organizations listed in Appendix E.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Report No. 94-139 **June 17, 1994**
(Project No. 3FG-5030)

AIR FORCE MERGED ACCOUNT OBLIGATIONS

EXECUTIVE SUMMARY

Introduction. On June 21, 1993, the Chairman, Senate Subcommittee on Defense, Committee on Appropriations, requested that we review the validity of $649.0 million of the $901.1 million of M-account appropriations restored to the Air Force by the Comptroller of the Department of Defense on September 30, 1990. During past audits, both the GAO and the Inspector General, Department of Defense, questioned the validity of the $649.0 million.

Merged accounts contained those unexpended balances of appropriations that had been expired for at least 2 years. As of June 30, 1993, the Air Force reported obligated but unexpended balances totaling $1.4 billion for all "M" account appropriations. We reviewed three appropriations with unliquidated "M" account balances totaling $574.0 million.

Objectives. This audit was made to validate the remaining unliquidated obligations in those Air Force "M" account appropriations containing the largest "M" account balances. Also, we evaluated the validity of outstanding obligations, including support for funds that had been deobligated and reobligated. (Deobligation is the release of unspent funds from a contract, and reobligation is incurring of a new obligation or binding agreement of funds expected to be spent for a valid need.) The three appropriations included in the audit were 3010 (Aircraft Procurement), 3020 (Missile Procurement), and 3600 (Research, Development, Test, and Evaluation).

Audit Results. The "M" account obligations were not effectively managed by the Air Force.

o Of $574.0 million in unliquidated obligations we reviewed, $440.0 million (76 percent) was deemed to be invalid. Accordingly, funds no longer needed for their intended purposes were not released for use on other programs, and financial reports were erroneous (Finding A).

o Two Air Force system program offices made advance payments to contractors for $9.8 million for as yet unearned on-orbit incentive fees, without complying with statutory and regulatory requirements. As a result, those prepayments were made improperly (Finding B).

Internal Controls. The audit identified material internal control weaknesses. Controls were not adequate to identify $440.0 million in invalid unliquidated obligations. That weakness (Finding A) had been reported in prior Inspector General, Department of Defense, reports. Also, the Comptroller of the Department of Defense and the Air Force had no procedure in place to ensure that the prepayment of incentive fees to

contractors complied with the requirements in 31 U.S.C. 3324 and 10 U.S.C. 2307, the Federal Acquisition Regulation, or the Defense Federal Acquisition Regulation Supplement (Finding B). Because of time constraints and limited scope, implementation of the DoD Internal Management Control program was not reviewed and the internal controls over the automated systems that generated the obligation data were not evaluated. Details of the internal controls reviewed are presented in Part I.

Compliance with Laws and Regulations. Accounting and system program office personnel did not follow internal control procedures that would have identified the $440.0 million in unliquidated obligations as needing to be deobligated. The noncompliance occurred because of contracting, billing, paying, recouping, and recording practices (Finding A). Part II discusses the causes for the noncompliance. The Comptroller of the Department of Defense and the Air Force did not comply with statutory and regulatory requirements for the advance payments of on-orbit incentive fees (Finding B).

Potential Benefits of Audit. Recommendations in this report, when implemented, will improve accuracy of accounting records, oversight of unliquidated obligations, use of funds, and financial operations, as well as compliance with laws and regulations. See Appendix C for details of the benefits associated with the audit.

Summary of Recommendations. We recommended that a single paying and accounting system be developed and implemented. No recommendations were made to correct fund control problems because actions initiated as a result of another Inspector General, Department of Defense, audit should correct those problems. Also, we recommended rescinding DoD approval of "budgeting lead-time away from need" for on-orbit incentive fees; making a policy change regarding the prepayment of incentive fees; reevaluating incentive fee payments totaling $9.8 million that were previously prepaid; and adopting an appropriate accounting alternative for unearned on-orbit incentive fees.

Management Comments. The Comptroller of the Department of Defense; the Assistant Secretary of the Air Force (Financial Management and Comptroller); and the Director, Defense Finance and Accounting Service, were asked to comment on a draft of this report. Comments were received from the Deputy Assistant Secretary of the Air Force (Budget) and the Deputy Director (Finance), Defense Finance and Accounting Service. Both concurred with the findings and related recommendations. However, if the Comptroller of the Department of Defense rescinds the July 14, 1992, memorandum that approved budgeting of lead-time away from need for unearned on-orbit incentive fees, the Air Force will have to reissue policy consistent with any new DoD policy for such fees. No comments were received from the Comptroller of the Department of Defense. Accordingly, we ask that the Comptroller of the Department of Defense provide comments to the final report. Comments must be received by August 16, 1994.

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This report was prepared by the Financial Management Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

Part I - Introduction

Background

History. In 1956, Public Law 84-798, "Appropriations-Fiscal Management," established the merged accounts ("M" accounts) and the merged surplus authority account as repositories for unexpended funds. Unexpended funds retained fiscal year identity for 2 years after their period of availability ended. At the end of 2 years, unexpended obligated balances went into the "M" account and unobligated balances were withdrawn into the merged surplus authority account. The two accounts were used for different purposes. The "M" accounts were used to liquidate obligations properly incurred against any of the appropriations from which the account was derived. Withdrawn unobligated balances from the surplus authority account under certain circumstances could be restored to adjust previously recorded obligations or to liquidate obligations that arose but that had not been formally recorded. On June 30, 1993, the unliquidated obligation balance in the Air Force "M" account was $1.4 billion.

Public Law 101-510. Public Law 101-510, "National Defense Authorization Act for Fiscal Year 1991," November 5, 1990, eliminated "M" accounts and canceled all merged surplus authority. It allowed obligated "M" account balances to be canceled over a 3-year period ending September 30, 1993.

Public Law 101-510, section 1406, "Audit of Obligated Balances of the Department of Defense," required the DoD to conduct a one-time audit of each "M" account balance to establish balances supported by valid obligations. On December 31, 1991, the Inspector General (IG), DoD, estimated that $8.0 billion (50 percent) of $16.1 billion of DoD "M" account obligations was not supported.

Public Law 101-511. Public Law 101-511, section 8080, "Department of Defense Appropriations Act, 1991," November 5, 1990, provided for the restoration of obligated balances that had been withdrawn under the provisions of section 1552(a) of 31 U.S.C. The law also stated that those "unobligated funds withdrawn prior to the enactment of this Act (other than those restored pursuant to the provisions of this subsection) are canceled."

Public Law 102-484. Public Law 102-484, "National Defense Authorization Act for Fiscal Year 1993," October 23, 1992, contained a provision for reciprocal cancellation related to "M" account obligations, known as the "2 for 1" rule. Under Public Law 102-484, section 1003:

> The Secretary of Defense may not reobligate any sum in a merged (or so-called "M") account of the Department of Defense until the Secretary has identified an equal sum under section 1406 of the National Defense Authorization Act for Fiscal Year 1991 (Public Law 101-510; 104 Stat. 1680) that can be canceled.

> Whenever the Secretary of Defense reobligates funds from a merged (or so-called "M") account of the Department of Defense, the Secretary shall at the same time cancel with the Treasury of the United States a sum in the same amount as the reobligation from a merged account of the Department of Defense.

