

**GAO**

Report to the Chairman,  
Subcommittee on Defense,  
Committee on Appropriations,  
House of Representatives

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May 1990

**FINANCIAL  
MANAGEMENT**

**Army Records Contain  
Millions of Dollars in  
Negative Unliquidated  
Obligations**



Accounting and Financial  
Management Division

B-235940

May 2, 1990

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

Dear Mr. Chairman:

In response to your request of January 3, 1990, we are reporting to you the results of our review of the Department of the Army Materiel Command's control procedures over negative unliquidated obligations (ULO) related to the purchase of supplies and equipment inventories. Transactions result in negative ULOs when the recorded expenditure exceeds the amount obligated.

We undertook this work to follow up on our earlier review of negative unliquidated obligations of the Air Force Logistics Command that identified over \$24 million in overpayments to contractors and over \$67 million in processing errors.<sup>1</sup> We reported the results of our Air Force work to you in June 1989. As agreed with your office, this report focuses on the number of negative ULOs on the Army Materiel Command's records and the adequacy of controls to assure that they are corrected in a timely manner.

## Results in Brief

At September 30, 1989, the records of the Army Materiel Command's six major subordinate commands included about 4,500 negative ULO balances totaling about \$328 million. Our review focused on two of the subordinate commands, which had 1,483 negative ULO account balances totaling about \$272 million. Although Army Regulation 37-1 on Army Accounting Guidance requires immediate corrective action on negative ULOs, these two commands were not always promptly resolving negative balances. Our analysis of 84 of the negative ULO balances totaling about \$49 million showed that 47 of the balances valued at over \$23 million were more than 6 months old. Coordination problems between the commands and other Department of Defense (DOD) organizations caused these delays in resolving the negative balances. Further, because Army regulations do not require that negative ULOs be separately disclosed in

<sup>1</sup>Financial Management: Air Force Records Contain \$512 Million in Negative Unliquidated Obligations (GAO/AFMD-89-78, June 30, 1989).

reports to management officials, Army headquarters personnel did not know the magnitude of negative ULOs.

Subordinate command officials advised us that most negative ULOs occurred because (1) a contractor was paid too much or (2) information on an obligation, payment, or collection transaction was inaccurately or incompletely processed. Of the about \$49 million in negative ULOs we reviewed in detail, \$7.6 million was caused by overpayments, \$23.8 million was due to processing errors, and \$2.7 million was related to other causes. In addition, the causes for \$18.0 million could not be determined.<sup>2</sup> Negative ULOs caused by overpayments tie up Army funds which could be used to meet other Army requirements. If not collected promptly, these overpayments can be considered interest-free loans to contractors and may be lost in the case of contractor bankruptcy. Also, the disbursing officers responsible for making overpayments to contractors are personally liable for any overpayments that are not recovered unless the Comptroller General relieves them of that liability.

We are making several recommendations which will strengthen management controls over negative ULOs to ensure they are promptly resolved.

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## Background

The Army has control procedures intended to ensure that it does not obligate or spend more money than the Congress has appropriated. In accordance with these procedures, (1) the Army incurs and records obligations when it enters into a contract, (2) these obligations are reduced or "liquidated" in the Army's accounting records as payments are made, and (3) a ULO balance for the total contract indicates the amount remaining to be spent for that contract. Since the amount to be paid should always be equal to or less than the amount obligated, ULO balances should not be negative.

The Army Materiel Command has six major subordinate commands located throughout the United States through which it purchases, stocks, and distributes billions of dollars worth of materiel. It carries out these tasks for Army units, other military services, and foreign governments.

In most instances, the subordinate commands share purchasing responsibilities with the Defense Logistics Agency's nine Defense Contract

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<sup>2</sup>Because certain negative ULOs have multiple causes, the total dollar value of the causes for negative ULOs is greater than the dollar totals for the 84 sampled balances.

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Administration Services Regions (DCASR), which administer contracts for the military services. In general, the former are responsible for awarding the contracts, while the latter are responsible for making the payments and recovering money from contractors in the event of an overpayment. The DCASR provides the information on payment and collection transactions to the subordinate command, which enters the data into its contract accounting system. Both entities are responsible for insuring that the (1) amounts paid to contractors do not exceed the amounts obligated in the contracts and (2) payments are charged to the correct appropriations. While both activities are responsible for insuring that these payments are made and recorded correctly, the major subordinate commands are ultimately accountable for correcting the negative ULOS.

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## Objectives, Scope, and Methodology

The objectives of our work were to review the Army's outstanding negative ULOS related to supply and equipment inventory purchases to determine (1) the magnitude of negative ULOS on the Army Materiel Command's records, (2) the procedures used to monitor and report them to senior Army officials, and (3) their causes. To respond to the Subcommittee's January 1990 request, we relied on our follow-up work of the Army Materiel Command's negative unliquidated obligations. We conducted our work at the headquarters of the Army Materiel Command and the Defense Logistics Agency, both located in Alexandria, Virginia. Appendix I contains more detailed information on our objectives, scope, and methodology.

We performed our work in accordance with generally accepted government auditing standards. The Department of Defense provided written comments on a draft of this report. These comments are included in full in appendix III.

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## Negative ULOS Are Not Reported and Corrected

The major subordinate commands are not promptly correcting negative ULOS. At September 30, 1989, the six subordinate commands had about 4,500 negative ULO balances totaling about \$328 million. They did not have reports that provided managers with information on the age of negative ULOS. However, our analysis of 84 negative balances at the two subordinate commands we visited showed that 47 of the negative balances (56 percent) were over 6 months old. Action to correct negative ULOS is slow because the major subordinate commands (1) have problems in obtaining the information they need from the DCASRS to reconcile the negative ULOS and (2) do not always follow up on outstanding negative

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ULOs in a timely manner. As a result, related overpayments to contractors and processing errors are not resolved in a timely manner.

