Audit Report

OFFICE OF THE INSPECTOR GENERAL

FINANCIAL STATUS OF AIR FORCE EXPIRED YEAR APPROPRIATIONS

Report No. 94-062 March 18, 1994

Department of Defense

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Acronyms

DAO	Defense Accounting Office
DFAS	Defense Finance and Accounting Service
FMFIA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
"M" Account	Merged Account
NULO	Negative Unliquidated Obligation
OMB	Office of Management and Budget
RDT&E	Research, Development, Test and Evaluation
R&D	Research and Development

INSPECTOR GENERAL
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March 18, 1994

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

SUBJECT: Audit Report on the Financial Status of Air Force Expired Year Appropriations (Report No. 94-062)

This report is provided for your review and comment. The audit resulted from our review of the status of Air Force Missile Procurement appropriations for FYs 1987 and 1988. We believed that other expired year Air Force appropriations have problems similar to those found in the Missile Procurement appropriations. Those problems were fund shortfalls, potential violations of the Antideficiency Act, and accounting problems.

A draft of this report was provided on October 21, 1993. Although we asked for comments from management concerning the draft, none have been received. DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, all addressees must provide final comments on unresolved recommendations and monetary benefits by May 17, 1994. See the chart at the end of each finding for the specific requirements for your comments.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. David C. Funk, Program Director, at (303) 676-7392 (DSN 926-7392), or Mr. Donald F. Broderick, Project Manager, at (303) 676-7433 (DSN 926-7433). Appendix E lists the distribution of this report. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Report No. 94-062 **March 18, 1994**
(Project No. 2FD-2017)

FINANCIAL STATUS OF AIR FORCE EXPIRED YEAR APPROPRIATIONS

EXECUTIVE SUMMARY

Introduction. This report gives the results of our audit of the financial status of Air Force expired year appropriations. We made the audit to determine whether other appropriations in the Air Force were experiencing problems similar to those previously reported in our audit of the FYs 1987 and 1988 Air Force Missile Procurement appropriations. In our report on that audit, we found that the Air Force experienced deficits and accounting problems relating to funding upward cost adjustments to obligations when such costs were charged to expired year appropriations.

Public Law 101-510, the National Defense Authorization Act for Fiscal Year 1991, phased out each appropriation's merged and merged surplus accounts. Now, unobligated balances and obligated unexpended balances are not merged. Instead, they retain fiscal year identity, and there is now a maximum 5-year period after expiration of an appropriation when obligations can be recorded, adjusted, and liquidated. After that 5-year period, residual obligations must be paid with current year funds.

Objectives. The primary audit objective was to review the financial status of Air Force expired year appropriations and determine whether significant financial problems, including funding shortfalls, existed. We focused on the methods and internal controls Air Force officials used to manage the financial status of major procurements and related financial operations. Because of discrepancies encountered, we expanded our objectives to include Air Force use of current year dollars to finance obligation growth in open merged accounts and Air Force policy on the use and disclosure of appropriation refunds receivable in fund records and reports.

Audit Results. Four of the eight Research, Development, Test, and Evaluation and Aircraft Procurement expired appropriations were experiencing financial difficulty. The FY 1991 Research, Development, Test, and Evaluation and the FY 1989 Aircraft Procurement appropriations were potentially deficient by $14.1 million and $21.1 million, respectively. Also, both FY 1990 appropriations had very small available fund balances and were at high risk of being deficit in the near future. In addition, uncorrected erroneous accounting entries for negative unliquidated obligations and progress payments totaled over $1.8 billion and have the potential to further distort available fund balances. As a result, potential violations of the Antideficiency Act have occurred, and more are likely to occur (Finding A).

In our draft of this report we criticized the Air Force for using available Military Construction appropriation current year funds totaling $6.6 million to finance adjustments to merged account obligations. Those adjustments appeared to cause the original appropriation for the Military Construction merged account to be exceeded. We correspondingly recommended that the Air Force report a violation of the Antideficiency Act. Subsequently, in discussions with officials at the Defense Finance and Accounting Service (DFAS)-Denver Center and the Office of the Deputy General Counsel (Inspector General), we established that the Air Force obligation adjustments

in question pertained to the settlement of meritorious contractor claims. Therefore, the use of Military Construction appropriation current funds was authorized by statute, specifically 10 U.S.C. 2863. Therefore, we have withdrawn that part of the finding and deleted the related recommendation. However, the DFAS-Denver Center did not track the use of $217.1 million in current funds to finance merged account obligation growth against unobligated balances. Absence of a tracking means may contribute to future violations of the Antideficiency Act and Public Law 101-510 (Finding B).

The DFAS-Denver Center permitted uncollected refunds receivable worth $40.9 million to be used to finance obligation growth. Also, Air Force and DFAS-Denver Center managers recognized questionable Air Force refunds receivable worth $135.0 million for matters in litigation and used them as budgetary resources. Further, $432.2 million of refunds deemed to be uncollectible were not disclosed in Reports on Budget Execution. If the receivables are not collected, appropriation deficits and violations of the Antideficiency Act may occur. Not disclosing refunds deemed to be uncollectible distorted the budgetary perception of Air Force debt management practices.

Internal Controls. The audit identified material internal control weaknesses as defined by Office of Management and Budget Circular No. A-123, and DoD Directive 5010.38. Internal controls were not adequate to correctly report the financial position of Air Force appropriations (Finding A), to track the use of funds (Finding B), or to value Air Force-managed receivables (appropriation refunds) in fund control records and financial reports (Finding C). We evaluated management's compliance with the requirements in the DoD Internal Management Control program. Management did report some weaknesses, but did not report weaknesses in accounting for receivables or the effect a weakness identified had on the potential for violating the Antideficiency Act. Details of the internal controls reviewed are presented in Part I of this report.

Potential Benefits of Audit. Recommendations in this report, if implemented, will result in compliance with laws and regulations and improved economy and efficiency of operations, and increase expired year funds by $9.8 million. Better fund control and financial decisionmaking should result when accounting and fund control records and reports for the appropriations reflect corrections of material error. See Appendix C for a summary of all benefits.

Summary of Recommendations. We recommended that the Assistant Secretary of the Air Force (Financial Management) investigate the potential deficits in the FY 1991 Research, Development, Test, and Evaluation and the FY 1989 Aircraft Procurement appropriations; fix responsibility; and report violations of the Antideficiency Act as appropriate. We also recommended that the DFAS correct erroneous accounting conditions that caused material error in Air Force fund accounting reports and resulting financial decisionmaking and institute adequate procedures to comply with fund limitations set by Public Law 101-510. Finally, we recommended the Comptroller of the Department of Defense require the DFAS to implement DoD accounting policy for Air Force refunds receivable and amend the DoD Accounting Manual to specify how matters in litigation should be presented in fund control and accounting records.

Management Comments. The Comptroller of the Department of Defense, the Assistant Secretary of the Air Force (Financial Management), and the Director, Defense Finance and Accounting Service, were asked to comment on a draft of this report. No comments were received. We ask they comment on this final report. Comments must be received by May 17, 1994.

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

Part I - Introduction

Background

History. In FY 1992, the Inspector General, Department of Defense, audited the Air Force Missile Procurement appropriations for the expired FYs 1987 and 1988. The audit showed that finance and accounting records were materially misstated and, therefore, did not provide reliable information to support budget decisions. The Air Force management of Missile Procurement appropriations resulted in funding shortfalls and apparent violations of the Antideficiency Act. The potential existed for similar problems in other DoD and Air Force appropriations. Consequently, we initiated this audit, as well as a series of audits of expired appropriations in the other Services and the Defense agencies. This audit primarily deals with all expired fiscal years of two of the largest Air Force appropriations.

Expired Year Appropriations. Office of Management and Budget (OMB) Bulletin No. 91-07, "Budget Execution Procedures for Closing Accounts," January 17, 1991, implemented Public Law No. 101-510 and 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."