Objectives

On June 21, 1993, the Chairman, Senate Subcommittee on Defense, Committee on Appropriations, requested (Appendix A) that we review the validity of $649.0 million of the $901.1 million the Comptroller of the Department of Defense (DoD Comptroller) had restored for the Air Force from the "M" accounts under the authority provided in Public Laws 101-510 and 101-511. The Chairman was concerned about the validity of $649.0 million of the $901.1 million that was restored. Because of the previous audits, the primary objective of this audit was to validate the remaining obligated balances for selected Air Force appropriations that contained the largest "M" account balances.

We also evaluated the support for selected unliquidated obligations, including support for funds that had been deobligated and reobligated as allowed by Public Law 102-484, section 1003.

Scope and Methodology

We performed this financial related audit from July through September 1993. Our scope was limited because our field work had to be completed by September 30, 1993. We limited our audit coverage to unliquidated obligation balances at four Air Force locations. Only three appropriations were reviewed. We reviewed unliquidated obligation balances in "M" accounts as of June 30, 1993, for FYs 1984 through 1986 for 3010 (Aircraft Procurement) and 3020 (Missile Procurement) funds, and for FYs 1985 through 1987 for 3600 (Research, Development, Test, and Evaluation) funds.

The appropriations reviewed accounted for $958.0 million of the $1.4 billion in unliquidated obligation balances in the Air Force "M" accounts as of June 30, 1993. Of the $958.0 million balance, we evaluated $574.0 million managed at four Air Force Materiel Command locations. The four locations were Los Angeles Air Force Base (AFB), California; Tinker AFB, Oklahoma; Wright-Patterson AFB, Ohio; and Warner Robins AFB, Georgia. We reviewed the process used by each Air Force system program office for determining the need for the unliquidated obligations of funds remaining on contracts with "M" account balances.

In addition, we judgementally selected 11 contracts managed by the system program offices at Wright-Patterson AFB and paid by the Defense Finance and Accounting Service (DFAS) Center at Columbus, Ohio, for in-depth analyses to determine the validity of selected "M" account balances. Official accounting records showed unliquidated obligation balances totaling $21.4 million for the 11 contracts. For those contracts, we reviewed the contract modifications and payment histories and contacted or visited the contracting offices, program offices, and paying office. See Appendix D, "Organizations Visited or Contacted," for specifics.

The audit was made in accordance with the auditing standards issued by the Comptroller General of the United States as implemented by the IG, DoD, and accordingly included such tests of the internal controls as were considered necessary. Due to time constraints, we did not evaluate the reliability of computer-processed data used in our review.

Internal Controls

Controls Assessed. We reviewed internal control procedures used at the four Air Force locations to validate unliquidated obligations for the "M" account balances, ensure that reobligations were in compliance with Public Laws 101-510 and 102-484, and ensure that advance payments to contractors of contingent liabilities for on-orbit incentive fees met the requirements of 31 U.S.C. 3324, 10 U.S.C. 2307, the Federal Acquisition Regulation (FAR), and the Defense Federal Acquisition Regulation Supplement (DFARS). We did not review the implementation of the DoD Internal Management Control program due to time restraints.

Internal Control Weaknesses Identified. A material internal control weakness was identified as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. The invalid obligations identified in Finding A demonstrate an internal control weakness. However, that weakness has been reported in prior audit reports and action has been initiated to correct it.

Controls also were not established to provide for accounting and budgeting recognition of long-term contingent liabilities and to prevent premature payments for as yet unearned incentive fees. The Commander, Los Angeles AFB, issued local policy that formalized the practice of advance payment of contingent liabilities. The Air Force could not demonstrate that the advance payments were in compliance with the statutory provisions of 31 U.S.C. 3324, 10 U.S.C. 2307, the FAR, and the DFARS.

In response to an Air Force request for advance payment authority, the Deputy DoD Comptroller (Program/Budget) approved "budget[ing] of lead-time away from need for on-orbit incentive fees" as an exception to DoD full-funding policy. Budgeting lead-time away would postpone a request for budget authority until the year in which the future event is expected to occur. The

waiver highlights the problem of accounting and budgeting for contingent liabilities and if followed could lead to violations of the Antideficiency Act (Finding B).

Recommendations B.1.a, B.1.b., B.2.a, and B.2.d. address the specific problems associated with the Air Force's advance payments for on-orbit incentive fees and the general problems in accounting and budgeting for contingent liabilities. If implemented, they should improve internal controls.

Benefits of Audit. No quantifiable monetary benefits are attributable to correcting this material internal control weakness. Other benefits are explained in Appendix C, "Summary of Potential Benefits Resulting From Audit."

Compliance With Laws and Regulations

In evaluating the support for funds that had been deobligated and reobligated, the audit showed that the Air Force complied with the law by deobligating at least 2 dollars for every 1 dollar reobligated. Thus, documentation supported the reobligations, and we have no finding related to that objective.

Accounting and system program office personnel did not follow internal control procedures that would have identified the $440.0 million in invalid obligations. The noncompliance occurred because of contracting, billing, paying, recouping, and recording practices (Finding A). If implemented, agreed-upon actions resulting from a prior audit will allow for timely compliance with current internal control procedures.

Accounting and system program office personnel at Los Angeles AFB did not follow the statutory and regulatory provisions for advance payment of incentive fees (Finding B). The noncompliance occurred because of the lack of legal review of a waiver of full-funding policy for the advance payment of on-orbit incentive fees. Rescission of the Deputy DoD Comptroller (Program/Budget) waiver and establishment of an on-orbit contingent liabilities policy in consonance with statutory requirements will improve internal controls.

Prior Audits and Other Reviews

We identified five audit reports related to "M" accounts that were issued by the GAO and the IG, DoD, between June 30, 1989, and April 2, 1993.

GAO Reports. The GAO issued two reports relating to this audit.

o The GAO report, "Agencies' Actions to Eliminate 'M' Accounts and Merged Surplus Authority" (OSD Case No. 9279), April 2, 1993, was issued in response to a congressional inquiry regarding the implementation of Public

Law 101-510. The audit showed that $649.0 million in restored funds was not supported by specific documented requirements. The report also stated that the DoD procedures for deobligating and reobligating "M" account funds were inconsistent with section 1406 of Public Law 101-510, which requires that an audit of all "M" account balances be completed before September 30, 1993. The DoD did not agree with the GAO position.

o The GAO report, "Financial Management - Air Force Records Contain $512.0 million in Negative Unliquidated Obligations" (OSD Case No. 8091), June 30, 1989, was issued in response to a congressional request regarding negative unliquidated obligations. The audit showed that the five Air Logistics Centers had 6,257 individual negative unliquidated obligation (NULO) account balances totaling about $512.0 million. Although an Air Force regulation requires that immediate corrective action be taken on NULOs, the Air Logistics Centers had more than $132.0 million in NULOs that were at least 6 months old. The GAO found that the DFAS (formerly the Defense Contract Administration Services Regions) was not responding to requests by the Air Logistics Centers for payment information needed to research the NULOs. The DoD Comptroller agreed with the report.

