United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations, Committee on Government Reform, House of Representatives

For Release on Delivery
Expected at
10 a.m. Thursday,
July 26, 2001

CANCELED DOD APPROPRIATIONS

$615 Million of Illegal or Otherwise Improper Adjustments

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Accountability * Integrity * Reliability

GAO-01-994T

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me here today to discuss the Department of Defense's (DOD) adjustments to canceled appropriation accounts. Our related report,[1] issued today and developed at the request of this Subcommittee and the House Budget Committee, describes DOD's problems in establishing the requisite systems, controls, and managerial attention to properly account for its disbursements. My testimony today will summarize the detailed findings included in our report.

In 1990, the Congress changed the law governing the use of appropriation accounts because it determined that controls over them were not working.[2] Committee reports and other statements relating to the legislation show that members of the Congress were concerned that the Congress had inadequate control over the expenditure of hundreds of millions of dollars of expired appropriations, particularly at DOD. Without adequate control, the Congress was concerned that agencies could disburse money in amounts and for purposes that it had not approved. The 1990 law was intended to improve congressional control by providing that, 5 years after the expiration of the period of availability of a fixed-term appropriation, the appropriation account be closed and all remaining balances canceled. After closing, the appropriation account could no longer be used for obligations or expenditures for any purpose.

Because agencies need to keep accurate records, they may, in limited circumstances, adjust accounting records pertaining to closed accounts to correct unrecorded or improperly charged disbursements. To justify such an adjustment, an agency must have sufficient documentation for each proposed adjustment to show that it clearly meets each of the following three criteria:

- the disbursement was made when the appropriation account to be charged was available to cover the disbursement,
- the agency either did not record the disbursement when it was made or charged it to the wrong appropriation account at that time, and

[1] *Canceled DOD Appropriations: $615 Million of Illegal or Otherwise Improper Adjustments* (GAO-01-697, July 26, 2001).

[2] National Defense Authorization Act for Fiscal Year 1991 (Public Law 101-510, dated November 1990).

- the proposed adjustment will result in the disbursement being charged to the proper appropriation account.

From the enactment of the 1990 law through September 30, 1999, DOD requested that the Department of the Treasury (Treasury) make adjustments affecting 333 closed accounts valued at $26 billion. By comparison, during the same period, all other federal agencies combined requested that Treasury make adjustments affecting only 21 closed accounts valued at $5 million.

According to DOD, adjustments affecting closed appropriation accounts during fiscal year 2000 exceeded $2.7 billion. Amid concerns over the magnitude of DOD adjustments affecting closed appropriation accounts and whether they complied with the 1990 account closing law, you and the Chairman of the House Budget Committee asked that we review the adjustments. Our review focused primarily on large dollar value adjustments made during fiscal year 2000, representing $2.2 billion (81 percent) of the $2.7 billion of DOD's reported closed appropriation account adjustments made during fiscal year 2000.

Illegal or Otherwise Improper Adjustments

Our review of $2.2 billion of DOD's fiscal year 2000 adjustments affecting closed appropriation accounts found that about $615 million (28 percent) of the adjustments were illegal ($146 million) or otherwise improper ($469 million). As shown in table 1, these adjustments to closed accounts should not have been made for four reasons.

Table 1: Fiscal Year 2000 Illegal or Otherwise Improper Adjustments

(Dollars in millions)

Problem with adjustment	Adjustment amount
Appropriation already canceled when disbursement was made	$107.7
Appropriation not yet enacted when disbursement was made	38.2
No adjustment was necessary	364.0
Insufficient documentation	104.9
Total	**$614.8**

The following is an explanation of each of the four categories of adjustment problems.

Appropriation Already Canceled

The 1990 account closing law specifically provides that closed appropriation accounts are not available for expenditures. We found that about $108 million of the adjustments resulted in charging appropriation accounts that had closed before the disbursements were made. These adjustments produced the same result as if DOD had made expenditures from and charged closed appropriation accounts at the time the disbursements were made. Therefore, these adjustments violated the 1990 account closing law. For example, in December 1999, the Defense Finance and Accounting Service (DFAS) Columbus Center recorded an adjustment that changed $79 million of disbursements from charges against fiscal years 1993 through 1995 research and development appropriations to charges against a fiscal year 1992 research and development appropriation. According to documentation in the contract files, the adjustment was to correct previous disbursing errors by redistributing the payments in accordance with the payment terms specified in the contract. The payment terms of the contract specified that payments should be made using “oldest funds first.” Under this instruction, payments should be charged to the oldest appropriation cited on the contract until the obligated balance has been exhausted for that appropriation. Subsequent payments are then charged to the next oldest available appropriation, and so on, until all the funds are used up or the contract is complete. Making the adjustment that charged the $79 million disbursement to the closed fiscal year 1992 research and development account used up the unspent balances in that appropriation account and freed up funds on still open 1993 through 1995 research and development appropriation accounts for other disbursement charges.

