

GAO

Report to the Secretary of Defense

March 1987

**FINANCIAL
MANAGEMENT**

**Defense Accounting
Adjustments for Stock
Fund Obligations Are
Illegal**



038349

**Accounting and Financial
Management Division****B-224614**

March 11, 1987

The Honorable Caspar W. Weinberger
The Secretary of Defense

Dear Mr. Secretary:

In a January 21, 1986, letter to the Assistant Secretary of Defense (Comptroller), we raised several questions concerning the appropriateness of a series of obligation adjustments, which effectively provided additional obligational authority totaling some \$563 million in fiscal year 1984, derived largely from Treasury merged surplus fund balances.¹ The Air Force and Army made these adjustments to implement an accounting policy change for orders placed with Department of Defense (DOD) stock funds.²

After considering the Assistant Secretary's responses and other information, we have concluded that the obligation adjustments are illegal because the adjustments do not comply with the documentation requirements of 31 U.S.C. 1501, "Documentary Evidence Requirements for Government Obligations." We are recommending that the Secretary of Defense direct the Secretaries of the Air Force and Army to ensure future obligation adjustments comply with existing legal requirements.

We are also concerned with the extent of disclosures of these adjustments to the Congress at the time the Air Force and Army were making the adjustments. In these times of budgetary constraints, given the extraordinary nature and magnitude of these obligation adjustments, we believe DOD should have fully disclosed to the Congress the methodology used and resulting impacts on the services' obligational authority. We do not believe that the methods used by DOD to inform the Congress were adequate or that the information provided was sufficient.

We have noted that the House Committee on Appropriations, in its August 14, 1986, report (House Report 99-792) on DOD's 1987 appropriation bill, expressed concern not only about these adjustments but also about DOD's management of its large surplus fund and "M" account balances. The committee report directed DOD to implement certain actions to

¹See appendix I for an explanation of merged surplus and "M" account balances.

²Stock funds, which are operated under the working capital fund concept, finance the purchase of materials and common-use items and hold these items in inventory until purchased by customers—generally, the military services or Defense agency operating units.

improve management of these balances and to report back to the committee by April 1, 1987, on how DOD will implement the committee's directions.

We share the committee's concern about the adequacy of management controls over surplus fund and "M" account balances, and we are making recommendations to improve controls by having (1) the Assistant Secretary of Defense (Comptroller) review and approve individual service adjustments to surplus fund and "M" account balances exceeding a certain threshold, such as \$1 million, and (2) adjustments exceeding this threshold promptly and fully disclosed to the appropriate congressional committees.

Background

Since the late 1960's, DOD regulations required that obligations for purchases from stock funds be recorded at the time of delivery to the services. This policy created problems because (1) the services had little control over when funds were obligated since deliveries could be delayed for years and (2) the services were forced, near the end of the fiscal year, to order less critical but available items to utilize expiring funds. Beginning in 1974, DOD made several attempts to change the stock fund obligation policy to allow service funds to be obligated upon placement of an order with a stock fund. DOD approved such a change in 1982 and, as part of its fiscal year 1984 budget, requested \$194.6 million to fund the stock fund accounting change for the Air Force and Army. (About \$1 million of this amount was for other defense agencies.) The Navy implemented the change during fiscal year 1982.

The Congress denied DOD the \$194.6 million to implement the change but directed that the change be implemented by the Air Force and Army within available resources by the end of fiscal year 1984. The Army and Air Force implemented the accounting policy change in October 1983 and in April 1984, respectively.

Objectives, Scope, and Methodology

The primary objectives of our review were to determine the magnitude of the accounting adjustments in question, the procedures used to calculate and record the adjustments, the degree of control that was exercised in the overall process, and whether the adjustments complied with existing legal requirements. We conducted our review in Washington, D.C., where all key personnel and documents were located.

We interviewed Air Force and Army personnel who were directly involved in calculating the adjustments and reviewed available documentation to (1) determine how the adjustments were calculated and supported and (2) assess whether the adjustments complied with existing legal requirements. We also contacted (1) officials at the Army Audit Agency who had reviewed the Army's proposed adjustment plan to determine the extent of their review and (2) Office of the Assistant Secretary of Defense officials to determine the extent of review and approval of the adjustments above the service level.

Our review was conducted from October 1985 to September 1986 in accordance with generally accepted government auditing standards.

Issues Raised in Our Letter to Assistant Secretary of Defense

In January 1986, we wrote the Assistant Secretary of Defense (Comptroller) requesting information concerning the role of his office in authorizing and/or approving the obligation adjustments and questioning the legality of the transactions. We also provided supplemental information in a letter to his Director of Accounting Policy. In those letters, we provided the following description of the events leading up to the adjustments. (See appendix II for copies of our letters.)

In 1974, and again in 1982, the Department of Defense proposed a change in accounting policy so that obligations for stock fund purchases would be recorded when orders were placed with a stock fund rather than at the time of delivery. In both instances, DOD asked the Congress for additional obligational authority to fund or "buy out" the stock fund pipeline—those orders that would remain unfilled at fiscal year-end and that, under the then-existing DOD policy, would be obligated with subsequent-year appropriations when the orders were filled. In both instances, the Congress denied the additional funds, citing budget constraints. During fiscal year 1984 budget deliberations, the House and Senate appropriations committees denied DOD's request for \$194.6 million to fund the accounting policy change and directed that the change be implemented within available resources.

The Air Force and Army, after being denied the additional \$194.6 million, decided to fund the pipeline orders by implementing the new accounting policy retroactively, that is, reclassifying obligations for existing pipeline orders to appropriations available in the years the orders were placed.

The majority of the existing pipeline orders originated in the 2 prior years (fiscal years 1982 and 1983) and, thus, under the new accounting policy would be chargeable to these two expired-year appropriations. However, documentation supporting the adjustments and discussions with service officials disclosed that insufficient unobligated balances were available in these expired appropriations to cover the entire amount of the existing pipeline orders. Therefore, lacking sufficient unobligated balances in the 2 prior years, the Air Force and Army decided to extend the change in accounting policy retroactively to orders that had been delivered and paid for. These included orders that would be considered chargeable to fiscal year 1981 and prior appropriations whose unobligated balances had merged into the surplus fund which had sufficient unobligated balances to fund the pipeline orders.

Although agencies may properly make retroactive adjustments to correct accounting errors, in order to properly record the accounting adjustments discussed above to the prior years, it would have been necessary to determine the specific orders that were placed in each prior year and obligated in subsequent years when delivered. However, because field installations did not identify in detail the years in which prior-year orders were actually delivered, the Air Force and Army calculated and recorded the adjustments at the departmental level. The adjustments were estimated using percentage factors derived statistically from an analysis of the then-existing pipeline orders.

By implementing the accounting policy change retroactively and calculating the amount of the adjustments through statistical means, the Air Force and Army eventually obligated some \$625 million of merged surplus authority (appropriations that had expired for new obligations 2 or more years previously and had lost fiscal year identity) and thus made available to fund fiscal year 1984 orders and/or other operating requirements some \$563 million, derived primarily from the \$625 million recorded in the "M" accounts. The \$563 million that the Air Force and Army made available in additional obligational authority amounted to about \$368 million more than DOD originally requested from, and was denied by, the Congress during the fiscal year 1984 budget deliberations.