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## Negative ULOs Are Not Aged

Although Army Regulation 37-1 on Army Accounting Guidance requires the major subordinate commands to age negative ULOs, we found that they do not produce reports that show the age of their negative ULO balances. The use of such aging reports is one method of determining if negative ULOs are being promptly resolved. However, because the subordinate commands were not producing aging reports, they did not know how long the negative balances had been outstanding.

Information provided to us at the two subordinate commands we visited showed they had 1,483 negative ULO balances totaling about \$272 million. Our analysis showed that 47 of the 84 sampled balances were over 6 months old. These 47 balances represented \$23 million (47 percent) of the \$49 million in negative ULOs we reviewed. Of the 47 balances over 6 months old, 40 balances totaling \$19.4 million were more than 1 year old. The results of this aging analysis demonstrate the need to produce aging reports as a means for closely monitoring negative ULO balances.

Army officials acknowledged that negative ULOs were not being aged as required by the Army regulation and that they did not know how long the balances had been outstanding. According to the officials, their accounting system currently does not have the capability to age negative balances. The officials told us, however, that they are in the process of planning a change to their accounting system which will age negative ULO balances. They could not tell us when the change would be implemented.

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## Requests to Reconcile Negative ULOs Do Not Receive Prompt Responses

Negative ULOs should act as internal control flags to alert the major subordinate commands of overpayments or errors. Corrective action on the negative ULO balances requires cooperation and coordination with the DCASRS, who usually maintain the official contract files and are responsible for paying the contractor for materials and supplies provided.

For 43 of the 47 negative balances over 6 months old, we found that the DCASRS had been asked to (1) provide the information needed to determine the cause of the negative ULO or (2) take corrective action once the cause of the problem was identified. However, the DCASRS did not always take timely action to resolve the negative ULOs. For example, during the

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period from July 1987 through July 1989, a subordinate command asked a DCASR four times to research and correct various negative ULOS totaling over \$800,000 on a contract. According to the subordinate command's notification letters, the \$800,000 represented overpayments resulting from contract modifications which reduced the price of items below the amounts already paid the contractor. However, as of October 1989—over 2 years after the first notification letter was sent—the DCASR still had not responded.

We spoke about the \$800,000 balance with a DCASR official who acknowledged that no response had been sent and could not explain why this had happened. The official agreed to resolve the balances after we brought the matter to her attention in August 1989. Two months later, however, an accounting official told us the contract was still being reconciled. In this case, over 2 years had elapsed during which the contractor may have been holding \$800,000 of the government's money interest free.

For another contract, a subordinate command requested in July 1988 that a DCASR resolve a \$3.5 million negative ULO whose cause could not be determined. As of August 1989, over 1 year later, there was still no response to this request and the negative balance had increased to over \$12 million. A DCASR accounting official told us he was waiting for the contract to be completed in early 1990 before starting the reconciliation.

The DCASRS' slow responses to requests for reconciliation hinder the subordinate commands' ability to promptly resolve negative ULOS. They also significantly increase the amount of time it takes the DCASRS to identify and collect overpayments and resolve accounting errors.

Defense Logistics Agency accounting officials acknowledged that the DCASRS share the responsibility for ensuring that negative ULOS, as well as other contract payment problems, are promptly resolved. To address these problems, the Defense Logistics Agency is redesigning the DCASRS' automated services system to improve their overall contract payment process. Defense Logistics Agency accounting officials stated that they expect full implementation of the redesigned system to improve the quality and accuracy of DCASR accounting data for contract payments. Officials also told us that one goal of the redesign is to reduce the number of negative ULO balances. Originally, this redesign effort was to be completed in 1982. However, scheduled implementation has slipped about 8 years (to late 1990) for various reasons, including problems in redesigning the system and higher priority projects within the Agency.

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## Outstanding Negative ULOs Are Not Followed Up

The subordinate commands do not have adequate follow-up procedures to ensure that negative ULOs are resolved when the DCASR does not respond to the subordinate commands' notification letters in a timely manner. Army Regulation 37-1 on Army Accounting Guidance requires that immediate corrective action be taken to resolve negative ULO balances. However, we found that in many cases the subordinate commands do not initiate follow-up actions for a year or more to resolve outstanding negative balances if the DCASRs do not respond to the notification letters.

Our analysis showed that over 6 months to more than 2 years elapsed before follow-up actions were taken for 43 of the 47 balances. The 43 balances represented about one-half of the \$23 million of negative ULOs over 6 months old. Neither we nor the subordinate command accounting officials could determine why the DCASR had not been notified for the other four balances, which were all over 1 year old.

Follow-up action is needed to ensure the timely collection of overpayments or the correction of processing errors. For example, we found that a \$2.8 million overpayment had been outstanding for more than a year as of October 1988. However, the subordinate command had not followed up with the DCASR since February 1988 to determine why the payment had not been collected. After we brought this to the attention of DCASR officials, the \$2.8 million overpayment was collected.

In addition, during our detailed review of the 84 sample balances, a subordinate command accounting official advised us of two other contracts that were not part of our sample which had 124 negative ULO balances totaling about \$9 million. According to the official, the 124 balances were overpayments caused by contract changes which reduced the amount owed the contractors. The official told us that, because of the complexity of the contracts, the subordinate command was waiting until the contracts were completed before trying to recover the overpayments. Such action does not conform to Army Regulation 37-1, which requires immediate corrective action to resolve negative ULOs.

