Audit Report

OFFICE OF THE INSPECTOR GENERAL

FINANCIAL STATUS OF ARMY EXPIRED YEAR APPROPRIATIONS

Report No. 95-235 June 14, 1995

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Acronyms

ACRN	Accounting Classification Reference Number
DAO	Defense Accounting Office
DFAS	Defense Finance and Accounting Service
DSN	Defense Switched Network
GAO	General Accounting Office
IG	Inspector General
OMB	Office of Management and Budget
PRON	Procurement Request Order Number
CLIN	Contract Line Item Number
SLIN	Subsidiary Contract Line Item Number

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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June 14, 1995

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit Report on the Financial Status of Army Expired Year Appropriations (Report No. 95-235)

We are providing this report for review and comments. We have considered management's comments on a draft of this report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Army's comments on the draft of this report left no unresolved issues. Therefore, no additional Army comments are required. As a result of comments from the Office of the Under Secretary of Defense (Comptroller) on behalf of the Defense Finance and Accounting Service, we revised recommendations A.2., A.3., A.4., and B.1.c. Also, management comments did not address the potential monetary benefits. Therefore, we request that the Under Secretary of Defense (Comptroller) and the Director, Defense Finance and Accounting Service, provide additional comments on this final report by August 14, 1995.

We appreciate the courtesies extended to the audit staff. Questions should be directed to Mr. Christian Hendricks, Audit Program Director, at (703) 604-9140 (DSN 664-9140), or Mr. Dennis L. Conway, Audit Project Manager, at (703) 604-9158 (DSN 664-9158). See Appendix G for the report distribution. Audit team members are listed on the inside back cover.

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Office of the Inspector General, Department of Defense

Report No. 95-235 **June 14, 1995**
(Project No. 3FG-2006)

FINANCIAL STATUS OF ARMY EXPIRED YEAR APPROPRIATIONS

EXECUTIVE SUMMARY

Introduction. The audit was made to determine whether the Army had problems with expired appropriations similar to those we found in the Air Force and the Navy. An appropriation is spending authority set aside by Congress for a specific use. An expired appropriation is one for which new obligations may not be created, but its funds can be used for previously incurred obligations. In the Navy and the Air Force, we identified potential violations of the Antideficiency Act, improper use of current year appropriations to fund expired year requirements, and disbursements that had not been charged to obligations owed by a specific program, project, or activity.

Objectives. The overall objective of the audit was to determine whether the Army's prior year requirements were funded from the correct appropriations. We reviewed the methods used to manage the expired and merged year appropriations that existed during the transition period provided by Public Law 101-510, "National Defense Authorization Act for Fiscal Year 1991." We also evaluated the Army's implementation of management controls over financial operations, and its implementation of the DoD management control program as it pertained to the audit objectives.

Audit Results. The Army Materiel Command's prior year requirements were not always funded from the correct appropriations, and the balances in its financial records could not always be relied on for making financial decisions.

o Progress payments to contractors and liquidations of previous payments were not necessarily recorded against the correct appropriations; as a result, appropriation balances were distorted, potential violations of the Antideficiency Act could have occurred, and overpayments to contractors were not recouped in a timely manner. About $1.1 billion in unliquidated progress payments was recorded in January 1994 for Army contracts funded with expired appropriations. The balance was partially attributable to deficiencies in the recording and liquidation of progress payments, rather than to outstanding progress payments that were valid but had not been liquidated (Finding A).

o Contingent liabilities of at least $29.7 million were reported in the expired procurement appropriations for Aircraft; Missiles; Weapons and Tracked Combat Vehicles; and Other Procurement items. Those liabilities were not adequately tracked, and could result in funding deficiencies and a potential violation of the Antideficiency Act in the Aircraft appropriation (Finding B).

o The Army had about $3.9 billion in unliquidated obligations charged to expired appropriations; however, the Army and the Defense Finance and Accounting Service were not effectively validating unliquidated obligation balances in expired appropriations. As a result, at least $19.3 million in unliquidated obligations was invalid as of January 1994. Unliquidated obligations that are invalid should be deobligated in a timely manner so the funds can be used for valid obligation adjustments of expired appropriations (Finding C).

Summary of Recommendations. We recommended that the Under Secretary of Defense (Comptroller) require reporting and revalidation of contingent liabilities, establish procedures to create obligations for valid commitments prior to the expiration of appropriations, and establish policy for using reserves to pay for contingent liabilities that exceed available funds. We recommended that the Defense Finance and Accounting Service bring the DoD accounting and disbursing systems into compliance with the revised "DoD Accounting Manual"; establish procedures for maintaining visibility over contingent liabilities; periodically report unliquidated progress payments to the DoD Components for validation; recoup overpayments made to contractors; and periodically reconcile progress payment and liquidation data. We also recommended that the Defense Finance and Accounting Service and the Army Materiel Command establish procedures to ensure that unliquidated obligations are periodically revalidated. Further, we recommended that the Army validate contingent liabilities, establish the need for obligations where necessary, and report any violations of the Antideficiency Act as appropriate.

Management Comments. The Army concurred with the recommendations and provided information on actions taken or planned (see Part II for a complete discussion of those comments). The Office of the Under Secretary of Defense (Comptroller), on behalf of the Defense Finance and Accounting Service, partially concurred with recommendations considered applicable to the DoD Components and nonconcurred with the recommendations pertaining to validation of progress payments, liquidation data, and the establishment of reserves for contingent liabilities. Management did not address the material management control weaknesses or potential monetary benefits. For the complete text of management's comments, see Part IV.

Audit Response. The Under Secretary of Defense (Comptroller) and the Defense Finance and Accounting Service's comments were partially responsive. As a result of those comments, we have revised four recommendations and provided additional information for management to consider in responding to our recommendations. Additional comments are requested from the Under Secretary of Defense (Comptroller) and the Defense Finance and Accounting Service on the material management control weaknesses and potential monetary benefits by August 14, 1995.

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This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

Part I - Introduction

Background

History. During FYs 1992 and 1993, we audited the financial status of Air Force and Navy expired year appropriations. We identified potential violations of fiscal statutes, including the Antideficiency Act (Appendix A summarizes these statutes); the improper use of current year appropriations to fund expired year requirements; and unmatched disbursements. Therefore, we initiated this audit of the Army's expired year procurement accounts.

Public Law 101-510. Public Law 101-510, the "National Defense Authorization Act for Fiscal Year 1991," November 5, 1990, phased out merged accounts and canceled all merged surplus authority. Now, unobligated balances and obligated unexpended balances are not merged. Instead, they retain fiscal year identity, with a new period of availability extended to 5 years after expiration, in which certain obligational transactions can be recorded. Generally, after that 5-year period, those transactions must be paid with current year funds.

Expired Year Appropriations. Office of Management and Budget (OMB) Bulletin No. 91-07, "Budget Execution Procedures for Closing Accounts," January 17, 1991, implemented the changes on the closing and availability of appropriation accounts that Section 1405 of Public Law 101-510 made to subchapter IV of 31 United States Code. It also added Part XI to OMB Circular No. A-34, "Instructions on Budget Execution." Part XI defines the term "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." The unobligated balance of an expired appropriation is available for obligational adjustments within the same appropriation.

Public Law 102-484. Section 1004 of Public Law 102-484, the "National Defense Authorization Act for Fiscal Year 1993," October 23, 1992, was enacted in response to a proposal by the Comptroller of the Department of Defense (now the Under Secretary of Defense [Comptroller]). Section 1004 provided additional transition authority for closing appropriation accounts. It permitted charging obligations and adjustments to obligations for accounts of a fiscal year before FY 1992 to current appropriation accounts available for the same purpose with the provision that the period of availability had to be expired but not closed. The total amount chargeable to a current appropriation under such authority " . . . may not exceed an amount equal to the lesser of (i) one percent of the total amount of the appropriation for that account; or (ii) one percent of the total amount of the appropriation for the expired

account." The authority can only be used if the Secretary of Defense certifies to the Congress that the provisions of the Antideficiency Act, as amended, are followed.

Objectives

The overall objective of the audit was to determine whether the Army's prior year requirements were funded from the correct appropriations. We reviewed the methods used to manage the financial status of the expired and merged year appropriations under transition authority provided by Public Laws 101-510 and 102-484. We evaluated management controls over financial operations, and we also evaluated the Army's implementation of management controls required by the DoD management control program as it pertained to the audit objectives.

Scope and Methodology

This financial-related audit was performed from April 1993 through November 1994. 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), DoD, and accordingly included such tests of management controls as were considered necessary.

The audit was limited to reviewing the expired appropriation accounts for five Army procurement appropriations and the research, development, test, and evaluation appropriation at the five major subordinate commands of the Army Materiel Command. The procurement appropriations were Aircraft Procurement, Army; Missile Procurement, Army; Procurement of Weapons and Tracked Combat Vehicles, Army; Procurement of Ammunition, Army; and Other Procurement, Army. The major subordinate commands were the U.S. Army Aviation and Troop Command; U.S. Army Armament, Munitions, and Chemical Command; U.S. Army Missile Command; U.S. Army Communications-Electronics Command; and U.S. Army Tank-automotive and Armaments Command. See Appendix F for a complete list of the organizations we visited or contacted.

The audit covered the expired FYs 1987 through 1990 for the five procurement appropriations, and the expired FYs 1988 and 1991 for the research, development, test, and evaluation appropriation. We compared known future funding requirements to unobligated available balances in the expired

appropriation accounts. The appropriations and activities audited were judgmentally selected; therefore, our results cannot be projected beyond the amounts actually identified during the audit.

To evaluate the Army's accounting records and reports, we reviewed several laws (see Appendix A) and DoD and Army accounting policies for expired year appropriations. We also reviewed the methods used to compile official accounting records, and we verified the reliability of computer-related information provided during the audit. Verification was accomplished by comparing the amounts recorded for transactions in computer reports with amounts shown on documents that were used to create the computer reports. The amounts recorded in the computer reports did not always match the amounts shown on the documents; therefore, information in the official accounting records was not always reliable.

Management Controls

Review of the Army Materiel Command's Management Control Program. Our review of the Army Materiel Command's management control program included an analysis of management controls over the status of funds in the Army's expired appropriations. Specifically, we evaluated the Army's policy of accounting for funds in expired appropriations. We also examined the Army's procedures for recording, correcting, and analyzing the effects of accounting transactions on the balances of those funds. Further, we reviewed the results of any self-evaluation of those management controls.

Adequacy of Management Controls. Army officials identified general accounting activities as an assessable unit and, in our opinion, correctly identified the risk associated with general accounting activities as high. One of the major subordinate commands, the U.S. Army Communications-Electronics Command, reported a material management control weakness initially found by the General Accounting Office (GAO). The material weakness involved negative unliquidated obligations remaining in the procurement accounts for extended periods of time without followup or corrective action. The command's plan for correcting these deficiencies showed that actions were started in March 1990 and were continuing. We also found this material weakness during our audit (see Finding C for details), and we identified other material management control weaknesses as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. The other material weaknesses showed that the Army Materiel Command's management controls were not adequate to ensure that payments to contractors were charged to the proper appropriation based on the underlying nature of the work performed (Finding A); identify contingent liabilities of at least $29.7 million that could

result in a potential violation of the Antideficiency Act (Finding B); and ensure that unliquidated obligation balances were effectively reviewed (Finding C). The Army Materiel Command's self-evaluation processes for management controls need to be improved to help ensure corrective action in those areas.

All recommendations in this report, if implemented, will assist in correcting the weaknesses. Potential monetary benefits will accrue if the recommendations are implemented (see Appendix E), but the amounts are undeterminable until the actions have been completed. A copy of this report will be provided to the senior DoD and Army officials who are responsible for management controls.

Prior Audits and Other Reviews

Both the GAO and the IG, DoD, have reviewed the status of Army appropriations and issues related to funds in expired accounts (funds that can no longer be used to pay for new obligations). Appendix B summarizes eight prior audit reports related to the issues discussed in this report.

Other Matters of Interest

During the audit, we identified a matter that is not reported in our findings because we did not identify any actual adverse effect. Managers at the major subordinate commands did not always obtain proper approvals for making increases (upward adjustments greater than $100,000 but less than $4 million) to contracts. These requirements are specified in Army Regulation 37-1, "Army Accounting and Fund Control," April 30, 1991. In addition, the Defense Accounting Offices (DAOs) did not always maintain records of these approvals. Further, the Army had no system for tracking contract adjustments that required additional work costing $4 million or more. Public Law 101-510 requires that upward adjustments costing $4 million or more be approved by the Under Secretary of Defense (Comptroller), and that adjustments of $25 million or more be approved by Congress.

We identified 249 upward adjustments totaling $205.3 million at the 5 major subordinate commands. No approvals were on file for 109 adjustments totaling $81.2 million. The Defense Accounting Officers are using Army Regulation 37-1 as guidance for making upward adjustments to contracts. Army Regulation 37-1 clearly states that finance and accounting officers (now called Defense Accounting Officers) must review and approve upward adjustments greater than $100,000 but less than $4 million; however, managers did not

emphasize this requirement or ensure that the reviews were made and approvals were obtained. Generally, the DAOs approved the upward adjustments requested by the major subordinate commands' program managers. In the absence of proper approval, adjustments could be made that cite incorrect appropriations or appropriations that contain insufficient funds, although we did not find any instances of this.

Part II - Findings and Recommendations

Finding A. Management of Contract Payments

Contract payments were not always properly recorded by the Defense Finance and Accounting Service and the Army Materiel Command. We identified the following problems:

o Progress payments were not properly recorded when made or liquidated. Unliquidated progress payments for the Army's expired year procurement appropriations exceeded $1.1 billion. This balance was partially due to uncorrected errors in recording and liquidation of progress payments, rather than outstanding progress payments that were valid, but had not been liquidated. Procedures did not exist for properly charging payments or liquidations to the correct expired appropriation.

o Potential overpayments of $18.5 million were not promptly identified and collected from contractors.

o Potential errors in recording contract transactions, identified by edit checks, were not reconciled.

Payments to contractors had sometimes been improperly recorded and liquidated. This occurred because neither Government contracting officers nor contractors were required to identify the appropriation accounting data to permit recording based on the underlying nature of the work performed. In the absence of this information, disbursements were made based on availability of appropriated funds, regardless of the purpose for which the funds were appropriated. The potential overpayments were not identified or collected promptly and error reports were not reviewed because these areas received low management priority.

As a result, Army managers at the major subordinate commands did not have accurate accounting data and could not determine the availability of funding. Also, because the payments were not recorded against the appropriation properly chargeable for the work performed, violations of 31 U.S.C. 1301 have occurred, and additional violations could occur in the future. We consider the absence of controls over the recording of payments to violate 31 U.S.C. 1514, which requires a system of administrative control for appropriations. These conditions can cause violations of the Antideficiency Act.

