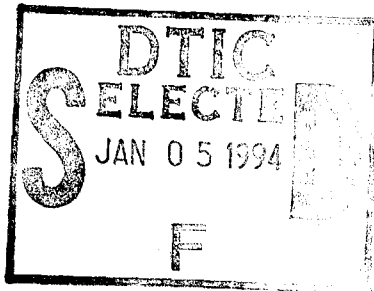


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TITLE

IMPLEMENTING PUBLIC LAW 101-510

AUTHOR

ANN-CECILE M. MCDERMOTT

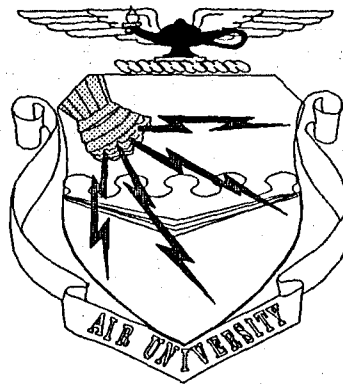
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4170 Hebble Creek Road, Suite 1

Wright-Patterson AFB OH 45433-5644

EXECUTIVE SUMMARY

Public Law 101-510 eliminated the merged "M" account and required that all unexpended appropriation balances cancel after a 5-year expired status. As a result, programs must use current appropriations to make payments chargeable against cancelled appropriations.

While these changes in fiscal rules imposed needed financial discipline on acquisition programs, improvements in the contracting arena could reduce adverse program impacts. In addition, the current law and its implementation by OSD do not recognize some valid acquisition funding requirements, the full impact on overall program execution, and prudent financial management actions to avoid Antideficiency Act violations.

Improving this situation will require coordinated efforts between the Air Force financial management and contracting communities, as well as interservice initiative support. Recommendations include (1) emphasizing the heightened importance of cost and schedule analysis to reduce the impact of cancelling appropriations, (2) establishing a joint working group and training to address interrelationships between acquisition strategies, contract structures, and financial impacts, and (3) working with Navy and Army personnel to establish and defend joint positions on commitments in expired appropriations and possible exceptions to Public Law 101-510.

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INTRODUCTION

Public Law 101-510 (Fiscal Year 1991 National Defense Authorization Act), 5 November 1990, significantly changed financial management for all of DoD. The immediate effect of this law was fairly straightforward--it eliminated the merged ("M") account as of 30 September 1993. The law also extended the expired status for all appropriations from 2 years to 5 years. Without the "M" account, however, all unexpended appropriation balances cancel when the 5-year expired status ends. (4:1-1, 2-1)

Realizing that DoD organizations cannot always complete required payments prior to cancelling the appropriations, Congress included provisions to allow programs to use up to 1 percent of current accounts to pay for prior-year bills. Investment accounts--such as Air Force procurement (3010, 3020, and 3080) and research, development, test and evaluation (3600) appropriations--are hardest hit by the "M" account loss and the requirement to use current funds to pay cancelled appropriation bills. This situation occurs because these appropriations typically fund complicated weapon system acquisitions with long performance periods and complex contract types.

Actual and perceived abuses of the "M" account certainly caused Congress to rewrite the law and impose more financial discipline on acquisition programs. While such discipline has been needed for a long time, some current Office of the Secretary of Defense (OSD) policies conflict with prudent financial management actions to avoid Antideficiency Act violations. In addition, the current law and its implementation by OSD

do not recognize some valid acquisition funding requirements or the full impact on overall program execution.

Positive impacts from this law can be heightened by (1) changes to some contracting approaches, (2) improved communication between the contracting and financial communities, (3) some revised OSD implementation policies, and (4) a few limited amendments to the law. This paper will discuss contracting and financial management possibilities, the effect of current OSD guidance and policies, and situations that may warrant exceptions to the current law. It will then provide recommendations for achieving improvements in these areas.

DISCUSSION

Contracting and Financial Management

Expenditure profiles for Air Force procurement accounts reveal that it currently takes 12-15 years to close out contracts. Under the new law, this time frame equates to 3 current years, 5 expired years, and 4-7 cancelled years. (3:1) While program personnel cannot control all factors affecting contract completion and close-out, they must take proactive steps to reduce the impact on future program funds. These actions consequently must focus on (1) determining total funds requirements, (2) paying contractors as soon as possible, and (3) structuring contracts to facilitate payments, proper accounting, and contract closeout audits.

