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The Government's Use of "M" and  
Merged Surplus Accounts

Statement of  
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Before the  
Senate Committee  
on Governmental Affairs



Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss the government's use of "M" and merged surplus accounts and to provide our perspectives on legislation to strengthen control and oversight of these accounts.

What Are "M" and Merged Surplus Accounts?

Government agencies receive appropriations with differing periods of availability--generally 1, 2 or 3 years. After that time, the appropriations expire and are not to be used to incur new obligations. They remain available, however, to pay bills associated with obligations that were incurred during the period of availability.

When entering contracts, agencies cannot always precisely identify all the costs they will incur on those contracts and adjustments are commonplace. Unused obligational authority can be used to fund increases in valid obligations if an agency subsequently finds that it has underestimated the amount of the obligation or receives an unexpected charge that can be clearly associated with a given fiscal year and appropriation. Adjustments can also go the other way when agencies find that they have overestimated the amount of an obligation.

In order to streamline a cumbersome process for certifying separate payments from appropriation account balances that were being maintained forever, the Congress, in 1956, established the current system of surplus, merged surplus, and so-called "M" accounts for federal agency use in recording and accounting for transactions affecting expired appropriations. (See attachment I for a diagram of the relationship and operation of these accounts.)

The system works as follows. At the end of the period an appropriation is available for obligation, the unobligated balances expire and are withdrawn to the Treasury where they are designated as surplus authority. The surplus funds of an expired appropriation retain their fiscal year identity for 2 years, after which time any remaining balances are transferred to merged surplus accounts. Once surplus funds enter a merged surplus account, Treasury maintains a record of the general purpose of the original appropriation, but the balances lose their fiscal year identity. For example, there is a separate merged surplus account for the appropriation, Operation and Maintenance, Army, which includes unused obligational authority back to the account's 1956 inception. Surplus funds are available for restoration to an expired appropriation or an "M" account to pay upward adjustments in obligations.

The obligated balances of appropriations also retain their

fiscal year identity for 2 years following the end of their period of availability. At the end of this 2-year period, agencies transfer any remaining obligations to an "M" account. The "M" account accumulates unliquidated obligations from all prior appropriations for the same general purpose (the Operation and Maintenance, Army, appropriation, for example) and the fiscal year identity is no longer maintained.

It is important to note that the balances in the surplus, merged surplus and "M" accounts are not stashes of cash waiting for a rainy day to be spent. They are not intended to be used as a slush fund. Rather, they constitute spending authority that may legally be used only to pay valid preexisting obligations or valid adjustments to these obligations. But, because these are an accumulation of old balances, without fiscal year identification and without the kind of visibility and scrutiny afforded current appropriations, "M" and merged surplus accounts are subject to abuse. We have reported on abuses in the past.

#### The Growth of "M" and Merged Surplus Accounts

The balances in "M" and merged surplus accounts are large and have grown considerably in recent years. At the end of fiscal year 1989, as detailed in attachment II, "M" accounts for executive agencies totaled over \$28 billion. Two-thirds of that amount came from the military services (i.e., Army, Navy, and Air

Force). The balances for the Departments of Labor and Education, the Agency for International Development (AID), and the Foreign Military Sales Program account for about 70 percent of the remainder. For the military services, the "M" account balance grew from \$2.7 billion in fiscal year 1980 to \$18.5 billion in fiscal year 1989, an almost 7-fold increase.

The military services held over \$25 billion in their merged surplus accounts at the end of fiscal year 1989, up from a little over \$15 billion at the end of fiscal 1980. At your request, we are making a similar analysis of the other agencies. By any measure, however, we are talking about large balances that have typically received little visibility.

Treasury records show that in fiscal year 1989 there were 1,362 individual payments from agency "M" accounts of \$500,000 or more which totaled \$8.1 billion. While over half of this amount came from the military services, AID was the second largest user having 367 such payments valued at almost \$1.3 billion. AID officials explained that U.S. foreign assistance appropriations are often obligated by means of a bilateral agreement with a foreign government. Final bills are not paid until after delivery of the goods or services. They said funds must be available for a long period because of the lead times involved in international competitive bidding, the delays involved in dealing with less developed countries to finalize procurement

requirements, and the long delivery times involved in providing goods and services to frequently remote project sites.

Treasury records show there were 36 restorations over \$500,000 in fiscal year 1989, that amounted to \$320 million. While the military services had over two-thirds of this amount, AID had less than \$1 million. Finally, individual withdrawals (or deobligations) over \$500,000 from the "M" accounts to the merged surplus accounts totaled almost \$1 billion, or almost 3 times the amount of restorations.