We found that charging the $79 million of disbursements to the fiscal year 1992 research and development appropriation was illegal because the disbursements were made in February 1999—4 months after the fiscal year 1992 research and development appropriation account had closed on September 30, 1998. DFAS Columbus officials agreed that the adjustment violated the 1990 law and should not have been made. Our report, issued today, includes several additional examples of this type of illegal adjustment.

Appropriation Not Yet Enacted

Under 31 U.S.C. 1502 (a), an appropriation may be used to pay only those expenses properly incurred during the appropriation’s period of availability. However, we found that over $38 million of the closed appropriation account adjustments resulted in charging disbursements to appropriation accounts that had not yet been enacted at the time the disbursements were actually made. For example, in January 2000, a total of $21 million of disbursements charged to fiscal years 1989 and 1990 appropriations were changed to charges against fiscal years 1998 and 1999 missile procurement appropriations. Since the actual disbursements were for expenses that were incurred before the fiscal years 1998 and 1999 appropriations were enacted, charging disbursements to these two appropriations violated 31 U.S.C. 1502 (a).

Further, included in the $21 million were $9.9 million in overpayments, which the contractor identified as a return of funds that were paid from the fiscal years 1988 through 1990 appropriations. These appropriations were canceled at the time the overpayments were returned. As discussed in our companion report, the 1990 law requires that the collection of canceled funds be deposited into the Treasury as miscellaneous receipts. However, we found that instead of forwarding the overpayments to the Treasury, DFAS Columbus redistributed the $9.9 million to current and expired appropriations that were funding the still-open contract. In discussing these errors with responsible DOD officials, they agreed that the $21 million adjustment and the $9.9 million redistribution were incorrect and should not have been made. According to the officials, they plan to reverse the adjustments and determine what actions are required to correct the accounting records, including returning the $9.9 million to the Treasury.

No Adjustment Necessary

Closed account adjustments totaling $364 million were improper because the initial payments had been charged to the correct appropriations and should not have been adjusted. DOD made these adjustments during contract reconciliations to try to correct errors in recording disbursements made under the contracts. Generally, these reconciliations were initiated if DOD could not pay invoices because other disbursements had been erroneously recorded against the wrong appropriations funding contracts. For example, in November 1999, DFAS Columbus received an invoice from a contractor for $685,000. DFAS Columbus could not pay the contractor because there were not sufficient funds available in the cited accounting line to pay the invoice. As a result, DFAS Columbus reconciled the fiscal year 1988 contract, which resulted in over $590 million of adjustments affecting closed appropriation accounts. Our review of these found that $210 million of the adjustments should not have been made because the actual disbursements—some of which were made over 10 years earlier—were initially recorded correctly. As a result of this process to free up sufficient funds to pay the $685,000 invoice, DFAS Columbus made improper adjustments affecting the closed accounts. Thus, the reconciliation resulted in at least $210 million of accounting errors that did not exist before the reconciliation took place.

Insufficient Documentation

To adjust its records, an agency must have sufficient documentation to show that the adjustment is legal and changed an incorrect charge to a correct one. However, neither DOD nor we could find sufficient documentation in DOD's accounting and contract records to support about $105 million of closed appropriation account adjustments. For example, in June 2000, DFAS Columbus made an adjustment that changed over $2.4 million of disbursements from charges against a fiscal year 1993 appropriation that had not yet been canceled to a fiscal year 1992 appropriation that had been canceled. According to the contract files, the adjustment was to correct a previous disbursing error. However, in reviewing the contract files for this adjustment, neither DOD nor we could identify the original invoice or other supporting documentation to show which appropriation should have been charged for the goods or service. We considered these types of unsupported adjustments improper because DOD must be able to provide documentation to show that the adjustments are legal and that they changed incorrect charges to correct ones. DOD is researching these transactions further to determine if additional documentation can be located to support the adjustments.