IG, DoD, Reports. The IG, DoD, issued four related reports.

o Audit Report No. 93-053, "Report on the Audit of Missile Procurement Appropriations for the Air Force," February 12, 1993, concluded that the Air Force missile procurement appropriation for FYs 1987 and 1988 was insufficient to meet obligations and adjustments chargeable to those accounts and legislative relief was needed. It also concluded that the available appropriation balances in the Air Force accounting and finance records were materially misstated. In the report, we recommended that the DoD Comptroller seek legislation to allow contingent liabilities (contractor incentive and award fees) to be funded from current appropriations. The Deputy DoD Comptroller (Management Systems) responded that under the existing opinion of the Comptroller General, contingent liabilities arising from clauses originally contained in a contract are chargeable to the fiscal year when earned. The DoD policy is to cover contingent liabilities such as incentive and award fees within appropriations authorized by the Congress. Limited relief has been provided in Public Laws 101-510 and 102-484. Those authorities permit charging current appropriations when sufficient funds do not exist in merged or expired accounts. Additional legislation is not needed at this time. The Deputy DoD Comptroller (Management Systems) generally agreed with the report.

o Audit Report No. 92-064, "Titan IV Program," March 31, 1992, showed that the Air Force did not have adequate oversight of, and control over, the expenditure of multiple appropriations, including "M" accounts, on the Titan IV contract. The situation occurred because the contractor's request for a progress payment did not identify how much of the progress payment was for work funded from each appropriation on the contract. The audit resulted in agreement by the Director, Defense Procurement, and DoD Comptroller to work toward accounting and procurement policies and systems that will ensure adequate oversight and control of expenditures are maintained and costs are properly charged.

o Audit Report No. 92-028, "Merged Accounts of the Department of Defense," December 30, 1991, showed that obligations in DoD accounting records did not accurately show the status of merged accounts. The audit disclosed that $8.0 billion (50 percent) of the $16.1 billion of "M" Account obligations reviewed was invalid and should be deobligated. The report also questioned the request for restoration of $649.1 million and recommended that the use of all restorations be withheld or restricted pending full justification and approval of unrecorded obligations. The audit further disclosed about $1.0 billion in negative unliquidated obligations, several accounts that were overdisbursed, and the unsupported obligations that are also discussed in the Background portion of this report. Because official DoD accounting records were inaccurate, the DoD Comptroller requested restorations to cover obligations that the Military Departments identified from sources other than official accounting records. The Deputy DoD Comptroller (Management Systems) generally agreed with the report, but nonconcurred that many of the restorations were unjustified.

o President's Council on Integrity and Efficiency Report No. 93-058, "Summary Report on Audits of the Contract and Grant Closeout Process," February 23, 1993, indicated that untimely contract closeout is a problem in numerous Federal agencies. One of the contributing factors was a backlog of Defense Contract Audit Agency audits of overhead rates. Five Offices of Inspector General and the General Accounting Office made 87 recommendations to six agencies, which agreed on various actions to improve the process.

Other Matters of Interest

The Comptroller General issued a decision that affects the way merged appropriation account balances canceled under the 1991 National Defense Authorization Act may be used after cancellation. Comptroller General Decision B-251287, dated September 29, 1993, allows the Treasury to restore canceled budget authority under certain circumstances to correct obvious reporting and clerical errors consistent with prior decisions of the Comptroller General and to record disbursements made before the cancellation of expired accounts.

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Part II - Findings and Recommendations

Finding A. Invalid Obligation Balances

The Air Force "M" accounts contained at least $440.0 million in invalid unliquidated obligations as of June 30, 1993. That situation occurred because of Air Force contracting practices; contractor billing practices; Defense Finance and Accounting Service (DFAS) paying, recouping, and recording practices; and the existence of multiple paying and accounting systems. Accordingly, funds no longer needed for their intended purpose were not released for use on other programs, and financial reports used to make management decisions were erroneous.

Background

On June 30, 1993, the obligated balance for the three Air Force appropriations selected for review was $958.0 million. The three appropriations were 3010 (Aircraft Procurement), 3020 (Missile Procurement), and 3600 (Research, Development, Test, and Evaluation). For the four audit sites visited, the "M" account balances for the three appropriations totaled $574.0 million. The four audit sites were the largest holders of "M" account unliquidated obligated balances.

Unliquidated Obligation Balances

Of the $574.0 million in unliquidated obligations reviewed, we determined that $440.0 million (76 percent) was invalid.

Unliquidated obligations (ULOs) are obligations recorded for a contract that have not resulted in disbursements to a contractor. A ULO was considered invalid when any of the following was true:

o no specific documentation existed at the program office to support the balance,

o the contracting officer or system program office official stated that all deliverables had been received and paid,

o no additional costs were identified by the program office, or

o the applicable system program office for the weapon system could not determine the total cost that should be associated with the "M" account in completing the contract.

The status of the $574.0 million in "M" account ULO balances is shown in the following table.

Status of "M" Account ULO Balances Reviewed
($ millions)

Activity	Net ULO	Valid	Invalid
LAAFB	$ (7)	$ 49	$(56)
TAFB	105	22	83
WPAFB	411	42	369
WRAFB	65	21*	44
Totals Net	$574	$134	$ 440

*Additional funds of $9.0 million were needed for termination fees on two contracts with negative balances.

Acronyms

LAAFB	Los Angeles Air Force Base
TAFB	Tinker Air Force Base
WPAFB	Wright-Patterson Air Force Base
WRAFB	Warner Robins Air Force Base

The majority of the invalid obligations were for the Aircraft Procurement appropriation. Only $89.8 million of the $509.1 million in Aircraft Procurement was valid. Program managers for the F-15 and F-16 programs had the most difficulty in validating and supporting their unliquidated obligations. Specific problems are outlined below.

Validation Process. A number of problems existed in the validation process relating to unreliable financial records. Officials at the system program offices said that they were unable to determine the validity of the unliquidated obligations because the financial records were unreliable and because they felt the Air Force's official accounting and finance system, the General Accounting and Finance System, lacked integrity.

Accounting and system program office personnel stated that they had been validating balances for more than a year. They said that the following specific problems affected the reliability of the financial records and the validation of the ULO balances: billing practices by contractors; paying, recouping, and recording practices by the DFAS-Columbus Center; and systems integration.

Because of those problems, officials in the program offices said, verifying ULOs related to any particular contract was difficult and time consuming. Of four programs we reviewed at Wright-Patterson AFB, we could verify the unliquidated obligations balance for only one program, the B-1 aircraft.

The system program office for the B-1 aircraft program could verify balances for the unliquidated obligations because that program was in the final stage of closing out its contracts and all items required to be delivered on the contract had been received. Even so, it took one person assigned full-time for over 1 year to reconcile and validate the ULO balances for the B-1 program. For that program, we verified the procedures and records used by the system program office to attempt to validate the $137.3 million ULO balance for the B-1 program as of July 29, 1993, which showed $31.6 million as valid and $105.7 million as invalid. However, final payment disbursement had not been made.

Other system program offices, at both Wright-Patterson AFB and the other Air Force bases, had greater difficulty reconciling and validating the ULO balances for their programs. For example, the system program office for the F-16 program, which had ULO balances totaling $78.2 million, refused to consider any amount as invalid because of the inaccuracy of the financial records. The program managers stated that limited manpower and time restraints made it impossible to validate all contracts for their individual programs by September 30, 1993, the date by which all "M" account balances were to be canceled.

