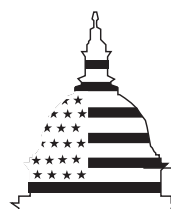
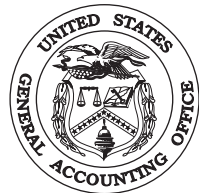


July 2001

CANCELED DOD APPROPRIATIONS

\$615 Million of Illegal or Otherwise Improper Adjustments



G A O

Accountability * Integrity * Reliability

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United States General Accounting Office
Washington, DC 20548

July 26, 2001

The Honorable Stephen Horn
Chairman, Subcommittee on Government
Efficiency, Financial Management and
Intergovernmental Relations
Committee on Government Reform
House of Representatives

The Honorable Jim Nussle
Chairman, Committee on the Budget
House of Representatives

In 1990, the Congress changed the law governing the use of appropriation accounts because it determined that controls over them were not working.¹ Committee reports and other statements relating to the legislation show that members of the Congress were concerned that the Congress had inadequate control over the expenditure of hundreds of millions of dollars of expired appropriations, particularly in the Department of Defense (DOD). Without adequate control, the Congress was concerned that agencies could disburse money in amounts and for purposes that it had not approved. The 1990 law was intended to improve congressional control by providing that, 5 years after the expiration of the period of availability of a fixed-term appropriation, the appropriation account be closed and all remaining balances canceled. After closing, the appropriation account could no longer be used for obligations or expenditures for any purpose.

Because agencies need to keep accurate records, they may, in limited circumstances, adjust accounting records pertaining to closed accounts to correct unrecorded or improperly charged disbursements. To justify such an adjustment, an agency must have sufficient documentation for each proposed adjustment to show that the

- disbursement was made when the appropriation account to be charged was available to cover the disbursement,

¹National Defense Authorization Act for Fiscal Year 1991 (Public Law 101-510, dated November 1990).

-
- agency either did not record the disbursement when it was made or charged it to the wrong appropriation account at that time, and
 - proposed adjustment will result in the disbursement being charged to the proper appropriation account.

From the enactment of the 1990 law through September 30, 1999, DOD requested that Treasury make adjustments affecting 333 closed accounts valued at \$26 billion. By comparison, during the same period, all other federal agencies combined requested that Treasury make adjustments affecting only 21 closed accounts valued at \$5 million.

Amid concerns over the magnitude of DOD adjustments affecting closed appropriation accounts and whether they complied with the 1990 account closing law, you asked that we review the adjustments. The objectives of our review were to (1) assess the adequacy of DOD procedures for adjusting closed appropriation accounts and (2) determine if adjustments affecting closed appropriation accounts complied with the 1990 law. According to DOD, adjustments affecting closed appropriation accounts during fiscal year 2000 exceeded \$2.7 billion. Our review focused primarily on large dollar value adjustments made during fiscal year 2000. These represented \$2.2 billion (81 percent) of the \$2.7 billion of DOD's reported closed appropriation account adjustments made during fiscal year 2000. We selected fiscal year 2000 closed account adjustments because they were for the most recent complete year available at the time of our review.

On May 25, 2001, we requested comments on a draft of this report from the Secretary of Defense or his designee, but none had been provided at the time we finalized our report on July 17, 2001. Appendix I contains more detailed information on our scope and methodology.

Results in Brief

DOD did not have adequate systems, controls, and managerial attention to ensure that the \$2.7 billion of adjustments affecting closed appropriation accounts made during fiscal year 2000 were legal and otherwise proper. Our review of \$2.2 billion of these adjustments found about \$615 million (28 percent) of the adjustments should not have been made, including about \$146 million that violated specific provisions of appropriations law and were thus illegal. For example, the stated purpose of one adjustment was to charge a \$79 million payment made in February 1999 to a fiscal year 1992 research and development appropriation account to correct previous

payment recording errors. However, the fiscal year 1992 research and development appropriation account closed at the end of fiscal year 1998—4 months before the \$79 million payment was made.² Therefore, the adjustment had the same effect as using canceled funds from a closed appropriation account to make the February 1999 expenditure, which is prohibited by the 1990 law.

In addition to the \$146 million of illegal adjustments, about \$364 million of the improper closed appropriation account adjustments should not have been made because the actual payments had been charged to the correct accounts. DOD made these adjustments as part of an effort to correct other errors in recording disbursements made under the contracts. Generally, these recording errors were discovered when DOD could not pay an invoice because the balance for a contract funding line was already used up. We considered another \$105 million to be improper adjustments because there was insufficient documentation to support the adjustments. Agencies must be able to provide documentation to show that adjustments are legal and that they corrected incorrect charges.

System deficiencies in DOD's Contract Reconciliation System (CRS) significantly contributed to many of the illegal closed account adjustments.³ Specifically, CRS did not compare the actual disbursement date with the appropriation being adjusted to ensure that the adjustment met certain appropriation law requirements. DOD had been aware of the system deficiency since at least 1996, but took no action to upgrade CRS until we brought this problem to its attention. Had CRS been upgraded to make this comparison in 1996 when the programming defect was first identified, the \$146 million of illegal adjustments made during fiscal year 2000 may not have occurred.

We also noted that DOD contracting officers were using contract modifications and other methods of communication to instruct the

²Research and development appropriation accounts are available for obligation for 2 years after which they expire and remain available for an additional 5 years for obligation adjustments and disbursements against existing obligations. At the end of the 5-year period, the appropriation balance is canceled and the account is closed. Therefore, the 5-year expired period for a fiscal year 1992 research and development appropriation account began on October 1, 1993, and ended on September 30, 1998.

³CRS is an automated reconciliation system that has been used since 1995 by DOD's Defense Finance and Accounting Service Columbus Center to perform contract reconciliations and to correct errors.

Defense Finance and Accounting Service (DFAS) Columbus Center to charge disbursements to older appropriation accounts without regard to whether adjustments would result in charging disbursements to appropriations that had been canceled. This practice, when combined with the deficiencies in CRS, resulted in some adjustments that were improper.