Public Law 101-510. Public Law 101-510, the National Defense Authorization Act for Fiscal Year 1991, November 5, 1990, canceled all merged surplus authority and phased out merged accounts ("M" accounts). As one of its changes, the act extends the life of expired appropriations from 2 to 5 years. In essence, it requires fixed appropriations to forever retain the integrity of the fiscal year for which each appropriation was made. The appropriations can no longer benefit from the surplus authority of other years to avoid potential violations of the Antideficiency Act. Additionally, if obligations are not paid by the end of the new 5-year expired life, they have to be paid with 1 percent or less of current year funds available in the same appropriation. No data exists to indicate whether or not all obligations can be liquidated within the new appropriation terms set by Public Law 101-510. Merged accounting systems were not designed to gather the data needed to determine the payout life by fiscal year for a given 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 (DoD Comptroller). Section 1004 provided additional transition authority for closing appropriation accounts. It permitted charging current appropriation accounts available for the same purpose with obligations and adjustments to obligations for accounts of a fiscal year before FY 1992. The only provision was that the period of availability for that obligation had to be expired but not closed. The total amount charged 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 appropriations for that account; or (ii) one percent of the total amount of the appropriations for the expired

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

DoD Implementation of the Antideficiency Act. DoD Directive 7200.1, "Administrative Control of Appropriations," dated July 27, 1987, implements the Antideficiency Act and requires that:

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

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.

Section 1341 of 31 U.S.C. stipulates:

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

A separate investigation is required for each suspected violation of the Antideficiency Act.

Objectives

The primary audit objective was to review the financial status of Air Force expired year appropriations to determine whether significant financial problems, including funding shortfalls, existed. We focused on the methods and internal controls Air Force officials used to manage the financial status of major procurements and related financial operations for the unclassified elements of two of the largest Air Force appropriations, Research, Development, Test, and Evaluation (RDT&E), FYs 1988 through 1991, and Aircraft Procurement, FYs 1987 through 1990. During the audit, we encountered other issues that caused us to expand our audit objectives and the scope of our audit. Those issues dealt with Air Force use of current year dollars to finance obligation growth in merged accounts and Air Force policy on the use and disclosure of appropriation refunds receivable in fund records and reports.

Scope and Methodology

To isolate potential funding problems, we reviewed the financial position of all Air Force expired year appropriations presented in Reports on Budget Execution, DD Forms 1176, from September 30, 1992, through May 31, 1993. Financial data in the reports were produced by DFAS-Denver Center's Departmental On-Line Accounting and Reporting System. That computer-based system consolidates and summarizes at Departmental level the detailed appropriation accounting data of the Air Force. Due to limited resources, this audit did not address the reliability of computer data processed by that system. The results showed that four fiscal years of three appropriations were in a deficit position: the FY 1985 Missile Procurement appropriation, the FYs 1986 and 1987 Air Force Reserve Military Construction Appropriations, and the merged account of the Air National Guard Military Construction appropriation. All those deficits had been previously identified by Defense Finance and Accounting Service (DFAS)-Denver Center accountants and were either being reviewed or investigated for potential violations of the Antideficiency Act. We therefore focused our efforts on the expired year financial positions for the unclassified elements of two of the largest Air Force appropriations. One was the RDT&E appropriation, FYs 1988 through 1991, and the other was the Aircraft Procurement appropriation, FYs 1987 through 1990. We reviewed factors influencing the accuracy of recorded obligation data in each of the four expired years of those two appropriations. We also interviewed representatives of program management offices for the major activities funded by those appropriations and reviewed the representatives' current and planned requests for upward obligation adjustments.

We performed this financial-related audit from November 1992 through May 1993 in accordance with the auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, Department of Defense, and accordingly included such tests of internal controls as were considered necessary. Appendix D lists the organizations visited or contacted during the audit.

Internal Controls

Controls Assessed. We evaluated internal controls relating to compliance with laws, regulations, and procedures governing budget execution and accounting for the fund status of Air Force expired year appropriations.

Weaknesses Identified. Absence of internal controls constituted material internal control weaknesses as defined by OMB Circular No. A-123 and DoD Directive 5010.38. Specifically, internal controls were not adequate to correctly report the financial position of Air Force appropriations (Finding A), to track the Air Force use of funds (Finding B), or to value Air Force-managed receivables (appropriation refunds) in fund control records and financial reports (Finding C). Recommendations A.1. and A.3., B.1., B.2., C.1., and C.2., if

implemented, will aid in correcting the control weaknesses. A $9.8 million monetary benefit can be realized by implementing the internal control related to Recommendation A.3.d. It is described in Appendix C, "Summary of Potential Benefits Resulting from Audit." A copy of the report will be provided to the senior DoD Comptroller, Defense Finance and Accounting Service, and Air Force officials responsible for internal controls.

DoD Internal Management Control Program. As part of our audit, we evaluated the Air Force implementation of the Internal Management Control (IMC) program as it pertained to the audit objectives. The DFAS-Denver Center reported in its October 1992 IMC report that its General Accounting and Finance System was "non-compliant" because of material weaknesses in general ledger control and financial reporting requirements. No material weaknesses were reported, however, pertaining to accounting for receivables. The Center also reported that its Departmental On-Line Accounting and Reporting System and the Air Force's Central Procurement and Accounting System " . . . were substantially in compliance with General Accounting Office accounting principles, standards, and related requirements." The report acknowledged, however, a continuing material weakness dealing with inaccurate and unreliable contract accounting. Specifically, controls were not adequate to ensure that contract and payment data were recorded in the accounting systems accurately and in a timely manner. Management's report did not address the effect the control weakness had on the potential for violating the Antideficiency Act. We were unable to determine why management's Internal Management Control program failed to prevent all weaknesses identified or to detect some weaknesses we identified.

Prior Audits and Other Reviews

Both the General Accounting Office (GAO) and the Inspector General, Department of Defense, have issued reports on issues relating to implementing Public Law 101-510 and Public Law 102-484, as well as relevant expired year appropriation accounting practices.

GAO Reports. The GAO issued two reports on topics related to those in this audit.

o In GAO/AFMD-93-7 (OSD Case No. 9279), "Agencies' Actions to Eliminate 'M' Accounts and Merged Surplus Authority," April 2, 1993, the GAO concluded that the DoD had serious problems in implementing the law and indicated in part that the DoD may have overobligated Air Force expired accounts by as much as $46.0 million and charged the overobligations to current appropriations, in violation of the Antideficiency Act. The DoD did not agree with the GAO position.

o In GAO/AFMD-91-42 (OSD Case No. 8736), "Air Force Systems Command is Unaware of the Status of Negative Unliquidated Obligations," August 29, 1991, the GAO observed that weaknesses existed in managing

negative unliquidated obligations in the Air Force. The DoD agreed with the GAO recommendations.

Inspector General, Department of Defense, Reports. The Inspector General issued four reports.

o Report No. 94-036, "Financial Status of Navy Expired Year Appropriations," February 10, 1994, concluded that though the Navy was attempting to comply with appropriation law, four apparent and uninvestigated funding deficiencies totaling $17.5 million occurred in three line-item appropriated major procurement programs of the Weapons Procurement appropriation; the Weapons and Aircraft Procurement appropriations had potential funding deficiencies that could total $168.4 million; and unfunded claims of $861.6 million were pending in the Research, Development, Test, and Evaluation appropriation that could cause fund deficiencies. Also, Navy records did not reflect the status of expired year appropriations because $6.1 million in charges to current appropriations had to be reversed and charged to correct prior year appropriations and almost $1.0 billion in unmatched disbursements needed to be reconciled. The Navy's Director of Budget and Reports concurred with the findings that apparent funding deficiencies had occurred in procurement programs and potential funding deficiencies could occur if claims became actual liabilities. However, the Director did not concur with recommendations dealing with accounting for contingent liabilities and charges for contract modifications. Those issues are still pending. The Defense Finance and Accounting Service concurred in principle, stating that procedures were being developed to create a more reliable accounting and reporting structure.

o Report No. 93-053, "Missile Procurement Appropriations, Air Force," February 12, 1993, concluded that the Air Force Missile Procurement appropriations for FYs 1987 and 1988 were deficient and that legislative relief was needed. The report identified causes of material misstatements in the accounting records and cited several funding issues and accounting problems that had to be resolved before the value of the deficiencies could be calculated. One funding issue addressed the appropriateness of DoD Comptroller guidance that allowed current funds to be used to finance cost growth for within-scope contract changes pertaining to other fiscal years. This issue is still pending. The Deputy DoD Comptroller (Management Systems) concurred or partially concurred with all remaining recommendations.

o Report No. 92-064, "Titan IV Program," March 13, 1992, concluded, among other matters, that progress payments for the Titan IV contract were made from a predetermined sequence of appropriations rather than from the appropriation that reflected the type of work done. The DoD Comptroller, in response to pertinent recommendations, agreed to revise the DoD Manual 7220.9, "DoD Accounting Manual," October 1983 (DoD Accounting Manual), to require assurance that sufficient undisbursed fund balances are available on the accounting record before a payment is made.

