BY THE COMPTROLLER GENERAL

Report To The Congress

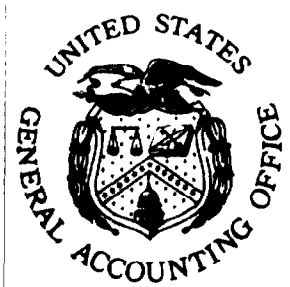
OF THE UNITED STATES

The Air Force Has Incurred Numerous Overobligations In Its Industrial Fund

The Air Force has incurred numerous overobligations in its industrial fund in recent years, ranging up to $210 million, and has not reported the deficiencies to the President and the Congress as required by law. Further, the Air Force illegally adjusted balances on its yearend accounting reports. Because of these adjustments, existing overobligations were not disclosed.

The Air Force practice of obligating its industrial fund in excess of available budgetary resources, based on anticipated customer orders, circumvents the appropriation and apportionment process and is not in accordance with the intent of the Congress or OMB guidelines.

The Air Force should limit its industrial fund obligations to available resources and report all violations of the Anti-Deficiency Act to the President and the Congress.



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-195316

To the President of the Senate and the
Speaker of the House of Representatives

This report summarizes the results of our review of selected aspects of financial operations in the Air Force industrial fund. It discusses the need for action to eliminate practices that led to violations of the Anti-Deficiency Act. Our review was made to determine whether procedures for financing, accounting for, and reporting results of Air Force industrial fund operations were in accordance with existing statutes, the intent of the Congress, and applicable Federal guidance and regulations.

Copies of the report are being sent to the Director, Office of Management and Budget and the Secretary of Defense.

Milton J. Socolar

Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

THE AIR FORCE HAS INCURRED NUMEROUS OVEROBLIGATIONS IN ITS INDUSTRIAL FUND

D I G E S T

The Department of the Air Force has incurred numerous overobligations in its industrial fund in recent years, in amounts up to $210 million, and failed to report the deficiencies to the President and the Congress as required by law. Also, the Air Force illegally adjusted industrial fund account balances on yearend certified financial reports. Because of the adjustments, these violations of the Anti-Deficiency Act (31 U.S.C. 665) were not apparent on the yearend reports.

The Air Force has erroneously contended that overobligations have not occurred and that the adjustments to yearend reported balances are valid because it can obligate the industrial fund on the basis of anticipated customer orders. GAO is making recommendations to the Congress and the Department of Defense to correct these illegal practices. (See p. 16.)

GAO made this review pursuant to its responsibilities under the Accounting and Auditing Act of 1950 for reviewing agency accounting systems from time to time. The objective was to determine whether Air Force industrial fund operations were being conducted in accordance with existing statutes, including provisions outlined by the Congress in legislation authorizing establishment of those funds, and within guidelines on budget execution issued by the Office of Management and Budget (OMB).

SPENDING LIMITATIONS UNDER THE ANTI-DEFICIENCY ACT

To help ensure that Federal agencies do not obligate or disburse more funds than are available, the Congress enacted the Anti-Deficiency Act, which provides for administrative control over funds by restricting obligations and expenditures to amounts appropriated by the Congress and, where applicable, apportioned by OMB. The act requires agencies to report to the President

AFMD-81-53
AUGUST 14, 1981

Tear Sheet

and the Congress any overobligations or other violations of the act. The act also makes OMB responsible for approving agency systems for administrative control over funds. In line with these responsibilities, OMB publishes instructions on budget execution, accounting and fund control procedures, and requirements for yearend reporting by Federal agencies. (See p. 3.)

FINANCING AIR FORCE INDUSTRIAL FUND OPERATIONS

The Air Force industrial fund provides goods and services to customers on a cost reimbursable basis.

As in any Government fund, industrial fund obligations are limited by law to available budgetary resources. OMB has defined available budgetary resources for activities such as the Air Force industrial fund as including balances on deposit with the Treasury, accounts receivable, and unfilled customer orders.

As a revolving fund, the Air Force industrial fund obtains most of its spending authority through the reimbursable process. Under this process, industrial fund obligational authority is increased by the receipt of customer orders. As primary control over the reimbursable process, OMB requires that for a customer order to qualify as spending authority in a revolving fund it must be received and recorded by the fund and be obligated on the accounting records of the customer ordering activity. (See pp. 1-2.)

Yearend reports to the Treasury footnoted

During GAO's review the Air Force pointed out that yearend financial reports to the Treasury have been footnoted to indicate that reported budgetary resources included anticipated customer orders. GAO noted, however, that reports on budget execution sent to OMB were also adjusted but were not footnoted. Further, GAO does not consider the footnote on the Treasury report as full disclosure of or as justification for a practice that is illegal.

Adjustments approved by internal financial management group

The adjustments to the yearend reports have been approved each year by an Air Force internal

financial management review committee comprising representatives from the Accounting and Finance Center, the Directorate of Budget, and the Staff Judge Advocate. The committee has contended that the practice of obligating the industrial fund against anticipated customer orders and, in turn, adjusting yearend balances to include customer orders anticipated for the following year, is supported by internal legal decisions. Those rulings, however, were based on the erroneous assumption that because the Air Force industrial fund is exempt from the apportionment process, as are all Defense industrial funds, OMB provisions for administrative control of funds and restrictions on the use of reimbursements do not apply. (See pp. 9-13.)

When made aware of the Air Force practice, OMB officials told GAO that the practice was contrary to the intent of their guidance on budget execution. OMB officials were adamant in their contention to GAO that the provisions of Circular A-34 regarding availability of budgetary resources created by the receipt of customer orders apply equally to apportioned and nonapportioned funds. (See pp. 13-14.)

By permitting obligations to be incurred in excess of currently available budgetary resources (based on anticipated customer orders), the Air Force is also neglecting the primary limitations imposed under the Anti-Deficiency Act; it is incurring obligations in many cases before the funds to support them have been apportioned (to the ordering activity), and in other cases before they have been appropriated by the Congress.

GAO noted that the practice of obligating the Air Force industrial fund in excess of budgetary resources on hand, based on anticipated customer orders, is an issue that has been questioned on numerous occasions within the Department of the Air Force. Despite strong and repeated criticisms by its own internal auditors since fiscal 1976, Air Force officials have continued to permit obligations to be incurred in excess of available budgetary resources and to direct that official yearend account balances be adjusted on certified reports sent to the Treasury and OMB (See p. 10.)

In accordance with OMB's role as the responsible office for approving agency procedures for administrative control of funds, and particularly with

the numerous questions and criticisms raised about the industrial fund practice, the Air Force, as a minimum, should have requested a ruling from OMB on the propriety of the practice. OMB officials assured GAO that the Air Force procedures, if submitted for approval, would have been disapproved. (See p. 14.)

DEFENSE AND OFFICE OF MANAGEMENT AND BUDGET FAILED TO QUESTION FUND STATUS REPORTS

Although the industrial fund deficiencies that occurred during these fiscal years were apparent on monthly reports on budget execution sent through Defense to OMB, Air Force officials told GAO that neither office has questioned the reports. GAO believes that officials responsible for reviewing these reports should have questioned the Air Force about the apparent deficiencies. (See pp. 8 and 14.)

OMB informed GAO that it is considering implementing procedures to better detect such potential fund control problems and prevent a recurrence of this situation. (See p. 14.)

FINANCING MULTIYEAR DEPOT MAINTENANCE CONTRACTS

In response to GAO's report, Defense stated that the need to use anticipated customer orders as current obligational authority results from the industrial fund's practice of entering into contracts for depot maintenance that extend beyond the end of the current fiscal year. (See p. 14.)

Subsequent to GAO's review, to eliminate the need to cite anticipated customer orders as obligational authority, Defense requested a supplemental appropriation of $322 million and enactment of a general provision that would extend the availability of those funds beyond the normal 1-year period. (See p. 15.)

Both the House and Senate Appropriations Committees deleted the request for the appropriations and enactment of the general provision to extend their availability. The House Appropriations Committee, while acknowledging potential savings from the multiyear contracting practices, also expressed its concern over the current Air Force

practice of using funds before they were appropriated. The committee deferred its decision on the matter until GAO's report was issued. (See p. 15.)

RECOMMENDATION TO THE CONGRESS

If the Congress wishes the Air Force to continue to fund these multiyear contracts through the industrial fund, GAO recommends that it enact legislation that will provide the budgetary resources to finance the contracts. To provide sufficient budgetary resources GAO believes the Congress should authorize the industrial fund to be given contract authority. Such authority should be made subject to appropriate controls similar to those now being applied to certain Defense stock funds which currently have contract authority. Suggested legislative language to accomplish this is shown on p. 16.

RECOMMENDATIONS TO AGENCY OFFICIALS

GAO recommends that the Secretary of Defense have the Secretary of the Air Force

--stop the practice of obligating the Air Force industrial fund in excess of available budgetary resources;

--report only those budgetary resources as defined by OMB on yearend financial reports; and

--determine the correct industrial fund account balances since fiscal 1970, together with all pertinent facts and circumstances concerning the overobligations, and report all overobligations to the President and the Congress as required by law.

GAO further recommends that responsible officials in the Air Force, Defense, and OMB make sure that their procedures for reviewing monthly and yearend financial reports are adequate to detect improper reporting practices and balances that indicate fund deficiencies. GAO's review showed that correct industrial fund account balances can be determined with minimal effort on the part of the Air Force.

AGENCY COMMENTS

Office of Management and Budget

OMB agreed that the Air Force industrial fund procedures discussed in this report were improper, provided no control over obligations, and were contrary to the intent of longstanding OMB guidance. However, OMB questioned the desirability and the practicality of the Air Force filing reports since 1970, indicating that no benefit would be obtained by reiterating the specific instances of the overobligations. GAO noted that very little effort would be needed to gather the financial information necessary for preparing the reports and it could determine no valid reasons, practical or otherwise, why the Air Force should not comply with the law and report all overobligations to the President and the Congress. The OMB response is included as appendix IV.

Department of Defense

Defense strongly disagreed with GAO's report and made arguments, primarily legal, in addition to those presented by Air Force officials during the review. Defense contended that the practices used in the Air Force industrial fund were supported both by existing statutes and prior Comptroller General decisions. GAO's careful review of the Defense response found those arguments to be invalid. Appendix III shows Defense comments and GAO's detailed evaluation where it is appropriate.

Contents

ABBREVIATIONS

DOD	Department of Defense
GAO	General Accounting Office
OMB	Office of Management and Budget

CHAPTER I

INTRODUCTION

The National Security Act of 1947, as amended (10 U.S.C. 2208), gave the Secretary of Defense authority to establish working capital funds in the Department of Defense in order to

> "...(1) finance inventories of such supplies as he may designate; and (2) provide working capital for such industrial-type activities, and such commercial-type activities that provide common services within or among departments and agencies of the Department of Defense, as he may designate."

Pursuant to this authority, the Secretary of Defense has established the Defense industrial fund, the Army industrial fund, the Navy industrial fund, and the Air Force industrial fund. Regulations governing the operations of these industrial funds have been published under Department of Defense Directive 7410.4. That directive provides that, among other objectives, industrial funds in the Department of Defense are designed to

- --provide a more effective means for financing, budgeting, accounting for, and controlling the costs of goods and services produced by industrial and commercial type activities; and

- --create contractual relationshps between industrial type activities and customers in order to provide management advantages and incentives for economy and efficiency.