Finally, the remaining \$1.6 billion (72 percent) of the \$2.2 billion of adjustments we reviewed were adequately documented corrections of errors that DOD had made over the years and, therefore, were not in violation of appropriations law or otherwise improper. They do, however, exemplify the broad-based, high-risk problems associated with the accuracy of DOD's payment and accounting process. As we have previously reported, DOD has serious problems with its ability to accurately account for and report on payments to contractors, which in these cases resulted in \$2.7 billion in adjustments to closed appropriation accounts in fiscal year 2000 alone. DOD acknowledges that it has problems with its accounting and reporting of disbursements and has various ongoing initiatives aimed at resolving its problems.

We are making recommendations that address the need for DOD to reverse and correct the \$615 million of closed account adjustments we identified as illegal or otherwise improper and to take action to strengthen its policies, procedures, and controls over closed appropriation account adjustments. To the extent that DOD is unable to make proper correcting adjustments because insufficient balances remain in the correct accounts, we are also recommending that DOD investigate and report on these adjustments, as required by the Antideficiency Act, 31 U.S.C. 1351, and implementing guidance.

Background

The Congress generally provides budget authority to an agency for use during a specific period, referred to as the period of availability.⁴ During this period of availability, the agency may incur new obligations, for example, those for goods and services, and charge them against the appropriation. At the end of the period of availability, the appropriation expires, meaning that it may not be used to incur new obligations.

⁴In some instances, the Congress appropriates funds that remain available "until expended." These "no year" funds are not subject to the time limits that apply to other appropriations.

Prior to fiscal year 1991, an appropriation account maintained its fiscal year identity for 2 years after its period of availability expired. After the 2-year period, the remaining obligated balance and unobligated balance were transferred and merged into “M” accounts and merged surplus authority, respectively, with the obligated and unobligated balances of previously expired appropriation accounts available for the same general purpose. The M accounts and merged surplus authority were available to pay and adjust valid obligations incurred prior to expiration. However, because M accounts and merged surplus authority had no fiscal year identity, upward adjustments were not limited to the balances from any particular appropriation.

From 1956, when the Congress established the M accounts and merged surplus authority, through December 1990, federal agencies’ reported that M accounts and merged surplus authority had grown to over \$70 billion, with DOD reported to have about \$50 billion, over 70 percent, of this total. In addition, the use of the merged surplus authority to fund upward adjustments to M accounts increased dramatically. For example, DOD’s use of large amounts from the merged surplus authority to cover upward adjustments to M accounts and other expired surplus accounts increased each year over a 5-year period from about \$57 million in fiscal year 1985 to \$560 million in fiscal year 1989. DOD’s use of large amounts from the merged surplus authority to cover upward adjustments to obligations prompted the Congress to pass legislation in 1990 to strengthen its oversight and control over expired appropriations.

Among other things, the 1990 law eliminated the merged surplus authority and M accounts. Instead, under the 1990 law, an expired appropriation account remains available for 5 years, during which it may be used for recording, adjusting, and making disbursements to liquidate obligations that were properly chargeable to the account. At the end of the 5-year period, the appropriation account closes, and any remaining obligated and unobligated balances are canceled. The closed appropriation account may not be used for obligation or expenditure for any purpose. After an account closes, obligations and adjustments to obligations that would have been properly chargeable to the account before closing may be

charged to currently available appropriations subject to certain limitations.⁵

Even in those cases in which current appropriations must be used to make payments after appropriation accounts close, the closed appropriation accounts are still subject to the provisions of the Antideficiency Act. Among other things, the act prohibits officers or employees of the government from making or authorizing obligations or expenditures that exceed the amounts available in appropriations or funds. Therefore, agencies must continue to maintain current and accurate records of disbursements attributable to the canceled appropriations to ensure that payments do not exceed the originally appropriated amounts.

If a violation of the Antideficiency Act occurs, section 1351 of title 31 requires the head of the agency to immediately report to the President and the Congress all relevant facts and a statement of actions taken. Also, under section 1349 of title 31, the officer or employee who violates the act is subject to administrative discipline.

The Office of Management and Budget (OMB) issues guidelines for budget execution for executive branch agencies in OMB Circular A-34. Section 40 of that circular sets forth the requirements for reporting Antideficiency Act violations. Section 40.6 requires that an agency head transmit a report to the President, through OMB, providing information about the violation, including the appropriation involved, the date and amount of the violation, the identity of the person(s) responsible for the violation, a statement of administrative discipline taken, a statement regarding the sufficiency of the agency's fund control regulations, and a statement of any actions taken to prevent similar future violations. Section 40.6 also requires the agency head to send an identical report to the Speaker of the House of Representatives and the President of the Senate.

DOD implements the provisions of the Antideficiency Act and OMB's Circular A-34 guidance in Volume 14 of its *Financial Management Regulation*. Chapters 4 through 7 of that volume contain detailed instructions on investigating and reporting on possible Antideficiency Act violations. Chapter 9 contains instructions on discipline for violations.

⁵Under 31 U.S.C. 1353(b), obligations or adjustments to obligations that would have been chargeable to the closed account may be charged to a current account available for the same purpose. The total amount of charges to a particular current account may not exceed 1 percent of the total appropriations for that account.

Contract Reconciliation

As stated previously, because of the need to keep accurate records, agencies may, in limited circumstances, adjust their records pertaining to closed appropriation accounts. For example, if an agency determines that the balances reflected in the records of a closed account are erroneous because of reporting and clerical errors, it may adjust those records to correct the errors. An agency may also adjust its records if it discovers that a disbursement actually made before an appropriation account closed and properly chargeable to an obligation incurred during the appropriation's period of availability was either not recorded at all or was charged to the wrong appropriation. Neither of these types of adjustments constitutes charging obligations against or disbursing funds from the closed appropriation accounts. They represent corrections of the accounting records. Since the appropriations, in effect, no longer exist, these adjustments affect only the agency's records. They have no effect on the availability or use of obligated or unobligated balances formerly contained in those appropriation accounts.

According to DFAS headquarters officials, DFAS Columbus makes about 99 percent of DOD's annual closed appropriation account adjustments. DFAS Columbus relies on the Mechanization of Contract Administration Services (MOCAS) system to process DOD contract payment transactions and CRS for performing and processing reconciliation transactions. MOCAS and CRS transactions are recorded in various DFAS accounting systems used for the military services and other DOD organizations that maintain the official accounting records, including the status of canceled funds. During fiscal years 1997 through 2000, DFAS Columbus' records showed that it made about \$10 billion of adjustments affecting closed appropriation accounts.⁶

DFAS Columbus conducts two types of contract reconciliations—limited and full scope.⁷ Limited scope reconciliations are usually performed to resolve problems that require immediate action, such as when there are insufficient funds on the cited accounting classification reference number

⁶Complete information on the numbers and dollar values of closed account adjustments prior to January 1997 were not maintained by DFAS and were not readily available and, thus, could not be verified.

