Audit Report

OFFICE OF THE INSPECTOR GENERAL

FINANCIAL STATUS OF NAVY EXPIRED YEAR APPROPRIATIONS

Report No. 94-036 February 10, 1994

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Department of Defense

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Acronyms

AO	Administering Office
APN	Aircraft Procurement, Navy
ASN(FM)	Assistant Secretary of the Navy (Financial Management)
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
GAO	General Accounting Office
IG	Inspector General
"M" Account	Merged Account
NAVAIR	Naval Air Systems Command
NAVCOMPT	Navy Comptroller
NAVSEA	Naval Sea Systems Command
O&M,N	Operation and Maintenance, Navy
OCNR	Office of the Chief of Naval Research
OMB	Office of Management and Budget
RDT&EN	Research, Development, Test and Evaluation, Navy
RO	Responsible Office
SCN	Shipbuilding and Conversion, Navy
SSPO	Strategic Systems Program Office
STARS	Standard Accounting and Reporting System
WPN	Weapons Procurement, Navy

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

February 10, 1994

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on the Financial Status of Navy Expired Year Appropriations (Report No. 94-036)

We are providing this final report for your review and comments. During our audit of Air Force expired year Missile Procurement appropriations, we identified actual and potential Antideficiency Act violations, improper use of current year appropriations to fund expired year requirements, and unmatched disbursements. For this audit of the Navy, our objectives were to review the Navy's expired year appropriations and determine whether similar problems existed. Comments on a draft of this report were considered in preparing this final report.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, we request that the Navy review the "Response Requirements for Each Recommendation" chart at the end of each finding and provide comments on the final report by April 11, 1994. The charts indicate the specific requirements for your comments.

The courtesies extended to the audit staff are appreciated. If you have questions about this audit, please contact Mr. F. Jay Lane, Program Director, at (703) 693-0430 (DSN 223-0430), or Mr. Dennis L. Conway, Project Manager, at (703) 693-0476 (DSN 223-0476). If you have suggestions for future audit work, please feel free to contact us. Copies of the final report will be distributed to the organizations listed in Appendix D. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 94-036
Project No. 2FG-2016

February 10, 1994

AUDIT REPORT ON THE FINANCIAL STATUS OF NAVY EXPIRED YEAR APPROPRIATIONS

EXECUTIVE SUMMARY

Introduction. We made the audit to determine whether the Navy had problems with expired year appropriations similar to those in the Air Force. The Air Force had difficulty in funding upward adjustments to obligations for contract changes when costs were properly chargeable to expired year appropriations. Such changes had previously been funded from merged surplus accounts. The National Defense Authorization Act for Fiscal Year 1991 (the Act) changed the period of time and the procedures for the liquidation and adjustment of obligations after an appropriation's period of availability. In general, the new law provided that an appropriation will maintain its fiscal year identity after its period of availability has expired, and will be available for legitimate obligational adjustments for 5 years, but not for new obligations. The Act canceled all merged surplus authority effective December 5, 1990. Consequently, merged surplus accounts were no longer available for restoration of obligational adjustments approved after that date. Amounts transferred to merged accounts ("M" accounts) as of or before September 30, 1990, remained available for obligational adjustments and disbursements until September 30, 1993 (a 3-year transition period during which, at each September 30, any deobligated balances were canceled.)

Objectives. The objectives of the audit were to identify expired appropriations that may have financial problems and to review the financial status of those appropriations. We reviewed the methods used to determine the financial status of expired year appropriations and evaluated the financial status of major procurements citing these appropriations.

Audit Results. The Navy was attempting to fully comply with appropriation law; however, in three major procurement programs that were line-item appropriated in the Weapons Procurement appropriation, there were four apparent funding deficiencies amounting to $17.5 million that were not investigated (Finding A). In the Weapons and Aircraft Procurement appropriations, there were potential funding deficiencies that could total $164.8 million. These deficiencies may occur if contingent liabilities become actual liabilities. Further, the Navy had claims of $861.4 million pending in the Research, Development, Test and Evaluation appropriation that could result in funding deficiencies if additional funds are not available (Finding B). Navy records do not accurately reflect the status of expired year appropriations. As a result, there were $6.1 million in charges to current year appropriations that should be reversed and charged to the correct prior year appropriations, and almost $1.0 billion in unmatched disbursements that need to be reconciled (Finding C).

Internal Controls. The audit identified material internal control weaknesses as defined by Public Law 97-255, OMB Circular No. A-123, and DoD Directive 5010.38. Internal controls were not adequate to identify appropriations with apparent and potential violations of the Antideficiency Act (Findings A and B), or to accurately reflect the status of expired year appropriations (Finding C). See Part I for details of the internal controls reviewed and Part II for a discussion of the weaknesses.

Potential Benefits of Audit. Recommendations in this report, if implemented, will result in compliance with regulations and improved economy and efficiency of operations, and will also increase the amount of current year funds available by $6.1 million. Fiscal responsibility should improve when the Navy's records show obligated amounts at the time obligations are incurred. Appendix B summarizes the potential benefits resulting from the audit.

Summary of Recommendations. We recommended that the Assistant Secretary of the Navy (Financial Management) investigate apparent appropriation account deficiencies for the MK-50, the Standard Missile, and the Phoenix Missile, fix responsibility, and report any actual Antideficiency Act violations; record obligations even if they may cause deficiencies; establish procedures for identifying requirements that may cause deficiencies in the future; maintain contingent liabilities in accounting records after funds expire; and properly record obligations supporting contingent liabilities. We also recommended that the Navy correct obligational adjustments, post them to the correct fiscal year, and establish procedures to verify that administering offices obtain proper approvals for obligational adjustments within established thresholds. Further, we recommended that the Director, Defense Finance and Accounting Service, establish automated procedures for ensuring that correct funding information is entered into the Standard Accounting and Reporting System.

Management Comments. The Director of Budget and Reports, Department of the Navy, concurred with the findings that apparent funding deficiencies had occurred in the procurement programs and that potential funding deficiencies could occur if claims become actual liabilities. He did not concur with our recommendations to maintain contingent liabilities in accounting records after funds expire and to correct accounting entries to show the proper charges for contract modifications. Therefore, we request that the Navy review our audit responses in Part II and provide comments on this final report by April 11, 1994. The Deputy Director for General Accounting, Defense Finance and Accounting Service, concurred in principle and stated that procedures are being developed to improve the integrity of the Standard Accounting and Reporting System and interfacing systems to create a more reliable reporting structure. The full text of comments from the Navy and Defense Finance and Accounting Service is in Part IV.

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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

In FY 1992, we audited the Air Force's expired Missile Procurement appropriations. The audit showed that finance and accounting records were materially misstated and did not provide reliable information to support budget decisions. The Air Force's Missile Procurement Appropriations were poorly managed, resulting in funding shortfalls and apparent violations of the Antideficiency Act. We believed there was potential for similar problems in other DoD appropriations. As a result, we initiated a series of audits of expired appropriations in the other Services and Defense agencies.

Control Over Funds. Federal agencies, including the Department of the Navy, are responsible for ensuring that their funds are spent as specified by Congress. For example, under 31 United States Code (U.S.C.) 1301, agencies may use appropriations only for their intended purposes. Further, the Antideficiency Act (31 U.S.C. 1341 and 1517) prohibits agencies from overobligating or overexpending their appropriations, apportionments, and administrative divisions of funds. To implement these requirements, DoD Directive 7200.1 specifies the requirements for accounting and fund control systems for DoD. The Directive states that these systems are to ensure that funds are used only for congressionally authorized purposes, and that payments do not exceed amounts available.

The Navy's administrative control procedures are designed to prevent unauthorized disbursements and purchases and to ensure that the Navy does not obligate or spend more funds than Congress has appropriated. These control procedures require Navy organizations to:

- commit or administratively reserve funds based on firm procurement directives, orders, requisitions, or requests;

- record obligations in appropriation accounts when placing orders, awarding contracts, receiving services, or executing similar transactions; and

- match disbursements with related obligations in the accounting records as payments are made.

Navy funding organizations[1] are responsible for executing the first two control procedures, while Navy accounting organizations are generally responsible for carrying out the third procedure.

[1] Funding organizations, as used in this report, refer to Navy administering offices. These organizations, which include the Navy systems commands, are responsible for preparing and executing approved budgets, ensuring that funds are used only for appropriate purposes, and ensuring accurate and timely reporting of program and funding status.

The Navy's 11 major funding organizations are the Naval Sea Systems Command, Naval Air Systems Command, Naval Supply Systems Command, Space and Naval Warfare Systems Command, Naval Facilities Engineering Command, Strategic Systems Project Office, Naval Education and Training Command, Pacific Fleet, Atlantic Fleet, Naval Reserve Force, and Marine Corps Headquarters.

Although Navy funding organizations commit and obligate funds, other Navy and DoD offices disburse the funds. Disbursing offices are required to ensure that payments are made only for goods and services authorized by purchase orders, contracts, or other documents; that the Government receives and accepts the goods and services; and that payment amounts are accurately computed. Disbursing offices are also responsible for ensuring that complete and accurate accounting data are recorded on supporting documents. Disbursing offices submit daily and monthly disbursement reports to 12 regional Navy processing centers.

Merged Accounts. In 1956, Public Law (P.L.) 84-798 established the merged accounts ("M" accounts) and merged surplus authority accounts as repositories for unspent budget authority from expired appropriations. The "M" accounts accumulated balances of obligated but unpaid budget authority, and the merged surplus authority accumulated budget authority that had not been obligated. Neither could be used to incur new obligations. The budget authority in these accounts could be used to pay bills as they became due, and under certain circumstances to fund valid but previously unrecorded obligations or upward adjustments to amounts previously obligated.