In our January 1986 letter, we stated that we believe that since the charges of over a half billion dollars to the surplus fund were extraordinary, apparently without precedent, and that since large sums (about \$25.5 billion) remain available in the surplus fund for future adjustments, we believe that when such adjustments are made, DOD should

fully disclose this to the Congress. We noted that the Army Audit Agency suggested obtaining congressional approval in its comments on the Army's proposed adjustments, even without knowledge at the time that merged surplus authority would provide the bulk of the funds

We also expressed our concern about the legality of the methods used to calculate and record the adjustments to prior-year obligations. We stated that while statistical sampling of individual transactions is acceptable under certain circumstances for verifying the validity of obligations reported to the Office of Management and Budget and to the Congress, and certain obligations are estimated temporarily for fund control purposes, use of statistical methods to estimate and adjust recorded obligations lacks legal foundation when the specific underlying transactions cannot be identified and do not support the calculated totals. The adjustments must be made on a specific obligation-by-obligation basis. We stated that adjustments to obligations which are not supported by evidence of the underlying transactions (the actual orders) appeared to be inconsistent with the documentation requirements of 31 U.S.C. 1501, "Documentary Evidence Requirement for Government Obligations."

Assistant Secretary of Defense Response to Our Questions

The Assistant Secretary responded by letters dated January 31 and April 11, 1986, maintaining that the adjustments were legal. (See appendix III.) The Assistant Secretary acknowledged that while the Air Force and Army did not request his office to authorize or approve their procedures, they informally briefed his office on the proposed general concepts to be followed. The Assistant Secretary noted that at these informal briefings it was stated that the Army counsel had determined that the actions were legal.

The Assistant Secretary further stated that his office had concluded that the use of statistically derived estimates by the Air Force and Army was proper and that the requirements for recording obligations contained in 31 U.S.C. 1501 are not so rigid as to preclude a statistical adjustment. The Assistant Secretary also maintained that DOD provided full disclosure to the House and Senate appropriations committees of the fact that statistical procedures were to be used and of the approximate dollar amount of the adjustments.

Finally, the Assistant Secretary pointed out that while the accounting problem was unique and unprecedented, it was an issue that had to be resolved in order to bring DOD into compliance with accepted accounting

principles and standards and to continue the process of upgrading DOD accounting systems to meet GAO accounting requirements.

Our Opinion on Legality of Obligation Adjustments and on Congressional Disclosure

We do not agree with the Assistant Secretary's position concerning the legality of the statistical methods used in making the adjustments or the adequacy of disclosure of these adjustments to the Congress. In order to record an obligation against an appropriation, 31 U.S.C. 1501, "Documentary Evidence Requirement for Government Obligations," requires documentary evidence of an agreement or order placed during the period of availability for obligation of an appropriation. The use of statistical methods to estimate and adjust recorded obligations lacks legal foundation if the underlying transactions cannot be identified and do not support the calculated totals. Since DOD did not identify the underlying transactions supporting the adjustments retroactively charged to the "M" accounts, such adjustments are not valid obligations in our opinion.

Concerning the Assistant Secretary's contention that the Army counsel had determined the adjustments were legal, the counsel, who is actually the counsel for the Army Audit Agency, told us that he did not consider the legality of statistical methods to estimate and adjust obligations because he did not know at the time that such methods would be used.

We also do not agree that DOD provided adequate disclosure to the Congress of the services' plans to make these adjustments. While the services sent letters to staff members of both the House and Senate appropriations committees notifying them of the planned strategy to implement the accounting policy change, we found no evidence that the committee chairmen or members were formally notified. Further, the letters sent to the committee staff members did not mention that merged surplus authority would be used, that the obligation adjustments would not be supported by documentary evidence, or that the adjustments would provide additional obligational resources far in excess of the amounts DOD requested from the Congress to fund the adjustments but which the Congress had previously denied.

We acknowledge DOD is not legally required to obtain congressional approval for accounting adjustments such as these. However, we believe it is not in the government's best interests, especially in these times of budgetary constraints, for the military services to augment current appropriations by over a half billion dollars through retroactive

accounting adjustments which have not been approved by the Office of the Secretary of Defense or fully disclosed to the Congress.

We agree with the Assistant Secretary that the accounting policy change discussed in this report is necessary to bring DOD into compliance with accepted accounting principles and standards and have recommended such a change in a report we issued in August 1983.³ However, in that report we stated that if the Congress did not provide the funds DOD requested for the change, the new accounting changes could be phased in over a period of time.

House Appropriations Committee Concerned With DOD Management of Surplus Fund/"M" Account Balances

In its report on DOD's 1987 appropriation bill (House Report 99-792, August 14, 1986), the House Committee on Appropriations expressed concern, not only with the large and ever-increasing surplus fund and "M" account balances, but also with the management of these funds. The committee directed DOD to undertake actions intended to improve management of these balances, including requiring (1) all upward adjustments of obligations in excess of \$100,000 which involve any individual action or contract to be reported and approved by the service secretaries and (2) the services to develop specific definitions and examples to be used in determining whether they may adjust obligations utilizing surplus fund balances. The committee directed DOD to report back by April 1, 1987, on how it will implement these directions

The House Appropriations Committee's directed actions to improve management controls over the use of surplus fund and "M" account balances should improve controls within the military services. However, the large adjustments made by the Air Force and Army without sufficient notification to the Office of the Secretary of Defense and the Congress cause us to believe additional controls are needed

First, this report shows the need for the Assistant Secretary of Defense (Comptroller) to review and approve large adjustments, for example \$1 million or more, to the merged surplus fund balances. The services should not be permitted to bypass the funding approval process exercised by the Office of the Assistant Secretary of Defense by making retroactive accounting adjustments to the surplus fund.

³Criteria for Recording Obligations for Defense Stock Fund Purchases Should Be Changed (GAO/AFMD-83-54, August 19, 1983)

Second, in these times of fiscal constraint, the Congress should be promptly notified of any large additional budgetary resources resulting from the services' use of surplus fund balances

Conclusions

We support DOD's efforts to change its accounting policy for recording stock fund obligations. While we do not object in principle to DOD's using merged surplus authority balances to adjust previously recorded obligations, such adjustments must comply with existing legal requirements. The series of obligation adjustments made by the Air Force and Army to implement accounting policy changes for orders placed with Department of Defense stock funds do not comply with the documentation requirements of 31 U.S.C. 1501 and are therefore illegal. We believe that DOD should ensure future obligation adjustments comply with all existing legal requirements.

Aside from the issue of legality, given the extraordinary nature and magnitude of these obligation adjustments, we believe DOD should have fully disclosed the methodology used and the resulting impacts on the services' obligational authority to the Congress. We do not believe that the methods used by the Air Force and the Army to inform the Congress and the Office of the Assistant Secretary of Defense were adequate or that the information provided was sufficient.