In order for an industrial fund activity to be established, a charter describing the activity, its functions, and the amount of its working capital must be approved by the Assistant Secretary of Defense (Comptroller). Defense activities typically financed under industrial funds include shipyards, depot maintenance (major repairs and overhauls), and airlift and sealift transportation service.

FINANCING INDUSTRIAL FUND OPERATIONS

Department of Defense industrial funds are operated as revolving funds. As such, they should be self-sustaining; that is, costs incurred in producing or contracting for goods and services ordered by customers of the fund are to be recovered from the ordering activities. To facilitate the financial operations of industrial funds, limited amounts of working capital, or fund corpus, have been provided through one-time appropriations by the Congress. However, most industrial fund budgetary resources (authority to incur obligations), are generated through the receipt of customer orders. Under this reimbursable process, customer activities use their appropriations to fund orders placed with the Defense industrial funds. When the customer submits the order, it records

an obligation on its accounting records for the amount of the order. When the industrial fund activity receives and records the order, its own budgetary resources (obligational authority) are increased by the amount of the order. These industrial fund budgetary resources are then used to finance obligations incurred to fill the customer order.

At September 30, 1979, the Air Force operated its industrial fund with four administrative subdivisions. Each activity has its own charter, approved by the Assistant Secretary of Defense (Comptroller), and is separately managed and accounted for. During fiscal 1979, the Air Force received and recorded over $3.2 billion in industrial fund customer orders. Thus, during fiscal 1979, as those orders were obligated on the customers' accounting records and received and recorded by the industrial fund, the budgetary resources available for obligation in the industrial fund were increased by that amount. As indicated below, the depot maintenance services and airlift services activities accounted for about 97 percent of the total Air Force industrial fund fiscal 1979 customer orders.

Industrial fund activity	Date of charter approval	Fiscal 1979 customer orders (thousands)	Percent of total
Airlift services	Apr. 12, 1958	$1,137,825	34.9
Depot maintenance services	Jan. 12, 1967	2,017,441	61.9
Laundry and dry cleaning services	Dec. 4, 1974	4,515	0.1
San Antonio real property maintenance agency	July 20, 1977	97,903	3.0
		$3,257,684	a/ 100.0

a/Individual percentages as shown total 99.9; differences due to rounding.

While most of the operations of revolving funds such as the Air Force industrial fund are financed in a different manner than many other Government funds (through reimbursements rather than direct appropriations), they are subject to most of the same basic controls and restrictions used to limit spending in all Federal agencies.

CONTROLS OVER SPENDING IN FEDERAL AGENCIES

The U.S. Constitution is the source of authority for the financial powers of the Federal Government. It provides that the

Congress has the sole authority to appropriate funds for financing Government operations. The Constitution requires that "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law..."

To help ensure that Federal agencies do not obligate or disburse moneys not authorized by the Congress, in 1870 the Anti-Deficiency Act (31 U.S.C. 665) was put into effect. This law, as amended, was intended to strengthen administrative control over Federal agency funds by restricting obligations and expenditures to the amounts appropriated by the Congress and, where applicable, apportioned by the Office of Management and Budget (OMB). The act requires agencies to investigate and report to the President, through OMB, and to the Congress any overobligations or other violation of the act. The act also makes OMB responsible for approving agency systems of administrative control over funds. In line with these responsibilities, OMB has published accounting guidelines, administrative fund control instructions, and requirements for yearend reporting by Federal agencies in its Circular A-34, "Instructions on Budget Execution."

Since the Anti-Deficiency Act applies to industrial funds, obligations in industrial funds are limited by law to available budgetary resources. Available budgetary resources of a revolving fund such as the Air Force industrial fund are defined by OMB as including cash on deposit with the Treasury, accounts receivable (customer orders that have been earned but not collected), and unfilled (unearned) customer orders on hand. Because the industrial fund has been exempted from the apportionment process, the limitation on obligations under the Anti-Deficiency Act applies to the fund as a whole, not to each of the four subdivisions.

Apportionment of funds by OMB

Customer appropriations used to finance orders placed with the industrial fund are for the most part subject to the apportionment process. The apportionment process provides an additional degree of control by limiting annual spending authority to amounts specified by OMB on a quarterly basis. However, since the budgetary resources created in Defense industrial funds by receipt of customer orders have been designated by OMB as exempt from apportionment controls, they immediately become available in total for obligation. Since the oversight and control provided in the apportionment process do not apply directly to industrial fund budgetary resources, it is critical that other administrative controls over these funds be maintained internally.

Industrial fund reporting requirements

The Budget and Accounting Procedures Act of 1950 (31 U.S.C. 66,66a) places the responsibility for full disclosure of the results of the financial operations of the Government upon the head of each executive agency. Disclosure is the process by which information is made known on financial status, flow of funds, and

financial results of operations relating to the activities conducted and funds administered by an agency. Achievement of fair presentation through full disclosure in financial reports requires that all financial data presented shall be accurate, reliable, and truthful.

The legislation authorizing the establishment of Defense industrial funds requires annual reports to the President and the Congress on the results of operation and the financial condition of those funds. In addition to these special reporting requirements, industrial funds are subject to the Government-wide requirement for monthly reports on budget execution to OMB and annual reports on yearend fund balances to the Treasury. Section 1311 of the Supplemental Appropriation Act, 1955 (31 U.S.C. 200), requires agency heads to certify in writing to the accuracy of any statement of obligations furnished in connection with the submission of a request for proposed appropriations to OMB. Treasury regulations also require certification to the accuracy of amounts reported to it at yearend. While the Air Force separately operates and accounts for each of the four industrial fund activities, monthly and yearend financial reports are prepared in summary for the entire industrial fund.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review of Air Force industrial fund administrative control procedures was made pursuant to our responsibilities under the Accounting and Auditing Act of 1950 for reviewing agency accounting systems from time to time.

We wanted to determine whether procedures for financing, accounting for, and reporting results of Air Force industrial fund operations were in accordance with existing statutes, including provisions outlined by the Congress in legislation authorizing establishment of those funds, and with guidelines on budget execution issued by OMB.

Our work centered around the issue of what constituted available budgetary resources in the Air Force industrial fund, and particularly whether anticipated customer orders qualified as budgetary resources available for obligation. We limited our evaluation to the Air Force procedures after being informed that the Army and Navy do not consider anticipated customer orders as available budgetary resources and do not adjust yearend industrial fund account balances to include customer orders expected to be generated in the ensuing fiscal year.

To familiarize ourselves with existing requirements for reporting results of operations and the financial position of Defense industrial funds, including the Air Force industrial fund, we reviewed pertinent Air Force and Defense directives, regulations, and other guidance, and discussed the requirements with appropriate Air Force and Defense officials. We also reviewed existing guidelines from OMB and the Treasury.

In the Air Force, we looked at industrial fund yearend financial reports and accounting records from 1970 to 1979, and monthly reports on budget execution and accounting records from the beginning of fiscal 1978 to the middle of fiscal 1980. We did not review or try to evaluate the overall operations of the Air Force industrial fund.

We met with officials of the Air Force Audit Agency and, to the extent possible, used the work done by the Audit Agency related to this matter.

Our work was done at Headquarters, Departments of Defense and Air Force in Washington, D.C., and the U.S. Air Force Accounting and Finance Center in Denver. Discussions were also held with officials at the Department of the Treasury and OMB.

CHAPTER 2

OVEROBLIGATIONS AND ILLEGAL ADJUSTMENTS TO YEAREND REPORTS IN THE AIR FORCE INDUSTRIAL FUND

Since fiscal 1970, the Air Force has incurred numerous overobligations in its industrial fund, ranging up to $210 million in fiscal 1980. These overobligations violated the Anti-Deficiency Act. The Air Force has continued to routinely incur obligations in excess of available resources, which include fund corpus and customer orders received, because it contends that anticipated customer orders also qualify as available obligational authority. Because of this erroneous contention, which is contrary to existing guidance from the Office of Management and Budget as well as Air Force and Defense regulations, the Air Force has failed to report, as required by law, the overobligations. Further, the Air Force illegally adjusted upward amounts of reported industrial fund budgetary resources on its yearend certifications of fund balances. Because of these adjustments, the overobligations existing at yearend for 4 of the 10 fiscal years from 1970 to 1979 were not apparent on those yearend reports.

Air Force officials contend that the use of anticipated reimbursements as current obligational authority in the industrial fund is necessary to cover multiyear depot maintenance contracts. Officials stated that the practice of entering into multiyear contracts, which are estimated by Air Force officials to be valued at several hundreds of millions of dollars, saves money for the Government. However, as discussed in more detail on pp. 12-13, the improper practice of entering into obligations against anticipated customer orders circumvents fund controls and limitations intended by the Congress for industrial funds. Further, the practice has resulted in the Air Force incurring obligations in many cases before the funds to support them have been apportioned (to the customer) by OMB or even before they have been appropriated by the Congress.

The Air Force has continued these practices despite repeated criticisms by its own internal auditors.

OVEROBLIGATIONS IN THE AIR FORCE INDUSTRIAL FUND

On numerous occasions since fiscal 1970, the Air Force has incurred overobligations in its industrial fund. These overobligations, which violate the Anti-Deficiency Act (31 U.S.C. 665), occur when cumulative obligations of a fund or account exceed available budgetary resources. As explained in chapter 1, available budgetary resources of the industrial fund include fund corpus plus customer orders received.

We reviewed industrial fund accounting records and financial reports at fiscal yearend from 1970 to 1979, and monthly for fiscal 1978, 1979, and the first half of 1980. Those records showed that the overobligations have occurred at various times both during and at the end of the fiscal years involved.

For example, review of monthly industrial fund balances for fiscal 1978, 1979, and the first half of 1980 showed that overobligations existed for 11 of the 28 months, in amounts ranging from $11 million to $210 million. Examples are shown below.

Date of monthly report	Reported available budgetary resources	Reported obligations incurred	Over - obligations
	(thousands)		
Nov. 30, 1977	$ 587,850	$ 681,628	$(30,778)
Dec. 31, 1977	667,660	779,987	(112,327)
Mar. 31, 1978	1,372,639	1,512,622	(139,983)
Dec. 31, 1979	1,019,367	1,229,584	(210,217)
Mar. 31, 1980	2,008,210	2,145,620	(137,411)

Accounting records also showed overobligations in the Air Force industrial fund at yearend for 4 of the 10 years reviewed, as shown below.

Fiscal year ending	Available budgetary resources	Obligations incurred	Over - obligations
	(thousands)		
June 30, 1970	$400,575	$420,079	$(19,504)
June 30, 1972	436,013	462,430	(26,417)
June 30, 1975	404,429	485,941	(81,513)
Sept. 30, 1977	554,569	556,311	(1,742)

As discussed on the following pages, the industrial fund overobligations that occurred during the fiscal year (prior to yearend) have been evident on monthly financial reports submitted by the Air Force. However, because of adjustments that illegally increased reported budgetary resources, the deficiencies existing at yearend were not shown on certified reports sent to the Treasury and OMB.

A schedule of yearend industrial fund account balances from fiscal 1970 through 1979, with and without the illegal adjustments, is included as appendix I. A schedule of monthly balances for fiscal 1978, 1979, and the first half of 1980 is included as appendix II.

Monthly financial status reports

As described in chapter 1, one of the primary financial status reports prepared on Air Force industrial fund operations is the monthly report on budget execution sent to OMB. We found that for those months reviewed, account balances as recorded on official accounting records were accurately shown for each of the 11 monthly reports prior to yearend. As a result, any deficiencies in the fund were apparent on the reports on budget execution. Despite this, no action was taken by the Air Force to investigate the Anti-Deficiency Act violation or report it to the President and the Congress, as required by law. Further, Air Force officials told us that no one in Defense or OMB questioned the reports submitted.

