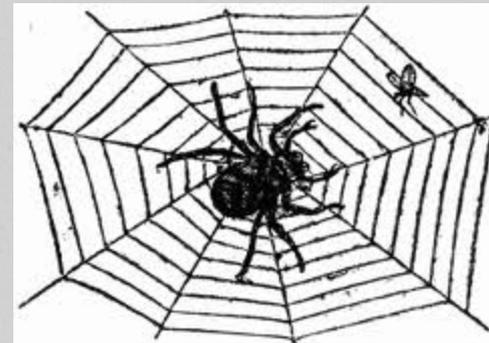


Obligations and Cobwebs

by Ed Martin, Jan Smith, and Bing Bradshaw



What is an obligation?

- Spending money is something we all understand
- An “obligation” is one action in the Federal spending process
- Appropriations laws establish whether funds are available to obligate
- The concept of obligation is central to appropriations law

OMB Circular No. A-11

An obligation is:

- o A binding agreement that will result in outlays, immediately or in the future.*
- o Budgetary resources must be available before obligations can be incurred legally.*

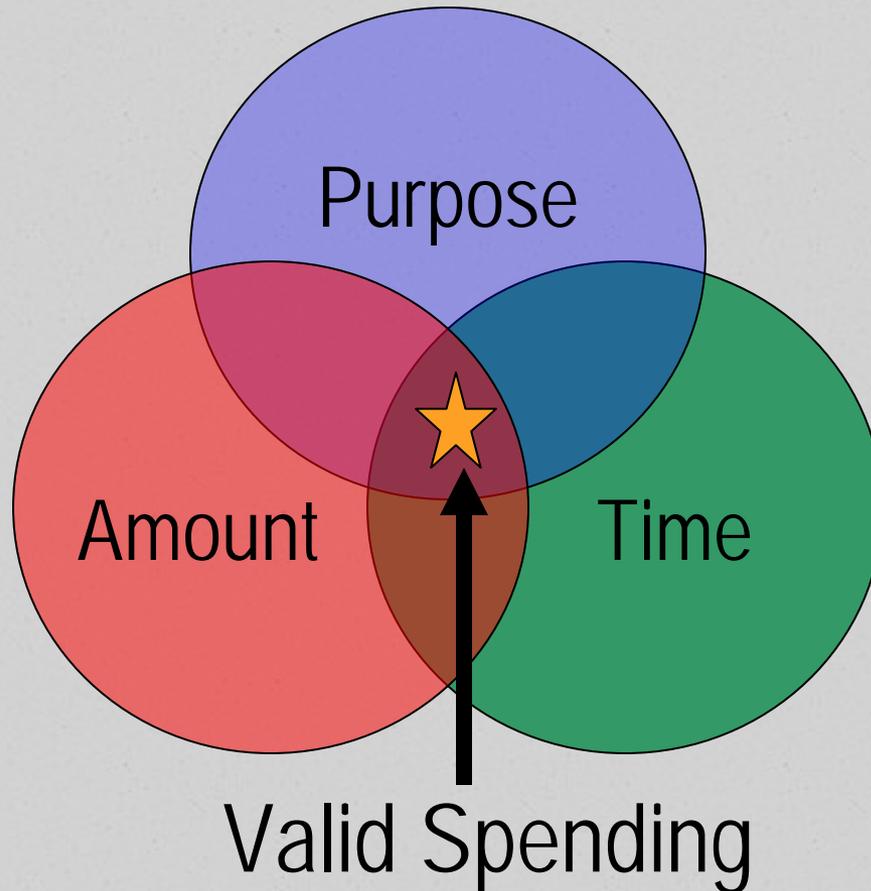
How do obligations relate to the other actions in the spending process?

- o A law **appropriates** funds, called budgetary resources (budget authority and balances of BA)
- o OMB **apportions** the budgetary resources
- o The head of the agency **allots** the budgetary resources through the budget staff
- o Agency procurement staff **obligate** the budgetary resources
- o Agency financial staff **certify** the bill to be paid.
- o Treasury disbursing officers disburse the funds, i.e. **outlay the cash**

Appropriations Law Context

- o All federal spending must follow the principles of appropriations law
 - o Spend only for **purposes** authorized by law (31 USC 1301)
 - o Don't spend more than the **amount** appropriated or before it is appropriated (31 USC 1341)
 - o Spend only during **time** period provided for a Bona Fide need of that time period (31 USC 1502)

Appropriations Law Context



What is needed to Obligate?