#### "M" Account Problems

Over the years, we have reported problems with the use of "M" accounts and the merged surplus funds and have recommended actions to strengthen oversight, accountability, and control. For example, in a March 1987 report, Financial Management: Defense Accounting Adjustments for Stock Fund Obligations Are Illegal (GAO/AFMD-87-1), we detailed Defense's improper use of \$563 million of "M" account balances and recommended that significant adjustments to "M" and merged surplus balances be approved by the Defense Comptroller and reported to the Congress. This followed a report by the House Committee on Appropriations (House Report 99-792, August 14, 1986) which called on Defense to improve the management and control of these balances.

Subsequently, the Defense Authorization Act for fiscal years 1990 and 1991 (Public Law 101-189, November 29, 1989) required that the Secretary of Defense approve "M" account restorations from the merged surplus authority for any late contract change exceeding \$4 million in a fiscal year. Any restoration causing the total amount of restorations for a program, project, or activity to exceed \$25 million in a fiscal year requires 30-day advance written notification to the Senate and House Committees on Armed Services and Appropriations.

In another case, we reported in October 1989 that Air Force transfers of \$238 million of merged surplus funds to its Stock Fund lacked the documentary evidence required by law and should not have been made (B-236940). Because the Stock Fund is a revolving fund, amounts transferred from the merged surplus would be available to fund current Stock Fund operations.

In 1989, the President's Council on Integrity and Efficiency (PCIE), under the direction of the Treasury Inspector General (IG), initiated a review of "M" accounts. Inspectors general in 13 agencies participated in the review, and 12 have issued reports on the status of selected "M" accounts. The PCIE expects to issue an overall report early in fiscal year 1991.

The two most common problems identified in the IG reports involve poor documentation of "M" account obligations and the

continued retention of excessive balances in these accounts. For example, in total, the IGs reviewed "M" account obligations amounting to \$842 million and recommended that \$383 million, or 45 percent, be deobligated. Most of these recommended deobligations were for contracts, grants, or loans that had expired or for which there had been no activity for several years.

The types of problems reported by GAO and the IGs are not new, and, if anything, have probably worsened over the years as the government has struggled with weak accounting systems and internal controls. It seems that every few years concerns arise over the use of "M" and merged surplus accounts. In the early 1970s there was concern about these accounts, and in a March 1981 letter responding to concerns raised by Senator Levin, we recommended a reduction in the merged surplus fund and additional controls over and periodic audits of "M" and merged surplus accounts.

Recent Legislative and Other Proposals  
Could Result in Needed Changes to  
"M" and Merged Surplus Accounts

Recent public debate has again highlighted concerns over the use and potential for abuse of "M" and merged surplus accounts, leading to a reevaluation of current statutory provisions. The



recent use by the Air Force of over \$1 billion of expired and merged surplus funds to cover contract modifications, contracts that have exceeded their contract prices, and contingent liabilities and claims for the B-1B program has helped fuel the debate. Although these Air Force actions were legal, the result was that the B-1B program will use about \$500 million more than it contributed to the surplus accounts in unused obligation authority.

In recent months, legislation has been introduced in both houses of the Congress which would affect the availability of and control over expired appropriations. The principal areas of change typically center on the establishment of limits to the time period for which "M" and merged surplus accounts are available for use, the rescission of funds after specific time periods or the completion of specific activities, and the funding of preexisting obligations after the rescission of funds available for those obligations. While Chairman Glenn's and Senator Roth's bills differ somewhat as to approach, we support the overall purpose of both bills in limiting the availability of expired appropriations and eliminating the "M" and merged surplus accounts.

Specifically, we favor the approach in Chairman Glenn's bill, under which individual appropriation balances would be carried forward for 5 years after expiration. It provides the

flexibility needed to pay valid obligations and increases control over these accounts by retaining fiscal year identity. This would provide for fiscal year visibility of appropriations which is now lacking with the "M" accounts. Both bills would eliminate the "M" account and merged surplus.

Chairman Glenn's bill would permit limited use of current year appropriations to cover any preexisting obligation that needs to be paid after the 5-year period has passed. This would eliminate the need for an agency to come to the Congress for immaterial amounts to pay bills. Also, we believe it prudent, as the bill calls for, to close no-year accounts when no disbursement has been made against the appropriation for 2 consecutive fiscal years and the agency head determines that the purposes for which the appropriation was made have been carried out.

We do have some suggestions for further strengthening the legislation. We need better financial information on the status of appropriations. As highlighted in the recent IG studies of "M" accounts, the balances of reported "M" account obligations are not reliable. We recommend that the legislation include a new requirement for an annual certification from the head of each agency that obligated balances in the account are accurate and expenditures since the previous year's review were supported by program obligations. In addition, we suggest that the

legislation require that the IGs review and report each year on the reasonableness of, and basis for, the agency head's certification.

In addition, as I mentioned earlier, the Department of Defense has legislative approval and notification requirements for "M" account adjustments over certain amounts. We suggest that this requirement be expanded beyond Defense to include all agencies.