We believe the actions directed by the House Appropriations Committee will help improve DOD's internal controls over the use of surplus fund and "M" account balances. On the basis of our review of the obligation adjustments discussed in this report, we believe some additional controls are needed.

Recommendations

We recommend that the Secretary of Defense direct that the Secretaries of the Air Force and Army ensure future obligation adjustments made to surplus fund and "M" account balances comply with existing legal requirements, including the documentation requirements of 31 U.S.C. 1501.

We also recommend that the Secretary of Defense (1) require the Office of the Assistant Secretary of Defense (Comptroller) to review and approve individual service adjustments to surplus fund and "M" account balances exceeding a certain threshold, such as \$1 million, and (2) promptly and fully disclose adjustments exceeding this threshold to the appropriate congressional committee chairmen

Our draft report submitted for DOD review and comment proposed that the Secretary of Defense (1) require that the entries which provided \$563 million of additional obligational authority be reversed, (2) report any deficiencies resulting from the adjustments to the Congress and the President, and (3) request deficiency appropriations, if necessary, in accordance with 31 U.S.C. 1517, commonly known as the Antideficiency Act. We have deleted these proposals from our final report since the unobligated balance of the fiscal year 1984 appropriation in question became part of the merged surplus fund as of October 1, 1986. Accordingly, any adjusting entries at this time would have no impact because the amounts in that fund far exceed the amounts of obligations which would be charged to it as a result of reversing the entries. Further, this report and DOD's report under 31 U.S.C. 720 will serve to inform the Congress of our recommendations.

Agency Comments and Our Evaluation

DOD maintains the volume of orders involved in the change in policy is a primary reason for the statistical method used to make the adjustments and precluded resolving the problem in a practical and expeditious manner with any other approach. DOD indicated a detailed review of each order would have included researching the history of between 7 and 8 million individual orders to make the required adjustments on a transaction by transaction basis. Because of this unique and unprecedented situation, DOD believes the Army and Air Force made an appropriate management decision to document adjustments based upon the application of a statistical analysis to the dollar amount of the orders outstanding at the end of each of the related fiscal years.

We recognize this was a unique and unprecedented situation. The fact remains, however, that 31 U.S.C. 1501 requires documentary evidence to support obligations and adjustments to obligations. Use of statistical methods to calculate and record obligation adjustments is not acceptable because such amounts could be subject to unsubstantiated assumptions, manipulation, and could otherwise, in fact, not be correct.

For example, our review of Army documents indicates that statistical factors used to calculate hundreds of millions of dollars in adjustments were based on test data from only one of hundreds of Army field activities and "educated guesses from field supply personnel." In addition, the Army made assumptions concerning such things as order cancellation rates, inflation rates, and what appropriations were affected—all of which could significantly affect the adjustment amounts. There was no

independent audit of the validity of the statistical factors or the assumptions made by the Army.

If any of the statistical factors or assumptions used by the Army are incorrect, the resulting obligation adjustments could be higher or lower than DOD estimates by millions of dollars. Questions regarding the reliability of obligation amounts were the primary reason why the Congress enacted the documentary evidence requirements for recording obligations in 1954. The legislative history of 31 U.S.C. 1501 indicates that prior to enactment of this legislation, congressional appropriation committees experienced difficulty in obtaining reliable obligation figures from the executive agencies in connection with the budget review. Loose practices had developed in various agencies, particularly in recording obligations in situations where no real obligation existed, and, as a result, the Congress did not have reliable information in the form of accurate obligations on which to determine an agency's future requirements.

In order to comply with the documentation requirements of 31 U.S.C. 1501, we believe the Air Force and Army should have limited the adjustments to those years where they could readily identify and document the affected orders—fiscal years 1982 and 1983—because reviewing orders from earlier years could have entailed a massive research effort. This would have presented funding problems to Defense, however, since according to service officials, there were insufficient unobligated balances available for these years to absorb the adjustments. Given this situation, we believe DOD had at least two other alternatives to implement the accounting change within existing law: (1) phasing in the accounting change over a period of years so that the change could be absorbed within available resources or (2) requesting a supplemental appropriation to fund the change during fiscal year 1984.

These two alternatives conflict with congressional direction that the accounting change be implemented within available resources during fiscal year 1984. However, congressional direction contemplates action within the requirements of existing law unless such laws are specifically amended or repealed. Since the documentary requirements of 31 U.S.C. 1501 were not amended or repealed, DOD must adhere to these requirements even though DOD believes that doing so would conflict with congressional direction. We believe DOD could have advised the appropriate congressional committee chairmen of this conflict and sought to reach agreement on an alternative that would allow DOD to implement the

accounting policy change within existing legal requirements and satisfy congressional direction.

DOD maintains that there was disclosure to the House and Senate Appropriations Committees concerning the adjustments. DOD referred to the services' letters sent to the committee staff members and maintained that the letters provided sufficient disclosure of the services' actions. DOD expressed three major concerns with our contention that there was not adequate disclosure to the Congress.

First, DOD stated that while the services' letters to the committee staff members do not specifically mention the words "merged surplus authority," the only funding available to apply the policy to all prior years as stated in these letters are surplus and merged surplus authority. DOD also stated that a record of a telephone call between Air Force personnel and a House Appropriation Committee staff member indicates that the staff member understood that prior-year funds were going to be used to cover the adjustments.

Secondly, DOD stated that while the services' letters do not specifically state that the adjustments will not be documented to each requisition and its related deliveries, the letters state that the summary adjustments will be calculated based upon a "statistical analysis" which, according to DOD, would appear to mean something other than documentation of each individual order and its deliveries.

Thirdly, DOD pointed out, in response to our contention that the letters did not mention that the adjustments would provide additional obligatory resources far in excess of the amounts that DOD had previously requested and been denied by the Congress, that the enclosure to the Army letter clearly stated that the Army estimated that the result of the adjustments would be a \$600-million impact on the surplus fund

We continue to believe that there was not adequate disclosure of these adjustments to the Congress. Most importantly, we do not believe the services' letters sent to committee staff members or subsequent telephone conversations between service personnel and these same staff members can be considered an adequate process for notifying the Congress. We believe the services should have formally advised the appropriate congressional committee chairmen of these adjustments

Furthermore, the information provided to committee staff members was not specific as to the source of funding for the adjustments or the methodology that would be used to calculate the adjustments, nor did the Air Force and Army state that the adjustments would not be supported by documentary evidence as required by existing laws

For example, we do not agree with DOD's contention that the enclosure to the Army letter clearly disclosed that the Army estimated the result of the adjustments would have a \$600 million impact on the surplus fund. While the enclosure states that the Army estimated the cost to finance the accounting change at about \$600 million, the enclosure also notes that, during the budget process, DOD asked for \$81 million to finance the Army's accounting change. There is no discussion in the enclosure as to why the figures differ or what the final approved estimate is. Also, contrary to DOD's statement, the enclosure does not mention that the surplus fund would be used for the adjustments.

We are concerned with the issue of disclosure since the Congress is not routinely made aware of the large surplus fund and "M" account balances⁴ nor of the use made of these balances. We do not believe it is appropriate to make obligational adjustments totaling \$563 million to these balances without promptly and fully disclosing the actions to the Congress.