Cancellation of Merged Accounts. The National Defense Authorization Act for Fiscal Year 1991, P.L. 101-510, November 5, 1990 (the Act), canceled all merged surplus authority and phased out "M" accounts. The Act provided that after the end of the period of availability for obligation of a fixed appropriation account and before the closing of that account, the account would retain its fiscal year identity and would remain available for recording, adjusting, and liquidating obligations properly chargeable to that account. In addition, the Act extended the availability of expired appropriations from 2 to 5 years.

The Act also provided that on September 30 of the 5th fiscal year after the period for obligation of a fixed appropriation account, the account shall be closed, and any remaining balance (obligated or unobligated) shall be canceled and thereafter shall not be available for obligation or expenditure for any purpose. Obligations and adjustments to obligations that would have been properly chargeable to those accounts (both as to purpose and amount) before closing, and that are not otherwise properly chargeable to any current appropriation account, may be charged to any current appropriation account available for the same purpose. However, the amount charged may not exceed 1 percent of the total appropriations for the account being charged, and must be approved and reported if contract changes involve additional work. Obligations for contract changes requiring additional work in excess of $4.0 million during a fiscal year must be approved by DoD, and work in excess of $25.0 million

during a fiscal year must be approved by Congress. The term "contract change," as defined in P.L. 101-510, sec. 1553(c)(3), excludes adjustments to pay claims or increases under an escalation clause.

Office of Management and Budget (OMB) Bulletin No. 91-07 implemented P.L. 101-510 and added information to OMB Circular No. A-34 on budget execution. OMB Circular No. A-34 defined expired accounts as "appropriation or fund accounts in which the balances are no longer available for incurring new obligations because the time available for incurring such obligations has expired." This definition includes balances in open "M" accounts.

Initial DoD Guidance. In a memorandum issued on December 10, 1990, "Guidance on the Accounting for Expired Accounts Including 'M' and Merged Surplus Accounts" (the guidance), the Comptroller of the Department of Defense (the DoD Comptroller) issued guidance for implementing P.L. 101-510. This guidance reiterated the law, which states that a "contract change" is a change under which a contractor is required to perform additional work, and does not include adjustments to pay claims or increases under an escalation clause.

On April 10, 1991, the Navy Comptroller (NAVCOMPT) issued NAVCOMPT Instruction 7040.37B, "Guidance for Administration of Appropriations After the Period of Availability," which supplemented and detailed the guidance. NAVCOMPT Instruction 7040.37B prescribed policies and procedures for the financial administration, approval, accounting, and reporting of appropriation balances and upward obligational adjustments to appropriations after the period of availability. The NAVCOMPT instruction correctly stated that:

> In general, the new legislation provides that after an appropriation's period of availability to incur obligations (ends), the appropriation will maintain its fiscal year identity and both the obligated and unobligated balances of that appropriation will be available for recording, adjusting, and liquidating obligations properly chargeable to that account. Unobligated balances will not be withdrawn from expired accounts, but will remain available for legitimate obligation adjustments for five years. During this five-year period, new obligations may not be incurred. However, obligations may be adjusted and disbursements may be made. On September 30th of the fifth fiscal year after the availability ends for each account, all obligated and unobligated balances will be canceled and the expired account will be closed. No disbursements may be made from closed expired accounts.
>
> The use of unobligated balances for upward obligation adjustments is only available for within-scope cost growth or increases in costs arising from claims that are antecedent liabilities attributable to the original obligation.

The NAVCOMPT instruction also directed that when upward obligational adjustments exceed $100,000 and involve any individual action or contract, they must be approved in advance by the Secretary of the Navy or a designee. Obligational adjustments under $100,000 may be approved by the Administering Office (AO) to which the budget authority was allocated. The instruction further stated that each AO must establish appropriate

internal controls and records to ensure compliance with the $4.0 million and $25.0 million constraints with respect to cumulative adjustments for each program, project, or activity.

Revised DoD Guidance. In a memorandum issued on June 13, 1991, "Revised DoD Guidance on Accounting for Expired Accounts, Including 'M' and Merged Surplus Accounts" (the revised guidance), the DoD Comptroller confused matters by extending the definition of contract changes to read, "...to also include changes in scope as well as any other change that results in additional contractor billable costs" (emphasis added). Except for certain obligational adjustments related to shipbuilding and overhauling, the guidance provided that all contract changes would be charged to current appropriations. Further, it stated that charges to current appropriations would have no impact on the 1-percent limitation.

However, the DoD guidance correctly stated that the control of maintaining reporting requirements applicable to an appropriation will continue to apply to that appropriation, following the expiration of the period of availability for obligation of that appropriation. Thus, if an appropriation act contains a limitation on the obligation of funds for a program, project, or activity, the limitation will continue to apply during the 5-year period following the period of availability for obligation of that appropriation.

On September 30, 1991, NAVCOMPT provided guidance implementing the DoD Comptroller's "major changes" to include "expansion of the term contract change and the financing of these changes." NAVCOMPT directed: "Contract changes are defined as all changes that result in additional billable work and costs and must now be financed with appropriations currently available for new obligations."

The NAVCOMPT guidance also stated, "Because contract changes that involve additional billable work and costs must be charged to current appropriations, the reporting requirements of $4.0 million and $25.0 million discussed in the April 10, 1991, guidance now apply only to the extended availability authority of the Shipbuilding and Conversion, Navy (SCN), and Operation and Maintenance, Navy (O&M,N), appropriations."

Reversal of Revised DoD Guidance. In a memorandum issued on April 20, 1992, "DoD Accounting Guidance for Contract Changes" (the accounting guidance), the DoD Comptroller reversed the June 13, 1991, accounting policy regarding the charging of contract changes, and reiterated the longstanding rule that requires within-scope contract changes to be funded from appropriations current at the time the contract or modification was executed (that is, with appropriate expired year appropriations). The accounting guidance stated that "the policy regarding the charging of contract changes shall be the same policy in effect prior to June 13, 1991. See Chapter 25 of the 'DoD Accounting Manual,' DoD 7220.9-M." The April 20, 1992, accounting guidance reconfirmed that within-scope contract changes are obligational adjustments properly chargeable to the unexpended balances of expired appropriation accounts, whereas out-of-scope changes are chargeable to current appropriation accounts.

The National Defense Authorization Act for Fiscal Year 1991, P.L. 101-510, November 5, 1990, provided transition authority regarding the closing of appropriation accounts and the cancellation of unobligated and obligated balances.

Recent Transition Authority. The National Defense Authorization Act for Fiscal Year 1993, P.L. 102-484, October 23, 1992, provided additional transition authority regarding the closing of appropriation accounts. Section 1004 authorized obligations and adjustments to obligations for expired but not closed accounts for fiscal years before FY 1992 to be charged to any current DoD appropriation account available for the same purpose as the expired account, if:

o the obligation would have been properly chargeable (except as to amount) to the expired account before the end of the period of availability of that account; and

o the obligation is not otherwise properly chargeable to any current appropriation account of the Department of Defense.

However, the total amount charged to a current appropriation account under this authority may not exceed an amount equal to the lesser of:

o 1 percent of the total amount of the appropriation for that account, or

o 1 percent of the total amount of the appropriation for the expired account.

No obligation or adjustment of an obligation may be charged using this transition authority until the Committees on Armed Services and the Committees on Appropriations of the Senate and House of Representatives are notified of the intent to make such a charge, and a period of 30 days elapses after the notification is submitted. Additionally, no obligation or adjustment of an obligation may be charged until the Secretary of Defense certifies to Congress that the limitations on expenditures and obligations, established by 31 U.S.C. 1341, are being observed, and that reports on any violations of 31 U.S.C. 1341, whether intentional or inadvertent, are being submitted to the President and Congress immediately and with all relevant facts and a statement of actions taken, as required by 31 U.S.C. 1351.

On December 4, 1992, the DoD Comptroller issued guidance that implemented P.L. 102-484.

Objectives

The overall objectives of the audit were to identify expired year appropriations that may have financial problems, including funding shortfalls, and to review the financial status of these expired year appropriations. We reviewed the

methods used to determine the financial status of expired year appropriations and evaluated the financial status of major procurements under these appropriations. We also evaluated the internal controls over financial operations. Finally, we evaluated the Navy's implementation of the Internal Management Control Program required by the Federal Managers' Financial Integrity Act as it pertained to the audit objectives.

Scope and Methodology

This financial-related audit was performed from June 1992 through April 1993. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General (IG), Department of Defense, and accordingly included such tests of the internal controls as were considered necessary.

Our audit was limited to three Department of the Navy appropriations and four Navy organizations. The appropriations were Aircraft Procurement, Navy (APN); Weapons Procurement, Navy (WPN); and Research, Development, Test and Evaluation, Navy (RDT&EN). The organizations were the Naval Air Systems Command (NAVAIR), the Naval Sea Systems Command (NAVSEA), the Strategic Systems Program Office (SSPO), and the Office of the Chief of Naval Research (OCNR). See Appendix C for a list of the organizations we visited or contacted.

The expired years for procurement appropriations were FYs 1987, 1988, and 1989. For the RDT&EN appropriation, the expired years were FYs 1988, 1989, and 1990. We compared future funding requirements estimated at $231.5 million with expired year funds available for these appropriations. We judgmentally selected the appropriations and activities we audited. Therefore, we did not project, assume, or estimate results beyond what we identified during our audit.

