Comptroller General
of the United States

Washington, D.C. 20548

B-245856.4

April 16, 1992

The Honorable Andy Ireland
House of Representatives

Dear Mr. Ireland:

By letter dated March 17, 1992, you questioned whether continuation of the practice of netting out adjustments to obligations recorded in the remaining "M" accounts was proper under the new account closing provisions. See Pub. L. 101-510, § 1405, 104 Stat. 1675-1681 (1990) (codified at 31 U.S.C. §§ 1551-1558). As we explained during our March 24, 1992 meeting with you and your staff, we agree with the OMB position (see OMB Cir. A-34, section 111.6, as amended by OMB Bulletin No. 91-07, January 17, 1991) that the new account closing procedures contained in section 1405 of Public Law 101-510 do not require a departure from the prior practice of netting out adjustments. The attached analysis explains in detail the basis for our position in this respect.

Your letter and subsequent discussions with you and your staff raised a related issue regarding the Department of Defense's compliance with the requirement of section 1406 of Public Law 101-510, 104 Stat. 1681 (1990). As you know, section 1406 requires DOD to arrange for an audit of its accounts for purposes of determining the valid and invalid balance thereof. As explained in detail in the attached analysis, DOD to date has not satisfied the requirements of section 1406. In this regard, we would view DOD's adjustment of valid "M" account obligations using amounts freed up by "deobligating" invalid "M" account obligations as inconsistent with the purposes and objectives of section 1406.

We trust the foregoing responds to your concerns.

Sincerely yours,

Milton J. Socolar

for Comptroller General
of the United States

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ANALYSIS OF THE EFFECT OF SECTIONS 1405 AND 1406 OF PUBLIC LAW 101-510 ON DOD'S AUTHORITY TO NET OUT ADJUSTMENTS TO "M" ACCOUNTS

The following provides our detailed analysis of the effect of sections 1405 and 1406 of Public Law 101-510 on the authority of the Department of Defense to net out adjustments to obligations in the "M" accounts.

BACKGROUND

Most appropriations to agencies are available for fixed periods of time. For example, most DoD procurement appropriations are available for a 3-year period, research and development appropriations are available for a 2-year period, and the operations and maintenance appropriations are available for a 1-year period. By law appropriations may be obligated only to satisfy a legitimate bona fide need that arises during the period of availability and that is consistent with the purpose for which the appropriation was made. At the end of the period of availability, the appropriation expires and can no longer be used to fund new obligations.

Prior to the 1990 amendments to the account closing legislation, the obligated and unobligated balances of an expired appropriation were treated in the following manner. The unobligated balance[1] was withdrawn to the Treasury and designated as "surplus authority." The balances of surplus authority retained their fiscal year identities for 2 years after which time the surplus authority account was closed and the balances were transferred to "merged surplus authority" accounts. The merged surplus authority accounts accumulated unobligated balances from appropriations for the same general purpose from all prior fiscal years.

Similarly, the obligated balance[2] of an appropriation

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[1]For the purpose of both the former and current account closing law, the unobligated balance of an appropriation account as of the close of the fiscal year is the difference between the obligated balance and the total unexpended balance. 31 U.S.C. § 1551(a)(2) (1988) and (Supp. II 1990).

[2]For the purpose of both the former and current account closing law, the obligated balance of an appropriation account as of the end of a fiscal year is the amount of unliquidated obligations applicable to the appropriation less amounts collectible as repayments to the appropriation.
(continued...)

retained its fiscal year identity for 2 years after the expiration of the appropriation's period of availability ("expired appropriation account"). At the end of that period, the expired appropriation account was closed, and the unpaid obligated balances were transferred to merged or "M" accounts that were maintained without fiscal year identity for appropriations of the same general purpose.

Under the procedures in effect under the prior law, the obligated balances of an appropriation remained available indefinitely to pay the underlying obligations. Similarly, the unobligated balances in the surplus authority remained available for two years, and the merged surplus authority remained available indefinitely, for restoration to adjust the expired appropriation accounts and the "M" accounts respectively. These adjustments were authorized when necessary to pay (1) valid obligations that were incurred during the period of availability but were not recorded, and (2) upward adjustments of previously recorded obligations.

