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REPORT TO THE CONGRESS

Substantial Understatement Of Obligations For Separation Allowances For Foreign National Employees B-179343

Department of Defense

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

~~710776~~

094173

OCT. 21, 1974



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

B-179343

To the Speaker of the House of Representatives
and the President pro tempore of the Senate

This is our report on substantial understatement of obligations by the Department of Defense for separation allowances for foreign national employees.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget; Secretary of the Treasury; Administrator of General Services; and Secretaries of Defense, Army, Navy, and Air Force.

James B. Stacks

Comptroller General
of the United States

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ABBREVIATIONS

DOD	Department of Defense
GAO	General Accounting Office

DEFINITIONS

1-year appropriation	An authorization by an act of Congress to incur obligations only during a specific fiscal year and to make payments out of the Treasury for specific purposes.
Expired appropriation	An appropriation which is no longer available for obligation but which is available for payment of existing obligations, including those transferred to successor accounts.
Successor account	A consolidated account into which all prior-year obligated balances are merged 2 years after the appropriation expires for obligations and which is available indefinitely for the payment of obligations chargeable to any expired appropriation for the same general purpose.
Withdrawal	Reversion to the general fund of the Treasury of the unobligated balances of appropriations expiring for obligation.
Restoration	Return of obligational authority previously withdrawn from an expired or successor appropriation account.

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

SUBSTANTIAL UNDERSTATEMENT OF
OBLIGATIONS FOR SEPARATION
ALLOWANCES FOR FOREIGN NATIONAL
EMPLOYEES

Department of Defense B-179343

D I G E S T

WHY THE REVIEW WAS MADE

In Far East countries--primarily Japan, Okinawa, Korea, Taiwan, and the Philippines--the Department of Defense is required under binding agreements to pay lump-sum separation allowances to about 72,000 foreign national employees when they resign, retire, or are separated through no fault of their own.

Generally, the allowance is granted whether the employee separates after a few years of service or continues working until retirement age. The amount of allowance paid is based generally on length of service, rate of pay at time of separation, and type of separation.

GAO investigated military installations in eight countries to determine whether Defense procedures were adequate to insure that obligations for separation allowances were properly recorded and that payments were made legally.

Basic facts

Obligations for separation allowances should be recorded when employees earn rights to be paid in the future. The Antideficiency Act requires Federal agencies to have an administrative control which restricts obligations or expenditures to amounts appropriated and amounts apportioned

or reapportioned for applicable fiscal periods.

To meet requirements of the act, obligations must be recorded as they are incurred to permit a comparison of obligations to apportionments and to fix responsibility for overobligations.

Accounting principles and standards prescribed by the Comptroller General require that accounting systems provide for identifying obligations with applicable appropriations at the time they are incurred.

FINDINGS AND CONCLUSIONS

The Army and Air Force are obligating separation allowances for foreign employees at the time allowances are paid instead of recording obligations at the time they are incurred; i.e., when employees earn rights to be paid in the future.

As a result, the two military services have understated the amount of obligations recorded and reported to the Congress.

Assuming that services of all foreign employees terminated at the end of fiscal year 1973, the unrecorded obligations for separation allowances at June 30, 1973, would amount

Tear Sheet. Upon removal, the report cover date should be noted hereon.

to \$305 million. (See p. 5.)

The Army and Air Force obligate and pay the major portion of allowances by restoring unobligated balances of expired and merged prior-year appropriations that had been withdrawn to the Treasury, instead of requesting sufficient obligational authority each year.

In this way obligations for allowances are, for the most part, recorded against appropriations without regard to fiscal year identity.

Delaying the recording of most of the obligations until after annual appropriation accounts are merged into successor accounts results in inadequate administrative control of funds. Further, a violation of the Antideficiency Act could occur without being disclosed. (See p. 6.)

The Navy generally records obligations at the time allowances are earned. It does not, however, record obligations against the current appropriation for the full amount of the liability which accrues during the year.

Instead, a pro rata portion of obligations relating to increases in the liability for separation allowances due to changes in pay and exchange rates are recorded in the appropriations made for each year during which the employee worked.