- o A budgetary resource (31 USC §1341(a))
- o A funds control process
 - o Apportionment (31 USC §1517)
 - o Allotment/Allowance (31 USC §1514)
- o Documentary evidence (31 USC §1501)
- o Certifications and records (31 USC §1108)



Why Documentary evidence?

- o Before 1954:
 - o No uniform meaning of obligation
 - o Agencies recorded “bogus” obligations where none existed to keep funds from lapsing
 - o Appropriations Committees could not obtain reliable obligation amounts
 - o Actual agency needs not clear

- o Led to passage of section 1311, Supplemental Appropriations Act, 1955 (P.L. 83-663) – codified at 31 USC §1501
- o Established standards for proper recording of obligations
- o Ensures that agencies record only those transactions which meet specified standards for legitimate obligations

Evidence of what?

You must be able to support the amounts reported by the documentary evidence required by 31 U.S.C. 1501 of

- (1) a binding agreement between an agency and another person (including an agency), that is, a **contract**.
- (2) a **loan agreement** showing the amount and terms of repayment
- (3) an **order** required by law
- (4) an **order** issued under a law
- (5) a **grant or subsidy** payable
- (6) a liability that may result from **pending litigation**
- (7) **employment or services of persons** or **expenses of travel** under law
- (8) services provided **by public utilities**
- (9) **other legal liability** of the Government against an available appropriation or fund.

Must you Record an Obligation?

- o If any of the previous criteria are met, the agency *must* record the transaction as an obligation
- o Recording provides evidence of the obligation, but *does not* create it
- o If a transaction doesn't meet one of the previous criteria, recording will not make it valid
- o Failing to record a valid obligation does not diminish its validity or change the FY to which it is properly chargeable

What rules apply in terms of timing and amount

- A. The general rule
- B. Personnel compensation and benefits
- C. Contractual services and supplies
- D. Intragovernmental services and supplies
- E. Land and structures
- F. Grants and fixed charges
- G. Federal credit programs

A. The General Rule

- o Obligation means a legally binding agreement that will result in outlays, immediately or in the future.

- o You incur an obligation when you:
 - o place an order,
 - o sign a contract,
 - o award a grant,
 - o purchase a service, or
 - o take other actions that require the Government to make payments to the public or from one Government account to another.

B. Personnel compensation and benefits

- o For personnel compensation and benefits the issue is usually the "timing" of the obligation and not the "amount" of the obligation.
- o The amount is prescribed by laws that cover the civil service and the uniformed service and determined by well-established personnel procedures.
- o As for the timing of the obligation, the amounts generally are recorded as obligations as the amounts are earned during the reporting pay period, with some exceptions:

B. Exceptions – cont'd.

1. Severance Pay
2. Relocation Expenses
3. Cash Awards
4. Allowances for Uniforms & Quarters
5. Subsidies for Commuting Costs
6. Unemployment Compensation Costs to Labor
7. Annual Leave
8. Funded Annual Leave

B.-cont'd -- Exceptions

- o **Severance pay** is obligated at the time paid on a pay period by pay period basis because the severance pay is not earned with regular salaries and wages.
- o Authorized reimbursable expenses estimated to be paid to employees for real estate, temporary subsistence, and other **expenses incident to relocation** at the request of the Government is obligated when the individual orders are approved because the travel is a bona fide need at the time the order is approved.