To evaluate the Navy's accounting records and reports, we reviewed DoD Comptroller and NAVCOMPT policies for accounting for expired year appropriations. We also reviewed the methods used to compile official accounting reports and reports on almost $1.0 billion in unmatched disbursements. For evaluating the impact of the DoD Comptroller's erroneous revised guidance issued on June 13, 1991, our scope was limited because the Navy could not provide us with a universe of all obligational adjustments that were made using expired year funds. Therefore, our conclusions on the appropriateness of the types of funds used for obligational adjustments apply only to $217.1 million of the Navy's adjustments. We determined that the Navy's Standard Accounting and Reporting System did not accurately match disbursements with obligations; however, we did not verify the accuracy of other computer-based data.

Internal Controls

We evaluated internal controls relating to compliance with laws, regulations, and procedures governing budget execution and accounting for the fund status of Navy expired year appropriations. The audit identified material internal control weaknesses as defined by P.L. 97-255, OMB Circular No. A-123, and DoD Directive 5010.38.

The Navy's Director of Budget and Reports had assessed the Navy's controls over funds as moderately subject to the risks of waste, loss, and misuse. The Director stated that, as of September 30, 1992, the systems of internal controls over funds provided reasonable assurance that the standards and objectives of the Federal Manager's Financial Integrity Act were achieved. Also, the Director stated that there were no unresolved significant material weaknesses in FY 1992. However, we found that internal controls were not adequate to identify appropriations with apparent and potential violations of the Antideficiency Act, or to accurately reflect the status of expired year appropriations. Recommendations in Findings A through C in this report, if implemented, will aid in correcting the internal control weaknesses. A copy of this report will be provided to senior officials of the Defense Finance and Accounting Service and the Navy, who are responsible for internal controls.

Prior Audits and Other Reviews

Both the General Accounting Office (GAO) and the IG, DoD, have evaluated Navy appropriations and related issues.

GAO Reviews. The GAO issued a report on unmatched disbursements, ("Financial Management: Navy Records Contain Billions of Dollars in Unmatched Disbursements," GAO/AFMD-93-21, OSD Case No. 9315), on June 9, 1993. According to the GAO, the Navy had $12.3 billion in unmatched disbursements as of February 1992, and almost $5.0 billion had been unmatched for more than 2 years. The GAO stated that current initiatives did not address the causes of the problem, and that unmatched disbursements significantly impaired the Navy's ability to ensure that funds were safeguarded and spent in accordance with legal requirements. The GAO recommended that the Navy provide adequate resources for researching and resolving existing unmatched disbursements. The GAO also recommended that the Navy record all obligations promptly and accurately in the accounting system to prevent future unmatched disbursements. DoD concurred with the recommendations except for reporting the recommendation for unmatched disbursements as a material internal control weakness.

IG, DoD. The IG, DoD, recently issued two reports related to this audit:

o "Merged Accounts of the Department of Defense," Report No. 92-028, issued on December 30, 1991, showed that obligations in DoD

accounting records did not accurately reflect the status of merged accounts. The audit disclosed about $1.0 billion in negative unliquidated obligations and several overdisbursed accounts. Because official DoD accounting records were very inaccurate, the DoD Comptroller requested restorations to cover obligations that the Military Departments had identified from sources other than official accounting records. The Deputy Comptroller for Management Systems generally agreed with the report.

o "Report on the Audit of Missile Procurement Appropriations for the Air Force," Report No. 93-053, issued February 12, 1993, concluded that the FY 1987 and 1988 Air Force missile procurement appropriations were insufficient to meet obligations and adjustments properly chargeable to those accounts, and that legislative relief was needed. The available appropriation balances in Air Force accounting and finance records were materially misstated. The misstatements had several causes, including the improper recording of obligations and the use of questionable funding practices. At the time of the audit, the Air Force could not calculate the value of the deficiencies in appropriations. The Air Force sought to avoid declaring an Antideficiency Act violation by not recording obligational adjustments and allowing work to continue until all available funds were expended. The Air Force then terminated contracts for the convenience of the Government and initiated reprocurement actions on the following day, using current year funds. The DoD Comptroller generally agreed with the report.

We have not begun follow-up actions on the DoD Comptroller's implementation of the recommendations we made in either IG, DoD, report.

Other Matters of Interest

P.L. 101-510 extended the period that appropriations remain in expired status from 2 to 5 fiscal years. On September 30 of the 5th fiscal year after the period of availability for which the obligation has ended, the account is closed; any remaining balance (whether obligated or unobligated) is canceled, and is not available for obligations or expenditures for any purpose. Table 1. shows the obligated balances for each of the appropriations we audited that were closed and canceled in FYs 1991 and 1992.

Table 1. Canceled Obligated Balances

Fiscal Year	APN [1]	WPN [2]	RDT&EN [3]
1991	$103,089,135	$198,026,796	$104,235,747
1992	100,447,695	48,016,810	12,899,067
Totals	$203,536,830	$246,043,606	$117,134,814

Because of the 1-percent limitation in P.L. 101-510 on the use of current year funds to meet valid obligations for closed accounts, all WPN requirements may not be met. The use of 1 percent of current year funds, authorized by P.L. 101-510 and P.L. 102-484, will reduce the amounts of current appropriations that are available to meet current year needs. The transition authority allows current year funds to be used for obligations and obligational adjustments that are properly chargeable to expired accounts, but not to closed accounts. This authority also may not allow all additional requirements to be met.

[1] APN: Aircraft Procurement, Navy

[2] WPN: Weapons Procurement, Navy

[3] RDT&EN: Research, Development, Test and Evaluation, Navy

Part II - Findings and Recommendations

Finding A. Apparent Appropriation Deficiencies

The balances in the Navy appropriations audited were apparently insufficient to meet $17.5 million in obligations and obligational adjustments properly chargeable to those expired year appropriations. This occurred because the Navy incurred, but did not promptly record, target-to-ceiling increases in the MK-50 Torpedo program, the Standard Missile program, and the Phoenix Missile program. As a result, the Navy's expired accounts in the Weapons Procurement, Navy (WPN) appropriations apparently have appropriation deficiencies in the line-item appropriated MK-50 Torpedo program for FY 1987, the Standard Missile program for FY 1987, and the Phoenix Missile program for FYs 1987 and 1988.

Background

31 U.S.C. 1341 provides:

> that an officer or employee of the United States Government or of the District of Columbia government may not make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation.

DoD Directive 7200.1, "Administrative Control of Appropriations," dated July 27, 1987, implements 31 U.S.C. 1341 and states that:

> each DoD Component shall establish and maintain adequate systems of accounting for and positive control of appropriations and other funds made available. These accounting and fund control systems shall provide a capability for an official to be assured of the availability of funds before incurring an obligation.

Most important, the Directive provides that:

> the system shall provide the necessary information for establishing responsibility if a violation of 31 U.S.C. subsection 1341(a) or 1517(a) or section 1342 occurs and for the reporting of such a violation.

An appropriation may be designated as line-item for a specific program or as a lump-sum appropriation. In either case, a violation of 31 U.S.C. 1341(a) or 1517(a) (a violation of the Antideficiency Act) occurs if balances are exceeded. In the Navy, the WPN appropriation was line-item appropriated until 1989. For example, in FYs 1987 and 1988, the appropriation contained 40 line-item accounts and 36 line-item accounts, respectively. In 1989, WPN line items

were combined and appropriated by budget activity. For FY 1993, the Navy WPN appropriation changed from a predominantly program-oriented appropriation by line-item designation to a lump-sum appropriation.

We audited the expired WPN appropriations (FYs 1987, 1988, and 1989) at NAVAIR, NAVSEA, and SSPO. In the past, the Navy maintained line-item integrity until the appropriations were merged and the merged WPN account became available to pay for any WPN obligational adjustments. Because WPN was line-item appropriated, management of the account was more difficult; transfer of funds from one program to another, permissible for lump-sum appropriations, was prohibited. Funds appropriated for line-item programs had to be maintained individually, and remained under the provisions of the Antideficiency Act.

Cost Increases

Funding deficiencies were caused by target-to-ceiling cost increases. The increases were greater than the balances available in the appropriations.

MK-50 Torpedo. The MK-50 Torpedo program included two contracts that had been funded with line-item appropriations in FYs 1987, 1988, and 1989; those line-item appropriations were subject to the requirements of the Antideficiency Act. The two contracts had target-to-ceiling increases higher than the available balance of each year's appropriation. The increases were reported to the DoD Comptroller in May 1990.

In March 1992, the DoD Comptroller requested that the Senate Defense Appropriations Subcommittee approve the use of $6.2 million in funds from the Defense Business Operations Fund (DBOF) to pay target-to-ceiling increases from FY 1987.

In August 1992, Congress approved the DoD Comptroller's request to reprogram funds from the SCN appropriation to cover the FY 1988 and 1989 increases; however, Congress did not approve the request to use DBOF funds for FY 1987 increases. Congress approved only the authority to fund the increase after the Navy identified a source from which the funds could be reprogrammed. If the Navy uses the 1-percent authority in P.L. 102-484, sec. 1004, to cover the FY 1987 deficiency, the MK-50 program still will not have sufficient funding authority available to cover the apparent deficiency. One percent of the expired appropriation account (the total amount of the original FY 1987 appropriation account for the FY 1987 WPN MK-50 account) is $681,370, and is less than 1 percent of current funds available for this purpose. As of April 1993, the Navy and the DoD Comptroller had not identified a source of funds from which the MK-50 contractor would be paid for the FY 1987 increases.

NAVSEA had not investigated the apparent Antideficiency Act violation or reported any deficiency in the FY 1987 MK-50 line-item appropriation to

Congress. NAVCOMPT and NAVSEA managers said the violation occurred because they believed that a line-item designation in the WPN appropriation did not apply when carried over into expired years, and that once an appropriation account expired, the balance could be combined and made available for any program. In March 1992, the NAVCOMPT counsel reemphasized the previous written guidance, which stated that line-item appropriations should maintain their fiscal year identity and line-item limitations until closure and cancellation.