Yearend reports and certification of fund balances

While the monthly reports on budget execution prior to yearend that we reviewed accurately reflected official account balances, balances at yearend had been adjusted during the preparation of official fund status reports, including the yearend certifications of fund balances sent to the Treasury and OMB. The adjustments involved increasing the amounts of reported customer orders received and therefore the obligational authority by amounts ranging from $19.5 million in fiscal 1970 to $351.7 million in fiscal 1979 (no adjustment was made at the end of fiscal 1971). As a result of these adjustments, yearend overobligations in the industrial fund, which existed four times from fiscal 1970 to 1979, were not disclosed.

The Air Force contended that the industrial fund has not been overobligated either during or at the end of the fiscal year. This contention is based on the premise that the industrial fund can include estimates of anticipated customer orders as currently available obligational authority.

In response to our report, the Acting Assistant Secretary of Defense (Comptroller) pointed out that since 1973 the Air Force has footnoted the annual fiscal yearend certification of appropriation and fund balances (TFS 2108), which goes to the Treasury, to indicate the amount of anticipated customer orders being reported as unfilled customer orders. We acknowledge that those certified reports included a footnote identifying the amount of the yearend adjustment. However, we do not consider those footnotes to be adequate disclosure of the procedures or as justification for a practice we have determined is illegal. Further, yearend reports on budget execution sent to OMB, which contain much of the same information reported to the Treasury, have not been footnoted. In response to our report, the Deputy Director, OMB pointed out that the Air Force was remiss in not disclosing the industrial fund procedures when requesting OMB approval of its procedures for administrative control of appropriations. OMB officials informed us that the procedures, if identified in the submission, would have been disapproved.

USE OF ANTICIPATED CUSTOMER ORDERS AS CURRENT OBLIGATIONAL AUTHORITY

According to Air Force records, the precedent for adjusting balances of industrial fund resources reported at yearend to include amounts of anticipated customer orders was established in fiscal 1970. At that time, yearend official accounting records showed that obligations exceeded total resources available for obligation by $19.5 million. These balances included only those customer orders that had been received and recorded by the industrial fund and obligated on the accounting records of the customer activity. However, the deficiency was not disclosed because Air Force officials directed that during the preparation of the yearend certified reports to the Treasury and OMB, the balances of unfilled customer orders, and therefore available budgetary resources, be increased by $19.5 million, representing "anticipated customer orders" (for the following fiscal year) to the industrial fund. This adjustment resulted in available budgetary resources being shown as exactly equal to total obligations.

While the fiscal 1970 adjustment was made for the precise amount of the deficiency, the adjustments made at yearend since then have been for increasing amounts and grew to $351 million at the end of fiscal 1979. While the amounts of the adjustments since 1970 have been somewhat arbitrary, in each case the amount exceeded the existing fiscal yearend deficiencies.

The contention that the industrial fund can use anticipated customer orders as obligational authority has been used not only as justification for adjusting official account balances on yearend financial reports, but also for not reporting overobligations, which have been evident on accounting records and financial reports during the fiscal year.

In responding to our report, the Acting Assistant Secretary of Defense (Comptroller) provided additional arguments, primarily from a legal standpoint, that the practices used in the Air Force industrial fund are consistent with existing statutes and are supported by prior views of the Comptroller General. These contentions are incorrect. As explained in greater detail in appendix III, we have carefully considered each point in the Defense response and concluded there is nothing in existing statutes, including related legislative histories or previous Comptroller General decisions, to support Defense's position.

Approval by internal financial management group

The Air Force has a management oversight committee to, among other things, evaluate significant accounting adjustments and the validity of balances on yearend financial reports. This group, known as the Section 1311 Funds Certification Committee, was established in the late 1950s to act primarily as an administrative appeals body for disagreements between Air Force auditors and

financial managers. At the time of our review, the certification committee was composed of representatives of the Air Force Accounting and Finance Center, the Directorate of Budget, and the Staff Judge Advocate. The committee also has advisors from the Finance Center and the Air Force Audit Agency.

The certification committee has, since 1970, annually reviewed the proposed fiscal yearend adjustment to reported industrial fund resources. Despite the apparent conflicts with provisions of OMB Circular A-34 and the Defense Accounting Guidance Handbook, both of which provide that in order to qualify as obligational authority, customer orders must be received and recorded and represent obligations on the accounting records of the ordering activity, the certification committee has continued to direct that the adjustments in question be made.

Beginning in fiscal 1976, and each year since then, the Air Force Audit Agency has taken exception to the Air Force practice of incurring obligations in the industrial fund in excess of available budgetary resources as defined by OMB and adjusting official account balances to augment budgetary resources on yearend financial status reports. The Audit Agency has repeatedly pointed out that in addition to being contrary to provisions of OMB Circular A-34 and existing Air Force regulations, the adjustments distorted the actual yearend status of the fund. Despite these repeated criticisms from its internal auditors, the Air Force has continued this practice.

From fiscal 1970 through 1974, the adjustments were approved based on a 1968 Air Force General Counsel ruling which the committee contended authorized industrial fund obligations against anticipated customer orders. Beginning with its justification for the fiscal 1975 adjustments, the committee referred to the 1968 General Counsel opinion as well as to a 1975 opinion by the Air Force Staff Judge Advocate which the committee felt reaffirmed the earlier decision. These legal decisions are discussed below.

Air Force legal decisions regarding industrial fund resources

On September 11, 1968, the Air Force General Counsel issued a decision stating that:

> "...the DMIF [Depot Maintenance Industrial Fund] has authority to enter into contracts against its general operating requirements and in advance of reimbursable orders as long as (1) the assets of the fund together with its anticipated reimbursements are sufficient to cover the obligations incurred; (2) the contract is within the fund's approved operating budget; and (3) such obligations are held to a minimum appropriate in the light of the character of the fund's operations." (Underscoring added.)

Air Force officials informed us that the "fund's approved operating budget" referred to by the General Counsel was the amount approved by Defense and OMB for inclusion in the President's budget for that fiscal year. The General Counsel further concluded that pertinent Defense regulations also authorized the Air Force "...to enter into contracts in advance of receipt of reimbursable orders sufficient to cover those contracts" in the industrial fund.

The second legal memorandum referred to by the 1311 Committee in its approvals of the yearend adjustments to industrial fund resource balances came from the Air Force Staff Judge Advocate on April 8, 1975. In that decision, the Staff Judge Advocate further addressed the question as to what constituted available budgetary resources in the Air Force industrial fund. The Staff Judge Advocate pointed out that in order to give consideration to the use of anticipated reimbursements as available budgetary resources it must first be concluded that the provisions in OMB Circular A-34 deal only with funds subject to the apportionment process and therefore do not apply to the Air Force industrial fund. Adding that "it appears that DOD recognized an authority to obligate against an industrial fund to the extent of the corpus of the fund plus anticipated reimbursements for one year," the Staff Judge Advocate finally concluded that, if provisions in OMB Circular A-34, section 66, do not apply to industrial funds, there was "nothing in pertinent statutes and DOD and Air Force directives to preclude inclusion of anticipated reimbursements for one year, as indicated in the fund's operating budget, as a budgetary resource."

On November 3, 1980, in response to a request from the Assistant Secretary of the Air Force (Financial Management), the General Counsel reaffirmed its 1968 decision authorizing industrial fund obligations based on anticipated reimbursements and added that the practice was "supported by language in a Comptroller General decision concerning a Navy industrial fund activity in 1972 (52 Comp. Gen. 598)."

Air Force officials told us that they have interpreted these rulings as legal authority for the industrial fund to enter into obligations based on 1 year's anticipated reimbursements. Officials told us that they consider "1 year's anticipated reimbursements" as the amount of customer orders expected to be received during the next 12 months, beginning from any point in a fiscal year. Therefore, the Air Force contends that no deficiency exists in the industrial fund at any point as long as available budgetary resources (cash, accounts receivable, and unfilled customer orders) together with anticipated customer orders for 12 months thereafter are sufficient to cover outstanding obligations.

GAO evalution of Air Force legal opinions

The Air Force legal opinions discussed above are incorrect and the procedures used by the Air Force for operating its industrial

fund based on those rulings violate the Anti-Deficiency Act, contradict provisions in OMB Circular A-34, and, in effect, circumvent the appropriation and apportionment process.

By obligating the industrial fund in excess of currently available budgetary resources (based on anticipated customer orders) the Air Force is neglecting the most important fund control requirement in the Federal Government--that obligations be limited to amounts of budgetary resources available. Further, by permitting obligations based on anticipated customer orders, the Air Force is incurring obligations in many cases before the funds to support them have been apportioned (to the ordering activity) by OMB and even before they have been appropriated by the Congress.

The Air Force Staff Judge Advocate recognizes in his opinion that in order to consider anticipated reimbursements as a budgetary resource available for obligation, one must first conclude that provisions in OMB Circular A-34, section 66, do not apply to the industrial fund because it has been made exempt from the apportionment process. Section 66 defines budgetary resources of revolving funds as including "cash, balances on deposit with Treasury, accounts receivable, and unfilled customer orders..." and also provides that "Anticipated reimbursements and anticipated customer orders for the remainder of the year are not considered a budgetary resource for purposes of determining the status of funds on any given day..."

We met with OMB officials to discuss the provisions of Circular A-34 and how those provisions applied to the practices used by the Air Force to finance and account for its industrial fund operations. OMB officials were emphatic in their statements to us during the review, and again in responding to our report, that the provisions under section 66 of Circular A-34 regarding budgetary resources, and particularly the stipulation that anticipated customer orders do not qualify as available budgetary resources, apply equally to apportioned funds and those exempt from the apportionment process. While orders may be anticipated before the end of the fiscal year based on approved budgeted program levels, obligational authority is not generated in the industrial fund until orders are received by the industrial fund and recorded, and obligated on the customer's accounting records. This point is discussed further in the Defense response to our report and our rebuttal to that response. (See app. III.)

In discussions with Air Force officials, they pointed out to us that certain provisions of OMB Circular A-34 were not in effect at the time of the 1968 General Counsel ruling. While we agree that the specific provisions in section 66 of the circular discussed above were first put into effect in the 1971 revision of the circular, we found that earlier versions of the circular clearly provided that obligational authority from customer orders does not materialize until the orders are received by the fund and obligated on the books of the ordering activity. Further, as pointed out

above, in full awareness of the current OMB provisions, the General Counsel recently reaffirmed the conclusions in its 1968 decision.

We also noted that legislation authorizing the establishment of Defense working capital funds such as industrial funds and stock funds (10 U.S.C. 2208) makes no mention of authority to incur obligations against anticipated receipts. Defense stock funds, which are operated to buy and stock materials and supplies which are then sold to customer activities, are also revolving funds and are operated similarly to Defense industrial funds. However, under 10 U.S.C. 2210, Department of Defense stock funds may incur such obligations subject to approval by the Congress and apportionment by OMB. No comparable authority exists with regard to industrial funds. Since the provisions of sections 2208 and 2210 were both enacted under Public Law 87-651, September 7, 1972, 76 Stat. 506, 521-522, it is apparent that the Congress intended for only stock funds to incur obligations based on anticipated receipts. This issue is addressed in further detail on pp. 29-36.