Even when serious attempts to reconcile and validate the contracts for a specific program were made, problems with accuracy of financial records remained. Program officials at Los Angeles AFB stated that improper billing, paying, and recording practices were the main causes of problems affecting the accuracy of the financial contract records processed on the General Accounting and Finance System. The budget office at Los Angeles AFB hired a commercial firm to reconcile and validate those contracts with the largest "M" account ULO balances. However, the reconciliation at Los Angeles AFB only temporarily corrected the inaccurate data records.

Validation of Unliquidated Obligations on Specific Contracts. To further assess "M" account balances, we specifically reviewed the need for the unliquidated obligations on 11 open contracts managed at Wright-Patterson AFB and paid by the DFAS-Columbus Center. We analyzed payment histories, payment vouchers, and contract modifications maintained at the DFAS-Columbus Center and those maintained at the accounting office at Wright-Patterson AFB. The amount thought to be needed for future disbursements on each of the 11 contracts was determined in conjunction with the program office and contract responsibilities. Of the total (absolute) value of $53.1 million ULOs for the 11 contracts selected, we determined that $49.8 million (93 percent) was deemed unneeded for future disbursements. For the 11 contracts, the payment records showed a net balance of negative $25.6 million and the official accounting records showed a net balance of positive $21.4 million (a discrepancy of $47.0 million). That further illustrates the discrepancy between the accounting records at the finance office and paying records at the disbursing office, which compounded the problem of determining the validity of unliquidated obligations. Appendix B shows the comparative amounts for each contract.

Inadequate Fund Control

The lack of adequate fund control over unliquidated obligations had several causes: contracting practices by the Air Force; billing practices by the contractor; paying, recouping, and recording practices by the DFAS; and the existence of multiple paying and accounting systems.

Air Force Contracting Practices. When more than one appropriation is used to fund a contract, the Air Force is supposed to assign a separate accounting classification reference number (ACRN) for each contract line item number (CLIN) for the work under the contract. Air Force contracts do not uniformly require contractors to bill the Air Force by ACRN and CLIN for such contracts. In the absence of a clause in the contract, the FAR does not require the contractor to bill the Government by CLIN and ACRN. Procurement officers told us they were not aware of the billing problem. Because they did not write a contract clause to require the contractor to bill by CLIN and ACRN, invoices for payment from the contractor did not consistently contain the information needed by the paying office.

Contractor Billing and DFAS Paying Practices. We discussed billing and paying problems with accounting officials at the DFAS-Columbus Center. They stated that when contractors did not include the ACRN and CLIN on bills submitted to the DFAS, accounting clerks had to make a decision as to which appropriation's unliquidated obligations the disbursement should be recorded against. The accounting clerks also stated that if they could not specifically identify the ACRN and CLIN that should be paid on a particular invoice, the Mechanization of Contract Administrative Services system used a formula to charge disbursements to all appropriations with unliquidated obligations for the contract at the time of the disbursement and not to the specific appropriation that was obligated.

However, even when the ACRN and CLIN were shown on the invoice, the payment was not always charged to the correct account. For example, we found one contract for which $11.2 million was disbursed and charged to the "M" account that should have been charged to the FY 1988 3010 (Aircraft Procurement) account.

The DFAS accounting clerks were concerned with paying the invoices promptly to avoid interest penalties and lost discounts; therefore, they used whatever funds were readily available when no specific funds were specified through use of the appropriate ACRN and CLIN. Accordingly, as time passed and more and more progress payments were made, visibility over appropriation accounting decreased, and reconciliation required more time to complete.

DFAS Recouping Practices. The DFAS-Columbus Center did not ensure progress payments were credited to the correct accounts. Since progress payments are made to contractors for work completed but not yet delivered to the Government, progress payments should have been charged to the correct account or accounts. Similarly, recoupment of progress payments from the contractor should have been credited to the account or accounts that had already

paid for the completed work. We found, however, that the contractors' billings for progress payments only showed the amount and did not show appropriate CLINs and ACRNs. Those billing and paying practices necessitated continuous review and reconciliation of each balance with the contractor to maintain the accurate status of each ACRN and CLIN. One Air Force document showed that it took an estimated 2,000 staff hours to complete the reconciliation and validation of a medium-sized contract. Because the DFAS-Columbus Center did not have the staff to do the necessary reconciliations and validations for its contracts, it hired an accounting firm to reconcile its contract files at a cost estimated at $30.0 million for about 4.5 years.

DFAS Recording Practices. For the 11 contracts that were specifically reviewed, we found that the contract files maintained in the Defense Accounting Office (DAO) at Wright-Patterson AFB were inconsistent with those maintained at the DFAS-Columbus Center. While the DAO maintained the official finance and accounting records, personnel at the system program offices stated that they used the paying records maintained by the DFAS-Columbus Center because they felt those records were more accurate.

We found that modifications and payment vouchers were missing or not recorded in the system. For example, on contract F33657-80C-0441, 32 modifications were missing from the contract files maintained at the base DAO. Also, disbursements of $13.6 million had not been recorded in the Mechanization of Contract Administrative Services system. In addition, as contract lines neared completion, we found that DFAS-Columbus Center recorded obligations and disbursements to date with a numeric designation that differed from the ACRNs that were used to record the obligations and disbursements; however, subsequent disbursements were frequently recorded to the original ACRNs. That practice resulted in numerous negative unliquidated obligations (NULOs). DAO personnel moved the total obligations and payments from the ACRNs to numeric designations when they assumed all deliveries and payments had been completed for those ACRNs. If an invoice was received later, the DAO posted the payment to the original ACRN, resulting in a NULO.

Multiple Paying and Accounting Systems. The number of paying and accounting systems complicated the ability of the system program office to track and validate unliquidated obligations. Four separate paying and accounting systems were used to track accounting transactions. The four systems in use were the General Accounting and Finance System, the Acquisition Management Information System, the Central Procurement Accounting System, and the Mechanization of Contract Administrative Services system.

The General Accounting and Finance System, the official Air Force accounting system, relied on the Mechanization of Contract Administrative Services system, a DFAS system, to make disbursements against its appropriations. The Acquisition Management Information System, a system for disbursing funds for major procurement programs, was maintained at Wright-Patterson AFB, but payments were made at Albuquerque, New Mexico. The Central Procurement

Accounting System was used at Warner Robins AFB to track payments made by the Mechanization of Contract Administrative Services system against appropriations of the "M" account.

Disbursements were made by all four systems. The four systems made disbursements on the type of funds residing on the contract and also the location of the paying station for the contract. For example, the Central Procurement Accounting System was maintained at Warner Robins AFB for making payments on contracts at that location. Not every contract is maintained on all four systems. Depending on when and where payments were made, delays in recording transactions of up to 9 months occurred. Because of the delays (as well as inaccuracies in accounting records), contracting and system program office officials had difficulty determining the validity of their ULO balances. To make data timely and accurate, a single paying and accounting system should be used for disbursing and financial accounting and management of contract payments.

Other Factors Affecting "M" Account Balances

Other factors that made it difficult to validate "M" account balances included recording of NULOs and slow closeout of contracts.

