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

B-179708

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The Honorable
The Secretary of Defense

Dear Mr. Secretary:

The Navy's method of recording and reporting financial data in successor accounts and related surplus fund accounts needs to be improved.

Each year the Navy systematically deobligates, without proper justification, millions of dollars in obligations recorded in its Military Personnel and Operation and Maintenance appropriations successor accounts. It also writes off large amounts in accounts receivable which were recorded in these accounts without determining whether the accounts due were collectable. As a result, it does not have adequate accounting control over successor account obligations and receivables. Further, its financial reports do not accurately show (1) obligations and/or liabilities it has incurred, (2) accounts receivable from others, and (3) withdrawals from appropriations and restorations to appropriations from related surplus fund accounts.

BACKGROUND

Successor and related surplus fund accounts were established Government-wide in 1956, pursuant to Public Law 798, 84th Congress, 2d session (31 U.S.C. 701-708). Under the provisions of this law, the net balances of unpaid obligations and accounts receivable applicable to appropriations which have been expired for 2 years for obligation purposes are merged into a successor account with unpaid obligations and accounts receivable of other previously expired appropriations made for the same general purposes.

Unobligated amounts of expired appropriations are required to be withdrawn from the appropriation to the Treasury. The Treasury maintains a record of these amounts in an account called the Surplus Fund. An appropriation's related surplus fund balance is merged with surplus fund balances of similar prior years' appropriations 2 years after the appropriation expires. The act authorizes the heads of agencies to restore funds to its successor accounts from surplus fund accounts if the amounts necessary to liquidate obligations applicable to the years covered by the fund exceed the balances in related successor accounts.

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Section 703(a) of title 31 requires agencies to review successor accounts at least once each year, to determine the amounts to be withdrawn from their successor accounts to the related surplus fund or restored to the successor account.

SCOPE OF REVIEW

We evaluated the effectiveness of the Navy's accounting for successor and related surplus fund accounts pertaining to the Military Personnel and Operation and Maintenance appropriations. We examined legislation, policies, procedures, documents, and transactions dealing with accounting for and reporting on appropriation successor accounts and related surplus fund accounts.

We made our review at the Navy's headquarters offices in Washington, D.C.

INADEQUATE CONTROL AND ACCOUNTING FOR OBLIGATIONS, ACCOUNTS RECEIVABLE, AND SURPLUS FUNDS

From June 30, 1973, to June 30, 1975, the Navy arbitrarily deobligated $51 million in obligations and wrote off, without proper justification, $38 million in accounts receivable applicable to the successor accounts for the Military Personnel and Operation and Maintenance appropriations. A breakdown of the deobligations and accounts receivable writeoffs by year and appropriation follows.

Navy appropriation	Date of action	Amounts deobligated	Accounts receivable written off
		(millions)	
Operation and maintenance	6/30/73	$18.3	$28.2
Military personnel	6/30/73	5.6	-
Operation and maintenance	6/30/74	17.4	9.7
Military personnel	6/30/75	10.1	-
Total		$51.4	$37.9

The Navy took the above actions in accordance with its accounting procedures which provide generally that:

1. Once Military Personnel and Operation and Maintenance appropriations are merged in successor accounts,

accounting for such appropriations at local accounting units stop.

2. Navy headquarters keep summary totals for obligations and receivables for only the most recent appropriation merged into the successor account.

3. As of June 30 each year all previous successor account obligations be deobligated and all previous successor accounts receivable be written off.

4. The net amount of obligations deobligated be withdrawn and credited to the related surplus fund.

5. Navy headquarters be notified each month by its disbursing units of payments made against obligations that previously had been deobligated. An obligation and a disbursement are then recorded simultaneously at the headquarters level.

6. Navy headquarters be notified also when collections are made on accounts receivable which were previously written off and for which increases to accounts receivable and collections were simultaneously recorded.

7. At the end of the fiscal year, funds be restored to successor accounts from the surplus fund accounts to cover obligations for which there are insufficient balances in related successor accounts.

Navy officials said that documentation supporting obligations that were deobligated and accounts receivable which were written off are retained at various Navy organizations and at Defense Contract Administration Services regions. This documentation is used to verify whether it is proper and correct to pay bills for obligations that have been deobligated and to monitor the collection of those accounts receivable which have been written off.

At least $9 million of the $51.4 million which was arbitrarily deobligated proved to be for obligations which were valid and which were later paid and $2 million of the $37.9 million was for accounts receivable which were previously written off and which were later collected. The Navy's practice, therefore, has resulted in (1) the loss of formal accounting control over valid obligations and accounts receivable in its successor accounts and (2) distortion of financial data on liabilities, receivables, and withdrawals reported to the Treasury. The Treasury uses data reported by the Navy to prepare consolidated financial reports which it distributes to the Congress and to the public. 38

As noted above, 31 U.S.C. 703(a) requires agencies to review their successor accounts at least once each year, to determine the amount to be withdrawn from or restored to the successor accounts. To properly make this determination, the Navy must review the validity of recorded obligations and receivables. The Navy does not make this review but, as stated previously, arbitrarily deobligates recorded obligations and writes off accounts receivable in its successor accounts. We believe, therefore, that the Navy's procedures violate the intent of 31 U.S.C. 703(a).