To insure adequate administrative control over funds and to charge the period benefiting from the services rendered by foreign employees, the current

appropriation should be obligated for the full amount of the liability accruing during the year.

RECOMMENDATIONS OR SUGGESTIONS

To provide disclosure and improved administrative control of the Government's obligations for separation allowances, the Secretary of Defense should direct military departments to

--immediately record all unrecorded obligations for separation allowances and

--record all future obligations when they are incurred.

Further, the Secretary should require that the amount of obligations recorded against current appropriations be equal to the total increase in the liability for separation allowance payments.

AGENCY ACTIONS AND UNRESOLVED ISSUES

Beginning in fiscal year 1976, Defense will record obligations at the time the separation allowances are earned. Defense, however, did not agree with that part of GAO's recommendation requiring immediate recording of all existing unrecorded obligations.

Defense believes there is a need for a transition period to convert from existing long-standing budgeting and accounting practices. Further, it has indicated there may not be sufficient funds to cover those unrecorded separation allowance obligations which are applicable to appropriations for fiscal years 1973 and 1974.

Remaining balances in these appropriations will not be known

until after payments for all retroactive pay increases have been made and balances have been certified as required by section 1311 of the Supplemental Appropriation Act, 1955.

Unrecorded obligations will be disclosed by the military services in Defense's annual statement of financial condition submitted to the Treasury.

As separations occur, the amount of unrecorded obligations will gradually diminish over the years. Defense's proposed actions will result in extensive delays in recording all unrecorded obligations.

Because there is no legal authority for Defense to delay the recording of obligations

for separation allowances, Defense either should request authority from the Congress to implement its proposal or should recognize and record all obligations.

MATTERS FOR CONSIDERATION
BY THE CONGRESS

GAO is reporting this matter to inform the Congress of the significant amount of liability which exists for payment of separation allowances.

Also, the House and Senate Committees on Appropriations may want to inquire further into the Department of Defense proposal to delay the recording of obligations for separation allowances.

CHAPTER 1

INTRODUCTION

In foreign countries--primarily Japan, Okinawa, Korea, Taiwan and the Philippines--the Department of Defense (DOD) is required under binding agreements to pay lump-sum separation allowances to foreign national employees when they resign, retire, or are otherwise separated through no fault of their own. The separation allowance is generally paid whether the foreign national employee separates after a few years of service or continues working until retirement age. The amount of the allowance paid is based generally on length of service, rate of pay at the time of separation, and type of separation.

In Japan and Okinawa, where the largest liability for separation allowances exist, the labor contract with the Japanese Government provides that separation allowances will be paid to all permanent employees who are separated for any reason, except for cause, after a minimum of 1-year's service. Because the average length of service of foreign national employees is about 15 years, most of the 38,000 employees in Japan and Okinawa will receive lump-sum allowances upon separation.

In Korea, Taiwan, and the Philippines, the only other countries where significant amounts of separation allowances will be paid, binding agreements with the 34,000 employees contain provisions similar to those in the contract with the Japanese Government.

The pay and allowances of foreign national employees are chargeable primarily to appropriations made by the Congress for the operation and maintenance of military activities. These are 1-year appropriations available for obligation only during the fiscal year for which made.

Obligated amounts are retained in the annual operation and maintenance appropriation accounts for an additional 2 years and are available for the payment of obligations incurred during the obligating period. At the end of this additional period, the obligated balance of the appropriation is transferred to a successor account in which obligated balances of all expired appropriations for the same general purposes are merged. Subject to statutes of limitations applicable to the payment of claims against the Government, the successor accounts remain available indefinitely for the payment of unliquidated obligations charged to any and all of the predecessor appropriations.

Unobligated balances of expired appropriations are withdrawn to the general fund of the Treasury. Under the Act of July 25, 1956 (31 U.S.C. 701-8), any portion of withdrawn balances of expired appropriations may be restored to the appropriate accounts if the head of the agency determines that such action is necessary to liquidate obligations or effect adjustments.