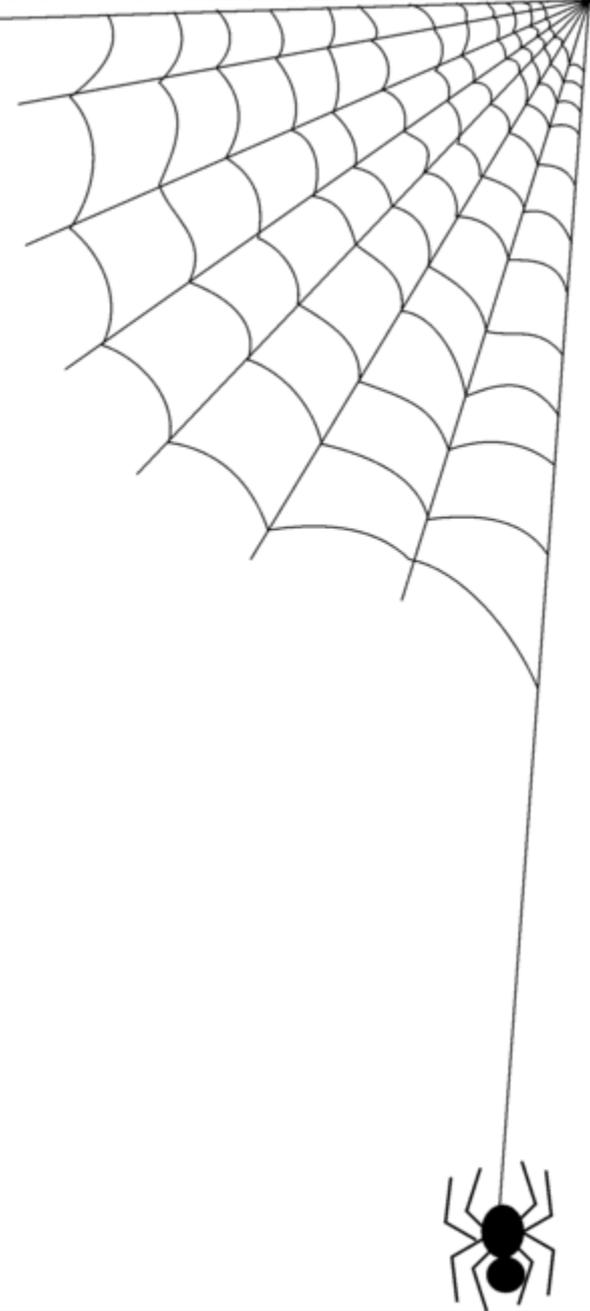
B.-cont'd -- Exceptions

- o **Cash awards** that do not become part of the employee's basic rate of pay,
- o **allowances** for uniforms and quarters, and
- o subsidies for **commuting costs** are obligated when payable to the employee because this is the time the amount is definite.

B.-cont'd -- Exceptions

- o **Unemployment compensation** payments to the Department of Labor for former employees are obligated when the agency receives the bills rendered by Labor because of the underlying law.
- o **Annual leave** is obligated when it becomes due and payable as terminal leave or taken in lieu of a lump sum payment because annual leave is normally unfunded

C. Contractual services & supplies



C. Contractual services & supplies

- Services and supplies that are purchased by contract are recorded as obligations at the time there is a binding agreement, which is usually when the contract is signed.
- As a general rule, the amount of the obligation is the maximum liability to the Federal Government. The maximum liability to the Government is normally limited by the terms of the contract (e.g., cancellation clauses).

Bona Fide Need

- o Annual appropriations are available only to meet *bona fide* needs of the fiscal year for which they were appropriated. Originally, these are not available to meet the needs of future fiscal years.
- o If an agency fails to obligate its annual funds by the end of the fiscal year for which they were appropriated, they cease to be available for incurring and recording new obligations and are said to have “expired.”
- o Annual appropriations remain available for an additional five fiscal years beyond expiration, however, to adjust and make payments to liquidate liabilities arising from valid obligations made within the fiscal year for which the funds were appropriated.

- o You can not use this year's appropriations for the needs of the next fiscal year.
- o Except...

Severable versus Non-Severable

- When a need arises in one fiscal year for services that, by their nature, cannot be separated for performance in separate fiscal years.
- The Comptroller General has held that the question of whether to charge the appropriation current on the date the contract is made, or to charge funds current at the time the services are rendered, depends upon whether the services are “severable” or “entire”.

Non-severable

- o A contract that is viewed as non-severable or “entire” is chargeable to the fiscal year in which it was made, notwithstanding that performance may have extended into the following fiscal year. The term non-severable is also used in place of entire.
- o The determining factor for whether services are severable or entire is whether they represent a single undertaking.
- o Thus, in 23 Comp. Gen. 370, a contract for the cultivation and protection of a tract of rubber-bearing plants, payable on completion of the services, was chargeable against fiscal year funds for the year in which the contract was made.
- o Because the services necessarily covered the entire growing period, which extended into the following fiscal year, the Comptroller General characterized them as a single undertaking, which “although extending over a part of two fiscal years, nevertheless was determinable both as to the services needed and the price to be paid therefor at the time the contract was entered into.”