We contacted officials responsible for operating the industrial funds in the Departments of the Army and Navy. Those officials told us that obligations are incurred based on customer orders received and accepted and, when informed of the Air Force practice of obligating against anticipated customer orders, that they believed that the practice was illegal.

Finally, the inference in the General Counsel memorandum dated November 3, 1980, that a 1972 Comptroller General decision does not preclude the practice being used in the Air Force industrial fund, is not correct. In that decision, the Comptroller General reiterated the proscription against obligations exceeding revenue without explicit authority to do so. The 1972 decision raised no objections to charging the Navy industrial fund with the cost of a multiyear contract because sufficient assets were available either within the fund or by transfer from other accounts. This point is addressed in more detail on pp. 38-40.

Lack of OMB approval of Air Force industrial fund control procedures

As stated in chapter 1, OMB is responsible under 31 U.S.C. 665 for establishing guidelines for budget execution and reporting for Federal agencies, establishing basic fund control elements required in Government agency accounting systems, and reviewing and approving each agency's system for administrative control over funds.

To obtain this approval, the Department of Defense submitted a single package covering all Defense activities, including each military service, consisting of its own internal directive on administrative control of appropriations. These general procedures were approved by OMB on September 11, 1978. The approved procedures, however, make no provision for obligating against

anticipated reimbursements in industrial funds. In fact, the approved procedures specify that only certain Defense stock funds have such authority. As stated above, those stock funds receive contract authority as approved by the Congress and apportioned by OMB; industrial funds do not.

When made aware of the procedures used by the Air Force to finance, account for, and report results of its industrial fund operatons, OMB officials told us that those procedures were improper and would not have been approved had they been identified in the fund control procedures submitted by Defense.

We agree with OMB officials that these procedures are improper. However, we also believe Defense and OMB officials responsible for reviewing industrial fund financial reports, particularly the monthly reports showing apparent overobligations, should have questioned the reported balances.

In responding to our report, the Deputy Director of the Office of Management and Budget reiterated his Office's position that the Air Force industrial fund practices were contrary to the intent of guidance in Circular A-34. The Deputy Director also said that, to prevent a recurrence of such a situation, his Office is exploring the possibility of an automated system to "detect 'potential' fund control problems and will focus more attention on this area in the future."

FINANCING MULTIYEAR DEPOT MAINTENANCE CONTRACTS

In response to our draft report, the Acting Assistant Secretary of Defense (Comptroller) states that the Air Force industrial fund has been permitted to award 12-month depot maintenance contracts throughout the fiscal year.

Therefore the period covered by many of these contracts extends into the subsequent fiscal year. The Acting Assistant Secretary argues that this practice necessitates using anticipated reimbursements--customer orders which the Air Force anticipates will materialize during the following fiscal year.

During our review, Air Force officials informed us that the depot maintenance contracts actually covered periods ranging up to 3 years. However, in response to our requests for information on the number and value of such contracts, the Air Force told us that such information was "not readily available." Officials later estimated the carryover value of such contracts--the amount of existing contracts applicable to periods beyond the current fiscal year--at $358 million. They added, however, that to identify the actual number of contracts and their value would require significant research on the part of the Air Force.

ACTIONS TAKEN BY DEFENSE TO CHANGE PROCEDURES FOR FINANCING AIR FORCE DEPOT MAINTENANCE CONTRACTS

Subsequent to our review, the Department of Defense, through OMB, requested a supplemental appropriation of $322 million and enactment of a general provision to extend the period of availability of those funds beyond the normal 1-year period. Defense officials contend that this would eliminate the need to obligate the industrial fund against anticipated reimbursements.

Both the House and Senate Appropriations Committees deleted these items in their consideration of Defense's request for supplemental appropriations. In its report on the Supplemental Appropriations and Rescission Bill, 1981 (H. Rept. 97-29), the House Appropriations Committee acknowledged that there may be efficiencies and economies in the Air Force multiyear contracting procedures, but expressed its concern over the Air Force incurring obligations prior to the appropriation of funds. In acknowledging our draft report, the committee stated that it would defer its final decision on the request for funds and enactment of the general provision until our final views were made known.

CONCLUSIONS

The Air Force is entering into industrial fund obligations before funding for those obligations is legally available. As a result, the Air Force has incurred numerous overobligations in its industrial fund, in amounts ranging up to $210 million. The Air Force has failed to report these Anti-Deficiency Act violations to the President and the Congress as required by law. Further, the Air Force has illegally adjusted its official yearend certified reports on industrial fund balances without fully disclosing the nature of these adjustments. These adjustments resulted in the yearend deficiencies not being disclosed.

The Air Force has continued to obligate its industrial fund in excess of available budgetary resources and to adjust its yearend certifications despite strong and repeated criticism of the practice by the Department's internal auditors. Air Force officials are incorrect in their contention that the practice is legal. The legal opinions offered as support for the practice are based on the erroneous presumption that certain fund controls that apply to other Government funds do not apply to the Air Force industrial fund because it is exempt from the apportionment process.

Without specific authority to do otherwise, obligations in the industrial fund must be limited to available budgetary resources. OMB has been very explicit on this matter and OMB officials consider the Air Force actions in conflict with OMB guidance.

In addition to violating existing guidelines, the accounting and financial reporting practices followed by the Air Force for its industrial fund have circumvented the Federal appropriation

process by using funds before they become legally available. Further, the practices are not in accordance with the procedures outlined by the Congress for industrial funds.

We believe that responsible Defense and OMB officials should have questioned Air Force monthly reports on budget execution which showed industrial fund overobligations.

Finally, however, notwithstanding the internal legal opinions issued by the Air Force, the (1) apparent conflict with provisions of OMB Circular A-34 and internal Defense regulations and (2) strong and repeated criticisms by its own internal auditors should have prompted responsible Air Force officials to finally resolve the issue by going to OMB for a formal ruling. Rather, the Air Force has decided to continue to operate the industrial fund in its frequently overobligated status and to illegally adjust balances reported and certified at yearend. Our review showed that correct industrial fund account balances since fiscal 1970 can be determined with minimal effort on the part of the Air Force.

RECOMMENDATION TO THE CONGRESS

If the Congress wishes the Air Force to continue to fund these contracts through the industrial fund, GAO recommends that it enact legislation that will provide the budgetary resources to finance the contracts. To provide sufficient budgetary resources GAO believes the Congress should authorize the industrial fund to be given contract authority. Such authority should be made subject to appropriate controls similar to those now being applied to certain Defense stock funds which currently have contract authority. (See 10 U.S.C. 2210.) This could be accomplished by adding a new subsection (j) to section 2208 of title 10, United States Code, to read as follows:

> "(j) Obligations may, without regard to fiscal year limitations, be incurred against anticipated reimbursements to the Air Force Depot Maintenance Industrial Fund established under this section in such amounts and for such period as the Secretary of Defense, with the approval of the Director of the Office of Management and Budget, may determine to be necessary for the efficient operation of the fund."

RECOMMENDATIONS TO AGENCY OFFICIALS

We recommend that the Secretary of Defense have the Secretary of the Air Force

- --stop the practice of obligating the Air Force industrial fund in excess of available budgetary resources;
- --report only those budgetary resources as defined by OMB on yearend financial reports; and

--determine the correct industrial fund account balances since fiscal 1970, together with all pertinent facts and circumstances concerning the overobligations, and report all overobligations to the President and the Congress as required by law.

3 We further recommend that responsible officials in the Air Force, Defense, and OMB make sure that their procedures for reviewing monthly and yearend financial reports are adequate to detect improper reporting practices and balances that indicate fund deficiencies.

AGENCY COMMENTS

Office of Management and Budget

OMB agreed that the Air Force industrial fund procedures discussed in the report were improper, provided no control over obligations, and were contrary to the intent of longstanding guidance issued by OMB. However, OMB questioned the desirability and the practicality of the Air Force filing reports since 1970, indicating that no benefit would be obtained by reiterating the specific instances of the overobligations. We noted that very little effort would be needed to gather the financial information necessary for preparing the reports and we could determine no valid reasons, practical or otherwise, why the Air Force should not comply with the law and report all overobligations to the President and the Congress. The OMB response is included as appendix IV.

Department of Defense

Defense strongly disagreed with our report and made arguments, primarily legal, in addition to those presented by Air Force officials during the review. Defense contended that the practices used in the Air Force industrial fund were supported both by existing statutes and prior Comptroller General decisions. GAO's careful review of the Defense response found those arguments to be invalid. Appendix III shows Defense comments and our detailed evaluation where it is appropriate.

FINANCIAL STATUS OF AIR FORCE INDUSTRIAL FUND

AT FISCAL YEAREND

FISCAL 1970 to 1979

Fiscal year ending	Reported available budgetary resources	Amount of illegal adjustments	Actual budgetary resources	Unpaid obligation	Available balance (overobligation)
	(thousands)				
June 30, 1970	$ 420,079	$ 19,504	$400,575	$420,079	$(19,504)
June 30, 1971	570,426	-0-	570,426	467,560	102,866
June 30, 1972	462,430	26,417	436,013	462,430	(26,417)
June 30, 1973	617,812	116,438	501,374	447,106	54,268
June 30, 1974	646,562	119,211	527,351	518,134	9,217
June 30, 1975	573,467	169,039	404,428	485,941	(81,513)
Sept. 30, 1976	987,113	293,892	693,221	487,566	205,655
Sept. 30, 1977	884,424	329,855	554,569	556,311	(1,742)
Sept. 30, 1978	993,273	340,624	652,649	633,433	19,216
Sept. 30, 1979	1,285,959	351,652	934,307	805,363	128,944

APPENDIX I

MONTHLY FINANCIAL STATUS OF AIR FORCE INDUSTRIAL FUND FROM FISCAL 1978 THRU MID FISCAL 1980

Date of report	Available budgetary resources	Obligations incurred	Available balance (overobligation)
	----------(thousands)----------		
Oct. 31, 1977	$ 443,194	$ 395,425	$ 47,769
Nov. 30, 1977	587,850	618,628	(30,778)
Dec. 31, 1977	667,660	779,987	(112,327)
Jan. 31, 1978	1,153,735	1,046,234	107,501
Feb. 28, 1978	1,241,075	1,252,057	(10,982)
Mar. 31, 1978	1,372,639	1,512,622	(139,983)
Apr. 30, 1978	1,883,987	1,744,257	139,730
May 31, 1978	1,995,760	1,965,554	30,206
June 30, 1978	2,121,395	2,181,104	(59,709)
July 31, 1978	2,533,061	2,376,024	157,037
Aug. 31, 1978	2,667,902	2,605,459	62,443
Oct. 31, 1978	578,544	458,867	119,677
Nov. 30, 1978	708,515	707,338	1,177
Dec. 31, 1978	859,703	937,532	(77,829)
Jan. 31, 1979	1,378,853	1,220,781	158,072
Feb. 28, 1979	1,511,888	1,444,700	67,188
Mar. 31, 1979	1,630,362	1,705,930	(75,568)
Apr. 30, 1979	2,198,492	1,948,788	249,704
May 31, 1979	2,322,697	2,314,812	7,885
June 30, 1979	2,424,449	2,406,808	17,641
July 31, 1979	2,932,930	2,619,424	313,506
Aug. 31, 1979	3,083,598	2,839,419	244,179
Oct. 31, 1979	686,252	675,611	10,641
Nov. 30, 1979	846,585	1,002,515	(155,930)
Dec. 31, 1979	1,019,367	1,229,584	(210,217)
Jan. 31, 1980	1,602,892	1,571,641	31,251
Feb. 29, 1980	1,801,787	1,859,149	(57,362)
Mar. 31, 1980	2,008,210	2,145,620	(137,410)

APPENDIX III

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

COMPTROLLER

1 MAY 1981

Mr. D. L. Scantlebury
Director, Accounting and Financial
Management Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Scantlebury:

As requested in your letter of March 27, 1981, we have reviewed the General Accounting Office draft report entitled, "Lack of Integrity in the Air Force Industrial Fund (Code 903930)." We do not concur in the allegations contained in the report that there are numerous unreported overobligations and a lack of fiscal integrity in the Air Force Industrial Fund. Further, we feel the tonal quality of the report is inflammatory, and contains characterizations and innuendos that are unfair and untrue.