DOD's comments and further details of our evaluation are contained in appendix IV.

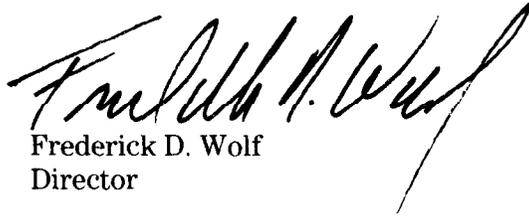
The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Chairmen, House and Senate Appropriations Committees, House and Senate Budget Committees,

⁴As of September 30, 1985, DOD's merged surplus authority and "M" account balances were \$25.5 and \$6.3 billion, respectively.

Senate Committee on Governmental Affairs, House Committee on Government Operations, Senate and House Armed Services Committees, and to the Director, Office of Management and Budget. Copies will be made available to other interested parties upon request.

Sincerely yours,



Frederick D. Wolf
Director

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Abbreviations

DOD	Department of Defense
GAO	General Accounting Office

Explanation of Merged Surplus and “M” Account Balances

The Department of Defense receives a variety of appropriations with differing periods of availability to incur obligations. For example, operation and maintenance (O&M) appropriations are available for obligation for a 1-year period, whereas procurement appropriations are generally available for obligation over a 3-year period.

Once appropriated, authority to spend appropriated funds exists until obligations are liquidated. At the end of the period of obligational availability of an appropriation, the unobligated balance of the appropriation expires and reverts to Treasury, where the balance is designated as surplus authority. These balances retain their fiscal year identity for 2 years, after which the balances are transferred to merged surplus authority accounts which accumulate unobligated balances for DOD appropriations. Once unobligated balances enter the merged surplus authority account, Treasury no longer maintains the fiscal year identity of the appropriations from which the unobligated balances resulted.

Appropriations do not represent cash actually set aside by Treasury for purposes specified in the appropriation. Thus, the expiration of an appropriation and withdrawal of the unobligated balance of obligational authority do not constitute the preservation of an ever-increasing amount of funds set aside by Treasury to remain idle until needed for restoration⁵ purposes.

Obligated balances of appropriations retain their fiscal year identity for 2 years following the expiration of the obligational period for the appropriation. At the end of the 2-year period, any obligated balance remaining which has not been liquidated (that is, an obligation which has not been paid) is transferred to a merged or “M” account maintained by the services. This account accumulates unliquidated obligation balances from all prior appropriations made for the same general purpose, such as O&M, procurement, etc. Once DOD transfers the balance to this account, they no longer maintain the balances’ fiscal year identity for expenditure purposes.

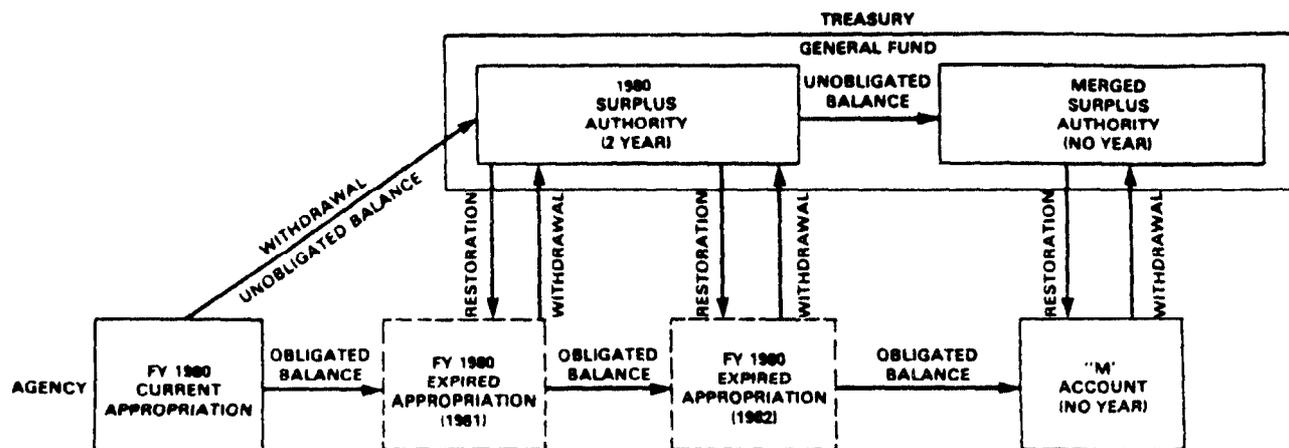
The appropriation balances in the surplus authority, merged surplus authority, and “M” account are available for specified purposes. Surplus authority balances are available to cover adjustments to obligations during the 2-year period after the obligation authority of the appropriation expires. Merged surplus authority balances are also available for

⁵An unobligated amount previously withdrawn by administrative action that is again made available for obligation and payment.

Appendix I
Explanation of Merged Surplus and "M"
Account Balances

restoration to the "M" account to cover obligation increases. The restoration authority merely authorizes an agency to adjust upward previously underrecorded obligations or to initially record obligations that should have been recorded (but were not) against an expired appropriation before its expiration without seeking an additional appropriation. Without restoration authority, a new appropriation would be necessary since an agency's current appropriation would not be available. Balances in the "M" account remain available indefinitely for payment of obligations. Figure I.1 illustrates this process.

Figure I.1: Illustration of the Process of Withdrawals, Restorations, and Transfers of Appropriation Balances



Source: GAO Policy and Procedures Manual for Guidance of Federal Agencies, title 7—"Fiscal Procedures."

Since the merged surplus authority and "M" accounts accumulate the unobligated balances of, and unliquidated obligations against, DOD's appropriations over many years, the balances have become quite substantial. As of September 30, 1985, DOD's merged surplus authority and "M" account balances were \$25.5 and \$6.3 billion, respectively.

GAO Letters to the Assistant Secretary of Defense (Comptroller) and Director, Accounting Policy



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

21 JAN 1986

ACCOUNTING AND FINANCIAL
MANAGEMENT DIVISION

The Honorable Robert W. Helm
Assistant Secretary of Defense (Comptroller)

Dear Mr. Helm:

We are conducting a survey¹ of internal controls over Department of Defense (DOD) M account and related surplus fund balances. Our work thus far has concentrated on a series of obligation adjustments recently recorded by the Army and Air Force.

These adjustments had the effect of providing additional obligational authority totaling some \$563 million, derived largely from Treasury surplus fund balances, by retroactively implementing a change in accounting policy for recording obligations for orders placed with DOD stock funds. The \$563 million increase was nearly three times the \$194 million requested of, and denied by, the House and Senate appropriations committees to implement the change in accounting policy. The magnitude of these adjustments, coupled with their ultimate impact of increased federal outlays, suggests that the Congress should have been fully consulted prior to making such adjustments. We also have a legal question concerning the Army and Air Force employing statistical processes to estimate and record the obligation adjustments at the appropriation level. Adjustments to obligations based on such estimates may lack legal foundation.

