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United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-253494

July 1, 1993



149477

The Honorable Sam Nunn
Chairman, Committee on Armed Services
United States Senate

The Honorable Strom Thurmond
Ranking Minority Member
Committee on Armed Services
United States Senate

In its report on the National Defense Authorization Act for Fiscal Year 1993, the Senate Committee on Armed Services expressed its concern about certain related actions taken by the Air Force on the C-17 contract to (1) establish separate ceiling prices for the full scale engineering development (FSED) effort and the first two production lots of C-17s; (2) use expired Air Force aircraft procurement funds as part of the funding for the contract; and (3) reprogram C-17 research, development, test, and evaluation (RDT&E) funds. The Committee asked us to determine whether any of these actions by the Air Force may have resulted in a violation of the Anti-Deficiency Act, 31 U.S.C. 1341(a), which prohibits agencies from making expenditures or incurring obligations that exceed available appropriations. As discussed below, we do not believe that any of the actions taken by the Air Force violated the Anti-Deficiency Act.

The C-17 contract (F33657-81-C-2108) between the Air Force and the Douglas Aircraft Company of the McDonnell Douglas Corporation has been used as a vehicle to fund three segments of the C-17 program--FSED and the first two production lots. It is a fixed price incentive contract with an aggregate ceiling price of \$6.67 billion as of July 15, 1992, the effective date of the modification in question. Although the contract originally listed separate ceiling prices for each segment of the contract, McDonnell Douglas and the Air Force did not have a common understanding about whether the separate ceiling prices for each segment or a single,

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aggregate ceiling price for the entire contract would apply for final price redetermination purposes.¹

McDonnell Douglas believed that the contract had a single, aggregate ceiling price and that it should be paid for costs incurred in excess of any one of the separate ceiling prices, so long as the total costs incurred on the entire contract were within the aggregate ceiling. The Air Force did not agree, but was concerned that if there was a cost overrun on the FSED segment of the contract and a cost underrun on the production lots, the government might have been responsible under the contract as written for the excess FSED costs up to the aggregate ceiling price for the entire contract.

This concern vanished in late 1991, when the projected cost of each of the two production lots increased and exceeded their separate ceiling prices. The Air Force determined, however, that a contract modification regarding the ceiling prices was necessary to facilitate administration of the contract and to avoid future disputes. McDonnell Douglas was reluctant to agree to the contract modification until it became clear that the final costs incurred on each of the three segments of the contract would exceed their separate ceilings. Agreement was then reached on a modification, which became effective July 15, 1992, that eliminated any ambiguity by clearly providing that the separate ceiling prices would be used for final price redetermination and other purposes. The modification did not affect the total amount for which the government could have been held responsible under the contract at that time, \$6.67 billion.

Before the contract modification, the Air Force was confident that the total cost to the government would not exceed the aggregate ceiling price of the contract, but it was uncertain of the breakdown between RDT&E and procurement funds. The Air Force had budgeted funds in excess of the FSED ceiling price, while limiting funding

¹Prior to the final closeout of the contract and after all items have been delivered, the contractor submits a final accounting of all costs incurred under the contract. The government and the contractor then negotiate a final "price" for the contract.

for the production lots to their then-current billing prices (slightly above target prices). In May and June of 1992, after all cost estimates for the first two production lots were in excess of their separate ceiling prices, the Assistant Secretary of the Air Force for Financial Management approved the use of expired procurement funds to cover the anticipated cost growth up to the separate ceiling prices for the two production lots. In a letter to Congressman Andy Ireland, B-250171, September 14, 1992, copy enclosed, our Office recognized that expired appropriations may be used to pay increases resulting from the type of contract cost growth that occurred here. In August 1992, the excess RDT&E funds were reprogrammed to other Department of Defense programs, with the approval of Congress. As a result of these actions, each segment of the contract was budgeted or funded up to its negotiated ceiling price, which will be used during the eventual price redetermination process.

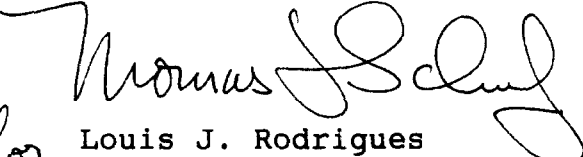
The contract modification establishing separate ceiling prices for each segment of the contract, the use of expired procurement appropriations, and the reprogramming of C-17 RDT&E funds did not increase or decrease the total dollars applied to the contract. While the mix of RDT&E and procurement dollars applied to the contract changed from the amounts previously budgeted, we do not believe that a violation of the Anti-Deficiency Act occurred because the Air Force did not incur obligations for procurement or FSED in excess of the unobligated balances of appropriations, including expired appropriations, legally available to satisfy those obligations.

