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July 16, 2014

The Honorable Hal Rogers
Chairman
The Honorable Nita Lowey
Ranking Member
Committee on Appropriations
House of Representatives

Subject: *Department of Defense—Obligation of Bonuses under Military Service Agreements*

This responds to your request for our opinion regarding the Department of Defense's (DOD) obligational practice for certain recruiting and retention bonuses.¹ DOD components offer these bonuses in various agreements with individuals in exchange for terms of military service. DOD generally pays the bonuses in installments over a number of years. As we explain in further detail below, we conclude that DOD incurs an obligation for the entire bonus amount when it enters into these agreements. DOD should charge the obligation to an appropriation current at the time of agreement.

In accordance with our regular practice, we contacted DOD to obtain relevant facts and its legal views on this matter. GAO, *Procedures and Practices for Legal Decisions and Opinions*, GAO-06-1064SP (Washington, D.C.: Sept. 2006), available at www.gao.gov/legal/lawresources/resources.html. DOD provided us with a letter containing that information. Letter from Deputy General Counsel (Fiscal), DOD, to Assistant General Counsel for Appropriations Law, GAO, *Subject: Department of*

¹ H.R. Rep. No. 113-113, at 17–18 (2013) (“The Committee directs the Comptroller General to issue a legal opinion not later than 180 days after the enactment of this Act assessing the obligation of military personnel multi-year bonuses to determine if the Department of Defense obligation practices comply with fiscal law.”). The committee report was later incorporated by reference into the joint explanatory statement accompanying the Consolidated Appropriations Act, 2014. 160 Cong. Rec. H533 (daily ed. Jan. 15, 2014); Pub. L. No. 113-76, § 4, 128 Stat. 5, 7 (Jan. 17, 2014).

BACKGROUND

DOD offers bonuses to recruits and current servicemembers when it is “necessary to attain recruiting and retention objectives.” *Id.*, at 1. DOD is authorized to pay various bonuses under title 37 of the U.S. Code. *Id.*, at 1–2. For instance, the Secretary of Defense may pay a bonus to an individual who enlists in an armed force; enlists in or affiliates with a reserve component of an armed force; reenlists or voluntarily extends an enlistment; or transfers from a regular component of an armed force to a reserve component or vice versa. 37 U.S.C. § 331(a). The Secretary may also pay a bonus to an individual who accepts a commission or appointment as an officer in a uniformed service, affiliates with a reserve component of a uniformed service; agrees to remain on active duty for a specific period of time; or transfers from a regular component of an armed force to a reserve component or vice versa. *Id.* § 332(a).

DOD offers these bonuses to individuals via a written agreement. *Id.* §§ 331(d), 332(d). See, e.g., DOD Letter, Attachment 6 (sample agreement with the Army), Attachment 7 (sample agreement with the Army National Guard); Attachment 8 (sample agreement with the Navy Reserve), Attachment 9 (sample agreement with the Air Force Medical Corps). These agreements generally specify the amount of the bonus, the term of obligated military service (typically no more than six years), and the conditions of service (such as completing certain training programs). 37 U.S.C. §§ 331(d), 332(d). See, e.g., DOD Letter, Attachments 6–9. The agreements also specify whether the bonus will be paid as a lump sum or in installments. 37 U.S.C. §§ 331(d)(2), 332(d)(2). If the bonus is paid in installments, then DOD often pays an initial bonus installment to the servicemember and then pays subsequent installments on the anniversary of the agreement. DOD Letter, at 3.

For example, DOD offers retention bonuses to certain medical officers. *Id.*, Attachment 9. The medical officer agrees to “remain on active duty in the Air Force Medical Service (AFMS) Medical Corps (MC) for a minimum of one, two, three, or four consecutive years” and to “possess a current and valid license . . . for the duration of the contract.” *Id.*, at 1 (emphasis omitted). In exchange, the medical officer receives a defined bonus “paid annually upon execution of this contract and its subsequent anniversary dates as applicable and specified in the current pay plan.” *Id.*

DOD does not record an obligation when the agreement is executed. *Id.* Rather, DOD records an obligation for the initial installment and subsequent installments in the months they become payable to the servicemember. *Id.*; Department of Defense

Financial Management Regulation 7000.14-R, vol. 3, ch. 8, para. 080901, *Personal Services and Benefits* (Sept. 2009).²

DISCUSSION

The issues presented here are: (1) when does DOD incur an obligation for a bonus under the agreements described above; and (2) in what amount does DOD incur an obligation.

