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UNITED STATES GOVERNMENT

GENERAL ACCOUNTING OFFICE

# Memorandum

AUG 17 1977

B-132900-O.M., Nov. 1, 1977

TO : General Counsel

FROM : Director, FGMSD - D. L. Scantlebury

*D. L. Scantlebury for*

SUBJECT: Request for legal opinion on matters related to appropriation reimbursements in Air Force appropriations (Code 90362)

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GAO-100-2-1115

At the request of the Chairman of the House Appropriations Committee, we are reviewing financial management procedures in the Department of the Air Force to determine whether they have experienced problems similar to those recently found in the Army and, if so, whether appropriate corrective action has been taken.

Based on our preliminary survey work, including review of recent Air Force Audit Agency reports, we have questions about the legality of certain procedures used by the Air Force in accounting for appropriation reimbursements resulting from Foreign Military Sales (FMS). Early resolution of these issues would help us in planning the approach to and scope of our review. Details of our questions follow.

### Recording of appropriation reimbursements

FMS sales cases are established upon the execution of a Letter of Offer and Acceptance (DD Form 1513). The year in which the case is established is referred to as the case year. Although the DD Form 1513 represents authority to obligate funds on certain types of sales cases, for most types of cases assigned to the Air Force Logistics Command (AFLC), there must be a firm, definitized customer order (requisition) against the case before obligational authority is established. These requisitions may be, and often are, received in fiscal years subsequent to the case year. Also, obligations and earnings associated with the customer order may occur in even later years.

In 1976, the Air Force Audit Agency reported that procedures used to account for AFLC-managed FMS cases were not in accordance with applicable Department of Defense and Air Force directives. Customer orders, representing obligational authority, were being established (applied) in the case year, regardless of when they were received and accepted, or when funds to fill the order were obligated. The related earnings and collections for these orders were also being recorded in the case year even though obligations were incurred to support the order in subsequent fiscal year appropriations.

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The Department of Defense Accounting Guidance Handbook specifies that customer orders must be applied to the most current account available when the orders are received, and that new orders may not be recorded in a multiple-year appropriation after its first year of availability.

The practice of incurring obligations against current year accounts while applying related customer orders, earnings, and collections to the case year distorts the status of the procurement appropriation accounts. For example, the Air Force Audit Agency (AFAA) found that as of December 31, 1975, \$82.3 million in reimbursements recorded in the fiscal year (FY) 1973 Air Force Aircraft Procurement Appropriation (3010) (representing additional obligational authority to the appropriation) were derived from customer orders received subsequent to FY1973. As of December 31, 1975, \$53.2 million in obligations against these orders were recorded in fiscal years 1974, 1975, and 1976.

The Air Force Audit Agency recommended that a legal determination be made on the propriety of applying reimbursements to an appropriation year other than the year in which customer orders are definitized, accepted, and recorded and whether fund integrity includes the requirement to establish a reimbursement in the appropriation which was obligated to support the order. The Air Force subsequently requested a legal opinion but the request only addressed a new procedure which was implemented October 1, 1976. At that time AFLC changed its accounting system so that customer orders are now recorded in the year received. The objective of this change was to match reimbursements to the fiscal year account in which funds are obligated in accordance with DOD and Air Force guidelines. We have included the Air Force request and Air Force General Counsel ruling for your information (attachment I).

We would like your opinion as to whether the practice of using appropriation reimbursements in a year other than the year in which obligations are incurred to fill that order is legal.

Application of Cooperative Logistics advances

The Air Force participates in a Department of Defense FMS program known as Cooperative Logistics. The program is intended to permit foreign countries the opportunity to buy equity in the service's inventory to support weapon systems obtained from the United States. By bringing the Air Force inventory up to a sufficient level the customer country can be assured of receiving timely logistics support for its identified requirements.

Under the Cooperative Logistics program, an advance of 5/17's of the stock level case value is collected from the foreign country. The advance is intended to finance increased stockage levels to support future requirements of the foreign country. The advance is subject to upward and downward adjustment based on periodic renegotiation of Cooperative Logistics agreements.

The Air Force Audit Agency reported that the Air Force was crediting 100 percent of advances received to the 3010 Procurement Appropriation although material was being supplied from 5 sources. According to the Agency's report, at March 15, 1976, advances totaling \$42.1 million intended to finance procurement of material out of the 3020 and 3080 procurement appropriations, the Systems Support Stock Fund, and the Defense Logistics Agency Stock Fund, had been incorrectly recorded as reimbursements to the 3010 procurement account.

In our opinion the AFLC procedure of allocating 100 percent of the advances received from stock level cases to the 3010 appropriation is improper. It results in 2 procurement appropriations (3020 and 3080) and 2 stock funds using other funds to finance stockage levels used to support the needs of foreign countries.

