DECISION

THE COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

26246

FILE: B-207433 **DATE:** September 16, 1983

MATTER OF: Magnavox--Use of Contract Underrun Funds

DIGEST:

Once the period of availability expires for an appropriation used to finance a contract, the Army may not use cost underrun money which results from that contract to order an additional quantity of items. A modification to increase the quantity would exceed the scope of the original contract and would be chargeable only to funds current at the time of the modification.

This decision results from requests by two members of Congress concerning whether after the period of availability expires for an appropriation used to finance a contract for the purchase of thermal viewers, the Department of the Army may use cost underrun money due it under that contract to modify the contract to provide for an increased quantity. For reasons which follow, we hold that the Army may not enter into the modification agreement, except by using current funds.

Background

In 1977, the United States Department of the Army intended to purchase 557 thermal viewers 1/ from the Magnavox Government and Industrial Electronics Company. For this purchase the Army planned to obligate fiscal year 1977 funds which, under a multi-year appropriation, were available until the end of fiscal year 1979. 2/ For the amount of money which the Army was willing to

1/ Hand-held devices to enable infantry to see in darkness or through camouflage.

2/ The funds were part of a lump-sum appropriation for "Other Procurement, Army," contained in the Defense Department Appropriation Act for FY 1977, Pub. L. No. 94-419, 90 Stat. 1286. The appropriation had a 3-year period of availability, expiring for obligational purposes on September 30, 1979.

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spend, however, Magnavox would agree to provide only 509 viewers. Therefore, in April 1977, the Army and Magnavox entered into a fixed price incentive contract (No. DAAB07-77-C-4401) for the Army to purchase 509 viewers. The Army recorded the fixed price ($8.1 million) as an obligation against the FY 1977 appropriation. The contract also contained an option clause which, in 1978, the Army exercised to order 285 additional viewers, obligating FY 1978 funds. 3/

In 1981, Magnavox learned that its cost would be below the target cost contained in the contract. It therefore proposed to modify the 1977 contract to increase the quantity to be provided from 509 viewers to 557 viewers. It suggested to the Army that the combined amount of the underrun money from the original contract and the option contract could be used for the purchase of additional viewers instead of decreasing the contract price.

The Army, citing Army Regulation 37-21, believed that such a procedure was contrary to law and refused to execute the modification agreement. The Army's position was that a modification to increase the quantity would be beyond the scope of the original contract. As such, it could not be charged to appropriations whose period of availability had expired, but would constitute an obligation against funds current at the time of the modification. We agree.

Discussion

Where funds are made available for obligation during a specific time period, once that period expires the funds may be used only to liquidate obligations which were properly incurred within that period of availability. 31 U.S.C. § 1502(a) (formerly §§ 200(d), 712a). Funds from the appropriation which are not obligated must be withdrawn. 31 U.S.C. § 1552(a)(2) (formerly § 701(a)(2)). Further, when an agency obligates more funds than are needed for a project, it must, upon learning the correct amount, deobligate the excess amount. See B-183184, May 30, 1975.

3/ Defense Department Appropriation Act for FY 1978, Pub. L. No. 95-111, 91 Stat. 893. This was also a lump-sum "Other Procurement, Army" appropriation available for 3 years (until September 30, 1980).

Based on these principles, we previously have determined that surplus funds which result from a cost underrun may not be used in a succeeding fiscal year. See 58 Comp. Gen. 321 (1979). This result was reached notwithstanding that the agency desired to extend an existing contract. Accord, B-183184, supra. This holding would apply to the present situation to preclude the Army from using the surplus funds to procure additional thermal viewers. The Magnavox Corporation, however, maintains that in 1977 the Army obligated sufficient funds to permit it to procure 48 additional thermal viewers in 1981.

First, Magnavox seeks to define the amount of money obligated in terms of the Army's original requisition for 557 viewers. Magnavox reasons that because the Army originally desired to purchase 557 viewers, the amount it obligated was intended to cover as many of this quantity as possible, rather than just to obtain 509 viewers. This argument, however, does not accurately reflect either the governing law or the terms of the contract.

The requirements for a valid obligation are stated in 31 U.S.C. § 1501 (formerly § 200(a)). In the case of a contract, the obligation must be supported by documentary evidence of a binding written agreement for the delivery of specific goods or services. In addition, the agreement must be executed while the appropriation to be charged is available for obligation. Id. Further, the agreement must provide evidence of an offer and acceptance, and must impose legal liability to perform the contract upon both parties. 39 Comp. Gen. 829, 831 (1960); B-118654, August 10, 1965.

The record here shows that although the Army originally sought to purchase 557 viewers, Magnavox refused to supply this quantity for the amount of money which the Army wanted to pay. Instead, Magnavox agreed to produce, and the Army agreed to accept, 509 viewers. Thus, there was no offer and acceptance for 557 viewers. As the contract terms demonstrate, neither was there imposed any legal liability upon the Army to pay for or upon Magnavox to supply 557 viewers.

The contract does not state that Magnavox will produce as many viewers as it can for the amount of money available. Rather, it provides for Magnavox to supply a fixed quantity of 509 viewers

and the target cost for this quantity. Moreover, it does not state that Magnavox will produce additional viewers if the cost incurred in producing 509 viewers is below the stated target cost. On the contrary, the contract provides that in the event of a cost underrun, the Army will benefit from a downward adjustment in the contract price. 4/ Accordingly, under this contract, the Army could not have incurred a valid obligation for 557 viewers against the appropriation which was available in 1977. Cf. B-182081, February 14, 1979 (no obligation can be incurred for materials which were not ordered).