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

records did not accurately reflect the status of accounts. The audit identified overobligated and overexpended Air Force merged accounts and material levels of negative unliquidated obligations. The DoD accounting records were deemed so inaccurate that the DoD Comptroller believed it necessary to seek restorations from the Department of the Treasury of the United States (Treasury) to cover unrecorded obligations identified by the Military Departments. The Deputy DoD Comptroller (Management Systems) generally agreed with the report.

Part II - Findings and Recommendations

Finding A. Status of Expired Year Appropriations

The FY 1991 RDT&E and the FY 1989 Aircraft Procurement expired year appropriations were potentially deficient $14.1 million and $21.1 million, respectively. Also, the FY 1990 expired year appropriations for RDT&E and Aircraft Procurement were at risk of being deficient. The deficits in the 1989 and 1991 appropriations occurred because accounting records contained $48.7 million of gross errors that created net overstatements (1991 - $33.9 million) and understatements (1989 - $5.0 million) of available funds; erroneous guidance issued by the DoD Comptroller was followed; and the costs of pending upward obligation adjustments identified during the audit were included. The FY 1990 appropriations were at risk of being deficit because of similar conditions. Also, other accounting errors with a gross value of $61.3 million negatively influenced all those appropriations. In addition, over $1.8 billion of uncorrected erroneous accounting entries dealing with negative unliquidated obligations and progress payments were embedded in the accounting system and further distorted the reliability of fund reports. Those conditions materially misstated the financial status of the appropriations in fund status reports and seriously impaired the ability of Air Force fund managers to make knowledgeable expired year financial decisions. As a result, potential violations of the Antideficiency Act have occurred, and more are likely to occur in the future.

Background

A deficit or shortfall exists when the value of actual and known potential obligations exceeds the amount of an appropriation. If sufficient funds are not available in an appropriation to cover actual obligations, a deficiency occurs, which violates the Antideficiency Act. Projecting the deficit potential in expired year appropriations as of April 30, 1993, involved completing two tasks: first, examining the accounting records at a selected point in time, in this case December 31, 1992, to gain assurance that obligation data were accurately recorded and reflected in the unobligated balances shown in fund status reports; and, then, updating those unobligated balances by identifying known requirements that have yet to be recorded as obligations, in this case those known as of April 30, 1993.

Fund Accounting Records. Air Force fund accounting systems (General Accounting and Finance System, Central Procurement and Accounting System, and Departmental On-Line Accounting and Reporting System) track both direct and reimbursable obligations incurred under the authority of specific programs in a fixed appropriation. Direct obligations involve buying goods or services directly supporting the specified purpose of the appropriation. Reimbursable obligations are incurred to buy goods or services that are sold to others (such as

appropriations and individuals) under the provisions of the appropriation. Revenues realized from those sales offset the costs represented by the reimbursable obligations.

Reimbursable Programs. Reimbursable programs of the DoD for expired fiscal years of multiple year appropriations, such as the Air Force RDT&E and Aircraft Procurement appropriations, require reimbursable obligations for goods and services acquired for sale to be in balance with customer sales orders for those same commodities. According to guidance issued by the DoD Comptroller in a September 30, 1985, letter, "Accounting for Reimbursements in Multiple Year Appropriation Accounts," reimbursable unobligated authority shall not remain in an appropriation account at expiration. To describe the concept in accounting terms, amounts recorded in the expired year appropriations as reimbursable obligations to acquire goods or services must reconcile with amounts recorded for validated unfilled and filled customer orders to buy those same goods or services at the end of a fiscal year (September 30). Differences between the reimbursable obligations and the reimbursable orders, if uncorrected, can lead to violations of the Antideficiency Act.

DoD Comptroller Guidance. On December 10, 1990, the DoD Comptroller issued guidance to implement Public Law 101-510. That guidance correctly stated that a contract change is a change under which a contractor is required to perform additional work and does not include adjustments to pay claims or increases under an escalation clause. On June 13, 1991, the DoD Comptroller issued a memorandum, "Revised DoD Guidance on Accounting for Expired Accounts, Including 'M' and Merged Surplus Accounts." That memorandum extended the definition of a contract change to " . . . also include changes in scope as well as any other change that results in additional contractor billable costs." It also provided that obligation adjustments such as incentive or award fees and price inflation (escalation or economic price adjustments) are not considered contract changes. The DoD Comptroller, on April 20, 1992, reversed the June 13, 1991, guidance by issuing another memorandum, "DoD accounting Guidance for Contract Changes." That guidance reiterated the long-standing rule that required within-scope contract changes to be funded from appropriate available expired year appropriation accounts. The revised guidance stated that " . . . the policy regarding the charging of contract changes shall be the same policy in effect prior to June 13, 1991," and that DoD Components were to follow the provisions of Chapter 25 of the DoD Accounting Manual. The revised accounting policy reconfirmed that within-scope adjustments to prior year contracts must be obligated against available balances of the fiscal year appropriations that financed the original contract. The revised guidance did not, however, address the need to reverse any transactions that had been incorrectly made under the June 13, 1991, guidance.

Negative Unliquidated Obligations. A Negative Unliquidated Obligation (NULO) is essentially an error that results when a payment has not been matched to a related unliquidated obligation. A NULO occurs when bills are paid using a contracting system representation of the accounting record at one location, and that representation does not agree with data in the actual accounting record at another location. When such differences occur, the

records in each system must be reconciled to correctly account for the transaction. Citing a wrong fiscal year, contract, contract line, appropriation, or agency when making the payment may cause the errors. The NULOs may also be duplicate vendor payments that must be recovered or be instances of fraud. For the most part, NULOs represent the Air Force version of "unmatched disbursements."

Progress Payments. Central disbursing functions make progress payments to contractors based on work performed under the terms specified in contracts. The payments are ultimately settled (or liquidated) when the contractor's product is accepted by the U.S. Government. Like NULOs, progress payments have been made at one location using a contracting system representation of funding data in the contract, without reference to the actual accounting record at another location. Consequently, payments have been charged to accounting lines where sufficient funds are not available to match or absorb the payment. Similarly, when the U.S. Government eventually receives the product or service for which progress payments have been made, a settlement or liquidating transaction is made in the accounting record to clear the related unsettled progress payment. Negative obligation values are created when settlement transactions are recorded on accounting lines where a previously made progress payment has either not been recorded, or has been recorded in an amount that is less than the settlement. When such differences occur, the records in each system must be reconciled to correctly account for the transaction. The errors may be caused when either the payment cites, or the accounting record reflects, a wrong fiscal year, contract, contract line, appropriation, or agency. Another cause could be simple error misapportioning the value of a payment across open accounting lines.

Expired Year Appropriations

Four of the eight fiscal years of the RDT&E and Aircraft Procurement expired year appropriations have serious financial problems.

Our assessment of the financial status of the RDT&E and Aircraft Procurement expired year appropriations was based on an evaluation of obligation and commitment data entered in the accounting system on December 31, 1992, and a tabulation of known upward obligation adjustment activity that had yet to enter the accounting system projected through April 30, 1993. The pending upward obligation adjustments were gathered during our review and validated in discussions with responsible budget officials and visits to 53 financial representatives of Air Force systems project offices/divisions.

Shortfalls. According to fund accounting data reflecting the effects of upward adjustments either pending or occurring through April 30, 1993, and accounting and funding errors identified during the audit, the FY 1991 RDT&E and the FY 1989 Aircraft Procurement expired year appropriations were deficit $14.1 million and $21.1 million, respectively. As a result, both appropriations were in potential violation of the Antideficiency Act. Also, those same factors

negatively influenced the very small available fund balances in the FY 1990 expired year RDT&E and Aircraft Procurement appropriations. We believe those appropriations are at high risk of being deficient in the very near future. Given the size of upward obligation adjustments in those appropriations, operating margins are so small that significant increases may not be able to be absorbed in the future without invoking Public Law 102-484 and reporting related violations of the Antideficiency Act. Appropriation status for the two appropriations is shown in Table 1.

