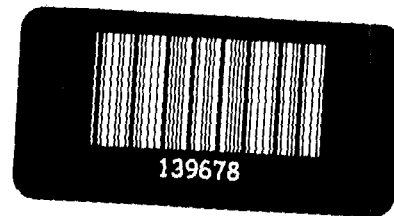


GAO

September 1989

STRATEGIC BOMBERS

B-1B Program's Use of Expired Appropriations



National Security and
International Affairs Division

B-235114

September 5, 1989

The Honorable Daniel K. Inouye
Chairman, Subcommittee on Defense
Committee on Appropriations
United States Senate

The Honorable John P. Murtha
Chairman, Subcommittee on Defense
Committee on Appropriations
House of Representatives

As requested, we have evaluated the Air Force's proposed use of expired appropriations accounts¹ by the B-1B program. Our primary focus was on whether the proposed use of these funds complies with all applicable laws and regulations, including whether the planned B-1B modifications to fix the defensive avionics system (ALQ-161A) are within the scope of the original contracts.

On June 28, 1989, we briefed your offices on our findings. This report summarizes that briefing.

Results in Brief

The modifications planned for the B-1B defensive avionics system are within the scope of the original contracts. Therefore, the Air Force may use balances in the expired appropriations accounts to fund the contract modifications.

The Air Force plans to use about \$1,020 million for the B-1B program from expired appropriations accounts. This amount includes about \$526 million for the ALQ-161A modifications, about \$309 million for contract over-target costs, and about \$185 million for contingent liabilities and claims. The B-1B program will use about \$500 million more than the \$527 million that it transferred to the expired appropriations accounts. The Air Force's use of these funds complies with applicable legislation and regulations. However, the Congress has less oversight when these funds are used than it would otherwise have if the modifications were funded through the full legislative process or a reprogramming action.

¹Expired appropriations accounts include surplus authority, merged surplus authority, and "M" accounts. These terms are defined on pages 2 and 3.

The House and Senate Committees on Armed Services and the House Committee on Appropriations have recently reported out proposed legislation that would restrict the use of and increase the Congress' oversight of expired appropriations accounts. The House bills specifically restrict the B-1B's use of expired appropriations. The Senate bill places restrictions on the use of all expired appropriation accounts.

Explanation of Surplus, Merged Surplus and "M" Accounts

The Department of Defense (DOD) receives a variety of appropriations with differing periods of availability. For example, most procurement appropriations are available for obligation for a 3-year period, a research and development appropriation is available for a 2-year period, and an operations and maintenance appropriation is available for a 1-year period. At the end of the period that an appropriation is available to be obligated, the unobligated balance expires and is withdrawn to the Treasury, where it is designated as "surplus authority." These balances retain their fiscal year identity (i.e., the fiscal year(s) that the appropriation was available for obligation) for 2 years. After this time the balances are transferred to "merged surplus authority" accounts, which accumulate unobligated balances for prior fiscal years (see generally 31 U.S.C. 1552 (1982)). Once unobligated balances enter the merged surplus authority accounts, the Treasury maintains general purpose identification (e.g., Air Force aircraft procurement) but does not maintain the fiscal year identity of the original appropriation. According to DOD officials, the DOD surplus and merged surplus authority accounts in the general fund of the Treasury contained about \$30 billion as of September 30, 1988.²

Obligated balances of appropriations also retain their fiscal year identity for 2 years after the end of their availability. At the end of that period, any obligated balances remaining that have not been liquidated (i.e., expended) are transferred to an "M" account. This account, which is maintained by the agency, accumulates unliquidated obligations from all prior appropriations made for the same general purpose. The fiscal year identity is no longer maintained once the balances are transferred to the "M" accounts.