Background

Introduction. Progress payments are made to contractors for costs incurred as work progresses under the contract. They are a form of contract financing distinguished by the Federal Acquisition Regulation part 32 from payments based on the percentage or stage of completion accomplished; payments for partial deliveries accepted by the Government; or partial payments for a contract termination proposal. Progress payments and other contract financing payments are authorized by 10 U.S.C. 2307 for DoD contracts that provide for such payments. The law requires the payments to be commensurate with the work accomplished, which meets the standards of quality established under the contract. The customary progress payment rate is 80 percent, applicable to the total costs of performing the contract.

Progress payments help the contractor pay for materials, labor, and other costs until the finished products are delivered and the contractor collects full payment. The contractor incurs a debt to the Government in the amount of the progress payments until delivery occurs. Progress payments are liquidated through the deduction of liquidations from payments that would otherwise be due to the contractor for completed contract items. Liquidation amounts are determined by applying a liquidation rate to the contract price of the contract items delivered and accepted.

Progress payments are generally not provided on contracts where such payments are not a customary commercial practice, such as subsistence, clothing, medical, and dental supplies, and standard commercial items not requiring a substantial accumulation of predelivery expenditures by a contractor. The Army generally authorizes progress payments on contracts for at least $1 million, or when a contract is written to cover a long period of time.

Requests for Procurement. The Army Materiel Command uses procurement request order numbers (PRONs) for management control and identification of program directives and work orders issued by and between the Army Materiel Command's field commands, installations, and activities. The PRONs are to be shown on contracts, requests for procurement or work, and other contract actions; on related cost and performance reports; and on delivery reports.

Each PRON is a unique number that identifies:

- the customer or originator of the requirement,

- the fiscal year in which the Department of the Army approved the program (a constant FY identifier except in cases of reimbursable orders),

o the sequential number of the program directive or work order assigned by the customer or originator,

o the initiating activity or customer's organization,

o the performing activity (the installation activity or procurement office to which the program directive or work order is addressed), and

o the number of modifications to the original program directive or work order.

Headquarters, U.S. Army Materiel Command Regulation 11-2, "Army Programs, Use of the Procurement Request Order Number," August 25, 1989, states that each request for procurement or work must have a PRON. Each request for procurement or work contains a certification by the Defense Accounting Officer that funds are available to pay for the request. When an obligation is expected to exceed the amount shown on the request for procurement or work, the performing activity must obtain an amendment for the additional funds before entering into the obligation.

Use of Appropriations. 31 U.S.C. 1301 requires that an appropriation be used only for the program or purpose for which it was made. 31 U.S.C. 1501 states, "An amount shall be recorded as an obligation of the United States Government only when supported by documentary evidence . . ." 31 U.S.C. 1514 requires a system of administrative control over an appropriation to ensure that obligations and expenditures do not exceed available amounts. Specifically, 31 U.S.C. 1514 restricts obligations or expenditures from each appropriation to the amount of apportionments or reapportionments of the appropriation and requires a simplified system for administratively dividing appropriations. Correspondingly, 31 U.S.C. 1341 states, "An officer or employee of the United States Government . . . may not (A) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation." These statutes are implemented by DoD Directive 7200.1, "Administrative Control of Appropriations," as amended on July 27, 1987. Appendix A, "Summary of Fiscal Statutes," provides the text of referenced and related statutes.

The GAO publication, "A Glossary of Terms Used in the Federal Budget Process," March 1981, defines an "expenditure" as an outlay. An "outlay" is defined as a liquidation of obligations, such as when a check or cash is disbursed. Definitions of "expenditure" are used interchangeably to describe issuances of checks or disbursements of cash by paying activities. The GAO publication, "Principles of Federal Appropriation Law," First Edition, 1982, states that an expenditure is the actual disbursement of funds. Army Regulation 37-1, "Army Accounting and Fund Control," April 30, 1991,

defines an "expenditure" as "a payment by check or equivalent action that constitutes a charge against the appropriation cited." A check is issued to the contractor upon approval of a progress payment request. Although the contractor's obligation to the Government is not liquidated until the delivery or rendering of the item or service for which the contract was made, a progress payment fits the definition of an expenditure as defined in the laws explaining appropriations. If the DoD does not ensure that expenditures are made from the correct appropriations, appropriation laws may be violated.

Recording of Progress Payments

For the Army's expired year procurement appropriations, unliquidated progress payments exceeded $1.1 billion as of January 31, 1994. Progress payments and liquidations of progress payments previously made were not properly recorded in accounting records maintained by the DFAS Center in Columbus, Ohio (DFAS Columbus Center), and the DAOs. We examined the procedures used to process and record the requests, disbursements, and liquidations of progress payments.

Processing Requests for Progress Payments. The procedures used to process requests for progress payments did not ensure that the payments recorded against the procurement appropriation accounts corresponded to the work actually performed. We selected contract DAAJ09-89-C-A003 for our review of requests for progress payments. This contract was for Apache Helicopter procurement and support. The contractor's requests for progress payments did not specify which appropriations or the amounts of appropriations that should be charged for the progress payments; and Army officials, in the absence of a contractor's segregation, did not provide an estimate of how the payments should be charged to appropriations.

On contract DAAJ09-89-C-A003, the administrative contracting officer reviewed and approved the requests for progress payments and attached a list of all accounting classification reference numbers (ACRNs) on the contract. However, this process did not ensure that payments would be charged to the correct appropriation. Neither the requests for progress payments nor the lists of ACRNs identified how the progress payments related to individual appropriations, or which appropriations should be charged when making the payments. The list attached to the requests for progress payments showed 22 ACRNs obligated at $1.3 billion from Aircraft Procurement, Army, funds, representing each fiscal year from FYs 1988 to 1992. In the absence of information from the contractor, contracting officer, or the Army Materiel Command, payments were made based on availability of appropriated funds rather than the correct appropriation for the work performed.

Disbursing and Liquidating Progress Payments. Disbursements and liquidations of progress payments were not recorded properly. Contractors did not identify the work by contract line item number (CLIN) or subsidiary contract line item number (SLIN) on the request for payment, and neither the contracting officer nor DAO personnel asked for this information, which was necessary to accurately record the payments against the correct appropriation accounts. Therefore, the DFAS Columbus Center and the DAO applied payments incorrectly.

Chapter 32 of the "DoD Accounting Manual" states that the liquidation of progress payments shall be applied against the ACRN to which the deliveries are applicable, and the remainder shall be applied against the progress payments made for other ACRNs on a percentage basis. Chapter 32 was revised, effective November 26, 1993, to require non-research and development contracts to be written so that a separate CLIN or SLIN is established for each unique obligation. The revised Chapter 32 further requires that the contractor identify the applicable CLINs or SLINs with the request for progress payment.

We determined that when an item was delivered on a CLIN or SLIN, the contractor prepared an invoice showing the item, its price, and the specific CLIN or SLIN. The ACRNs associated with the CLIN identified the appropriation(s) and fiscal year(s) obligated for the CLIN or SLIN delivered. When the DFAS Columbus Center and the DAO received the invoices approved by the administrative contracting officers, the progress payments were liquidated; however, the liquidation of the progress payments was not recorded properly, although information from the CLIN, SLIN, and ACRN was provided.

For example, we reviewed the transaction history of contractual actions identified with PRON 469P260846EJ on contract DAAJ09-89-C-A003, established by the Aviation and Troop Command. As of June 9, 1993, progress payments totaling $73.9 million were identified with this PRON and were funded with FY 1989 Aircraft Procurement, Army, appropriations. We reviewed the contractor's request for $17.3 million of the $73.9 million of progress payments. The request was paid and recorded in the DFAS Columbus Center's accounting records. The payment was also recorded in the official accounting records of the DAO. When the contractor submitted an invoice requesting liquidation of $13.6 million of the $17.3 million of progress payments, the invoice identified the work performed by ACRN. However, the liquidation was not recorded correctly by the DFAS Columbus Center or DAO personnel. Table 1 shows the accounting made by the DFAS Columbus Center and the DAO for the disbursement and liquidation of the progress payments. Table 1 also shows our analysis of how disbursements and liquidations should be distributed based on the percentage of work completed, as shown in the contractor's invoices.

Table 1. Amounts Recorded for Disbursements and Liquidations of Progress Payments
($ in millions)

	Disbursements			Liquidations		
Type of Record	Fiscal Year of Funds	ACRN	Amount	Fiscal Year of Funds	ACRN	Amount
Contractor's Request for Payment	Not provided	Not provided	$17.3			
Total			**$17.3**			
DFAS-CO Records	1990	AL	$17.3	1990	AL	$ 4.5
				1990	AV	9.1
Total			**$17.3**			**$13.6**
DAO St. Louis Records	1989	AD	$17.3	1989	AD	13.6
Total			**$17.3**			**$13.6**
Auditor Analysis of Distribution	1989	AE	$2.2	1989	AE	$1.7
	1990	AL	15.1	1990	AL	11.9
Total			**$17.3**			**$13.6**

Acronyms

ACRN	Accounting Classification Reference Number
DFAS-CO	Defense Finance and Accounting Service Columbus Center
DAO St. Louis	Defense Accounting Office St. Louis, MO

DAO personnel told us that they would liquidate or make payments from any of the appropriation accounts identified with the PRONs used on a contract that had enough unliquidated obligations to fulfill a contractor's request, but not necessarily from the appropriation for which the progress payment was actually made or the appropriation that should have been charged. The liquidations were recorded incorrectly because the accounting charges were arbitrarily made

against the PRON-identified accounts that contained unliquidated progress payments equal to or greater than the amount of the liquidations. Thus, the procedures used to process requests for progress payments and liquidations did not ensure that the payments recorded against the procurement appropriation accounts corresponded to the work actually performed.

Command-Wide Problems in Accounting for Progress Payments

The DAOs sometimes established PRONs solely for recording and tracking progress payments. This practice was less time-consuming and simplified the monitoring of outstanding progress payments; however, it did not accurately show financial managers the status of appropriations, because progress payments were not properly recorded. However, with the recent revision to the "DoD Accounting Manual," this condition should not recur in future contracts if personnel in contracting and paying offices comply with the regulation.

When contract provisions do not require the contractor to identify the work or costs on the contract by CLIN or SLIN for which the contractor is requesting progress payments, then the contracting officer or the certifying and disbursing officials must obtain this information in order to accurately record the transactions in the accounting records. Unless this information is obtained, DAO personnel will not have the information needed to record the charges to the proper appropriation accounts. Because progress payments were not properly recorded, the DAO records did not accurately show the status of appropriations. Our review was limited to the expired appropriations; however, the problem included current and canceled appropriations, as well as expired appropriations.

Significance of Progress Payments

Improper recording of progress payments was a common practice at DFAS and the DAOs. We believe this practice is inconsistent with existing laws and regulations regarding the accounting for expenditures of appropriated funds. Under this practice, violations of fiscal statutes would not necessarily become apparent until contract closeout, because accounting by appropriation account is not accurate. The decisions of the Comptroller General have long held that it violates statutory prohibitions to record obligations and expenditures against

appropriations for the sake of administrative expediency, without knowing whether those appropriations are available for the payment of a particular expense, in the first instance, even with the expectation of making subsequent adjustments to transfer the charges to the correct appropriations.

IG, DoD, Report No. 92-064, "Titan IV Program," issued March 31, 1992, identified problems with recording progress payments. The report recommended that the DoD Comptroller (now the Under Secretary of Defense [Comptroller]) review accounting policies and procedures to ensure that adequate oversight and control were maintained on expenditures related to progress payments, and that progress payments were charged to the applicable appropriations. The DoD Comptroller had partially implemented the recommendation by revising the "DoD Accounting Manual."

Significant amounts of progress payments made with expired year appropriations have been recorded incorrectly in the DFAS and DAO accounting systems. The likelihood exists that Antideficiency Act violations could have occurred and will not become apparent until these errors are corrected or the contracts are reconciled before closure. This condition will continue to exist until the recommendations in our Titan IV Program audit report are fully implemented for all contracts, and progress payments are accounted for in recognition of the work performed. To ensure the integrity of reported fund balances, progress payments and liquidations must be properly recorded.

Payments Made to Contractors

Payments were not always charged to the correct appropriation, even when the ACRN and CLIN were shown on the invoice. For example, we identified three contractor's invoices on contract DAAJ09-89-C-A003, showing that $2.3 million should have been charged to ACRN AE and SLIN 201AC. The DFAS Columbus Center recorded the $2.3 million as a disbursement from the FY 1989 Aircraft Procurement, Army, appropriation for ACRN AE. The DFAS Columbus Center's ledger showed that FY 1989 Aircraft Procurement, Army, funds should have been used for the payment. However, the DAO records showed that the payment was disbursed from PRON 4609A13246EJ, which contained FY 1990 Aircraft Procurement, Army, funds. Therefore, we believe that FY 1990 Aircraft Procurement, Army, funds were expended for purposes other than those appropriated, in violation of 31 U.S.C. 1301.

Identifying and Collecting Funds From Contractors

Payments to contractors had been made on contracts funded with expired funds, and adequate actions were not being taken to liquidate overpayments. As a result, these overpayments were not being identified or collected promptly. Personnel at the DFAS Columbus Center acknowledged that they had a backlog of inquiries from serviced activities, which could include overpayments made to contractors.

The DFAS Columbus Center personnel told us that they answered such inquiries on a last-in, first-out basis. They used this method because in October 1992, when they began using the last-in, first-out method, they had a large backlog of inquiries from the serviced activities. As a result, older inquiries remained unresolved for long periods of time and may never be resolved. In addition, personnel did not prioritize contractor overpayment inquiries based on the greatest potential monetary benefit. As a result, possible overpayments owed to the Government were unnecessarily delayed or were not resolved.

During the audit, we obtained 64 inquiries from the Army Materiel Command regarding contractor overpayments; these inquiries involved $19.7 million in payments. The Army Materiel Command had sent the inquiries to the DFAS Columbus Center for potential collections of overpayments from contractors. Of the 64 inquiries, we identified 53 inquiries, totaling $18.5 million, that had been received and recorded in the DFAS Columbus Center's records. The DAOs had sent the 53 inquiries to the DFAS Columbus Center from 18 to 1,120 days before we began our review, and only 1 inquiry was being processed for collection. Personnel at the DFAS Columbus Center told us they would have to review the entire contract file before they could process the inquiries for collection. Most of the inquiries resulted from unliquidated progress payments or overpayments on contracts (see Appendix C for the types of inquiries we reviewed). Because of the delays in resolving these inquiries, $18.5 million or more may not be collected from contractors.

Between April 28, 1983, and January 31, 1994, DFAS had collected $3.4 billion in overpayments from contractors. DFAS personnel could not determine how much of the $3.4 billion had been paid from expired appropriation accounts. The $3.4 billion included $2.2 billion in voluntary repayments made by contractors. Those voluntary repayments should have been identified as overpayments and collected by DFAS Columbus Center personnel without the contractors' assistance, but the system was slow in identifying and collecting overpayments.

