

*Memorandum*

February 17, 1983

TO : Acting Regional Manager, Los Angeles - George Grant

FROM : *Harry R. Van Cleve*  
Acting General Counsel - Harry R. Van Cleve

SUBJECT: Contract restructuring due to underfunding at Army Missile Command (File B-206283-O.M.)

This memorandum is in response to several questions raised by Assistant Regional Manager J. W. Dorris concerning the propriety of certain contract restructuring actions taken by the Army Missile Command in connection with the Stinger missile program. The questions and our answers follow.

Question 1: Does the practice, required by Army Regulation (AR) 37-21 § 2-8(b) (May 26, 1977), of recording fixed-price incentive contract obligations at target price, instead of at ceiling price, violate the Antideficiency Act, 31 U.S.C. § 1341(a) (recently recodified from 31 U.S.C. § 665(a))?

Answer: No, this practice does not violate the Antideficiency Act. Army Regulation AR 37-21 § 1-7(b)(1) requires, however, that, for fixed-price incentive contracts, contingent liabilities for contract price increases over target amount be recorded as outstanding commitments at an amount estimated to be sufficient to cover the additional obligations which may materialize, based upon judgment and experience. It is unclear whether the Army complied with this regulation.

Question 2: By restructuring the Stinger missile procurement to delete from one fiscal year's production an amount of missiles whose costs, due to overruns, exceeded available appropriations, and by using a later year's appropriations to repurchase amounts thus cancelled, did the Army Missile Command violate the "bona fide needs" rule of 31 U.S.C. § 1502(a) (recently recodified from 31 U.S.C. § 712a)?

Answer: No. The "bona fide needs" rule restricts the use of appropriations to expenditures required for the service of the particular period for which they were made. We do not consider the actions taken by the Army Missile Command to have violated this rule, so long as the cancelled missiles that were repurchased with later year's appropriations were bona fide needs of the fiscal year whose funds were actually used.

Question 3: Did the use of fiscal year 1981 funds to purchase missiles cancelled from previous years' productions violate the fiscal year 1981 appropriation act?

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Answer: No. The source of fiscal year 1981 funding for the Stinger missile program was a lump-sum appropriation for Army missile procurement. Pub. L. No. 96-527, tit. IV, 94 Stat. 3068, 3074-75 (1980). Nothing in the language of the appropriation act or its legislative history indicates that the Congress intended to exclude procurement of missiles cancelled from previous productions.

A more detailed analysis of our conclusions is attached.

Attachment

cc: Mr. Dorris, L.A.R.O.  
Mr. Bononi, L.A.R.O.

ATTACHMENT

CONTRACT RESTRUCTURING DUE TO UNDERFUNDING AT ARMY MISSILE COMMAND

- DIGEST:
1. The Army did not violate the Antideficiency Act (31 U.S.C. 1341(a), recodified from 31 U.S.C. § 665(a)) by recording fixed price incentive contracts at target price instead of at ceiling price. Contingent liabilities under the contracts, however, should have been recorded as outstanding commitments at an amount based on current agency cost estimates, as required by Army Regulation 37-21 § 2-8(b).
  2. The Army's use of fiscal year 1981 funds to pay for missiles deleted from previous years' procurements in a contract restructuring action did not violate the requirement that appropriations be used solely for the service of the period for which they were made (the "bona fide needs" rule). Provided the need still continues, missiles deleted from one fiscal year's production may be considered bona fide needs of the year in which they are later purchased.
  3. The Army's use of fiscal year 1981 funds to purchase missiles deleted from previous years' productions was not inconsistent with the fiscal year 1981 appropriations act or its legislative history.