⁷Most requests for reconciliations come from the military services or DOD organizations responsible for awarding the contracts. In some instances, DFAS Columbus initiates reconciliation when problems occur with paying an invoice.

(ACRN) to pay a contractor's invoice.⁸ These reconciliations generally result in making only those adjustments necessary to resolve the problems that are preventing payment of the invoice.

A full scope reconciliation is generally performed if a limited scope reconciliation failed to adequately resolve a problem or a contract is being prepared for final close-out due to contract completion. Depending on the size of the contracts, these type of reconciliations can result in large numbers of adjustments since they involve identifying and correcting all errors made over the life of the contract.

DFAS Columbus uses CRS to help identify discrepancies between a contract's hard copy documentation and information recorded in MOCAS. To complete this process, reconciliation staff re-enters into CRS all hard copy documents pertaining to the contract. These include documentation for obligations, invoices, disbursements, shipments, and modifications. After all the hard copy information has been entered into CRS, it reconstructs the payments in accordance with the payment instructions input by the reconciliation staff. For example, if the contract payment terms specified that certain payments were to be applied to specific ACRNs in the contract and the reconciliation staff input these data into CRS, it would apply the payments accordingly. However, if the staff failed to instruct CRS to apply the payments as specified in the contract, CRS' default program would redistribute the payments on an "oldest funds first" basis. Either way, after redistributing the payments, CRS generates accounting transactions to adjust MOCAS' contract obligation and payment history so that it will agree with CRS.

Before the adjustments to the closed appropriation account records can be made, however, reconciliation staffs are required to request approval from the appropriate fund holder.⁹ Once DFAS Columbus has provided the appropriate fund holder with the request for approval, the fund holder has 45 days to accept or reject the proposed adjustments. DOD procedures provide that if DFAS Columbus does not receive a response to the request for approval within 45 days of notification, the adjustment will be considered approved and processed accordingly.

⁸An ACRN is a two-character code that DOD assigns to each appropriation accounting line on the contract. As payments are made, they are allocated to the applicable ACRN.

⁹In DOD, the fund holder's accounting functions are usually performed and maintained by a DFAS field location. In these instances, the DFAS location would be the approving activity.

\$615 Million of Adjustments Were Illegal or Otherwise Improper

Our review of \$2.2 billion of the fiscal year 2000 closed appropriation account adjustments found that \$615 million (28 percent) were either illegal (\$146 million) or otherwise improper (\$469 million). These adjustments should not have been made because the initial disbursements (1) occurred after the appropriation being charged had already canceled, (2) occurred before the appropriation being charged was enacted, or (3) were charged to the correct appropriation in the first place and no adjustment was necessary. Also included in the \$615 million were \$105 million of adjustments that were not sufficiently documented to establish that they were proper. These were considered to be improper because agencies must be able to provide documentation to show that adjustments are legal and that they changed an incorrect charge to a correct one. Table 1 provides additional details on the \$615 million of adjustments that should not have been made. See appendix II for a detailed list of illegal or otherwise improper adjustments.

Table 1: Fiscal Year 2000 Illegal or Otherwise Improper Adjustments

Dollars in millions	
Problem with adjustment	Adjustment amount
Appropriation already canceled when disbursement was made	\$107.7
Appropriation not yet enacted when disbursement was made	38.2
No adjustment was necessary	364.0
Insufficient documentation	104.9
Total	\$614.8

Appropriation Already Canceled When Disbursement Was Made

The 1990 account closing law specifically provides that closed appropriation accounts are not available for expenditures. We found that about \$108 million of the adjustments resulted in charging appropriation accounts that had closed before the disbursements were made. These adjustments produced the same result as if DOD had made expenditures from and charged closed appropriation accounts at the time the disbursements were made. Therefore, these adjustments violated the 1990 account closing law. Following are several examples in which the adjustments had the effect of spending canceled funds from the closed accounts.

In December 1999, DFAS Columbus recorded an adjustment that changed \$79 million of disbursements from charges against fiscal years 1993 through 1995 research and development appropriations to charges against a fiscal year 1992 research and development appropriation. According to

documentation in the contract files, the adjustment was to correct previous disbursing errors by redistributing the payments in accordance with the payment terms specified in the contract. The payment terms of the contract specified that payments should be made using “oldest funds first.” Under this instruction, payments should be charged to the oldest appropriation cited on the contract until the obligated balance has been exhausted for that appropriation. Subsequent payments are then charged to the next oldest available appropriation, and so on, until all the funds are used up or the contract is complete. Making the adjustment that charged the \$79 million of disbursements to the closed fiscal year 1992 research and development account used up the unspent balances in that appropriation account and freed up funds on still open 1993 through 1995 research and development appropriation accounts for other disbursement charges.

We found that charging the \$79 million of disbursements to the fiscal year 1992 research and development appropriation was illegal because the disbursements were made in February 1999—4 months after the fiscal year 1992 research and development appropriation account had closed on September 30, 1998. DFAS Columbus officials agreed that the adjustment violated the 1990 law and should not have been made. According to the officials, the adjustment was made by CRS, which lacked the necessary controls to prevent this from occurring. (CRS weaknesses are discussed in more detail later in this report.) After we pointed out this illegal adjustment, DFAS Columbus personnel responsible for resolving this problem told us that they would reverse the transaction and begin a review of the contract to determine what they will need to do to properly record the \$79 million of disbursements, including using current-year appropriations if necessary.

In another case, DOD was not able to pay an \$832,907 invoice properly chargeable to a fiscal year 1993 appropriation account because sufficient funds were not available in the cited ACRN to pay the invoice. This prompted a reconciliation of the contract to determine why sufficient funds were not available to pay the invoice. Among other things, the reconciliation identified \$721,037 of overpayments made from August 1991 through February 1992 that were charged to a fiscal year 1989 aircraft procurement appropriation—an appropriation account that was closed at the time of the reconciliation. To recover this overpayment, DFAS Columbus offset the amount against a current invoice. On September 28, 2000, DFAS Columbus paid the contractor \$111,870, which DFAS Columbus calculated as the net amount owed to the contractor after

deducting the \$721,037 of overpayments from the \$832,907 invoice amount.