Lack of Fundamental Controls

DOD's contract reconciliation process lacked the controls necessary to ensure that adjustments to closed appropriation accounts were proper. For example, system deficiencies in DOD's Contract Reconciliation System (CRS) significantly contributed to many of the illegal closed account adjustments.[3] Specifically, CRS did not compare the actual disbursement date with the appropriation being adjusted to ensure that the adjustment met certain appropriation law requirements. DOD had been aware of the system deficiency since at least 1996, but took no action to upgrade CRS until we brought this problem to its attention. DOD officials could not tell us why they had not taken action to correct the problem, which they estimated would have cost $24,460 to fix in 1996. Had CRS been upgraded to make this comparison in 1996 when the programming defect was first identified, the $146 million of illegal adjustments made during fiscal year 2000 may not have occurred.

[3]CRS is an automated reconciliation system that has been used since 1995 by DFAS Columbus to perform contract reconciliations and to correct errors.

We also noted that DOD contracting officers were using contract modifications and other methods of communications to instruct DFAS Columbus to charge disbursements to older appropriation accounts without regard to whether adjustments would result in charging disbursements to appropriations that had been canceled. This practice, when combined with the deficiencies in CRS, resulted in some improper adjustments.

Large Number of Adjustments Exemplify DOD's Long-standing Financial Management Problems

Finally, the remaining $1.6 billion (72 percent) of the $2.2 billion of adjustments we reviewed were adequately documented corrections of errors that DOD had made over the years and, therefore, were not illegal or improper. They do, however, exemplify the broad-based, high-risk problems associated with the accuracy of DOD's payment and accounting process. As we have previously reported, DOD has long-standing, serious problems with its ability to accurately account for and report on payments to contractors, which in these cases resulted in $2.7 billion in adjustments to closed appropriation accounts in fiscal year 2000 alone. Such issues have led us to report on the DOD's financial management as an area of high risk since 1995.[4] DOD acknowledges that it has major problems with its accounting and reporting of disbursements and has various ongoing initiatives aimed at resolving them.

In conclusion, Mr. Chairman, DOD circumvented the provisions in the account closing law that were intended to strengthen the Congress' control over the amounts and purposes for which appropriated funds were spent. DOD was aware of the limitations the account closing law placed on the availability of canceled appropriations and that the law was enacted because of previous abuses by DOD's use of old appropriations. DOD also knew that a major system used to control its use of appropriations allowed for disbursements to be charged inconsistent with that law. However, it did nothing to fix the system, although it estimated the cost to do so to be minimal.

[4] GAO has designated government operations and programs as "high risk" because of either their greater vulnerabilities to waste, abuse, and mismanagement or major challenges associated with their economy, efficiency, or effectiveness. See *Major Management Challenges and Program Risks: Department of Defense* (GAO-01-244, Jan. 2001) and *High-Risk Series* (GAO-01-263, Jan. 2001).

Our companion report on these issues includes recommendations that address the need for DOD to immediately reverse and correct the $615 million of closed account adjustments we identified as illegal or otherwise improper and to take action to strengthen its policies, procedures, and controls over closed appropriation account adjustments. To the extent DOD is unable to make proper correcting adjustments because insufficient balances remain in the correct accounts, we are also recommending that DOD investigate and report on these adjustments, as required by the Antideficiency Act, 31 U.S.C. 1351, and implementing guidance.

In the longer term, DOD will need to resolve its financial management problems, including the lack of leadership and accountability that have been the subject of numerous reports and recommended corrective actions over the years. The Secretary and the Comptroller of DOD have stated their intention to vigorously pursue financial management reform and plans are being developed to transform DOD's financial management systems and practices.

Mr. Chairman, this concludes my formal statement. I would be pleased to answer any questions that you or other members of the Subcommittee may have.

Contact and Acknowledgements

For future contacts regarding this testimony, please contact Jeffrey C. Steinhoff at (202) 512-2600. Individuals making key contributions to this testimony include Bertram J. Berlin, Dennis B. Fauber, Jeffrey A. Jacobson, Mary Jo Lewnard, Larry W. Logsdon, Keith E. McDaniel, Michael S. Peacock, and Harold P. Santarelli.

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