Timely follow-up on the negative ULOs caused by overpayments is essential to ensure the efficient use of government funds. Subordinate command accounting supervisors informed us that negative ULOs (1) tie up Army funds that could be used to meet other Army requirements and (2) indicate that millions of dollars in overpayments may have been

made to contractors. However, subordinate command accounting officials acknowledged that they did not always send out follow-up letters in a timely manner.

Negative ULOs are internal control "red flags" that should alert managers of problems. Because negative ULOs can indicate overpayments to contractors or erroneously recorded transactions, we believe more emphasis needs to be placed on following up on them.

## Negative ULOs Are Not Identified in Reports to Senior Army Officials

Senior Army officials did not know about the magnitude of the negative ULO problem because the Army does not require subordinate commands to report information on negative ULOs separately. When the subordinate commands prepare accounting reports, negative and positive ULOs are combined to arrive at a net figure. For example, if the subordinate command had a \$5 million negative ULO balance and a \$15 million positive ULO balance, it would net the two balances and report a \$10 million positive ULO balance. As a result, the \$5 million negative ULO would not be disclosed in reports to senior Army officials.

Until we provided Army Materiel Command officials with the total number and dollar value of negative ULOs we obtained from each of the six subordinate commands, the officials did not know that their records included about 4,500 negative ULO balances totaling about \$328 million. They believed negative ULO balances were being promptly resolved during the routine reviews the subordinate commands perform continuously throughout the year. We believe the previously discussed lack of emphasis given to correcting negative ULOs stems, in part, from Army officials not being aware of the problem.

Army Materiel Command officials need information on negative ULOs to monitor the subordinate commands' performance and take corrective action when necessary. These problems may not be resolved if specific information on the magnitude and causes of the negative ULOs is not reported to the Army Materiel Command.

## Causes of Negative ULO Balances

Since the subordinate commands did not maintain statistics on the causes of their negative ULOs, we asked their accounting supervisors to identify the primary causes. Most of their responses could be grouped into two categories:

- the contractor was paid too much or



- the subordinate commands or DCASRs inaccurately or incompletely processed information (for example, charging the payment to the wrong item on the contract or not updating contract modifications).

These observations, which were also confirmed by a top Defense Logistics Agency official, are consistent with the results of our analysis of the 84 negative ULO balances in our sample. Our results are summarized in table 1.

**Table 1: Causes of Sampled Negative ULOs**

Dollars in millions		
Cause	Number of balances	Dollar value
Contractor was overpaid	39	\$7.6
Processing error	24	23.8
Unknown	24	18.0
Other causes <sup>a</sup>	4	2.7
<b>Total<sup>b</sup></b>	<b>91</b>	<b>\$52.1</b>

<sup>a</sup>Negative ULOs classified as other causes occurred because the contract (1) was affected by fluctuations in the foreign currency rates, (2) had an accounting classification change, or (3) was affected by other sundry causes.

<sup>b</sup>The totals for balances and dollar values in the table are greater than the totals for the 84 sampled balances because certain negative ULOs have multiple causes.

The unknown category in table 1 refers to negative ULOs for which neither we nor the subordinate commands could readily identify the cause due to the lack of adequate documentation needed to perform the reconciliation. Our detailed analysis showed that balances in the unknown category had been outstanding for periods ranging from 3 months to over 1 year. Until the reason for the unknown negative balances can be determined, corrective action cannot be taken. We did determine the causes for the remaining 67 negative ULOs. The two major causes are discussed below.

### Negative ULOs Caused by Overpayments

When a DCASR pays a contractor too much money, a negative ULO will occur if the amount disbursed is greater than the amount obligated. As shown in table 1, we found that overpayments to contractors valued at \$7.6 million were the cause of 39 negative ULOs in our sample.

Defense Logistics Agency and subordinate command accounting officials told us there are three major reasons why DCASRs overpay contractors. The following discussion illustrates each of these reasons with examples we found in our sample:

- Contract modifications sometimes reduce the price of items below the amount already paid the contractor under the original terms of the contract. In these instances, the DCASR is responsible for collecting the overpayment. In the case of one negative ULO, an April 1987 contract modification reduced the price of an item from \$122,800 to \$118,598. Because the contractor received payment for 59 of the items at the original price, the contract change resulted in an overpayment of \$247,918.
- Duplicate payments are sometimes made for the same invoice. Our analysis of a contract for another negative ULO showed that the DCASR mistakenly paid a contractor's invoice twice in May 1988, causing an overpayment of \$307,326. However, the subordinate command did not identify the duplicate payment until April 1989 during a negative ULO reconciliation.
- DCASRs sometimes pay invoices without considering the amount of progress payments already made. Our analysis of a contract for another negative ULO showed that a DCASR overpaid a contractor \$81,000 because progress payments were not considered. In this instance, the amount paid to the contractor should have been reduced by the amount of progress payments. Although the DCASR was notified of the overpayment in May 1985, it did not collect the overpayment. Because the contractor filed for bankruptcy in July 1986, it is unclear how much of the \$81,000 the government will collect.

Because overpayments tie up funds that could otherwise be used to meet Army requirements, their prompt identification and collection is important.<sup>3</sup> In addition, overpayments can be interest-free loans to contractors when prompt collection is not made or may be lost if, as previously discussed, the contractor files for bankruptcy. The adverse effects of overpayments, however, can be minimized if the overpayments are identified and recouped promptly.

## Negative ULOs Caused by Processing Errors

Negative ULOs can also occur if obligation, payment, or collection data are inaccurately or incompletely processed. These errors can range from erroneous charges to the wrong item in the contract to not recording contract modifications. As table 1 illustrates, processing errors were the cause for 24 negative ULOs in our sample valued at \$23.8 million. These processing errors distort accounting reports that Army officials use to make management decisions.

<sup>3</sup>As stated in our prior report cited in footnote 1, disbursing officers responsible for making overpayments to contractors are personally liable for amounts not recovered unless the Comptroller General relieves them of liability.