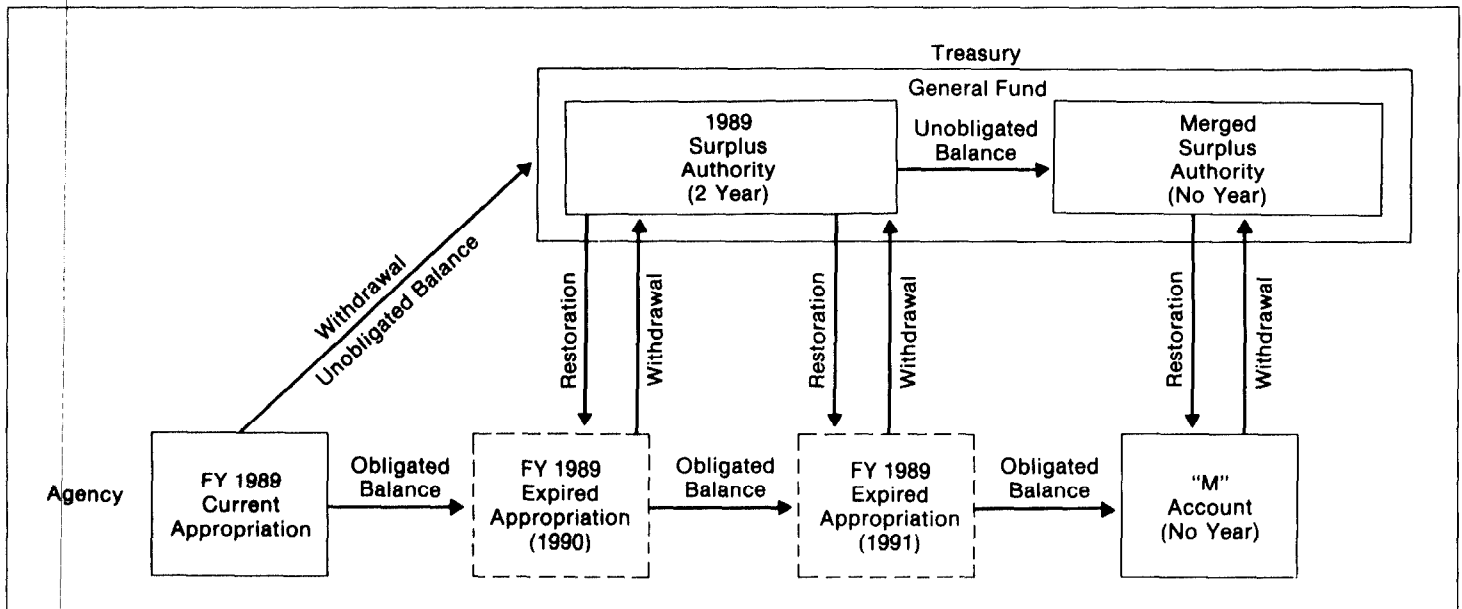
²The balances in these accounts do not represent cash actually set aside by the Treasury. If an agency decides to use these accounts, the Treasury would have to provide the means to finance the proposed action.

The balances in the surplus authority, merged surplus authority, and "M" accounts remain available indefinitely to an agency to meet previously underrecorded or unrecorded obligations. Surplus authority balances are available for restoration to cover adjustments to obligations during the 2-year period after the appropriation has expired. Merged surplus authority balances remain available for restoration to the "M" account. "M" account balances remain available indefinitely for payment of obligations.

The unobligated balances in the surplus and merged surplus authority maintained by the Treasury and the obligated balances in the expired appropriation and "M" accounts maintained by the Air Force are each available for specific purposes. The expired appropriation and "M" accounts are used to liquidate valid obligations, whereas the surplus and merged surplus authority are available to cover increases to these obligations through the restoration of funds.

Figure 1 illustrates the process of withdrawals, restorations, and transfers of appropriation balances.

Figure 1: Surplus Authority, Merged Surplus Authority, and "M" Accounts



Modifications Are Within Scope of Contract and Eligible for Expired Funds

Court cases and Comptroller General decisions provide that contract changes that are within the scope of the original contract can be funded with expired appropriations. The Air Force General Counsel concluded, and we agree, that the modifications planned for the B-1B's defensive avionics system, the ALQ-161A, are within the scope of the original contract.

ALQ-161A Modifications

In 1982 the Air Force awarded separate contracts to Eaton Corporation for the development of the ALQ-161A and for the production of 100 units and related support equipment. However, as stated in our February 1989 report,³ production and performance problems have delayed completion of the development program.