SCOPE OF REVIEW

We reviewed the manner in which the military services were establishing and liquidating obligations for separation allowances for foreign national employees. We made our review at overseas activities employing foreign national civilian employees and at activities in the United States which are responsible for overall administrative control of the operation and maintenance appropriations. We selected military bases in Germany, Japan, Korea, Okinawa, the Philippines, Taiwan, Thailand, and Vietnam for our review because approximately 90 percent of the DOD foreign national civilian employees are located in these 8 countries. At each activity visited, we examined labor contracts and agreements to determine whether foreign national civilian employees were entitled to lump-sum separation allowances, and we reviewed the procedures used for accounting for such entitlements.

CHAPTER 2

OBLIGATIONS FOR SEPARATION ALLOWANCES

NOT RECORDED AS REQUIRED BY LAW

The Army and Air Force are not recording, as required, obligations for separation allowances at the time they are incurred. Instead of recording the obligations at the time the employees earn rights to be paid, the Army and Air Force are recording them at the time allowances are paid. As a result, the two military services have consistently understated the amount of obligations for separation allowances reported to the Congress. We estimate that unrecorded obligations at June 30, 1973, amounted to at least \$305 million.

The Navy generally records obligations at the time allowances are earned. It does not, however, obligate the current appropriation for the full amount of the liability which accrues during the year.

NEED TO RECORD OBLIGATIONS FOR SEPARATION ALLOWANCES WHEN INCURRED

We have consistently held that an appropriation is obligated when a definite commitment is made or a legal liability incurred to pay funds therefrom. (See 18 Comp. Gen. 363, 38 id. 81.)

Section 1311(a) of the Supplemental Appropriation Act, 1955 (31 U.S.C. 200 (a)), states:

"* * *no amount shall be recorded as an obligation of the Government of the United States unless it is supported by documentary evidence of

"(1) a binding agreement in writing between the parties thereto, including Government agencies, in a manner and form and for a purpose authorized by law, executed before the expiration of the period of availability for obligation of the appropriation * * * concerned * * * for * * *"

* * * * *

"(7) employment or services of persons * * *."

Since separation allowances are covered by binding agreements and, with minor exceptions, will be paid to each employee eventually, liabilities for future payment of separation allowances meet the criteria for valid obligations of section 1311 of the Supplemental Appropriation Act of 1955. Therefore, obligations for separation allowances should be recorded when they are earned.

The amount of separation allowances earned and the related obligation to be recorded periodically consists of the increase in entitlements accruing to the employees during the period. For those foreign nationals who are not separated during the year, the amount of obligations incurred during the year can be determined by recording the difference between what DOD would have to pay if it separated every employee as of the last day of each year and the amount of unliquidated obligations for separation allowances remaining in prior years appropriation accounts. To illustrate: If, at the end of fiscal year 1974, the amount of separation allowances DOD would have to pay if all employees were separated would be \$450 million and if the amount of unliquidated separation allowance obligations in prior year appropriation accounts amounted to \$415 million, the amount of obligations recorded at the end of fiscal year 1974 would be \$35 million.

MANNER IN WHICH OBLIGATIONS AND PAYMENTS
ARE RECORDED BY THE ARMY AND AIR FORCE

The Army and Air Force record separation allowance transactions in their accounts only when payments are made. When a payment is made, obligations for a pro rata portion of the payment are recorded in the accounts of the appropriations made for each of the years during which the employee worked.

To illustrate, if an employee with 10 years' service was to have been paid a separation allowance of \$5,000 at the end of fiscal year 1974, obligations and disbursements would have been recorded as follows:

<u>Appropriation account</u>	<u>Pro rata portions</u>	<u>Amounts recorded as obligations and disbursements</u>
FY 1974 (current)	1:10	\$ 500
FY 1973 (expired)	1:10	500
FY 1972 (expired)	1:10	500
Successor account (expired)	<u>7:10</u>	<u>3,500</u>
Total	10:10	<u>\$5,000</u>

During fiscal years 1970, 1971, and 1972, the Army and Air Force paid about \$50 million in separation allowances to Japanese employees. Only about \$3 million was recorded as obligations against and paid out of current appropriations. The balance of \$47 million was recorded as obligations against and paid out of expired appropriations. Of the \$47 million, \$40 million was charged against obligational authority which was restored to successor accounts.