For example, our review of a contract that contained five negative ULO balances totaling \$2 million showed that the DCASR had recorded payments against items that had previously been deleted from the contract. According to the subordinate command accounting official, the DCASR may have erroneously recorded the contract change against another item.

Subordinate command accounting officials stated that processing errors can cause significant differences between the data in the DCASR and subordinate command accounting records. They also noted that it is difficult and time-consuming to identify the causes of the differences and to correct negative ULO balances recorded in the subordinate command records. Our detailed review of one contract supported this statement. Although the contract had only a \$145,000 negative ULO balance, we found a difference of about \$12 million between the recorded obligated balances on the subordinate command and DCASR accounting records. See appendix II for our detailed analysis.

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## The Army Has Not Reported Negative ULOs as a Material Internal Control Weakness

The Army has not reported negative ULOs as a material control weakness in its Federal Managers' Financial Integrity Act reports. On August 15, 1988, the Office of Management and Budget provided guidance to agencies on determining whether material weaknesses and system nonconformances exist. If a material weakness or system nonconformance is found, it should be reported in an agency's Federal Managers' Financial Integrity Act report. Specifically, a material weakness or nonconformance exists when an actual loss or material misstatement of either \$10 million or 5 percent of a budget line item occurs. As of September 30, 1989, the six subordinate commands' accounting records contained about \$328 million of negative ULO balances, indicating a material internal control weakness.

The Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512) requires that each agency establish internal accounting and administrative controls in accordance with standards prescribed by the Comptroller General. The act further requires a separate report on whether the agency's accounting system conforms to the accounting principles, standards, and related requirements established by the Comptroller General.

Although the Army has not reported negative ULOs in its Federal Managers' Financial Integrity Act reports, Army Materiel Command accounting officials recognize DCASR payment problems, including those that result in negative ULOs. Officials believe these problems severely restrict the

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subordinate commands' ability to maintain accurate accounting records. The Army Materiel Command has recommended, in a July 1989 memorandum to the Director, Army Accounting and Finance, that the Army report the DCASR payment problems as a material weakness in its Federal Managers' Financial Integrity Act report. According to Army Materiel Command officials, this suggestion is being reviewed by the Army's Director of Accounting and Finance.

Since 1985, the Defense Logistics Agency has reported material weaknesses in the DCASRS' disbursing of funds to contractors, including duplicate and erroneous payments, in its Federal Managers' Financial Integrity Act reports. The Defense Logistics Agency is taking corrective action to improve the DCASRS' processing of contractor payments by redesigning the entire contract payment and reporting process. As discussed previously, this effort has experienced serious delays of about 8 years.

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## Conclusions

Negative ULOs are red flags that indicate a breakdown in internal controls. Reconciling negative ULOs is important because they can be caused by overpayments to contractors and can result in inaccurate accounting reports on the budget execution for individual appropriations. Because overpayments tie up funds that could otherwise be used to meet Army requirements, their prompt identification and collection is important. Overpayments can be interest-free loans to contractors when prompt collection is not made or may be lost in the case of contractor bankruptcy.

Since the subordinate commands and the DCASRS have a shared responsibility for accounting for purchases of supplies and equipment that have resulted in the negative ULOs, resolving the negative ULO problem will require a joint effort. Concentrating initial resolution efforts on overpayments to contractors would most immediately benefit the government because it would result in the recovery of government funds.

The subordinate commands do not have summary information on negative ULOs. Until Army officials receive this type of information, they will not have the management indicators needed to correct negative ULOs. Also, the Army has not placed sufficient management emphasis on the need to follow existing regulations that require immediate corrective action on negative ULOs.

We believe that the negative ULO balances we have reported are a material internal control weakness in the Army's accounting system. However, the weakness has not been reported in the Army's Federal Managers' Financial Integrity Act reports to the Secretary of Defense.

## Recommendations

We recommend that the Secretary of Defense direct the Secretary of the Army and the Defense Logistics Agency Director to establish policies and procedures to ensure that adequate coordination and cooperation exists between the subordinate commands and DCASRs to

- resolve negative ULOS already recorded in the subordinate commands' accounting records and collect any overpayments made to contractors and
- determine the control weaknesses that have caused negative ULOS and institute controls to correct these problems with the intent of eliminating negative ULOS.

We also recommend that the Secretary of the Army

- direct the subordinate commands to (1) comply with existing regulations on aging negative balances and taking immediate action to correct negative ULOS and (2) report summary level data on the total amount and age of negative ULOS to the Army Materiel Command on a quarterly basis and
- identify negative ULOS as a material weakness in the Army's annual Federal Managers' Financial Integrity Act report to the Secretary of Defense until this weakness is corrected.

## Agency Comments

DOD concurred with our findings and recommendations. The DOD Principal Deputy Comptroller agreed that the reported conditions reflect a systemic DOD problem related to payments being made for all DOD components. He stated that action will be taken as part of the DOD Corporate Information Management effort to address this problem.

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We are sending copies of this report to the Secretaries of Defense and the Army, the Director of the Defense Logistics Agency, and other interested parties. We will also make copies available to others upon request.

Please contact me at (202) 275-9507 if you or your staff have any questions concerning this report. Other major contributors to this report are listed in appendix IV.

Sincerely yours,

A handwritten signature in black ink, reading "Jeffrey C. Steinhoff". The signature is written in a cursive style with large, flowing loops.

Jeffrey C. Steinhoff  
Director, Financial Management  
Systems and Audit Oversight

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## Abbreviations

DCASR	Defense Contract Administration Services Region
DOD	Department of Defense
ULO	unliquidated obligation





# Objectives, Scope, and Methodology

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As stated earlier in this report, the objectives of our work were to review the Army's outstanding negative ULOs related to supply and equipment inventory purchases to determine (1) the magnitude of negative ULOs on the Army Materiel Command's records, (2) the procedures used to monitor and report them to senior Army officials, and (3) their causes.