We would like your opinion as to the legality of the procedure of allocating 100 percent of the advances on stock level cases to the 3010 appropriation although related obligations are recorded in the other 2 Air Force procurement accounts and 2 stock fund accounts.

Transfer of earnings and collections  
between Air Force procurement  
appropriations

Between May and July 1976 the Air Force made a series of accounting adjustments which resulted in the transfer of about \$7.5 million of earnings and collections belonging in the Aircraft Procurement Appropriation to the fiscal year 1973 Missile Procurement Appropriation. The transfer was made to avoid an overobligation of the missile account. In our opinion these adjustments were illegal and should be reversed. Details of the adjustments are discussed below.

FMS orders (representing obligational authority) received by the Air Force are initially recorded as unfilled orders in one of their current appropriation accounts. As deliveries of goods and services are made, orders are filled and earnings are realized in the appropriation. At any point in time, obligational authority related to FMS orders is equal to unfilled orders plus earnings (filled orders).

Prior to March 31, 1975, the criteria for determining which procurement appropriation would be used to initially finance obligations to fill various FMS orders was different from the criteria for determining which appropriation would be credited with the related earnings and collections. As a result, obligations were sometimes recorded in appropriation accounts other than those receiving related reimbursements.

Effective March 31, 1975, the Air Force changed its criteria for determining which procurement appropriation would be credited with earnings and collections from various FMS orders. Earnings and collections

realized after the effective date of the change were to be recorded in the account specified by the new criteria. Earnings and collections already recorded at the time of the change, however, were not transferred. Further, unfilled order balances (representing obligational authority) recorded under the old criteria would not be transferred initially, but would be reduced in the account in which it was originally recorded as earnings were realized in the account specified by the new criteria.

Under the old criteria, customer orders valued at \$7.5 million relating to a particular 1973 FMS case were initially recorded in the fiscal year 1973 Missile Procurement account. However, obligations incurred to fill these orders were to be recorded in the fiscal year 1973 Aircraft Procurement account. As a result of the March 31, 1975, change in criteria for recording earnings and collections, amounts earned and collected against these FMS orders after that date were required to be recorded in the Aircraft account rather than the Missile account.

Under the provisions of the change, the \$7.5 million in unfilled FMS orders (representing obligational authority) were to remain in the Missile account until obligations were incurred and related earnings realized in the Aircraft account.

A determination was erroneously made, however, that the \$7.5 million in the unfilled FMS orders in the Missile account represented free assets. Accordingly, management responsible for administering the appropriation authorized use of the funds for other purposes within the Missile account.

Subsequently, however, obligations were incurred and earnings realized from these FMS orders in the Aircraft account. As the orders were being filled in the Aircraft account, unfilled order balances in the Missile account were being reduced. Since obligations for purposes other than the FMS orders were already being incurred in the Missile account (under the assumption the unfilled FMS orders would be filled by delivery of free assets), the reduction in unfilled order balances (representing obligational authority) put the account in a position where obligations were about to exceed obligational authority, a violation of the Anti-Deficiency Act.

To avoid such a violation, the Air Force had to increase obligational authority in the fiscal year 1973 Missile account. To do this, the Air Force made a series of accounting entries which eliminated the remaining unfilled order balances relating to the \$7.5 million in orders from the fiscal year 1973 Missile account and then transferred \$7.5 million in earnings and \$7.5 million collections from the fiscal year 1975 Aircraft account to the fiscal year 1973 Missile account. All obligations relating to these FMS orders, however, remained in the fiscal year 1973 Aircraft Appropriation.

Another problem noted with the above transfers is that at the time they were made, a significant portion of the \$7.5 million had not yet been earned or collected. Thus, the Air Force moved some earnings and collections from the Aircraft Appropriation generated from sources unrelated to the \$7.5 million in FMS orders.

We would like your opinion as to whether the entries recorded by the Air Force to avoid an apparent violation of the Anti-Deficiency Act were legal.

These issues have been discussed with George Kielman of your staff. Because of the significance of the procedures being questioned in determining whether the Air Force violated the Anti-Deficiency Act and because several of the accounts involved are scheduled to lapse into the M account on September 30, 1977, we would appreciate your response as soon as possible.

Attachment

3-132900-0.3.

Indorsements:

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Director, FGMSD

Returned. The request concerns three separate matters involving the crediting of reimbursements by the United States Air Force. They are dealt with below in the order in which presented.