Because not all of the Army Materiel Command's major subordinate commands kept historical files of inquiries that had been sent to the DFAS Columbus

Center, we could not determine the total number of inquiries on overpayments. Also, the computer system at the DFAS Columbus Center was not designed to allow personnel to select information only on inquiries affected by expired funds. Failure to recover the overpayments for expired appropriations can result in the loss of availability of those funds for valid requirements.

Corrective Actions Taken by the Department of Defense

As previously stated, IG, DoD, Report No. 92-064, "Titan IV Program," issued March 31, 1992, identified problems with recording progress payments. The report recommended that the DoD Comptroller review accounting policies and procedures to ensure that adequate oversight and control were maintained on expenditures related to progress payments, and that progress payments were charged to the applicable appropriations. The Under Secretary of Defense (Comptroller) implemented the recommendation by revising the "DoD Accounting Manual" to state that:

> . . . for financing payments, the distribution to CLINs or SLINs can be made on best estimates based on available information. If at any time the Administrative Contracting Officer becomes aware of information that indicates a distribution of financing payments is in error, the paying office shall be immediately advised of the necessary change in distribution. If prior payments are involved, the matching of such payments to obligations shall be adjusted and the payments correctly applied. However, such adjustments to the payment records should not impact actual payments to the contractor. . . . upon completion of a delivery payment, the applicable amounts of financing payments previously identified with each obligation shall be adjusted to reflect the matching delivery payment.

However, DFAS has not yet developed and implemented a plan of action and milestones to bring DoD accounting and disbursing systems into compliance with the revised "DoD Accounting Manual," and the procurement community has not yet revised acquisition regulations to require contractors or contracting officers to provide disbursement information. On November 18, 1994, the Under Secretary for Defense (Comptroller) issued a memorandum requiring that DFAS match disbursements to obligations before payment, when payments exceed $1 million. This action should reduce future unmatched disbursements. However, the corrective action does not address the need to properly record liquidations of progress payments or rejections of transactions that do not contain sufficient information to ensure proper accounting.

Use of Reports Containing Notices of Potential Errors

DAOs at each of the Army Materiel Command's five major subordinate commands received reports containing notices of potential errors in contract payments identified during edit checks; however, these reports generally were not reviewed. Four of the five DAOs did not review the error reports. The Missile Command made limited use of the error reports for identifying and resolving negative unliquidated obligations. The reports identified transactions that had been entered in accounting records, but needed adjustments or corrections in order to accurately show financial activity and expired appropriation balances. For example, at the Communications-Electronics Command, the reports contained notices of potential errors made during July and August 1993 that amounted to $125.8 million. The reports showed that the potential errors:

o may have caused disbursements to exceed obligations, creating negative unliquidated obligations;

o may have caused accounts payable to have negative balances; and

o may have caused transactions to be recorded against incorrect fiscal years or types of funds.

DAO personnel at the Communications-Electronics Command agreed that these potential errors should be reviewed.

At the DAO for the Tank-automotive and Armaments Command, the reports for July through September 1993 showed 70 potential error transactions amounting to $2.3 billion. We judgmentally selected and reviewed 25 transactions valued at $2.2 billion. Two of the 25 transactions had resulted in negative unliquidated obligation balances of $2.9 million, a definite error that had not been researched or corrected at the time of our review. These errors could have been corrected if DAO personnel had reviewed the reports and taken the necessary actions. No followup procedures existed to ensure that proper and timely actions are taken to resolve the errors reported on these notices. Notices of errors did not reappear on subsequent reports; therefore, if corrective actions are not taken before reports are destroyed, the errors may remain uncorrected indefinitely. We found that the DAOs kept the reports for periods ranging from 1 day to more than 1 year.

Because the DAOs did not use the error reports to identify and correct erroneous transactions, determining accurate balances of the expired appropriations was difficult. Also, for some of the Army's expired

procurement appropriations, the unobligated balances will be inadequate if large amounts of unforeseen obligations occur (see Finding B), resulting in apparent violations of the Antideficiency Act.

Summary

The Army Materiel Command did not ensure that adequate information was provided to DFAS to properly charge disbursements to the correct appropriations. Specifically, the Army Materiel Command did not require CLIN or SLIN information in progress payment requests to facilitate accounting for the disbursements in accordance with the nature of the work performed, and did not provide estimates for the recording of disbursements where contractor information was impracticable.

The integrity of reported fund balances must be maintained by ensuring that progress payments are properly recorded; overpayments to contractors are promptly liquidated; and potential errors in the recording of accounting transactions are identified, researched, and corrected. Large dollar amounts of progress payment transactions involving the Army Materiel Command's expired procurement appropriations may have been misquoted. Therefore, a strong possibility exists that Antideficiency Act violations have occurred or may occur. Those potential violations will not become apparent until errors are identified and corrected.

Recommendations for Corrective Action

Revised Recommendations. As a result of management comments, we revised draft Recommendations A.2., A.3., and A.4. to clarify our intent.

We recommend that the Director, Defense Finance and Accounting Service:

1. Develop and implement a plan of action and milestones to bring DoD accounting and disbursing systems into compliance with the revised "DoD Accounting Manual," requiring financing payments to be distributed by contract line item number or subsidiary contract line item number.

Management Comments. The Deputy Chief Financial Officer concurred with the recommendation.

Audit Response. The Deputy Chief Financial Officer concurred with the recommendation and proposed corrective actions, but did not provide a completion date. Therefore, we request that a completion date be provided in comments on this final report.

2. Periodically report to the DoD Components unliquidated progress payments in expired appropriations that are considered overdue for liquidation payments.

Management Comments. The Deputy Chief Financial Officer nonconcurred with the recommendation, stating that validation of progress payments was a responsibility of the DoD Components. However, DFAS will provide support and assistance, if required.

Audit Response. The Deputy Chief Financial Officer's comments are responsive and, as a result, we revised the draft recommendation. The intent of our recommendation was for the DFAS to provide the DoD Components with periodic reports of unliquidated progress payments that are considered overdue for liquidation payments so that the DoD Component can perform the validation. The role we recommend for the DFAS is to facilitate the validation process by providing the reports discussed above and making whatever corrections are requested.

The response provided by the Deputy Chief Financial Officer satisfies the intent of the recommendation. Additional comments are not required.

3. Reject requests for progress payments unless sufficient information is available concerning amounts to be recorded by accounting classification reference numbers to properly record progress payments.

Management Comments. The Deputy Chief Financial Officer nonconcurred with the recommendation, stating that DFAS does not have the authority to require contractors to provide accounting classification reference numbers on invoices.

Audit Response. The Deputy Chief Financial Officer's comments are responsive and, as a result, we revised the draft recommendation to clarify that we did not intend for only the contractor to provide payment distribution information. The intent of our recommendation was for DFAS to apply Chapter 32 of the "DoD Accounting Manual" to all requests for progress payments. According to Chapter 32, the distribution of progress payments can be made based on best estimates from available information. Chapter 32 allows the use of such information as delivery schedules, historical spending patterns of contractors, or an estimate of a contractor's anticipated work progress. We

consider the availability of information needed to properly record progress payments to be essential for prevalidation of disbursements as required by the FY 1995 DoD Authorization Act.

Further, in the Deputy Chief Financial Officer's response to our Recommendation A.1., he agreed to reject "requested payments that do not conform with stated requirements" of a proposed change to the Defense Federal Acquisition Regulation that will provide for a more accurate distribution of progress payments to contract line item numbers. The response provided by the Deputy Chief Financial Officer satisfies the intent of our recommendation. Additional comments are not required.

4. Record liquidations of progress payments against the proper accounting classification reference numbers.

Management Comments. The Deputy Chief Financial Officer nonconcurred with the recommendation, stating that the DFAS does not have the authority to require contractors to provide accounting classification reference numbers on invoices for progress payments.

Audit Response. The Deputy Chief Financial Officer's comments are responsive and, as a result, we revised the draft recommendation. The intent was for Defense Accounting Officers to apply Chapter 32 of the "DoD Accounting Manual" when recording liquidations of progress payments. According to Chapter 32, after payment has been made for a delivery, progress payments will be matched with the appropriate accounting classification reference numbers for which the payments were obligated. Progress payments will then be adjusted. In response to our Recommendation A.1., the Deputy Chief Financial Officer agreed to bring DoD accounting and disbursing systems into compliance with the revised "DoD Accounting Manual." The response made by the Deputy Chief Financial Officer satisfies the intent of the recommendation. Additional comments are not required.

5. Implement procedures to periodically match progress payment and liquidation data between the Defense Finance and Accounting Service Columbus Center's and the Defense Accounting Office's databases, and correct discrepancies noted.

6. Establish procedures for Defense Accounting Officers requiring review of exception reports containing notices of potential errors in contract payments, and make corrections within a reasonable period of time.

7. Assign priorities to the processing of inquiries that may involve overpayments made to contractors. Inquiries with the largest potential monetary value to the Government should be processed first.

Management Comments. The Deputy Chief Financial Officer concurred with Recommendations A.5., A.6., and A.7., stating that corrective actions will be completed by August 31, 1995, August 31, 1995, and May 31, 1995, respectively.

Finding B. Contingent Liabilities

The Army Materiel Command's management of obligations for expired year appropriations was inadequate. Unobligated balances in the Army Materiel Command's expired appropriation accounts may be insufficient to meet obligational adjustments that may become chargeable to those balances in the future, if and when contingent liabilities become actual liabilities. Specifically, the Army Materiel Command was not always accruing or tracking contingent liabilities that may have to be paid from expired appropriations. These conditions occurred because the Army Materiel Command and the DAOs were not consistently following Army or DoD procedures for identifying, accruing, and tracking contractual liabilities that may have to be paid in the future. As a result, the Army Materiel Command had at least $29.7 million in contingent liabilities that could result in at least one Antideficiency Act violation if they become actual liabilities, because the expired FY 1987 Aircraft Procurement, Army, appropriation may not contain sufficient unobligated fund balances.

Background

Introduction. A contingent liability is a liability that may have to be paid in the future. The GAO publication, "A Glossary of Terms Used in the Federal Budget Process," defines a contingent liability as "an existing condition, situation, or set of circumstances involving uncertainty as to a possible loss to an agency that will ultimately be resolved when one or more future events occur or fail to occur."

Only if and when the contingency materializes does the liability become a recordable obligation. Sound financial management and Antideficiency Act considerations dictate recognizing contingent liabilities even when these liabilities are not sufficiently definite or certain to support the formal recording of an obligation.

Accrual and Tracking of Contingent Liabilities. Chapter 46 of the "DoD Accounting Manual" states that contingent liabilities are to be accrued and tracked when amounts can be reasonably estimated. The treatment of contingent liabilities is largely a matter of sound judgment.

Recognition of contingent liabilities may be in the form of an administrative reservation or commitment of funds; however, neither preserves funds beyond their period of availability. Further, commitments should be established only

for the portion of a contingent liability that can be reasonably estimated. A commitment should be recorded for the estimated contingent liability as no more than the difference between the target and ceiling prices. All commitments for contingent liabilities must be deleted from the accounting records when an appropriation expires.

Chapter 46 of the "DoD Accounting Manual" states that when a commitment has been established to meet contractual contingencies and has not been moved to obligation status by the close of the fiscal year when the appropriation expires for original obligation, the commitment shall be canceled.

Funds that are returned to the unobligated balance, and are withdrawn by administrative action to the surplus fund of the U.S. Treasury at the expiration of the period of availability, shall be available for restoration. Such amounts shall include sufficient funds to cover the contingent liabilities.

Amounts recorded as contingent liabilities shall include those commitments that were canceled and returned to the surplus fund of the U.S. Treasury as available for restoration. DoD Components shall establish subsidiary accounts as necessary to track such balances, so that a perpetual audit trail is maintained until the funds are restored or a determination has been made that the liability will not materialize.

Sources of Funds for Paying Contingent Liabilities. The Judgment Fund (the Fund) is a permanent, indefinite (not limited by amount) appropriation, controlled by the GAO 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 lawsuits against Armed Forces Exchanges. Judgments and settlements of lawsuits brought under the statutes are the only instances in which 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.

Section 2414 of 28 U.S.C. authorizes compromise settlements. 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. A Comptroller General decision, 58 Comptroller General 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. The 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."

Accounting for Contingencies. An overobligation of funds caused by inaccurate estimates, or failure to reserve enough funds to account for contingent liabilities, can result in a violation of 31 U.S.C. 1341. This law states that "an officer or employee of the United States Government or 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," July 27, 1987, which implements 31 U.S.C. 1341, states that:

> . . . each DoD Component shall establish and maintain adequate systems of accounting for and positive control of appropriation 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.

In a very important passage, 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.

The DFAS Indianapolis Center issues the "Appropriation Status by Fiscal Year Program and Subaccounts Report" on a monthly basis. The report gives the available (unobligated) balance of funds by fiscal year, and allows management to monitor the unobligated balances of funds. If the status of funds is not constantly monitored, a potential violation of the Antideficiency Act may occur if contingent liabilities exceed unobligated balances.

Army Compliance with the Antideficiency Act. A separate investigation is required for each suspected violation of the Antideficiency Act. As of March 21, 1995, the Army was investigating 14 apparent violations of the Antideficiency Act, valued at $453.7 million. Appendix D gives details of those investigations.

Identification of Contingent Liabilities

Personnel in the Army Materiel Command's major subordinate commands and at the DAOs did not always identify the sources of contingent liabilities. Although the Army and DoD had issued guidance, the major subordinate commands and the DAOs had not identified or recorded $15.7 million of the $29.7 million of contingent liabilities found during our review. The major subordinate commands and the DAOs had identified and recorded $14 million of contingent liabilities in the Army Procurement Appropriations Reporting System.

Accrual of Contingent Liabilities

The Army Materiel Command and the DAOs did not have consistent procedures for accruing contingent liabilities resulting from some contract actions. We reviewed only the systems used to account for contracts with fixed-price incentive fees.

The differences between target and ceiling prices in contracts were not consistently identified as contingent liabilities. As a result, on 13 contracts with target and ceiling prices, $15.7 million of contingent liabilities was not accumulated or accrued. These contracts may require unobligated funds in the amounts shown in Table 2.

Table 2. Amounts of Contractual Contingent Liabilities Potentially Requiring Unobligated Funds
($ in millions)

Appropriation	Fiscal Years	Amount of Liabilities
Aircraft Procurement, Army	1987, 1989, 1990	$ 8.5
Procurement of Weapons and Tracked Combat Vehicles, Army	1987-1990	6.1
Other Procurement, Army	1987, 1988, 1990	1.1
Total		**$15.7**

Our review was limited to contracts with target and ceiling prices; however, the actual amounts of the Army's contingent liabilities will not be known until Army and DoD guidance is followed consistently and reviews are conducted to identify all contingent liabilities.

Tracking of Contingent Liabilities

Financial systems at the DAOs did not always show contingent liabilities that may be paid with funds from expired appropriations. Contractual contingent liabilities amounting to $15.7 million were not properly identified or accrued; therefore, they were not tracked.