We also need leadership to improve the reporting and control over appropriations. Mr. Chairman, you and Senator Roth have introduced legislation (S. 2840) to establish a chief financial officer structure for government which we fully support. We see the Chief Financial Officer as having the responsibility for monitoring the uses of appropriations and for annually reporting an accurate set of numbers. We see the counterpart chief financial officers in the agencies taking the lead for assuring the job is done well and for providing the agency head with the basis for the annual certification.

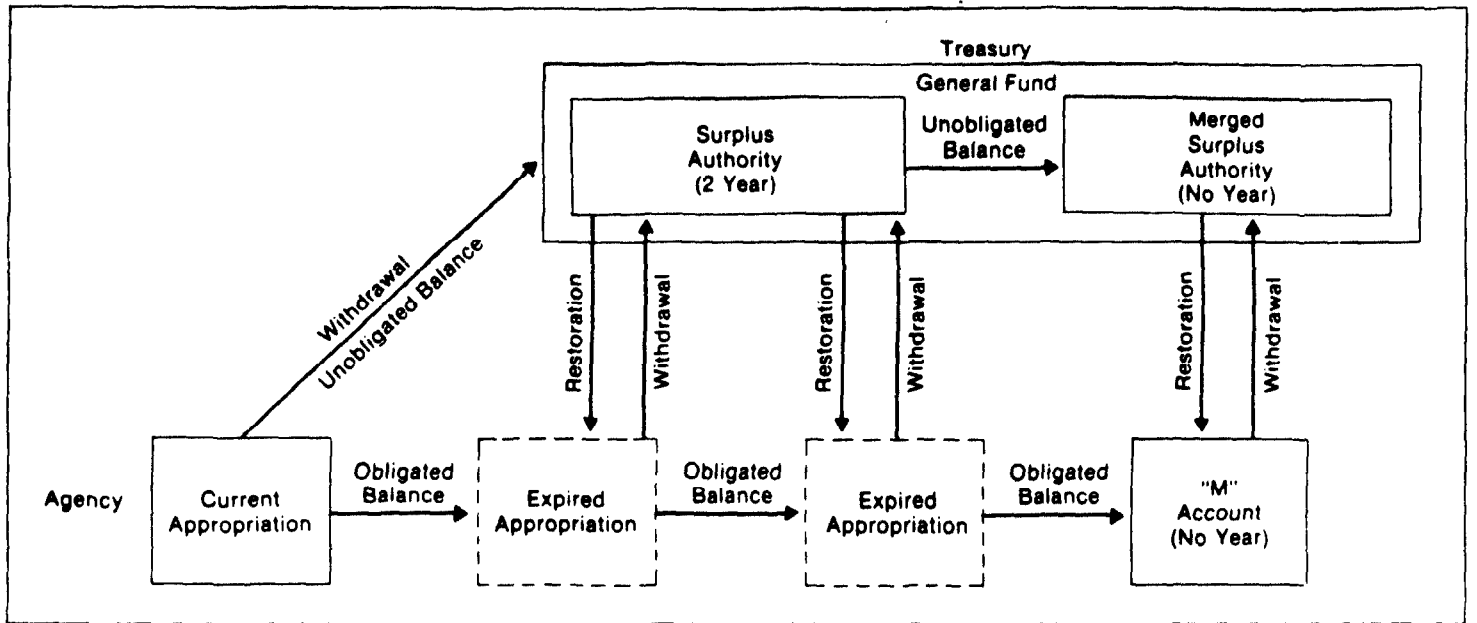
Another aspect of S. 2840 is a requirement for annual agency financial statements which should strengthen control over appropriations. To improve visibility, we propose the expansion of financial statement reporting to include an analysis of the unliquidated obligation and unobligated balances for each expired

appropriation and will be working with agencies to achieve this.

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Mr. Chairman, this concludes my formal statement. We will be available to assist the Committee as it considers this legislation, and we will be happy to answer any questions you or members of the Committee may have at this time.

The Process of Withdrawals, Restorations, and Transfers of Appropriation Balances



Executive Agency "M" Account Balances  
as of September 30, 1989  
(Dollars in Millions)

Executive Office of the President <sup>a</sup>	\$ 4,275
Agriculture	183
Commerce	94
Department of Defense <sup>b</sup>	18,671
Education	1,253
HHS	428
HUD	474
Interior	88
Justice	177
Labor	1,221
State	122
Transportation	571
Treasury	101
Veterans Affairs	64
EPA	98
GSA	11
NASA	174
OPM	13
SBA	3
Energy	7
Independent agencies	<u>181</u>
 Total	 <u>\$ 28,208</u>

<sup>a</sup>This figure consists mainly of funds appropriated for Foreign Military Sales Credit, Economic Support Funds, and Development Assistance.

<sup>b</sup>This figure includes Army, Navy, Air Force, and Defense Agencies.

Source: Data compiled from the Department of the Treasury's 1989 annual report and not verified.