Standard Missile. NAVCOMPT personnel said that as of April 1993, the FY 1987 Standard Missile appropriation account, a line-item appropriation, had a $2,295,000 deficiency because of target-to-ceiling cost increases. As of April 1993, the appropriation had only $134,000 available to fund $2,429,000 in obligational adjustments. Although the work was performed, the Navy had not recorded the target-to-ceiling increase due on Standard Missile contract N00024-88-C-5342. The $2,429,000 cost increase represents a Government obligation payable to the Standard Missile contractor.

Navy officials are not sure how this liability will be covered. The Navy has an apparent appropriation deficiency of $2,295,000 for the FY 1987 Standard Missile appropriation account. If the Navy uses the 1-percent authority in P.L. 102-484, sec. 1004, the Standard Missile program will have $4,786,110 to cover the deficiency. The $4,786,000 represents 1 percent of the $478,611,000 in the original FY 1987 WPN appropriation for the Standard Missile appropriation account. However, the Navy is still required to investigate the apparent violation of the Antideficiency Act and report to Congress if any actual Antideficiency Act violation is found to have occurred.

Phoenix Missile. The Phoenix missile line-item appropriation account had potential funding deficiencies for FYs 1987 and 1988 of $1.5 million and $7.5 million, respectively. The potential deficiencies were a result of target-to-ceiling cost overruns. NAVCOMPT personnel told us that as of January 13, 1993, the FY 1987 Phoenix Missile line-item appropriation had an available balance of $31,000, and the FY 1988 appropriation had an available balance of $281,000. Although NAVAIR is awaiting the final price from the contractor, and the exact amount of the deficiency cannot be determined, an apparent violation has occurred.

If the Navy uses the 1-percent authority in P.L. 102-484, sec. 1004, the Phoenix Missile program will have $2,672,720 and $3,435,960 to cover the deficiencies in FYs 1987 and 1988, respectively. These amounts represent 1 percent of the original FY 1987 and 1988 appropriation balances for the Phoenix Missile account. Use of the authority in P.L. 102-484 will allow the Navy to offset the $1.5 million deficiency for FY 1987, but the FY 1988 requirement of $7.5 million cannot be completely paid. Therefore, the Navy may need to seek a supplemental appropriation from Congress to cover this deficiency.

Reporting of Funding Violations. For the MK-50, Standard Missile, and Phoenix Missile programs, the Navy had not complied with Chapter 25 of the "DoD Accounting Manual," DoD Manual 7220.9-M, June 6, 1988, or the

Antideficiency Act investigation and reporting requirements in 31 U.S.C. 1351, as implemented by DoD Directive 7200.1, "Administrative Control of Appropriations," July 27, 1987.

Conclusion

The Navy incurred $17.9 million in liabilities when work was performed on the MK-50, Standard Missile, and Phoenix Missile contracts. The obligations were not recorded in official accounting records, as required by Chapter 25 of the "DoD Accounting Manual." As required by DoD Directive 7200.1, the Navy should identify, investigate, and report violations of the Antideficiency Act caused by target-to-ceiling increases in FY 1987 for the MK-50 Program, in FY 1987 for the Standard Missile Program, and in FYs 1987 and 1988 for the Phoenix Missile Program.

Recommendations for Corrective Actions

We recommend that the Assistant Secretary of the Navy (Financial Management):

1. Record obligations for the FY 1987 MK-50, the FY 1987 Standard Missile, the FY 1987 and 1988 Phoenix Missile, and all other unrecorded obligations that may cause deficiencies. Obligations should be recorded in one of the following ways:

a. Record the obligations against current year funds of the same type and purpose, to the extent that these current funds do not exceed 1 percent of the balance of the expired appropriation or 1 percent of the current appropriation, whichever is less; or

b. Request specific reprogramming of other appropriated funds from Congress; or

c. Request a supplemental appropriation from Congress.

2. Investigate the apparent appropriation deficiencies for the MK-50, the Standard Missile, and the Phoenix Missile; fix responsibility; and comply with the reporting requirements of 31 United States Code 1351 and DoD Directive 7200.1 if any violation of the Antideficiency Act has occurred.

Management Comments. The Director of Budget and Reports, Department of the Navy, agreed to record obligations and investigate apparent appropriation deficiencies.

Audit Response. The Navy concurred with the recommendations and proposed corrective actions, but did not provide completion dates. Therefore, we request that the Navy provide completion dates in its comments on this final report.

Response Requirements for Each Recommendation

Responses to the final report are required from the addressee shown for the items indicated with an "X" in the chart below.

		Response Should Cover:		
Number	Addressee	Concur/ Nonconcur	Proposed Action	Completion Date
1.a.	ASN(FM)*			X
1.b.	ASN(FM)			X
1.c.	ASN(FM)			X
2.	ASN(FM)			X

* ASN(FM): Assistant Secretary of the Navy (Financial Management)

Finding B. Potential Appropriation Deficiencies

Navy appropriation balances may be insufficient to meet obligational adjustments that may become chargeable in the future if contingent liabilities become actual liabilities. This could occur because the Navy does not have consistent procedures to identify future requirements and contingent liabilities that may become actual liabilities in the future, or to maintain contingent liabilities after an appropriation expires. As a result, contingent liabilities may exceed the remaining available balances in the WPN and the Aircraft Procurement, Navy (APN), appropriations during FYs 1987, 1988, and 1989, and the Research, Development, Test and Evaluation, Navy (RDT&EN), appropriation during FYs 1988 and 1989. Also, the potential exists for $164.8 million in deficiencies in the expired accounts of the Navy WPN and APN appropriations. Further, the Navy had pending claims in the RDT&EN appropriation valued at $861.4 million that could result in additional funding deficiencies if additional funds are not available.

Background

A contingent liability is a potential liability that may become an actual liability if one or more future events occur or fail to occur. Only if and when the contingency occurs does such a liability become a recordable obligation. An amount equal to the maximum contingent liability of the Government must always be available for obligation from appropriations current at the time the contract is made.

Contingent liabilities, by definition, are not sufficiently definite or certain to support the formal recording of an obligation.[1] However, sound financial management, as well as Antideficiency Act considerations, dictate that contingent liabilities be recognized. Treatment of contingent liabilities is largely a matter of sound judgment exercised with respect to possible financial implications, since no hard-and-fast rules have been established.

Recognition of contingent liabilities may be in the form of an administrative reservation or commitment of funds; however, the funds are not preserved beyond their period of availability, and the administrative reservations and commitments must be repeated each fiscal year. Important contingent liabilities should also be recognized in a footnote to financial statements.

[1] In some instances, the Comptroller General has held that termination liability amounts to an actual obligation. 62 Comp. Gen. 143 (1983); B-238581, October 31, 1990.

Identified Contingent Liabilities

There were contingent liabilities estimated at $69.9 million resulting from contract incentive and award fees in the Navy WPN appropriations. Also, there was $161.6 million from pending contractor claims in the APN appropriations. Pending claims made by contractors represent a significant part of the contingent liabilities that the Navy may incur. The Navy's appropriation balances could cover only $66.7 million of the $231.5 million in liabilities. Therefore, potential deficiencies could be as much as $164.8 million. There were pending claims of $861.4 million against the Navy in the RDT&EN appropriation that could result in additional funding problems. If any of these pending claims results in an actual liability payable from the Navy's appropriations rather than from the Judgment Fund, an Antideficiency Act violation may occur.

So that agencies can pay for settlements arising from contractor claims, Congress created the Judgment Fund (the Fund). The Fund is a permanent, indefinite (not limited by amount) appropriation, controlled by the General Accounting Office to satisfy certain obligations of all three branches of the Federal Government. When agencies are required to reimburse the Fund for awards and judgments paid under the Contract Disputes Act, funds from current appropriations must be used. An Antideficiency Act violation does not occur when an agency has insufficient current appropriations to reimburse the Fund or to satisfy an award or judgment against the agency under the Contract Disputes Act.

Reimbursement of the Fund from agencies' appropriations requires specific statutory authorization. The only statutes that authorize reimbursement of the Fund are 28 U.S.C. 2414, as applied to the Contract Disputes Act, and 31 U.S.C. 1304(c)(1) and (2), involving suits against Armed Forces Exchanges. Judgments and settlements of suits brought under these statutes are the only instances where the Fund is reimbursed by agency appropriations. In the case of monetary awards and judgments under the Contract Disputes Act, reimbursement is properly chargeable to funds current at the time the award or judgment is entered.

The definition of a compromise settlement authorized by 28 U.S.C. 2414 is important because the Fund and agency appropriations are mutually exclusive sources for payment. 58 Comp. Gen. 667 (1979) focused on the agency's position, not on whether litigation was threatened or suit had been filed to determine whether payment should be made from the Fund. This decision stated that a "compromise settlement must be made because resolution of the dispute otherwise seems possible only in court. That is, there must be a genuine disagreement or impasse."

Future Funding Problems

There were contingent liabilities that could cause future funding deficiencies. The Navy cannot fund all of these possible liabilities from expired appropriations because its expired balances are less than the current estimates of contingent liabilities. (If and when these contingent liabilities become actual liabilities, they may not be in the amounts presently estimated, or they may not be required to be funded from the expired or closed appropriation accounts.) Of the programs and expired appropriations examined, the Navy's contingent liabilities are estimated at $231.5 million. Available appropriation balances currently equal $66.7 million; therefore, potential deficiencies could be as much as $164.8 million.