The 1990 account closing law requires that collections related to closed appropriation accounts be deposited in the Treasury as miscellaneous receipts.¹⁰ However, we found that instead of forwarding the \$721,037 of overpayments, which it collected through payment offset, to Treasury, DFAS Columbus processed adjustments to move the overpayments to a fiscal year 1993 ACRN on the contract that was still open and available for new disbursements. It then used the overpayments to offset the amount owed to the contractor. In discussing this adjustment with DFAS Columbus officials, they told us that it is standard practice to offset collections against invoices when making payments, even if closed accounts are involved. However, they agreed that, regarding collections of disbursements made from accounts that closed before collection, the proper procedure would be to forward those collections to the Treasury and use other sources of funding to pay the invoice. Therefore, in this case, the proper procedure would have been to (1) record the collection of the overpayments as a deposit to Treasury's miscellaneous receipts and (2) use available appropriations to cover the \$721,037 needed to replace the funds returned to Treasury. While DFAS Columbus officials could not tell us why they had not followed proper procedures in this case, they told us they would review this transaction to determine how to correct the error.

Appropriation Not Yet Enacted When Disbursement Was Made

Under 31 U.S.C. 1502 (a), an appropriation may be used to pay only those expenses properly incurred during the appropriation's period of availability. However, we found that over \$38 million of the closed appropriation account adjustments resulted in charging disbursements to appropriation accounts that had not yet been enacted at the time the disbursements were actually made. For example, in January 2000, a total of \$21 million of disbursements charged to fiscal years 1989 and 1990 appropriations were changed to charges against fiscal years 1998 and 1999 missile procurement appropriations. Since the actual disbursements were for expenses that were incurred before the fiscal years 1998 and 1999

¹⁰31 U.S.C. 1552(b) addresses collections that would ordinarily be credited to an appropriation account. When a collection is not received until after the account closes, it cannot be credited to that account. Therefore, the law provides that the collection shall be deposited in the Treasury as miscellaneous receipts.

appropriations were enacted, charging disbursements to these two appropriations violated 31 U.S.C. 1502 (a).

Further, included in the \$21 million were \$9.9 million in overpayments, which the contractor identified as a return of funds that were paid from the fiscal years 1988 through 1990 appropriations. However, these appropriations had been canceled before the overpayments were returned. As discussed earlier in this report, the 1990 law requires that the collection of canceled funds be deposited into the Treasury as miscellaneous receipts. However, we found that instead of forwarding the overpayments to the Treasury, DFAS Columbus redistributed the \$9.9 million to current and expired appropriations that were funding the still-open contract. In discussing these errors with responsible DOD officials, they agreed that the \$21 million adjustment and the \$9.9 million redistribution were incorrect and should not have been made. According to the officials, they plan to reverse the adjustments and determine what actions are required to correct the accounting records, including returning the \$9.9 million to the Treasury.

No Adjustment Was Necessary

Closed account adjustments totaling \$364 million were not necessary because the initial payments had been charged to the correct appropriations and should not have been adjusted. DOD made these adjustments during contract reconciliations to try to correct errors in recording disbursements made under the contracts. Generally, these reconciliations were initiated if DOD could not pay invoices because other disbursements had been erroneously recorded against the wrong appropriations funding contracts. For example, in November 1999, DFAS Columbus received an invoice from a contractor for \$685,000. DFAS Columbus could not pay the contractor because there were not sufficient funds available in the cited ACRN to pay the invoice. As a result, DFAS Columbus reconciled the fiscal year 1988 contract, which resulted in over \$590 million of adjustments affecting closed appropriation accounts. Our review of these found that \$210 million of the adjustments should not have been made because the actual disbursements—some of which were made over 10 years earlier—were recorded correctly. As a result of this process to free up sufficient funds to pay the \$685,000 invoice, DFAS Columbus made unnecessary adjustments affecting the closed accounts. Thus, the reconciliation resulted in at least \$210 million of accounting errors that did not exist before the reconciliation took place.

Insufficient Documentation

In order to adjust its records, an agency must have sufficient documentation to show that the adjustment is legal and changed an incorrect charge to a correct one. However, neither DOD nor we could find sufficient documentation in DOD's accounting and contract records to support about \$105 million of closed appropriation account adjustments. For example, in June 2000, DFAS Columbus made an adjustment that changed over \$2.4 million of disbursements from charges against a fiscal year 1993 appropriation that had not yet canceled to a fiscal year 1992 appropriation that had canceled. According to the contract files, the adjustment was to correct a previous disbursing error. However, in reviewing the contract files for this adjustment, neither DOD nor we could identify the original invoice or other supporting documentation to show which appropriation should have been charged for the goods or service. We considered these types of unsupported adjustments improper because DOD must be able to provide documentation to show that the adjustments are legal and that they changed incorrect charges to correct ones. DOD is researching these transactions further to determine if additional documentation can be located to support the adjustments.

Contract Reconciliation Process Lacks Certain Fundamental Controls

The contract reconciliation process lacks the controls necessary to ensure that adjustments to closed appropriation accounts are proper. Our review disclosed that CRS routinely processed billions of dollars of closed appropriation account adjustments without regard to the requirements of the 1990 account closing law, which prohibits making disbursements or obligations from closed accounts. Further compounding this shortfall was the lack of oversight on how contract modifications were written and processed, which, when combined with the deficiencies in CRS, changed the payment terms of some contracts to free up current and expired funds. As noted earlier, these deficiencies contributed to at least \$615 million in illegal or otherwise improper closed account adjustments during fiscal year 2000.