Consistent with the above practices, the Army and Air Force include in their appropriation requests provisions for only the pro rata portions of allowances expected to be paid during the budget year that will be charged to the appropriations for that year. Accordingly, funds for the larger portion of separation allowance payments are not justified, requested, appropriated, and apportioned as such, but rather are obtained from left-over funds that were justified for other purposes.

AMOUNT OF UNRECORDED OBLIGATIONS

During our review we obtained information on separation allowances at Army and Air Force activities in Japan, Okinawa, Korea, the Philippines, and Taiwan. We estimated the amount of unrecorded obligations at the end of fiscal year 1973 using this information and providing for the 1973 devaluation of the dollar in Japan and for adjusted employment data. Assuming that all foreign national employees were separated at June 30, 1973, the unrecorded obligations amounted to \$305.2 million.

The following schedule shows the estimated unrecorded obligations for separation allowances by military service and country.

<u>Country</u>	<u>Number of employees</u>	<u>Unrecorded obligations</u>		
		<u>Army</u>	<u>Air Force</u>	<u>Total</u>
----- (000 omitted) -----				
Japan (including Okinawa)	26,150	\$151,000	\$ 99,300	\$250,300
Korea	15,140	47,200	4,500	51,700
Philippines	2,500	-	2,200	2,200
Taiwan	950	200	800	1,000
Total	<u>44,740</u>	<u>\$198,400</u>	<u>\$106,800</u>	<u>\$305,200</u>

Although there are foreign national employees in other countries employed by the Air Force and Army, the separation

allowance obligations applicable to these employees are minimal because of either limited entitlements or the small number of employees involved.

INADEQUATE ADMINISTRATIVE
CONTROL OF OBLIGATIONS

Every agency is required by the Antideficiency Act (31 U.S.C. 665) to have a system of administrative control, approved by the Director of the Office of Management and Budget, which will restrict obligations or expenditures to the amounts appropriated and to the amounts of the apportionments or reapportionments made for the current fiscal period. The system must also fix responsibility for the creation of any obligation, incurrence of any expenditure, or making of any disbursement in excess of an apportionment, reappportionment, or other subdivision.

Obviously, to meet the requirements of the act it is necessary that obligations be recorded as they are incurred to permit a comparison of obligations to apportionments and to fix responsibility for overobligations. In this regard the accounting principles and standards prescribed by the Comptroller General in General Accounting Office Policy and Procedures Manual for Guidance of Federal Agencies (2 GAO 10.3) require that accounting systems provide for identifying obligations with applicable appropriations at the time they are incurred.

Since separation allowance obligations are not recorded until payments are made, Army and Air Force administrative controls are inadequate. Further, as previously mentioned, most of the obligations are charged against successor accounts. Annual appropriations lose their identity when they are transferred to successor accounts. Consequently, if in any 1 year the amount of obligations incurred for separation allowances exceeds the annual appropriation's unobligated balance, violations of the Antideficiency Act would not be disclosed.

A comparison, as of June 30, 1973, of the unobligated balances of expired 1-year operation and maintenance appropriations to the unrecorded obligations for separation allowances is shown below.

<u>Military department</u>	<u>Unrecorded separation allowance liabilities</u>	<u>Unobligated balances of expired appropriations</u>
	(000 omitted)	
Army	\$198,400	\$211,378
Air Force	106,800	408,605

Accordingly, it cannot be said that the unrecorded obligations are unfunded because, under the act of July 25, 1956 (31 U.S.C. 701-708), any portion of the withdrawn balance of an expired appropriation may be restored to the appropriate accounts if the head of the agency concerned determines that such action is necessary to liquidate obligations or effect adjustments.

MANNER IN WHICH OBLIGATIONS
ARE RECORDED BY THE NAVY

The Navy generally records obligations at the time separation allowances are earned. It does not, however, record obligations against the current appropriation for the full amount of the liability which accrues during the year. Instead, a pro rata portion of obligations relating to increases in the liability for separation allowances due to changes in pay and exchange rates are recorded in the appropriations made for each of the years during which the employee worked.

The Navy's practice results in inadequate administrative control in that there is no assurance that sufficient unobligated authority will always be available in prior year appropriations to cover separation allowance obligations. The practice also results in charging obligations to prior years when it is the current year that receives the benefit of the services rendered by foreign national employees.