After substantial negotiations with Eaton, the Air Force decided to resolve all issues and disputes regarding who is responsible for correcting deficiencies in the ALQ-161A through a restructuring of the contract requirements, commonly referred to as "global restructure." According to Air Force documents, the restructuring was designed to continue the process of correcting identified deficiencies so that the ALQ-161A's design and hardware would meet contract specifications.

The contract modification plans were finalized by the Air Force and Eaton in January 1988. However, tests conducted on the ALQ-161A between March and June 1988 disclosed major design deficiencies that would prevent the ALQ-161A from meeting contract specifications. Subsequently, the Air Force negotiated with Eaton for the completion of the full-scale development, production, and logistic support efforts of the existing contracts. These negotiations, designated as the Core program, were ongoing as of July 1, 1989. The Air Force estimates that the Core program will cost about \$725 million, of which about \$199 million will be funded from active appropriations and about \$526 million will be funded from expired appropriations.

Modifications Are Within Scope of Contract

The restructuring was accomplished pursuant to the "changes" clause and "correction of deficiencies" provisions in each contract. The "changes" clause authorizes the contracting officer to make changes

³Strategic Bombers: B-1B Cost and Performance Remain Uncertain (GAO/NSIAD 89-55, Feb. 3, 1989).

within the general scope of the contracts. The "correction of deficiencies" provisions permit the government to require the contractor to correct deficiencies in certain circumstances.

Air Force Regulation 170-8 provides that a price adjustment resulting from a contract change made pursuant to a contract provision, such as a "changes" clause, which is within the scope of the original contract, is generally chargeable against the appropriation current at the time the contract was originally made. A modification may not be charged to the prior year appropriation when the modification is beyond the general scope of the original contract.

Determining what constitutes a modification beyond the general scope of the original contract can be difficult. The Comptroller General and the Courts, in determining whether contract modifications are within the scope of the original contract, have adopted the "cardinal change" rule. The Claims Court stated in *Air-A-Plane Corporation v. United States* that

"The basic standard . . . is whether the modified job 'was essentially the same work as the parties bargained for when the contract was awarded. Plaintiff has no right to complain if the project it ultimately constructed was essentially the same as the one it contracted to construct.' Conversely, there is a cardinal change if the ordered deviations 'altered the nature of the thing to be constructed.' Each case must be analyzed on its own facts and in light of its own circumstances, giving just consideration to the magnitude and quality of the changes ordered and their cumulative effect upon the project as a whole." (408 F. 2d 1030 (1969))

In addition, the Comptroller General has concluded that a change would be deemed to be within the scope of the original contract if it was "...essential to fulfillment of [original] contract requirements."

The Air Force General Counsel concluded that the proposed modifications to the ALQ-161A are within the scope of the original contracts and can therefore be charged to the original appropriations. The DOD Accounting Manual and Air Force Regulation 170-8 provide that the contracting officer is primarily responsible for determining whether a change is within the scope of a contract. To make this determination, the contracting officer is guided by regulations and legal principles that apply to scope changes. The DOD Accounting Manual states that in cases when no clear-cut determination can be made by the contracting officer, the military department's or defense agency's general counsel should provide appropriate guidance and determinations concerning the scope of a contract.

In this case, the Air Force's Office of General Counsel concurred with the contracting officer that the modifications were within the scope of the original contract. Our evaluation supports the Air Force's position. The modifications lowered specified performance capabilities with regard to certain hostile threats and changed the calculation of liability under the "correction of deficiencies" provisions. Nonetheless, the modifications appear to be designed to ensure delivery of a defensive avionics system that conforms as closely as possible to the system for which the Air Force originally contracted. Accordingly, as provided in court cases, Comptroller General Decisions, and Air Force regulations, the ALQ-161A modifications may be funded with expired appropriations.