Further we believe that the Navy's procedures violate section 1311 of the Supplemental Appropriation Act, 1955, as amended, which provides criteria for recording obligations on the books of Federal agencies. If a transaction meets the criteria for a valid obligation and the obligation is recorded in the accounting records, the Navy cannot legally deobligate the obligation unless it is determined to be invalid.

NAVY'S RATIONALE FOR PRESENT PRACTICE AND OUR EVALUATION

We asked the Assistant Secretary of Navy (Financial Management) to explain the rationale behind the Navy's practice described above. In his June 5, 1975, letter (see enclosure), the Assistant Secretary said that the procedures were adopted on May 2, 1973. He also said that

> "* * * Prior to that time, the obligation balances reported at the end of each fiscal year represented the cumulative total of such balances from all lapsed fiscal years pursuant to the Act of 25 July 1956. The cumulative balances reflected liquidations and adjustments of obligations, but had not been systematically purged of potentially invalid obligations which would never result in payments. The current method of reporting the balance of unpaid obligations in the 'M' [successor] account, therefore, enables this Department to report a sum which can currently be supported by records and documents. This was deemed a more accurate reflection of the total government

liability than the previous situation of reporting a cumulative balance which had not been purified."

The Assistant Secretary neglected to comment on the reasons why the Navy arbitrarily wrote off accounts receivable. This is an important matter since the formal accounting system should provide management with the amount of valid accounts receivable. Management could use this information to insure that Navy organizations promptly collect amounts owed the Navy.

We agree that accounting and reporting a cumulative balance which had not been purged of invalid obligations is not desirable. We believe, however, that, to maintain accounting control and accurately report financial data, the solution to this problem is to deobligate obligations which are not valid rather than, as provided by Navy procedures, deobligate all obligations whether valid or invalid.

The Assistant Secretary also indicated that amounts of unliquidated obligations merged into successor accounts are minimal compared with the total amount of the appropriation and therefore do not justify the expense of detailed accounting. He said that, if the Navy

"* * * were required to maintain total formal accounting visibility for each unliquidated obligation in the 'M' [successor] account until paid, collected, or determined to be no longer valid, a separate ledger would have to be retained for each year and active posting to many years' ledgers would be required each month by all activities involved. Such controls would substantially negate the intent of the 'M' account legislation to merge all such balances into a single account."

Considering that millions of dollars of obligations and accounts receivable have been arbitrarily deobligated or written off, we believe that the amounts are material enough to justify detailed accounting. Although the Navy might incur additional administrative expenses, this fact does not justify (1) eliminating formal accounting for valid obligations and receivables and (2) violating the provisions of section 1311 and 31 U.S.C. 703(a). Further the Navy need not keep separate ledgers for each appropriation year in successor accounts. Like the Army and Air Force, it can merge all obligations and accounts receivable into a single account.

CONCLUSIONS

We are always willing to concur in any reasonable procedure which makes accounting easier, so long as it does not skew the results or fail to comply with applicable legal requirements. We therefore are sympathetic to the Navy's objectives, but we believe they are inappropriate in this case. Specifically, we believe that the Navy's procedures violate the provisions of section 1311 and 31 U.S.C. 703(a). Further they do not provide for adequate accounting control over successor account obligations, receivables, and surplus fund balances nor result in accurate and complete disclosure of the Navy's accounts receivable and obligations.

RECOMMENDATIONS

We recommend that, to meet the requirements of law and provide for adequate accounting and reporting of financial data with regard to Operation and Maintenance and Military Personnel appropriation successor accounts, you direct the Secretary of the Navy to:

--Change existing procedures to require that local accounting units properly account for (1) obligations until paid or determined to be no longer valid and (2) accounts receivable until collected or determined to be uncollectable.

--Reestablish in successor accounts those obligations and accounts receivable which previously were deobligated or written off and against which future expenditures or collections are anticipated.

--Have the Navy's accounting staff or internal auditors periodically review the validity of obligations and the balances of accounts receivable.

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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

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We are sending copies of this report to the Director, Office of Management and Budget; the Chairmen of the House and Senate Committees on Government Operations, Appropriations, and Armed Services; and the Secretary of the Navy.

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Sincerely yours,

Comptroller General
of the United States

Enclosure

DEPARTMENT OF THE NAVY
OFFICE OF THE SECRETARY
WASHINGTON, D C 20350

5 JUN 1975

Mr. D.L. Scantlebury
Director, Division of Financial and
General Management Studies
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Scantlebury:

Thank you for the opportunity to explain the rationale behind the practice of the Department of the Navy (DON) with respect to reporting of balances of obligations and receivables for lapsed Military Personnel and Operation and Maintenance appropriations (OSD Case #4059).