We strongly suggest that the report be withdrawn. If not withdrawn, it should be significantly revised to give full consideration to the attached comments.

Sincerely,

John R. Quetsch

John R. Quetsch
Acting Assistant Secretary of Defense
(Comptroller)

Enclosure

DEFENSE COMMENTS ON GAO DRAFT REPORT (CODE 903930)

We have reviewed the General Accounting Office draft report entitled "Lack of Fiscal Integrity in the Air Force Industrial Fund" submitted with your letter of March 27, 1981. The allegations that there are numerous unreported overobligations and a lack of fiscal integrity are unfounded.

The entire draft report is based on a difference of opinion between the Air Force and the General Accounting Office auditors on the narrow technical issue as to whether it is proper to incur obligations in the Air Force Industrial Fund based on anticipated reimbursements. We believe that the draft report addresses this complex technical question superficially, by taking sound general concepts of fiscal law and procedures and misapplying them to the unique statutory authorities applicable to the working-capital funds of the Department of Defense. In addressing this substantive question, we will point out that the draft report is inconsistent with--

1. accounting system approval by the General Accounting Office of the Air Force Industrial Fund Department Level System;

2. the statutes applicable to working-capital funds of the Department of Defense; and

3. prior views of the Comptroller General.

As a preliminary matter, however, we take strong exception to the tone and quality of the draft report. The draft report alleges that the Air Force has circumvented the appropriation and apportionment process and has hidden its practices over the last eleven years, with implications of improper conduct and motivation on the part of Air Force officials. These, and other such characterizations and innuendos, are unfair and untrue. The misleading tone of the draft report is established in its very title "Lack of Fiscal Integrity..." Even if the draft report is correct on the main substantive point, which we do not concede to be the case for the reasons hereafter indicated, this hardly translates into a "lack of fiscal integrity." If the Air Force practice is technically illegal it should be stopped, but the practice has had no impact on government spending or on the integrity of federal or Air Force funds except, ironically, beneficial impact. The repeated references to spending demonstrates a fundamental lack of understanding of the financial impact of the Air Force practice, which is at most technical, short-term, self-correcting overobligations. The failure to comprehend these elementary points casts doubt on the quality of the draft report's abbreviated analysis of the much more complex substantive matters at issue.

(c o p y)

GAO response:

This office has and will continue to support practices which, whether for the sake of economy and efficiency or otherwise, are in the best interest of the Government. The illegal practices discussed in this report, however, circumvent the appropriation and apportionment process and, as confirmed by the Office of Management and Budget in their response to this same draft report, the practice "provides no controls over obligations since the amount of orders that can be anticipated is unlimited." Whether to provide legal authority for the Air Force to continue to negotiate multiyear contracts for depot maintenance and, if so, whether to finance those contracts out of the industrial fund are matters for consideration by the Congress. However, for the Air Force to disregard what has occurred since 1970, in clear violation of existing statutes, we do not believe is proper.

The title of the final report has been changed to more clearly reflect its message.

Defense comment:

As will be discussed in somewhat more detail below, the Air Force practices are reflected in the accounting system design package that was submitted to and approved by the General Accounting Office in 1975 and 1976. The submission also contained documentation showing that the Annual Fiscal Year-End Certification of Appropriations and Fund Balances (TFS2108), as has been the case since Fiscal Year 1973, have been footnoted to indicate clearly the nature of the Air Force's year-end adjustments that are now questioned. We do not believe it is possible for the General Accounting Office to have meaningfully approved the accounting system without being cognizant of these practices. It is therefore disturbing to be faced with an audit report challenging criteria that have been established in an approved accounting system. It is even more disturbing to be accused of not disclosing year-end adjustments that have, in fact, been disclosed.

GAO response:

Defense is in error in indicating that documentation was submitted to us for approval showing the footnote used to describe the nature of the Air Force yearend adjustments. A review of the design package submitted to us by the Air Force shows no documentation with such a footnote. If the footnote had been submitted to us as alleged, we would have questioned the year-end adjustment.

Regarding our approval of the accounting system design package in 1975 and 1976, Defense is referring to approval of several Air Force industrial fund systems.

APPENDIX III

Activity	Approved
Laundry and Dry Cleaning	June 1975
Airlift Service	June 1976
Department Level	Sept. 1976

However, the industrial fund system that is causing the problems discussed in this report, that is, the Depot Maintenance Industrial Fund, has never been submitted for our approval. None of the approved accounting system designs contain provisions for financing large, multiyear contracts through the depot maintenance industrial fund, using anticipated customer reimbursements as budget authority. Accordingly, we have never had an opportunity to evaluate from a systems approval standpoint the problems described in this report. Regarding Defense's contention that the yearend adjustments have been disclosed, as we discussed on p. 8, we do not consider the footnote which has been included on one of the two primary yearend financial reports as full disclosure of the adjustments or as justification for the illegal practice.

Defense comment:

The draft report's exaggerated allegations of impropriety do not put the Air Force's practices in context. It is generally agreed that obligational availability is increased when customer orders are received. In the Air Force Industrial Fund, it also has been the practice to consider that obligational authority is increased based on anticipated reimbursements from customer orders that have not yet been received but are anticipated. This practice is followed during the Fiscal Year and at year-end when adjustments are made to financial reports. This practice has been followed in the Air Force Industrial Fund in particular, because it has permitted that Fund to award twelve-month depot maintenance contracts in a more orderly manner throughout the Fiscal Year. This has resulted in economies and efficiencies by spreading the administrative workload and, in addition, cost savings by contracting in this manner rather than in a piece-meal fashion as customer orders are received. In addition, if there are what are perceived to be "overobligations" they are largely self-correcting as customer orders are received. Contrary to the implications in the draft report, this practice has not resulted in overspending by the Industrial Fund or overobligating or overspending by the customer accounts of the Industrial Fund.

GAO response:

Records reviewed during our audit showed that it was not until it first discovered a fiscal yearend overobligation in the industrial fund that the Air Force decided to use the logic by which it now

justifies the entire practice. Enclosed as appendix V is a memorandum for the record prepared by an accountant at the Air Force Accounting and Finance Center. The memorandum provides:

> "While preparing Bureau of Budget A-11 worksheets, it became apparent that obligations exceeded fund resources by $19,504,119.97. This had not been exposed earlier for two reasons: (a) during the year the anticipated reimbursement program provided adequate resources, (b) unfilled customer orders on hand had included orders for which collection had already been made under the new accelerated collection procedure.
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> - - - - -
>
> "Possible courses of action included (a) field deobligation of multiple year contracts (b) movement of MAP unfilled orders from other appropriations (c) recording of additional unfilled orders. HQ USAF Budget discussed the condition and provided us with a letter requesting us to record an additional $19,504,119.97 in unfilled orders. The certification was revised accordingly, reducing the "other" authority from Col 6 and increasing Col 8 Reimbursements Anticipated. Footnote relating to the amount was removed. A Section 1311 Committee item was written to cover this case."

It is apparent from this memorandum and other information reviewed during our audit that the Air Force first discovered an overobligation and then searched for the best way to handle the situation. Recording additional unfilled orders, one of the options discussed in the memorandum, was ultimately chosen as the best course of action. This action, however, was illegal.

Defense's reference to 12-month contracts is not entirely consistent with information provided to us by individuals at the Air Force Logistics Command. These officials told us the contracts run up to 3 years in length. As pointed out in the report, the Air Force could not readily provide us with the number or amount of such contracts. While we fully support economy and efficiency of operations in the Government, business must be conducted within the parameters of existing statutes. As shown on p. 16, if the Congress wants the Air Force to continue to finance multiyear depot maintenance contracts out of the industrial fund, we are recommending that it enact legislation that will provide the necessary budgeting resources and with proper control. This authorization could be similar to that currently granted certain Defense stock funds under 10 U.S.C. 2210(b).

Defense comment:

Further, as a result of the pending draft report, year-end adjustments were not made at the close of Fiscal Year 1980. To be sure, they were not needed at that time, because sufficient customer orders had been received by year-end to provide sufficient obligational availability, by any standard, before the close of the Fiscal Year. Moreover, in an attempt to avoid any future problems, the President's Budget Amendments of March 10, 1981, request funding and accompanying appropriation language that will obviate the need for the Air Force to continue its practice in the future. This budget request should not be interpreted as an admission of the impropriety of the Air Force's practice. It is simply an attempt to put the matter before the Congress, change procedures, and avoid future controversy. If this funding request is not accepted by the Congress, the Air Force may continue with its past practices, hopefully after your further consideration of this matter without objection by the General Accounting Office.

GAO response:

During our review, Air Force officials informed us that during the initial preparation of the yearend industrial fund financial reports for fiscal 1980, adjustments for anticipated customer orders of $383 million were included. However, when questions were raised by the Assistant Secretary of the Air Force (Financial Management) about the support for the adjustments, the adjustments were eliminated. The revised reports, without adjustments, were submitted to the Treasury and OMB.

Defense comment:

The draft report concludes that the Air Force practice is illegal because it results in an obligation in excess of the amounts in the Air Force Industrial Fund and therefore is an overobligation of funds in violation of the Anti-Deficiency Act (31 U.S.C. 665). Because the Air Force Industrial Fund is not apportioned, there can only be a violation of the first subsection of the Anti-Deficiency Act that prohibits overobligation at the appropriation or fund level. However, 31 U.S.C. 665(a) permits a contract and obligation in excess of what would ordinarily be available funds if such a "contract or obligation is authorized by law." For the following reasons, we believe that the obligation incurred by the Air Force in anticipation of reimbursements are obligations authorized by law within the meaning of the Anti-Deficiency Act.

In a decision dated August 18, 1967, B-159141, the Comptroller General construed the meaning of a "contract or obligation authorized by law" as used in the Anti-Deficiency Act in connection with a matter concerning funding of the supersonic aircraft program. It concluded in that case that one did not even need a statute to be "authorized by law" to obligate in advance of appropriations. The mere direction of the Committee on Appropriations as contained in a House Report, coupled with a reduction of funding in a subsequent Appropriation Act without statutory language, constituted authority to incur an obligation "authorized by law" within the meaning of the Anti-Deficiency Act. In the instant matter, we believe there is a far more compelling case to conclude that the authority provided by 10 U.S.C. 2208, 50 U.S.C. 412, and a recurring provision in the annual Department of Defense Appropriation Act, e.g., section 735 of the FY 1981 Act, provides "authority by law" to support the Air Force practice.

GAO response:

As the Department of Defense (DOD) comments suggest, we believe that the Air Force practice of incurring obligations in its industrial fund in anticipation of customer orders not yet received violates that portion of the Anti-Deficieny Act, 31 U.S.C. 665(a), which prohibits overobligations at the appropriation or fund level unless such obligations are "authorized by law."