Air Force procedures require that after a decision has been made to use expired appropriations, either the Air Force Systems Command or the Air Force Comptroller, depending upon certain dollar thresholds, approve the use of these funds. However, because of the high visibility of the B-1B program, the Secretary of the Air Force has retained approval authority for requests related to that program. As of June 1989, the Air Force planned to use an estimated \$1,020 million of expired appropriations and "M" account funds for the B-1B program. Of that amount, about \$386 million has been approved for use. The remaining \$634 million has not been submitted for approval by the B-1B program office.

The use of expired funds does not provide the level of visibility or control that the Congress would have had if the Air Force had funded the modifications with a request through the full legislative process or through a reprogramming action.⁴ For example, if the Air Force had used the reprogramming process, DOD guidance would have required it to obtain prior approval for its plans from the House and Senate Committees on Armed Services and on Appropriations. The reprogramming arrangement is based on agreements between DOD and congressional committees and provides a way for the Congress to oversee the use of DOD appropriations. DOD guidance states that prior congressional approval is required when a reprogramming request affects an item that is known to be or has been designated as an item that is of special interest to one or more of the congressional defense authorization or appropriations committees. (See app. I for a more detailed discussion of the reprogramming process as it relates to DOD.)

⁴We expressed similar concerns in a previous report, Financial Management: Defense Accounting Adjustments for Stock Fund Obligations Are Illegal (GAO/AFMD 87-1, Mar. 11, 1987).

Use of Expired Funds in Excess of B-1B Contribution

Under the Air Force's current plans, the B-1B program will need about \$1,020 million restored to the expired appropriations and "M" accounts from the surplus and merged surplus authority accounts, or about \$500 million more than the program has contributed.

During the year-end restoration process, any funds used from expired appropriations or "M" accounts that resulted from upward adjustments to amounts required to liquidate obligations are restored to these accounts from the surplus and merged surplus authority. The expired appropriation and "M" accounts are maintained for the purpose of funding unliquidated obligations. Therefore, only unobligated amounts transferred by the B-1B program to the surplus and merged surplus authority should be considered when defining the B-1B program's total contribution to expired accounts.

According to the Air Force Accounting and Finance Center, about \$2.4 billion was in the surplus and merged surplus aircraft procurement accounts as of September 30, 1988. This amount is comprised of contributions from the B-1B program as well as from other Air Force aircraft programs. As of September 30, 1988, the B-1B program's contribution was \$527.1 million.

Our review of Air Force documents and discussions with program office officials showed that the B-1B program will need about \$1,020 million restored to the expired appropriations and "M" accounts from the surplus and merged surplus authority balances. This amount includes about \$526 million for the Core work, about \$309 million for contract over-target costs (i.e., contracts that have exceeded their target price), and about \$185 million in contingent liabilities for undefinitized contractual actions and claims. Eaton Corporation and Rockwell International Corporation will receive the majority of the funds, \$621.6 million and \$313.6 million, respectively.

Under the Air Force's current plan, the B-1B program will use about \$500 million more in expired funds than the program contributed. The plan does not appear to conflict with relevant statutes or regulations governing the use of expired appropriations. However, the B-1B program is restricted to a \$20.5 billion (in fiscal year 1981 dollars) baseline cost cap by appropriation act provisions. Therefore, the Air Force may use the total balance in the surplus and merged surplus accounts only to the extent that it does not exceed the cost cap. Program office officials provided us with information, which we did not verify, that shows the ALQ-161A modifications (Core program) will not exceed the cost cap.

However, other requirements such as deferred support equipment and a radar warning receiver would breach the cap. These requirements will not be funded from expired appropriations, but will require new appropriations. On June 29, 1989, the Secretary of Defense requested that the Congress lift the \$20.5 billion restriction.

DOD Has Implemented Some Committee Directives

In its report on the DOD fiscal year 1987 appropriations bill, the House Committee on Appropriations directed DOD to implement several procedures that were intended to better manage DOD's use of expired appropriations. The Committee directed DOD to take the following actions.