Determining the Obligation Event

It is at the point of obligation that we determine compliance with various fiscal laws such as the Antideficiency Act. B-300480.2, June 6, 2003; B-300480, Apr. 9, 2003. Under that act, an agency may not incur an obligation in excess of the amount available in its appropriation. 31 U.S.C. § 1341(a)(1)(A). Accordingly, in order to ensure compliance with the Antideficiency Act, agencies must properly record their obligations and track available budget authority.

Thus, the federal government generally operates on an obligational basis. B-300480.2; B-300480; B-316915, Sept. 25, 2008. In other words, the government takes some action that “obligates” it to pay, and then the actual disbursement of funds usually follows at some later time. *Id.* An obligation is defined as a “definite commitment that creates a legal liability of the government for the payment of goods and services ordered or received, or a legal duty on the part of the United States that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States.” GAO, *A Glossary of Terms Used in the Federal Budget Process*, GAO-06-734SP (Washington, D.C.: Sept. 2005), at 70. See also B-322147, July 6, 2011.

Here, DOD enters into various agreements providing for a bonus if an individual fulfills a required term of service—that is, DOD offers a monetary incentive for a time commitment. DOD Letter, at 5. We already addressed this type of agreement in a 2003 opinion, B-300480. In that case, the Corporation for National and Community Service (CNCS) executed binding agreements authorizing grantees to enroll up to a certain number of new participants in AmeriCorps, a national community service program. *Id.* At the time of agreement, CNCS was statutorily committed to fund education benefits for all participants who completed a fixed term of service. *Id.* CNCS, like DOD, had been recording obligations for the education benefits on an outlay basis, that is, at the time the grantee drew down funds to make payments to

² DOD obligates bonus installments against the military personnel appropriation for the applicable service. DOD Letter, at 3. DOD generally receives one-year appropriations for the pay, benefits, incentives, allowances, housing, sustenance, travel, and training of servicemembers. See, e.g., Pub. L. No. 113-76, div. C, title 1, 128 Stat. at 86–88.

AmeriCorps participants who fulfilled their terms of service. *Id.* We concluded that CNCS should have recorded an obligation for the education benefits when it signed the grant agreement. *Id.* It was at that time that CNCS incurred a legal duty to pay; it was at that time that CNCS authorized grantees to enroll a certain number of new participants; it was at that time CNCS relinquished control of the extent of the government's liability to the grantee. *Id.*

DOD's obligational practice, like CNCS's practice, fails to recognize that when DOD enters into the agreement, it has taken an action that can mature into a legal liability if the servicemember upholds his or her end of the agreement. DOD, like CNCS, has entered into an agreement to incentivize an individual to accept a time commitment. DOD has accepted a fiscal liability, which is fully payable should the servicemember satisfy the time commitment. In our view, because DOD has ceded control of its fiscal exposure to the servicemember, DOD incurs an obligation for the bonus at the time it signs the agreement.

DOD argues that bonuses are statutorily defined as "military pay compensation" in title 37 of the U.S. Code. DOD Letter, at 4. DOD believes it cannot record an obligation for a bonus installment until it has "evidence of employment during the required period of obligated service." *Id.* DOD points to section 20.5(b) of OMB Circular No. A-11, which states that personnel compensation and benefits should generally be recorded as obligations "as the amounts are earned during the reporting period." OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, pt. 1, § 20.5(b) (Nov. 5, 2013).

We disagree with DOD's position. The fact is that generally all amounts an employer pays to an employee have a nexus to the employee's service to the employer—for example, performance bonuses, spot awards, and student loan repayments. That does not mean that an agency should obligate all amounts as it does basic pay, which is done on a pay period basis. 24 Comp. Gen. 676, 678 (1945). Here, DOD has entered into an agreement for a time commitment from the servicemember. DOD will pay the servicemember his or her basic pay regardless of whether the servicemember satisfies the time commitment. See 37 U.S.C. § 331(e) ("A bonus paid to a person or member under this section is in addition to any other pay and allowance to which the person or member is entitled.").