We concentrated on the Army Materiel Command's major subordinate commands because they have the primary responsibility for buying supplies and equipment for the Army. We analyzed negative ULOs in detail at two of the six subordinate commands: the Communications and Electronics Command, Fort Monmouth, New Jersey, and the Tank and Automotive Command, Warren, Michigan. Since the six subordinate commands operate similarly, we judgmentally selected these two for detailed review and believe their negative ULO problems are generally representative of the other four. We met with responsible officials at the two subordinate commands and reviewed pertinent accounting regulations, policies, accounting reports, and internal studies and evaluations.

To determine the magnitude of the negative ULOs, we asked the six subordinate commands to provide us with the number and dollar value of negative ULOs recorded in their accounting records as of September 30, 1989. In addition, at the two subordinate commands selected for detailed review, we asked officials to generate, from their automated systems, computer listings to determine the total number and dollar value of negative ULOs contained in their accounting records.

At the two subordinate commands, we judgmentally selected 84 negative ULO balances for detailed review from 1,483 negative ULO balances that were recorded in reports between August 1988 and July 1989. We selected the 84 balances based on whether (1) the dollar value of an individual item in a contract was large or (2) the total contract ULO balance was negative. The 84 negative ULO balances accounted for about \$49 million (18 percent) of the two subordinate commands' total negative ULO balances of about \$272 million.

To determine if negative ULOs were promptly corrected at the two subordinate commands selected for detailed review, we compared the date of special computer listings of negative ULOs to the last transaction date recorded in the accounting records or other contract data to determine how long the negative balances had remained outstanding. Since the subordinate commands did not have reports showing the age of their

negative ULO balances, it was not practical for us to review all 1,483 individual account balances to determine their age. Therefore, we limited our aging analysis to the 84 sampled balances.

We also discussed negative ULO reporting procedures with accounting officials at the two subordinate commands and the Army Materiel Command to determine how information on negative ULOs is reported to senior Army officials. In addition, we reviewed various reports which contained obligation data the subordinate commands were required to submit to the Army Materiel Command to ascertain if negative ULOs were identified separately.

To determine why negative ULO balances occurred, we interviewed subordinate command and Defense Logistics Agency accounting supervisors and reviewed pertinent contract files and other detailed transaction records. We also analyzed in detail pertinent accounting transactions and related source documents for one judgmentally selected contract to test the accuracy of recorded balances.

We also reviewed the Army's and Defense Logistics Agency's Federal Managers' Financial Integrity Act<sup>1</sup> reports for 1983 through 1988, which contain information on internal control weaknesses and accounting system deficiencies to determine if negative ULOs had been previously reported.

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<sup>1</sup>Federal agency accounting systems must include internal controls that comply with the Comptroller General's internal control standards and related requirements, such as the Treasury Financial Manual and OMB circulars. GAO's Policy and Procedures Manual for Guidance of Federal Agencies contains the principles, standards, and related requirements to be observed by federal agencies.

# Processing Errors Cause Differences in Agency Records

To obtain a better understanding of the problems involved in correcting negative ULOS caused by processing errors, we judgmentally selected for detailed review a contract that had an overall negative ULO balance of \$145,000, the cause of which was unknown. Our detailed review of the contract confirmed what subordinate command officials told us about how the significant differences caused by processing errors make correcting negative ULOS a time-consuming effort. For example, although the contract had only a \$145,000 negative ULO balance, we found a difference of about \$12 million between the recorded obligated balances on the subordinate command and DCASR accounting records. We also found that those records did not agree for 427 of the 449 obligation and payment transactions reviewed. Because of missing records, incomplete data, and the number of errors, we could not completely reconcile the contract. Obtaining all the needed documentation to do so would have taken a significant amount of time. However, we did calculate the dollar value of the difference between the subordinate command and DCASR records for each of the 449 transactions we analyzed. Table II.1 shows the seven largest differences between those balances.

**Table II.1: Differences Between Subordinate Command and DCASR Balances**

<b>Subordinate command</b>	<b>DCASR</b>	<b>Difference</b>
\$6,842,268	\$5,708,926	\$1,133,342
29,454	1,100,001	1,070,547
2,160,036	1,642,568	517,468
27,620	345,694	318,074
121,320	418,680	297,360
292,806	585,672	292,866
227,192	489,230	262,038

A subordinate command accounting supervisor was not aware of the many errors in this contract and generally could not explain why they had occurred. The supervisor told us they had not reconciled the contract but agreed to do so after we informed them of the results of our analysis.

# Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

APR 10 1990

Mr. Donald H. Chapin  
Assistant Comptroller General  
Accounting and Financial  
Management Division  
Washington, D.C. 20548

Dear Mr. Chapin:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Draft Report, "Financial Management: Army Records Contain Millions of Dollars in Negative Unliquidated Obligations," dated March 2, 1990 (GAO Code 903100) OSD Case 8258.

The DoD concurs with the findings and recommendations in the report. The Department agrees that the reported conditions reflect a systemic DoD problem related to payments being made for all DoD Components. Action will be taken as a part of the Corporate Information Management effort to cure this systemic problem.

The detailed DoD comments on the report findings and recommendations are provided in the enclosure. The Department appreciates the opportunity to comment on the draft report and the GAO efforts in helping to identify the problem of negative unliquidated obligations.

Cordially,

A handwritten signature in cursive script that reads "Donald B. Shycoff".