The adjustments to obligations payable from the expired appropriation account and the "M" account were netted out (upward adjustments were set off against downward adjustments) during the year and accounted for by withdrawal or restoration at the end of the fiscal year. If the net adjustment increased the account balance, a restoration was made from the surplus, or merged surplus, authority. If the net adjustment decreased the account balance, a withdrawal was made to the surplus, or merged surplus, authority.[3] Upward adjustments during the year could not exceed amounts in the surplus, or merged surplus, authority plus total downward adjustments.[4]

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[2](...continued)
31 U.S.C. § 1551(a)(2) (1988) and § 1551(a)(1) (Supp. II 1990).

[3]31 U.S.C. § 1554(a) (1988). See also GAO, Policy and Procedures Manual for Guidance of Federal Agencies, tit. 7, Ch. 5 (TS 7-42, Feb. 12, 1990) and Office of Management and Budget Cir. No. A-34, Revised August 1985, § 22.2 concerning adjustment to expired accounts that, for purposes of the circular, include "M" accounts (OMB Cir. No. A-34, § 21.1 definition of "funds").

[4]It has become common practice to refer to the downward adjustment of amounts previously recorded as obligations as deobligations. The deobligations may result from the cancellation of a project or contract, price revisions, or corrections of estimates. The use of the budget authority (continued...)

During the 34 year history of the prior law, large unobligated balances accumulated in many merged surplus authority accounts, particularly DoD. The use of surplus, or merged surplus, authority to fund large contract modifications such as for the B-1B bomber[5] or to fund newly discovered but previously unrecorded obligations such as for the Air Force Stock Fund[6] raised congressional concern about the potential for abuse and the adequacy of congressional control and oversight. In addition, large obligated balances had accumulated in many "M" accounts, particularly those of DoD, raising concerns as to whether the balances reflected valid obligations. As a result, Congress adopted section 1405 to limit the availability of expired appropriations and to provide additional controls on the use of such authority. In addition, the Congress adopted section 1406 to require DoD to determine the proper balances of its "M" accounts.

SECTION 1405

On November 5, 1990, section 1405 revised the procedure for closing accounts. The new procedures applied to appropriation accounts that had not been closed by transfer to the merged surplus authority and the "M" accounts as of October 1, 1990. Section 1405(b)(1). Under the revised procedures, once a fixed period appropriation expires for the purpose of incurring obligations, it remains in the expired account for 5 years. At the end of the fifth year, the account is closed and the remaining balance (whether obligated or unobligated) in the account is canceled and unavailable for obligation or expenditure for any purpose. 31 U.S.C. § 1552 (Supp. II 1990). Section 1405(b)(1) restored the unobligated (surplus authority) balances to appropriations that had expired as of October 1, 1990.

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[4](...continued)
that is freed up through deobligation to cover another obligation is commonly referred to as reobligation. Payment of an obligation results in the budget authority being expended so that it ceases to exist for the purpose of obligation. Thus, it is unavailable for purposes of further obligation.

[5]See, GAO, Strategic Bombers; B-1B Program's Use of Expired Appropriations, NSIAD-89-209 (September 1989).

[6]See our opinion to John P. Murtha, Chairman, Subcommittee on Defense of the House Appropriations Committee (B-236940, October 17, 1989).

During the five year period, the expired account retains its fiscal year identity and remains available for recording, adjusting, and liquidating obligations properly chargeable to that account.[7] 31 U.S.C. § 1553(a) (Supp. II 1990). After the account is closed, obligations and adjustments to obligations that would have been properly chargeable to the closed account, both as to purpose and amount[8], may be charged to any current appropriation account available for the same purpose, provided that the total amount of charges to a current account does not exceed 1 percent of the total appropriations for the current account. 31 U.S.C. § 1553(b) (Supp. II 1990). In addition, certain upward adjustments to obligations in expired accounts are subject to agency approval and congressional reporting requirements. 31 U.S.C. § 1553(c) (Supp. II 1990).

Section 1405(b)(3) of the law will cancel the remaining "M" account balances on September 30, 1993. Section 1405(b)(4) of the Act canceled the merged surplus authority on December 5, 1990. Section 1405(b)(6) of the Act required the deobligation and withdrawal of any amount that had been in the "M" account for more than 5 years on March 6, 1991.[9] Amounts deobligated and withdrawn were not available for restoration. Finally, section 1405(b)(7) provides that:

> After cancellation of unobligated balances under paragraph (3) or cancellation of obligated balances under paragraph (4) or paragraph (6) . . . obligations and <u>adjustment to obligations that would have been chargeable to those balances before such cancellations . . . may be charged to current appropriations</u>." (Emphasis added.)

As we have previously pointed out, under the law in effect prior to the amendment, adjustments to obligations that would have been chargeable to the merged surplus authority

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[7]Thus previously unrecorded obligations that were incurred prior to the account's expiration are properly chargeable to the expired account. Further, upward adjustments legally attributable to obligations incurred prior to the account's expiration are properly chargeable to the expired account.

[8]The amount that would have been properly chargeable to the closed account is the unobligated balance of that account.

[9]After the initial cancellation on March 6, 1991, OMB Cir. A-34, as amended by OMB Bull. 91-07, §111.8, provides that at the end of September 30th of each following year, any obligated balances that have been in the "M" account for more than five years must be canceled.

would not arise (1) until the end of the fiscal year and (2) until upward and downward adjustments in the "M" account were netted out. Thus, section 1405(b)(7) would merely serve to permit (not require) use of current appropriations to pay adjustments to obligations, if after netting them out, insufficient budget authority remained in the "M" account to cover all the adjustments. However, nothing in its language precludes the netting out of adjustments to obligations.

Even though the practice of netting out adjustments to "M" accounts described above was developed to implement the law in effect prior to the 1990 Act, the continuation of this practice is reflected in section 111.6 of OMB Cir. A-34, as amended by OMB Bulletin No. 91-07, January 17, 1991, which specifically provides that remaining "M" account balances remain available for obligation adjustment and disbursement until September 30, 1993. The Circular also states, by way of limitation, that "any remaining deobligated balance not used to offset legitimate increases in obligations in the "M" account at each September 30 must be canceled each year and is not available for restoration." Furthermore, any net increase in the "M" account balance would have to be charged to current appropriations.

Thus, to the extent there are downward adjustments to "M" account obligations during the year, the deobligated budget authority may be reobligated to cover upward adjustments to obligations during that particular fiscal year. If not used for upward "M" account adjustments, the deobligated funds must be canceled on September 30. Finally, upward adjustments may not exceed the amount of downward adjustments plus amounts available from then current appropriations for the same purpose subject to the following limitations: (1) the adjustment may not exceed 1 percent of the current appropriation, and (2) it may not exceed the unobligated expired balance of the original appropriation available for the same purpose.[10] We concur in the continuation of this practice since nothing in the language of the 1990 Act or its history requires a departure from the pre-1990 practice.

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[10]In other words, once the year end netting of adjustments to obligations is completed, to the extent the deobligated amount exceeds the reobligated amount, such amount is canceled and no longer available to cover adjustments to obligations.

SECTION 1406

Simply stated, section 1406 of the Act requires a one-time audit of each DoD "M" account in order for the Secretary to establish the balance of each account necessary to pay valid obligations (as supported by documentary evidence as required by 31 U.S.C. § 1501 (1988)).[11] If, based on the audit, DoD determined that the "M" account balances it had previously recorded were in excess of the amount that the audit showed were necessary to pay valid obligations, DoD was required to deobligate and cancel the excess "M" accounts balances.[12] Once the proper balance was determined, this balance would then be subject to the general requirements concerning adjustments to "M" accounts discussed above. The Act does not require the continual segregation, deobligation and cancellation of specific obligations during the year. Rather, once the audit

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[11]Section 1406 provides:

> (a) AUDIT REQUIREMENT.--The Secretary of Defense shall provide for an audit of each ["M" account]. The audit shall, with respect to each such account, identify--
> (1) the balance in the account;
> (2) the amount of such balance that is considered by the Secretary (as of the time of the audit) to represent amounts required for valid obligations (as supported by documentary evidence as required by section 1501 of title 31) and the amount of such balance that is considered by the Secretary (as of the time of the audit) to represent amounts for obligations that are considered no longer valid...
> (b) DEOBLIGATION OF OBLIGATIONS NO LONGER VALID.--Any obligated amounts in ["M" accounts] that are determined pursuant to the audit under subsection (a) to represent amounts for obligations that are no longer valid shall be deobligated and canceled.

[12]Section 8080 of the FY 1991 DoD Appropriations Act, Pub. L. No. 101-511, Nov. 5, 1990, which provides for DoD "M" and Surplus Fund Account reform, mirrors the requirements in section 1405 of the FY 1991 DoD Authorization Act. There is, however, no provision in the DoD Appropriations Act which provides for a one-time audit of DoD "M" accounts. The "M" account audit requirement in the DoD Authorization Act only applies to DoD; there is no "M" account" audit requirement that is applicable to the civilian agencies.

determined the proper "M" account balance, and excess amounts previously recorded in the "M" accounts were canceled, the requirements of section 1406 are met. While the law is silent as to the date as of which the Secretary was to fix the "M" account balances, section 1406(c)(1) required the Secretary to submit to Congress by December 31, 1991, a report containing the results of the audit.

The purpose of section 1406 is twofold. First the Congress wanted to prevent amounts in the "M" accounts that had accumulated over 34 years and that represented invalid obligations from being deobligated and used to fund adjustments to valid obligations as of the date of the audit. Second the Congress wanted DoD to identify and maintain the appropriate balances in the "M" accounts that represented valid obligations remaining to be liquidated at the time of the audit.

DOD AUDIT

On January 6, 1992, the Deputy Secretary of Defense submitted to the President of the Senate and the Speaker of the House of Representatives, the report on the Department of Defense audit of the merged and surplus accounts.[13] The audit was conducted by the Office of the Inspector General, DoD, and the internal audit organizations of the Military Departments. The letter states that "any issues remaining after management has reviewed and commented on the report will be promptly resolved through our internal audit resolution process."

In the report, the Inspector General concluded that DoD's "M" account balances as of November 4, 1990, were materially misstated. The IG reported that the DoD Comptroller reported a balance of $18.8 billion in "M" accounts as of November 30, 1990. The IG states that using statistical sampling techniques, the IG reviewed $16.1 billion, or 86 percent of the reported balance. The IG's sample included 3,183 obligations amounting to $5.2 billion. Of the $5.2 billion the IG determined that $2.9 billion was valid and $2.3 billion of reported balances were invalid. Based on this sample, the IG reported that "Our review showed that only $8.1 billion, or 50 percent of the obligations were valid. The remaining $8 billion was invalid and should be deobligated." The report also indicates that the IG has a 95-percent confidence level that the invalid amount of

[13]Inspector General, Department of Defense, Merged Accounts of the Department of Defense, Rep. No. 92-028 (December 30, 1991).

obligations is precise within plus or minus $2.2 billion (plus or minus 27 percent) of the projected invalid amount.

In response to the IG's audit report, the Deputy Comptroller (Management Systems) stated that "In a number of instances, the report does not contain detailed data required to explain the findings, therefore, we cannot agree or disagree with many dollar amounts contained in the report." The report also contained other matters of disagreement between the IG and Deputy Comptroller. Nowhere in the report is a statement of the amount that DoD determined to be the amount of valid "M" account obligations as of the time of the report.[14]

It appears from the foregoing that the report submitted by DoD does not clearly set forth the amount of valid "M" account obligations that the law requires the Secretary to report to Congress. Furthermore, we are unaware of any subsequent transmittal containing information on the final DoD internal audit resolution of any issues left unresolved at the time of the report to Congress. Thus, to date, DoD has not satisfied the section 1406 audit reporting requirements. In view of the foregoing, it is our view that DoD's practice of netting out adjustments to "M" accounts when it has not determined the proper balance of the "M" accounts as required by section 1406, does not comply with the purpose and objective of section 1406.

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[14] We have been informally advised by an official of DoD that the total unaudited "M" account balances subject to review as of November 30, 1990, was about $20.5 billion. Further, DoD apparently determined that the only identified invalid obligations were the $2.3 billion the IG audit identified as part of the sample, and not the projected amount. We were further advised that the current "M" account balances are about $8 billion.