ANALYSIS:

J. W. Dorris, Assistant Regional Manager, Los Angeles, has asked for our views as to the propriety of certain actions taken by the Army Missile Command in connection with its procurement of Stinger surface-to-air missiles. We conclude that the Army's actions did not violate the Antideficiency Act, 31 U.S.C. § 1341(a) (recodified from 31 U.S.C. § 665(a)), the "bona fide needs" rule, 31 U.S.C. § 1502(a) (recodified from 31 U.S.C. § 712a), or the fiscal year 1981 appropriation act, Pub. L. No. 96-527, tit. IV, 94 Stat. 3068, 3074-75 (1980).

BACKGROUND

In October 1978, the Army awarded letter contract DAAK40-79-C-0007 to General Dynamics Corporation to commence production of fiscal year 1979 Stinger missile requirements at a cost not to exceed \$19,635,000. At the same time, the Army entered into negotiations for a definitive contract, and on April 20, 1979, through modification PZ0007, the parties agreed to a fixed-price contract, subject to incentive price revision, for 2678 missiles and equipment. The negotiated target price of this contract was \$83,049,646; the actual price could be revised up to a ceiling of \$96,881,218. On December 31, 1979, a similar fixed-price incentive contract was awarded to General Dynamics for the fiscal year 1980

production buy (2054 missiles and equipment), at a target price of \$60,103,200 and a ceiling price of \$69,030,400. Each contract contained a standard incentive price revision clause. See Defense Acquisition Regulation (DAR), paragraph 7-108.1 (Sept. 1978).

In accordance with Army Regulation (AR) 37-21 § 2-8(b) (May 26, 1977), the contracts in question were recorded as obligations at target price. AR 37-21 § 2-8(b) provides, in pertinent part:

"b. Fixed-price contracts with escalation, price redetermination, or incentive provisions.

"(1) Obligations will be recorded for the amount of the \* \* \* target or billing price in the case of a contract which contains \* \* \* incentive clause provisions even though the contract may contain a ceiling price in a larger amount.

"(2) For contracts having both target and ceiling prices, obligations will be recorded in the amount of the target price. The amount so recorded will be adjusted as required based upon amendments to the contract."

In late 1980, it became apparent to the Army that the contracts in question would overrun costs to the ceiling prices. Available funding was, however, limited to the amounts of the target prices, and attempts to obtain additional funding were unsuccessful. The Army therefore took steps to modify existing contracts so that each year's contractual obligation would not exceed available funding. In March 1981, General Dynamics agreed to modify the Stinger contracts: as restructured, the fiscal year 1979 purchase of Stinger missiles was reduced to 1965 missiles and equipment, an amount that could be bought with available funds (i.e., the previous target price). A similar reduction (to 1629 missiles) was made with regard to those missiles under the fiscal year 1980 purchase. The quantity of missiles deleted from each of the two purchases was reacquired as the fiscal year 1981 purchase (a total of 1138 missiles), using funds appropriated for the fiscal year 1981 needs of the Stinger missile program.

## DISCUSSION

### I. Antideficiency Act

We have first been asked whether the practice, required by AR 37-21 § 2-8(b), of recording fixed-price incentive contract obligations at

target price, instead of at ceiling price, violates the Antideficiency Act. For the reasons discussed below, we consider that it does not.

The Antideficiency Act, section 3679 of the Revised Statutes, now codified at 31 U.S.C. § 1341(a), prohibits officers or employees of the United States from making expenditures or incurring obligations in excess or in advance of available appropriations. The act thus prohibits the incurring of any contractual obligations in excess of available appropriations, and our decisions have consistently upheld this rule. See, e.g., 42 Comp. Gen. 272, 277 (1962). Nonetheless, this Office has recognized that many contracts contain clauses that provide for an adjustment of the contract price (and thereby the amount of the obligation) based on the occurrence or non-occurrence of certain contingencies. These contingent obligations must still be considered in terms of the agency's compliance with the requirements of the Antideficiency Act, and with 41 U.S.C. § 11 (1976), which prohibits the making of a contract under an appropriation that is not adequate for its fulfillment. Id.