Table 1. Status of RDT&E and Aircraft Procurement Expired Year Appropriations By Fiscal Year - April 30, 1993
($ in millions)

RDT&E	1987	1988	1989	1990	1991	Total
Upward Adjustments Pending (4/30/93)	N/A	$ (1.0)	$ 6.3	$17.4	$ 40.7	$63.4
Accounting Errors (12/31/92)	N/A	(10.5)	1.4	21.0	33.9	$45.8
Net Change	N/A	$(11.5)	$ 7.7	$38.4	$ 74.6	
Unobligated Balance 12/31/92	N/A	15.0	40.7	41.7	60.5	
(Deficit)/Surplus 4/30/93	N/A	$ 26.5	$33.0	$ 3.3	$(14.1)	
Aircraft Procurement						
Upward Adjustments Pending (4/30/93)	$ 46.2	$ 27.2	$ 41.8	$157.1	N/A	$272.3
Accounting Errors (12/31/92)	(1.8)	0.3	(5.0)	9.1	N/A	$2.6
Erroneous Comptroller Guidance	5.2	6.8	8.8	(2.6)	N/A	$18.2
Net Change	$ 49.6	$ 34.3	$ 45.6	$163.6	N/A	
Unobligated Balance 12/31/92	190.4	114.7	24.5	165.8	N/A	
(Deficit)/Surplus 4/30/93	$140.8	$ 80.4	$(21.1)	$ 2.2	N/A	

The risk of future funding shortfalls in all eight fiscal years of those appropriations is further increased by over $1.8 billion in unresolved erroneous accounting entries recorded in the Air Force fund accounting system. Those errors deal with "Negative Unliquidated Obligations" and unabsorbed and unsettled "Progress Payments."

Upward Obligation Adjustments. Upward obligation adjustments for RDT&E and Aircraft Procurement appropriations totaling $335.7 million had not yet been recorded as obligations. Appendix A shows the values of the pending upward obligation adjustments identified during our review. The values are by appropriation, weapon system or system or purpose, and fiscal year. Some of those adjustments were awaiting formal Major Command or Air Force approval, while others were being prepared for submission. Still

other adjustments were recorded as commitments (administrative reservations of funds) in the accounting records. Those adjustments, however, did represent known obligations where, for example, system project offices/divisions were negotiating final costs before seeking formal Major Command and Air Force fund approval of the adjustment. During the audit, we did not identify any potential upward obligation adjustment that was not previously known to both responsible budget officials and system project financial representatives.

Accounting Errors. Specific accounting errors identified during our visits to Defense Accounting Offices (DAOs) totaled over $110.0 million. Table 2 (below) categorizes the errors by type, appropriation, and fiscal year, as of December 31, 1992. Negative values, those that decrease available funds, are shown in parentheses. When DAOs correct the errors, the fund status of the appropriations will be both positively and negatively affected. The most significant error condition occurred at Los Angeles Air Force Base where the reimbursable program was out of balance, resulting in significant overstatements of revenue potential in the 1990 and 1991 RDT&E appropriations.

Table 2. Accounting Errors By Appropriation, Category and Fiscal Year, December 31, 1992
($ in millions)

RDT&E	1987	1988	1989	1990	1991	Total
Reimbursement Program	N/A	$ (1.8)	$(3.8)	$(21.5)	$(35.0)	$(62.1)
Customer Orders	N/A	15.2	3.1	0.8	1.0	20.1
Refunds Receivable	N/A	(2.9)	(0.7)	(0.3)	0	(3.9)
Temporary Obligations	N/A	0	0	0	0.1	0.1
Totals*	N/A	$ 10.5	$(1.4)	$(21.0)	$(33.9)	$(45.8)
Aircraft Procurement						
Reimbursement Program	$0	$0	$(3.8)	$(7.1)	N/A	$(10.9)
Unearned Revenue	1.8	(0.3)	8.3	0	N/A	9.8
Customer Orders	0	0	0	(2.0)	N/A	(2.0)
Temporary Obligations	0	0	0.5	0	N/A	0.5
Totals*	$1.8	$(0.3)	$5.0	$(9.1)	N/A	$ (2.6)

*The gross value of individual errors that are reflected in these totals equals $110.0 million.

Reimbursable Programs. An unbalanced condition was reported in reimbursement data presented for the expired year RDT&E and Aircraft Procurement appropriations in the Air Force Appropriation Status Reports, September 30, 1992 (the end of fiscal year 1992). That condition had not been corrected by December 31, 1992. The amounts recorded for customer orders (orders to buy goods and services) exceeded the amounts recorded for reimbursable obligations (obligations incurred to acquire goods and services). The excess of orders overstated the unobligated balances in the RDT&E and Aircraft Procurement appropriations by $62.1 million and $10.9 million, respectively. Those overstatements erroneously made money available to finance obligation growth in those appropriations. The majority of the

differences occurred at Los Angeles Air Force Base, the only DAO visited that had not attempted to reconcile the reimbursable program. Not reconciling differences in the reimbursable programs of expired year appropriations will misstate unobligated appropriation balances.

Customer Orders. Customer orders worth $20.1 million in the expired year RDT&E appropriations were misvalued. Those orders had erroneous "negative" values that reduced future revenue potential and unobligated fund balances at Los Angeles Air Force Base. Also, earned customer orders for the Aircraft Procurement appropriation were overstated by a $2.0 million accounting error at the San Antonio Air Logistics Center. Both error conditions had been recorded in the accounting records for an extensive period of time and should have been detected by DAO personnel through periodic validation. Reversing those errors would increase unobligated balances in the RDT&E appropriation and decrease unobligated balances in the Aircraft Procurement appropriation.

Refunds Receivable. The DAO at Hanscom Air Force Base overstated the value of reported refunds receivable by $3.9 million. The overstatement occurred when the DAO duplicated the value of expired year refunds receivable in fund status reports submitted to the DFAS-Denver Center. Appropriation refunds receivable increase unobligated fund balances. When collected, they will create budgetary resources that can be used to finance expired year obligation growth.

Unearned Revenues. Security assistance training revenues were incorrectly reported as exceeding related costs by $9.8 million. The revenue overstatement occurred when the Air Force Security Assistance Training Group misreported collections of revenue to the DFAS-Denver Center. DFAS-Denver Center accounting personnel did not follow established internal controls to detect the incorrectly reported collections. If the overstatement had not been detected, amounts would have been transferred to the Treasury as an overcollection of costs. Instances of true unearned revenues occur when money has been received but goods or services sold have yet to be delivered. Unearned revenues reduce unobligated fund balances. Therefore, correcting the $9.8 million unearned revenue overstatement will make more money available in the Aircraft Procurement appropriation to finance obligation growth.

Temporary Obligations. Temporary obligating instruments known in the Air Force as Miscellaneous Obligation/Reimbursement Documents are prepared to record obligations and reimbursements in accounting records pending the receipt of actual obligation/reimbursement documents. Limited tests at San Antonio Air Logistics Center identified one instrument worth $500,000 in the Aircraft Procurement appropriation that was unsupported, while two instruments totaling $100,000 at Eglin Air Force Base, when checked to their sources, proved to be invalid.

DoD Comptroller Guidance. From June 13, 1991, until April 22, 1992, upward obligation adjustments for within-scope contract changes properly chargeable to expired year appropriation accounts were incorrectly funded with $18.2 million from then-current Aircraft Procurement appropriation accounts

(Table 1). The DoD Comptroller guidance that was operative during that period was contrary to law. No authority existed for the use of current rather than expired year funds to finance within-scope upward obligation adjustments. Reversing the transactions will reduce expired year unobligated balances in FYs 1987, 1988, and 1989 of the Aircraft Procurement appropriation by $20.8 million and increase the FY 1990 balance in the same appropriation by $2.6 million. In the latter case, FY 1990 funds were used when that appropriation was current to finance obligation growth in other expired years. Reversal will therefore increase the charges to those affected years and restore funds to FY 1990.

Validating Customer Orders and Obligations. The advanced age of many backlogged customer orders and temporary obligating instruments often indicates questionable validity, especially in the expired years of an appropriation. Invalid customer orders erroneously increase available funds, while invalid temporary obligating instruments erroneously decrease available funds.

Aged Customer Orders. As of December 31, 1992, Los Angeles Air Force Base DAO personnel had not validated $330.8 million of reimbursable orders for the expired year RDT&E appropriations that were unfilled or that were filled, but uncollected. Of that amount, $122.3 million in RDT&E unfilled orders had no activity in over a year. No effort had been made to determine if the orders were still valid. The DAO claimed it lacked manpower to validate the old orders. Additionally, filled but uncollected orders totaling $31.0 million that were earned in the RDT&E appropriations over 1 year ago had not been collected. Unobligated balances will be overstated to the extent that old orders are determined to be invalid, and the collection of old earned orders will favorably impact the Treasury cash position. Table 3 shows the distribution of that $153.3 million by fiscal year.