Negative Unliquidated Obligations. The recording of NULOs distorted the balances in the "M" accounts. NULOs result when expenditures exceed recorded obligations, causing the contract balance to show a negative value. In order to eliminate a NULO, a positive amount must be posted to the accounting records to reduce the NULO to zero. Records at the four Air Force bases showed more than $2.0 billion in NULOs. The accounting personnel at the DAOs were required to record the data that came from the DFAS Center system. Because of the large number of transactions being recorded, reconciliations were not effective. Accounting personnel further stated that although they reconciled a contract or a contract line, discrepancies resulting in NULOs recurred because of the payment practices at the DFAS-Columbus Center.

Prior to the enactment of Public Law 101-510, appropriations were merged two years after their availability for obligation had expired. Organizations merged fiscal year funds when appropriations changed from expired to merged status. At that time fiscal year designation for appropriations was changed to an "M," hence the term "M" accounts.

With enactment of Public Law 101-510, organizations were to phase out the "M" account unliquidated obligation balances by September 30, 1993. The "M" accounts were phased out incrementally by fiscal year, with the oldest "M" accounts canceled first. To do so, the organizations were to review and maintain their "M" accounts by fiscal year.

Air Force guidance stated that while "M" account unliquidated obligations would not actually be canceled until September 30, 1993, those "M" account unliquidated obligations to be phased out annually would be removed from the active accounting records and placed within a "set aside" account until September 30, 1993 when the actual cancellation of the "M" accounts would occur. The "set aside" account was deemed a memo account: once unliquidated obligations were placed in the account, the funds were closed from active usage.

At Los Angeles AFB, disbursements and posting adjustments had to be made against unliquidated obligations that had been mistakenly put into the "set aside" account. That occurred because those unliquidated obligations had not been identified by fiscal year as required under Public Law 101-510. Consequently, Los Angeles AFB set aside $160.0 million for cancellation, causing NULO balances to occur when disbursements were later made for valid billings received from contractors. Accordingly, Los Angeles AFB needed additional funding to cover those premature set asides.

NULOs also resulted from disbursement and recording errors. On contract F33657-83C-2149, we found that the DFAS-Columbus Center payment history showed that expenditures exceeded recorded obligations by $20.1 million, while the official records maintained at Wright-Patterson AFB still showed unliquidated obligations (recorded obligations exceeding expenditures) as $14.8 million. The $34.9 million discrepancy occurred partly because DFAS-Columbus Center erroneously obligated $101.3 million and erroneously disbursed $121.5 million. The remainder of the $34.9 million discrepancy ($14.7 million) was attributed to other financial recording errors.

NULOs also occurred when progress payments were made to contractors. Progress payments are recorded in the Air Force General Accounting and Finance System as credit amounts. Therefore, unliquidated progress payments are shown as NULOs on the official accounting records. We were unable to determine the value of progress payments that were not liquidated (collected from the contractor).

Los Angeles AFB had a positive unliquidated balance of $1.193 billion and negative unliquidated balance of $1.200 billion. As a result, the DAO reported a net NULO balance of $7.0 million. Accounting personnel at Los Angeles AFB stated that delays in receiving detailed payment records and system updates to their accounting records caused delays in reconciling the "M" accounts. Updates to accounting records at Los Angeles AFB were behind by as much as 9 months. As a result, system program offices called the contractors to find out the current status of their contract balances.

Slow Contract Closeout. Air Force personnel at the system program offices cited the Defense Contract Audit Agency as partly to blame for the inability of Air Force personnel to validate the ULOs and deobligate invalid fund balances. Air Force officials stated that the Defense Contract Audit Agency was about 2 years behind in auditing and closing contracts. A report maintained by the Air Force Materiel Command at Wright-Patterson AFB showed $119.8 million

in open contracts awaiting Defense Contract Audit Agency closeout audit and validation. We did not determine the cause for the backlog or validate its dimensions, because previous audits had confirmed its existence and the deleterious impact on contract closeout by the DoD components.

Conclusion

Air Force accounting records were materially misstated. Misstatements were due to contracting practices of the Air Force; billing practices of the contractor; paying, crediting of progress payment liquidations, and recording practices by the DFAS-Columbus Center; and lack of integration of the systems used to process the financial data. As a result, the financial records overstated the need for "M" account funds valued at $440.0 million that could have been deobligated and used to fund other programs. Further, our findings support the results in Audit Report No. 92-028, which showed that 50 percent of the DoD "M" Account obligations reviewed were invalid.

Corrective Actions Initiated

The problems identified in this finding are similar to those found in the IG, DoD, audit on the Titan IV Program discussed under Prior Audits and Other Reviews in this report. Corrective actions agreed to in the mediation process for that report should correct some of the problems found in our audit. Policy changes will require that contractors specifically bill the Government by ACRN and CLIN and that disbursing officers not make expenditures that cannot be identified by appropriation. In addition, the DFAS has initiated two efforts that should result in the documentation and implementation of corrective actions for bringing DoD accounting and disbursing systems into compliance with revisions in the DoD Manual 7220.9, "DoD Accounting Manual." As a result, we are not making recommendations in those areas for this finding. We will monitor the progress made on those initiatives during future audits.

Recommendation, Management Comments, and Audit Response

We recommend that the Director, Defense Finance and Accounting Service, develop and implement one paying and accounting system to replace the four systems currently used.

Management Comments. Management concurred and stated that it is working toward implementing standard migration systems that will eventually result in one paying and accounting system. Systems reductions will take place as Defense Finance and Accounting Service operating locations are evaluated and consolidation takes place. See Part IV for the full text of management's comments.

Audit Response. Management comments meet the intent of the recommendation.

Finding B. Advance Payment of Incentive Fees

Two Air Force system program offices at Los Angeles Air Force Base (AFB) prepaid two contractors at least $9.8 million for unearned on-orbit incentive fees for satellite systems. That occurred because the system program offices, the contracting offices, and the disbursing offices did not comply with statutory requirements in the Federal Acquisition Regulation (FAR), the Defense Federal Acquisition Regulation Supplement (DFARS), and DoD Manual 7220.9-M, "Department of Defense Accounting Manual" (DoD Accounting Manual). Section 3324 of 31 U.S.C. allows advance payments only when authorized by a specific appropriation, other laws, or the President. Instead of complying with statutory requirements, two system program offices followed a local policy issued by Headquarters, Space and Missile Systems Center (SMC). That policy allowed prepayment of incentive fees and created a vehicle to permit the use "M" account funds before those funds were made unavailable through the phasing out of "M" accounts. As a result, payments to the two contractors were made improperly. Also, a DoD waiver on budgeting lead-time away from need for unearned on-orbit incentive fees may result in violations of the Antideficiency Act.

Background

Provisions of Law. Advance payments are authorized by law only if they comply with specific statutory requirements. Advances under a contract are payments for which performance has not occurred. Section 3324 of U.S.C. 31 provides:

> (a) Except as provided in this section, a payment under a contract to provide a service or deliver an article for the United States Government may not be more than the value of the service already provided or the article already delivered.
>
> (b) An advance of public money may be made only if it is authorized by
>
> (1) a specific appropriation or other law; or
>
> (2) [by]--the President [under certain conditions].