Donald B. Shycoff  
Principal Deputy Comptroller

Enclosure

GAO DRAFT REPORT - DATED MARCH 2, 1990  
GAO CODE 903100 - OSD CASE 8258

"FINANCIAL MANAGEMENT: ARMY RECORDS CONTAIN MILLIONS OF DOLLARS  
IN NEGATIVE UNLIQUIDATED OBLIGATIONS"

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FINDINGS

o FINDING A: Background: Army Procedures. The GAO explained that the Army has control procedures to ensure that it does not obligate or spend more money than the Congress has appropriated. According to the GAO, the key features of these procedures are that (1) the Army incurs and records obligations for one or more appropriation accounts when it enters into a contract, (2) these obligations are reduced or "liquidated" in the Army accounting records as payments are made, and (3) an unliquidated balance for a total contract price indicates the amount remaining to be spent for that contract. The GAO noted that since the amount paid should always be equal to or less than the amount obligated, unliquidated obligation balances should not be negative. The GAO observed that the Army Materiel Command has six major subordinate commands, located throughout the United States, through which it purchases, stocks, and distributes billions of dollars worth of materiel. The GAO further noted that these Commands carry out these tasks for Army units, other Military Services, and foreign governments. The GAO noted that the subordinate commands share purchasing responsibilities with the Defense Logistics Agency's nine Defense Contract Administration Services Regions, which administer contracts for the Military Services. The GAO observed that, generally, the Army commands are responsible for awarding the contracts, while the Defense Contract Administration Services Regions are responsible for making the actual payments and recovering money from contractors in the event of overpayments. The GAO further described the contract administrator's role as providing the information on payment and collection transactions to the subordinate command level, which enters the data into its contract accounting system. The GAO emphasized that both entities are responsible for insuring that the (1) amounts paid to contractors do not exceed the amounts obligated in the contracts and (2) payments are charged to the correct appropriations. The GAO pointed out that while both activities are responsible for insuring that these payments are made and recorded correctly, the major subordinate commands are ultimately accountable for correcting the negative unliquidated obligations.

DOD POSITION: Concur.

o FINDING B: Negative Unliquidated Obligations Are Not Aged. The GAO observed that Army Regulation 37-1, Army Accounting Guidance, requires the major subordinate commands to age negative unliquidated obligations. The GAO found, however, that the major subordinate commands do not produce reports that show the age of their negative unliquidated obligation balances. The GAO explained that the use of such aging reports is one method of

determining if negative unliquidated obligations are being promptly resolved. The GAO indicated that, since the subordinate commands were not producing aging reports, they did not know how long the negative balances had been outstanding. The GAO evaluated the negative unliquidated obligations at two subordinate commands and found 1,483 negative unliquidated obligation balances totaling about \$272 million. The GAO analysis showed that 47 of the 84 sampled balances were over 6 months old. The GAO further found that these 47 balances represented \$23 million (47 percent) of the \$49 million in negative unliquidated obligations reviewed. The GAO calculated that 40 balances totaling \$19.4 million of the 47 balances were over one year old. The GAO concluded that the analysis demonstrates the need to produce aging reports as a means for closely monitoring negative unliquidated obligations. According to the GAO, Army officials acknowledged that negative unliquidated obligations were not being aged, as required by the Army regulation, and that they did know how long the balances had been outstanding. The GAO explained that Army officials stated that their accounting system currently does not have the capability to age negative balances. The GAO further explained these same officials stated that they are in the process of planning a change to the accounting system, which will age negative unliquidated obligation balances. According to the GAO, however, these officials could not estimate when the change would be implemented.

**DOD POSITION:** Concur. The Department agrees that failure to age negative balances limits the ability of management to take corrective actions.

o **FINDING C: Requests to Reconcile Negative Unliquidated Obligations Do Not Receive Prompt Responses.** The GAO reported that negative unliquidated obligations should act as internal control flags to alert the major subordinate commands of overpayments or errors. The GAO pointed out that corrective action on the negative unliquidated obligation balances requires cooperation and coordination with the Defense Contract Administration Service Regions--(1) where the official contract files are usually maintained and (2) which are responsible for paying the contractor for materials and supplies provided. The GAO found that, for 43 of the 47 negative balances over 6 months old, the Defense Contract Administration Services Regions had been asked to (1) provide the information needed to determine the cause of the negative unliquidated obligation or (2) take corrective action once the cause of the problem was identified. The GAO learned that the contract administrators did not always take timely action to resolve the negative unliquidated obligations. The GAO cited an example where a subordinate command asked a contract administrator four times during a 2-year period to research and correct various negative unliquidated obligations totaling over \$800,000 on a contract. According to the GAO, the Army records indicated that the \$800,000 represented overpayments resulting from contract modifications, which reduced the price of the items below the amounts already paid to the contractor. The

GAO noted that two years later the Defense Contract Services Administration Region still had not responded. The GAO indicated that the Defense Contract Service Administration Region officials could not explain why the response had not been prepared and sent. The GAO concluded the slow responses to request for reconciliation by the Defense Contract Administration Service Regions hinder the subordinate commands' ability to resolve negative unliquidated obligations promptly. The GAO also noted that this also significantly increases the amount of time it takes the contract administrators to identify and collect overpayments and resolve accounting errors. According to the GAO, Defense Logistics Agency accounting officials acknowledged that the Defense Contract Administration Service Regions share the responsibility for ensuring that the negative unliquidated obligations, as well as other contract payment problems, are promptly resolved. The Defense Logistics Agency accounting officials advised the GAO that the Defense Contract Administration Service automated services systems is being redesigned to address these problems and to improve the regions' overall contract payment process. The GAO stated that full implementation is expected to improve the quality and accuracy of the system of accounting data for contract payments. The GAO observed, however, that this redesign effort was to be completed in 1982, but scheduled implementation has slipped about 8 years because of problems in redesigning the system--to late 1990.