Table 3. Over 1-Year Old Unvalidated RDT&E Appropriation Unfilled and Uncollected Reimbursable Orders by Fiscal Year, December 31, 1992
($ in millions)

	1988	1989	1990	1991	Total
Unfilled Orders	$10.5	$20.5	$25.0	$66.3	$122.3
Uncollected Orders	20.5	1.4	9.1	0	31.0
Totals	$31.0	$21.9	$34.1	$66.3	$153.3

Aged Temporary Obligating Instruments. Because of their temporary nature, the validity of temporary obligating instruments becomes more questionable as they age. As of December 31, 1992, 447 of the 531 temporary obligating documents that were recorded in the accounting records for the expired years of the appropriations reviewed were over 1 year old. Those more than 1 year old were valued at $55.6 million. A judgmental test of 92 of those more than 1 year old having the largest dollar values identified 82 instruments worth a total of $38.2 million. For those 82, accounting personnel had never completed reviews to confirm their validity (71 in the RDT&E expired year

appropriations worth $31.2 million and 11 in the Aircraft Procurement expired year appropriations worth $7.0 million). Those unvalidated obligating documents had an average age of 2.7 years. Those conditions existed at every location visited, except the San Antonio Air Logistics Center. We concluded that material sums recorded as temporary obligations may not be valid, and unobligated fund balances may be understated. Therefore, validation may provide a potential source of funds to the appropriations.

Other Uncorrected Erroneous Accounting Entries Impacting Deficit Determinations. The accounting records for obligations in those expired year appropriations had over $1.8 billion of uncorrected erroneous accounting entries in the form of NULOs and unmatched and incorrectly settled progress payments. Basically, the erroneous entries occurred whenever a disbursing station made a payment against a contract line for which the accounting station's records showed that money was not sufficient or available to cover the charge. Those unresolved errors affect the accuracy and reliability of unobligated balances shown in status of fund reports. Distortions of this magnitude seriously impair the ability of financial managers to make knowledgeable funding decisions and to avoid violations of the Antideficiency Act. Details of the unresolved $1.8 billion in erroneous accounting entries are in Table 4.

Table 4. Values of Unresolved Accounting Errors
($ in millions)

Negative Unliquidated Obligations		$962.5
Progress Payments:		
Unmatched	$582.9	
Unsettled	268.2	851.1
Total		$1,813.6

To put the errors in perspective, Table 1, Appendix B, compares the erroneous entries by appropriation and fiscal year to related amounts of available funds.

Negative Unliquidated Obligations. The expired year appropriations as of December 31, 1992, contained NULOs totaling almost $1.0 billion (see Table 4). Those NULOS are presently resolved through a manual comparison and reconciliation of information recorded in systems at the accounting function and the paying station. The process is very labor intensive and involves the matching of two records and much research to determine what happened (often years earlier). Accordingly, few accounting functions are attempting to complete the directed reconciliation process, while others are not doing reconciliations at all. All accounting functions claim the process is too labor intensive. The DoD Comptroller has recognized that the NULO problem seriously impacts the quality of financial management and has directed action to correct the situation. The status of those initiatives as they affect the Air Force are described in Appendix B.

Progress Payments. As of December 31, 1992, the accounting records for the expired year RDT&E and Aircraft Procurement appropriations contained

$851.1 million of unresolved errors relating to the management of progress payments as illustrated in Table 4.

Unmatched Progress Payments. Progress payments totaling $582.9 million were recorded against accounting lines that did not have sufficient funds to absorb the charges. That occurred because the payments were made without checking the fund status on the source accounting records. Table 2, Appendix B, distributes the amount of those payments by appropriation and fiscal year. If the payment cites the wrong appropriation, fiscal year, or agency, the value of the unabsorbed progress payment reduces obligations in the appropriation, which erroneously increases available funds.

Settling Progress Payments. Progress payment settlements totaling $268.2 million were recorded as open transactions on accounting lines that had no outstanding progress payments. The settlement transactions, which should have corresponded to the distribution of previous progress payments, were made without reference to the source accounting record. Table 3, Appendix B, shows the distribution of those transactions by appropriation and fiscal year. Settlement transactions that are not matched to their related unsettled progress payments may be incorrectly recorded in the wrong fiscal year or appropriation, and therefore can misstate the unobligated fund balances of the affected appropriations.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Comptroller of the Department of Defense direct the Air Force to reverse all charges made to current funds for contract within-scope upward obligation adjustments that are properly chargeable to the expired year Research, Development, Test, and Evaluation and Aircraft Procurement appropriation accounts.

2. We recommend that the Assistant Secretary of the Air Force (Financial Management) investigate the deficits in the Research, Development, Test, and Evaluation and Aircraft Procurement appropriations; fix responsibility; and report violations of the Antideficiency Act as required by DoD Directive 7200.1.

3. We recommend that the Director, Defense Finance and Accounting Service-Denver Center:

a. Evaluate and appropriately correct the capability of the Defense Accounting Office at Los Angeles Air Force Base to maintain and provide accurate reimbursable transaction fund accounting data to the Air Force financial managers.

b. Direct Defense Accounting Offices providing fund accounting service to the Air Force to regularly validate temporary obligating instruments. Those temporary obligating instruments that are the oldest should be validated first.

c. Require all Defense Accounting Offices serving Air Force fiscal entities to use prescribed manual reconciliation methods to correct erroneous negative unliquidated obligation and progress payment accounting entries until such time as other Comptroller of the Department of Defense and Defense Finance and Accounting Service curative initiatives are implemented.

d. Correct the net $9.8 million overstatement of unearned revenue relating to security assistance training and correspondingly adjust the reimbursable programs of the Aircraft Procurement appropriations for FYs 1987 through 1989.

Management Comments. We have not received comments on the foregoing recommendations from the DoD Comptroller, the Assistant Secretary of the Air Force (Financial Management), and the Director, Defense Finance and Accounting Service.

Audit Response. DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, all addressees must provide final comments as follows. Comments must be received by May 17, 1994.

RESPONSE REQUIREMENTS FOR EACH RECOMMENDATION

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

		Response Should Cover			
Number	Addressee	Concur Nonconcur	Proposed Action	Completion Date	Related Issues[1]
1.	DoD Comptroller	X	X	X	IC
2.	SAF/FM[2]	X	X	X	
3.a.	DFAS	X	X	X	IC
3.b.	DFAS	X	X	X	IC
3.c.	DFAS	X	X	X	IC
3.d.	DFAS	X	X	X	IC, M

[1]IC = material internal control weakness; M = monetary benefit.
[2]Assistant Secretary of the Air Force (Financial Management).

Finding B. Using Current Funds for Merged Account Obligations

The DFAS-Denver Center did not track the Air Force use of $208.6 million in current funds to finance upward obligation adjustments to merged accounts against the unobligated expired balances of original appropriations and within the 1 percent limit specified by Public Law 101-510. That condition occurred because the DFAS-Denver Center had no procedures in place to track such use. Absence of a means to track, and therefore control, funds used to finance the obligations may contribute to possible violations of the Antideficiency Act and Public Law 101-510.

Complying with Fund Limitations

The DFAS-Denver Center had not developed a means to control and track the Air Force use of $208.6 million in current funds for merged account upward obligation adjustments to comply with the provisions of the Antideficiency Act and Public Law 101-510. The DFAS-Denver Center had developed means to track the use of current funds to pay canceled and merged account obligations and had reported that use in monthly Reports on Budget Execution. For example, on April 30, 1993, the DFAS-Denver Center reported the use of Air Force current funds totaling $54.5 million to pay canceled and merged account obligations in various fiscal years of 10 appropriations.

At that same time, however, as Table 5 illustrates, Air Force officials had approved the use of current funds totaling $208.6 million to finance merged account upward obligation adjustments. Fund accounting systems of the DFAS-Denver Center have not been modified to track those resulting obligations against related merged surplus account unobligated balances to assure compliance with the Antideficiency Act. As a result, that absence of a means to control and track the obligations may contribute to violations of the Antideficiency Act and Public Law 101-510.

Table 5. Upward Adjustments Financed with Current Funds
($ in millions)

Appropriation	Under DoD Authority	Under Air Force Direction: Before 10/1/92[1]	Under Air Force Direction: After 9/30/92[1]	Totals[2]
Aircraft Procurement	$23.3	$7.8	$138.9	$169.9
Missile Procurement	3.2	.5	.5	4.3
Other Procurement	10.0	6.7	0	16.7
Operation & Maintenance	2.7	0	0	2.7
RDT&E	4.9	9.7	0	14.5
Family Housing	.5	0	0	.5
Totals[2]	$44.6	$24.6	$139.4	$208.6
Number of Adjustments	44	17	16	77

[1]Section 1004, Public Law 102-484, effective October 1, 1992.
[2]Differences are due to rounding.