We are sending you this letter of inquiry to give you an opportunity to provide any additional information surrounding the obligation adjustments and to ask some specific questions as to (1) the role your office played and (2) the legality of the transactions.

In 1974, and again in 1982, your office proposed a change in accounting policy so that obligations for stock fund purchases would be recorded when orders were placed with the stock fund rather than at the time of delivery. In both instances, DOD asked the Congress for additional obligational authority to fund or "buyout" the stock fund pipeline--those orders that would remain unfilled at fiscal year-end and that, under the previous policy, would be obligated with subsequent-year appropriations when the orders were filled. In both instances the Congress denied the additional funds, citing budget constraints. During fiscal year 1984 budget deliberations, the

¹GAO Job Code 903072.

Appendix II
GAO Letters to the Assistant Secretary of
Defense (Comptroller) and Director,
Accounting Policy

House and Senate appropriations committees directed DOD to implement the accounting policy change within available resources.

In an August 1983 report,² we had endorsed the policy change, noting that it would improve administrative controls over appropriations and provide other benefits. We also stated that if all or part of the \$194.6 million in additional funds, requested by DOD for fiscal year 1984 to implement the change, were not approved by the Congress, the Army and Air Force could phase in the implementation of the new accounting procedures over time.

The Army and Air Force, after being denied the additional \$194.6 million, decided to fund the pipeline orders by implementing the new accounting policy retroactively, that is, reclassifying obligations for existing pipeline orders to appropriations that were current in the years the orders were placed. In this manner the services eventually obligated some \$625 million of merged surplus authority (appropriations that had expired for new obligations 2 or more years previously and had lost fiscal year identity) and thus made available to fund current-year orders and/or other operating requirements some \$563 million, derived primarily from the \$625 million recorded in the M accounts.

Treasury surplus authority balances that may be restored to M accounts are comprised of unobligated expired appropriation balances accumulated over many years. The balances have grown to a tremendous size--about \$24 billion currently in Defense alone. Laws governing the use of these balances were intended to ease the recordkeeping burdens on agencies while permitting routine accounting adjustments to be processed. No congressional approval is required to use unobligated balances of the merged surplus authority. Similarly, we found no formal written approval from the Office of the Secretary of Defense was required of or received by the two services to make the adjustments in question.

We believe that since the amounts charged to the surplus fund were extraordinary, probably without precedent, and that since there remain large sums in the surplus fund available for future retroactive changes in accounting policy, there is a need to have such adjustments fully disclosed to the Congress. Congressional approval was suggested by the Army Audit Agency in its comments on the Army's proposed adjustments, even without knowledge at the time that merged surplus authority would provide the bulk of the funds.

²"Criteria For Recording Obligations For Defense Stock Fund Purchases Should be Changed" GAO/AFMD-83-54, August 19, 1983.

**Appendix II
GAO Letters to the Assistant Secretary of
Defense (Comptroller) and Director,
Accounting Policy**

During fiscal year 1984 the Army and Air Force budget offices sent letters to two staff members of the House and Senate appropriations committees notifying them of the planned strategy to implement the accounting policy change. However, neither of these letters mentioned the use of the merged surplus authority or the fact that the adjustments would provide resources nearly three times the amount requested of and denied by the Congress.

We are also concerned about the legality of the methods used to calculate and record the adjustments to prior-year obligations. The adjustments were calculated and recorded at the departmental level because field installations could not identify in detail the years in which prior-year requisitions were actually delivered. The adjustments were estimated using percentage factors derived statistically from an analysis of the then-existing pipeline. These factors were then applied to two different, prior year-end obligation balances at the appropriation level.

While statistical sampling of individual transactions is acceptable under certain circumstances for verifying the validity of obligations reported to the Office of Management and Budget and the Congress, and certain obligations are estimated temporarily for fund control purposes, use of statistical methods to estimate and adjust recorded obligations appears to lack legal foundation, particularly when the underlying transactions cannot be identified and do not support the calculated totals. The adjustments must be made on a specific obligation by obligation basis. Adjustments to obligations which are not supported by evidence of the underlying transactions (the actual orders) appear to be inconsistent with the documentation requirements of 31 U.S.C. 1501.

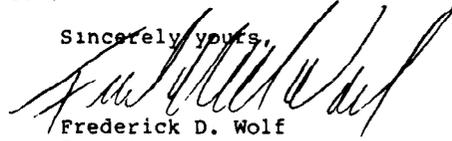
In the near future, we intend to discuss this matter with congressional committees and provide them a copy of this inquiry. We plan to address various alternatives to the present system, including whether positive congressional action in appropriation acts should be required prior to making large adjustments to M account and related surplus fund balances. As stated above, we are providing this letter to you to give you an opportunity to disclose any additional information surrounding the obligation adjustments. Further, we would appreciate your addressing the following questions:

1. What role, if any, did your office play in authorizing and/or approving the adjustments in question?
2. Considering the requirements of 31 U.S.C. 1501, what legal basis did the Army and Air Force have for the methods used to calculate and record the adjustments to prior-year obligations?

**Appendix II
GAO Letters to the Assistant Secretary of
Defense (Comptroller) and Director,
Accounting Policy**

We would appreciate your written response by February 3, 1986. If you need any additional information please do not hesitate to call me on 275-9461.

Sincerely yours,



Frederick D. Wolf
Director

(903072)

Appendix II
GAO Letters to the Assistant Secretary of
Defense (Comptroller) and Director,
Accounting Policy



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

24 JAN 1986

ACCOUNTING AND FINANCIAL
MANAGEMENT DIVISION

Mr. Michael J. Melburn
Director, Accounting Policy
Assistant Secretary of Defense (Comptroller)

Dear Mr. Melburn:

This letter confirms the information we provided Mr. Dent of your staff concerning a key aspect of the obligation adjustments we inquired about in our letter of January 21, 1986, to Mr. Helm.

On the second page of our January 21 letter, we said that the Army and Air Force, after being denied the additional \$194.6 million, decided to fund the stock fund pipeline orders by implementing the new accounting policy retroactively, that is, reclassifying obligations for existing pipeline orders to appropriations that were current in the years the orders were placed.

The majority of the existing pipeline orders originated in (and would thus be chargeable to) the 2 prior-years' expired appropriations. However, we were informed that insufficient unobligated balances were available in these expired appropriations to cover the entire amount of the existing pipeline orders. The two services therefore decided to extend the new policy to orders that had been delivered and already paid for in prior years.

It was as a result of the latter decision that the Army and Air Force obligated some \$625 million of merged surplus authority and made available for current-year orders and/or operations some \$563 million derived primarily from the \$625 million recorded in the M accounts. It was also the reason why statistical methods were used to estimate and record the adjustments, since field installations could not identify in detail the years in which prior-year requisitions were actually delivered.

Sincerely yours,

A handwritten signature in cursive script that reads "David Lowe".