DOD POSITION: Concur. The Department agrees that the Defense Logistics Agency needs to respond promptly to requests from the Military Services to reconcile negative unliquidated obligations. However, the statement that the redesign effort has slipped about 8 years because of problems in redesigning the system is not completely accurate. A slippage occurred in various areas subsequent to redesign. The Functional Description for redesign was completed in 1985. The slippage in programming the redesigned system occurred because of (1) higher priority projects within the agency (such as, establishment of the Defense Logistics Agency Finance Center, the establishment of the Defense Contract Management Command), (2) modeling studies to ascertain the best technology approach (main frame, distributed processing, etc.) and (3) mandated changes (such as Prompt Payment Act and cash management).

o FINDING D: Outstanding Negative Unliquidated Obligations Are Not Followed Up On. The GAO found that the subordinated commands do not have adequate followup procedures to ensure that negative unliquidated obligations are resolved when the Defense Contract Administration Service Region does not respond to the subordinate command notification letters in a timely manner. The GAO observed that Army Regulation 37-1, Army Accounting Guidance, requires that immediate corrective action be taken to resolve negative unliquidated obligation balances. The GAO found, however, that in many cases the subordinate commands do not initiate followup action for a year or more to resolve outstanding negative balances -- if the contract administrators do not respond to the notification letters. The GAO calculated that over 6 months to

See comment 1.

more than 2 years elapsed before followup action were taken for 43 of the 47 balances over 6 months old. The GAO estimated that these 43 negative balances represented about one half of the \$23 million of negative unliquidated obligations over 6 months old. The GAO emphasized that followup action is needed to ensure timely collection of overpayments or the correction of processing errors. The GAO cited an example where, as of October 1988, a \$2.8 million overpayment had been outstanding for more than a year and the subordinate command had not followed up with the contract administrator for 8 months as to why the overpayment had not been collected. The GAO concluded that negative unliquidated obligations are internal control "red flags" that should alert managers of problems. The GAO asserted that because negative unliquidated obligations indicate overpayments to contractors or erroneously recorded transactions, more emphasis needs to be placed on following up on them.

DOD POSITION: Concur. The Department agrees that negative unliquidated obligations indicate problems with the transactions.

o FINDING E: Negative Unliquidated Obligations Are Not Identified In Reports To Senior Army Officials. The GAO deduced that senior Army officials did not know about the magnitude of the negative unliquidated obligation problems because the Army does not require subordinate commands to report information on negative unliquidated obligations separately. The GAO explained that, when the subordinate commands prepare accounting reports, negative and positive unliquidated obligations are combined to arrive at a net figure. The GAO pointed out that the Army Materiel Command officials were not aware of the total number and dollar value of negative unliquidated obligations at each of its six subordinate commands until the GAO provided information that their records included about 4,500 negative unliquidated obligation balances totaling about \$328 million. The GAO concluded that Army Materiel Command officials need information on negative unliquidated obligations in order to monitor subordinate commands' performance and to take corrective action when necessary. The GAO further concluded that these problems may not be resolved if specific information on the magnitude and causes of the negative unliquidated obligations are not reported to the Army Materiel Command.

DOD POSITION: Concur. The Department agrees that information on negative unliquidated obligations needs to be reported to senior Army officials.

o FINDING F: Negative Unliquidated Obligations Caused by Overpayments. The GAO learned that, when a Defense Contract Administration Services Region pays a contractor too much money, a negative unliquidated obligation will occur if the amount disbursed is greater than the amount obligated. The GAO found that overpayments to contractors valued at \$7.6 million were the cause of 39 negative unliquidated obligations in the sample.



According to the GAO, there are three major reasons why Contract Administration Services Regions overpay contractors, as follows:

- contract modifications decrease the contract price and related obligation below the amount already paid to the contractor;
- duplicate payments are made for the same invoice; and
- progress payments made to contractors before work is actually completed are not considered when the final payment is made to the contractor.

The GAO concluded that, because overpayments tie up funds that could otherwise be used to meet Army requirements, their prompt identification and collection is important. In addition, the GAO concluded that the overpayments can serve as interest-free loans to contractors. The GAO further concluded that the adverse effect of overpayments can be minimized, if the overpayments are identified and recouped promptly -- however, under current procedures, years can pass before overpayments are identified and collected.

DOD POSITION: Concur. The Department agrees that overpayments to contractors are one of the causes of negative unliquidated obligations and that aggressive action needs to be taken to recover contractor overpayments when identified.

o FINDING G: Negative Unliquidated Obligations Caused By Processing Errors. The GAO observed that negative unliquidated obligations can also occur if obligation, payment, or collection data is inaccurately or incompletely transmitted to the Army subordinate command accounting offices. The GAO explained that these errors can range from erroneous charges to the wrong item in the contract to not recording contract modifications. The GAO found that processing errors caused 24 negative unliquidated obligations valued at \$23.8 million in the sample. The GAO pointed out that these processing errors distort accounting reports that Army officials use to make management decisions. According to the GAO, subordinated command accounting officials stated that processing errors can cause significant differences between the data in the Defense Contract Administration Services Region and subordinate command accounting records. The GAO reported these officials also noted that it is difficult and time-consuming to identify the causes of the differences and to correct negative unliquidated obligation balances recorded in the subordinate command records. The GAO cited a review of one contract, which had a \$145,000 negative unliquidated obligation balance -- but the GAO found a difference of about \$12 million between the recorded obligation balances on the subordinate command and the Defense Contract Administration Services Region accounting records.