Section 2307 of U.S.C. 10 provides the authority and the conditions under which the Secretary of Defense and the Secretaries of the Military Departments, or their delegees, may make non-emergency advance payments under contracts for property or services made by the agency for amounts in excess of the amount of the small purchase threshold.

Comptroller General Decision. Comptroller General Decision, B-180713, April 10, 1974, specifically states that advance payments are prohibited "to preclude the possibility of loss to the Government in the event the contractor, after receipt of payment, should fail to perform his contract, [and should] refuse or fail to refund moneys advanced."

Provisions of the FAR and DFARS. The statutory requirements of section 2307 of U.S.C. 10 and other general contracting regulatory requirements are set out in the FAR, Subpart 32.402, "Advance Payments."

Key FAR provisions are that all statutory requirements be met; the contractor give adequate security; the advance payments not exceed the unpaid contract price; and the agency head or designee, at a sufficiently high organization level, approve the advance payment based on written findings that the payment is in the public interest. Paragraph 32.409-1 of the FAR provides a list of things the contracting officer must transmit to the approving authority when the contracting officer recommends approval of advance payments.

The DFARS requirements for advance payments are found in Subpart 232.4. Paragraph 232.409-1, "Recommendation for approval," requires the departmental or agency contract financing office to prepare the documents required by FAR 32.409-1(e) and (f) in order to ensure uniform application of that subpart.

The DoD Accounting Manual. Chapter 25 of the DoD Accounting Manual prescribes that a contingent obligation must be recorded against the same source of funds that originally was obligated for in the contract. Chapter 35 prescribes the principles and standards to be followed by DoD Components to account for advances and prepayments.

The DoD Accounting Manual also provides an overview of the authority and approvals required for advances and related accounting principles and sets out the procedures to account for those payments.

Full-Funding Policy. It is the policy of the Federal Government to fully fund procurements that are covered within the annual Defense Appropriation Act. The objective is to identify at the outset of the program the total funds required so that Congress and the public are aware of the cost when the program is first presented in the budget. That identification of funds also assists the Congress in monitoring the total cost of each major procurement program. Included in the

"full-funding" cost estimate are the incentive fees that may come due at a future date. Full funding of military procurement programs is not a statutory requirement, and a deviation from full funding does not automatically constitute a violation of 31 U.S.C. 1341, the Antideficiency Act.

Incentive Fees. Some major system procurement contracts include an incentive fee clause to pay the contractor a bonus as an incentive if the product meets specific performance requirements (i.e., satellites operate more than 5 years or a launch is successful). Performance requirements may not occur until after the funds obligated for use on a contract have expired, and current year funds have to be used. We recommended the DoD seek legislative relief for contingent liabilities, such as incentive fees, in our Audit Report No. 93-053, "Missile Procurement Appropriations, Air Force," February 12, 1993. The Deputy DoD Comptroller (Management Systems) responded to our recommendation and stated that section 1004 of Public Law 102-484 authorizes the DoD under certain circumstances to use funds from any current DoD appropriation account available for the same purpose as the expired account.

In keeping with the full-funding policy, the Air Force budgets on-orbit performance incentives in the same fiscal year as procurement of the satellite. In many instances, the incentive fee is not earned until after the fiscal year appropriation that was available for payment of these fees has been canceled. Prior to enactment of Public Law 101-510, that did not present a problem because unliquidated obligational authority in "M" accounts was charged with the disbursement.

With the elimination of "M" accounts, the Air Force believed the full-funding policy should be waived in the case of the on-orbit performance incentive fees. The Air Force felt there was a predictable loss of budget authority if fees were not earned and disbursed before cancellation of the affected appropriations.

Incentive Fee Payments

The fees earned by and paid to contractors for satellites that stay on orbit in space and operate as stated and for the periods of time specified in the contracts are called on-orbit incentive fees.

In FY 1991, prepaid incentive fees of $2.0 million were paid from "M" account funds on a satellite contract for the Defense Support System Program. In FY 1993, prepaid incentive fees of $7.8 million were paid from "M" account funds on a satellite contract for the Defense Meteorological System Program. Air Force officials involved had determined that the incentive fees would be earned after the cancellation of the "M" accounts on September 30, 1993.

We talked with officials in the system program offices at Los Angeles AFB to determine whether adequate security was provided by the contractor in either case. We also discussed the officials' method for assessing whether making the advances was in the public interest. Air Force officials stated that no security

was acquired from the contractors and no analysis of whether making the advance was in the public interest was made. Nevertheless, Air Force officials at Los Angeles AFB approved, and SMC policy may have encouraged, prepayment of the on-orbit incentive fees to the contractors from restored "M" account balances that were to be canceled on September 30, 1993.

Local Practice and Policy. We asked Air Force officials for written documentation that described or approved the practice of prepaying on-orbit incentive fees. They provided a SMC, Field Activity Management, policy dated July 14, 1992, signed by the Commander, Headquarters, SMC, Los Angeles AFB.

The SMC policy stated that contractors may request to be paid the full present value (discounted time value of money calculated from the estimated launch date using the current U.S. Treasury rate as of the date negotiations were completed) of the incentive fee at acceptance or at the earliest possible time if past acceptance on current satellite contracts for which incentive fees had been negotiated. Payback to the Government (of incentive fees not earned by future performance) was to include the amount of the original payment and the time value of money. However, the SMC policy document did not set out the statutory and regulatory requirements that should be satisfied before an advance payment may be made.

The SMC policy also stated that, "Program offices that have already negotiated a methodology that covers the 'M' Account/Expired Funds problem on current contracts may have this policy waived."

We were told that no legal review of the SMC local policy was done to ensure it complied with all statutory and regulatory requirements.

No discernible differences existed in actions taken by Air Force officials on prepayments made before or after the SMC policy document was issued. For the payments making up the $9.8 million in unearned on-orbit incentive fees discussed above, Air Force system program offices, contracting offices, accounting officials, and others who may have had responsibilities for advance payments, did not independently take the required steps to ensure that the statutory and regulatory requirements had been met.

Request for Waiver of Full-Funding Policy. By memorandum dated June 25, 1992, the Deputy Assistant Secretary of the Air Force (Budget) asked the Deputy DoD Comptroller (Program/Budget) to waive the full-funding policy on the payment of on-orbit incentive fees.

In that memorandum, the Deputy Assistant Secretary recommended that "performance incentive fees should be budgeted in the fiscal year in which the contractor is expected to earn the fee" and acknowledged that such an accounting change would require a statutory change.

The memorandum also referred to the draft of IG, DoD, Audit Report, "Missile Procurement Appropriations, Air Force," February 12, 1993, which had recommended that the DoD Comptroller seek legislative relief to allow

unliquidated obligations for incentive and award fees that have not been earned when the obligated appropriations are canceled to be funded in the future when the fees are earned from current appropriations available for the same purpose.

In responding to the IG, DoD, final audit report, the Deputy DoD Comptroller (Management Systems) stated that under the transition authority provided in section 1004 of Public Law 102-484, October 5, 1992, the DoD was authorized, under certain circumstances, to charge any current appropriation account that was available for the same purpose as the expired account.