Depending on the contract type, contractors may be reluctant to submit billings or overrun proposals that accurately reflect contract performance. For example, program personnel reduce progress payments to contractors when the contractors project overtarget cost growth on fixed price incentive contracts. Conversely, the longer contractors delay admitting that overruns will occur, the longer they receive payments at the initial rate. In addition, the perception exists that the more sunk costs a program has, the less likely it is that the service or Congress will cancel the program.

Since it may not be in the contractor's best interest to identify cost overruns early, it is imperative that program personnel carefully monitor contract cost and schedule information. By thoroughly analyzing contract performance, challenging contractor assumptions, and developing well thought out program office estimates at completion, program personnel could evaluate the need to reserve additional funds to complete the contract. In addition, contracting officers would then have a firm basis for unilaterally adjusting progress payments or taking other actions to encourage contractors to submit realistic billing price adjustments and overrun proposals. This, in turn, would allow program personnel to identify funds requirements and pay contractors earlier.

Program personnel have more opportunity to proactively influence new contracts. Given the elimination of the "M" account, program personnel must consider the appropriation life when they establish contract performance periods. One possibility is to split performance into smaller contracts that can be consecutively closed out as performance is completed. An example of this approach would be to issue separate

contracts to obtain long-lead items and follow-on production options. Current production contracts frequently include these long-lead purchases and production options as separate line items on a single contract. Of course, the financial management benefits of this approach must be weighed against the additional time and costs associated with awarding and administering more contracts. It may nevertheless be worth evaluating the source selection process to determine whether programs can award a basic contract with a "package" of related optional contracts or ordering agreements. This strategy could reduce the time and cost related to totally separate contract awards.

In addition to contracting for shorter performance periods, contracting personnel must consider the effects of contract structure on payment actions. DoD has already directed the services to greatly reduce their use of special Accounting Classification Reference Numbers (ACRNs) created by combining fund cites. Further action is required, however, because incorrect accounting records and payments made against improper ACRNs are negatively impacting future program budgets.

Improving the accounting record accuracy and timeliness is crucial, since OSD bases program budget cuts on obligation and expenditure rates reflected in the DoD accounting records. To improve this situation, program personnel need to understand how contract structure, including the use of numerous ACRNs and contract line items, can affect accounting accuracy and timely payments to contractors. Training sessions and improved communication between the financial and acquisition communities could help resolve this

situation by highlighting ways to structure contracts to facilitate timely payments and accurate accounting while still effectively directing contractor performance.

OSD Guidance and Policies

The DoD Comptroller maintains that commitments for contingent liabilities are unobligated appropriation balances that are available to pay any upward obligation properly payable from that account. (5:2) While it is understandable that OSD does not want to prematurely declare Antideficiency Act violations, the DoD Comptroller position is inconsistent with prudent financial management. Further, this position does not reflect the fiscal integrity mandated by Public Law 101-510.

Both the Antideficiency Act (31 U.S.C. 1512(c)) and the Impoundment Control Act (2 U.S.C. 684(b)) recognize funds reservations for contingent liabilities. (5:2) In fact, the DoD Accounting Manual (2:21-7) specifically states that

The allottee is responsible for reserving funds to cover the Government's potential or contingent liability under the contract. If the allotment becomes overobligated or overexpended because of...failure to reserve sufficient funds to cover contingencies, a violation of 31 U.S.C. 1517(a) has occurred. If such a violation...causes an overobligation or overexpenditure of an appropriation, a violation of 31 U.S.C. 1341(a) also has occurred.

Clearly, program and financial managers have a legal responsibility to reserve funds to cover estimated liabilities under the contract. This responsibility is likewise reflected in the detailed guidance the DoD Accounting Manual provides for recording contingent liability commitments in current appropriations. The manual further states that "Amounts to cover these contingent liabilities should be carried as outstanding commitments pending determination of actual obligations." (2:25-1-2) It is therefore illogical that the DoD Accounting Manual also requires the services to cancel outstanding commitments when the appropriations expire! (2:24-3) The mere change in appropriation status has done nothing to lessen the liability to the contractor or the associated funds requirement!