Contingent liabilities of $14 million were identified by the major subordinate commands and were recorded in the Army Procurement Appropriations Reporting System at four of the five DAOs we visited. Although these contingent liabilities were appropriately recorded as commitments when current, they were erroneously recorded as commitments in the Army Procurement Appropriations Reporting System after the use of funds had expired. Chapter 46 of the "DoD Accounting Manual" states that when a commitment has been established to meet contractual contingencies, and has not been moved to an obligation status by the close of the fiscal year when the appropriation expires for original obligation, the commitment shall be canceled.

Although the DAOs had allowed the commitments to remain in their financial system, which is contrary to Chapter 46 of the "DoD Accounting Manual," we recognize that the result was that $14 million of contingent liabilities were tracked. The DAOs should establish a means of tracking contingent liabilities after commitments are deleted at the time of fund cancellation. However, because the major subordinate commands had not consistently followed Army and DoD guidance, they did not always identify and accrue contingent liabilities for tracking purposes.

Therefore, the true amount of contingent liabilities was not available for inclusion in the DAOs' financial systems, and funds may not be available if contingent liabilities are realized.

Inadequate Appropriation Balances

In the FY 1987 Aircraft Procurement, Army, appropriation, the unobligated balance may not be sufficient to pay for all contingent liabilities. For that appropriation, contingent liabilities totaling $4.8 million were shown in accounting reports and contracts.

According to the "Appropriation Status by Fiscal Year Program and Subaccounts Report," March 31, 1993, the appropriation contained only $4.7 million of funds to pay for $4.8 million of contingent liabilities. As a result, the appropriation may have a funding deficiency if the entire amount of the target-to-ceiling contingency is realized.

U.S. Army Materiel Command Regulation 37-6, "Establishing, Recording, and Reporting Procurement Program Reserves," September 25, 1978, listed 15 types of contracts that might contain contingent liabilities. Our review was limited to the Army Materiel Command, and included contracts with both target and ceiling prices. Therefore, the Army may have much higher amounts of contingent liabilities for expired appropriations. Consistent procedures are needed for identifying, accruing, and tracking all contingent liabilities, in order to avoid exceeding unobligated balances. Also, appropriations with potential deficiencies may incur additional funding requirements.

Reserves for Contingent Liabilities

Funds may not be available to pay for all contingencies. In 1956, Public Law 84-798 established merged accounts to accumulate unspent budget authority from expired appropriations. The budget authority in those accounts could be used to pay bills as they became due, and under certain circumstances to pay for previously unrecorded obligations. Those funds are no longer available for use. Specifically, Public Law 101-510, the "National Defense Authorization Act for Fiscal Year 1991," November 5, 1990, phased out the merged accounts, but extended the use of expired funds from 2 to 5 years.

Public Law 102-484, the "National Defense Authorization Act for Fiscal Year 1993," October 23, 1992, also authorized obligations against expired accounts to be charged to any current DoD appropriation that is available for the same purpose as the expired account. However, the total amount charged to a current appropriation under that 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.

Comptroller General decisions have required that an amount equal to the Government's maximum contingent liability under a contract must always be available for obligation from appropriations current at the time the contract is made. Comptroller General decisions also state that recognition of contingent liabilities, in the form of an administrative reservation or commitment of funds, is an imperfect solution to the problem that occurs when unliquidated obligations do not result in disbursements before the charged appropriations are canceled. Reserves for contingencies are little used, but are recognized in 31 U.S.C. 1512(c) and 2 U.S.C. 684(b).

In summary, the Army and DFAS need to improve oversight of contingent liabilities in contracts funded with expired year appropriations. Since contingencies cannot be paid with funds from merged accounts, and only 1 percent of funds from current appropriations can be used to pay these contingent liabilities, the Army may not have sufficient funds to pay all contingent liabilities. Although contracts must be fully funded, contingent liabilities should be identified, tracked, and reviewed to ensure compliance with fiscal statutes.

Undistributed Disbursements

As of January 31, 1994, $450.5 million of disbursements for expired year procurement appropriations had not been distributed to Army programs ($280.9 million of charges and $169.6 million of credits, for a net amount of $111.3 million). The $450.5 million consisted of 3,418 disbursements recorded by the DFAS Indianapolis Center as undistributed disbursements that will be held in suspense until accepted by a command or activity. The Army has subtracted these undistributed disbursements from U.S. Treasury balances and adjusted its appropriations accordingly; however, many of the undistributed disbursements may have been erroneously posted. If so, they will need to be adjusted.

About $24.5 million of the undistributed disbursements had been unresolved for over 180 days, and some had been unresolved for over 5 years. Until the disbursements are charged to the correct appropriation, the Army assumes the risk that cumulative disbursements may exceed appropriation or other statutory limits.

Corrective Actions Taken by the Department of Defense

The IG, DoD, issued Report No. 94-048, "Uncleared Transactions By and For Others," March 2, 1994, which addressed the problem of undistributed disbursements. Recommendations made in that report, if implemented, should reduce the problem to a manageable level. In addition, the DoD Senior Financial Management Oversight Council has addressed the problem of undistributed disbursements in DoD, and is recommending both short- and long-term actions to solve the problem. Because of the recommendations in our previous report and the efforts of the DoD Senior Financial Management Oversight Council, this report does not make recommendations on undistributed disbursements. However, the magnitude and age of the undistributed disbursements increases the likelihood of errors that could affect reported appropriation balances, and of potential Antideficiency Act violations that will not be recognized until the records have been corrected.

Recommendations for Corrective Action

Revised Recommendations. As a result of management comments, we revised draft Recommendation B.1.c.

1. We recommend that the Under Secretary of Defense (Comptroller):

a. Require contingent liabilities to be reported to the Defense Finance and Accounting Service and be periodically revalidated.

Management Comments. The Deputy Chief Financial Officer partially concurred with the recommendation, stating that in November 1994, the Federal Accounting Standards Advisory Board (FASAB) issued, for public comments, its Exposure Draft on "Accounting for Liabilities of the Federal Government." The Exposure Draft contains six standards that address the topic of accounting for liabilities of the Federal Government, as well as a definition and general principles for the recognition of liabilities. One of those standards addresses contingencies.

The accounting standard proposed by the FASAB for contingent liabilities will require the DoD to reevaluate its current policy in this area. The Office of the Under Secretary of Defense (Comptroller) has already anticipated this near-term requirement. Thus, a revision to the "DoD Financial Management Regulation" (DoD Regulation 7000.14-R) will be considered when the OMB issues its guidance on contingent liabilities.

Audit Response. The comments of the Deputy Chief Financial Officer are responsive to our recommendation. We request that the Under Secretary of Defense (Comptroller) provide an estimated completion date for recommendation B.1.a.

b. Establish procedures for the valuation of all commitments associated with contingent liabilities prior to expiration of the appropriation, and creation of obligations for valid commitments.

Management Comments. The Deputy Chief Financial Officer partially concurred with the recommendation, stating that DoD is following 31 U.S.C. 1501 when recording obligations. Further, the Deputy Chief Financial Officer stated that the "DoD Accounting Manual" provides guidance for recording commitments and obligations; therefore, no additional guidance is needed.

Audit Response. The intent of this recommendation was for the Under Secretary of Defense (Comptroller) to establish procedures that would better ensure that DFAS coordinates and assists the DoD Components in identifying and evaluating all commitments associated with contingent liabilities prior to expiration of the appropriation. Such procedures should also request that the DFAS, after reviewing commitments, create obligations for valid commitments.

These actions would provide more assurance that Chapter 46 of the "DoD Accounting Manual" is fully implemented. Chapter 46 states that when a commitment has not been moved to obligation status by the close of the fiscal year when the appropriation expires for original obligation, the commitment shall be canceled. However, we still consider that procedures are necessary to review these commitments prior to cancellation in order to determine whether they should be moved to obligation status.

Therefore, we request that the Under Secretary of Defense (Comptroller) reconsider the comments on Recommendation B.1.b. and provide additional comments in response to this final report.

c. Update the policy in DoD 7220.9-M, the "DoD Accounting Manual" concerning the use of commitments and reserves to pay for contingent liabilities.

Management Comments. The Deputy Chief Financial Officer nonconcurred and stated that "as written, the recommendation appears to request that the Department establish reserves in amounts that are in excess of amounts appropriated by the Congress. The Department does not have funds available to establish "reserves" in excess of funds appropriated by the Congress. Further, while the Department might have sufficient funds available to establish reserves in excess of 1 percent of current appropriations--in order to pay amounts that

otherwise might be chargeable to expired accounts in certain circumstances--the Department lacks the statutory authority to expend such amounts."

Audit Response. We revised the recommendation. The intent of the recommendation was to administratively reserve funds from appropriations current at the time a contract is made in an amount equal to the Government's maximum contingent liability under the contract. We request that the Under Secretary of Defense (Comptroller) provide comments on revised Recommendation B.1.c. in response to this final report.

2. We recommend that the Director, Defense Finance and Accounting Service, establish procedures to consistently track contingent liabilities.

Management Comments. The Deputy Chief Financial Officer partially concurred with the recommendation, stating that DoD Components are responsible for tracking contingent liabilities. However, the DFAS plans to establish operational procedures to assist such efforts by tracking contingent liabilities for which commitments have been recorded.

Audit Response. The comments of the Deputy Chief Financial Officer are responsive to our recommendation. We agree that the DoD Components should periodically validate these contingent liabilities to verify that a liability still exists and the amount of the liability, as addressed in Recommendation B.3.

Therefore, we request that the Under Secretary of Defense (Comptroller) provide estimated completion dates for these operating procedures to track contingent liabilities in response to Recommendation B.2.

3. We recommend that the Commander, U.S. Army Materiel Command, validate all contingent liabilities currently reported for expired appropriations, establish the need for obligations where necessary, and report any resulting potential violations of the Antideficiency Act for investigation.

Management Comments. The recommendation was reworded based on Army comments. The Commander, U.S. Army Materiel Command, concurred with the recommendation and stated that all contingent liability balances would be validated as part of a quarterly review by April 28, 1995.

Finding C. Validating and Resolving Unliquidated Obligations

The Army had about $3.9 billion in unliquidated obligations against expired appropriations; however, Defense Accounting Offices (DAOs) did not adequately review accounting records to validate unliquidated obligations. We found that:

o Program financial reviews held jointly by DAOs and command personnel did not identify unsupported unliquidated obligations amounting to $10.2 million for contracts and $6.7 million for reimbursable orders.

o The Army Materiel Command had contracts amounting to $26.2 million that contracting officers considered complete. However, those contracts included $2.4 million of unliquidated obligations that were no longer needed and should have been deobligated. If the Defense Accounting Officers had adequately reviewed these unliquidated obligations, the funds would have been deobligated.

o The Army Materiel Command's accounting records contained $151.2 million in questionable progress payment balances. These payments had not been reviewed to determine whether adjustments or liquidations should be made.

These conditions occurred because:

o reviews of unliquidated obligation balances in accounting records were often not timely or thorough (it is particularly important to reconcile unliquidated obligations and deobligate invalid obligations in order to permit the funds to be used for valid requirements);

o unliquidated obligation balances on completed contracts were not analyzed to determine whether a continuing need existed; and

o research was not always conducted on abnormal balances of progress payments that had been made to contractors.

As a result, at least $19.3 million in unliquidated obligations was invalid and should be deobligated to permit proper closeout of the appropriation account upon cancellation and permit use of the funds for valid obligation adjustments prior to cancellation. In addition, at least $151.2 million in progress payments to contractors needs to be reconciled in order to permit contract closeout and to determine whether overpayments have occurred.

Background

Conducting Reviews of Unliquidated Obligations. Army Regulation 37-1, paragraph 28-14, requires and provides procedures for joint reviews of unliquidated obligations. The regulation requires personnel in finance and accounting offices (now called DAOs) and major subordinate commands' activity directors to jointly review the validity of unliquidated obligations at least three times each fiscal year, and to place special emphasis on reviewing unliquidated obligations that have historically resulted in significant recoveries after accounts expire. Statistical sampling is acceptable for unliquidated obligation balances under $50,000, and guidelines for sampling stratified document populations are provided. The population of unliquidated obligation balances should be stratified into groups by appropriation status (current, unexpired, expired, or merged), type of appropriation, and type of revolving fund.

The regulation expressly recognizes that "joint reviews are not a substitute for the activity director's day-to-day management" and that "directors must perform continual reviews to ensure all current-year funds are legitimately obligated and that recoveries [deobligations] after the appropriation expires are minimized."

The joint review for outstanding commitments is required to ensure that contingent liabilities are reasonable, and supportable documentation is on file recording method criteria, and rationale for determining contingent liabilities; target dates for obligating these contingent liabilities are realistic; and adjustments to outstanding commitments are documented and processed promptly.

A copy of the documentation from each review is to be maintained "for audit purposes and for use in future reviews." Both the DAO and the reviewing activity are required to maintain a copy of the documentation. The regulation states:

> . . . MACOMs will . . . require the following documentation, as a minimum, to support the periodic joint reviews:
>
> (1) An overall summary of the method criteria, and rationale used to select items for review, such as statistical aging methods and months past delivery date.
>
> (2) Mechanized or manual listings identifying items selected for review and results of the review.
>
> (3) Annotated supply status reports and letters or records of telephone calls requesting delivery status from contracting or procurement activities.

(4) Work papers identifying adjustments made as a result of the review, amount for each document, and rationale for each adjustment.

Administering Orders for Goods and Services. A reimbursable order is an agreement made by an activity to provide goods or services to another activity. The activity providing the goods or services is reimbursed by the other activity for performing the work.

Classifying Reimbursable Orders. Chapter 25 of the "DoD Accounting Manual" requires that each reimbursable order be classified as either a project order or an Economy Act order. Our audit was limited to reviews of project orders. DoD Instruction 7220.1, "Regulations Governing the Use of Project Orders," May 4, 1971, gives directions for administering project orders. The instruction requires that project orders be issued for the manufacture of materials, for supplies and equipment, or for other work or services. It also requires that the work or services be performed at a Government-owned and Government-operated facility by a component of a Military Department or Defense agency.

Reviews of Project Orders. Army Regulation 37-1 states that transactions such as project orders should be reviewed monthly. Reviews should include analyses of commitments more than 90 days old, undelivered orders for which the delivery date has passed, and accounts that have been payable for more than 90 days. The regulation also states that after the reviews, a determination should be made as to why the anticipated events did not occur and whether funds have been reserved unnecessarily.

Completed Contracts. A contract is considered completed, or closed, when the contractor has completed the required deliveries and the Government has given the contractor a notice to terminate the contract. The Federal Acquisition Regulation subpart 4.8, "Contract Files," requires that when contract funds are shown in the accounting records as available for making payments, the need for these funds be reviewed. Any unneeded funds are to be deobligated before the contract is closed. Therefore, no unliquidated obligation balances should remain on the accounting records for contracts that have been closed.

Accounting for Progress Payments. Progress payments (payments made to contractors for their progress in completing work) are a form of contractor financing made to help contractors pay for goods and services until deliveries of the finished products are completed and full payment is made to the contractor.