David Lowe
Senior Group Director

Assistant Secretary of Defense (Comptroller) Responses



COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON D C 20301

31 JAN 1986

Mr. Frederick D. Wolf
Director, Accounting and Financial
Management Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Wolf:

Your letter of January 21, 1986, raises questions about a transition in accounting for orders on stock funds that began over two years ago, and was completed during FY 1984 without controversy. Until receipt of your letter, the Department of Defense had no reason to believe that there were any questions concerning this matter. Accordingly, we have not had the opportunity to examine this complex matter thoroughly. In the interest of accuracy and completeness, we recommend that you defer reporting to the Congress until we can give you the benefit of our analysis.

There are some observations that we can make initially that respond to your two specific questions:

o The Office of the Assistant Secretary of Defense (Comptroller) was not requested to authorize or approve the procedures followed by the Army and Air Force. Some elements in the office were briefed informally on the general concepts being followed. These briefings stated that Army counsel had determined that the actions were legal, and that members of congressional staffs had been advised fully as to what Army and Air Force were going to do.

o Regarding the legality of the methods used to calculate and record the adjustments to prior year obligations, the number of transactions involved were in the millions and the Conference Committee on the DoD Appropriations Act directed the implementation of the new policy prior to the end of FY 1984. Given the volume of transactions involved and the time allowed, a statistical approach to accomplishing the adjustments well may have been proper.

We appreciate the opportunity to comment on the adjustments that your letter of inquiry has afforded us.

Sincerely,

A handwritten signature in cursive script that reads "Robert W. Helm".

Robert W Helm
Assistant Secretary of Defense
(Comptroller)

Appendix III
Assistant Secretary of Defense
(Comptroller) Responses



COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON D C 20301

11 APR 1986

Mr Frederick D Wolf
Director, Accounting and Financial
Management Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr Wolf:

Your letter of January 21, 1986, requested answers to two questions on the procedures followed in implementing accounting policy changes for recording obligations for orders placed with DoD stock funds. This change was directed by the Congress during FY 1984 budget deliberations and was to be completed by the end of FY 1984. Our letter of January 31, 1986, provided a response to your first question and advised we would respond to your second question after we had an opportunity to review available documentation. This letter provides the response to your second question on the use of statistical methods to calculate the adjustment.

We have concluded that the use of statistically derived estimates was proper. The requirements for recording obligations contained in 31 U S C 1501 are not so rigid as to preclude a statistical adjustment. Indeed, if that statute were generally so inflexible, the issue of obligations for stock fund purchases would not have been a matter of concern and sometimes contention from time to time for 30 years. Significantly, there was full disclosure to the House and Senate Appropriations Committees of the fact that statistical procedures were to be used and of the approximate dollar amount of the adjustment. The Army provided the committees this information by letters dated October 13, 1983, and the Air Force by letters dated April 10, 1984.

It is important to realize that this was a very difficult and complex accounting problem that both of our offices had been trying to solve for many years. As stated in your January 21, 1986, letter the problem was unique and unprecedented. However, it was an issue that had to be solved in order to bring DoD into compliance with accepted accounting principles and standards and move on with the process of upgrading our accounting systems to meet GAO accounting requirements. We would have thought that in recognition of your involvement, the full congressional awareness of the situation and planned remedial action, and the complexity of the problem, that you would not be critical, but rather supportive of the Army and Air Force actions to bring their obligation procedures in this area into compliance with prescribed accounting standards.

Sincerely,

Robert W Helm
Assistant Secretary of Defense
(Comptroller)

Department of Defense Comments

Note GAO comments supplementing those in the report text appear at the end of this appendix



COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON D C 20301

10 NOV 1986

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and
International Affairs Division
General Accounting Office
Washington, D C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Draft Report, "FINANCIAL MANAGEMENT: Defense Accounting Adjustments for Stock Fund Obligations are Illegal," dated September 17, 1986, (GAO Code 903087/OSD Case 7130).

The DoD is concerned that the draft report does not adequately address the unique circumstances which contributed to the use of the approach adopted to make the adjustments. Specifically, the background should be expanded to recognize that this change in policy solved a grave and complex accounting problem that had troubled the DoD for almost twenty years. The Congress directed that the change in policy be made during fiscal year 1984, which overcame the GAO recommendation to phase in the new policy over a period of time. The volume of orders involved in the change in policy should be described since their magnitude is a primary reason for the approach used to make the adjustments and precluded resolving the problem in a practical and expeditious manner with any other approach.

The DoD reaffirms its position that the obligation adjustments cited in the draft report were proper as stated in our April 11, 1986, letter. In essence, the adjustments merely resulted in recording obligations that should have been recorded (assuming earlier implementation of the policy) against an expired appropriation before its expiration without seeking an additional appropriation. As noted in Appendix I of the report, this is a proper use of surplus funds.

It is estimated that if the Army and the Air Force had used the approach that the GAO contends is the only acceptable method of documenting these adjustments, the analysis of between 7 and

See pages 2 and 9

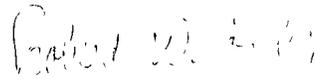
See comment 1

**Appendix IV
Department of Defense Comments**

See comment 2

8 million individual orders would have been required to identify each delivery affected by the change in policy. Under those conditions, it is doubtful that the DoD could have complied with Congressional and the GAO direction to implement the change in policy.

Sincerely,



Enclosure

Robert W Helm
Assistant Secretary of Defense
(Comptroller)

Appendix IV
Department of Defense Comments

GAO DRAFT REPORT - DATED SEPTEMBER 17, 1986
(GAO CODE 903087) - OSD CASE 7130

"FINANCIAL MANAGEMENT: DEFENSE ACCOUNTING ADJUSTMENTS FOR STOCK
FUND OBLIGATIONS ARE ILLEGAL"

DOD RESPONSE TO THE GAO DRAFT REPORT

* * * *

FINDINGS

FINDING A. Change In Accounting Policy. The GAO noted that (1) in 1974, and again in 1982, the DoD proposed a change in accounting policy so that obligations for stock fund purchases would be recorded when orders were placed with the stock fund rather than at the time of delivery, and (2) in both instances, the DoD asked the Congress for and was denied, additional obligational authority to fund or "buy out" the stock pipeline (i.e., those orders that would remain unfilled at fiscal year-end and that, under the then-existing policy, would be obligated with subsequent-year appropriations when the orders were filled). During the FY 1984 budget deliberations, the House and Senate Appropriations Committees denied the DoD's request for \$194.6 million to fund the accounting policy change and directed that the change be implemented within available resources. The GAO reported that, in January 1986, it (the GAO) wrote to the Assistant Secretary of Defense (Comptroller) and his Director, Accounting Policy, raising several questions concerning a series of obligation adjustments. The GAO found that the Air Force and the Army had made these adjustments to retroactively implement the accounting policy change for orders placed with the DoD stock funds. In responding to its letter, the Assistant Secretary pointed out that, while the accounting problem was unique and unprecedented, it was an issue that had to be resolved in order to bring the DoD into compliance with accepted accounting principles and standards and to continue the process of upgrading the DoD accounting systems to meet the GAO accounting requirements. While agreeing with the Assistant Secretary that the accounting policy change discussed in the subject report is necessary, the GAO concluded because the Congress did not provide the DoD with requested funds for the change, the new accounting changes should have been phased in over a period of time. (p. 1, p. 3, p. 6, p. 8/GAO Draft Report)

DOD RESPONSE: Partially Concur. The Department of Defense does not agree that the Congress intended this accounting policy change to be phased in over a period of time. The House Appropriations Committee, Senate Appropriations Committee, and Joint Conference Committee Reports on FY 1984 DoD Appropriations directed the DoD to implement the change in policy, within available resources, during FY 1984. Surplus funds are available to cover within scope increases and any obligation

Now pages 1 to 7

See pages 10 and 11

that should have been properly recorded during the original period of availability as noted in Appendix I of the report. The Army and the Air Force implemented the change, within available resources, during fiscal year 1984 as directed.