RECORDING OF APPROPRIATION REIMBURSEMENTS

The provisions of the Foreign Military Sales Act do not expressly address the crediting of reimbursements. However, in 3-1797000.3, December 11, 1975, we held, by analogy to other statutory provisions, that an option exists to credit Sales Act reimbursements either to the applicable account current at the time of collection or to the account which "earned" the reimbursement, i.e., financed the sale. See pages 11-12 of our 1975 memorandum. We see no basis to support the crediting of reimbursements to an account which either earned the reimbursement nor constitutes the current version of the earning account.

It is notable that those statutes relied on in our 1975 memorandum which specifically provide for the option approach refer to the current account or the earning account. See 22 U.S.C. §§ 2392(z), 2395(a), (c) and (d) (1976), quoted on pages 8-10 of the 1975 memorandum. Even apart from this, the fundamental purpose of allowing an agency to retain

reimbursements is to make whole the earning appropriation directly by crediting that account (or indirectly by credit to the current appropriation, where the earning appropriation has expired and the credit is not necessary to balance that account). Crediting reimbursements to an account which bears no relation to the transaction giving rise to the reimbursement would constitute an unauthorized augmentation of that account and would also run the risk of creating an overobligation in the account which actually earned the reimbursement.

Accordingly, the Air Force practice described in your first question was illegal to the extent that the "cash year" appropriations credited with Sales Act reimbursements did not earn such reimbursements.

#### APPLICATION OF COOPERATIVE LOGISTICS ADVANCES

Clearly the advance payments here described must be credited on a pro rata basis to the accounts used to finance the supplies for which the payments are made. Thus it would be illegal for the Air Force to credit all of the advance payments to the 3010 Procurement Account and record portions of the related obligations to other accounts. This practice would augment the 3010 Account and run the risk of overobligating the other accounts in a manner similar to the former Air Force practice described in your first question.

However, your memorandum does not specifically indicate what material was intended to be supplied at the time the advances were initially credited. It is intended that all materials would be derived from the 3010 Procurement Appropriation, the credit of advances to that account would not have been improper, although accounting adjustments would have to be made to relate the payments to the accounts which ultimately provided the supplies. The Air Force's original intent and understanding in this regard is a factual question which, we assume, can be determined by review of relevant documents.

#### TRANSFER OF EARNINGS AND COLLECTIONS BETWEEN AIR FORCE PROCUREMENT APPROPRIATIONS

As we understand the situation from your memorandum and informal conversations, this matter arises out of accounting procedures which had been used for years, which caused one procurement appropriation to be used to initially finance obligations to fill various FMS orders and another appropriation account for a different purpose to be credited with related earnings and collections. This occurred because different criteria were used for determination of which account to credit and which account to charge. Effective March 31, 1975, the Air Force changed its criteria so that the same procurement appropriation would be charged with the obligation and credited with the subsequent reimbursements

received. All parties apparently agree that the new procedure is the correct one to follow, since under the previous procedure, account balances would be distorted by the recording of obligations and subsequent reimbursements in accounts unrelated as to purpose.

In simple terms, however, the Air Force made a selective decision, after changing its old criteria, to continue recording obligations and reimbursements under one set of orders (in this case \$7.5 million in unfilled FMS orders) under the old method of accounting. This was apparently done because the 1973 Missile Procurement account was in a position where obligations were about to exceed obligational authority due to an erroneous determination that the \$7.5 million in unfilled FMS orders in the Missile Procurement account represented free assets, and those funds were accordingly used for other purposes within the Missile Procurement account.

The net effect of the Air Force adjustment in this case was to make a selective accounting entry to continue crediting reimbursements for these orders in the same manner in which reimbursements would have been credited prior to the change in criteria. This permitted all obligations relating to these FMS orders to remain in the fiscal year 1973 Aircraft Procurement Appropriation, whereas reimbursements were credited to the fiscal year 1973 Missile Procurement account. This accounting adjustment increased the cash position in the Missile Account so that moneys therein would be available to cover the misspent \$7.5 million, while increasing fund resources in the 1973 Aircraft Procurement Appropriation on the basis of orders received therein.

These entries were clearly not permitted by the Air Force's new criteria, and, in any event, they raise legal objections similar to those discussed in response to your other questions. Therefore, we agree that the entries made should be reversed.

Paul G. Dembling

Paul G. Dembling  
General Counsel

Attachment

APPROPRIATIONS

Augmentation  
Reimbursements from foreign military sales

APPROPRIATIONS

Adjustments  
Accounts receivable

Augmentation  
Missile Procurement account

APPROPRIATIONS

Deficiencies  
Antideficiency Act  
Violations

Augmentation  
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FOREIGN GOVERNMENTS

Military assistance  
Foreign Military Sales Act

Augmentation  
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PAYMENTS

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Disposition

APPROPRIATION

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Obligation  
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Violations

APPROPRIATIONS

Adjustments  
Necessity

Augmentation