Weapons Procurement, Navy. The Navy had contingent liabilities of $30.8 million for the FY 1988 Trident II Missile appropriation account and $39.1 million for the FY 1989 Ballistic Missile appropriation account. (The Trident II Missile Program was combined with the Ballistic Missile appropriation account in FY 1989.)

As of January 13, 1993, the Trident line-item appropriation for FY 1988 had an available balance of $9.9 million. Contract incentive and award fee contingencies for the FY 1988 Trident II appropriation account were estimated at $30.8 million, which could result in a deficiency of $20.9 million.

In the FY 1989 Ballistic Missile line-item appropriation, $7.4 million remained to cover incentive and award fee contingencies of approximately $39.1 million. As a result, the FY 1989 Ballistic Missile line-item appropriation could result in a potential deficiency of $31.7 million.

Trident II program officials said they believe that deobligations of expired year funds will cover expected incentive and award fees. If sufficient funds are not available, the Navy may violate the Antideficiency Act and be subject to the Act's investigating and reporting requirements.

Aircraft Procurement, Navy (APN). We reviewed NAVAIR's APN appropriation for expired FYs 1987, 1988, and 1989. The APN appropriations for FYs 1987 and 1988 contained $24.5 million and $137.1 million, respectively, in contingent liabilities. As of December 1992, APN's available balances for FYs 1987 and 1988 were $18.7 million and $30.7 million.

NAVAIR personnel had identified $24.5 million of FY 1987 future funding requirements for the A-6, C-2, F-14, and P-3 aircraft programs and the support equipment program. These future funding requirements consisted of contractors' claims and requests for equitable adjustment. As of December 1992, only $18.7 million in APN funds was available to cover these requirements; therefore, the APN appropriation could have a potential deficiency of $5.8 million.

NAVAIR personnel told us that of the $137.1 million in contingent liabilities for FY 1988, $112.7 million represented the APN portion of a claim from McDonnell Douglas. The claim, received in August 1990, was the result of cost overruns that were caused by the contractor's failure to convert specifications into requirements for the T-45A program. As of June 1993, contracting officers were negotiating the claim. Depending on the outcome of the claim, the potential exists for a deficiency in the FY 1988 appropriation. The remaining $24.4 million of FY 1988 funding requirements was for the A-6, F-14, ES-3, and P-3 aircraft programs and the support equipment program. Only $30.7 million in APN funds was available to cover the total requirements of $137.1 million; therefore, the appropriation could have a potential deficiency of $106.4 million.

NAVAIR had identified future requirements for FY 1989, but at the time of our review, sufficient funds were available to cover the requirements. NAVAIR officials stated that these future requirements represented the worst possibility and could be reduced or eliminated during negotiations.

Future Funding of Research, Development, Test, and Evaluation Claims

Research, Development, Test and Evaluation, Navy. NAVAIR identified future requirements of $861.4 million, including three major claims ($328.0 million, $344.0 million, and $163.8 million) totaling $835.8 million. There were seven smaller claims totaling $25.6 million.

The $328.0 million claim was from Lockheed Aeronautical Systems Company (Lockheed) on the P-7 program. The Office of the General Counsel, Department of the Navy, received the claim in October 1992. In discussions with the senior attorney, we learned that the Navy terminated the contract for default and lack of progress by Lockheed in July 1990. Lockheed is attempting to recover its costs, although the Navy received no contract deliverables. The Navy's senior attorney stated that the claim may be adjudicated by the Armed Services Board of Contract Appeals, which may not make a determination until FY 1995.

The $344.0 million claim was from Boeing Aerospace Corporation (Boeing) for work completed on the P-3 program. Initially, the amount of the claim was for the difference between funds obligated by Navy personnel and the costs that the contractor claimed had been incurred. The Navy terminated the contract for the convenience of the Government. In a letter to Boeing, the contracting officer stated that the claim was not valid and that Boeing must recalculate the termination costs and price it had submitted on the initial claim. The contracting officer told us that he expected the claim to be resubmitted and that it would probably be adjudicated.

The $163.8 million claim was from McDonnell Douglas for the T-45A program. The T-45A program manager had received notification of the claim

in August 1990 from the NAVAIR contracting office. The T-45A deputy program manager told us that the contract required McDonnell Douglas to convert a land-based training aircraft so that it could land on an aircraft carrier. McDonnell Douglas had problems associating the specifications with the actual conversions needed to land the plane on an aircraft carrier, and was making a claim for the costs associated with the work on these specifications. As of April 1993, the contracting officer was reviewing the claim.

NAVAIR program managers could not tell us how these claims would affect each of the expired fiscal years. According to the "Report of Budget Execution" (DD Form 1176) for the period ending December 31, 1992, the RDT&EN appropriation had unobligated balances of $89.7 million for FY 1988, $100.8 million for FY 1989, and $757.4 million for FY 1990. Depending on the final determination, the claims may result in deficiencies.

Identifying and Monitoring Funding Requirements

The Navy did not have consistent procedures to identify future requirements and contingent liabilities that may become actual liabilities in the future, or to maintain contingent liabilities after an appropriation expires. As a result, Navy officials were unaware of some of the future requirements that were identified in this audit. Also, NAVSEA officials inappropriately obligated funds in advance to ensure that funds would be available when needed.

Agencies may maintain administrative reservations or commitments for contingent liabilities while the funds are current. However, after the appropriation expires, administrative reservations or commitments are no longer maintained. Navy officials did not ensure that contingent liabilities for expired years were disclosed in accounting records and reports.

According to P.L. 101-510, expired appropriations will be available for recording, adjusting, and liquidating obligations for 5 fiscal years. The Navy did not track incentive-award fees or other contingent liabilities in expired year accounts. Better management of appropriated funds should include procedures for monitoring contingent liabilities, so that both fund managers and program managers are aware of their program needs and the financial implications that may result if contingent liabilities are realized.

Recommendations for Corrective Actions

We recommend that the Assistant Secretary of the Navy (Financial Management):

1. Establish procedures for identifying future requirements and contingent liabilities that may cause deficiencies in the future.

Management Comments. The Director of Budget and Reports, Department of the Navy, concurred with Recommendation B.1. The Director stated that the Navy has policies, processes, and procedures in place to identify contingent liabilities.

Audit Response. The Director concurred and stated that recommended actions had already been taken. However, because of the significant future requirements and contingent liabilities that were identified, it must be concluded that the procedures were not being followed consistently. Therefore, we are requesting proposed actions and completion dates for ensuring that the procedures are consistently followed. The "Response Requirements for Each Recommendation" chart at the end of this section lists the requirements for further comments.

2. Maintain contingent liabilities in the accounting records and reports after funds expire.

Management Comments. The Director nonconcurred and stated that in accordance with DoD Accounting Manual 7220.9-M, commitments cannot be made from expired appropriation accounts. The Director further stated that a claim should only be recorded after review and a specific determination of Government liability.

Audit Response. We agree that the DoD Manual states that outstanding commitments shall be canceled as of the end of the period of availability for new obligations. However, the Navy needs procedures to identify and monitor contingent liabilities that may become actual liabilities. Therefore, we request that the Navy reconsider its response to the recommendation.

3. Discontinue recording obligations supporting contingent liabilities until a contingency occurs.

Management Comments. The Director concurred and stated that according to DoD guidance, obligations should not be recorded until the point when an incurred liability occurs.

Audit Response. The Director concurred with the recommendation, but cited the DoD guidance as the proposed action to implement the recommendation. The DoD guidance was in effect prior to the audit, but was not always followed. Therefore, we are requesting that the Navy propose a corrective action to prevent the recording of obligations supporting contingent liabilities until a contingency occurs.

Response Requirements for Each Recommendation

Responses to the final report are required from the addressee shown for the items indicated with an "X" in the chart below.

		Response Should Cover:		
Number	Addressee	Concur/ Nonconcur	Proposed Action	Completion Date
1.	ASN(FM)		X	X
2.	ASN(FM)	X	X	X
3.	ASN(FM)		X	X

Finding C. Accounting and Recording

The Navy's records do not accurately reflect the status of expired year appropriations, and appropriation balances may be materially misstated. The Navy failed to record obligations that resulted in deficiencies (discussed in Finding A); did not follow reporting requirements for the $4.0 million and $25.0 million thresholds; and did not consistently apply the procedures for obtaining approval to make upward obligational adjustments. These conditions occurred because the Navy followed erroneous guidance issued by the DoD Comptroller for the funding of contract changes; the Standard Accounting and Reporting System (STARS) did not accurately match disbursements with obligations; and no standardized procedures had been established for correcting unmatched disbursements. As a result, the Navy used current year funds to pay for about $6.1 million in obligational adjustments that were properly chargeable to expired year appropriations, and the expired year appropriations contained $1.0 billion in unmatched disbursements.

Background

For program managers to make informed decisions about expired year appropriations, the Navy's accounting records must be accurate. There are several reasons why the expired year accounting data could not be relied on for decisionmaking purposes.

The Defense Authorization Act of 1991, P.L. 101-510, provided special procedures and reporting requirements that apply to the authority to provide funds for contract changes. P.L. 101-510 defined a contract change as a change to a contract under which a contractor is required to perform additional work. Under this definition, a contract change does not include an adjustment to a pay claim or an increase under an escalation clause.

P.L. 101-510 also requires the head of an agency to approve contract changes when the changes in a program, project, or activity cost over $4.0 million during a fiscal year. When contract changes exceed $25.0 million during a fiscal year for a program, project, or activity, the head of the agency must also notify Congress in writing, and must wait 30 days before making the changes.