Severable

- o However, where the services are continuing and recurring in nature, such as rent, the contract is severable. Service contracts that are severable may not cross fiscal year lines unless authorized by statute.
- o BUT most federal agencies have authority to enter into a 1-year severable service contract, beginning at any time during the fiscal year and extending into the next fiscal year, and to obligate the total amount of the contract to the appropriation current at the time the agency entered into the contract.

Nuance of Contracts with Certain Characteristics

- o For contracts with a **maximum price**, the amount obligated is the maximum price at the time the contract is signed. Then the amount is adjusted downward (i.e., deobligated) when there is documentary evidence that the price is reduced.
- o For **letters of Intent** and **letter contracts** normally no amount is obligated at the time the letter is signed. Except if the letter constitutes a binding agreement under which the contractor is authorized to proceed, then the maximum amount indicated in the letter is obligated at the time the letter is signed.

Nuance of Contracts-cont'd

- o For **contracts for variable quantities followed by “purchase orders”**, usually no amount is obligated at the time the contract is signed. Instead when the purchase order is issued, the amount of the actual order is obligated when the order is issued.
- o Sometimes these are called indefinite delivery indefinite quantities (IDIQs)

D. Intragovernmental services and supplies

- Obligations are incurred for services when the materials or services are ordered using a memorandum of understanding (MOU) or a military interdepartmental purchase request (MIPR).
- The laws under which you make purchases from another Federal government account vary widely from the **Economy Act** to the laws applying specifically to each **revolving fund**, including franchise funds and working capital fund, or other laws such as the Foreign Assistance Act.
- Each will have to be discussed separately. But there is one **GAO case** that is likely to apply, it is called **FEDLINK**.

FEDLINK

- o The precise parameters of transfer authority will, of course, depend on the terms of the statute which grants it. The analytical starting point is the second sentence of 31 U.S.C. § 1532:
- o “Except as specifically provided by law, an amount authorized to be withdrawn and credited [to another appropriation account or to a working fund] **is available for the same purpose and subject to the same limitations provided by the law appropriating the amount.**”

FEDLINK – cont'd

- o In a 2001 decision, the Comptroller General found that funds withdrawn from other agencies' appropriations and credited to the Library of Congress FEDLINK revolving fund retained their time character and did not assume the time character of the FEDLINK revolving fund.
- o The Library of Congress proposed retaining in the fund amounts of fiscal year money advanced by other agencies in earlier fiscal years when orders were placed and, to the extent the advances were not needed to cover the costs of the orders, applying the excess amounts to new orders placed in subsequent fiscal years. The Library pointed out that the law establishing the revolving fund made amounts in the fund available without fiscal year limitation.
- o The Comptroller General concluded that "amounts withdrawn from a fiscal year appropriation and credited to a no year revolving fund, such as the FEDLINK revolving fund, are available for obligation only during the fiscal year of availability of the appropriation from which the amount was withdrawn."

FEDLINK – cont'd.

- The Comptroller General noted that section 1532 is a significant control feature protecting Congress's constitutional prerogatives of the purse. Placing time limits on the availability of appropriations is a fundamental means of congressional control because it permits Congress to periodically review a given agency's programs and activities.
- Given the significance of time restrictions in preserving congressional powers of the purse, GAO looks for clear legislative expressions of congressional intent before interpreting legislation to override time limitations that Congress, through the appropriations process, has imposed on an agency's use of funds.
- The Comptroller General rejected the Library's view that the language in the FEDLINK statute overrode the time limitation imposed on funds transferred into FEDLINK because, until the Library had earned those amounts by performing the services ordered from the Library, these transferred amounts were not a part of the corpus of FEDLINK. Id.

FEDLINK – cont'd.

- o The FEDLINK decision references a situation that GAO addressed in 1944 with regard to a **no-year revolving fund** called the Navy Procurement Fund.
- o The Navy incorrectly believed that because the revolving fund was not subject to fiscal year limitation, advances to the fund made from annual appropriations were available until expended.
- o A number of other GAO decisions, several predating the enactment of 31 U.S.C. § 1532, have made essentially the same point—that, except to the extent the statute authorizing a transfer provides otherwise, transferred funds are available for purposes permissible under the donor appropriation and are subject to the same limitations and restrictions applicable to the donor appropriation.