Air Force Military Construction Merged Account

In our draft of this report, we criticized the Air Force for using available Military Construction appropriation current year funds totaling $6.6 million to finance adjustments to merged account obligations. Those adjustments appeared to cause the original appropriation for the Military Construction merged account to be exceeded. We correspondingly recommended that the Air Force report a violation of the Antideficiency Act. Subsequently, in discussions with officials at the DFAS-Denver Center and the Office of the Deputy General Counsel (Inspector General), we established that the Air Force obligation adjustments in question pertained to the settlement of meritorious contractor claims. Therefore, the use of Military Construction appropriation current funds was authorized by statute, specifically 10 U.S.C. 2863. The statute provides that:

> Notwithstanding any other provision of law, the Secretary concerned may pay meritorious contractor claims that arise under military construction or family housing contracts. The Secretary of Defense, with respect to a Defense Agency, or the Secretary of a military department may use for such purposes any unobligated funds appropriated to such department and available for military construction or family housing construction as the case may be.

This statute was added to Title 10 by Section 2303 of the National Defense Authorization Act for Fiscal Years 1988 and 1989, December 4, 1987 (Public Law 100-180). Therefore, we have withdrawn this part of the finding and deleted the related recommendation.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Finance and Accounting Service-Denver Center, institute procedures to:

1. Track and report all current funds used to finance obligations in merged accounts.

2. Control current funds used to finance obligations in merged accounts within merged surplus account appropriation limits and within the 1 percent limitation set by Public Law 101-510.

Management Comments. We have not received comments on the foregoing recommendations from the Director, Defense Finance and Accounting Service.

Audit Response. DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, all addressees must provide final comments as follows. Comments must be received by May 17, 1994.

RESPONSE REQUIREMENTS FOR EACH RECOMMENDATION

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

		Response Should Cover			
Number	Addressee	Concur Nonconcur	Proposed Action	Completion Date	Related Issues*
1.	DFAS	X	X	X	IC
2.	DFAS	X	X	X	IC

*IC = material internal control weakness.

Finding C. Refunds Receivable

The DFAS-Denver Center permitted uncollected refunds receivable worth $40.9 million to be used to finance obligation growth. Also, Air Force and DFAS-Denver Center managers recognized questionable Air Force refunds receivable worth $135.0 million for matters in litigation and used them as budgetary resources. Further, $432.2 million of refunds deemed to be uncollectible were not disclosed in Reports on Budget Execution. Those conditions occurred because Air Force practice was contrary to that mandated by the DoD. If the receivables are not collected, appropriation deficits and violations of the Antideficiency Act may occur. Not disclosing refunds deemed to be uncollectible distorted the budgetary perception of Air Force debt management practices.

Background

In Reports on Budget Execution dated May 31, 1993, the DFAS-Denver Center reported that uncollected refunds receivable totaling $571.5 million existed in 14 Air Force appropriations. The GAO's "Policy and Procedures Manual for Guidance of Federal Agencies," gives guidance on collections that may be credited to appropriations and fund accounts. The following paragraphs summarize this guidance and describe DoD and Air Force accounting practices concerning the use of refunds receivable as budgetary resources.

GAO Fiscal Guidance. Title 7, "Fiscal Guidance," of the GAO's "Policy and Procedures Manual for Guidance of Federal Agencies," February 1990, states that "Collections which may be credited to appropriation and fund accounts fall within two general classifications: refunds and reimbursements." Those are defined as follows.

> 1. Refunds are returns of advances, collections for overpayments, adjustments for previous amounts disbursed, or recovery of erroneous disbursements from appropriation or fund accounts that are directly related to, and are reductions of, previously recorded payments from the accounts. Even in the absence of express statutory authority, refunds may be deposited to the credit of the appropriation or fund charged with the original expenditures or the successor account (31 U.S.C. 1552(b)).
>
> 2. Reimbursements (which may be designated as fees, proceeds, etc.) are sums received by the government in payment for commodities sold or services furnished, either to the public or to another government account. Reimbursement may be deposited to the credit of an appropriation or fund account when authorized by law.

The GAO addresses collection documentation with the following guidance.

> Collections that are credited to appropriation . . . accounts must be proper and be authorized by law or appropriate regulations. Agencies must be able to produce references to such authorizations if they are called for in connection with audit of the accounts. Agency collection records pertaining to refunds . . . will include descriptions of transactions sufficient for identifying the source of, or reason for the collection.

The GAO guidance also provides that:

> Unless otherwise authorized by law, refunds should be deposited to the credit of the appropriation account initially charged with the overpayment and, if the account has expired for the purpose of incurring new obligations, to the credit of the successor account (31 U.S.C. 1552(b)).

Public Law 101-510, as summarily described in the introduction of this report (Part I), changed the account closing procedures in 31 U.S.C. 1552. Now, all fixed term appropriation accounts have a defined closing date. Specifically:

> (b) Collections authorized or required to be credited to an appropriation account, but not received before the closing of that account. . . shall be deposited in the Treasury as miscellaneous receipts.

Fund Accounting Practices. Significant differences existed between DoD and Air Force practices on accounting for appropriations refunds.

DoD Practice. DoD fund control and reporting practices for appropriation refunds receivable are presented in chapters 24, 33, 93, and 94 of the DoD Accounting Manual. Chapter 33 describes refunds receivable as refunds to appropriations that are due but uncollected. Chapter 24 discusses "Installation-Level Budgetary Resources," and prescribes the general ledger entries components must use to account for appropriation refunds receivable. When those entries are followed, refunds receivable will not be considered as budgetary resources until collected. Chapters 93 and 94 present instructions that are to be used to present uncollected appropriation refunds in the Report on Budget Execution and in the Report on Financial Position, respectively. Those chapters also stipulate that appropriation refunds receivable be recorded at best estimate of value where those refunds receivable represent claims in litigation in reports on accounts receivable due from the public. The manual specifies neither who is to make the best estimate of value, nor criteria that is to be used to make an estimate.

Air Force Practice. Air Force fund accounting and reporting practices for appropriation refunds receivable are presented in Air Force Regulation 177-101, chapter 21. That regulation is now administered by the DFAS-Denver Center. Air Force practice required that only supported and collectible refunds receivable were to be recorded in fund control records. No controls or accounting entries were established to prevent those uncollected refunds from being used as budgetary resources. Air Force refunds receivable considered

uncollectible were to be manually tracked, but were to be excluded from fund control reports. Field accounting offices manually accumulated balances of uncollectible receivables and reported them by appropriation each month to the DFAS-Denver Center for "visibility" purposes only. The Air Force practice existed before the DFAS-Denver Center assumed responsibility for Air Force finance and accounting matters. The DFAS-Denver Center has no specific guidance on the treatment of appropriation refunds for matters in litigation.

Refunds As Budgetary Resources

Contrary to practice mandated by the DoD, the DFAS-Denver Center permitted uncollected refunds totaling $40.9 million to be used to finance obligation growth. Inappropriate accounting for uncollected refunds and the absence of controls to prevent obligations and/or expenditures in excess of available appropriations could result in violations of the Antideficiency Act (31 U.S.C. 1341). The appropriations in Table 6 had obligations in the amounts shown that were financed by uncollected, but not necessarily uncollectible, refunds receivable.

Table 6. Refunds Used as Budgetary Resources[1]
May 31, 1993
($ in millions)

Appropriation	Fiscal Year[2]	Amount
Aircraft Procurement	M	$31.1
Missile Procurement	1988	3.3
	1987	2.8
Military Construction	1987	0.5
Military Personnel	1992	1.7
	1991	0.6
	1990	0.3
	1989	0.2
	M	0.3
Reserve Construction	M	0.1
National Guard Personnel	M	0.1
Total		$40.9[3]

[1]Amounts represent the differences obtained when refunds receivable are greater than the unobligated balances presented in Reports on Budget Execution, DD Form 1176.
[2]M = Merged Account.
[3]Detail exceeds total. Differences are due to rounding.

Because of the long-standing practice of the Air Force, existing fund accounting systems were not designed to include controls to prevent the use of refunds to finance obligation growth. In February 1993, we advised DFAS-Denver Center officials that the Air Force practice materially differed from that mandated by the DoD practice. The DFAS-Denver Center officials indicated they were not aware of the DoD practice. After confirming the DoD practice with

Headquarters, DFAS, in July 1993, DFAS-Denver Center officials directed DFAS field entities that account for Air Force appropriations to begin complying with the DoD refunds receivable practice effective October 1, 1993. The DFAS-Denver Center officials did not anticipate being able to make the necessary extensive system changes in the near term, however.