FINDING B: Retroactive Change In New Accounting Policy. The GAO found that, after being denied the additional \$194.6 million, the Air Force and the Army then decided to fund the pipeline orders by implementing the new accounting policy retroactively. According to the GAO, this meant reclassifying obligations for existing pipeline orders to appropriations available in the years the services placed the orders. The GAO reported that the majority of the existing pipeline orders originated during the two prior-years' expired appropriations (FY 1982 and FY 1983) and under the new accounting policy would be chargeable to those years. The GAO further found, however, that because insufficient unobligated balances were available in these expired appropriations to cover the entire amount of the existing pipeline orders, the Services decided to extend the change in accounting policy retroactively only to those orders that had been delivered and paid for and would be considered chargeable to FY 1981 and prior appropriations. The GAO observed that, in order to record the accounting adjustments to the prior years, it would have been necessary to determine the specific orders that were placed in each prior year. The GAO found, however, that because field installations could not identify the specific years in which prior-year orders were actually delivered, the Air Force and the Army calculated and recorded adjustments at the departmental level using percentage factors derived statistically from an analysis of the then-existing pipeline orders. The GAO concluded that by implementing the accounting policy change retroactively and calculating the amount of the adjustments through statistical means, the Services eventually obligated \$563 million from merged surplus balances. The GAO further concluded that by so doing, the Services effectively made available \$563 million in additional obligational authority--about \$368 million more than the DoD originally requested from the Congress in 1984 to fund the change and which was denied. (pp 3-4/GAO Draft Report)

DOD RESPONSE: Partially Concur. The GAO states that because field installations could not identify the specific years in which prior year orders were actually delivered, the Air Force and Army calculated and recorded adjustments at the departmental level using percentage factors derived statistically from analysis of the then-existing pipeline orders. The DoD does not concur that the required adjustments could not be identified to specific transactions. All of the documentation needed to adjust each order could have been found or reconstructed as a result of a massive research effort. The primary reason that the adjustments were made at the departmental level was to avoid the use of many thousands of manhours that would have been needed to research the details of each individual order outstanding at the end of each fiscal year commencing with 1984

See page 9

and then back to 1981. An analysis of available data indicates that in the Army and Air Force combined, there were approximately 2.5 million orders outstanding at the end of each fiscal year with a dollar value of about \$230.00 each. A detailed review of each order would have involved researching the history of between 7 and 8 million individual orders to make the required adjustment on a transaction by transaction basis. Such a labor intensive effort was not deemed to be a cost effective use of Army and Air Force manpower resources. These adjustments did not create any additional obligation authority but rather used funds that were legally available as stated in response to Finding C, below

FINDING C. The GAO Opinion On The Legality Of Obligation Adjustments. The GAO reported that the Assistant Secretary of Defense responded to its questions concerning the obligation adjustments by letters dated January 31 and April 11, 1986, maintaining that the adjustments were legal. Specifically, the Assistant Secretary (1) acknowledged that, while the Air Force and the Army did not request his office to authorize or approve their procedures, they informally briefed his office on the proposed general concepts to be followed, (2) noted that the Army general counsel had determined that the actions were legal, (3) concluded that the use of statistically derived estimates by the Air Force and the Army was proper and that the requirements for recording obligations contained in 31 U.S.C. 1501 are not so rigid as to preclude a statistical adjustment. According to the GAO, however, use of statistical methods to estimate and adjust recorded obligation lacks legal foundation if the underlying transactions cannot be identified and do not support the calculated totals. The GAO concluded, therefore, that since the DoD has no documentary evidence to support the statistical adjustments retroactively charged to the "M" account, such adjustments are not valid and should be reversed. Further, concerning the Assistant Secretary's contention that the Army counsel had determined that the adjustments were legal, the GAO reported it had been advised by the Army counsel that he did not consider the legality of statistical methods to estimate and adjust obligations because he did not know at the time such methods would be used. The GAO concluded that the series of obligation adjustments made by the Air Force and Army to implement accounting policy changes do not comply with the documentation requirements of 31 U.S.C. 1501 and are therefore illegal (pp 5-8/GAO Draft Report)

Now pages 5 and 6

DOD RESPONSE. Partially Concur The DoD position remains that the adjustments were proper as stated in our April 11, 1986, letter to GAO. As stated in the reply to Finding B, the histories of between 7 and 8 million individual orders involved in the retroactive adjustments could have been researched in a massive effort to document each delivery of each order. In this unique and unprecedented situation, an appropriate management decision was made by the Army and the Air Force to document the adjustments based upon the application of a statistical analysis

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Department of Defense Comments

See page 9

to the dollar amount of the orders outstanding at the end of each of the related fiscal years.

FINDING D: Adequacy Of The Disclosure Of The Adjustments To Congress The GAO reported the Assistant Secretary also maintained the DoD provided full disclosure to the House and Senate Appropriations Committees that statistical procedures were to be used and the approximate dollar amount of the adjustments. The GAO asserted, however, that while the Services sent letters to staff members of both the House and Senate Appropriations Committees notifying them of the planned strategy to implement the accounting policy change, there was no evidence that the Committee Chairmen or members were formally notified. The GAO also pointed out that the letters sent to the Committee staff members did not mention (1) merged surplus authority would be used, (2) the obligation adjustments would not be supported by documentary evidence, or (3) the adjustments would provide additional obligational resources far in excess of the amounts that DoD had previously requested and been denied by the Congress. While acknowledging that the DoD is not legally required to obtain congressional approval for accounting adjustments such as this, the GAO concluded that it is not in the Government's best interests for the Services to augment current appropriations by over a half billion dollars through retroactive accounting adjustment, which have not been approved by the Office of the Secretary of Defense or fully disclosed to the Congress (pp. 5-8/GAO Draft Report)

Now pages 5 to 7

DOD RESPONSE. Partially Concur The DoD has three major concerns with this finding. First, the GAO states that the letters sent to the committee staff members did not mention that merged surplus authority would be used. The Air Force letter states, "In effect, this approach will adjust prior year accounting records to charge obligations for orders with the stock fund to the year of order vice the year of delivery. Upon completion, the accounting records for all years will have been reconstituted on the same basis as will apply in the future." The enclosure to the Army letter includes the following statements: "Deobligate FY83 funds used to pay for FY82 and prior year requisitions delivered in FY83 and obligate FY82 and prior year funds for requisitions in those years. Apply same concept to FY82 and prior." Although the letters sent to the committee staff members do not specifically mention the words "merged surplus authority," the only authorities available to apply the policy to all prior years as stated in these letters are surplus and merged surplus authority. Also, a record of a telephone call between Air Force personnel and a congressional staff member of the House Appropriations Committee indicates that the staff member understood that prior year funds were going to be used to cover the adjustments.