As stated in your letter of 27 March 1975, the Department of the Navy procedures, as established by NAVCOMPT Notice 7301 of 2 May 1973, call for reporting as unpaid obligations against the successor (M) account of unpaid obligations against the most recently lapsed account only, together with the cumulative total of such obligations applicable to foreign nationals. This system of reporting was adopted as a reasonable and practical approach to compliance with the requirement to report the total of all valid obligated balances while at the same time meeting the requirement for supporting records.

The present "M" account procedures were adopted after a DON study of the administration of these accounts. Prior to that time, the obligation balances reported at the end of each fiscal year represented the cumulative total of such balances from all lapsed fiscal years pursuant to the Act of 25 July 1956. The cumulative balances reflected liquidations and adjustments of obligations, but had not been systematically purged of potentially invalid obligations which would never result in payments. The current method of reporting the balance of unpaid obligations in the "M" account, therefore, enables this Department to report a sum which can currently be supported by records and documents. This was deemed a more accurate reflection of the total government liability than the previous situation of reporting a cumulative balance which had not been purified. Additionally, this approach is in accord with our interpretation of the intent of the establishment of the successor (M) accounts.

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A further consideration in the adoption of the procedures in question is that they are supported by the principle of materiality inasmuch as the percentage of Military Personnel or Operation and Maintenance obligations remaining unpaid after three years (one year of obligational availability and two years in the expired account) is minimal. For example, experience over the past five years has reflected the following rates of cumulative liquidation of obligations in the Military Personnel, Navy and Operation and Maintenance, Navy appropriations:

PERCENTAGE OF LIQUIDATED OBLIGATIONS AT END OF THIRD YEAR
(Amounts in Thousands)

Appropriation	F.Y.	Cumulative Disbursements	Cumulative Obligations	% Liquidated
MP,N	1972	$ 5,119,187	$ 5,133,768	99.71%
	1970	4,883,260	4,886,754	99.92%
	1969	4,487,107	4,488,356	99.97%
	1968	4,184,352	4,190,089	99.86%
O&M,N	1972	$ 6,484,544	6,544,698	99.08%
	1971	5,778,440	5,821,928	99.25%
	1970	6,119,052	6,159,882	99.33%
	1969	6,157,158	6,217,260	99.03%
	1968	5,539,234	5,568,431	99.47%

By the end of the fourth year, when the account has been in the "M" account for one year, the percentage of unliquidated obligations is obviously still further reduced to a level which could not justify the expense of retention of detailed accounting.

We do not agree that accounting control is reduced significantly by the procedures in question. On the contrary, the 2 May 1973 NAVCOMPT Notice increased control by requiring the continued maintenance of documentary evidence for unpaid obligations at the activity level and the citation of such documents on related expenditure documents. Additionally there is a requirement for citation on expenditure/collection transactions of complete accounting data both for the "M" account and for the funds which would have been charged or credited prior to lapse. These measures provide an audit trail for review of any transactions as to propriety and validity. Controls are maintained on amounts available for restoration, and by analysis the responsible office can determine the net volume of obligations reestablished/cancelled pursuant to the annual "write-offs." Thus, while immediate management visibility may be affected by the "write-off" procedure, the status of the "M" account can be monitored.

In response to your question as to the nature and, if available, an estimate of the additional costs that would be anticipated if the Navy formally accounted for each unliquidated obligation and uncollected reimbursement when merged in the "M" account, it can be stated that, while no precise estimate is available, there would inevitably be a significant increase in costs and workload. Under current procedures, accounting for the successor appropriations is accomplished on Bureau Appropriation Control Ledgers at summary level. As previously stated, all detailed accounting at claimant and subclaimant levels and below, except that related to the liability for foreign nationals, is discontinued when an appropriation lapses. If the DON were required to maintain total formal accounting visibility for each unliquidated obligation in the "M" account until paid, collected, or determined to be no longer valid, a separate ledger would have to be retained for each year and active posting to many years' ledgers would be required each month by all activities involved. Such controls would substantially negate the intent of the "M" account legislation to merge all such balances into a single account. There would be additional costs (manpower, computer capability, etc.) at all levels of reporting (allotment/operating budget, subhead, appropriation). The number of activities and operating budgets involved in administering the appropriations under discussion make it impossible to provide more precise estimates at this time.

An example of the problems involved in the detailed accounting under discussion can be seen in the application to the Military Personnel and Reserve Personnel accounts. A high level of ledger posting activity would be necessary due to the continuing flow of personnel claims processed by payment centers for such transactions as changes in Pay Entry Base Date, retroactive claims for BAQ entitlements for women members, and other types of claims which may affect pay retroactively for several years. The dollar value of the claims is usually not high; however, the flow of retroactive claims and pay adjustments is constant. It has until now been considered that, assuming sufficient unliquidated obligations in the account, examination and maintenance of detailed voucher documentation available at the paying office is sufficient to meet all legal requirements without the necessity for detailed posting to account ledgers.

If further information is required in connection with your current examination of successor (M) accounts, my staff remains available to assist your representatives.

G. D. Penisten

G. D. PENISTEN
ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT)