

GAO

Testimony



142233

For Release  
on Delivery  
Expected at  
10:00 a.m. EST  
Thursday  
September 20, 1990

FINANCIAL MANAGEMENT

DOD's Use of Expired and Lapsed Appropriations

Statement of  
Nancy R. Kingsbury  
Director, Air Force Issues  
National Security and International Affairs Division

Before the  
Subcommittee on Legislation and National Security  
House Committee on Government Operations



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our work on the use of expired and lapsed budget authority by the Department of Defense (DOD), and to provide additional perspectives on legislation to strengthen control and oversight of these budget authorities. We testified last month before the Senate Governmental Affairs Committee on some government wide issues which concern us about lapsed and expired funds and on other legislative proposals relating to these accounts. Today we will focus on our analyses of DOD's use of these authorities, and provide some examples of specific instances of transactions. As you know, we are performing this work at the request of the Senate Committee on Appropriations, House Committee on Energy and Commerce, and the Honorable Andy Ireland. As you requested, we will also provide our views on the bill you have proposed to address some of the problems that we and others have reported on in the past.

#### BACKGROUND

Most appropriations for government activities, including DOD activities, are available for obligation for a finite period, normally one, two or three years. At the end of this period, the appropriations expire and are no longer available for incurring new obligations. The entire purchasing and payment cycle-- establishing requirements, developing programs, contracting for

goods and services, producing end items, modifying program elements, invoicing and paying of bills, and settling claims and adjustments--for government activities can take considerably longer than the period of time that the appropriations are available for obligation. Also, it is not always possible for agencies to precisely identify all costs they will incur on contracts, and adjustments are commonplace. Therefore, mechanisms have been established to pay bills as they become due or to fund increases to valid obligations recorded or incurred. These mechanisms are referred to as expired appropriations, "M" accounts, surplus, and merged surplus accounts.

I think at this point it would be helpful to briefly discuss the relationship and operation of these accounts. In essence, I will be discussing budget authority in, for want of a better term, three conditions: current, expired, and lapsed.

Federal agencies, including the Department of Defense (DOD) receive a variety of appropriations with differing periods of availability. For example, most procurement appropriations are available for obligation for 3-years and Operations & Maintenance appropriations are available for obligation for 1-year. These are current appropriations. At the end of the period that an appropriation is current or available to be obligated, the funds expire.

The unobligated balance of expired funds is withdrawn to the Treasury and designated as "surplus authority." These balances retain their fiscal year identity for 2 fiscal years. After this time, the balances lapse and are transferred to "merged surplus authority," which accumulates unobligated balances for all prior fiscal years. While the Treasury does maintain general purpose identity (e.g. Air Force aircraft procurement), it does not maintain the fiscal year identity of the original appropriation for balances in the merged surplus authority.

The obligated balances of expired appropriations also retain their fiscal year identity for 2 fiscal years. At the end of that period, any obligated balances remaining, those not disbursed or expended, lapse and are transferred to an "M" account where they lose their fiscal year identity. This lapsed budget authority account is maintained by the agency and accumulates unliquidated obligations from all prior appropriations made for the same general purpose.

The balances in the Treasury's surplus authority remain available for restoration to cover adjustments to obligations during the 2-year period after an appropriation expires. Balances of lapsed budget authority in the "M" accounts remain available indefinitely to an agency for payment of previously recorded obligations. Merged surplus authority balances remain available for restoration

to the "M" account to cover upward adjustments of previously recorded or incurred but unrecorded obligations.

### RESULTS IN BRIEF

As of September 30, 1989, the amount in the DOD "M" account was about \$18.7 billion. The DOD merged surplus accounts, which have accumulated surplus budget authority since their inception in 1956, contain an additional \$25 billion. By comparison, the "M" accounts for all other executive branch agencies total \$9.5 billion.

We obtained information on most of DOD's "M" account transactions over \$100,000 in the Army, Navy and Air Force for fiscal years 1985-1989. The number and dollar value of these transactions has increased significantly during that period. For example, in fiscal year 1985 the Air Force had 55 transactions using "M" account authority totalling about \$43 million; in fiscal year 1989, it had 111 transactions totalling about \$445 million.

We reviewed 18 "M" account transactions--6 each from the Army, Navy, and Air Force, with both large and small dollar values--to determine whether the use of the "M" account was appropriate. Although we are still reviewing some of the details, our initial review indicates that in 7 of these cases, the transactions appear to be appropriate. In 3 cases, we believe the transactions involved an improper use of the "M" account. In the other 8 cases,

the services used expired budget authority in circumstances which, for a variety of reasons, are questionable. In these latter instances, our case studies indicate that the questionable circumstances of the individual cases relate more to financial and contract management deficiencies within DOD, than to the use of expired and lapsed accounts.

We agree that additional legislation would be helpful to limit the amount of surplus budget authority which is available, and to improve accountability. We also believe that financial leadership, such as would be provided by the establishment of a Chief Financial Officer for the government, and improved reporting and auditing of transactions using lapsed authority, are necessary to resolve the kinds of problems we observed in our work. Finally, it is also necessary for DOD to correct certain financial and contract management practices which contribute to unnecessary use of "M" account authorities.

#### DOD "M" ACCOUNT TRANSACTIONS

In 1956, when the Congress established the "M" account and related mechanisms, it anticipated that the balances of these budget authorities would remain relatively small and that the number of transactions involving the use of these authorities would be few. Recently this has not been the case. In DOD, the amounts in these

budget authorities have become quite large and the number of transactions has increased dramatically.

We were able to obtain relatively complete information on "M" account transactions over \$100,000 in the Navy and Air Force. Both agencies significantly increased their use of "M" account funds during the last five years, as shown in table 1.

---

Table 1: Navy and Air Force Transactions Involving Lapsed Budget Authority

	<u>NAVY</u>				
	<u>FY 85</u>	<u>FY 86</u>	<u>FY 87<sup>a</sup></u>	<u>FY 88</u>	<u>FY 89</u>
Number of transactions	18	28	84	64	63
Value	\$13.6M	\$30.5M	\$132.2M	\$78.7M	\$117M

<sup>a</sup>In 1987 the Navy requested an unusually high amount of "M" account budget authority for Shipbuilding and Conversion.

	<u>AIR FORCE</u>				
	<u>FY 85</u>	<u>FY 86<sup>b</sup></u>	<u>FY 87</u>	<u>FY 88</u>	<u>FY 89</u>
Number of transactions	55	31	66	100	111
Value	\$43.3M	\$28.4M	\$74.9M	\$344.7M	\$444.9M

<sup>b</sup>Air Force "M" account data for the 4th quarter of 1986 was unavailable.

---

Information on Army "M" account transactions was only readily available for part of FY 1989 and FY 1990--a total of about 7

months. However, during that time, the Army identified 103 transactions over \$100,000 involving "M" account authority totalling \$133 million.

Our analysis also shows that more than 60% of the transactions involved surplus funds from the major procurement appropriations. Although we did not examine all of the transactions in detail, the services most frequently cited as justification for using lapsed budget authority such reasons as cost overruns and contract modifications.

#### DETAILS OF SELECTED CASE STUDIES

As I mentioned earlier, we reviewed in detail 18 "M" account transactions as case studies, in an effort to determine whether the use of the lapsed funds was appropriate, and to better understand the nature of any questionable practices if they occurred.

#### Examples of appropriate use of lapsed budget authority

##### Navy: Radio Procurement

The Navy used about \$29 million in expired and lapsed budget authority to procure secure channel radios that were being developed under an Army Contract. In this case, in 1983 the Navy originally contracted to buy a different radio (Bancroft) that



would provide interim capability until the more capable Single Channel Ground & Airborne Radio System (SINCGARS) became available in the early 1990s. The 1983 contract was terminated for default in June 1988, and the Navy initiated plans to issue a replacement contract for radios that were technically similar to the Bancroft radios for delivery in the mid-1990s. Because of concerns about having two different radios in use, particularly when SINCGARS would also be available in the mid-1990s, the Fiscal Year 1989 DOD Appropriation Act directed that "funds appropriated for the procurement of the...Bancroft...radios shall be available only for procurement of SINCGARS radios."

The resulting use of \$29 million of expired and lapsed funds for this procurement is consistent with Comptroller General decisions regarding replacement contracts. Such funds may be used when the contracting agency terminates a contract for default by the contractor, and enters into a replacement contract to satisfy the agency's continuing bona fide need for the goods and services involved. We have held that funds provided for the original contract remain available to fund a replacement contract of the same size and scope as the original contract. Therefore, we consider that this transaction was appropriate.

### Army: Procurement of Engine Repair

In another example of an appropriate use of expired or lapsed budget authority, the Army used about \$7.3 million in expired and lapsed budget authority to fund the negotiated settlement for repair and retrofit of T-700 engines on various Army aircraft. The settlement was the result of the contractor's claim for costs associated with a defect in the engines. According to Army officials, the settlement with the contractor is an implied admission of Army liability and this liability was interpreted to be within the scope of the contract.

In a number of Comptroller General decisions, we ruled that an agency's negotiated settlement of a claim which is within the scope of the contract is properly charged against the appropriation available at the time of the original contract. Accordingly, we believe that the Army's use of lapsed budget authority in this instance was appropriate.

### Examples of Improper Use of Lapsed Budget Authority

#### Air Force: Deferred Testing for Defense Support Program Satellites

In February 1988, the Air Force approved the use of \$38.5 million in lapsed budget authority and \$74.4 million in expired budget

authority to fund contract modifications calling for testing of four satellites, satellites 14 through 17, procured for the Defense Support Program. Two of the four satellites were procured in fiscal year 1983 and the other two were procured in fiscal year 1984. Although the original procurement contract included some contractor testing, certain "qualification and acceptance" testing was not included, unlike similar contracts in this program. Air Force documents indicate that this was a deliberate omission due to "budget limitations."

Lapsed and expired budget authority was requested to complete the previously omitted testing. An Air Force legal opinion dated January 27, 1988, noted that the deferred testing was "considered an integral part of this purchase and the program office had, at the time the contract was awarded, every intent of purchasing this type of testing." Further, the contracting officer had concluded that the modification was within the scope of the original contract for satellites 14 through 17.

We do not believe it was proper for the Air Force to use expired and lapsed authority to fund this contract modification. Although such funds may be used for unanticipated adjustments to obligations, it is not proper to fund a modification with expired funds when the performance called for by the modification deliberately was omitted from the original contract for budgetary reasons. The use of expired and lapsed funds in this fashion is

inconsistent with sound financial management and contracting practices.

Air Force: Payment of Contract Dispute Judgement

In the Sidewinder missile program, which is jointly funded by the Navy and Air Force, the contractor submitted a claim for the costs associated with correcting defects in some of the components being produced. The government disputed the claim in 1981, maintaining that the contractor was responsible for the costs. The contractor filed a claim before the Armed Services Board of Contract Appeals. In 1988, the Board ruled in favor of the contractor. The Air Force inappropriately used over \$1.4 million in lapsed procurement funds to pay its portion of the award to the contractor. The Navy, on the other hand, appropriately paid its share of the same award (about \$750 thousand) out of current funds. In Comptroller General decisions, we have held that, under the Contract Disputes Act of 1978, payments required by the Board or court judgments should be funded by appropriations current at the time of the judgment, as was done by the Navy in this case.

Examples of Transactions Involving  
Questionable Practices

Several of the cases we reviewed involved use of lapsed budget authority in circumstances where questionable actions were taken at the time the original obligation or funding commitment was or should have been made. As a direct result of these questionable actions, requests were made later to use expired or lapsed budget authority. The "M" account transactions themselves appear to satisfy the appropriate criteria for use of those funds. However, we believe that the circumstances as a whole point to serious deficiencies in financial and contract management which also need to be addressed if the perceived problems in the use of "M" account funds are to be resolved.

Navy: A-6 REWING Agreement

In 1985, the Navy contracted for replacement wings for the A-6E aircraft. In a July 1987 Memorandum of Agreement, the contractor and the Navy reached agreement on additional work that would be necessary to make the replacement wing compatible with the aircraft. This agreement provided that the cost for the work would not exceed \$19 million, and covered work that had been underway at the direction of the Navy since 1986. However, no funds were obligated or committed at this time because such funds were not available.