Under longstanding principles applied both by our Office and the Office of Management and Budget, agencies lack authority to incur obligations based on anticipated customer orders except as specifically provided by law. Our decision at 51 Comp. Gen. 598, 605 (1972), which concerned the Navy industrial fund, observed:

> "We have never recognized any authority of a Federal agency to incur obligations against receipts anticipated to be received beyond the end of the current year in the absence of specific authority of law therefor and we have considerable doubt that the mere disclosure of a 5-year defense plan to the committees authorizing and appropriating funds for the Department of Defense, constitutes authority to incur obligations against receipts anticipated during such 5-year period. It is of interest that section 31.3 of OMB Circular No. A-34 provides that even apportionments of anticipated receipts for the current year in no way authorizes an agency to obligate or make disbursements in excess of the amounts to become available from such sources."

APPENDIX III

Section 31.3 of OMB Circular No. A-34 (July 1976, revised Jan. 1981) remains essentially as described in our 1972 decision. This section states in part:

> "The inclusion of estimates in determining the amounts available for apportionment in no way authorizes an agency to obligate or make expenditures in excess of the budgetary resources available for obligation from such sources at the time the obligation or expenditure is made.
>
> * * * * *
>
> "In the case of reimbursable work, budgetary resources available for obligation include (a) entitlement to reimbursement based on goods and services furnished and, as authorized by law, (b) the amount of orders received from within the Government that represent valid obligations of the ordering account, to the extent that the reimbursements therefor will be placed in the current account when collected * * *." (Emphasis added.)

Sections 66.3 and 66.6 of OMB Circular No. A-34, concerning revolving fund accounting, are even more specific concerning the treatment of customer orders as budgetary resources. Section 66.3 states in part:

> "For purposes of budgetary accounting, a distinction is made between those assets that constitute a budgetary resource (i.e., are available for obligation) and those that do not. Budgetary resources include cash, balances on deposit with the Treasury, accounts receivable, and unfilled customers' orders, including advances received from others (to the extent described elsewhere in this Circular). Other assets, whether of a working capital nature such as inventories of stock or of a fixed asset nature, are not considered a budgetary resource.* * *" (Emphasis supplied.)

Section 66.6 of the Circular states in part:

> "***It is the responsibility of each fund manager to calculate requirements for capital and to request appropriations for capital in such a manner as to permit 'funding' of outstanding obligations at all times during the year with available budgetary resources. When capital appears to be insufficient for these

APPENDIX III

purposes, and until additional resources are obtained, it is the responsibility of the fund manager to defer the incurring of obligations until budgetary resources are on hand to fund them.

"The rules set forth earlier in this Circular should be noted in this regard--specifically, that unfilled customers' orders may be counted as a budgetary resource when they are from another Government account that has recorded a valid obligation therefor, or when they are from an outside source that has paid in advance. Anticipated reimbursements and anticipated customers' orders for the remainder of the year are not considered a budgetary resource for purposes of determining the status of funds on any given day--even though they may be anticipated at the time apportionments are made."

The Air Force practice of crediting anticipated orders appears to violate DOD guidance as well. Section 23005 of DOD Instruction 7220.9-H (Feb. 1978), the Accounting Guidance Handbook, discusses the treatment of certain anticipated reimbursements as budgetary resources in 1-year, multiple-year, and no-year appropriation accounts. It limits anticipated reimbursements based on customer orders to those orders that have been received and accepted and that represent obligations of the appropriation or fund under which they are issued. While the handbook is not intended to cover principles, standards, and requirements that are peculiar to revolving funds (see section 10004B), accounting for anticipated customer orders does not seem to require peculiar treatment in the case of revolving funds.

Based on the foregoing, the Air Force practice violates the Anti-Deficiency Act unless it is subject to a clear and specific statutory exception from the normal accounting rules. As discussed in detail hereafter, we do not agree that any of the statutes cited in the DOD comments—10 U.S.C. 2208, 50 U.S.C. 412, or the recurring provision in the annual DOD appropriation act--amount to such an exception. The Comptroller General decision referred to in the DOD comments, B-159141, Aug. 18, 1967, addressed a situation in which Congress had taken legislative action reflected in an appropriation act. That decision has no bearing on the present Air Force practice either in terms of the facts presented or the principles discussed.

Defense comment:

Section 2208 of Title 10, United States Code, was originally enacted as section 405 in title IV of the National Security Act of 1947 Amendments of 1949, P.L. 216 in essentially identical form. Section 2208 provides very broad authority "to control and account more effectively for the cost of programs and work performed in the Department of Defense." Subsection 2208(f) provides that each Military Department shall allocate its functions, powers, and duties to accomplish "the most economical, and efficient organization and operation of the activities... authorized by this section." This is precisely what the Air Force has done. The legislative history of section 2208 indicates that the Congress intended to operate the working-capital fund on a businesslike basis. Most businesses do not wait for a customer to appear before they incur obligations, instead they rely on a cash flow which is adequate to have bills paid as they come in. The Navy stock fund, which was the model for the defense working-capital funds, had operated on this basis for many years with the full knowledge of the Congress. While section 2208 provides that the customer of a working-capital fund may not incur costs beyond its available funds, no such restriction is placed on the working-capital fund itself.

Section 2208 does not contain any provision that addresses the limitations of obligations of a working-capital fund whether based on anticipated reimbursements or otherwise.

When fairly read in the context of what the Congress was trying to do at the time of its original enactment, the Air Force practice is clearly supportable. To understand section 2208 it is necessary to understand the Naval Stock Fund on which it is based. In this connection, we recommend, as an initial step, your review of the hearings before the Subcommittee on House Appropriations Committee on H.R. 3598, First Supplemental National Defense Appropriation Bill for 1944, 78th Congress, 6 October 1943, page 539 et seq., and the hearings before the Senate Subcommittee on Appropriations on the same legislation, 12 November 1943, page 570 et seq.

It is doubtful that limited excerpts from the legislative history of section 2208 can fully portray the broad authority that the Congress intended to convey. The following excerpts do indicate that the obligational authority was intended to be very broad with controls based on expenditures not obligations. The following language appeared in both Senate Report 336 and House Report 1064 in support of P.L. 216:

APPENDIX III

> As used in this section (i.e. P.L. 216, section 405) the term "inventory" is synonymous with the term "stock fund," and is one type of working capital fund, and may be referred to as such. In the operation of inventories, accurate inventory figures would be developed and priced, and the resulting sum taken up on a balance sheet covering the inventory account. Such an inventory account would also require the establishment of cash, or working capital adequate in amount to permit a department to pay for deliveries and carry the material delivered until the same or other material could be issued and consuming appropriations charged therefor. * * * Deliveries under such purchases would be limited to the ability of the fund to pay for them. (emphasis added.)

The following testimony of the Assistant Secretary of Defense (Comptroller) Mr. McNeil, in support of P.L. 216, at pages 252-53 before the Senate Committee on Armed Services is also pertinent.

> The inventory is carried under a revolving stock fund. The capital of that fund includes the value of the inventory and the cash in the account. As material is issued from store, it must be paid for with appropriated moneys. Congress appropriates it for definite purposes. Therefore, the use of stores is controlled by the appropriation process.
>
> When the material is withdrawn from store, the consuming activity pays for it, and the money goes into the cash account for the working-capital funds. The withdrawel of stores generates replenishment demands. Inventory control is based on established stock levels; for example, 6 months for some items, 9 months for other items. Inventory control involves the placing of orders only to maintain a certain inventory level. The orders are placed with the vendors; the material is delivered to the fund, and the vendors are paid from the working-capital account You have completely closed cycles for over-all control.
>
> The Chairman. The real control of that whole thing is your inventory.
>
> Mr. McNeil. Inventory control plus appropriation control.
>
> The Chairman. You have to have money, but the demand comes from inventory control. (emphasis added.)

If there is any doubt as to the broad authority provided by section 2208, it is dispelled by another provision of title VI, now 50 U.S.C. 412 that provides:

> All laws, orders, and regulations inconsistent with the provisions of this title are repealed insofar as they are inconsistent with the powers, duties, and responsibilities enacted hereby: Provided, That the powers, duties, and responsibilities of the Secretary of Defense under said sections shall be administered in conformance with the policy and requirements for administration of budgetary and fiscal matters in the Government generally, including accounting and financial reporting, and that nothing in said sections shall be construed as eliminating or modifying the powers, duties, and responsibilities of any other department, agency, or officer of the Government in connection with such matters, but no such department agency or officer shall exercise any such powers, duties or responsibilities in a manner that will render ineffective the provisions of this title.

The authorities provided by these provisions of law are so broad that it is not surprising that from time to time government officials are not aware, and are reluctant to accept, that operations of these working-capital funds can deviate from what would normally be considered appropriate practices. Thus, we do not find it surprising, nor do we find it significant, that unnamed Navy and Army officials did not believe the Air Force practice was proper. The Navy and the Army do not operate depot maintenance programs in the same way the Air Force does and therefore are not familiar with the authorities that permit the Air Force to operate their depot maintenance program in an efficient manner. That unnamed officials at the Office of Management and Budget reach similar conclusions is also not surprising, for comparable problems in the past have resulted in enactment of 10 U.S.C. 2210(b) as a matter of statutory clarification, not necessity, that further supports the Air Force practice.

In its entirety section 2210(b) provides:

> Obligations may, without regard to fiscal year limitations, be incurred against anticipated reimbursements to stock funds in such amounts and for such period as the Secretary of Defense, with the approval of the Director of the Bureau of Budget, may determine to be necessary to maintain stock levels consistently with planned operations for the next fiscal year.

The formal legislative history of section 2210 (b) is silent as to its purpose and intent. However, we can state with certainty that section 2210(b) was proposed to the Congress because the then Bureau of the Budget was willing to permit stock funds to incur obligations in anticipation of reimbursements for the balance of the Fiscal Year, but not to incur obligations based on anticipated reimbursements to come from appropriations for the following Fiscal Year not then in being. The Department's position was then, as it is now, that there was available authority to obligate against anticipated reimbursements not only from customer orders anticipated during the balance of the Fiscal Year but also for customer orders to be received in the ensuing years. In a spirit of cooperation, to obtain "clarifying" legislation, but not from legal necessity, the Department proposed what has become section 2210(b).

There are three points regarding section 2210(b) that are noteworthy. First, section 2210(b) only applies to incurring obligations against anticipated reimbursements to stock funds, not all working-capital funds, i.e., stock funds and industrial funds. We acknowledge that the provision of this explicit statutory authority for the stock funds can be used to infer that similar authority is not available for the industrial funds. Such an inferrence, however, ignores history. The Department of Defense did not propose to extend section 2210(b) to cover the industrial funds because there was no need to obligate against anticipated reimbursements in the industrial funds at that time. The need for such a practice to advance efficiency in operation only developed some eleven years ago when the Air Force initiated the practice of using the Air Force Industrial Fund to conduct its program of contracting for depot maintenance. Also, as previously indicated, the Department only proposed section 2210(b) for clarification for the practical purpose of resolving a dispute, not from legal necessity.

Second, the draft report draws the conclusion that Congress intended only stock funds, not industrial funds, to obligate in anticipation of reimbursements from the erroneous factual assertion that both sections 2208 and 2210(b) were enacted at the same time in 1962 by P.L. 87-651. Actually the 1962 Act was merely a codification of pre-existing law without substantive change. Section 2208 was enacted in 1949 and section 2210(b) some 4 years later in 1953 as section 645 of the Department of Defense Appropriation Act, 1954.