In 34 Comp. Gen. 418 (1955), we specifically considered the propriety of a proposed regulation which, like AR 37-21 § 2-8(b), provided for the recording of fixed-price incentive contracts at target price, rather than at ceiling price. In our decision, we stated that we had no objection to the recording of obligations on that basis. As a caveat, however, we stated that:

"\* \* \* such [a] practice might well result in a violation of section 3679, Revised Statutes, as amended, 31 U.S.C. § 665, unless appropriate safeguards are provided [in the proposed regulation] \* \* \*. Such safeguards normally would consist of administrative reservations of sufficient funds to cover at least the excess of the estimated increases over the decreases."  
32 Comp. Gen. 418, 420-21 (1955).

This caveat has been repeated in several subsequent decisions.

Based on our previous decisions, we do not find the Army's practice of recording Stinger missile contracts at target price, rather than at ceiling price, to violate the Antideficiency Act. We would again caution that the Army should have employed certain safeguards, for example through reservations of funds, to avoid potential overobligations. As it happens, such safeguards were unnecessary in the present case, as overobligations were avoided through contract modification.

Although administrative reservation of funds to cover contingent liabilities is not mandated by the Antideficiency Act, some obligation of funds to cover contingent liabilities may be required by 41 U.S.C. § 11

(1976). In B-133170, January 29, 1975, we were asked to examine a proposal by the Department of Defense regarding certain major defense system acquisitions involving fixed-price incentive contracts (recorded at target price). There, the Department of Defense had taken the position that, so long as contract target prices did not exceed available appropriations, there would be no violation of the Antideficiency Act: if contract deficits arose, an Antideficiency Act violation would be avoided, either through additional appropriations by the Congress, or through termination of contracts before the accrual of predicted deficits. B-133170, January 29, 1975, at 7.

In reply we again stated that we would not object on Antideficiency Act grounds to the recording of fixed-price incentive contracts at target price. We warned, however, that this alone might not be sufficient to comply with the requirements of 41 U.S.C. § 11 (1976). Id at 8. We stated that current agency cost estimates would constitute an appropriate standard for determining the legality of contract actions in this context. Thus, we would find contract actions objectionable if, and to the extent that, such actions initiated during the fiscal year involved, "by current estimates, costs exceeding amounts presently available therefor." Id. at 9.

The standard of "current agency cost estimates" is one which we have articulated in later decisions. See, e.g., 55 Comp. Gen. 812, 824 (1976). Significantly, it is also one that the Army itself requires to be used as the basis for determining the recording of contingent liabilities. In this regard, AR 37-21 § 1-7(b)(1) (May 26, 1977) provides:

"(1) Contingent liabilities remaining under outstanding contracts. In the case of fixed-price contracts containing escalation, price redetermination, or incentive clauses \* \* \* there remain contingent liabilities for price or quantity increases which cannot be recorded as valid obligations under the provisions of chapter 2.

"(a) The contingent liabilities should be carried as outstanding commitments pending determination of actual obligations. The contingent liabilities should be decommitted after the funds expire for obligation. The amounts of such contingent liabilities need not be recorded at the maximum or ceiling prices under the contracts, but at the amounts which may be conservatively estimated to be sufficient to cover the additional obligations which may materialize, based upon judgment and experience and allowing also for contingencies of price revisions downward or quantity underruns.

"(b) For purposes of estimating and recording, the commitment records may treat these contingent liabilities under one allotment or other administrative subdivision of funds, as a single commitment item, or subsidiary account, with avoidance of computing and record keeping for the contingent liability under each individual outstanding contract. Such records, however, shall be maintained in a manner that will facilitate audit."  
(Emphasis supplied.)