DoD Comptroller Guidance. On June 13, 1991, the DoD Comptroller issued a memorandum, "Revised DoD Guidance on Accounting for Expired Accounts, Including 'M' and Merged Surplus Accounts." The memorandum extended the definition of contract change to include "changes in scope and any other changes that result in additional contractor billable costs." This allowed or was interpreted to allow within-scope contract changes to be charged to current appropriations. This eliminated the reporting requirement and reduced Congressional oversight. The memorandum stated that all contract changes

would be charged to current appropriations, and that charges to current appropriations for contract changes would not affect the 1-percent limitation provided for in the law.

In a memorandum on April 20, 1992, "DoD Accounting Guidance for Contract Changes," the DoD Comptroller reversed the June 13, 1991, revised guidance that had required all contract changes to be charged to current appropriations. The April 20, 1992, memorandum stated that contract changes should be accounted for as directed in Chapter 25 of the "DoD Accounting Manual." However, the April 20, 1992, memorandum did not discuss the need to reverse any charges to appropriations that were erroneously allowed under the June 13, 1991, revised guidance.

Use of Funds

To assess the impact on Navy expired appropriations of the revised guidance that the DoD Comptroller issued on June 13, 1991, we determined the amount of current year funds used for expired year requirements between June 13, 1991, and April 30, 1992. We reviewed WPN and APN contracts that contained modifications, and we found charges valued at approximately $6.1 million that should be reversed. NAVCOMPT had approved the requests for modifications. Appendix A shows seven contracts with charges to current year funds that should be reversed.

NAVCOMPT officials told us that they were confused about how to implement the DoD Comptroller's guidance on this reporting requirement. Based on the September 20, 1991, guidance, NAVCOMPT officials continued to charge obligational adjustments for contract changes, involving additional costs but no additional billable work, to expired year accounts. For example, NAVCOMPT had approved the use of "M" account and expired year funds for an upward obligational adjustment of $68.0 million. The adjustment reflected final negotiated prices for three production options unilaterally determined by the contracting officer in July 1988, plus any interest due. According to the approval letter from NAVCOMPT, the adjustments were approved because they included only the final contract price for work performed; they did not include the performance of additional billable work. Although NAVCOMPT approved the adjustments while the erroneous DoD guidance was in effect, current year funds were not used, and the Navy's actions were in accordance with the intent of P.L. 101-510.

Obligational Approvals

Upward obligational adjustments for expired year appropriations were not always forwarded for approval. Therefore, a potential internal control weakness existed because funds could be obligated without proper approval.

When an administering office (AO) such as NAVAIR or NAVSEA has obligational adjustments in excess of $100,000, the AO must obtain approval from the responsible offices (ROs). The RO for WPN and APN is NAVCOMPT, and the Office of the Chief of Naval Research is the RO for the RDT&EN appropriation. The AOs have obligational authority; when requests for upward obligational adjustments exceed $100,000 in expired year funds, the AOs must send the requests to the ROs for approval. There were two problems with this procedure.

Approval Records. The AOs did not maintain approval records that would provide an audit trail, and could not provide a list of obligational adjustments for under $100,000 in expired year funds that had been requested by the program offices and approved by the AOs. The Navy AOs did not follow NAVCOMPT Instruction 7040.37B, "Guidance for Administration of Appropriation After the Period of Availability," April 10, 1991, which states, "ROs and AOs must establish systems to maintain cumulative records of upward and downward obligational adjustments by transaction for each appropriation during the five-year period."

Adjustments Over $100,000. NAVCOMPT Instruction 7040.37B also states that an AO may not approve upward obligational adjustments of over $100,000 without sending the request to the RO. AOs had not fully complied with this restriction. At NAVSEA, we found a contract change valued at more than $1.0 million for WPN that had not been approved by the RO.

Unmatched Disbursements

Unmatched disbursements are errors that occur when incorrect or incomplete disbursement data are entered into the Navy's Standard Accounting and Reporting System (STARS). The Navy had almost $1.0 billion in unmatched disbursements for the audited appropriations. Because of the large number of unmatched disbursements, STARS could not be relied on for accurate disbursement information on contracts for which payments were posted to the unmatched disbursements account.

In some cases, disbursements that were entered into STARS did not match a corresponding obligation line of accounting data; in other cases, the available balance did not cover the disbursement. In all cases, the payment was not posted to the contract; instead, it was posted to an unmatched disbursement account until the error was reconciled. The problem of reconciling unmatched disbursements occurred throughout DoD. The Navy's system accumulated the errors at the budget activity level, not at the contract level. That method of accumulation prevented the ready identification of errors or deficiencies in overdisbursed contracts. Additionally, there were no standardized procedures for correcting errors that caused unmatched disbursements. Because of the large number of unmatched disbursements, the Navy's financial records should not be relied on for making financial decisions on expired appropriations.

Table 4. summarizes unmatched disbursements, including both positive and negative values, for the audited appropriations by fiscal year. The information was taken from the Navy's unmatched disbursements account as of July 29, 1992.

Table 4. Unmatched Disbursements

($ in Thousands)

Fiscal Year	APN	WPN	RDT&EN	Total
1987	$ 78,921	$26,624	$ 0	$ 105,545
1988	133,683	11,480	202,430	347,593
1989	195,983	52,491	98,980	347,454
1990	0	0	204,060	204,060
Totals	$408,587	$90,595	$505,470	$1,004,652

For these appropriations, the Navy had $1.3 billion in positive unmatched disbursements and $0.3 billion in negative unmatched disbursements. Positive and negative unmatched disbursements affect obligation balances differently. Therefore, in order to understand the impact of the figures, positive and negative totals must be separated from the balance of the unmatched disbursement accounts. Positive unmatched disbursements are disbursements that have not been posted correctly. They do not affect unobligated balances unless they represent contract overpayments.

Negative unmatched disbursements are credit expenditures that have not been posted correctly. Our tests of $115.1 million of negative unmatched disbursements showed that $35.0 million of those expenditures represented adjustments for recoupments of progress payments that, after reconciliation, would not increase the unobligated balance available in an appropriation. However, $3.8 million of the $115.1 million of negative disbursements was a refund that would, after reconciliation, increase the available unobligated balance of an appropriation. Although the refund had been collected, it was not posted correctly. After this refund is posted to the correct contract, the funds can be deobligated, increasing the available balance of the appropriation from which it originated.

NAVSEA personnel told us that they had incorrectly made an overpayment of $126,000 on the Close-In Weapons System contract from the WPN Other Missiles appropriation for FY 1989, and that NAVSEA and the Defense Finance and Accounting Service (DFAS) had not recovered the overpayment until March 1993. The overpayment was made in August 1989, but was not discovered until November 1992. NAVSEA and DFAS did not plan to recover

this payment until the contract was reconciled at closeout. The overpayment should have been refunded to the Government immediately; waiting for contract closeout to recover the funds was inappropriate.

The RDT&EN appropriation also contained another example of misstated obligations and disbursements. Verification of commitment and obligation balances showed that NAVSEA had made a $3.5 million payment against the SCN appropriation. When we examined this payment, we found a modification to the contract that allowed the obligation to be posted as incentive award fees. The modification showed that the contractor should have been paid from SCN funds from FYs 1983 and 1984 and RDT&EN funds from FY 1984. The voucher showed that the payment was made only with FY 1984 SCN funds. Because NAVSEA used the wrong appropriation and fiscal year to pay the contractor, the possibility of an unmatched disbursement was increased. The use of SCN funds decreased the obligated balance because the payment was posted incorrectly, and increased the possibility that SCN funds could be overdisbursed. The STARS system would not allow payments like this one to be posted if an insufficient obligated balance was available. Such disbursements would become unmatched disbursements, which would increase the already large balance of unmatched disbursements.

Recommendations for Corrective Action

1. We recommend that the Assistant Secretary of the Navy (Financial Management):

a. Correct the accounting entries for the contract modifications listed in Appendix A to reflect the proper charges to current and expired year accounts, as required by law.

Management Comments. The Director of Budget and Reports, Department of the Navy, nonconcurred and stated that the Department of the Navy followed the Comptroller of the Department of Defense's (the Comptroller's) guidance by charging all contract changes to current year funds. The Director also questioned the inclusion of a contract in Appendix A.

Audit Response. After reviewing the Navy's comments, we agree that the modification P00024 to contract N00024-89-C-5308 should be deleted from the list of contract modifications requiring reversal (see Appendix A) and have adjusted the report accordingly. The Comptroller of the Department of Defense issued guidance on June 13, 1991, which required DoD organizations to charge all contract changes to current year funds. On April 20, 1992, the Comptroller reversed the guidance issued on June 13, 1991, and required DoD organizations to follow the policy in effect prior to June 13, 1991. Guidance issued prior to June 13, 1991, required the use of expired year funds for contract changes within the scope of the contract. The Comptroller's reversal of the guidance indicates that the earlier guidance was erroneous and contrary to law. As a result, we believe any erroneous charges made to current year funds should be

reversed. Therefore, we are requesting reconsideration of the comments on this recommendation. The "Response Requirements for Each Recommendation" chart at the end of this section lists the requirements for further comments.

b. Establish procedures to verify that administering offices obtain the proper approvals for obligational adjustments in amounts higher than the established thresholds.

Management Comments. The Director concurred and stated that the current guidance is accurate and has been properly distributed.

Audit Response. Although the Director concurred with the recommendation, the Navy's current guidance was not always followed. Therefore, we request that the Navy identify proposed actions that will prevent a recurrence of this problem and provide an estimated completion date.

2. We recommend that the Director, Defense Finance and Accounting Service, establish automated procedures for correcting errors at the time they occur, so that users may rely on the Standard Accounting and Reporting System for accurate contract balances.