DoD Response to the Air Force Request for Waiver. The DoD Deputy Comptroller (Program/Budget) responded to the Air Force's waiver request in a memorandum dated July 14, 1992, in which he approved the budgeting of lead-time away from need for unearned on-orbit incentive fees. In part, his memorandum stated:

> . . . these costs are not a direct part of the flyaway hardware[,] but reward the contractor for successful operations of the satellite and are frequently not incurred until after the appropriation would be canceled. Since the incentive payments support the successful operation and reliability of the satellite, [the incentive payments] can be treated in the same manner as other support costs and budgeted lead time away from the need.

The Deputy Comptroller further stated that the waiver was an "exception to the general rule that anticipated costs of award and incentive fees are budgeted with the end item. This exception is only being made for on-orbit incentives because of the delayed nature of these payments."

The SMC policy did not authorize budgeted lead-time away, but, in fact, authorized prepayments. Budgeted lead-time away allows flexibility to budget for funds in the year prior to the on-orbit incentive fee being earned.

To the extent the amount of future on-orbit incentive fees that can be earned under a contract is negotiated and agreed on before contract award, or shortly thereafter, as a modification to the contract, we question whether such a practice raises Antideficiency Act problems.

Section 1341 of U.S.C. 31, the Antideficiency Act, prohibits officers or employees of the United States Government from

> making or authorizing an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation, or involve [the United States Government] in a contract or obligation for the payment of money before an appropriation is made unless authorized by law.

As a general proposition, Comptroller General decisions have required that an amount equal to the maximum contingent liability of the Government under a contract must be always available for obligation from appropriations current at the time the contract is made. We also note that Comptroller General decisions that reflect recognition of contingent liabilities in the form of an administrative reservation or commitment of funds provide an imperfect solution to the

problem of unliquidated obligations that do not result in disbursements before the charged appropriations are canceled. Though little used, reserves for contingencies are recognized in 31 U.S.C. section 1512(c) and 2 U.S.C. section 684(b).

Conclusion

The Air Force prepaid $9.8 million in unearned incentive fees to two contractors without ensuring that all statutory and regulatory requirements for such prepayments had been met. That occurred because system program offices and other Air Force personnel followed local practice and SMC policy that did not adequately address those requirements or state that they must be met. Accordingly, the SMC policy needs to be changed to fully comply with the statutes, the FAR and DFAR, and the DoD Accounting Manual.

Although an Antideficiency Act violation did not occur in this case, the Deputy DoD Comptroller approval of delayed budgeting for unearned on-orbit incentive fees could result in violations related to other contracts and liabilities.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Comptroller of the Department of Defense:

a. Rescind the waiver from the Deputy Comptroller of the Department of Defense (Program/Budget) dated July 14, 1992, that approved the budgeting of lead-time away from need for unearned on-orbit incentive fees.

b. Issue a policy memorandum to DoD financial mangers emphasizing that the statutory and regulatory requirements for advanced payments must be met and explaining the legally available alternatives to account for unearned on-orbit incentive fees.

2. We recommend that the Assistant Secretary of the Air Force (Financial Management and Comptroller):

a. Rescind Space and Missile Systems Center Field Activity Management policy dated July 14, 1992, signed by the Commander, Los Angeles Air Force Base, that provided for the advance payment of on-orbit incentive fees.

b. Direct system program offices to identify advance payments for unearned on-orbit incentive fees that have not yet been earned and bring those payments into compliance with statutory requirements. For advance payments that cannot be brought into compliance with statutory requirements, require the program offices to recoup the payments from the contractor.

c. Identify any contracts awarded since the July 14, 1992, memorandum from the Deputy Comptroller of the Department of Defense (Program/Budget) that involve lead-time away budgeting for on-orbit incentive fees; determine if a violation of the Antideficiency Act occurred; investigate; fix responsibility; and comply with reporting requirements of DoD Directive 7200.1.

d. Adopt any of the legally available accounting alternatives to account for unearned on-orbit incentive fees.

Management Comments. Management comments were not received from the Comptroller of the Department of Defense. The Deputy Assistant Secretary of the Air Force (Budget) concurred with all of our recommendations related to Air Force policy on the payment of on-orbit incentive fees. See Part IV for the full text of management's comments.

Audit Response. The comments from the Deputy Assistant Secretary of the Air Force (Budget) were responsive. However, if the Comptroller of the Department of Defense rescinds the July 14, 1992, memorandum which approved budgeting of lead-time away from need for unearned on-orbit incentive fees, the Air Force will have to reissue policy consistent with any new DoD policy for such fees. DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, the Comptroller of the Department of Defense should provide comments to the final report by August 16, 1994.

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Part III - Additional Information

Appendix A. Request From Chairman, Senate Subcommittee on Defense, Committee on Appropriations

ROBERT C. BYRD, WEST VIRGINIA, CHAIRMAN

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J. KEITH KENNEDY, MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON APPROPRIATIONS
WASHINGTON, DC 20510-6025

June 21, 1993

Mr. Derek Vander Schaaf
Deputy Inspector General
400 Army Navy Drive
Arlington, VA 22202

Dear Mr. Vander Schaaf:

Through recent DoD I.G. and GAO reports, it has come to my attention that a question has been raised over the validity of $649 million in Air Force obligations restored from the "M" accounts under authority provided in the 1991 Defense Authorization Act. Moreover, Senator Charles Grassley of Iowa has raised serious concerns about the Air Force's failure to accurately account for these obligations.

Given Senator Grassley's concerns, and the questions raised by your organization and the GAO, I request that you undertake a formal audit of this restoration from the "M" accounts. The audit should determine the validity of these obligations by, at a minimum, answering the following questions: Is there documentation to support the obligation and expenditure of the $649 million and, if not, does this constitute a violation of current law? And, was the $649 million restored from the merged surplus account after it was closed under statute? Your audit also should determine what - if any - "Anti-deficiency Act" violations have occurred or would occur should funds not be available to meet such obligations, and the nature of Air Force bookkeeping methods which led to the "requirement" to restore these obligations.

Since your office already has looked into this problem, I urge you to provide a complete audit report to the Congress within 90 days after the receipt of this letter. Should you have any questions regarding this request, please feel free to contact David Morrison (202-224-7296), a member of my staff. I appreciate your prompt attention to this matter.

Sincerely,

Daniel K. Inouye
Chairman
Senate Appropriations
Subcommittee on Defense

Appendix B. Contract Status of Unliquidated Obligation Balances at Wright-Patterson Air Force Base

Contract Number	Program	MOCAS ULO[1]	ODL ULO[2]	Valid	Invalid
83C2149	B1	$(20,143,149)	$14,813,750	$ 1,922,409	$12,891,341
84C0018	B1	(2,499,293)	9,895,527	0	9,895,527
84C2135	B1	(1,946,486)	(219,508)	0	(219,508)
77C0565	F-16	(91,925)	1,324,533	0	1,324,533
81C2041	F-16	(3,107,830)	5,458,376	25,000	5,433,376
84C0173	F-16	(1,976,014)	438,199	0	438,199
86C2133	F-16	(1,359,639)	1,816,028	0	1,816,028
80C0441	Lantirn	(375,912)	(4,675,124)	73,000[3]	(4,748,124)
84C0004	Lantirn	2,011,743	1,384,352	1,384,352	0
77C0330	C-130 Combat Talon II	2,739,751	2,118,130	89,686	2,028,444
83C0264	Spares	1,194,693	(11,003,773)	0	(11,003,773)
Total		$ (25,554,061)	$ 21,350,490	$3,494,447	$ 17,856,043
ULO		$ 5,946,187	$ 37,248,895	$3,494,447	$ 33,827,448
NULO		$ (31,500,248)	$(15,898,405)	0	$(15,971,405)
Absolute		$ 37,446,435	$ 53,147,300	$3,494,447	$ 49,798,853

[1]Paying system records.
[2]Official accounting system records.
[3]The contract had a negative balance, but still needed $73,000.