- Establish and strictly enforce annual requirements for reviewing unliquidated obligations to ensure that the obligations were still valid. We found that DOD has requirements for such reviews, which are currently contained in the DOD Accounting Manual and Air Force regulations. However, we did not attempt to assess, as part of this review, the extent to which these reviews are actually conducted.
- Implement guidance that would (1) require the appropriate service Secretary's approval for all upward adjustments of obligations in excess of \$100,000 that involve any individual action or contract and (2) develop a specific definition, or series of definitions, of "Scope of Work" to be used by the services in determining whether they may adjust obligations using surplus fund balances. We found that this guidance had been added to the DOD Accounting Manual.
- Submit a proposal to the Office of Management and Budget for legislation that would allow federal agencies to "write down" or eliminate unnecessary surplus fund balances. According to DOD officials, this proposal "died" during coordination within DOD. One DOD official stated that an agreement could not be reached on a sound method for assessing when appropriated funds would no longer be needed.
- Submit proposed legislation to establish a Foreign National Employee Separation Pay Fund to provide for the orderly transfer of separation pay amounts out of the "M" account into a separation pay fund. This would require a change in accounting systems. DOD officials stated that this proposal also "died" in coordination within DOD. They commented that such an accounting system would be both difficult and expensive to establish and maintain. Moreover, they were uncertain how the system would be handled (e.g., by individual account, by country, etc).

Proposed Legislation Concerning the Use of Expired Appropriations

Several bills have recently been reported out of congressional committees that are intended to restrict the use of expired appropriation accounts.

The House Committee on Appropriations reported out H.R. 3072, a bill directing the Air Force not to spend funds from the surplus authority or "M" accounts to fix the ALQ-161A "... unless approved in advance by the congressional defense committees in accordance with procedures applicable to programs which have been designated as items of congressional interest."

The House Committee on Armed Services reported out H.R. 2461, a bill stating that the Secretary of the Air Force may use expired funds to fix the ALQ-161A but "... only to the extent that such funds are available from the B-1B program account." Other funds necessary for the recovery program would have to be derived from fiscal year 1990 appropriations for Air Force strategic bomber programs. The bill also requires that, before any funds are used, the Secretary shall submit to the congressional defense committees (1) a report that describes the funds to be used to fix the ALQ-161A including the amount and source of funds and (2) a report that includes an accounting of all B-1B aircraft program funds that have been transferred to the surplus authority accounts and the amount of B-1B funds that have been withdrawn or obligated from the accounts.

The Senate Committee on Armed Services reported out S.1352, a bill that would place limitations on DOD's use of all surplus authority accounts. The bill provides that no funds for any program, project, or activity can be used from the surplus authority unless the total amount during the fiscal year is less than \$4 million or the head of the military department or defense agency approves the amount to be restored. When the action to restore funds exceeds \$4 million, approval is also required by the Secretary of Defense. In addition, instances in which the amount to be restored is \$25 million or more, at least 30 days prior notification must be provided to the Senate and House Committees on Armed Services and on Appropriations.

Conclusions

The Congress' oversight of the use of surplus fund balances is not as strict as its oversight of reprogramming actions. However, several bills have recently been reported out of congressional committees which are designed to increase the Congress' oversight of the use of these funds. We agree that additional oversight is needed but are not making any

recommendations at this time in view of the pending congressional action on the issue.

Objectives, Scope, and Methodology

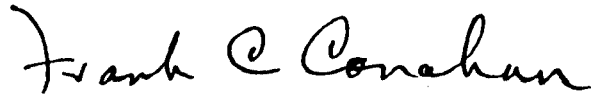
Our objectives were to determine (1) the amount of funds the B-1B program has contributed to and plans to use from expired appropriations accounts, (2) whether the use of expired appropriations in an amount greater than the B-1B program's contribution to these accounts is proper, (3) the effect that using expired appropriations has on the Congress' oversight of B-1B funding, and (4) the actions DOD has taken on the directives in the fiscal year 1987 report by the House Committee on Appropriations that were aimed at strengthening the control over the use of expired appropriations.

We reviewed the laws and regulations pertaining to the use of expired appropriations, the basis for the Air Force's decision that the contract modifications were within the scope of the original contract, and the funding aspects relative to the amount the B-1B program had contributed and planned to use from the surplus funds. We interviewed appropriate officials and examined pertinent documents at the Office of the Secretary of Defense and Air Force Headquarters, Washington, D.C.; Aeronautical System Division, Wright-Patterson Air Force Base, Ohio; Air Force Systems Command, Andrews Air Force Base, Maryland; and Air Force Accounting and Finance Center, Lowry Air Force Base, Colorado. Additionally, we requested and received information from the Air Force General Counsel on the legal matters concerning the use of expired appropriations for B-1B contract modifications.