Contract Reconciliation System Weaknesses

CRS does not contain a control to determine if an appropriation was available at the time the disbursement was made. Specifically, CRS does not compare the actual disbursement date with the appropriation involved in the adjustment to ensure that the adjustment does not result in charging disbursements (1) back to an appropriation that had canceled before the actual disbursement was made or (2) forward to an appropriation that had not yet been enacted at the time the actual disbursement was made. Furthermore, unless reconciliation staff input specific payment terms into CRS, it will redistribute disbursement charges on an "oldest funds first"

basis. As a result, it will change disbursements charged to current and expired appropriation accounts to charges against older appropriation accounts, even if they are closed, to use up any unspent balances in the closed appropriation accounts. This is a violation of the 1990 act.

DOD officials responsible for contract reconciliations told us that they have been using CRS to perform reconciliations since 1995 and that redistribution of disbursement charges to the closed appropriation accounts was a routine practice. They also acknowledged that, in 1996, they identified the CRS control weakness that allowed them to make adjustments that charged disbursements to closed accounts. However, they could not tell us why they had not taken action to correct the problem—a problem (1) they estimated would have cost \$24,460 to fix in 1996 and (2) that resulted in illegal and otherwise improper adjustments. After we identified the problem during our review and brought it to their attention, DOD officials implemented the control in May 2001.

In regard to the other needed control that would prevent making adjustments that charge disbursements against appropriation accounts that had not yet been enacted when the disbursement was actually made, DOD officials told us that they were not aware of this problem until we brought it to their attention during our audit. They told us they were reviewing the process to determine how to include this control in CRS and planned to have it implemented by September 2001.

In an effort to address some of the control weaknesses we identified, DFAS Columbus required all reconciliation staff to attend a 3-day refresher course on the adjustment process. According to DFAS Columbus officials, all of the 235 DFAS Columbus employees involved in performing contract reconciliations had completed this course as of March 2001. DFAS Columbus also issued interim guidance in January 2001 in response to our audit findings on the weaknesses in CRS. The implementing memorandum noted that the current process using CRS was flawed because it did not require that disbursements be compared with dates relevant to the use of appropriations before the adjustments were processed. It specifically noted that the current process allowed for the processing of an adjustment even if the date of the disbursement occurred after the date the funds canceled. To address these problems, the interim guidance provides detailed steps for staff to follow to ensure that the person preparing the adjustments performs the manual comparison of dates and that documentation is prepared to support the comparison process.

DFAS Columbus' efforts are a step in the right direction. However, addressing adjustments that involve moving disbursement charges forward to appropriations that were not enacted at the time the disbursement occurred could enhance the interim guidance. DFAS Columbus officials agreed that the interim guidance should also address this issue and were in the process of determining what needs to be done. They did not provide us an estimated date for completing this guidance update.

Contract Modifications or Other Instructions Led to Improper Adjustments

During our review of transactions, we noticed that DFAS Columbus personnel were relying on contract modifications or other contracting officers' informal instructions to justify adjustments that changed disbursements from charges against current or expired appropriations to charges against closed appropriation accounts. The modifications or informal guidance either instructed that payments be made using "oldest funds first" or specifically instructed that disbursements be moved from one ACRN to another.

According to DFAS Columbus officials, when contracting officers modify contracts or issue informal instructions to make adjustments that charge disbursements against older appropriations, DFAS Columbus will usually comply with the modifications without regard to the 1990 closed account law. We found several instances in which DFAS Columbus followed either a contract modification or informal instructions and made adjustments that resulted in improperly charging closed appropriation accounts.

We met with DOD accounting and acquisition officials to discuss the use of contract modifications to change payment terms to move disbursements back to closed appropriation accounts. According to the officials, there was no DOD policy that prohibited changing the payment terms of the contract. In fact, DFAS Columbus personnel responsible for reconciliations told us that when they receive a contract modification from a contracting officer to change payment terms, they take it for granted that the contracting officer wants DFAS Columbus to apply the modification retroactively on an "oldest funds first" basis in order to use up the unspent canceled funds. Air Force contracting officials also acknowledged that they intended for DFAS Columbus to apply the modification retroactively. They told us that the use of modifications was intended to redistribute the disbursements to the unspent canceled appropriations in order to avoid having to request current-year funds to replace the canceled appropriations. After pointing out this practice to DOD accounting and acquisition managers, they agreed that contract

modifications should not be written with the purpose of using up the unspent balances in closed appropriation accounts. They told us that they would review this issue and would revise their policy to prevent this type of contract modification.

Factors Contributing to the Need to Correct Disbursement Errors

The \$1.6 billion of closed account adjustments to which we do not take exception are part of a bigger problem facing DOD. While these adjustments were adequately documented corrections of prior errors, the fact that this large amount of transactions required adjustment in the first place is a result of a long-standing and well documented problem DOD has with correctly accounting for and recording obligations and the corresponding disbursements. For example, for fiscal year 1999, DFAS data showed that almost \$1 of every \$3 in contract payment transactions was for adjustments to previously recorded payments—\$51 billion of adjustments out of \$157 billion in transactions.

Over the years we have issued numerous reports discussing DOD's financial management problems, and we have designated DOD financial management as a high-risk area since 1995. In July 2000, we testified that DOD's inadequate process and control problems contribute to billions of dollars in improper payments.¹¹ For example, we noted that for fiscal years 1994 through 1999, DFAS records showed that defense contractors returned over \$5.3 billion of overpayments and erroneous payments due to contract administration actions and payment-processing errors. In 1997, we reported several key factors contributed significantly to problems in DOD's payment process that, for the most part, still exist today.¹² Among these is the "long line of accounting" DOD uses to allocate payment information among numerous accounting categories. The following discussion from our 1997 report describes this complex and convoluted process, which, we found, also contributed to DOD's \$2.7 billion closed account adjustments for fiscal year 2000.