Management Comments. The Deputy Director for General Accounting, Defense Finance and Accounting Service, concurred in principle. He stated that procedures were being designed to improve the integrity of the Standard Accounting and Reporting System and interfacing systems to create a more reliable reporting structure.

Audit Response. We consider the Deputy Director's comments as responsive to our recommendations; however, we request an estimated completion date for the proposed actions.

Response Requirements for Each Recommendation

Responses to the final report are required from the addressee shown for the items indicated with an "X" in the chart below.

		Response Should Cover:		
Number	Addressee	Concur/ Nonconcur	Proposed Action	Completion Date
1.a.	ASN(FM)	X	X	X
1.b.	ASN(FM)		X	X
2.	DFAS			X

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Part III - Additional Information

Appendix A: Reversals of Contract Modifications

Activity	Contract	Modification	Appropriation[1]	Funds Obligated in Fiscal Year	Amount	Recommended Fiscal Year[2]
NAVAIR	N00123-87-C-0219	N/A	1507	1991	457,417	1987
NAVAIR	N00019-82-G-0067	P0001A	1506	1991	1,245,887	1984
NAVAIR	N00019-82-G-0067	P0001A	1506	1991	1,246,471	1985
NAVAIR	N00019-83-C-0093	P00030	1506	1991	350,000	1986
NAVAIR	N00019-87-C-0096	P00013	1506	1992	926,045	1986
NAVAIR	N00019-85-G-0465	P00013	1506	1991	499,000	1985
NAVAIR	N00019-88-C-0178	P00006	1506	1992	763,699	1988
NAVAIR	N00019-88-C-0178	P00006	1506	1992	572,000	1989
Total					$6,060,519	

1 Appropriation 1507 contains Weapons Procurement, Navy, funds. Appropriation 1506 contains Aircraft Procurement, Navy, funds.

2 This column represents the fiscal year when funds should have been obligated.

Appendix B: Summary of Potential Benefits Resulting from Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
A.1.a, A.1.b., A.1.c., A.2.	Compliance and internal controls. Will strengthen internal controls and improve fiscal accountability and management in DoD.	Nonmonetary.
B.1.	Economy and efficiency. Will recoup overpayments in a more timely manner.	Nonmonetary.
B.2.	Compliance and internal controls. Will strengthen internal controls and improve fiscal accountability and management in DoD.	Nonmonetary.
B.3.	Economy and efficiency. Will ensure more accurate recordkeeping and reserve funds for actual liabilities.	Nonmonetary.
C.1.a.	Compliance. Will correct erroneous accounting entries and make available $6.2 million in current year appropriations.	Nonmonetary.
C.1.b., C.2.	Compliance. Will strengthen internal controls and improve the reliability of DoD's accounting data.	Nonmonetary.

Appendix C: Organizations Visited or Contacted

Defense Agencies

Headquarters, Defense Finance and Accounting Service, Washington, DC
- Defense Finance and Accounting Service-Cleveland Center, Cleveland, OH
  - Defense Accounting Office-Arlington, VA
- Defense Finance and Accounting Service-Columbus Center, Columbus, OH

Department of the Navy

Secretary of the Navy, Washington, DC
Assistant Secretary of the Navy (Financial Management), Washington, DC
Office of the Chief of Naval Operations, Washington, DC
- Strategic Systems Programs Office, Arlington, VA

Office of the Chief of Naval Research, Arlington, VA
Office of the Navy Comptroller, Washington, DC
Naval Air Systems Command, Arlington, VA
- Phoenix Missile Program Office, Arlington, VA

Naval Sea Systems Command, Arlington, VA
- Close-In Weapons System Program Office, Arlington, VA
- MK-48 Torpedo Program Office, Arlington, VA
- MK-50 Missile Program Office, Arlington, VA
- Standard Missile Program Office, Arlington, VA

Appendix D: Report Distribution

Office of the Secretary of Defense

Comptroller of the Department of Defense
General Counsel of the Department of Defense

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)
Office of the Chief of Naval Operations
  Program Manager, Strategic Systems Programs
Office of the Chief of Naval Research
Office of the Navy Comptroller
Commander, Naval Air Systems Command
  Program Manager, Phoenix Missile
Commander, Naval Sea Systems Command
  Program Manager, Close-In Weapons System
  Program Manager, MK-48 Torpedo
  Program Manager, MK-50 Torpedo
  Program Manager, Standard Missile
Commander, Space and Naval Warfare Systems Command

Defense Agencies

Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service-Cleveland Center
    Defense Accounting Office-Arlington
  Director, Defense Finance and Accounting Service-Columbus Center

Non-Defense Organizations

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

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

Senate Committee on Appropriations
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 Subcommittee on Investigations, Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations

Part IV - Management Comments

DEPARTMENT OF THE NAVY
OFFICE OF THE COMPTROLLER
WASHINGTON D.C 20350-1100

IN REPLY REFER TO
NCB-32
18 JAN 1994

MEMORANDUM FOR THE DEPARTMENT OF DEFENSE INSPECTOR GENERAL

Subj: DRAFT REPORT ON FINANCIAL STATUS OF NAVY EXPIRED YEAR APPROPRIATIONS, (Project No. 2FG-2016)

Ref: (a) DODIG memo of 14 Oct 93

Encl: (1) Department of the Navy Comments

I am responding to the draft audit report forwarded by reference (a) concerning the financial status of Department of the Navy (DoN) expired year appropriations.

The DoN concurs that balances in expired WPN appropriation line items for fiscal years 1987, 1988, and 1989 are apparently inadequate to meet certain contract obligations for the MK-50 Torpedo, the Standard Missile, and the Phoenix Missile. Also, the status of all the other line items in these appropriations is under review to identify any other apparent deficiencies.

In regards to claims, the DoN agrees that the possibility of deficiencies in expired APN, WPN, and RDT&EN accounts could be created if all claims were valid as to basis of the claim and submitted amounts. However, claims must be thoroughly analyzed before there can be a realistic assessment as to the basis and amount. Moreover, if the claims are litigated and the contractors receive monetary judgments from the Armed Services Board of Contract Appeals or the Court of Federal Claims, those judgments are payable with current appropriations. Therefore, at this time there is no basis to conclude that deficiencies exist.

W A EARNER
Rear Admiral, U S. Navy
Director of Budget and Reports

Copy to:
NAVINSGEN
NAVCOMPT (NCB-53)

Subj: DRAFT REPORT ON FINANCIAL STATUS OF NAVY EXPIRED YEAR APPROPRIATIONS, (Project No. 2FG-2016)

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COMNAVAIRSYSCOM
COMNAVSEASYSCOM
COMSPAWARSYSCOM
COMNAVSUPSYSCOM
OCNR

2

DEPARTMENT OF THE NAVY RESPONSE
to
DODIG DRAFT REPORT of 14 October 1993
on
Financial Status of Navy Expired Year Appropriations
Project No. 2FG-2016

Finding A: Apparent Appropriation Deficiencies

DODIG found balances in the Navy appropriations were apparently insufficient to meet $17 5 million in obligations and obligational adjustments properly chargeable to those expired year appropriations. This occurred because the Navy incurred, but did not promptly record, target-to-ceiling increases in the MK-50 Torpedo program, the Standard Missile program, and the Phoenix Missile program. As a result, the Navy's expired accounts in the Weapons Procurement appropriations apparently have appropriation deficiencies in the line-item appropriated MK-50 Torpedo program for FY 1987, the Standard Missile program for FY 1987, and the Phoenix Missile program for FYs 1987 and 1988

Department of the Navy Response:

The Department of the Navy (DoN) concurs that balances in expired WPN appropriation line items for fiscal years 1987, 1988, and 1989 are apparently inadequate to meet certain contract obligations for the MK-50 Torpedo, the Standard Missile, and the Phoenix Missile. The Department of the Navy is also reviewing the status of all the other line items in those appropriations to identify any other apparent deficiencies.

Recommendation A.1.

That the Assistant Secretary of the Navy (Financial Management) record obligations for the FY 1987 MK-50, the FY 1987 Standard Missile, the FYs 1987 and 1988 Phoenix Missile, and all other unrecorded obligations that may cause deficiencies. Obligations should be recorded in one of the following ways:

a. Record the obligations against current year funds of the same type and purpose, to the extent that these current funds do not exceed 1 percent of the balance of the expired appropriation or 1 percent of the current appropriation, whichever is less; or

b. Request specific reprogramming of other appropriated funds from Congress; or

c Request a supplemental appropriation from Congress.

Department of the Navy Response:

The Department of the Navy concurs that the contract liabilities must be recognized and the bills must be paid. The Department is reviewing all the available alternatives to

1 Enclosure (1)

funding the deficiencies, including the possibility of seeking supplemental appropriations from Congress. Final action will be consistent with the account closing law (31 U.S.C. §1551 et seq.) and section 1004 of the National Defense Authorization Act for Fiscal Year 1993. In the case of the Phoenix Missile, the amount of the liability has not been finally established.

Recommendation A.2.

Investigate the apparent appropriation deficiencies for the MK-50, the Standard Missile, and the Phoenix Missile, fix responsibility, and comply with the reporting requirements of 31 United States Code 1351 and DoD Directive 7200.1 if any violation of the Anti-deficiency Act has occurred.