Magnavox next alleges that because in 1977 the Army had a bona fide need for 557 viewers, the appropriation which was then available is the correct one to charge for the purchase of this quantity of viewers. This is an inversion of the so-called "bona fide needs rule." The essence of the rule is simply that an appropriation may be validly obligated only to meet a legitimate need existing during the period of availability. Under this concept, payments are chargeable to the year in which the obligation took place, even though not actually disbursed until a later year, as long as the need existed when the funds were obligated. See, e.g., 33 Comp. Gen. 57, 61 (1953). Here, the fact remains that the funds in question were obligated under a contract (a) calling specifically for the production of 509 viewers, and (b) providing for the return of a portion of any underrun funds to the Government (in the form of a downward price adjustment).

Certainly the Army could have used underrun funds to procure additional viewers at any time during the period those funds remained available for obligation. Also, we are of course aware than an unmet need does not somehow evaporate merely because the period of availability has expired. However, nothing in the bona fide needs rule suggests that expired appropriations may be used for an item for which a valid obligation was not incurred prior to expiration merely because there was a need for

4/ Under the contract clause entitled "Incentive Price Revision (Firm Target)-Alternate," Army was entitled to 80 percent of any underrun funds.

that item during that period. In this connection, it makes no difference whether we are talking about otherwise unobligated funds that were withdrawn to the Treasury or funds required to be deobligated pursuant to an underrun clause. Once the obligational period has expired, the procurement of an increased quantity must be charged to new money, and this is not affected by the fact that the need for that increased quantity may in effect be a "continuing need" that arose during the prior period. 5/

Magnavox finally claims that the present situation is analogous to the treatment of replacement contracts. When an agency terminates a contract because of the contractor's default, it may enter into a replacement contract with another contractor and may, within limits, charge the cost to the appropriation which was originally obligated even though that appropriation has expired for purposes of new obligations. 60 Comp. Gen. 591 (1981). This concept, however, has no application here.

First, there was no default by Magnavox, and Magnavox did in fact complete its work under the contract. More importantly, however, in order to charge the cost of a replacement contract against the original appropriation, the replacement contract must be for the purpose of completing the original contract or procuring the materials called for by the original contract. It must be "substantially similar in scope and size as the original contract," and may not be used to order additional work. 60 Comp. Gen. 591, supra. Compare 44 Comp. Gen. 399 (1965). Therefore, the treatment of obligations under a replacement contract would not permit the Army to order additional viewers in this case and charge an expired appropriation with their cost.

We have recognized that certain contract modifications within the scope of the original contract may be chargeable to the appropriation used to fund the original contract. E.g., 61 Comp. Gen. 609 (1982). Here, however, we are not dealing

5/ Cases cited by Magnavox distinguishing between when an obligation actually arises and when it is recorded, such as 38 Comp. Gen. 81 (1958), have no bearing. Those cases stand merely for the proposition that an obligation is chargeable to the year in which the liability or commitment was actually incurred, even though it may not have been recorded until the following year. The mere existence of the need does not create the obligation.

with a contractual right enforceable by the contractor. The Magnavox proposal is for an additional quantity in excess of the quantity fixed in the original contract. As such, it is not within the scope of the original contract and would have to be treated as a new obligation chargeable to current funds. See 44 Comp. Gen. 399 (1965).

The original contract did contain an option clause to permit the Army to order an additional quantity of viewers. However, under an option clause, an obligation is incurred only when the option is exercised. 56 Comp. Gen. 351, 353 (1977). Thus, for example, when the Army exercised the option in 1978 to order an additional 285 viewers, it properly charged the option cost to its 1978 appropriation.

Conclusion

Funds from an expired appropriation can be used only to liquidate obligations which were validly incurred while the appropriation was available. Since there was no binding agreement which provided for the purchase of the 48 thermal viewers in question, no obligation for them could have been incurred. Accordingly, we agree with the Army that it may not use the cost underrun money to modify the 1977 contract to provide for the purchase of 48 additional viewers.

for Milton J. Socolar
Comptroller General
of the United States

Circular A-76 and the related Cost Comparison Handbook emphasize that cost comparisons should be conducted in a realistic and equitable manner. Clearly, it would be inequitable, if not fundamentally unrealistic, for the Government to straight-line its Direct Labor estimate when the potential contractor has factored anticipated labor cost increases (not otherwise reimbursable under an economic price adjustment clause) into its bid price. In the present circumstance, however, we cannot conclude that the Navy's exclusion of such increases in years two and three of the contract had any material affect upon the cost comparison's ultimate outcome, given the difference of $403,891 between the in-house and contracting estimates, or $377,025 if the cost of terminating the COPARS contract is not included. In that regard, CSC would have to show that the Navy was required to anticipate labor cost increases of more than 20 percent in each of years two and three of the contract, a showing that CSC cannot reasonably make. Therefore, although the Navy's use of the straight-line method was erroneous, the error is not so significant as to cast doubt upon the comparison's outcome. Mar, Incorporated, supra.

Finally, CSC has alleged that the Navy miscalculated, in the in-house estimate, One-Time Conversion Costs, in that the firm's own experience under prior contracts has shown that such massive employee relocations as reflected in the cost comparisons in actuality do not occur. However, the Navy relates that it based its estimate of relocation costs upon a mock reduction-in-force which revealed that a large majority of those personnel affected by a contract award would choose to relocate. Such a methodology is expressly allowed by section 460(0)(2)(a) of OPNAVINST 4860.6C, which provides that "data used in estimating labor-related one-time costs should be developed locally; for example, through a mock Reduction In Force (RIF)." Therefore, we see no basis upon which to displace the Navy's methodology in favor of CSC's argument that such costs should reflect the actual reduction-in-force experiences of other contracting activities.

The protest is denied.

Milton J. Socolar

for Comptroller General
of the United States