Third, and most important, section 2210(b) authorizes incurring obligations against anticipated reimbursements in such amounts as may be necessary "to maintain stock levels consistently with planned operations for the next Fiscal Year." Section 2210(b) does not authorize incurring obligations against anticipated reimbursements for the current Fiscal Year. The foregoing demonstrates the previous assertion that in 1953 even the Bureau of the Budget agreed with the Defense position that obligations could be incurred against anticipated reimbursements for the balance of the current Fiscal Year. Even more significantly, it demonstrates that the Congress accepted this position, and did not even deem it necessary to provide clarifying legislation validating the use of anticipated reimbursements during the balance of the current Fiscal Year. It would be absurd to conclude that it is proper to buy a can of beans against anticipated reimbursements from a future sale in the next Fiscal Year and not be proper to buy a can of beans against anticipated reimbursements from a future sale during the current Fiscal Year. Section 2210(b) is premised on the propriety of the latter action clearly being authorized already.

The foregoing, we believe, has a profound impact on the instant draft report. Prior to enactment of section 2210(b), the laws applicable to the stock funds and industrial funds were identical. Therefore, if it were legal to obligate in the stock funds in anticipation of reimbursements at least for the balance of the current Fiscal Year, it is equally legal to do so in the industrial funds. For these reasons alone, the allegations in the draft report, at least insofar as illegal obligations in the industrial fund prior to year-end, are incorrect. But its significance is even greater. In the context of the Anti-Deficiency Act, if the obligation of funds in the industrial funds during the Fiscal Year does not constitute a violation then we can see no legal reason to conclude that there is a violation when obligations are based on anticipated reimbursements from the ensuing year. There may, or may not, be policy reasons that would lead the Office of Management and Budget or the General Accounting Office to object to such a policy, but we see no legal basis for concluding that there are violations of the Anti-Deficiency Act.

GAO response:

DOD's main contention is that 10 U.S.C. 2208 somehow provides authority for the Air Force practice of crediting anticipated orders to its industrial fund. We disagree. Neither the language of this statutory provision nor its legislative history supports the DOD contention.

Recognizing that the language of section 2208 does not affirmatively authorize the Air Force practice, DOD argues that neither does the language prohibit it:

" * * *While Section 2208 provides that the customer of a working-capital fund may not incur costs beyond its available funds, no such restriction is placed on the working-capital fund itself.

"Section 2208 does not contain any provision that addresses the limitations of obligations of a working-capital fund whether based on anticipated reimbursements or otherwise."

As discussed previously, agencies have no general authority to use anticipated orders as a budgetary resource; thus the burden is on DOD to establish a clear statutory exception. Obviously DOD cannot meet this burden by merely showing that section 2208 does not specifically prohibit a practice that is already unauthorized. Moreover, the above-quoted DOD comments imply that there are no legal limits on obligations from working-capital funds since none are stated in section 2208. This is patently unreasonable and unfounded.

For the same reasons, we also find unpersuasive DOD's arguments based on legislative history. There is no suggestion in the legislative history cited by DOD that any of the working-capital funds were designed to operate without regard to normal appropriation principles except as specifically provided otherwise in the relevant statutes. The legislative history discussed in the DOD comments does not indicate specifically or by implication an intent that industrial funds be permitted to incur obligations based on anticipated customer orders. In fact, it would be surprising if Congress had this in mind since, according to the DOD comments, there was no percieved need at the time the original statute was enacted to use anticipated orders as a budgetary resource. The DOD comments state that this need never has existed for the Army and Navy industrial funds, and did not arise with respect to the Air Force industrial fund until 12 years ago—well after the original version of the legislation now found in section 2208. Even now the DOD comments suggest that reliance on anticipated orders is not an essential or inherent need of the industrial fund, but is only necessary in view of the manner in which the Air Force industrial fund operates its depot maintenance program.

In any event, most of the legislative history discussed in the DOD comments concerns stock funds, rather than industrial funds. While there certainly are similarities in these two types of working-capital funds, there is one basic difference in the present context—stock funds are authorized specifically by 10 U.S.C. 2210 (b) to incur obligations in anticipation of reimbursements; industrial funds are not. The DOD comments "acknow-

ledge that the provision of this explicit statutory authority for the stock funds can be used to infer that similar authority is not available for the industrial funds." However, the comments suggest that such an inference is unjustified for several reasons. We have considered each of these reasons and find them unconvincing.

First, DOD asserts that, pursuant to an understanding between the Department and the Bureau of the Budget, section 2210(b) was proposed merely to "clarify" the authority of stock funds to incur obligations based on customer orders to be received beyond the current fiscal year. According to DOD, this same authority was not proposed for the industrial funds because there was no need at the time to obligate industrial funds in anticipation of customer orders. The DOD comments concede that these understandings are not reflected in the formal legislative history of section 2210(b). Therefore, any such understandings cannot be relied upon in construing the language of the statute or imputing an intent to the Congress. In any event, it seems unlikely that the Budget Bureau's position would have been as described in the DOD comments since it does not recognize authority to incur obligations based on anticipated orders even within the current year.

Secondly, DOD asserts that the draft report's conclusion that Congress intended only stock funds, not industrial funds, to obligate in anticipation of reimbursements is based on "the erroneous factual assertion that both sections 2208 and 2210(b) were enacted at the same time in 1962 * * *." DOD points out that the 1962 Act was merely a codification of preexisting law without substantive change. It is true that the 1962 Act codified title 10 of the United States Code, and that codifications do not make substantive changes in the law. However, the DOD comments contradict themselves on this point. According to DOD, industrial funds always had authority under section 2208 to incur obligations based on anticipated reimbursements. If this is true, the law could have been clarified in the codification without substantive change to reconcile the treatment of anticipated reimbursements for stock and industrial funds.

Thirdly, DOD argues that section 2210(b) does not authorize stock funds to incur obligations against anticipated reimbursements for the current fiscal year, but only for succeeding fiscal years. It argues that this is because agencies clearly have authority to incur obligations against anticipated reimbursements for the current fiscal year. It follows, according to DOD, that if agencies can incur obligations in anticipation of future year reimbursements, it is logical for them to do so for the current fiscal year. These bootstrap arguments are entirely without merit. Section 2210(b) does authorize stock fund obligations against anticipated reimbursements for the current year. Section 2210(b) provides that such obligations may be incurred "in such amounts and for such period"

as the Secretary of Defense, with the approval of the OMB Director, determines necessary to maintain stock levels consistent with planned operations for the next fiscal year. While the objective is to provide for the next year's operations, the statute does not limit the incurring obligations to orders anticipated for the next year.

DOD also refers to 50 U.S.C. 412 as a source of authority for the Air Force practice. We do not see how this provision, quoted in the DOD comments, supports the Department's position. On the contrary, this provision appears to confirm that working-capital funds are subject to "policy and requirements for administration of budgetary and fiscal matters in the Government generally, including accounting and financial reporting * * *."

Defense comments:

There is still another compelling reason to support the Air Force practices. A recurring provision, first enacted in 1966, in a Department of Defense Appropriation Act, limits cash in the working-capital funds to "such amounts as are necessary at any time for cash disbursements to be made from such funds" (e.g., section 735 in the Department of Defense Appropriations Act, 1981, P.L. 96-527). The legislative history of this provision indicates that it was designed to overrule certain administrative interpretations of the Anti-Deficiency Act and to allow the working-capital funds to operate in a businesslike manner.

We are pleased to note that in 1975, the significance of this recurring provision was recognized by the General Accounting Office staff. A General Accounting Office Counsel opinion, dated 7 January 1975, supports the position that reportable violations do not exist. That opinion states that after 1966, working-capital funds are not subject to the general Anti-Deficiency Act prohibition against "obligation under any appropriation or fund in excess of the amount therein, but that disbursements in excess of the cash balance would constitute a violation." At no time have cash disbursements exceeded the cash balance in the Air Force Industrial Fund.

GAO response:

The appropriation act provision referred to by DOD states in relevant part:

> "SEC. 735. During the current fiscal year, cash balances in working capital funds of the Department of Defense established pursuant to section 2208 of title 10, United States Code, may be maintained in only such amounts as are necessary at any time for cash disbursements to be made from such funds * * *." 94 Stat. 3087.

APPENDIX III

Neither the language nor the legislative history of this provision indicates that it was designed to permit working-capital funds to incur obligations in anticipation of orders. Rather, both the language and legislative history make clear that the provision was merely designed to ensure that these funds not maintain cash balances in excess of their disbursement needs at any time.

The DOD comments seriously misrepresent the 1975 GAO opinion to which they refer. The 1975 opinion recognized that the appropriation act provision was relevant only to cash balances of working-capital funds, rather than their overall obligational availability. Thus the 1975 opinion states as its basic conclusion:

> "* * * The effect of this appropriation provision is to allow total current contract obligations to exceed cash balances available without violation of the Anti-Deficiency Act. The provision is intended to thus reduce the cash balances necessary 'to be tied up in an inactive status.' H. Rept. No. 1316, 89th Cong. p. 14. The provision does not, however, remove the requirement that cash balances cover cash disbursements to be made. A disbursement in excess of the cash balance would still constitute a violation of the Act."

Nowhere in the language of the appropriation act provision, its legislative history, or the 1975 GAO opinion is there any suggestion that industrial funds have unlimited authority to incur obligations so long as they can meet their cash disbursement needs. We would only add that DOD's reliance on the appropriation act provision further highlights the inconsistencies in its arguments. First, DOD tells us that the industrial funds received virtually unbridled obligational authority when they were first established in the 1940s, so that they could operate in a businesslike manner. Then we are told that authority for industrial funds to incur obligations based on anticipated reimbursements was not added to the codification of title 10 in 1962 because the codification did not make substantive changes. Finally, we are told that the general appropriation act provision in 1966 was enacted to allow working-capital funds to operate in a businesslike manner. Before this change administrative interpretations governing working-capital funds were so restrictive that these funds could not incur any obligations in excess of cash on hand.

Defense comment:

In approving the Air Force Industrial Fund Department Level System, the General Accounting Office agreed with the practice of using anticipated reimbursements. Specifically, the following statements were a part of the documentation describing funded resources.

> An industrial fund activity has authority to enter into contracts within its approved operating budget to the extent its assets together with its anticipated reimbursements are sufficient to cover such obligations.
>
> * * * * *
>
> Fund requirements and all transactions are on an accrued expenditure basis rather than on an obligational basis, although obligational reporting and estimating are reflected on some standard budget forms.

Not only did the Acting Comptroller General of the United States, Mr. R. F. Keller, approve this practice, he commended the Air Force on its efforts to improve its financial management systems. The fund control features of the Air Force Industrial Fund systems as approved by the General Accounting Office are based on an approved operating budget and expenditure control concept rather than control of obligations in relation to budgetary resources. Statements of operating results and financial statements submitted by these funds have consistently shown that these operations were conducted within an approved operating program.

GAO response:

See page 22.

Defense comments:

In a decision dated May 23, 1972, 51 Comp. Gen. 598, the Comptroller General addressed a matter involving the obligation of Industrial Funds against anticipated reimbursements. The following limited excerpts from the lengthy decision are most pertinent.

> We have never recognized any authority of a Federal agency to incur obligations against receipts anticipated to be received beyond the end of the current year in the absence of specific authority of law therefore and we have considerable doubt that the mere disclosure of a 5-year defense plan to the committees authorizing and appropriating funds for the Department of Defense, constitutes authority to incur obligations against receipts anticipated during such 5-year period. It is of interest that section 31.3 of OMB Circular No. A-34 provides that even apportionments of anticipated receipts for the current year in no way authorizes an agency to obligate or make disbursements in excess of the amounts to become available from such sources.