As agreed with your offices, we did not request agency comments on this report. However, we discussed our findings with officials from the Office of the Secretary of Defense and Air Force Headquarters and incorporated their comments as appropriate. We performed our work from April through June 1989 in accordance with generally accepted government auditing standards.

Unless you announce its contents earlier, we plan no further distribution of the report until 30 days after its issue date. At that time we will send copies to appropriate congressional committees; the Secretaries of Defense and the Air Force; the Director, Office of Management and Budget; and other interested parties.

This report was prepared under the direction of Harry R. Finley, Director, Air Force Issues. Other major contributors are listed in appendix II.



Frank C. Conahan
Assistant Comptroller General

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Abbreviations

DOD	Department of Defense
GAO	General Accounting Office

Reprogramming Process in DOD

Reprogramming is the use of funds for purposes other than those contemplated by the Congress at the time originally appropriated. These actions do not represent requests for additional funds from the Congress. Rather, they normally involve the reapplication of resources. Reprogramming guidance within DOD is contained in two policy documents,⁵ which identify four categories of reprogrammings. These categories are listed below.

- Congressional prior approval reprogramming requires approval by the Secretary or Deputy Secretary of Defense and up to six congressional committees. It applies to actions involving general transfer authority, certain procurement quantity increases, or items that are known to be or have been designated as matters of special interest to one or more committees, regardless of the dollar amount.
- Congressional notification reprogramming requires approval by the Secretary or Deputy Secretary of Defense. The notification requests primarily involve actions exceeding the dollar thresholds shown in table I.1. Notification actions also include those initiating new programs exceeding a certain dollar threshold or resulting in significant follow-on costs. The Secretary of Defense assumes automatic congressional approval of notification requests, if notice of committee action is not received within 15 days after their delivery to the committees. Subsequent to January 1980, the Senate Committees on Appropriations and Armed Services required DOD to wait for their written approval before reprogramming funds.

⁵These are DOD Directive 7250.5, "Reprogramming of Appropriated Funds," and DOD Instruction 7250.10, "Implementation of Reprogramming of Appropriated Funds," dated January 9 and 10, 1980, respectively.

Appendix I
Reprogramming Process in DOD

Table I.1: Dollar Threshold Criteria Requiring Congressional Reprogramming Notification

Appropriation	Criteria
Military Personnel	Increases a budget activity by \$10 million or more.
Operation and Maintenance	Increases a budget activity by \$10 ^a million or more.
Procurement	Increases an existing line item by \$10 million or more. Adds a line item of \$2 million or more. Reduces an existing line item by \$10 million or more, or 20 percent of the appropriation level of the line item, whichever is greater, within a single fiscal year. Adds a new program estimated to cost \$10 million or more within a 3-year period.
Research, Development, Test and Evaluation	Increases an existing program element in an account by \$4 million or more. Adds a new program of \$2 million or more. Adds a new program estimated to cost \$10 million or more within a 3-year period. Reduces an existing program element by \$4 million or more, or 20 percent of the appropriated level of the program element, whichever is greater.

^aIncreased from \$5 million to \$10 million in the fiscal year 1989 DOD Appropriations Bills.

- **Internal reprogramming** requires approval by the DOD Comptroller. Internal reprogramming creates an audit trail and documents reclassification actions that do not involve changes from the purpose and amounts justified in the budget presentations to the Congress. For example, the Congress established an Environmental Restoration Defense appropriation. The allocation and reallocation of this appropriation among defense agencies for use on environmental projects were done by internal reprogramming.
- **Below-threshold reprogramming** is approved by the individual services and defense agencies. This includes all actions that do not meet the criteria for prior approval, notification, or internal reprogramming. The cognizant committees receive advance notice if a below-threshold reprogramming initiates a new program.

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