DOD POSITION: Concur. Processing errors are a systemic problem related to the current payment process for all DoD Components, including the Army. The DoD Corporate Information Management effort will address the systemic problems related to DoD centralized payments.

o FINDING H: The Army Has Not Reported Negative Unliquidated Obligations As A Material Internal Control Weakness. The GAO explained that, since negative unliquidated obligations generally should not occur, the magnitude and age of the Army negative unliquidated obligations it found indicates that the Army Materiel Command subordinate commands have a material internal control weakness--which was not disclosed in the Army Federal Managers' Financial Integrity Act Report to the Secretary of Defense. The GAO pointed out that the Office of Management and Budget provided guidance to agencies on determining whether weaknesses and system nonconformances should be reported in an agency's Federal Financial Managers' Financial Integrity Act report, which defined a material weakness as a misstatement or loss of either \$10 million or 5 percent of a budget line item. The GAO described the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512) requirement that each agency establish internal accounting and administrative controls in accordance with standards prescribed by the Comptroller General. The GAO indicated that the Act further requires a separate report on whether the agency's accounting system conforms to the accounting principles, standards, and related requirements established by the Comptroller General. The GAO observed that, although the Army has not reported negative unliquidated obligations in its Federal Managers' Financial Integrity Act reports, Army Materiel Command accounting officials recognize the Defense Contract Administration Services Region payment problems, including those that result in negative unliquidated obligations. According to the GAO, it is the view of these officials that these problems severely restrict the subordinate commands' ability to maintain accurate accounting records. The GAO pointed out that the Army Materiel Command has recommended, in a July 1989 memorandum to the Director, Army Accounting and Finance, that the Army report the Defense Contract Administration Services region payment problems as a material internal control weakness in its Federal Managers' Financial Integrity Act report. The GAO indicated that this suggestion is currently being reviewed by the Army's Director of Accounting and Finance. The GAO noted that, since 1985, the Defense Logistics Agency has reported material weaknesses in Defense Contract Administration Services Regions' disbursing funds to contractors, including duplicate and erroneous payments. The GAO added that the Defense Logistics Agency is taking corrective action to improve the Defense Contract Administration Services Regions' processing of contractor payments by redesigning the entire contract payment and reporting process. The GAO pointed out, however, that this effort has experienced serious delays of about 8 years.

DOD POSITION: Concur. This is a systemic problem related to the current payment process for all DoD Components including the Army. The DoD Corporate Information Management effort will address the systemic problems related to DoD centralized payments.

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RECOMMENDATIONS

o RECOMMENDATION 1: The GAO recommended the Secretary of Defense direct the Secretary of the Army and the Director, Defense Logistics Agency to establish policies and procedures to ensure that adequate coordination and cooperation exists between the subordinate commands and the Defense Contract Administration Services Regions:

- to resolve negative unliquidated obligations already recorded in subordinate commands' accounting records and
- to collect any overpayments made to contractors.

DOD POSITION: Concur. Before July 1990 the DoD will direct all DoD Components to implement the recommendation.

o RECOMMENDATION 2: The GAO recommended that the Secretary of Defense direct the Secretary of the Army and the Defense Logistics Agency Director to ensure that adequate coordination and cooperation exists between the subordinate commands and Defense Contract Administration Services Regions (1) to determine the control weaknesses that have caused negative unliquidated obligations and (2) to institute controls to correct these problems with the intent of eliminating negative unliquidated obligations.

DOD POSITION: Concur. Before July 1990, the DoD will instruct the Defense Logistics Agency, the Army, and other DoD Components to:

- determine the control weaknesses that have caused negative unliquidated obligations;
- institute controls to correct these problems with the intent of eliminating negative unliquidated obligations; and
- report back to the DoD on the corrective actions taken.

The DoD Corporate Information Management effort will also address these systemic problems.

Appendix III  
Comments From the Department of Defense

o RECOMMENDATION 3: The GAO recommended the Secretary of the Army direct the subordinate commands (1) to comply with existing regulations on aging negative balances and (2) to take immediate action to correct negative unliquidated obligations.

DOD POSITION: Concur. The Deputy Assistant Secretary of the Army for Finance and Accounting will:

- direct Army commands to comply with existing guidance to age and correct negative unliquidated obligations and
- require installations to report negative unliquidated obligations above a predetermined dollar threshold to the command not less than quarterly.

To ensure continued monitoring, the Army will include the requirements to age, correct, and report negative unliquidated obligations in their internal control checklists and make this a quality assurance review item. These requirements will go into effect in June 1990.

o RECOMMENDATION 4: The GAO recommended the Secretary of the Army direct the subordinate commands to report summary level data on the total amount and age of negative unliquidated obligations to the Army Materiel Command on a quarterly basis.

DOD POSITION: Concur. The Secretary of the Army will direct the Army Materiel Command to order subordinate commands to report summary level data on the total amount and age of negative unliquidated obligations on a quarterly basis starting June 1990. In addition, the Army has requested a milestone plan and monthly progress reports from the Army Materiel Command for correcting negative unliquidated obligations and collecting overpayments made to contractors.

o RECOMMENDATION 5: The GAO recommended the Secretary of the Army identify negative unliquidated obligations as a material weakness in the Army's annual Federal Managers' Financial Integrity Act report to the Secretary of Defense until the weakness is corrected.

DOD POSITION: Concur. The Army will include negative unliquidated obligations as a material weakness in the Army's annual Federal Managers' Financial Integrity Act report for fiscal year 1990. The Army requested the Army Materiel Command to include negative unliquidated obligations as a material weakness in its annual Federal Manager's Financial Integrity Act report submitted to the Secretary of the Army.

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The following is GAO's comment on the Department of Defense's letter dated April 10, 1990.

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**GAO Comment**

1. We agree that there were factors other than redesign problems that contributed to the implementation slippage of the DCASRS' system, and the report has been modified accordingly.

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