Second, the GAO states that letters sent to the Committee staff members did not mention that the obligation adjustments would not be supported by documentary evidence. The enclosure to the

Appendix IV
Department of Defense Comments

Army letter included the following statements: "Use the data reported in . . . and statistical analysis to calculate a one-time Department of the Army accounting adjustment to cover the total value of the undelivered orders. The summary adjustment will. . ." Although the procedures do not specifically state that the adjustment will not be documented to each requisition and its related deliveries, the procedures do state that the summary adjustment will be calculated based upon a "statistical analysis" which would appear to mean something other than documentation of each individual order and its deliveries.

Third, the GAO states the letters sent to the Committee staff members did not mention that the adjustments would provide additional obligational resources far in excess of the amounts that the DoD had previously requested and been denied by the Congress. As stated in the reply to Finding B, these adjustments did not provide funds to the DoD for any other purpose or program. The enclosure to the Army letter clearly announced that the Army estimated the result of the adjustments would be a \$600M impact on the surplus fund.

See page 11

FINDING E: House Appropriations Committee Concerned With DoD Management Of Surplus "M" Account Balances. The GAO reported that since the merged surplus authority and "M" accounts accumulate the unobligated balances of, and unliquidated obligations against, the DoD appropriations over many years, the balances have become quite substantial. In this regard, the GAO noted that as of September 30, 1985, the merged DoD surplus authority and "M" account balances were \$25.5 and \$6.3 billion, respectively. The GAO found that in its report on the DoD 1987 appropriation bill, the House Committee on Appropriations expressed concern, not only with the large and ever-increasing surplus fund the "M" account balances, but also with the management of these funds. The Committee, directed the DoD to undertake actions intended to improve management of these balances, and to report back by April 1, 1987, on how it will implement these and other committee directions. While the House Appropriations Committee's directed actions to improve management controls over the use of surplus fund and "M" account balances should improve controls within the Services, the GAO concluded that the large adjustments made by the Air Force and the Army, without sufficient notification to the Office of the Secretary of Defense and the Congress, indicate that additional controls are needed. The GAO further concluded that the additional controls should include requiring the Secretary of Defense approval of large upward adjustments and full and prompt disclosure of these adjustments to the Congress. (pp. 8-10/GAO Draft Report; p. 13/Appendix I GAO Draft Report)

Now pages 7, 8, and 15

DOD RESPONSE: Partially Concur. The DoD nonconcur with the GAO conclusions. There is a technical problem with the GAO description of the merged surplus and "M" accounts in that these are not considered unobligated balances but rather amounts that are available for restoration. They are not available for

See comment 3

obligation on a routine basis. The corrective actions directed by the House Committee on Appropriations have not yet been finalized. Pending completion of the corrective actions in response to the Committee Report, it would be premature to discuss additional controls. The DoD currently requires that material upward obligation adjustments affecting the Merged Surplus Fund be footnoted in budget execution reports to provide full disclosure on the use of those funds. In determining materiality, individual adjustments of less than \$1,000,000 may be excluded, provided the rule is applied consistently within an appropriation. This footnote requirement provides an audit trail that can be used by the GAO, as well as other audit staffs and the OSD staff, to initiate any investigation deemed appropriate.

See comment 4

RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense (1) require that the entries which provided \$563 million of additional obligational authority be reversed, (2) report any deficiencies resulting from the adjustments to the Congress and the President, and (3) request deficiency appropriations if necessary, in accordance with 31 U.S.C. 1517. (The GAO noted that if it is not possible to make these corrections before September 30, 1986, the Secretary should also require that year-end closing statement submitted to the Treasury be qualified as to the pending corrections.) (p. 10/GAO Draft Report)

DOD RESPONSE. Nonconcur. The DoD has determined that the documentation of the adjustments based upon a statistical analysis was proper in this unique and unprecedented situation, as stated in the DoD letter to GAO of April 11, 1986, and in reply to Findings B and C.

See comment 5

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense, in addition, to implementing the controls directed by the House Appropriations Committee to improve management of surplus funds and "M" account balances, (1) approve upward adjustments charged to these balances exceeding a certain threshold, such as \$1 million, and (2) fully and promptly disclose to the Congress the use made of these balances for upward adjustments exceeding this threshold. (p. 10/GAO Draft Report)

DOD RESPONSE: Concur in the Intent The DoD action in response to Congressional direction, coupled with the current requirement to footnote any use of the merged surplus fund that are excess of \$1 million, and lower in some instances, provides the necessary management visibility. At this time, it appears unwarranted to request the Secretary of Defense to personally approve all adjustments of \$1 million or more

See comment 6

The following are GAO's comments on the DOD letter dated November 10, 1986.

GAO Comments

1. Report changed to clarify that we do not object in principle to DOD's using merged surplus authority balances to adjust previously recorded obligations as long as such adjustments comply with existing legal requirements and are appropriately disclosed to the Congress. (See page 8.)
2. Report clarified to show alternatives that DOD could have used instead of reviewing records prior to fiscal year 1982. (See page 10.)
3. In a subsequent conversation with an Office of the Assistant Secretary of Defense (Comptroller) official to clarify DOD's comments, the official acknowledged DOD was incorrect in maintaining that our description of the merged surplus and "M" account had a technical problem. The official explained that DOD was attempting to make the point that the large accumulated merged surplus fund balances should not be confused with the unobligated balances of still current appropriations, which, along with unliquidated obligations, are continually subject to scrutiny by the Congress. He also said that DOD is concerned about, and wanted to clarify, the fact that the surplus balances are not available for any other purpose than for making adjustments that are allowed by law.
4. As discussed in this report on page 7, we continue to believe additional controls are needed beyond those directed by the House Appropriations Committee. While the footnote requirements referred to by DOD may provide an audit trail to investigate adjustments affecting the merged surplus fund, we do not believe this reporting requirement provides an effective control over the services' use of merged surplus balances since the service reporting of any adjustments is done after the adjustments are made and the adjustments are not subject to approval above the service level. In addition, an Office of the Assistant Secretary of Defense (Comptroller) official told us his office only reviews the service reports to assure supporting documentation is included with the service reports.
5. This recommendation has been revised. As discussed in our report on page 9, we are not recommending that any correcting adjusting entries be made since the unobligated balance of the fiscal year 1984 appropriation in question became part of the merged surplus fund as of October 1,

1986, and any adjusting entries made at this time would serve no purpose. We are now recommending, however, that the Secretary of Defense direct the Air Force and Army secretaries to ensure future obligation adjustments comply with existing legal requirements. (See page 8.)

6. This recommendation has been revised. We are now recommending that the Secretary of Defense require the Assistant Secretary of Defense (Comptroller) to review and approve large individual service adjustments to surplus fund and "M" account balances exceeding a certain threshold, such as \$1 million (See page 8.)

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