Army Regulation 37-1 requires DAO personnel to age and examine all contractual obligations to identify abnormal balances of unliquidated obligations. An abnormal balance could result when an activity fails to monitor the payment and liquidation of progress payments. For example, a progress payment balance should not exist when deliveries have been completed on contracts.

Procedures Used to Review Unliquidated Obligations

The procedures used to review balances of unliquidated obligations (unpaid balances recorded against appropriations) were not fully effective. As of March 31, 1993, the major subordinate commands had unliquidated obligations totaling $3.9 billion in expired appropriations.

We judgmentally selected $447.8 million of unliquidated obligation balances for review. Except at the Armament, Munitions, and Chemical Command, either the major subordinate commands' finance and accounting personnel or the DAOs had interviewed activity directors or had sent reports of unliquidated obligation balances to the directors for review each year. However, for five (55.6 percent) of the nine joint reviews, 14.5 percent of the activity directors had not sent results of their reviews to the DAOs. Therefore, potential deobligations of funds could have been delayed unnecessarily. In addition, DAO personnel at the Aviation and Troop Command were unaware that reviews were not being performed; therefore, they did not request reviews of unliquidated obligation balances for FY 1987 expired appropriations. According to the "Appropriation Status by Fiscal Year Program and Subaccounts Report," March 31, 1993, the FY 1987 unliquidated obligation balance for the Aircraft Procurement, Army, appropriation totaled $28.9 million. The Aviation and Troop Command managed most of those funds.

Army Regulation 37-1 requires delivery status reports to be used in analyzing unliquidated obligation balances. None of the five commands that we reviewed were using the reports in their reviews.

The DAOs could not fully assess the effectiveness of the joint reviews because:

- prompt completion of joint reviews sometimes received low priority;
- activities did not always report on the status of their unliquidated obligations; and
- delivery status reports were not used to calculate the amount of unliquidated obligations needed to pay for undelivered materiel.

Although most of the reviews were accomplished, they were not completely effective. As a result, we identified $10.2 million of $447.8 million in unliquidated obligations that was unsupported and should be deobligated. As of April 20, 1995, action had not been taken to deobligate the $10.2 million of unneeded funds in the FY 1988 Aircraft Procurement, Army, appropriation. Therefore, the amount of unobligated funds in that appropriation was understated. Additional amounts may need to be deobligated after unliquidated obligation balances in the FY 1987 Aircraft Procurement, Army, appropriation are

reviewed. By conducting more timely reviews and following up to ensure that all responses are received, the Army Materiel Command may be able to identify additional funds for deobligation.

Reviews of Project Orders

Personnel from the major subordinate commands and the DAOs did not review reimbursable orders for validity on a monthly basis, as required by Army Regulation 37-1. We limited our review to the analyses of project orders.

Funded reimbursement authority is provided on funding documents with specific dollar ceilings and obligations citing that authority may be recorded only to the extent that orders have been received from a customer and accepted by the performer of the work. Accepted customer orders establish obligational authority in a performing allotment, and Antideficiency Act ceilings. For example, acceptance and execution of funded orders in excess of the funded reimbursement authority may result in a violation of the Antideficiency Act. Earnings in excess of orders may indicate the use of direct funds to support a reimbursable mission and the need for order adjustments and collections. Army Regulation 37-1 sets out in great detail what accounting personnel must understand and do to effectively manage reimbursable activity, as well as the support that activity directors are required to provide in resolving problems.

Reviews should identify items such as undelivered orders for which the delivery date has passed, or orders that have not been filled by the expected date of contract termination. The regulation also requires DAO personnel to analyze items that have large quantities of items and high dollar values, in order to determine why the anticipated actions did not occur.

At the time of our audit, 4 of the 5 major subordinate commands had issued 1,870 project orders that had unliquidated obligation balances amounting to $137 million. DAO personnel at the fifth subordinate command, the Aviation and Troop Command, told us that they did not have project orders.

We judgmentally selected and reviewed 42 of the 1,870 project orders issued by the 4 commands, as shown in Table 3. Those project orders totaled $78.2 million in unliquidated obligations.

Table 3. Value of Unliquidated Obligations and Quantity of Project Orders
($ in millions)

	Orders Issued		Orders Reviewed		Percentage of	Value of
Command	Unliquidated Obligations	Number of Orders	Unliquidated Obligations	Number of Orders	Dollars Reviewed	Invalid Orders
AMCCOM	$ 11.3	415	$ 6.0	11	53.1	$ 0.6
CECOM	1.1	46	0.8	4	72.7	0.1
MICOM	80.1	739	45.0	17	56.2	4.5
TACOM	44.5	670	26.4	10	59.3	1.5
Totals	**$ 137.0**	**1,870**	**$ 78.2**	**42**	**57.1**	**$6.7**

Acronyms

AMCCOM	Armament, Munitions, and Chemical Command
CECOM	Communications-Electronics Command
MICOM	Missile Command
TACOM	Tank-automotive and Armaments Command

As shown in Table 3, by concentrating on project orders with high dollar values, we were able to review 57.1 percent of the total dollar value of the orders, although we selected only 2.2 percent (42 divided by 1,870) of the total number of orders.

None of the four DAOs had performed monthly reviews. DAO officials said they considered the reviews to be too time-consuming. Therefore, they generally reviewed project orders only once each year.

Based on our limited review of project orders, $6.7 million of funded reimbursement authority had been unnecessary and should have been deobligated and made available for other uses. When monthly reviews are not conducted, funds that could be used for other like purposes are reserved unnecessarily. By conducting monthly reviews when significant actions do not occur as planned, the major subordinate commands could identify these funds sooner and put them to alternate use while they are still available for new obligations, instead of having them available only for obligational adjustments.

Project managers at the Aviation and Troop Command had not determined which reimbursable orders should be classified as project orders. Therefore, we could

not select project orders with high dollar values or evaluate the validity of unliquidated balances for those project orders. However, accounting records showed that the command had more than 800 reimbursable orders amounting to about $42.7 million. As a result of the command's failure to identify project orders and conduct monthly reviews, the need for unobligated fund balances may have been overstated. Also, funds may be reserved unnecessarily that could be used to pay for obligations chargeable to those expired appropriations.

Completed Contracts With Unliquidated Obligations

Accounting records showed unliquidated obligations for contracts that the major subordinate commands considered complete. The Federal Acquisition Regulation subpart 4.8 requires that agencies review the need for any funds on a contract when these funds are shown in the accounting records as being available for making payments. Any unneeded funds are to be deobligated before the contract is closed. Therefore, no unliquidated obligation balances should remain on the accounting records for closed contracts.

To identify closed contracts with unliquidated obligation balances, we compared contract registers and the Mechanization of Contract Administration Services system's data base with the accounting records. We identified 308 contracts, amounting to $32.5 million, that were reported as closed; however, the accounting records showed an unliquidated obligation balance for each contract. This indicated that not all unliquidated obligations were properly deobligated before the contracts were closed, or that the contracts had not been closed. To determine whether the funds were needed to pay for valid obligations, we judgmentally selected a sample of 115 of the 308 contracts, totaling $26.2 million. We identified $2.4 million in unliquidated obligations that was not needed and could be deobligated.

The failure to deobligate these funds occurred because the Army Materiel Command did not have a system for identifying and reviewing closed contracts with unliquidated obligation balances. By periodically reviewing closed contracts for unliquidated obligation balances, the Army Materiel Command could more easily identify funds that have been unnecessarily reserved and could be used for other purposes.

Accounting for Progress Payments

The Army Materiel Command did not always review accounting records to identify inaccurate entries or overpayments of progress payments. At the five major subordinate commands, we identified $151.2 million in progress payments that had been recorded in accounting records. However, the balances of unliquidated obligations were zero or negative amounts. This indicated that the contractors had made all deliveries, and the Defense Accounting Officer had made recording errors or overpayments to contractors that needed to be liquidated. At the time of our review, two of the five DAOs and personnel at the DFAS Columbus Center were reconciling $47.7 million of the $151.2 million of progress payments shown in the accounting records. Table 4 shows the distribution of the remaining $103.5 million in unreconciled progress payments.

Table 4. Amounts of Unreconciled Progress Payments at the Major Subordinate Commands
($ in millions)

Command	Dates of IG, DoD Reviews	Net Amount of Unreconciled Payments*	Unreconciled Payments
Aviation and Troop Command	March 2, 1994	$ 62.4	$62.8
Armament, Munitions, and Chemical Command	March 1, 1994	7.7	7.7
Communications-Electronics Command	December 3, 1993	-0.1	72.4
Missile Command	May 31, 1993	10.5	10.9
Tank-automotive and Armaments Command	December 8, 1993	23.0	23.4
Total Unreconciled Progress Payments		**$103.5**	**$177.1**

*Net of charges and credits

The $103.5 million in unreconciled payments included $36.8 million in credits and $140.3 million in charges. The credits indicated that the Defense Accounting Officer may have made recording errors in the accounting records or liquidated

excessive amounts from contractors. Charges could represent recording errors or payments that were made to contractors and needed to be liquidated.

Reviews of progress payments were time-consuming because large numbers of payments and liquidations were made on contracts, and a clear audit trail did not always exist to show where progress payments had been recorded. (Finding A discusses the lack of a systematic method for recording progress payments.) For example, one completed contract for $4.6 million had $1.2 million of unliquidated progress payments. To determine whether the $1.2 million in progress payments was an overpayment, we reviewed documents supporting 200 transactions for 12 of the 38 PRONs associated with 4 appropriations on the contract. These appropriations were FYs 1988 and 1989, Aircraft Procurement, Army; and FYs 1988 and 1989, Other Procurement, Army.

Documents provided by the DAO showed that the transactions were properly recorded; therefore, we believe that the $1.2 million in outstanding progress payments was an overpayment that should be liquidated. DAO personnel at the Communications-Electronics Command told us that as of June 27, 1994, they had asked the DFAS Columbus Center to liquidate the $1.2 million of overpayments.

The $103.5 million in unreconciled balances existed because a method had not been developed to periodically provide DAO personnel with the questionable balances of progress payments for review. As a result, the DAOs did not know how much of the $103.5 million represented overpayments that were made to contractors and should have been collected, and how much was due to accounting errors that distorted the balances of outstanding progress payments in accounting reports. Reviewing progress payments is time-consuming; however, a method should be developed to periodically review all unreconciled balances of progress payments in order to detect and liquidate overpayments of funds that can be put to better use. To improve the accuracy and usefulness of accounting records, errors found during the reviews should be corrected.

Resolving Negative Unliquidated Obligations

For the appropriations we reviewed, DAO records showed $353.9 million in negative unliquidated obligations (19,235 accounting lines) that had not been resolved. (This total represented all appropriations accounted for by the Army.) A negative unliquidated obligation results when an expenditure is recorded in excess of the amount available for obligation.

Status of Negative Unliquidated Obligations. The Army Materiel Command's records contained $250.3 million (70.7 percent) of the Army's $353.9 million in

negative unliquidated obligations (2,668 accounting lines). DAOs at the five major subordinate commands had designated personnel to resolve the negative unliquidated obligations. However, these personnel did not always identify the balances for prompt resolution. A report prepared by the DFAS Indianapolis Center showed that 1,383 (51.7 percent) of the 2,668 negative unliquidated obligations in the major subordinate commands had existed for more than 180 days.

Actions Taken to Correct Negative Balances. The DoD Comptroller recognized that the problem of negative balances adversely affects the quality of financial management, and directed that corrective actions be taken. In November 1992, the DoD Comptroller, in response to the IG, DoD, audit Report No. 93-053, "Report on the Audit of Missile Procurement Appropriations for the Air Force," February 12, 1993, agreed that the problem of negative unliquidated obligations should be resolved by using a single record to account for funds and pay bills. (See Appendix B for more details.)

Since DFAS is addressing the problem of recurring negative unliquidated obligations, we are not making a recommendation in this area. However, future audits will monitor the effect of the proposed corrective action.

Summary

The Defense Finance and Accounting Service did not ensure that adequate procedures were in place to validate unliquidated obligations. Specifically, reviews of unliquidated obligation balances were often not timely or thorough, balances on completed contracts were not always analyzed to determine whether a continuing need existed, and research was not always conducted on abnormal balances of progress payments. More timely and thorough validations and resolutions of unliquidated obligations are needed in order to maintain the accuracy and integrity of the accounting information.

Recommendations for Corrective Action

1. We recommend that the Director, Defense Finance and Accounting Service:

a. Require that the Defense Accounting Offices conduct joint reviews with supported activities of unliquidated obligation balances at least three times each fiscal year.

Management Comments. The Deputy Chief Financial Officer partially concurred with the recommendation, stating that DoD Components are responsible for conducting reviews of obligation balances. However, the DFAS could provide information to the DoD Components.

Audit Response. Although the Deputy Chief Financial Officer partially concurred, we consider the comments responsive. Obligation balances will be more accurate if DAOs and the DoD Components periodically conduct joint reviews of the balances. Because the comments on the recommendation are considered responsive, no additional comments are required.

b. Establish procedures for the routine identification of closed contracts and project orders that contain unliquidated obligations, and deobligate the funds when appropriate.

Management Comments. The Deputy Chief Financial Officer partially concurred with the recommendation, stating that the DoD Components are responsible for tracking contingent liabilities. However, the Defense Finance and Accounting Service could provide assistance and information to the DoD Components.

Audit Response. Although the Deputy Chief Financial Officer partially concurred, we consider the comments responsive. The intent of this recommendation was that the DAOs establish a means of identifying closed contracts and project orders with abnormal balances of unliquidated obligations. These abnormal balances of unliquidated obligations should be provided to the DoD Components for review. Unnecessary obligations should be deobligated by the DFAS. Because the response meets the intent of our recommendation, no additional comments are required.

c. Require Defense Accounting Offices to review unliquidated progress payment balances monthly when unliquidated obligations are zero or negative, correct the accounting records, and liquidate overpayments.

Management Comments. The Deputy Chief Financial Officer partially concurred with the recommendation, stating that the DoD Components are responsible for reviewing unliquidated progress payment balances; however, the DFAS could provide information to the DoD Components.

Audit Response. Although the Deputy Chief Financial Officer partially concurred, we consider the comments responsive. The presence of unliquidated progress payment balances when unliquidated obligations are zero or negative suggests that accounting transactions have been recorded incorrectly. Therefore, our recommendation was addressed to the DFAS, although we recognize that DFAS may be required to coordinate with the paying office at the DFAS Columbus Center and with the DoD Components to fully reconcile some abnormal balances of unliquidated progress payments. Because the response meets the intent of our recommendation, no additional comments are required.

d. Review unliquidated obligations recorded for closed contracts identified in this report, and deobligate amounts no longer needed.

Management Comments. The Under Secretary of Defense (Comptroller) partially concurred with the recommendation, stating that the DoD Components are responsible for deobligating amounts no longer needed. However, the DFAS could provide information to the DoD Components.