In my opinion, OSD's refusal to recognize valid commitments in expired accounts undermines service strategies to exercise responsible financial management and avoid Antideficiency Act violations. These strategies were evident when the Air Force requested approval in June 1993 to use current funds to pay a prior-year claim settlement on the Joint Surveillance Tactical Air Reconnaissance System (JSTARS) program. The DoD Comptroller nevertheless denied the request and directed the Air Force to use unobligated commitments in expired accounts to pay the contractor. The Air Force consequently had no choice but to direct other weapon system programs to decommit funds to pay the JSTARS bill.

In the JSTARS case, it appears that OSD did not trust the Air Force's assessment of its financial status. However, it is unreasonable to assume that the services would frivolously request to use current funds to pay expired appropriation bills since they must declare a potential deficiency when they make the request. The services would certainly first verify that no legitimate decommitments or deobligations could be made to provide the needed funds! The DoD Comptroller should consequently allow the services to establish and maintain commitments in expired appropriations, include the commitment information on the Budget Execution reports (DD-1176), and allow services to use current funds when inadequate uncommitted expired year funds are available for payment.

Exceptions to Public Law 101-510

In my opinion, the new law's primary intent was to require program managers to fully identify funds requirements and manage acquisitions within appropriated amounts. Consequently, it does not seem reasonable that Congress intended current programs to become unexecutable because current accounts fund significant payments relating to cancelled appropriations. This situation appears particularly illogical when (1) adequate unexpended balances remain in the cancelled appropriations to cover the prior-year bills, and (2) the program managers could not significantly influence or control the timing of the payment.

Contractor claims and litigation frequently fall in this category. For example, contractors typically file claims after the appropriation has expired, and it is not unusual for settlement to take several years. By this time, affected appropriations have probably cancelled. A similar situation exists for foreign currency fluctuations. In March 1994, the Navy proposed two initiatives addressing these non-discretionary cost increases in investment appropriation programs. These initiatives request Secretary of Defense transfer authority among expired appropriations and expansion of the current Foreign Currency Fluctuations account to include investment appropriations. (1:1-2) Since these situations affect all services, it would be in the services' best interests to work together to present a unified position to OSD and obtain any required Congressional approvals.

CONCLUSION

Public Law 101-510 has brought needed changes to financial management in weapon system acquisitions. Air Force personnel can heighten positive impacts from the law by (1) changing some contracting approaches and management for new and existing contracts, and (2) improving communication between the contracting and financial communities. These actions would facilitate funds management and contract close-out and reduce the impact on future program funds. Nevertheless, strategies to exercise prudent financial management and avoid Antideficiency Act violations cannot be successful unless OSD revises commitment guidance and implementation policies for the law. It would consequently behoove the Air Force to work with the other services to convince OSD to (1) change its fiscal policy and related guidance, and (2) work to get Congress to recognize valid exceptions to the Public Law. Otherwise, acquisition programs risk

unnecessary deficiencies and funding shortfalls as current year dollars are depleted to pay for prior-year bills. This could result in programs becoming unexecutable and could consequently invite program cancellations.

RECOMMENDATIONS

The Assistant Secretary of the Air Force, Financial Management, in coordination with the Assistant Secretary of the Air Force, Acquisition, should take the following actions:

- a. Emphasize the heightened importance of accomplishing thorough cost and schedule analyses to establish realistic program office estimates at completion for contracts. This emphasis should highlight the need to obtain timely overrun proposals and billing price adjustments so programs can (1) obligate and expend funds prior to appropriation cancellations, and (2) determine the impact on the program's future funds.
- b. Establish a joint working group and associated training to address acquisition strategies and contract structures that minimize adverse financial impacts under Public Law 101-510.
- c. Work with Navy and Army financial management and acquisition personnel to (1) convince the DoD Comptroller that commitments in expired accounts are vital to service strategies to exercise responsible financial management and avoid Antideficiency Act violations, and (2) obtain OSD and Congressional approval for valid exceptions to Public Law 101-510 requirements.

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