We are sending copies of this letter to other interested congressional committees; the Secretaries of Defense and the Air Force; and the Director, Office of Management and Budget. We will make copies available to others on request.

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If you have any questions regarding the results of this assignment, please do not hesitate to call me on (202) 512-4841.

Sincerely,

for 

Louis J. Rodrigues
Director, Systems Development
and Production Issues

Enclosure



Comptroller General
of the United States

Washington, D.C. 20548

B-250171

September 14, 1992

The Honorable Andy Ireland
House of Representatives

Dear Mr. Ireland:

This responds to your letter of August 25, 1992 which questioned the Department of Defense's interpretation of 31 U.S.C. § 1553, as amended by Public Law No. 101-510 (Nov. 5, 1990). You state that in May and June 1992, the Air Force approved upward adjustments in the obligations for Lots I and II of the C-17 aircraft contract to cover a \$139.8 million "cost growth" and used expired Aircraft Procurement, Air Force, appropriations for fiscal years 1987, 1988 and 1989 to fund the increased obligations. You suggest that under section 1553, expired appropriations are only available for contract changes requiring additional work, not for cost growth. Consequently, you question the propriety of the Air Force's decision to use expired appropriations for cost growth. In this regard, you asked us to address the following questions:

- (1) Does section 1553 specifically authorize the use of expired appropriations for contract changes to cover "cost growth" as in the case of the \$139.8 million C-17 transaction?
- (2) Is the Air Force required under section 1553 to report the \$139.8 million C-17 transaction to Congress?

Section 1553(a) provides that an expired appropriation remains available for recording, adjusting, and liquidating obligations properly chargeable to that appropriation. The 1990 amendments to the account closing law, 31 U.S.C. §§ 1551-1558, did not alter the general rule that contractual liabilities and expenditures attributable to contracts made within the period of availability of a fixed period appropriation remain chargeable to that appropriation. 55 Comp. Gen. 768, 773 (1976). See also B-245856, Aug. 11, 1992, Comptroller General Letter to the Honorable Andy Ireland. Cost growth, such as that resulting from low original estimates for raw materials, for example, is a legitimate adjustment to an obligation, and should

typically be charged to the expired appropriation as delineated by section 1553(a).

The definition of "contract change" to which you refer in your letter is found in section 1553(c)(3). It defines "contract change" as "a change to a contract under which the contractor is required to perform additional work." As you suggest, this definition does not capture "cost growth", which does not require additional work; cost growth represents an increase in the cost of an item covered by the original contract.

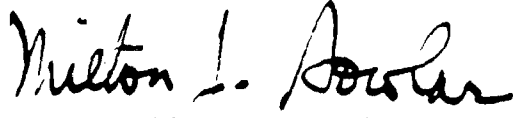
The definition of "contract change" in subsection (c), however, is not meant to delimit the availability of expired appropriations as provided in subsection (a); it applies only to the reporting requirement of subsection (c). 31 U.S.C. § 1553 (c). This point is clearly made by the language of 31 U.S.C. § 1553(c)(3), which provides that "in this subsection, the term 'contract change' means" (Emphasis added.) Hence, the definition of "contract change" only governs when the reports required by subsection (c) must be made, and was not meant to prescribe the obligational accounting for increases in obligations traditionally viewed as properly chargeable to expired accounts.

With regard to your second question, because the \$139.8 million was used to fund cost growth, the Air Force was not required to provide congressional committees with notification of its action. Section 1553(c)(2) requires agencies to notify specified congressional committees whenever the obligation of expired appropriations of a fixed appropriation account for contract changes for a program, project or activity would cause the total amount obligated from that appropriation during a fiscal year for that program, project or activity to exceed \$25 million. Reporting is required only of obligations to cover contract changes as that term is defined in section 1553(c)(3). As discussed above, the definition of "contract change" does not include "cost growth."

We trust that this responds to your request. Because you requested our views on an expedited basis, we were not able to confirm the Air Force's position that the increased costs

of its C-17 contract resulted solely from cost growth or to otherwise develop the facts as you have described them. If we can be of further assistance, please let us know.

Sincerely yours,

for 
Comptroller General
of the United States

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