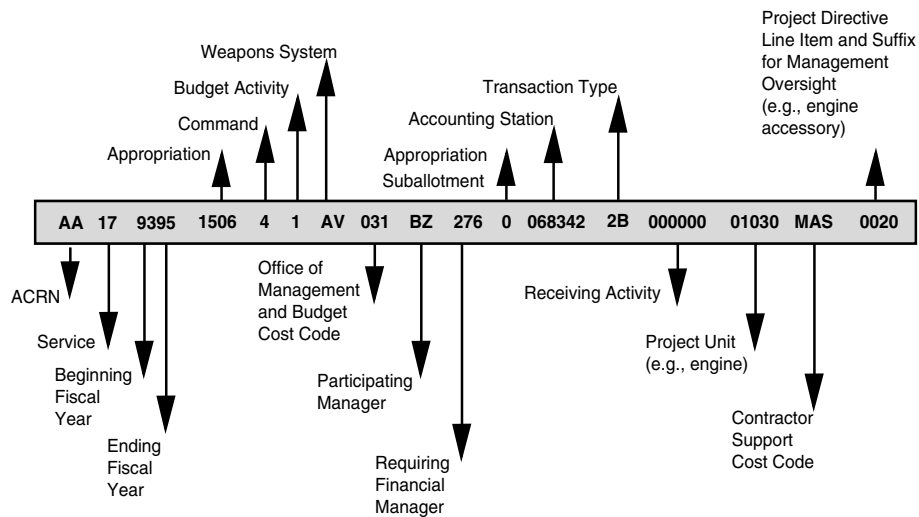
DOD uses what it refers to as a "long line of accounting" to accumulate appropriations, budget, and management information for contract payments. This long line of accounting can contain over 50 alphabetical and numerical symbols that identify such things as the military service,

¹¹*Department of Defense: Implications of Financial Management Issues* (GAO/T-AIMD/NSIAD-00-264, July 20, 2000).

¹²*Contract Management: Fixing DOD's Payment Problems Is Imperative* (GAO/NSIAD-97-37, April 10, 1997).

appropriation, beginning and ending fiscal years, and appropriation suballotment. The buying activities (generally military services that are responsible for administering these funding segments) assign a two-character ACRN to each accounting line containing unique information. DFAS Columbus allocates the payments to the ACRNs. Compounding the problem is that the type, quantity, and format of information vary among the services since there is not standardization of account transactions. Figure 1 is a sample of an accounting line.

Figure 1: Sample of DOD's "Long Line of Accounting"



Source: DOD.

Contracts can be assigned anywhere from 1 to over 1,000 ACRNs. A contract with numerous ACRNs involves extensive data entry, increasing the chance for errors, and manual payment processing. When buying activities assign numerous ACRNs to a complex contract, payment allocations to the ACRNs can be time-consuming. For example, as we noted in our 1997 report, a single payment on a contract with many ACRNs took DFAS Columbus 6 to 8 hours to process. The contractor, required to bill by ACRN, took 487 pages to assign \$2.1 million in costs and fees to 267 ACRNs. Ten of the ACRNs cited by the contractor had insufficient obligation balances to cover the payment, according to DFAS Columbus' records. The remaining 257 ACRNs corresponded to eight annual appropriations covering from 1 to 5 fiscal years and included Army, Air

Force, and general defense funds. Of the 257 transactions processed, 38 were for less than \$10, and some involved debits or credits for pennies. Unresolved discrepancies, such as insufficient funds on some ACRNs, had persisted for about 3 years.

Our 1997 report pointed out that even a simple purchase could cause extensive and costly rework if assigned numerous ACRNs. We noted that a \$1,209 Navy contract for children's toys, candy, and holiday decorations for a child care center was written with most line items (e.g., bubble gum, tootsie rolls, and balloons) assigned separate ACRNs. A separate requisition number was generated for each item ordered, and a separate ACRN was assigned for each requisition. In total, the contract was assigned 46 ACRNs to account for contract obligations against a single appropriation. To record this payment against the one appropriation, DFAS Columbus had to manually allocate the payment to all 46 ACRNs.

In addition, the contract was modified three times—twice to correct funding data and once to delete (deobligate) the funding on the contract for out-of-stock items. The modification deleting funding did not cite all the affected ACRNs. DFAS Columbus made errors in both entering and allocating payment data, compounding errors made in the modification. Consequently, DFAS Columbus allocated payment for the toy jewelry line item to fruit chew, jump rope, and jack set ACRNs—all of which should have been deleted by modification. Contract delivery was completed in March 1995, but payment was delayed until October 1995. DFAS Columbus officials acknowledged that this payment consumed an excessive amount of time and effort when compared to the time to process a payment charged to only one ACRN. A single ACRN would also have significantly reduced the amount of data entered into the system and the opportunities for errors.

Our 1997 report also noted that sometimes contracts do not require contractors to provide the accounting detail on the invoices necessary to allocate the payments. In these instances, DFAS Columbus prorates payments among ACRNs. How the payments are prorated may have little relationship to which activities received what goods and services, which may cause funds to be initially paid from the wrong appropriations. These errors will require correction at some later date. We found that this problem still exists.

DFAS Columbus officials agreed that they are still experiencing many of the same problems today that we identified in our 1997 report. They told us that when contracts do not include detailed payment terms, they would

generally pay a contractor's invoice by prorating the payment across all the applicable ACRNs on the contract. When this happens, sufficient funds may not be available at some later date because unspent balances in the older appropriations cancel. This can lead to contract reconciliations that redistribute the payments using some other form of payment allocation.

Conclusion

Because DOD had not established the requisite systems, controls, and managerial attention required to properly account for its disbursements consistent with the 1990 account closing law, DOD made at least \$615 million of illegal or otherwise improper adjustments during fiscal year 2000 alone. DOD was aware of the limitations the account closing law placed on the availability of canceled appropriations and that the law was enacted because of previous abuses by DOD's use of old appropriations. The department also knew that a major system used to control its use of appropriations allowed for disbursements to be charged in a way that was inconsistent with that law. However, it did nothing to fix the system, although it estimated the cost to do so to be minimal.

The \$615 million of adjustments we identified in this report as illegal or otherwise improper must be immediately reversed. Furthermore, at a minimum, DOD will need to effect changes to its systems, policies, procedures, and the overall weak control environment that fostered these practices and served to perpetuate this problem. Top management must clearly demonstrate its commitment to adhering to the account closing law and eliminating the abuses of appropriations law. In the short term, this will require that DOD immediately fix the system, contract modification problems, and inadequate policies and procedures identified in this report. In the long term, DOD will need to resolve its overall financial management problems, including the lack of leadership and accountability that have been the subject of numerous reports and recommended corrective actions over the years.