Department of the Navy Response:

Each of the deficiencies identified in the draft audit report is being or will be investigated. The Department of the Navy will make the appropriate reports required by DoD Directive 7200.1

Finding B: Potential Appropriation Deficiencies

Navy appropriation balances may be insufficient to meet obligational adjustments that may become chargeable in the future if contingent liabilities become actual liabilities. This could occur because contingent liabilities may exceed the remaining available balances in the Weapons Procurement, Navy (WPN) and Aircraft Procurement, Navy (APN) appropriations during Fiscal Years 1987, 1988, and 1989, and the Research, Development, Test, and Evaluation, Navy (RDT&EN) appropriation during Fiscal Years 1988 and 1989. The potential exists for $164.8 million in deficiencies in the expired accounts of the Navy's WPN and APN appropriations. The Navy had pending claims in the (RDT&EN) appropriation valued at $861.4 million that could result in additional funding deficiencies

Department of the Navy Response:

The Department of the Navy concurs that claims submitted by contractors create the possibility of deficiencies in expired APN, WPN, and RDT&EN accounts. The claims must be thoroughly analyzed before there can be a realistic assessment whether the ultimate liability will exceed the applicable appropriations. If the claims are litigated and the contractors receive monetary judgments from the Armed Services Board of Contract Appeals or the Court of Federal Claims, those judgments are payable with current appropriations. Therefore, at this time there is no basis to conclude the deficiencies exist.

Recommendation B.1.

Recommend that the Assistant Secretary of the Navy (Financial Management) establish procedures for identifying future requirements and contingent liabilities that may cause deficiencies in the future.

Department of the Navy Response:

Concur. The DoN already has policies, processes, and procedures in place which identify contingent liabilities. The Navy's Administering Offices (AO) for the procurement accounts conduct reviews to anticipate and plan for contract adjustments for incentive fee payments, economic price adjustments, and exchange rate adjustments while the accounts are still active. Claim's and requests for equitable adjustment are reported periodically to the ASN(RDA).

Many contingencies do not occur until late in the contract life cycle, usually after expiration of the appropriation. For example, many performance incentives are not earned until delivery or final testing. Target-to-ceiling adjustments are usually made after the contract has later performed.

Recommendation B.2.

Recommend that the Assistant Secretary of the Navy (Financial Management) maintain contingent liabilities in the accounting records and reports after funds expire.

Department of the Navy Response:

Nonconcur. In accordance with DoD Accounting Guidance Manual 7220.9-M, Chapters 24 and 25, contingent liabilities should be carried as outstanding commitments pending determination of actual obligations. The regulation then states that outstanding commitments shall be cancelled as of the end of the period of availability for new obligations. There cannot be commitments in the expired appropriation accounts. Furthermore, it is inappropriate to record liabilities upon the submission of a claim by a contractor, especially at the value of the claim. A claim should only be recorded after review by the Government and specific determination of the Government's liability.

Recommendation B.3.

Recommend that the Assistant Secretary of the Navy (Financial Management) ensure that obligations supporting contingent liabilities are not recorded until a contingency occurs

Department of the Navy Response:

Concur In accordance with DoD Accounting Guidance Manual 7220.9-M Chapter 24, obligations should not be recorded until such a point that an incurred liability occurs.

Finding C: Accounting and Recording

The Navy's records do not accurately reflect the status of expired year appropriations, and appropriation balances may be materially misstated. The Navy failed to record obligations that resulted in deficiencies (discussed in Finding A); did not follow reporting requirements for the $4.0 million and $25.0 million thresholds; and did not consistently

apply the procedures for obtaining approval to make upward obligational adjustments. These conditions occurred because the Navy followed erroneous guidance issued by the DoD Comptroller for the funding of contract changes, the Standard Accounting and Reporting System (STARS) does not accurately match disbursements with obligations, and no standardized procedures had been established for correcting unmatched disbursements. As a result, the Navy used current year funds to pay for $6.2 million in obligational adjustments that were properly chargeable to expired year appropriations, and the expired appropriations we reviewed contained $1.0 billion in unmatched disbursements.

Department of the Navy Response:

The DoD's policy, followed by the DoN, is to record obligations that are supported by documentary evidence as outlined in the DoD Accounting Guidance Manual 7220.9-M, Chapter 21

The Navy's policy for expired accounts, as outlined in NAVCOMPTINST 7040.37B of 10 Apr 91, states that any upward obligation adjustment to appropriations whose period of availability has expired in excess of $100,000 requires approval by the Responsible Officer (RO). Adjustments in excess of $500,000 requires approval by the Assistant Secretary of the Navy for Financial Management ASN(FM). The DoN policy is to meet all reporting requirements.

The DoN followed the DoD(C) issued guidance of 13 June 1991 on the Accounting for Expired Accounts Including "M" and Merged Surplus Accounts. This guidance instructed the Navy to charge all "contract changes" to current year funds. This was the prevailing guidance at the time Therefore, any obligation adjustment that used currently available funds was proper while that guidance was in effect. Further, the NAVSEASYSCOM contract N00024-89-C-5308 contained FY 1990 funds making the $106,860 adjustment proper. It should not be included on the Appendix A listing.

Recommendation C.1.a.

Recommend that the ASN(FM) correct the accounting entries for the contract modifications to reflect the proper charges to current and expired year accounts, as required by law.

Department of the Navy Response:

Do not concur. The DoN followed the DoD(C) guidance of 13 June 1991, titled "Revised DoD Guidance on Accounting for Expired Accounts, Including "M" and Merged Surplus Accounts," which instructed all DoD components to charge all "contract changes" to current year funds. Therefore, the obligation adjustments, cited in the audit, that used currently available funds were properly chargeable and in accordance with prevailing DoD(C) guidance. On 20 April 1992, the DoD(C) issued revised guidance titled "DoD Accounting Guidance for Contract Changes", which stated the policy regarding the charging of contract changes shall be the same policy in effect prior to 13 June 1991. In the absenceof further clarification from the OSD Comptroller, the change must be

considered to be prospective only. DoD components did not reverse any charges that were made under the previous guidance because the obligation adjustments were proper.

For NAVSEASYSCOM contract N00024-89-C-5308 the performance incentive fee was on a FY 1989 and FY 1990 multi-year contract. The adjustment was not a contract change, and was posted against the appropriate fiscal years. No adjustment is required.

Recommendation C.1.b.

Recommend that the ASN(FM) establish procedures to ensure that AOs obtain the proper approvals for obligational adjustments in amounts higher than the established thresholds.

Department of the Navy Response:

Concur. The Navy Comptroller has for years instructed the AOs on the proper approval procedures for obligational adjustments in amounts higher than the established thresholds. The current guidance is accurate and has been properly distributed. The current guidance is as follows: NAVCOMPTINST 7040.37B of 10 April 1991; NAVCOMPT memo of 30 September 1991; NAVCOMPT memo of 6 April 1992; NAVCOMPT memo of 11 August 1992; NAVCOMPT memo of 14 January 1993; and NAVCOMPT memo of 26 March 1993. No further action is required.

DEFENSE FINANCE AND ACCOUNTING SERVICE
WASHINGTON DC 20376-5001

(General Accounting) DEC 7 1993

MEMORANDUM FOR DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE, INSPECTOR GENERAL, DOD

SUBJECT: Draft Audit Report on the Financial Status of Navy Expired Appropriations (Project No. 2FG-2016)

We have reviewed the above report and concur in principle with the recommendation related to the Defense Finance and Accounting Service Our comments are attached.

My point of contact is Mr. Richard White on (703) 607-1120.

Arnold R. Weiss
Deputy Director for
General Accounting

Attachment

DoDIG Draft Audit Report on the Financial Status of Navy Expired Year Appropriations (Project No. 2FG-2016)

Comments

This is in response to your request for comments on the subject draft audit report. The subject report contains one recommendation for action by the Defense Finance and Accounting Service.

- **Finding C, Recommendation 2, page 28:** We recommend that the Director, Defense Finance and Accounting Service establish automated procedures for correcting errors at the time they occur, so that users may rely on the Standard Accounting and Reporting System for accurate contract balances.

DFAS Position: Concur in Principle. The Defense Finance and Accounting Service (DFAS) acknowledges the volume of unmatched disbursements has been a long standing DoD problem that requires direct resolution. It was most recently highlighted by the General Accounting Office (GAO) report, "FINANCIAL MANAGEMENT: Navy Records Contain Billions of Dollars in Unmatched Disbursements," draft issued January 27, 1993. In response to GAO's Audit, DFAS immediately organized a "Tiger Team" to identify and initiate solutions. DFAS initiated a project and formed teams in conjunction with service representatives with the primary goal of stemming the growth of the unmatched disbursement balance within a year and addressing the reduction of the backlog.

DFAS recognizes that $1.0 billion is significant and has reported unmatched disbursements as a material weakness in its Federal Managers' Financial Integrity Act annual statement of assurance. DFAS is addressing this material weakness via the "tiger teams" and DFAS Project participation. The cited $1.0 billion in unmatched disbursements for expired appropriations, however, represents less than one percent of the total disbursements processed against authorizations accounted for by the Standard Accounting and Reporting System (STARS).

The DFAS Unmatched Disbursement Project, is analyzing the process and identifying solutions to prevent future unmatched disbursements. These solutions extend beyond the establishment of automated error correction procedures as recommended in the draft report. These procedures are designed to improve the integrity of STARS and interfacing systems to create a more reliable reporting structure. Our deviation from the recommendation is based on our expansion of our scope to include the entire procedure/process as opposed to automated error correction at occurrence.

Attachment

Audit Team Members

Nancy L. Hendricks	Director, Financial Management Directorate
F. Jay Lane	Audit Program Director
Dennis L. Conway	Audit Project Manager
Andrew Katsaros	Senior Auditor
Jacqueline J. Vos	Auditor
Michael S. Smith	Auditor
Susanne B. Allen	Editor
Sheila L. Hampton	Administrative Support

INTERNET DOCUMENT INFORMATION FORM

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B. DATE Report Downloaded From the Internet: 04/10/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): **OAIG-AUD (ATTN: AFTS Audit Suggestions)**
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

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 04/10/99**

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