Compliance with this regulation would have fulfilled the requirements of 41 U.S.C. § 11, and also would have provided additional safeguards to avoid potential Antideficiency Act violations. We do not know, however, if the Army actually made any effort, based upon "current agency cost estimates," to obligate funds for contingent liabilities pursuant to AR 37-21 § 1-7(b)(1). In any event, we cannot conclude that the agency's actions in this case violated the Antideficiency Act.<sup>1/</sup>

## II. Bona Fide Needs Rule

The second question asked is whether the Army's restructuring of the Stinger missile procurement violated the so-called bona fide needs rule. The bona fide needs rule, a concept applied both to fiscal year and multiple year funding, prohibits the obligation of appropriations for any needs except those arising in the period for which the appropriations were made. See, e.g., 58 Comp. Gen. 471 (1979); 55 Comp. Gen. 471 (1979); 55 Comp. Gen. 768 (1976). The principal statutory basis for the rule is 31 U.S.C. § 1502(a) (recently recodified from 31 U.S.C. § 712a), which states that appropriations shall only be applied to the payment of expenses properly incurred during the period for which they are available or to the fulfillment of contracts made within that period.

The Army apparently contends that those Stinger missiles cancelled from the fiscal year 1979 and 1980 purchases were still bona fide needs of the Army in fiscal year 1981, the year whose fiscal year funds were ultimately used to purchase the missiles. Accordingly, the Army views its restructuring of the Stinger missile procurement as having been consistent with the bona fide needs rule. We agree.

<sup>1/</sup> We note, however, that if at any point prior to modification the Army had actually incurred obligations under these contracts in excess of amounts available (i.e. contract target prices), such obligations would have been in violation of the Antideficiency Act.

The principal contract restructuring action taken with regard to the Stinger missile procurement was the creation of a fiscal year 1981 contract that, in essence, repurchased those missiles that had been cancelled from the previous contracts. We do not consider the fact that the missiles in question were originally intended to be purchased in earlier fiscal years as precluding their being considered to be bona fide needs in fiscal year 1981. Instead, the Army's need for the missiles was of a continuing nature. It was therefore proper, after having cancelled missiles from earlier contracts for lack of funds, to enter into a new obligation in fiscal year 1981 for an equivalent number of missiles. Such an arrangement was certainly consistent with the requirements of 31 U.S.C. § 1502(a).

### III. Fiscal Year 1981 Appropriation Act

The final question that we are asked is whether the Army's use of fiscal year 1981 funds to purchase an amount of Stinger missiles equivalent to those deleted in earlier fiscal years violated the fiscal year 1981 appropriations statute. We conclude that it did not.

Fiscal year 1981 funding for the Stinger missile program was provided in a lump-sum appropriation for Army missile procurement contained in title IV of the Department of Defense appropriations act. The appropriate section provided the Army with over \$1.5 billion, to remain available until September 30, 1983, for "construction, procurement, production, modification, and modernization of missiles, equipment, including ordnance, ground handling equipment, spare parts, and accessories therefor \* \* \*." Pub. L. No. 96-527, tit. IV, 94 Stat. 3068, 3074-75 (1980). Of this total amount, some \$71.4 million was recommended for Stinger missile procurement by the appropriate congressional committees, that being the amount requested by the Administration. See S. Rep. No. 1020, 96th Cong., 2d Sess. 130 (1980); H.R. Rep. No. 1317, 96th Cong., 2d Sess. 229 (1980). The fiscal year authorization was also in lump-sum: "For missiles: for the Army, \$1,580,500,000 \* \* \*." Pub. L. No. 96-342, tit. I, 94 Stat. 1077 (1980).

Because the funds in question were in fact used by the Army for the production and procurement of Stinger missiles, their use was fully consistent with the express language of the appropriation act. There is nothing in the legislation or its history that would indicate that the Army's actions would be considered by the Congress to be improper. Indeed, the Congress has recognized a continued need for Stinger missile procurement though continued funding. See Pub. L. No. 97-114, tit. IV, 95 Stat. 1565, 1571 (1981); H.R. Rep. No. 410, 97th Cong., 1st Sess. 31 (1981).

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We do not find the use of Stinger missile appropriations to make up for previous gaps in procurement to be inconsistent with either the funding legislation or the intention of the Congress.