Recommendations for Executive Action

We recommend that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to direct the Director of the Defense Finance and Accounting Service to

- immediately reverse adjustments to closed accounts identified in this report as illegal or otherwise improper;
- determine the correct accounting for these adjustments after they have been reversed;
- ensure that the requisite controls are properly included and operating effectively in CRS so that it will prohibit charging disbursements against

appropriation accounts that (1) are closed or (2) have not yet been enacted at the time the disbursements are actually made;

- revise current policies and procedures pertaining to closed account adjustments to include specific detailed guidance to require that future adjustments to closed appropriation accounts satisfy the criteria discussed in this report; and
- establish a monitoring program for future adjustments to closed appropriation accounts and make clear to managers that they will be held accountable if abuses are identified.

To the extent that DFAS Columbus is unable to make correcting adjustments because insufficient balances remain in the correct accounts, we also recommend that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to investigate and report on these adjustments as required by the Antideficiency Act, 31 U.S.C. 1351, and implementing guidance.

We also recommend that the Secretary of Defense direct the Under Secretary of Defense for Acquisition, Technology, and Logistics to issue a policy that prohibits the writing of contract modifications to change the payment terms of a contract if the change would result in illegal or otherwise improper adjustments, as defined in this report, affecting closed appropriation accounts.

We are sending copies of this report to interested congressional committees. We are also sending copies of this report to the Secretary of Defense; the Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics; the Secretaries of the Army, Navy, and Air Force; the Director of the Defense Finance and Accounting Service; and the Director of the Office of Management and Budget. We will make copies available to others upon request.

If you have any questions regarding this report, please contact me at (202) 512-9505. Key contributors to this report are listed in appendix III.

A handwritten signature in black ink that reads "Gregory D. Kutz". The signature is written in a cursive style with a large, stylized initial 'G'.

Gregory D. Kutz
Director, Financial Management and Assurance

Appendix I: Scope and Methodology

To meet our first objective of assessing the adequacy of DOD procedures for adjusting closed appropriation accounts, we reviewed applicable laws, regulations, administrative guidelines, policies, and procedures. These included title 31 U.S.C. “Money and Finance,” Chapter 13, “Appropriations,” and Chapter 15, “Appropriation Accounting;” OMB Circular A-34; Volume 3, Chapter 10 of DOD’s *Financial Management Regulation*, “Accounting Requirements for Expired and Canceled Accounts;” and DFAS Columbus’ *Responsible Contract Reconciliation Agency Guide*, which defines the responsible contract reconciliation agent’s missions and responsibilities in conducting reconciliations in accordance with Office of the Secretary of Defense policy and DFAS procedures. We also reviewed DFAS Columbus’ Desk Procedure 808, “Coding of Adjustments,” that DFAS Columbus employees are to follow when using CRS to perform contract reconciliations and to correct errors. This review included the process used by DFAS Columbus to code, report, and record obligation, disbursement, and appropriation adjustments to closed accounts. We met with DFAS Columbus officials responsible for performing contract reconciliations to discuss and obtain an understanding of the process for reconciling closed account adjustments, including the roles and responsibilities of the military services in the overall process to make and approve adjustments to closed appropriation accounts. We also met with responsible DFAS Columbus officials that had responsibility for CRS to obtain an understanding of how the system processed and reported on closed account adjustments.

To meet our second objective to determine if closed appropriation account adjustments complied with the 1990 account closing law, we selected 268 such adjustments valued at over \$2.2 billion from a population of 4,470 adjustments valued at over \$2.7 billion. The 268 adjustments were selected based on their large dollar value—generally at least \$1.7 million each.¹ The 268 adjustments were limited to closed appropriation account adjustments made during fiscal year 2000 as recorded in the DFAS Columbus CRS database. We selected the adjustments from fiscal year 2000 data because they were the most complete fiscal year data available at the time. The reviewed adjustments represented 81 percent of the closed appropriation account adjustment dollars recorded in CRS during fiscal year 2000.

¹Included in the 268 adjustments were 62 adjustments that did not have a value of at least \$1.7 million. These adjustments were selected for other reasons.

To assess if DFAS Columbus had adequate documentation to support the propriety of the adjustments, we analyzed financial information from DFAS Columbus' records and reports, including contracts, contract modifications, shipping notices, invoices, payment vouchers, and schedules of adjustments. We identified and met with the DFAS Columbus officials knowledgeable about each adjustment and obtained their views on the results of our analysis. We also identified the responsible DFAS or military service locations that maintained the official account records and obtained documentation to show how each adjustment was recorded in the accounting records. We compared these documents with the DFAS Columbus adjustments and resolved any differences.

We performed our work primarily at the Defense Finance and Accounting Service Center in Columbus, Ohio. We also obtained documentation from the following DFAS locations that were responsible for maintaining official accounting records: Cleveland, and Dayton, Ohio; Limestone, Maine; Omaha, Nebraska; San Bernardino, California; and St Louis, Missouri. Our review was conducted from May 2000 through March 2001 in accordance with U.S. generally accepted government auditing standards, except that we did not validate the accuracy of the number of closed account adjustments and their related dollar values in the CRS database, which was provided to us by DFAS Columbus.

On May 25, 2001, we requested comments on a draft of this report from the Secretary of Defense or his designee, but none had been provided at the time we finalized our report on July 17, 2001.

Appendix II: Illegal or Otherwise Improper Adjustments

Contract Number	Voucher number	Appropriation was canceled at time disbursement was made	Appropriation was not enacted at time disbursement was made	Adjustment was not necessary	Insufficient documentation
N6226986C0217	W9480				\$ 1,998,358.00
	W9476			\$ 3,394,924.00	
N6133990C0060	N6779			2,677,997.70	
N6133989C0098	932771				1,776,895.62
N0016387C0180	S4654			2,386,896.53	
N0003991C0103	W5561			2,444,620.26	
	W5553			3,427,571.00	
N0002490C6044	S9238			2,166,058.00	
	S9027			2,165,752.48	
	S8892			2,165,752.48	
	S8472			4,666,393.64	15,831.36
N0002489C6006	S0405		\$ 2,096,307.00		25,829.00
N0002488C6067	N7812			151,710.00	
	N7800			4,269,136.00	
	N7795			2,354,093.00	
	N7789			2,267,414.13	
	N7786			2,713,316.00	
	N7782	\$ 21,349.00		27,815.00	
	N7776			18,036,414.00	
	N7775	1,934,449.50			
	N7772			1,889,754.00	
	N7765			1,889,754.00	
	N7763			3,779,508.00	
	N7756			1,891,872.00	
	N7741			21,592.00	
	N7739			468,149.00	
	N7716			1,889,754.00	
	N7714			1,287,627.54	
	N7712			148,364.00	
	N7710			1,909,026.00	
	N7689				310,219.20
	N7686				100,171.70
	N7684				103,719.98
	N7682				103,717.00
	N7676				113,661.55
	N7670				325,668.72
	N7668			52,069,213.98	
	N7667			26,239,843.37	
	N7659			505,586.34	
	N7657			176,588.00	94,261.50
	N7624			90,291.50	210,333.75
	N7571			15,135.00	