Audit Response. Although the Deputy Chief Financial Officer partially concurred, we consider the comments responsive. The DAOs maintain the official accounting records; therefore, these accounting offices should initially review unliquidated obligations recorded for closed contracts to determine whether transactions have been recorded properly. If all transactions have been recorded properly, the DAOs should work with the DoD Components to resolve the abnormal balances and deobligate amounts no longer needed.

Because the response meets the intent of our recommendation, no additional comments are required. However, we request additional comments on the validity of the monetary benefits.

2. We recommend that the Commander, U.S. Army Materiel Command, establish procedures to perform joint reviews of unliquidated obligation balances at least three times each year.

Management Comments. The Commander, U.S. Army Materiel Command, concurred with the recommendation, stating that the corrective actions will be completed by April 28, 1995.

Part III - Additional Information

Appendix A. Summary of Fiscal Statutes

31 U.S.C., section	Excerpt from Statute
1301	(a) Appropriations shall be applied to the objects for which the appropriations were made except as provided by law.
1341	(a)(1) An officer or employee of the U.S. Government or of the District of Columbia may not: (A) make or authorize an expenditure exceeding an amount available in an appropriation or fund for the expenditure or obligation; or (B) involve either government in a contract or obligation for the payment of money before an appropriation is made unless authorized by law.
1349	(a) An officer or employee of the United States Government or the District of Columbia government violating section 1341(a) or 1342 of this title shall be subject to appropriate administrative discipline including, when circumstances warrant, suspension from duty without pay or removal from office.
1350	An officer or employee of the United States Government knowingly and willingly violating section 1341(a) or 1342 of this title shall be fined not more than $5000, imprisoned for not more than 2 years, or both.
1351	If an officer or employee of an executive agency or an officer or employee of the District of Columbia violates section 1341(a) or 1342 of this title, the head of the agency or the Mayor of the District of Columbia, as the case may be, shall report immediately to the President and Congress all relevant facts and a statement of actions taken.

31 U.S.C., section	Excerpt from Statute
1501	(a) An amount shall be recorded as an obligation of the United States Government only when supported by documentary evidence.
1514	(a) The official having administrative control of an appropriation available to the legislative branch, the judicial branch, the United States International Trade Commission, or the District of Columbia government, and subject to the approval of the President, the head of each executive agency (except the Commission) shall prescribe by regulation a system of administrative control not inconsistent with accounting procedures prescribed under law. The system will be designed to: (1) restrict obligations or expenditures from each appropriation to the amount of apportionments or reapportionment of the appropriation; and (2) enable the official or the head of the executive agency to fix responsibility for an obligation or expenditure exceeding an apportionment or reapportionment. (b) To have a simplified system for administratively dividing appropriations, the head of each executive agency (except the Commission) shall work toward the objective of financing each operating unit, at the highest practical level, from not more than one administrative division for each appropriation affecting the unit.
1517	(a) An officer or employee of the United States Government or of the District of Columbia government may not make or authorize an expenditure or obligation exceeding: (1) an apportionment; or (2) the amount permitted by regulations prescribed under section 1514(a) of this title.

31 U.S.C., section	Excerpt from Statute
	(b) If an officer or employee of an agency or of the District of Columbia government violates subsection (a) of this section, the head of the executive agency or the Mayor of the District of Columbia, as the case may be, shall report immediately to the President and Congress all relevant facts and a statement of actions taken.
1518	An officer or employee of the United States Government or the District of Columbia government violating section 1517(a) of this title shall be subject to appropriate administrative discipline including, when circumstances warrant, suspension from duty without pay or removal from office.
1519	An officer or employee of the United States Government or of the District of Columbia government knowingly and willfully violating section 1517(a) of this title shall be fined not more than $5,000, imprisoned for not more than 2 years, or both.

Appendix B. Prior Audits and Other Reviews

GAO Reviews. The GAO has issued three reports related to this audit.

o "DoD Procurement: Millions in Overpayments Returned by DoD Contractors," GAO/NSIAD-94-106 (OSD Case No. 9602), was issued on March 14, 1994. The GAO found that the Defense Finance and Accounting Service (DFAS) had processed $751 million in checks from Defense contractors during a 6-month period ending April 8, 1993. At least $305 million of the $751 million consisted of overpayments returned by contractors; the contractors, not the Government, had detected most of the overpayments. Most overpayments had occurred because DFAS had paid contractors' invoices without recovering progress payments, or had made duplicate payments. Because the GAO was continuing its review of this area and DoD was taking corrective actions, this GAO report did not make any recommendations. We found similar conditions during our audit; see Finding A for a discussion.

o "Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability," GAO/AIMD-94-12 (OSD Case No. 9276-D), was issued on December 22, 1993. The GAO stated that the Army's data on budget execution could not be relied on to ensure that the Army complied with disbursement limits set by the Antideficiency Act. The report stated that because disbursements of about $5 billion were not promptly or accurately matched with related obligations at the end of FY 1992, there was an increased risk that the Army would make improper payments by exceeding authorized disbursement limits. The report also stated that the Army Materiel Command did not always retain adequate records to support recorded disbursements. Without the supporting records, the Army could not ensure the accuracy of recorded and reported disbursements, and could not research questionable items or discrepancies. The GAO report recommended that DoD ensure compliance with policies and procedures established to control disbursements, and that funding or paying offices be given the information they need to match payments to obligations. DoD concurred with the recommendations.

o "Financial Management: Army Records Contain Millions of Dollars in Negative Unliquidated Obligations," GAO/AFMD-90-41 (OSD Case No. 8258), was issued on May 2, 1990. According to the GAO, the records of the Army Materiel Command's six major subordinate commands showed $328 million in unmatched disbursements as of September 30, 1989 (see Finding B for the results of our review). The GAO reported that $23 million of disbursements had been unmatched for more than 6 months, and that delays in resolving the unmatched disbursements were caused by coordination problems between the Army Materiel Command's subordinate commands and other DoD organizations. The GAO also stated that Army regulations did not require negative unliquidated obligations to be separately disclosed in reports to managers; therefore, personnel at Department of the Army level were not aware of the large amounts of negative unliquidated

obligations. The GAO recommended that DoD resolve recorded negative unliquidated obligations and collect any overpayments made to contractors, and determine and correct the weaknesses that caused the negative unliquidated obligations. DoD concurred with the GAO's recommendations.

Inspector General, DoD, Reports. The IG, DoD, has issued five reports related to this audit.

o Report No. 94-048, "Audit of Uncleared Transactions By and For Others," March 2, 1994, found that increased management oversight was needed to eliminate delays in clearing transactions and to reduce undistributed disbursements, which were valued at $34.6 billion as of January 31, 1993. In addition, managers at Headquarters, DFAS, did not receive complete and accurate information on the status of undistributed disbursements, including uncleared transactions. The report recommended that the DoD Comptroller include in Volume 1, DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," May 1993, detailed guidance for clearing transactions and reducing undistributed disbursements. The report also recommended that DFAS improve procedures and controls over transactions that are not cleared promptly, and issue specific policies for reporting undistributed disbursements. The Deputy DoD Comptroller and the Director, DFAS, generally concurred with the findings and recommendations. Our audit also covered this area; see Finding B for a discussion of the results.

o Report No. 94-036, "Financial Status of Navy Expired Year Appropriations," February 10, 1994, stated that the Navy had four apparent funding deficiencies. The report also stated that potential funding deficiencies could total $164.8 million if contingent liabilities become actual liabilities. The report showed that $861.4 million in claims against the Navy could result in funding deficiencies if additional funds are not available to pay those claims. In addition, the Navy had almost $1 billion in unmatched disbursements that needed to be reconciled. The Director of Budget and Reports, Department of the Navy, agreed with the report, but did not agree that contingent liabilities should be maintained in the accounting records after funds expire. The Deputy Director for General Accounting, DFAS, generally agreed with the report.

o Report No. 93-053, "Report on the Audit of Missile Procurement Appropriations for the Air Force," 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. These misstatements were caused by 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 a violation of the Antideficiency Act 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.

o Report No. 92-064, "Titan IV Program," March 13, 1992, concluded that progress payments for the Titan IV contract were made from a predetermined sequence of appropriations, rather than from appropriations that corresponded to the type of work done. (See Finding A for a discussion of similar issues identified during this audit.) The DoD Comptroller agreed with the report and has partially implemented the recommendations.

o Report No. 92-028, "Merged Accounts of the Department of Defense," December 30, 1991, showed that obligations recorded in DoD accounting records did not accurately reflect the status of merged accounts. The audit showed that DoD had about $1 billion in negative unliquidated obligations, and that several accounts were overdisbursed. Because official DoD accounting records were 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, DoD, generally agreed with the report.

Appendix C. Types of Potential Overpayments

Contract	Amount of Inquiry	Type of Inquiry	Number of Days After DAO Sent Inquiry
DAAK01-87-C-A018	$ 8,846.65	Incorrect price	361
DAAK01-87-C-A018	121,125.01	Incorrect price	361
DAAJ09-89-C-1365	37,075.38	Incorrect price	29
Subtotal	**$ 167,047.04**		
DAAK70-83-C-0077	$ 595,249.20	Unliquidated progress payment	
DAAK01-90-C-0140	469,077.02	Unliquidated progress payment	618
DAAK01-88-D-D083-0002	46,980.25	Unliquidated progress payment	80
DAAK01-88-D-D083-0001	64,071.15	Unliquidated progress payment	80
DAAK01-88-D-D070-0001	39,239.89	Unliquidated progress payment	80
DAAK01-88-C-C020	96,899.16	Unliquidated progress payment	59
DAAK01-88-C-C038	570,669.75	Unliquidated progress payment	38
DAAJ09-91-C-0790	25,588.90	Unliquidated progress payment	80
DAAJ09-90-C-0334	61,366.80	Unliquidated progress payment	80
DAAJ09-87-C-A009	5,645,675.63	Unliquidated progress payment	724
DAAJ09-85-C-A008	513,157.26	Unliquidated progress payment	80
DAAH01-85-C-0293	71,073.18	Unliquidated progress payment	623
DAAB07-88-C-K068	29,603.82	Unliquidated progress payment	30
DAAB07-87-C-B002	6,554.57	Unliquidated progress payment	751
DAAA09-91-C-0736	29,604.17	Unliquidated progress payment	18
DAAH01-88-C-0886	4,339.64	Unliquidated progress payment	1120
DAAA09-88-C-0397	203,897.49	Unliquidated progress payment	547
DAAA01-88-C-0289	854,256.47	Unliquidated progress payment	2
Subtotal	**$9,327,304.35**		
DAAK01-87-F-0046	$ 629,101.74	Overstatement[1]	80
DAAJ09-88-C-A113	2,881.00	Overstatement	80
DAAK01-87-C-A018	69,088.38	Overstatement	361
DAAB07-91-C-P751	300,000.00	Overstatement	80
Subtotal	**$1,001,071.12**		

Contract	Amount of Inquiry	Type of Inquiry	Number of Days After DAO Sent Inquiry
DAAK70-89-D-0068-0046	$ 1,628.95	Overpayment	107
DAAK01-88-D-0041-0001	3,110.98	Overpayment	60
DAAJ09-89-C-A003	2,892,156.27	Overpayment	154
DAAJ09-89-C-A003	5,904.45	Overpayment	154
DAAJ09-89-C-A003	2,423,558.89	Overpayment	154
DAAJ09-89-C-A003	28,894.12	Overpayment	80
DAAH01-91-C-0108	2,817.20	Overpayment	637
DAAH01-91-C-0025	22,070.35	Overpayment	[2]
DAAB07-90-C-G435	110,281.00	Overpayment	27
DAAH01-89-D-0078-0008	250.28	Overpayment	[2]
DAAH01-88-P-4890	10,500.00	Overpayment	780
DAAH01-88-C-0292	11,477.39	Overpayment	[2]
DAAB07-90-C-S001	398,053.40	Overpayment	206
DAAB07-86-C-H080	119,982.00	Overpayment	511
DAAA09-84-G-0011-0006	133,903.76	Overpayment	[2]
DAAA09-76-E-0030	10,211.77	Overpayment	211
F41608-86-D-0280-0005	26,166.00	Overpayment	24
DAAH01-90-P-0732	15,571.50	Overpayment	220
M00027-84-C-0044	627,563.36	Overpayment	59
DAAH01-90-D-0133-0006	2,957.86	Overpayment	[2]
DAAH01-85-G-A002-0025	10,178.00	Overpayment	402
Subtotal	**$6,857,237.53**		
DAAK01-87-C-A018	$ 45,388.80	Contract adjustment	361
DAAK01-87-C-A018	36,652.34	Contract adjustment	361
DAAH01-90-D-0162-0001	100.04	Contract adjustment	522
DAAH01-90-C-0650	213.00	Contract adjustment	107
DAAH01-89-C-0336	369,043.33	Contract adjustment	190
DAAH01-87-C-0887	398,796.87	Contract adjustment	190
DAAA09-89-C-0752	295,774.00	Contract adjustment	493
Subtotal	**$ 1,145,968.38**		

Total Amount of Inquiries $18,498,628.42

Acronym
DAO = Defense Accounting Office

[1]Overstatement means that too large a quantity was shipped.
[2]Days could not be calculated because of the lack of documentation to support the date provided by the DAO.

Appendix D. Antideficiency Act Investigations

Number and Dollar Value of Investigations as of March 21, 1995
($ in millions)

Number of Cases Investigated	Dollar Value Range for Cases Investigated	Dollar Value of Cases Investigated
7	$ 0.0 - $ 0.1	$ 0.2
1	$ 0.1 - $ 1.0	0.2
3	$ 1.0 - $10.0	9.7
2	$10.0 - $50.0	25.3
1	More than $50.0	418.3
Total 14		**Total $453.7**

Appendix E. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Type of Benefit
A.1., A.2., A.3., A.4., and A.5.	Compliance and management controls. Will strengthen management controls and improve fiscal accountability and management in DoD.	Nonmonetary.
A.6., A.7.	Economy and efficiency. Will result in more economical processing of inquiries and notices of errors, and earlier identification of funds due the Government.	Nonmonetary.
B.1.a., B.1.b., B.1.c., B.2., and B.3.	Compliance and management controls. Will strengthen management controls and improve fiscal accountability and management in DoD.	Nonmonetary.
C.1.a.	Compliance and management controls. Will strengthen management controls and improve fiscal accountability and management in DoD.	Nonmonetary.
C.1.b., C.1.c.	Economy and efficiency. Will ensure more accurate recordkeeping and reserve funds for actual liabilities.	Nonmonetary.
C.1.d.	Economy and efficiency. Will reduce unneeded unliquidated obligations and make funds available for other uses.	Funds put to better use.* Amount is undeterminable until management action is completed.

*During the audit, we notified personnel at each of the DAOs of the need to deobligate $19.3 million of funds that could be put to better use (see chart on following page.)

C.2.	Compliance and management controls. Will strengthen management controls and improve fiscal accountability and management in DoD.	Nonmonetary.