APPENDIX III

* * * * *

> ...the Secretary of Defense, with the approval of the Office of Management and Budget, is authorized during the fiscal year 1972 by section 739 of the Department of Defense Appropriation Act, 1972, to transfer funds between the Industrial Funds of the three military departments. In view of the various statutory authorities relating to the Industrial Funds and the assurance of DoD that the obligational availability of the Navy Industrial Fund in fiscal year 1972 is more than sufficient to cover obligations for the total charges permitted under the initial period and all succeeding obligational periods without considering anticipated reimbursements beyond 1 year, we cannot question the legality of the proposed arrangement. (emphasis added.)

As a minimum, this decision clearly and unequivocally recognizes the propriety of incurring obligations in anticipation of reimbursements in an industrial fund of the Department of Defense during the current Fiscal Year. The allegations in the draft report of overobligations during the current Fiscal Year are therefore inconsistent with the decision.

Further, the Air Force has interpreted the decision as permitting, for the purposes of determining obligational availability, anticipating reimbursements for one full year beginning at any time. We recognize now that this may not have been the intent of the decision, but when one considers that the decision was rendered in March 1972, well into Fiscal Year 1972, and that the concluding portion of the decision (the second portion of the above quotation) permitting consideration of anticipated reimbursements that are not beyond one year, it is reasonably susceptible to the Air Force interpretation. The following points support the validity of that view.

Although expressing doubt about the propriety of obligating funds beyond one year (assuming that means beyond the current Fiscal Year) the decision did not reach a conclusion on that issue. In the context of the matter being considered it was apparently believed unnecessary for the Comptroller General to reach a conclusion on that issue and he did not do so. However, if the resolution of that issue was as clear cut in the negative, as the draft report contends, then there was no need to refrain from resolving that issue, thus leaving the door open for utilization of the practice.

APPENDIX III

As we have indicated earlier, we can find no statutory basis for concluding that there can be a violation of the Anti-Deficiency Act for overobligating resources based on anticipated reimbursements for the next Fiscal Year when there is no violation for doing the same thing within the current Fiscal Year. The concern that such a practice should not be followed as a matter of policy, because the appropriations from which the anticipated reimbursements are expected are not yet in being is generally understandable, but that does not amount to a legal requirement that can result in a violation of a quasi-criminal statute. Moreover, even such a concern is not warranted with regard to the industrial funds. As the Comptroller General decision states there is statutory authority to transfer funds between the industrial funds of the three Military Departments. The same transfer authority considered in the 1972 decision continues to exist today in the same manner and form it did then. Thus the obligations in anticipation of reimbursements could be covered by transfers in the event the anticipated reimbursements did not materialize. As a practical matter, of course, the appropriation of funds to customer accounts for the next Fiscal Year for depot maintenance will occur as surely as night follows day. Even if they did not, or there was no equipment to induct for depot maintenance in a following Fiscal Year, the contracts for depot maintenance could be terminated, with liability well within the budgetary resources of the Air Force Industrial Fund.

GAO response:

The decision referred to in the DOD comments, 51 Comp. Gen. 598, recognizes that agencies have authority to incur obligations against anticipated receipts for the current year. However, the decision does not provide any authority for incurring obligations on the basis of orders anticipated to be received in either the current or a future fiscal year. Contrary to the DOD comments, it is clear that this decision addressed "current year" in the context of the current fiscal year, not any 12-month period beginning at any time.

Defense comment:

Finally we turn briefly to OMB Circular A-34. Even if the Air Force practice were inconsistent with it, which we do not believe is the case, that inconsistency would not be tantamount to a violation of the Anti-Deficiency Act. That document has general application to the Government as a whole, but its application to particular funds must be judged by the pertinent applicable statutory provisions. Moreover, section 66 of the Circular is basically applicable to apportioned revolving funds

(the Defense Industrial Funds are not apportioned). As a peripheral matter, it does contain directions for "revolving fund reports" for unapportioned funds. Most significantly section 66.6 entitled "Meaning of violations" provides:

> The incurring of obligations in excess of apportioned budgetary resources, as explained in this Circular, is a violation of the Antideficiency Act and is reportable as such, whether or not a fund has unapportioned budgetary resources or non-budgetary assets greater than the amount of the deficiency. (Emphasis added.)

This is a recognition of the fact that the criteria for unapportioned funds are different.

GAO response:

The OMB comments on our draft report, set out in full in appendix IV, respond fully to the DOD contentions as to OMB's position. For ready reference, the OMB comments on this point are as follows:

> "The current Air Force practice is also contrary to the intent of the guidance on budget execution contained in OMB Circular No. A-34. The exemption of an account from apportionment does not permit that account to obligate funds in excess of its budgetary resources available for obligation (as defined in section 31.3 and 66.3 of Circular A-34), unless specifically permitted by law.
>
> "The apparent confusion about the application of section 66.6 of Circular No. A-34 stems from a misinterpretation of the first sentence which reads, 'The incurring of obligations in excess of apportioned budgetary resources as explained in this Circular, is a violation of the Antideficiency Act and is reportable as such, whether or not a fund has unapportioned budgetary resources or non-budgetary assets greater than the amount of the deficiency.' The intent of the sentence is to demonstrate that in an apportioned revolving fund, unapportioned resources (such as, unapportioned balances of revolving funds or a reportable deferral) may not be utilized in determining whether a violation exists in regard to the funds actually available for obligation."

Defense comment:

In conclusion, the Air Force position regarding the authority to obligate funds in a working-capital fund based on anticipated reimbursements has been supported by Air Force legal opinions in 1958, 1967, 1968, 1973, and 1980. It has been supported by a General Accounting Office Counsel opinion in 1975, and in our judgement by the Comptroller General Decision of 1972. We believe it was proper for Air Force officials to rely on these opinions. Moreover, we believe that the Air Force practice represents a longstanding administrative interpretation of the statutes they are charged with administering that has been disclosed to the Congress, and represents a proper interpretation of these statutes.

GAO response:

For reasons set forth throughout the report and this appendix, we strongly disagree with the Defense arguments.

APPENDIX IV

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MAY 7 1981

Mr. D. L. Scantlebury
Division Director and
Chief Accountant of GAO
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Scantlebury:

This letter is in response to your report entitled, "Lack of Fiscal Integrity in the Air Force Industrial Fund," dated April 2, 1981.

GAO's draft report concludes that the Air Force has incurred numerous overobligations in its industrial fund in violation of the Antideficiency Act (31 U.S.C. 665). The Air Force contends, however, that the practices discussed in the draft report are authorized under the last clause of 31 U.S.C. 665 (a), i.e., "unless such contract or obligation is authorized by law." OMB agrees as a matter of policy that the Air Force practice of obligating against anticipated orders should be eliminated. The practice provides no controls on obligations since the amount of orders that can be anticipated is unlimited.

The Department of Defense and OMB agree that Air Force procedures need to be changed. Towards this end, the March revisions to the Budget contain a request for a one-time appropriation of $322 million in the Air Force operation and maintenance accounts. These funds, together with a supporting language change, would permit the Air Force to place sufficient orders to preclude the necessity of obligating against anticipated orders.

OMB believes that the Department was amiss in not including their position on industrial funds as an exception to the normal rule when their Directive on the Administrative Control of Appropriations was submitted in 1978 for OMB approval. Consequently, the OMB-approved instructions for the monthly Report on Budget Execution did not include any special reporting instructions which would have been required for the Air Force Industrial Fund. OMB feels that the Air Force should have requested guidance on the proper reporting, since Air Force procedures deviated from the approved instructions for the Report on Budget Execution. Because the Air Force adjusted the entries on the year-end Report on Budget Execution, the Air Force practice of including anticipated orders was not detectable during the OMB year-end review. To prevent a recurrence of similar situations, OMB is exploring the possibility of an automated system to detect "potential" fund control problems and will focus more attention on this area in the future.

APPENDIX IV

The current Air Force practice is also contrary to the intent of the guidance on budget execution contained in OMB Circular No. A-34. The exemption of an account from apportionment does not permit that account to obligate funds in excess of its budgetary resources available for obligation (as defined in section 31.3 and 66.3 of Circular A-34), unless specifically permitted by law.

The apparent confusion about the application of section 66.6 of Circular No. A-34 stems from a misinterpretation of the first sentence which reads, "The incurring of obligations in excess of apportioned budgetary resources, as explained in this Circular, is a violation of the Antideficiency Act and is reportable as such, whether or not a fund has unapportioned budgetary resources or non-budgetary assets greater than the amount of the deficiency." The intent of the sentence is to demonstrate that in an apportioned revolving fund, unapportioned resources (such as, unapportioned balances of revolving funds or a reportable deferral) may not be utilized in determining whether a violation exists in regard to the funds actually available for obligation.

As a last point, we question the desirability of filing reports since 1970. Even if there were violations, which the Air Force disputes, no funding would be required to eliminate them and no benefit would be obtained by reiterating the specific instances. We ask, instead, that you support our efforts to secure enactment of our proposal to eliminate the problems.

Sincerely,

Edwin L. Harper
Deputy Director

APPENDIX V

(c o p y)

Memo for Record

SUBJECT: Air Force Industrial Fund Unfilled Orders, FY 1970 Certification

1. While preparing Bureau of Budget A-11 worksheets, it became apparent that obligations exceeded fund resources by $19,504,119.97. This had not been exposed earlier for two reasons: (a) during the year the anticipated reimbursement program provided adequate resources, (b) unfilled customer orders on hand had included orders for which collection had already been made under the new accelerated collection procedure. Specifically, customer unfilled orders on hand for Depot Maintenance Division of final 30 June 1970 reports amounted to a gross $308,794,344.40. However, included in this gross amount were $187,671,681.41 worth of orders for which cash had already been collected. When these collected orders were excluded from fund resources, the Industrial Fund obligations exceeded resources by $19,504,119.97.

2. We originally prepared our certification showing $19,504,119.97 in column 6 Other Authorization of Form BAR 2108. This treatment was consistent with Stock Fund contract authority, except that we could not cite 10 USC 2210(b) as this statutory reference applies only to Stock Fund. After consultation with Mr. Fitzpatrick of AF General Counsel, we footnoted the amount as simply "other". The facts of this case were discussed with all levels of coordination on the certification.

3. After submission of our original certification, OSD (Mr. Shel Taylor) called and stated that they could not accept certification as described in para 2 above. The OSD General Counsel (Mr. Lanman) had advised them that although the above treatment was not illegal, it exposed and jeopardized the AF apportionment system which has no specific statutory support.

4. Possible courses of action included (a) field deobligation of multiple year contracts (b) movement of MAP unfilled orders from other appropriations (c) recording of additional unfilled orders. HQ USAF Budget discussed the condition and provided us with a letter requesting us to record an additional $19,504,119.97 in unfilled orders. The certification was revised accordingly, reducing the "other" authority from Col 6 and increasing Col 8 Reimbursements Anticipated. Footnote relating to the amount was removed. A Section 1311 Committee item was written to cover this case.

5. The action above appears supportable by the fact that unfilled orders recorded as of July amounted to $433,814,827.71 (including $206,565,606.65 progress payments received).

(Signed)

Paul H. Tegeler
TCRAA

(903930)

(c o p y)

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