Receivables for Matters in Litigation

Matters in Litigation. Incorrect methods were used to value and record refunds receivable in fund control records for Air Force matters in litigation. Review of expired year refunds receivable identified two matters in litigation valued at $456.0 million. The matters had been identified by the field accounting function as uncollectible. Those refunds dealt with a claim against an entity in bankruptcy for $382.0 million and a defective pricing claim for $74.0 million. The receivables affected six fiscal years of the Aircraft Procurement appropriation. The largest part pertained to the open merged account. The Deputy Assistant Secretary of the Air Force (Financial Management), in consultation with officials at Headquarters, DFAS, decided to record those refunds receivable at an estimated recovery value of $135.0 million. The total estimated recovery value was recorded in the open merged account, rather than at full value appropriately apportioned to the source fiscal year as required by DoD practice. The refunds receivable of $135.0 million were also considered budgetary resources, again contrary to DoD practice.

Bankruptcy Claim. An uncollected refund receivable of $382.0 million due from an entity in bankruptcy was presented in fund reports at a value of $95.0 million, and the proceeds were used to finance obligation growth. Both actions were contrary to DoD-mandated practice. The Air Force claim for $382.0 million asked for the refund of expenditures made from appropriations for the years 1981 through 1986. At the time of audit, approximately 64 percent ($245.0 million) of the refunds pertained to fiscal years that were part of the open merged account. The remaining 36 percent ($137.0 million) pertained to fiscal years that had been canceled by Public Law 101-510. The legal assessment of the Air Force, and that of the Department of Justice attorney representing the Air Force in the case, indicated only part of the $382.0 million claim was potentially recoverable because of the defendant's limited assets and because of the values and merits of other claims lodged by creditors. Legal officials estimated the value of the bankrupt entity's assets and compared the estimate to the values of higher precedence claims to show a residual amount that might be available if the Air Force payout position is legally sustained. Legal officials, however, did not assert how much might be potentially recoverable.

Air Force and DFAS officials, however, used the difference between the estimated value of the entity's assets and the value of other creditor precedence claims to estimate recovery of the $382.0 million claim at $95.0 million. The $95.0 million value was recorded in fund accounting records as a refund

receivable due the open merged account of the appropriation. Such recording ignored the DoD refund receivable practice that requires recording at the gross value of the claim, as well as the fact that approximately 36 percent of the claim did not pertain to the open merged account. Air Force and DFAS officials could not explain why the entire amount of that estimate was shown as due the merged account.

Bankruptcy-Related Settlement. The gross value of the bankruptcy claim was overstated by approximately $20.0 million. The gross $382.0 million claim should be adjusted to reflect settlement of a related claim not previously recorded as a refund receivable. The settlement evolved from successful negotiations that recovered $32.0 million from a subcontractor of the bankrupt entity. The $32.0 million recovery reduced the total value of the more than $500.0 million contract with the entity in bankruptcy. Only part of the $32.0 million recovery will reduce the amount of the $382.0 million claim. The actual amount will not be known until an amending proof of claim is filed with the courts. Legal officials at this time estimate that amount at approximately $20.0 million.

Defective Pricing Claim. Contrary to DoD practice, an uncollected refund receivable of $74.0 million for a defective pricing claim against a contractor was presented in fund reports at a value of $40.0 million, and the proceeds were made available to finance obligation growth. The $74.0 million Air Force claim requested a refund on expenditures made in varying amounts from the Aircraft Procurement appropriations for FYs 1983 through 1986. The case is at the Armed Services Board of Contract Appeals for a decision. Legal officials advised us that any decision favorable to the Air Force would in all likelihood be challenged in the appeals process. Legal officials have not asserted any amount as a potential recovery; however, Air Force and DFAS officials agreed to estimate recovery of the $74.0 million claim at $40.0 million and record that value in the fund control records of the Aircraft Procurement appropriation open merged account. No information was available to show how that amount was determined. In any event, $40.0 million in uncertain refunds receivable was used as a funding source.

DoD Guidance. Guidance in the DoD Accounting Manual is unclear on recording refunds receivable in fund control and accounting records for matters in litigation. Present direction does not specify when or under what circumstances a refund receivable arising from litigation should be recorded. The DoD Accounting Manual, Chapter 94, "General Purpose Financial Statements," in reference to the Report on Accounts and Loans Receivable Due from the Public, Standard Form 220-9, requires that contractual claims due to bankruptcy, default, or renegotiation should be recorded and reported at best estimate. Chapter 24 requires refunds receivable to be recorded at their full amounts in budgetary accounts and reports. The Statements on Auditing Standards of the American Institute of Certified Public Accountants allow the recording of a receivable for a matter in litigation when supported by the assertion of legal officials. Present DoD guidance, coupled with the Air Force practice on treating refunds receivable as described above, influenced the preceding misrepresentations in Air Force fund control records.

Refunds Deemed Uncollectible

The Air Force practice also led to not disclosing in fund control reports $432.2 million of refunds receivables that were deemed uncollectible, but were not written off as bad debts. Gross uncollected appropriation refunds of $571.5 million shown in fund control reports were understated by $432.2 million. The reported amount excluded refunds considered by field entities as uncollectible. Such reporting distorted the budgetary perception of Air Force debt management practices by understating the $1.0 billion gross uncollected Air Force refund receivable position by 43 percent. Details of the understatement are shown in Table 7.

Table 7. Unreported Refunds Deemed Uncollectible
May 31, 1993
($ in millions)

Appropriation	Fiscal Year*	Amount
Aircraft Procurement	1990	$ 13.0
	1989	8.7
	1988	31.6
	1987	3.9
	M	358.4
Missile Procurement	M	.3
Other Procurement	1987	1.5
	M	3.6
RDT&E	M	9.9
Family Housing	M	1.3
Total		$432.2

*M = Merged Account.

Recommendations, Management Comments, and Audit Response

We recommend that the Comptroller of the Department of Defense:

1. Instruct the Director, Defense Finance and Accounting Service, to implement DoD-mandated practice and amend Air Force fund control systems and reporting mechanisms to:

a. Assure appropriation refunds receivable are not considered as budgetary resources until collected.

b. Disclose the full value of appropriation refunds, considered both collectible and uncollectible, in fund control records and reports, and in

accounting reports reflecting representations of Air Force debt management practices.

2. Amend DoD 7220.0-M, "DoD Accounting Manual," to specify how appropriation refunds receivable for matters in litigation should be recorded in fund control records. Such guidance should specify when and under what circumstances a refund receivable arising from litigation should be recorded, and also be consistent with existing refund receivable policies and the provisions of the Chief Financial Officers Act.

Management Comments. We have not received comments on the foregoing recommendations from the DoD Comptroller.

Audit Response. DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, all addressees must provide final comments as follows. Comments must be received by May 17, 1994.

RESPONSE REQUIREMENTS FOR EACH RECOMMENDATION

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

		Response Should Cover			
Number	Addressee	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues*
1.a.	DoD Comptroller	X	X	X	IC
1.b.	DoD Comptroller	X	X	X	IC
2.	DoD Comptroller	X	X	X	IC

*IC = material internal control weakness.

Part III - Additional Information

Appendix A. Pending Upward Obligation Adjustments as of April 30, 1993

($ in millions)

RDT&E Weapon System/ Purpose	1988	1989	1990	1991	Total
Aircraft					
B-2	$ 0	$ 0	$ 0	$ 0.1	$ 0.1
C-17	(2.1)	4.8	7.4	11.7	21.8
F-15	0	0.1	0	0	0.1
National Aerospace Plane	0	0	0	0.1	0.1
Missiles					
AGM 31	1.0	0.1	0.1	0.1	1.3
Minuteman	0	0	0.1	0.3	0.4
Titan IV	0	0	0	10.5	10.5
Other					
DMSP	0	0.9	0	0	0.9
Electronic Combat & Reconnaissance	0	0	0	1.2	1.2
JSTAR	0	0	7.3	15.0	22.3
MEGS	0	0	0	0.1	0.1
REACT	0	0	0	0.1	0.1
Eglin Range	0	0	0	0.1	0.1
Subsystems	0	0	1.4	0.9	2.3
Workmans Compensation Claim	0	0	0.3	0	0.3
Miscellaneous	0.1	0.4	0.8	0.5	1.8
Appropriation Totals	$(1.0)	$6.3	$17.4	$40.7	$63.4