DOD also makes an alternative argument. DOD states that it does not incur an obligation at the time of agreement because "payments remain under the control of the military department." DOD Letter, at 1. DOD explains that it retains control because "military departments can and do routinely and unilaterally discharge service members before bonus installments are earned and without having incurred any legal obligation to make such payments." *Id.* However, the fact that DOD may unilaterally terminate or modify the agreement does not negate the nature or scope of the obligation incurred at the time of agreement. Were it otherwise, every agreement permitting the government to terminate an agreement for convenience or to modify the agreement would not be deemed an obligation at the time of

agreement. B-300480. As we have previously explained, in a long-standing practice, both Congress and the accounting officers of the government have rejected such a view. *Id.*

DOD, like CNCS, appears to be confusing its commitment to record an obligation with the liquidation of the obligation. DOD is legally required to record an obligation at the time it signs such an agreement with a servicemember. 31 U.S.C. § 1501(a). However, should a servicemember not uphold his or her end of the agreement, DOD may have a basis for not liquidating the obligation. We discuss this in more detail below.

Amount of the Obligation

An agency should record its total obligation against funds available at the time the agreement was executed. B-322160; OMB Cir. No. A-11, at § 20.5(c). If the amount of the obligation is outside of the control of the government, then the government should obligate funds to cover its maximum amount of its liability. B-300480. As explained above, in this case, it is the servicemember who controls the extent of DOD's liability. Therefore, DOD must record an obligation to cover the total bonus against an appropriation current at the time of agreement. 31 U.S.C. § 1502(a). The amount of the bonus will be determinable from the terms of the agreement. 37 U.S.C. §§ 331(c)(2), 332(c)(2). See, e.g., DOD Letter, Attachments 6–9.

In the CNCS case, we recognized that ultimately, CNCS may not have to pay educational benefits to every AmeriCorps enrollee. Not every enrollee will fulfill his or her service commitment and become entitled to the payment. Alternatively, grantees could lose their authority to enroll participants in the AmeriCorps program or CNCS itself could have modified the grantees' authority. If those situations arose, we explained that CNCS should deobligate previously obligated amounts to reflect the change in its legal exposure. B-300480.

Similarly, here, DOD may not have to pay out the entire bonus amount under these agreements.³ Servicemembers may lose their entitlement to a bonus if they

³ We recognize that DOD will likely disburse some or all of the bonus amounts later in the year or in future fiscal years. DOD states that “[n]o components currently make bonus installment payments . . . later than the fifth anniversary of payment of an initial installment.” DOD Letter, at 3. DOD must ensure that it makes all payments in accordance with the account closing law. 31 U.S.C. §§ 1551–1553. Under the law, an appropriation available for a fixed period of time, such as a military personnel appropriation, expires at midnight on the last day of its period of availability. The expired appropriation remains available for a period of five fiscal years to record, adjust, and liquidate obligations properly chargeable to the appropriation. *Id.* § 1553(a). After five years, the expired appropriation is closed (continued...)

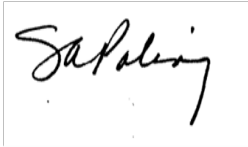
separate from the Armed Forces or otherwise fail to meet the terms of service. DOD Letter, at 2. If DOD determines that a servicemember has not fully performed under the agreement, then DOD may not make additional bonus payments and may choose to recoup previously disbursed bonus payments. 37 U.S.C. § 373; DOD-FMR 7000.14-R, vol. 7A, ch. 2, table 2-1. As in the CNCS case, we would advise DOD to deobligate previously obligated amounts to reflect the change in its legal exposure. B-300480.

We note that the result in this case is really no different from the obligational rule regarding a simple fixed-price contract. There, the government incurs an obligation to pay a specific amount, provided that the contractor fully performs under the agreement. B-255831, July 7, 1995; 62 Comp. Gen. 143, 146 (1983); 48 Comp. Gen. 497, 502 (1969). The possibility that the contractor may not perform up to the level or under the conditions defined in the agreement does not provide a basis for recording less than the full contract price.

CONCLUSION

Under the recording statute and the Antideficiency Act, DOD must record an obligation reflecting the full bonus amount when it executes military service agreements. DOD should change its obligational practices in accordance with these requirements and update its financial management regulations.

If you have any questions, please contact Edda Emmanuelli Perez, Associate General Counsel, at (202) 512-2853.



Susan A. Poling
General Counsel

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and all balances are canceled. *Id.* § 1552(a). Canceled balances are unavailable to pay any obligation even though properly incurred prior to the expiration of the appropriation. Instead, an obligation that would have been properly chargeable to the canceled appropriation must be paid from a current appropriation available for the same purpose. *Id.* § 1553(b).