Funds Put to Better Use
($ in millions)

Fiscal Year	Title	Appropriation Number	Amount
1988	Aircraft Procurement, Army	2031	$10.200
1990	Aircraft Procurement, Army	2031	0.035
1988	Missile Procurement, Army	2032	0.448
1989	Missile Procurement, Army	2032	0.058
1990	Missile Procurement, Army	2032	0.426
1988	Procurement of Weapons and Tracked Combat Vehicles, Army	2033	0.476
1989	Procurement of Weapons and Tracked Combat Vehicles, Army	2033	0.501
1990	Procurement of Weapons and Tracked Combat Vehicles, Army	2033	0.900
1989	Procurement of Ammunition, Army	2034	0.127
1987	Other Procurement, Army	2035	0.230
1988	Other Procurement, Army	2035	0.771
1990	Other Procurement, Army	2035	0.481
1989	Research, Development, Test and Evaluation	2040	4.600
			$19.253

Appendix F. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Washington, DC

Department of the Army

Secretary of the Army, Washington, DC
Assistant Secretary of the Army (Financial Management and Comptroller), Washington, DC
U.S. Army Materiel Command, Alexandria, VA
- U.S. Army Armament, Munitions, and Chemical Command, Rock Island, IL
- U.S. Army Aviation and Troop Command, St. Louis, MO
- U.S. Army Communications-Electronics Command, Fort Monmouth, NJ
- U.S. Army Missile Command, Huntsville, AL
- U.S. Army Tank-automotive and Armaments Command, Warren, MI

Defense Agencies

Defense Finance and Accounting Service, Arlington, VA
- Defense Finance and Accounting Service Columbus Center, Columbus, OH
- Defense Finance and Accounting Service Indianapolis Center, Indianapolis, IN
  - Defense Accounting Office, Indianapolis Center, U.S. Army Aviation and Troop Command, St. Louis, MO
  - Defense Accounting Office, U.S. Army Communications-Electronics Command, Fort Monmouth, NJ
  - Defense Accounting Office, U.S. Army Missile Command, Huntsville, AL
  - Defense Accounting Office, U.S. Army Tank-automotive and Armaments Command, Warren, MI
  - Defense Accounting Office, Indianapolis Center, Rock Island, IL

Appendix G. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
General Counsel of the Department of Defense
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Secretary of the Army
Commander, U.S. Army Materiel Command
Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army

Department of the Navy

Office of the Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Defense Agencies

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Finance and Accounting Service Indianapolis Center
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Central Imagery Office

Non-Defense Organizations

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

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 National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security

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Part IV - Management Comments

Under Secretary of Defense (Comptroller) Comments

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

COMPTROLLER

APR 21 1995

MEMORANDUM FOR DEPUTY DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE, ODODIG

SUBJECT: Audit Report on the Financial Status of Army Expired Year Appropriations (Project No. 3FG-2006)

Your memorandum of January 31, 1995, provided the subject draft report for review and comments.

The Office of the Under Secretary of Defense (Comptroller) and the Defense Finance and Accounting Service concur with the action suggested in several recommendations. However, the Office of the Under Secretary of Defense (Comptroller) and the Defense Finance and Accounting Service do not concur that several of the actions should be directed to the Defense Finance and Accounting Service. Rather, the recommended actions are the responsibility of the DoD Components, not the Defense Finance and Accounting Service. Therefore, the recommendations should be directed to the applicable DoD Component--which in this audit report is the Army. Additionally, this office does not concur with a recommendation that the Under Secretary of Defense (Comptroller) establish reserves for contingent liabilities.

Attached, as requested, are detailed comments on the subject draft report.

We appreciate the opportunity to comment on this draft report. Questions regarding this matter may be directed to Mr. De W. Ritchie, Jr., on (703) 697-3135 (DSN 225-3135).

Alvin Tucker
Deputy Chief Financial Officer

Attachment

Copy to: DFAS
ASA(FM&C)

Final Repor
Reference

OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER) COMMENTS ON AN OFFICE OF THE INSPECTOR GENERAL DRAFT REPORT ENTITLED "AUDIT REPORT ON THE FINANCIAL STATUS OF ARMY EXPIRED YEAR APPROPRIATIONS" (PROJECT 3FB-2006)

General Comments

The report appears to improperly characterize, as inadequate, accounting services provided by Defense Accounting Offices in support the Army Material Command. Such statements, although presented as facts, appear to be subjective in nature, fail to recognize systematic difficulties that must be overcome and the progress to date in overcoming past difficulties, fail to consider the overall scope of the workload, and do not recognize compensating factors such as staff experience and knowledge. In short, the report fails to recognize the high degree of professionalism that has been exhibited during a period of rapid change, and the maintenance of a quality of data that is equal to or in excess of prior standards.

The Executive Summary states that "financial records could not be relied on for making financial decisions." This statement appears to be subjective and is neither accurate nor supportable. There is no finding indicating that an alternative decision would have been potentially available, and considered, except that desired financial information was lacking. Added Page

In several instances throughout the draft report, statements are made regarding deobligating amounts and better using the deobligated resources. Such statements are misleading, at best, as regards expired appropriations addressed in the draft report. Obligation recoveries in expired accounts are available only for obligation adjustment amounts within the same appropriation, and are not available for new programs/new obligations. However, the report could lead a reader to conclude otherwise. Revised Pages ii, 2 33

On page 5 of the draft report, it is stated that Defense Accounting Offices review and approve large upward obligation adjustments. That is an inaccurate statement. Such obligation adjustments are approved by the DoD Components; they are only recorded by the Defense Accounting Offices after they are approved by the DoD Component. This delineation of responsibilities is in accordance with DoD policy requirements contained in chapter 25, paragraph L, of the "DoD Accounting Manual" (DoD 7220.9-M). Revised

On page 33, there is no clear distinction made between the issuer and acceptor of project orders. Table 3, page 34, indicates Army Material Commands that are issuers of project orders for which reimbursement to others will be made. The referenced transactions appear to be direct fund obligations, not project orders. Further, on page 33, it is stated that the Aviation and Troop Command does not have project orders. However, at the Revised Pages 37 ar 38

Attachment

bottom of page 34, it is stated that the Command had 800 reimbursable orders of which some could be project orders. There is no recognition of, or attempt to explain, this apparent contradiction.

Finding A. Management of Contract Payments

OUSD(C) Comments. Partially concur.

This office agrees that to the extent that known errors went uncorrected, and known overpayments were not promptly collected, such actions should not have occurred. Additionally, internal controls were not adequate to ensure that payments to contractors were charged to the proper appropriation based on the underlying nature of the work performed.

However, many procurements have long lead times, and a large amount of unliquidated progress payments normally could be expected to be found when procurement appropriations move into the five year expired status period. Therefore, $1.1 billion of unliquidated progress payment balances cited in the draft report should not, by itself, be considered abnormal or an indication that amounts were not properly recorded. Unliquidated progress payment balances of $1.1 billion or more reasonably could be expected to be liquidated by future contractor deliveries.

This office concurs that, currently, neither Government contracting officers nor contractors are required to identify appropriation accounting data at a level of detail that would permit payments to be properly charged and recorded at the accounting classification reference number level. However, the Defense Finance and Accounting Service does not have the responsibility or the authority to require the submission of such information. Thus, it may be inappropriate to criticize the Defense Finance and Accounting Service for not properly recording payments when the data required to properly record such payments is not provided to the Defense Finance and Accounting Service, and it is beyond the capability of the Defense Finance and Accounting Service to require the submission of such data. Rather, it would appear to be more proper for the draft report to explicitly state the reason for the lack of such information, and direct corrective actions/recommendations to those DoD organizations that have the responsibility and authority to correct the situation.

Pages 12 and 13 of the draft report, presents as fact, that the Defense Finance and Accounting Service improperly recorded charges of $17.3 million. The Defense Finance and Accounting Service reviewed the invoices purportedly used to identify the alleged mischarges. That review failed to determine a reason for the auditors' conclusion, other than perhaps a judgment on the part of the auditor.

The draft report notes, on page 15, a $2.3 million disbursement was incorrectly recorded against FY 1990 funds. However, the draft report does not recognize that, on September 3, 1993, a correction was entered charging the disbursement to FY 1989 funds.

Even though at the time of the audit the Defense Accounting Office did not review all system output notices of potential errors, the automated system was periodically queried to identify errors, such as negative unliquidated obligations and accounts payable. These conditions, when identified, were reviewed and corrected.

Due to clerical errors that may occur in the input of contract and payment data, payments may have been disbursed from the wrong appropriation and entered erroneously in accounting records. Such errors are corrected when discovered. Also the Defense Finance and Accounting Service-Columbus Center, both through employee training and rewritten procedures, is making significant achievement in reducing such clerical errors and resulting payment problems. However, as indicated above, one of the underlying causes is the lack of detailed information that would identify the correct accounting classification reference number level. However, in the absence of needed information, and lacking the authority to require the submission of such information, the Defense Finance and Accounting Service should not be expected to perform at a level of perfection.

Recommendation A.1. We recommend that the Director, Defense Finance and Accounting Service develop and implement a plan of action and milestones to bring DoD accounting and disbursing systems into compliance with the revised "DoD Accounting Manual," requiring financing payments to be distributed by contract line item number or subsidiary contract line item number.

OUSD(C) Comments. Concur. The Defense Finance and Accounting Service recently has been informed by the Office of Procurement Policy that a proposed Defense Federal Acquisition Regulation change to effect improved line item definition will be published in May 1995. The Defense Finance and Accounting Service is developing a detailed Plan of Action and Milestones to bring DoD accounting and disbursing systems into compliance with the revised "DoD Accounting Manual." The Plan of Action and Milestones will address those actions necessary to effect policy and systems changes within the DoD financial community. The stated policy is expected to provide for the rejection of requested payments that do not conform with stated requirements 90 days following implementation of required system changes in the DoD financial community.

Final Report Reference

Revised

Recommendation A.2. We recommend that the Director, Defense Finance and Accounting Service periodically validate progress payments in expired appropriations.

OUSD(C) Comments. Nonconcur. This is a responsibility of the DoD Components, not the Defense Finance and Accounting Service. Therefore, the recommendation should be directed to the Army and not the Defense Finance and Accounting Service. The Defense Finance and Accounting Service may provide the DoD Components support and assistance, if required.

Revised

Recommendation A.3. We recommend that the Director, Defense Finance and Accounting Service reject contractor requests for progress payments that do not contain sufficient information concerning amounts to be recorded by accounting classification reference numbers to properly record progress payments against an appropriation.

OUSD(C) Comments. Nonconcur. The Defense Finance and Accounting Service does not have the authority to require contractors to provide accounting classification reference numbers on invoices. If the DoDIG believes that such information is required from contractors, it should direct its recommendation to the OUSD(A&T)--not the Defense Finance and Accounting Service. The OUSD(A&T), and not the Defense Finance and Accounting Service, is the DoD organization that is responsible for requesting, and has the authority to require, such information from contractors.

Revised

Recommendation A.4. We recommend that the Director, Defense Finance and Accounting Service record liquidations of progress payments against accounting classification reference numbers provided in contractors' invoices.

OUSD(C) Comments. Nonconcur. As stated above, the Defense Finance and Accounting Service does not have the authority to require contractors to provide accounting classification reference numbers on invoices for progress payments. Even if the Department did require such information to be provided by a contractor, such information should not be relied upon solely as an expedient methodology to record the liquidation of progress payments. If bill paying offices relied solely on the accounting data supplied by a contractor to liquidate a progress payment, such action could be considered a material internal control deficiency and invite potential fraud by a contractor.

Recommendation A.5. We recommend that the Director, Defense Finance and Accounting Service implement procedures to periodically match progress payment and liquidation data between the

Defense Finance and Accounting Service Columbus Center's and the Defense Accounting Office's databases, and correct discrepancies noted.

OUSD(C) Comments. Concur. The Director, Defense Finance and Accounting Service plans to implement procedures to periodically match progress payment and liquidation data between the Defense Finance and Accounting Service-Columbus Center's and the Defense Accounting Office's databases. Estimated completion date is August 31, 1995.

Recommendation A.6. We recommend that the Director, Defense Finance and Accounting Service establish procedures for Defense Accounting Offices to review exception reports containing notices of potential errors, and make corrections.

OUSD(C) Comments. Concur. The Director, Defense Finance and Accounting Service plans to reemphasize procedures for Defense Accounting Offices to review exception reports containing notices of potential errors, and make corrections. Estimated completion date is August 31, 1995.

Recommendation A.7. We recommend that the Director, Defense Finance and Accounting Service assign priorities to the processing of inquiries that may involve overpayments made to contractors. Inquiries with the largest potential monetary value to the Government should be processed first.

OUSD(C) Comments. Concur. The Director, Defense Finance and Accounting Service plans to develop and implement operational procedures that will assign priorities to the processing of inquiries that may involve overpayments made to contractors. Estimated completion date is May 31, 1995.

Finding B. Contingent Liabilities

OUSD(C) Comments. Partially concur.

It is recognized that the Army Materiel Command consistently may not have followed procedures for identifying, accruing or tracking contingent liabilities that may [or may not] need to be paid in the future. It also is recognized that if potential liabilities, that are in excess of available funds, become actual liabilities, a violation of the Antideficiency Act could be incurred. However, there are numerous factors that will bear on whether the potential liabilities become actual liabilities, and whether additional resources may become available though deobligations or other actions.

Also it is recognized that internal controls were not adequate to identify all contingent liabilities. The draft report acknowledges that approximately one-half of the contingent liabilities were being tracked at some accounting locations. Further, it is recognized that consistent processes to encompass all contract contingent liabilities would have to be implemented to correct the internal control weakness. Whether additional processes are in fact implemented, is a decision to made by the Army Materiel Command and is not the responsibility of the Defense Finance and Accounting Service.

Recommendation B.1.a. We recommend that the Under Secretary of Defense (Comptroller) (USD(C)) require contingent liabilities to be reported to the DFAS and be periodically revalidated.

OUSD(C) Comments. Partially concur. The recommendation is not clear. As written, the facts presented do not explicitly state whether contingent liabilities are, or are not, reported to the DFAS; or whether contingent liabilities are, or are not, periodically revalidated. The finding is not sufficiently clear for management to conclude or implicitly deduce that contingent liabilities are not reported to the DFAS.

The Chief Financial Officers (CFO) Act; Office of Management and Budget (OMB) requirements; and Form and Content for financial statement reporting, as published by the Department of Defense, all require that contingent liabilities be reported in an entity's financial statements. As a result, contingent liabilities are reported in the Army's financial statements. Accordingly, the position of this office is that contingent liabilities are, in fact, reported to the DFAS. Also, since contingent liabilities are included in annual CFO financial statements, this office maintains that contingent liabilities are periodically revalidated.