Aircraft Procurement

Weapon System/ Purpose	1987	1988	1989	1990	Total
Aircraft					
AC-130H	$ 0	$ 2.7	$ 0	$ 0.8	$ 3.5
B-1	0	0	0.7	2.1	2.8
B-2	0	0.2	0	0.2	0.4
C-135	0	0	2.7	0	2.7
C-17	0	(3.2)	1.6	122.3	120.7
C-5B	8.8	0	0	0	8.8
EC-135	0	0.5	0	0	0.5
Engines	0	0	0.6	0	0.6
F-111	3.5	2.6	7.5	0	13.6
F-15	5.0	0.1	0	2.0	7.1
F-15/F-16	0	0.5	0	5.4	5.9
F-16	23.5	23.0	23.7	17.1	87.3
KC-135	0	0	0	0.1	0.1
MC-130H	0	0	1.8	0	1.8
T-43	0	0	0	0.9	0.9
Other					
ADINTS	0	0	0	0.4	0.4
Air Combat, Air Mobility, Special Operations	0	0	0	4.0	4.0
Air Conditioners	0	0	0.8	0	0.8
Aircraft Support Equipment	0	0	0.5	0	0.5
AN/ALQ-131	0.6	0	0	0	0.6
FLIR	0.9	0	0	0	0.9
JTIDS	0	0.2	0	0	0.2
Maverick	0.5	0	0	0	0.5
MILSTAR	3.3	0.5	0	1.4	5.2
Training	0	0	0	0.3	0.3
Miscellaneous	0.1	0.1	1.9	0.1	2.2
Appropriation Totals	$46.2	$27.2	$41.8	$157.1	$272.3

Total All Fiscal Years, Both Appropriations $335.7

Appendix B. Uncorrected Erroneous Accounting Entries

Correcting the NULO Problem. In November 1992, the DoD Comptroller, in response to the Inspector General, Department of Defense, report on the audit of the Air Force Missile Procurement Appropriations, agreed with the need to resolve the NULO problem by using a single record to account for funds and pay bills. The DoD Comptroller requested that each of the DoD Components submit to the DFAS plans to reduce NULOs. The DFAS was directed to implement corrective measures where feasible. Several initiatives have since been undertaken to help correct the problem. The initiatives described in the following paragraphs should reduce the size of the NULO problem pending development of a system that employs a single record to account for funds and pay bills.

DFAS Initiatives. The DFAS business plan now cites an objective of reducing unmatched disbursements and NULOs to "normal operational balances." The objective is to be achieved by the efforts of working groups at each DFAS Center formed to address the problem within their respective areas of responsibility. The DFAS anticipates reducing NULOs and unmatched disbursements within the next 18 months.

DFAS-Denver Center Initiatives. The DFAS-Denver Center, which provides accounting service to the Air Force, has developed the Direct Contract Payment Notice project. The project is scheduled to be implemented in April 1994. It is designed to promptly correct NULOs and unmatched disbursements by providing early payment notification to accountable stations. Other current proposals aim at correcting accounting errors already accumulated. At the time of audit, the most noteworthy dealt with developing a means to automate the present manual accounting record and payment record reconciliation processes.

Field Initiatives. The Air Force Materiel Command was expending extensive manpower effort to clear up some of the larger NULO and NULO-related errors in its fund accounting systems. Currently, its efforts are primarily focused on the open merged accounts. That focus was expected to shift to the oldest expired year appropriation starting on October 1, 1993.

Correcting Progress Payment Problems. As a result of recommendations in Inspector General, Department of Defense, Report No. 92-064, "Titan IV Program," March 13, 1992, the DoD Comptroller agreed to revise the DoD Accounting Manual to require progress payment costs for non-R&D (Research and Development) contracts to be matched and posted to the applicable obligation records, and progress payments to be identified to specific obligations of a non-R&D appropriation, before payment. When implemented, the number of future unabsorbed and unsettled non-R&D contract progress payment errors should virtually be eliminated. For progress payments pertaining to R&D contracts and all presently existing progress payment errors, however, problems

will continue to occur until such time as the NULO problem is finally resolved by use of a single record to account for funds and pay bills.

Distribution of NULOs and Erroneous Progress Payment Accounting Entries. The following tables distribute the errors discussed in Finding A by type, appropriation, and fiscal year.

Table 1. Erroneous Accounting Entries Versus Available Calculated Obligation Balances
($ in millions)

	1987	1988	1989	1990	1991	Total
RDT&E						
NULOs	N/A	$115.7	$193.5	$170.4	$ 45.7	$525.3
Progress Payments	N/A	176.3	127.8	49.2	8.5	361.8
Totals	N/A	$292.0	$321.3	$219.6	$ 54.2	$887.1
Available Funds	N/A	$ 26.5	$ 33.0	$ 3.3	$(14.1)	$ 48.7
Aircraft Procurement						
NULOs	$ 94.6	$ 76.0	$128.1	$138.5	N/A	$437.2
Progress Payments	113.0	48.3	263.5	64.5	N/A	489.3
Totals	$207.6	$124.3	$391.6	$203.0	N/A	$926.5
Available Funds	$140.8	$ 80.4	$(21.1)	$ 2.2	N/A	$202.3

Table 2. Unabsorbed Progress Payments
($ in millions)

	1987	1988	1989	1990	1991	Total
RDT&E	N/A	$132.3	$94.9	$36.6	$5.5	$269.3
Aircraft Procurement	41.5	13.1	204.5	54.5	N/A	313.6
Total						$582.9

Table 3. Unreconciled Settlements of Progress Payments
($ in millions)

	1987	1988	1989	1990	1991	Total
RDT&E	N/A	$44.0	$32.9	$12.6	$3.0	$ 92.5
Aircraft Procurement	71.5	35.2	59.0	10.0	N/A	175.7
Total						$268.2

Appendix C. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefits	Amount and/or Type of Benefit
A.1., A.2., C.1.a., C.1.b.	Compliance. Improve accountability in the Air Force and the DoD.	Nonmonetary
A.3.a., A.3.b., A.3.c., C.2.	Economy and Efficiency. Correct accounting entries and strengthen DFAS procedures to provide accurate Air Force accounting data.	Nonmonetary
A.3.d.	Economy and Efficiency. Reduce unearned revenue.	Funds of $9.8 million put to better use (Aircraft Procurement FY 87 - $1.8 million; FY 88 - $(.3) million; and FY 89 - $8.3 million).
B.1., B.2.	Compliance. Amend fund controls to comply with laws and regulations.	Nonmonetary

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Office of the Comptroller of the Department of Defense, Washington, DC
- Director, Financial Management Policy

Department of the Air Force

Deputy Assistant Secretary of the Air Force (Budget), Washington, DC
- Director, Budget Management and Execution

Deputy Assistant Secretary of the Air Force (Management Policy and Program Integration), Washington, DC
- Associate Deputy Assistant Secretary (Management Policy and Program Integration), Acquisition Management Policy and Program Integration

Air Force Materiel Command, Wright-Patterson Air Force Base, OH
- Directorate of Financial Management
- Aeronautical Systems Centers
  - Wright-Patterson Air Force Base, OH
  - Eglin Air Force Base, FL
- Ballistic Missile Office, Norton Air Force Base, CA
- Electronics Systems Center, Hanscom Air Force Base, MA
- Space and Missile Systems Center, Los Angeles Air Force Base, CA
- Oklahoma City Air Logistics Center, Tinker Air Force Base, OK
- San Antonio Air Logistics Center, Kelly Air Force Base, TX
- Warner Robins Air Logistics Center, Warner Robins Air Force Base, GA

Air Force Security Assistance Training Group, Randolph Air Force Base, TX

Defense Agencies

Headquarters, Defense Finance and Accounting Service, Washington, DC
- Defense Finance and Accounting Service Center, Denver, CO
- Defense Finance and Accounting Service Center, Columbus, OH

Defense Agencies (cont'd)

Defense Accounting Offices at the following locations:
- Bolling Air Force Base, DC
- Edwards Air Force Base, CA
- Eglin Air Force Base, FL
- Hanscom Air Force Base, MA
- Kelly Air Force Base, TX
- Los Angeles Air Force Base, CA
- Norton Air Force Base, CA
- Warner Robins Air Force Base, GA
- Tinker Air Force Base, OK
- Wright-Patterson Air Force Base, OH

Appendix E: Report Distribution

Office of the Secretary of Defense

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

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management)

Defense Agencies

Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service-Columbus Center
Director, Defense Finance and Accounting Service-Denver Center

Non-Defense Federal Organizations

Office of Management and Budget
U. S. General Accounting Office, National Security and International Affairs Division, Technical Information Center
Chairman and Ranking Minority Member of Each of the following Congressional Committees and Subcommittees:

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