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Contract Number	Voucher number	Appropriation was canceled at time disbursement was made	Appropriation was not enacted at time disbursement was made	Adjustment was not necessary	Insufficient documentation
	N7552			14,532.01	
	N7517			983,954.46	
	N7499			67,357.33	
	N7463			8,700.00	
	N7397		2,984,130.00	82,028,430.40	
N0002487C4581	N3134			2,770,000.00	
	N3133			2,770,000.00	
N0002487C4168	N5519				4,554,153.23
	N5518				2,079,581.91
N0001986C0326	DD0625			7,191,144.00	
	DC0719			3,381,621.50	
N0001986C0236	W7517				3,194,403.34
N0001985C0034	N5092				2,102,341.02
N0001984C0256	W8380				13,496,286.90
F4160893C0064	WO4063				2,458,044.38
	WC4062			1,730,215.00	
F3460187C3142	WO8548			355,408.00	
	WO8790	721,037.00			
F3365792C0003	WO7851			1,857,252.00	
	WO7845			5,132,911.42	
F3365789C0087	SC3875			2,651,107.00	
F3365788C0037	WC2669			19,355,150.81	
F3365786C0012	WO8334				43,051,906.24
F3365781C2108	WO8782	21,174,721.57			
	WO3179	79,777,518.18			
	WC3184			3,645,255.00	
	WC3181			2,745,542.00	
	WC3178			10,555,736.00	
	WC3176			9,092,777.00	
	WC1723		2,000,000.00		
F3365778C0645	WO0138				1,875,276.69
F1962892C0120	NO4684				4,294,186.00
	NO4681				3,407,738.00
F1962892C0049	NO3851			4,999,792.00	
F1962886C0131	SO5580				1,815,352.44
	SO5525			92,572.96	
	SO5475				1,980,175.00
	SO5465			2,195,495.93	
	SO5393			3,132,740.00	
	SO5392			2,410,310.00	
	SO5391			2,067,218.00	
	SO5388			4,528,346.00	

**Appendix II: Illegal or Otherwise Improper
Adjustments**

Contract Number	Voucher number	Appropriation was canceled at time disbursement was made	Appropriation was not enacted at time disbursement was made	Adjustment was not necessary	Insufficient documentation
	SO5383			2,499,656.00	
	SO5381			7,250,454.00	
	SO5379			170,565.70	
	SO5376				4,058,223.72
F0960393C0322	WO5376			134,639.00	
F0960392C0002	NO4355			1,833,397.40	
	NO4354			1,910,253.40	
	NO4353			2,734,630.60	
F0862693C0008	GC259			2,469,617.54	
F0470186C0022	WO5661			7,980,582.03	
	WO5548			1,763,491.04	
	WC5562		2,531,407.62		
	WC5551				2,136,241.90
F0470183C0031	WO7947				1,958,790.85
F0460688D00670261	SC0610			7,765,922.00	
DASG6092C0217	961061		3,271,794.85		
	961052		3,906,502.46		
	961048		2,182,311.18		
DAAJ0989CA086	906563				2,826,196.94
DAAB1088C0001	907417				1,988,499.52
DAAE0783EA007	931057	33,235.00			
F0470189C0081	SC0424			23,000.00	
	SC0425			33,497.64	
	SC0426			45,115.59	
	SC0427			45,986.57	
	SC0428			78,401.71	
	SC0429			127,317.42	
	SC0430			201,600.45	
	SC0431			120,665.62	
F0863592C0050	SC0686			23,918.48	
	SO0690				8,892.67
	SO0691			16,398.29	
F1962892C0035	SO0810				23,501.00
	SO0812			185,314.00	
	SO0818			185,314.00	
	SC0839				340,555.05
MDA90890C0022	S0089			248,549.68	135,000.00
N0014089CTB58	S5841			8,351.62	
N0042188C0081	S1214		272,717.64		1,194.65
N0003090C0012	N0201	1,395.00			
	N0017	4,521.58			
N0003092C0092	W5053				1,183,706.57

Appendix II: Illegal or Otherwise Improper Adjustments

Contract Number	Voucher number	Appropriation was canceled at time disbursement was made	Appropriation was not enacted at time disbursement was made	Adjustment was not necessary	Insufficient documentation
	W5054				419,339.07
	W4966				4,661.29
	W5055				5,015.55
	W5056				12,453.69
	W5057				167,306.01
	W5058	3,941.41			
	W5059	3,591.60			
	W5060				24.00
	W0003				3,164.36
N0012383C0333	EC469		8,956.08		
	EC606	22,837.99			
DAAK0185CB312	S0405	168,950.88			
F0470186C0022	WO8808		975,038.83		
	WO5522	560,510.91			
	WO5523	595,915.76			
	WO5536	1,217,836.82			
	WO5544		1,257,500.00		
	WO5638		6,379,406.38		
	WO5650		468,305.00		
	WO5651		5,606,294.71		
	WO5656		311,682.00		
	WO5658		3,355,725.29		
	WO5664		210,736.82		
	WO6242	1,455,157.15			
F3365772L0647	WO7317		172,680.97		
F3365787C0051	GD706				149,859.64
F2960189C0014	CD4229		168,076.00		
N0002490C6093	N2215			815,519.20	
Totals		\$107,696,969.35	\$38,159,572.83	\$364,023,650.75	\$104,910,739.01

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Larry W. Logsdon, (703) 695-7510

Acknowledgments

In addition to the contact named above, Bertram J. Berlin, Dennis B. Fauber, Jeffrey A. Jacobson, Mary Jo Lewnard, Keith E. McDaniel, Michael S. Peacock, and Harold P. Santarelli made key contributions to this report.

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