We believe that to insure adequate administrative control over funds and to charge the period benefiting from the services rendered by foreign national employees, the current appropriation should be obligated for the full amount of liability accruing during the year.

CONCLUSIONS

Recording obligations for separation allowances at the time the allowances are paid rather than incurred results in understatement of the obligations and inadequate administrative control of funds.

To insure adequate administrative control of funds and to charge the period benefiting from the services rendered by foreign national employees, the current appropriation should be obligated for the full amount of the liability for separation allowances which accrues during the year.

RECOMMENDATIONS

To provide disclosure and improved administrative control of the Government's obligations for separation allowances, the Secretary of Defense should direct the military departments to (1) immediately record all unrecorded obligations for separation allowances and (2) record all future obligations when they are incurred. Further, the Secretary should require that the amount of obligations recorded against current appropriations be equal to the total increase in the liability for separation allowance payments.

AGENCY COMMENTS AND OUR EVALUATION

The Assistant Secretary of Defense (Comptroller) concurs (see app. I) with our recommendation to record all future obligations for separation allowances when they are incurred and that the amounts of obligations recorded against appropriations be equal to the full amount of the liability for separation allowance payments that accrues during the applicable fiscal year. This procedure will become effective beginning in fiscal year 1976, assuming that the Congress will provide funds to cover the estimated liability that will be incurred during that year and succeeding years.

The Assistant Secretary does not agree with that part of our recommendation that requires the immediate recording of all unrecorded obligations which amounted to \$305 million as of June 30, 1973. He believes there is a need for a transition period to convert from existing long-standing budgeting and accounting practices. Further, he indicated there may not be sufficient funds to cover those unrecorded obligations which are applicable to appropriations for fiscal years 1973 and 1974. He indicated that funds in those years will most likely be exhausted due to financing the retroactive pay increases for the period October to December 1972. The remaining balances in these appropriations will not be known until after payments for all retroactive pay increases have been made and the balances are certified as required by section 1311 of the Supplemental Appropriation Act, 1955.

The unrecorded obligations will be disclosed by the military services in DOD's annual statement of financial condition which is submitted to the Treasury. As separations take place the amount of unrecorded obligations will gradually diminish over the years.

Because there is no legal authority for Defense to delay the recording of obligations for separation allowances, we believe that it either should request authority from the Congress to implement its proposal or should recognize and record all obligations.



COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

17 JUL 1974

Mr. D. L. Scantlebury, Director
Division of Financial and General
Management Studies
U.S. General Accounting Office

Dear Mr. Scantlebury:

The Secretary of Defense has asked that I respond to your draft report, dated May 1, 1974, "Substantial Understatement of Obligations for Separation Allowances for Foreign National Employees," in connection with Code 89206, (OSD Case No. 3827). We appreciate the opportunity to review the report and obtain your views on the subject.

The report contains a recommendation that the Secretary of Defense should direct the Military Departments to (1) record all unrecorded obligations for separation allowances and (2) record all future obligations when they are incurred. Further, it was recommended that the Secretary of Defense should require that the amount of obligations recorded against current appropriations be equal to the full amount of the liability for separation allowance payments that accrues during the applicable fiscal year.

The Department of Defense believes that the draft report suggests the desirability for a uniform policy applicable to each of the Military Departments. While we believe that various alternatives could be adopted as the uniform policy, we concur with your recommendation to record all future obligations when they are incurred and that the amounts of obligations recorded against appropriations be equal to the full amount of the liability for separation allowance payments that accrues during the applicable fiscal year.

However, we do not agree with that part of your recommendation that requires the recording of all unrecorded obligations. As indicated below, there would be a need for a transition period to convert from the existing long-standing budgeting and accounting practices, if they are to be changed.