Normally, commitment of funds for contract modifications is made at the time of the modification, although Navy officials stated that commitment of funds was only required when contract modifications are definitized, or prices finalized. Even so, Navy regulations require that contract modifications be definitized no more than 180 days after the award, in this case by January 1988. However, the agreement was not definitized until February 1990, or over two and a half years after it was signed, and almost four years after the Navy authorized the contractor to perform the work. The Navy used \$15.2 million in lapsed budget authority (\$7.6 million from each of fiscal years 1983 and 1985) and about \$3.8 million in expired and current budget authority to fund the agreement. We believe this case illustrates how improper contract management can result in the unnecessary use of lapsed and expired funds, and may raise other legal issues as well.

Air Force: Reprogramming Contingent  
Liability Funds in the Defense Support Program

As is appropriate under DOD and Air Force regulations, the Air Force had committed \$610,000 of fiscal year 1985 funds for contractor award fees in the Defense Support Program. The program encountered schedule delays, and in April 1987, the Air Force withdrew the funds committed for the award fees because they would otherwise have expired at the end of the fiscal year. The funds

were reprogrammed to help fund a classified program. In February 1988, the Air Force determined that the Defense Support Program contractor was entitled to the award fees and \$610,000 of expired fiscal year 1985 funds were used.

Air Force officials told us that it is a common practice to withdraw committed but unobligated funds to maximize the use of current budget authority. However, we believe the practice of withdrawing funds committed for a potentially valid requirement, reprogramming them for another purpose, and then using the expired or lapsed accounts to reinstate the funds for their original purpose results, at a minimum, in questionable budgeting practices.

#### COMMENTS ON HR 5645 AND RELATED LEGISLATION

In recent months, several bills have been introduced to limit the availability of expired appropriations and to provide additional controls on the use of such authority. Your bill, Mr. Chairman, is the most recent of these. While the bills differ somewhat in their approach, we support your bill and the general intent of each of the bills to eliminate the current "M" and merged surplus account structures, limit the amount of surplus budget authority which is available at any time, and improve accountability and the integrity of appropriation accounts after expiration.

For example, under your proposal, individual appropriation balances would be carried forward for 5 years after they expire. The current "M" account and merged surplus balances would be eliminated. This approach provides the flexibility needed to pay valid obligations while, at the same time, it increases control over these accounts by retaining fiscal year as well as appropriation identity. This provision revitalizes the Anti-Deficiency Act's application to expired accounts by providing for the fiscal year visibility of appropriations--a feature that is, for all practical purposes, now lacking for the "M" and merged surplus accounts.

Our analysis of the services' "M" account transactions revealed that, of 697 transactions for which information was available on either the year the contract was signed or the year from which "M" account funds were drawn, 16 percent used about \$120 million of funding authority from fiscal years which had been expired for more than 5 years. This analysis suggests that the five year period of availability of lapsed appropriations suggested in your legislation is a reasonable approach.

Your legislation also permits limited use of current year appropriations to cover preexisting obligations that must be paid after the period of availability of expired authority has passed. This would eliminate the need for any agency to come to the Congress for small amounts to pay bills. Also, we believe it



prudent, as the bill calls for, to close no-year accounts when no disbursement has been made against the appropriation for 2 consecutive fiscal years and the agency head or the President determines that the purposes for which the appropriation was made have been carried out.

ADDITIONAL ACTIONS MAY BE NEEDED

The "M" account transactions we examined for this study suggest that there are several concerns which need to be addressed in other aspects of DOD financial and contract management to avoid the questionable outcomes we observed. There is great variation in the details attendant to each case we examined; as a result we are not convinced that our sample is an exhaustive indicator of all of the concerns which need to be addressed. However, several matters are evident:

- Clarification may be necessary, at least for the Air Force, on the appropriate procedures for financing, from current rather than expired budget authority, contract claims awards by the Armed Services Board of Contract Appeals or the courts.
  
- Contract management appears to need strengthening in definitizing contract modifications and obligating the required funds on a more timely basis.

-- Additional controls may be necessary to ensure that committed funds for valid contingent liabilities are not reprogrammed but are retained for appropriate payment upon occurrence of the contingent event. In a separate report, we will soon be providing additional information on this issue.

Mr. Chairman, this concludes my formal statement. We will be happy to answer any questions you or members of the Subcommittee may have at this time.