Additionally, this office notes that in November 1994, the Federal Accounting Standards Advisory Board (FASAB) issued, for public comments, its Exposure Draft on "Accounting for Liabilities of the Federal Government." The Exposure Draft contains six standards which address the topic of accounting for liabilities of the federal government, as well as a definition and general principle for the recognition of liabilities. One of those standards addresses contingencies as summarized below:

> Contingencies - A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. This statement does not deal with contingent gains or with impairment of assets. Contingent future outflows or other sacrifices of resources as a result of past transactions or events may be recognized as a contingent liability, may be disclosed as a contingent liability, or may not be

reported at all. Contingencies should be recognized as liabilities when a past transaction or event has occurred, a future outflow or other sacrifice of resources is probable and the related future outflow or sacrifice of resources is measurable. Contingent liabilities should be disclosed if any of the conditions for liability recognition are not met and there is a reasonable possibility that a loss or an additional loss may have been incurred.

The Board is expected to approve the Exposure Draft in the near future; and the Board's sponsors--the Treasury, General Accounting Office, and Office of Management and Budget (OMB)--are expected to adopt those accounting standards. When they do, the standards will be published by the OMB for use by the federal government.

The FASAB proposed accounting standard for contingent liabilities will require the Department to reevaluate its current policy in this area. The Office of the Under Secretary of Defense (Comptroller) has already anticipated this near-term requirement. Thus, a revision to the "DoD Financial Management Regulation" (DoD 7000.14-R) will be considered when the OMB issues its guidance on contingent liabilities.

The Army is responsible for determining, for its appropriations, if a contingent liability does, or does not, exist. As such, it is incumbent upon the Army to commit or obligate or otherwise manage its appropriations and report contingent liabilities to the DFAS, and to conduct a periodic validation of its liabilities. If a deficiency in the Army's practices has been noted, then suggest that this recommendation be rewritten and readdressed to the Army to correct the noted deficiency.

Recommendation B.1.b. We recommend that the USD(C) establish procedures for the evaluation of all commitments associated with contingent liabilities prior to expiration of the appropriation, and creation of obligations for valid commitments.

OUSD(C) Comments. Partially concur. 31 U.S.C. 1501 prescribes the criteria for recording obligations and the Department follows that criteria. Additionally, chapters 24 and 25 of the "DoD Accounting Manual" (DoD 7200.9-M) prescribe when commitments and obligations should be recorded. Also, the Department's policies require obligations to be recorded when they occur. This office does not agree that when an appropriation is about to expire is a relevant factor as to whether an obligation has been incurred and, therefore, should be recorded. The need for additional guidance is not clear, nor warranted under the circumstances.

The Army, not the OUSD(C), is responsible for managing the Army's appropriations. Thus, if the Army determines that, in its sound management judgment, a contingent liability does, or

Final Report Reference

does not, exist, it is incumbent upon the Army to evaluate whether a contingent liability has ripened into a recordable obligation and commit or obligate its appropriations accordingly. These actions should be taken irrespective of whether an appropriation is nearing its expiration status. If the Army is not complying with such reasonable actions, such a deficiency in Army practices should be pointed out. However, noncompliance by the Army, if it exists, should not require that the Department establish new procedures for the evaluation of commitments associated with contingent liabilities and the creation of obligations immediately prior to the expiration of appropriations. Further, since the Army would be responsible for any potential or real Antideficiency Act violations if sufficient funds are not available to finance contingent liabilities, the Army has an adequate incentive to monitor, track, and periodically evaluate its contingent liabilities to determine whether a commitment associated with a contingent liability has ripened into a recordable obligation. Inasmuch as the evaluation of commitments associated with contingent liabilities is an Army responsibility, the managing of appropriations allocated to the Army is an Army responsibility, and potential violations of the Antideficiency Act are an Army responsibility, if a deficiency in Army practices has been noted, it is suggested that this recommendation be rewritten and readdressed to the Army to correct any noted deficiency.

Revised

Recommendation B.1.c. We recommend that the USD(C) establish reserves to pay for contingent liabilities that exceed either funds available in expired appropriations, or 1 percent of current appropriations.

OUSD(C) Comments. Nonconcur. As written, the recommendation appears to request that the Department establish reserves in amounts that are in excess of amounts appropriated by the Congress. The Department does not have funds available to establish "reserves" in excess of funds appropriated by the Congress. Further, while the Department might have sufficient funds available to establish reserves in excess of 1 percent of current appropriations--in order to pay amounts that otherwise might be chargeable to expired accounts in certain circumstances--the Department lacks the statutory authority to expend such amounts.

Recommendation B.2. We recommend that the Director, Defense Finance and Accounting Service, establish procedures to consistently track contingent liabilities.

OUSD(C) Comments. Partially concur. It is the responsibility of a DoD Component--not the Defense Finance and Accounting Service--to track and continually monitor the status of its contingent liabilities. The Director, Defense Finance and

Accounting Service, plans to establish operational procedures to assist such efforts, where requested, by tracking contingent liabilities for which commitments had been recorded.

Recommendation B.3. We recommend that the Commander, U.S. Army Materiel Command, validate the $29.7 million in contingent liabilities, establish the need for obligations where necessary, and report any resulting potential violations of the Antideficiency Act for investigation.

OUSD(C) Comments. Concur. The Army, in conjunction with the Defense Finance and Accounting Service, will be requested, no later than May 31, 1995, to validate the $29.7 million in contingent liabilities, establish the need for obligations where necessary, and initiate an investigation of a potential violation of the Antideficiency Act, if appropriate.

Finding C. Validating and Resolving Unliquidated Obligations.

OUSD(C) Comments. Partially concur. Internal controls may not have been adequate to ensure that all unliquidated obligation balances were effectively reviewed. However, joint Army Material Command and the Defense Accounting Station reviews of unliquidated obligations have been considered an effective management tool in the past, and generally have achieved good results. The Army Material Command, the Defense Finance and Accounting Service and the Defense Accounting Office joint reviews of unliquidated obligations have been in force for some time, and have been effective in identifying those balances where followup attention is necessary. These reviews have resulted in Army exercising some of the best control of obligated balances. This is an administrative deficiency and can be remedied by emphasis of supervisory responsibilities to assure the reviews are conducted thoroughly and properly. This is not considered a material weakness.

It should be noted that the $10.2 million unliquidated obligation discussed on page 32 has been liquidated.

The monetary benefits of $19.3 million referred to in the draft report may not be realistic. The funds involved are in expired appropriations and, therefore, are not available for new obligations. Timely closing of completed contract records is a necessary attribute of accurate accounting and reporting, but that is not a quantifiable monetary benefit.

Recommendation C.1.a. We recommend that the Director, Defense Finance and Accounting Service, require that the Defense Accounting Offices conduct reviews with supported activities of unliquidated obligation balances at least three times each fiscal year.

OUSD(C) Comments. Partially concur. Reviews of unliquidated obligation balances are a responsibility of the DoD Components, not the Defense Finance and Accounting Service. Therefore, the recommendation should be directed to the Army and not the Defense Finance and Accounting Service. However, if requested, the Defense Finance and Accounting Service may provide the DoD Components support and assistance in conjunction with such reviews.

Recommendation C.1.b. We recommend that the Director, Defense Finance and Accounting Service, establish procedures for the routine identification of closed contracts and project orders that contain unliquidated obligations, and deobligate the funds when appropriate.

OUSD(C) Comments. Partially concur. Identification of closed contracts and project orders that contain unliquidated obligations, and the deobligation of unneeded fund, is a responsibility of the DoD Components, not the Defense Finance and Accounting Service. Therefore, the recommendation should be directed to the Army and not the Defense Finance and Accounting Service. However, if requested, the Defense Finance and Accounting Service may assist in procedures for the routine identification of closed contracts and project orders that contain unliquidated obligations, and provide such information to the DoD Components.

Recommendation C.1.c. We recommend that the Director, Defense Finance and Accounting Service, require Defense Accounting Offices to review unliquidated progress payable balances monthly when unliquidated obligations are zero or negative, correct the accounting records, and liquidate overpayments.

OUSD(C) Comments. Partially concur. The review of unliquidated progress payable balances is a responsibility of the DoD Components, not the Defense Finance and Accounting Service. Therefore, this recommendation should be directed to the Army and not the Defense Finance and Accounting Service. The Defense Finance and Accounting Service may assist, if requested, by requiring Defense Accounting Offices to review unliquidated progress payable balances monthly and providing information to the DoD Components when unliquidated obligations are zero or negative. However, the Defense Finance and Accounting Service should correct known errors in accounting records and liquidate overpayments.

Recommendation C.1.d. We recommend that the Director, Defense Finance and Accounting Service, review unliquidated obligations recorded for closed contracts identified in this report, and deobligate amounts no longer needed.

:0 Attachment

OUSD(C) Comments. Partially concur. The deobligation of amounts no longer needed is a responsibility of the DoD Components, not the Defense Finance and Accounting Service. Therefore, this recommendation should be directed to the Army and not the Defense Finance and Accounting Service. To assist the DoD Components, if requested, the Defense Finance and Accounting Service may review unliquidated obligations recorded for closed contracts identified in this report and provide a report of such amounts to the applicable DoD Component.

Recommendation C.2. We recommend that the Commander, U.S. Army Materiel Command, establish procedures to perform joint reviews of unliquidated obligation balances at least three times a year.

OUSD(C) Comments. Concur. The Commander, U.S. Army Materiel Command, should establish procedures to perform joint reviews of unliquidated obligation balances.

Department of the Army Comments

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
FINANCIAL MANAGEMENT
100 ARMY PENTAGON
WASHINGTON DC 20310-0100

REPLY TO
ATTENTION OF

13 APR 1995

MEMORANDUM THRU AUDITOR GENERAL, U.S. ARMY AUDIT AGENCY

FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Audit Report on the Financial Status of Army Expired Year Appropriations

We have reviewed the subject audit report and endorse the U.S. Army Materiel Command (AMC) responses presented in the attached document.

Should you need additional information, the ASA(FM&C) point of contact for this audit report is Ms. Barbara A. Jefferson. She can be reached at (703) 695-2587 or DSN 225-2587.

Helen T. McCoy
Assistant Secretary of the Army
(Financial Management and Comptroller)

Attachment

DEPARTMENT OF THE ARMY
HEADQUARTERS, U.S. ARMY MATERIEL COMMAND
5001 EISENHOWER AVENUE, ALEXANDRIA, VA 22333-0001

REPLY TO ATTENTION OF

AMCIR-A (36-2b) 17 March 1995

MEMORANDUM FOR MR. JOHN BOURGAULT, ASSOCIATE DIRECTOR, AUDIT FOLLOWUP AND COMPLIANCE DIVISION, U.S. ARMY AUDIT AGENCY, ALEXANDRIA, VA 22202-0000

SUBJECT: Department of Defense Inspector General Draft Report, Financial Status of Army Expired Year Appropriations, Project 3FG-2006 (AMC No. D9327)

1. We are forwarding our position on subject report IAW AR 36-2.

2. Point of contact for this action is Mr. Robert Kurzer, (703) 274-9025.

3. AMC -- America's Arsenal for the Brave.

JOHN S. MACKY
Major General, USA
Chief of Staff

DoDIG Draft Report
Financial Status of Army Expired Year Appropriations
Project 3FG-2006 (AMC No. D9327)

FINDING B. AMC's management of obligations for expired year appropriations was inadequate. Unobligated balances in AMC's expired appropriation accounts may be insufficient to meet obligational adjustments that may become chargeable to those balances in the future, if and when contingent liabilities become actual liabilities. Specifically, AMC was not always accruing or tracking contingent liabilities that may have to be paid from expired appropriations. These conditions occurred because AMC and the DAO's were not consistently following Army or DoD procedures for identifying, accruing, and tracking contractual liabilities that may have to be paid in the future. As a result, AMC had at least $29.7 million in contingent liabilities that could result in at least one Antideficiency Act violation if they become actual liabilities, because the expired FY 1987 Aircraft Procurement, Army, appropriation may not contain sufficient unobligated fund balances.

RECOMMENDATION AND ACTION TAKEN

RECOMMENDATION 3.

RECOMMENDATION: We recommend that the CDR, AMC validate the $29.7 million in contingent liabilities, establish the need for obligations where necessary, and report any resulting potential violations of the Antideficiency Act for investigation.

ACTION TAKEN. Concur. AMC MSCs will validate the current expired year contingent liabilities as part of our normal quarterly review process. AMC will obligate for expired year contingent liabilities as necessary. Contingent liabilities associated with closed year appropriations actually materializing will be funded with current year funds. Any potential violation or the Antideficiency Act will be reported in accordance with AR 37-1.

We will reiterate, by 28 Apr 95, the requirement to validate the contingent liabilities balances for all expired year appropriations with current year funds. The AMC MSCs should accomplish this validation as part of the quarterly reviews for the fiscal year.

DoDIG Draft Report
Financial Status of Army Expired Year Appropriations
Project 3FG-2006 (AMC No. D9327)

FINDING C. Defense Accounting Offices (DAO'S) did not adequately review accounting records to validate unliquated obligations.

o Program financial reviews held jointly by DAO's and command personnel did not identify unsupported unliquidated obligations amounting to $10.2 million for contracts and $6.7 million for reimbursable orders.

o AMC had contracts amounting to $26.2 million that contracting officers considered complete. However, those contracts included $2.4 million or unliquidated obligations that were no longer needed and should have been deobligated. If the DAO's had reviewed these unliquidated obligations adequately, the funds would have been deobligated.

o AMC's accounting records contained $140.3 million in questionable progress payment balances. These payments had not been reviewed to determine whether adjustments or liquidations should be made.

These conditions occurred because: (i) reviews of unliquidated obligation balances in accounting records were often not timely or thorough; (ii) unliquidated obligation balances on completed contracts were not analyzed to determine whether a continuing need existed; and (iii) research was not always conducted on abnormal balances of progress payments that had been made to contractors.

RECOMMENDATION AND ACTION TAKEN:

RECOMMENDATION 2. We recommend that the CDR, AMC establish procedures to perform joint reviews of unliquidated obligation balances at least three times each year.

ACTION TAKEN. Concur. AMC MSCs have procedures in place to perform quarterly reviews of accounting records that include reviewing Unliquidated Obligations (ULOs). The AMC Internal Review and Audit Compliance issued a report verifying AMC MSCs are following procedures and reviewing ULOs.

DoDIG Draft Report
Financial Status of Army Expired Year Appropriations
Project 3FG-2006 (AMC No. D9327)

The Assistant Secretary of Army (Financial Management and Comptroller)(ASA(FM&C)) in conjunction with the Defense Finance and Accounting Service (DFAS) issued procedures to the Army major commands to perform a joint review of ULOs. In message, DFAS-IN-AM, 211721Z Arp 94, ASA(FM&C) established procedures for a three stage review process that includes reviewing ULOs. The ASA(FM&C) hosts a quarterly video teleconference to discuss the results of the various reviews that include all closing year appropriations ULOs. AMC and the MSCs contribute to these reviews.

We will reiterate to our MSCs, by 28 Apr 95, the procedures contained in the DFAS/ASA(FM&C) message.

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