E. Land and structures

Contracts for lands and structures generally follow the same rules as for contracts specified above with the following exceptions:

- o In the case of condemnation proceedings, the amount obligated is the estimated amount for the price of the land, adjusted to the amount of the payment to be held in escrow where there is a declaration of a taking. It is obligated at the time when you ask the Attorney General to start condemnation proceedings.

- o In the case of lease purchases and capital leases covered by the scorekeeping rules developed under the Budget Enforcement Act, see the requirements in Appendix B of OMB Circular No. A-11.

F. Grants and fixed charges

Discretionary grants will be obligated after the amounts are determined administratively and recorded at the time the grant award is signed. The grant award is normally the documentary evidence that the grant has been awarded. Letters of credit are issued after the grant awards are made and generally are not obligating documents.

For grants and fixed charges with **formulas in law** that automatically fix the amount of the charges, record the amount determined by the formula or, if there is an appropriation, then record the amount appropriated, whichever is smaller. The obligation is reported at the time the grantee is awarded the grant and is liquidated when the payment is made to the grantee. To the extent that a grant awarded in a previous year is no longer valid, you will record a recovery of prior year obligations. The exceptions follow:



F. Grants – cont'd.

- o **Grants for “in lieu of taxes”** are obligated after the amounts are appropriated at the time the amounts are due.
- o **Interest** is obligated in the amount owed at the time the interest is payable.
- o **Dividends** are obligated in the amount declared at the time the dividend is declared.

G. Federal credit programs

- o For the subsidy in the direct loan program accounts, the amount obligated is the portion of the subsidy cost for the direct loan contract that you are signing at the time you sign the direct loan contract.
- o For the subsidy in the guaranteed loan program account, the amount obligated is the portion of the subsidy cost for the binding agreement to make a loan guarantee at the time you make the loan guarantee commitment.

Problem Areas

- Monitoring (“house-cleaning”) undelivered orders (UDOs). An UDO is obligated. You have 5 fiscal years after the appropriation expires to pay the bill. Then the expired appropriation is cancelled which means you have to pay it out of your unexpired appropriation.
- Incurred but not reported (IBNR). Normally you reserve unobligated balance for the estimated amount of the claim.
- Entitlements – there are very few true entitlements and the few that exist are because of a Federal law and Congress can always change that law.
- Refunds – depends on the laws that apply

Legal requirement for certifying obligations

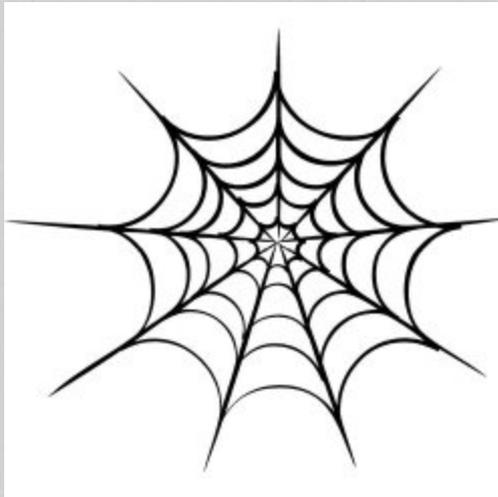
(c) The head of an agency shall include with an appropriation request submitted to the President a report that the statement of obligations submitted with the request contains obligations consistent with section 1501 of this title. The head of the agency shall support the report with a certification of the consistency and shall support the certification with records showing that the amounts have been obligated. The head of the agency shall designate officials to make the certifications, and those officials may not delegate the duty to make the certifications. The certifications and records shall be kept in the agency—

- (1) in a form that makes audits and reconciliations easy; and
- (2) for a period necessary to carry out audits and reconciliations.

OMB Circular A-11 on Agency Certification

- When year-end FACTS II information is submitted, the information must not only pass a number of FACTS II edit-checks, but a person separate from the "preparer" (i.e. data entry person) named a "certifier" must certify that the information is correct.
- In addition, GAO requires your auditors to determine whether controls exist to ensure that the amounts in your systems and the amounts submitted via FACTS II agree. See GAO-02-126G "Guide for Auditing the Statement of Budgetary Resources".

Questions?



Disclaimer

- o This presentation cannot substitute for the application by the Office of the General Counsel (OGC) of appropriations law to the facts and circumstances of a particular situation and should not be used as the sole basis for decision-making.
- o If there is any question concerning the application of appropriations law, you must seek the advice of your agency's OGC.

THE END