Acronyms

MOCAS	Mechanization of Contract Administrative Services
NULO	Negative Unliquidated Obligation
ODL	Open Document Listing
ULO	Unliquidated Obligation

Appendix C. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Type of Benefit
A.	Economy and Efficiency. Improve accuracy of accounting records, oversight of funds, and financial operations.	Nonmonetary
B.1.a., B.1.b., B.2.a., B.2.d.	Internal control. Will strengthen internal controls over fiscal accountability and management in DoD.	Nonmonetary
B.2.b., B.2.c.	Compliance. Will bring the Air Force into compliance with statutory requirements and DoD Directive 7200.1.	Nonmonetary

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Comptroller of the Department of Defense, Washington, DC

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller), Washington, DC
Headquarters, Air Force Materiel Command, Wright-Patterson Air Force Base, OH
- Air Force Materiel Command, Los Angeles Air Force Base, CA
- Air Force Materiel Command, Tinker Air Force Base, OK
- Air Force Materiel Command, Warner Robins Air Force Base, GA

Defense Agencies

Headquarters, Defense Finance and Accounting Service, Arlington, VA
- Defense Finance and Accounting Service Center, Columbus, OH
  - Defense Accounting Office, Los Angeles Air Force Base, CA
  - Defense Accounting Office, Tinker Air Force Base, OK
  - Defense Accounting Office, Warner Robins Air Force Base, GA
  - Defense Accounting Office, Wright-Patterson Air Force Base, OH

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition
Comptroller of the Department of Defense

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Acquisition)
Assistant Secretary of the Air Force (Financial Management and Comptroller)
Commander, Air Force Materiel Command, Wright-Patterson Air Force Base, OH
  Commander, Air Force Materiel Command, Los Angeles Air Force Base, CA
  Commander, Air Force Materiel Command, Tinker Air Force Base, OK
  Commander, Air Force Materiel Command, Warner Robins Air Force Base, GA

Defense Agencies

Director, Defense Contract Audit Agency
Director, Defense Contract Management Command
Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service-Columbus Center

Non-DoD Federal Organizations

Office of Management and Budget

National Security and International Affairs Division, Technical Information Center, U.S. General Accounting Office

Chairman and Ranking Minority Member of Each of the following Congressional Committees and Subcommittees:

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  Senate Subcommittee on Defense, Committee on Appropriations
  Senate Committee on Armed Services
  Senate Committee on Governmental Affairs
  House Committee on Appropriations
  House Subcommittee on Defense, Committee on Appropriations
  House Committee on Armed Services
  House Committee on Government Operations
  House Subcommittee on Legislation and National Security, Committee on Government Operations

Part IV - Management Comments

Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

DFAS-HQ/F

JUN 0 1 1994

MEMORANDUM FOR DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: DoD IG Draft Report, "Air Force Merged Account Obligations," (Project Code 3FG-5030)

As acknowledged in your draft report, the Defense Finance and Accounting Service (DFAS) is pursuing numerous actions in response to several audits regarding unliquidated obligations. We concur with your statement that monitoring progress achieved on these initiatives during future audits will adequately document the effectiveness of corrective actions.

In response to your recommendation to replace the four systems currently used with one, DFAS is working toward standard migration systems. At this time, transferring the payment process from the Automated Management Information System (AMIS) to the Mechanization of Contract Administrative Services (MOCAS) system has already begun and is scheduled for completion by March of 1995. Systems reductions will take place as the DFAS operating locations are stood-up and consolidation takes place. Also, while administration of these contracts might have occurred at various Air Force activities, payments were centralized at the DFAS-Albuquerque activity. Please note that the General Accounting and Finance System and the Central Procurement Accounting System have the ability to track entitlements and disbursements; they do not have the functionality to discharge these functions as indicated on page 15 of your report.

Michael E. Wilson
for Deputy Director for Finance

Department of the Air Force Comments

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

OFFICE OF THE ASSISTANT SECRETARY

MAY 26 1994

MEMO FOR SAF/FMPB

FROM SAF/FMBM

SUBJECT DoDIG Project 3FG-5030, Air Force Merged Account Obligations-INFORMATION MEMORANDUM

We are providing our management comments for the subject audit Additionally, we will prepare the appropriate SAF/FM correspondence to AFMC implementing these corrective actions

Our point of contact for this audit is Ms Sandra Thigpen, 54938

ROBERT W COOK
Director of Budget Management & Execution
Deputy Assistant Secretary (Budget)

Attachment
3FG-5030 Comments

DRAFT OF A PROPOSED AUDIT REPORT

AIR FORCE MERGED ACCOUNT OBLIGATIONS

Project No 3FG-5030

Findings B. Advance Payment of Incentive Fees.

Following a local policy issued by Headquarters, Space and Missile Systems (SMC), two system program offices allowed prepayment of incentive fees

In keeping with the full funding policy, the Air Force budgets on-orbit performance incentives in the same fiscal year as procurement of the satellite. In many instances, the incentive fee is not earned until after the fiscal year appropriation that was available for payment of these fees has been canceled Prior to enactment of P L 101-510, this did not present a problem because unliquidated obligation authority in "M" account was charged with the disbursement With the elimination of the "M" account, the Air Force believed the full funding policy should be waived in the case of on-orbit performance incentive fees Budget authority loss would be the result if fees were not earned and disbursed before cancellation of the affected appropriation Following a waiver request from the Air Force, the DoD Deputy Comptroller (Programs/Budget) issued a memorandum dated July 14, 1992, in which he approved the budgeting of lead-time away from need for unearned on-orbit incentive fees

RECOMMENDATIONS FOR CORRECTIVE ACTION

2a Concur SMC will be directed to rescind their Regulation 540-10 policy and to reissue policy consistent with the DoD memo, July 14,1992, which approved budgeting for these fees lead time away from need, not advance payment of on-orbit incentive fees

2b Concur SMC will identify advance payments for unearned on-orbit incentive fees that have not yet been earned and bring them into compliance with statutory requirements The important concern is that incentive payments must be tied to actual performance completed If advance payments cannot be brought into statutory compliance, SMC will be directed to recoup the payments from the contractor

2c A review of contracts awarded since July 14, 1992, that involve lead time away budgeting for on-orbit incentive fees, is being conducted If antideficiency violations appear to exist, an investigation will be conducted

2d Concur SMC will be directed to follow established accounting procedures for performance incentives to account for unearned on-orbit incentive fees

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INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Air Force Merged Account Obligations

B. DATE Report Downloaded From the Internet: 03/22/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): **OAIG-AUD (ATTN: AFTS Audit Suggestions)**
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D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ Preparation Date 03/22/99

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