The budgets for the Military Departments for FY 1975 have been formulated based on the methods used by each to record the obligations. Accordingly,

APPENDIX I

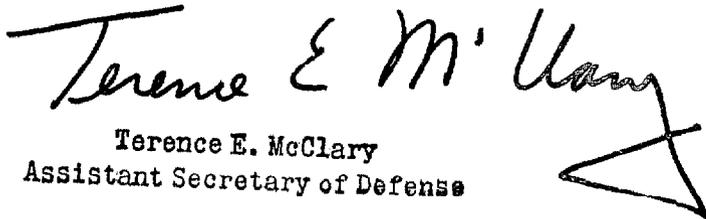
the budgets for the Army and Air Force included only those amounts expected to be paid during the current fiscal year while the Navy excluded amounts necessary to cover increases applicable to prior years.

As you point out, there appears to be sufficient balances available for restoration to the successor "M" accounts for recording applicable obligations. However, this is not necessarily true for FY's 74 and 73 which have not yet been merged with the related successor "M" accounts. In fact, the methods prescribed for financing the retroactive pay increases for the period of October - December 1972 as outlined in P.L. 93-305, "Making supplemental appropriations for the fiscal year ending June 30, 1974, and for other purposes," and OMB Bulletin No. 74-9, May 7, 1974, subject: "1973 Retroactive Pay Increases Costs," will most likely exhaust the balances available for FY's 73 and 74.

Rather than adopting your recommendation as written, we would propose the policy be effective starting with the FY 1976 budget. That budget, and future budgets, would include amounts for the current year's liability plus amounts necessary to cover the increase applicable to prior years. Thus, assuming the Congress provides funds in accordance with such budget requests, after a period of three years, when the FY 1976 accounts are merged with the related successor "M" accounts we would effectively be following the full spirit and intent of your recommendations from that time forward and have a uniform policy throughout the Department. This phased basis will also allow us sufficient time to formulate and publish the necessary policy guidance for budgeting and accounting and to work out the methods to be followed for employees transferring from one activity to another.

In the meantime, we would allow the Military Departments to follow their existing practice of recording unrecorded obligations applicable to prior year accounts at the time the separation payments are made. We would also disclose the amounts of the unfunded liability on the SF 220, "Statement of Financial Conditions," report to the Treasury. As separations take place, and, as we record the obligations on an accrual basis from FY 1976 forward, the amount of the unfunded liability should gradually diminish over the years.

Sincerely,


Terence E. McClary
Assistant Secretary of Defense

PRINCIPAL OFFICIALS
RESPONSIBLE FOR ADMINISTERING ACTIVITIES
DISCUSSED IN THIS REPORT

Tenure of office
From To

DEPARTMENT OF DEFENSE

SECRETARY OF DEFENSE:

Dr. James R. Schlesinger	June	1973	Present
William P. Clements (acting)	April	1973	June 1973
Elliot L. Richardson	Jan.	1973	Apr. 1973
Melvin R. Laird	Jan.	1969	Jan. 1973

ASSISTANT SECRETARY OF DEFENSE
(COMPTROLLER):

Terence E. McClary	June	1973	Present
Don R. Brazier (acting)	Feb.	1973	June 1973
Robert C. Moot	Jan.	1969	Jan. 1973

DEPARTMENT OF THE ARMY

SECRETARY OF THE ARMY:

Howard H. Callaway	May	1973	Present
Robert F. Froehlke	July	1971	May 1973

ASSISTANT SECRETARY OF THE ARMY
(FINANCIAL MANAGEMENT):

Hadlai A. Hull	Mar.	1973	Present
Richard L. Saint Sing (act- ing)	Sept.	1972	Mar. 1973
Eugene M. Becker	July	1971	Sept. 1972

DEPARTMENT OF THE NAVY

SECRETARY OF THE NAVY:

J. William Middendorf	June	1974	Present
John W. Warner	May	1972	Apr. 1974

ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT):

Vacant	May	1974	Present
Robert D. Nesen	May	1972	May 1974
Frank Sanders	July	1971	May 1972

APPENDIX II

Tenure of office
From To

DEPARTMENT OF THE AIR FORCE

SECRETARY OF THE AIR FORCE:

John J. McLucas	July	1973	Present
Dr. Robert C. Seamans, Jr.	Jan.	1969	July 1973

ASSISTANT SECRETARY OF THE AIR
FORCE (FINANCIAL MANAGEMENT):

William W. Woodruff	Apr.	1973	Present
Spencer J. Schedler	Jan.	1969	Apr. 1973

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