



# Office of Inspector General

## Audit of VA Medical Center Use of Prior Year Funds for Nonrecurring Maintenance Construction Projects

*VA medical centers need additional guidance to help ensure the appropriate use of prior year funds.*

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Office of Inspector General  
Washington DC 20420



**DEPARTMENT OF VETERANS AFFAIRS**  
**Office of Inspector General**  
**Washington DC 20420**

**Memorandum to:**  
**Under Secretary for Health (10)**  
**Acting Assistant Secretary for Management (004)**

**Audit of VA Medical Center Use of Prior Year Funds for  
Nonrecurring Maintenance Construction Projects**

1. The purpose of the audit was to evaluate the effectiveness of VA's management of the use of prior year (PY) funds to pay for work on nonrecurring maintenance (NRM) construction projects. PY funds, which are also called expired funds, are the residual unobligated funds remaining in an appropriation account at the end of a fiscal year (FY). In 1990, Congress passed the Expired Funds Control Act to address a concern that Federal agencies could accumulate PY funds from several appropriation years and could use these funds as "slush funds" to pay for contract changes or additional contract work that was outside the original scope of contracts as approved and funded by Congress. The Act required agencies to establish controls to ensure that PY funds were used only for valid contract obligations of the year covered by the appropriation.
2. In VA, responsibility for monitoring the use of PY funds was assigned to the Office of Financial Policy (OFP). The OFP established procedures under which VA medical centers (VAMCs) were required to obtain OFP approval to use PY funds to pay for contract changes on NRM contracts. PY funds were supposed to be used only to pay for contract changes that were within the scope of the contract. During the 4-year period FYs 1993 - 1996, VAMCs requested and OFP approved \$45.9 million in PY funds for use on NRM projects, an average of \$11.5 million a year. However, the actual amount of PY funds used was probably significantly larger, since our audit found that VAMCs had used PY funds without obtaining OFP approval.
3. To evaluate the effectiveness of VA management of PY funds, we analyzed OFP data on VAMC requests for PY funds and we reviewed the use of PY funds on 12 NRM projects at 4 VAMCs. We concluded that the Veterans Health Administration (VHA) and OFP had not established adequate controls to ensure that PY funds were properly requested and used only for work within the scope of contracts. Because of the absence of controls, VAMCs were not adequately complying with VA policy on PY funds, and there was a risk that some VAMCs could be viewed as using PY funds as slush funds for expanding projects without approval, for completing unnecessary or questionable construction, and for correcting avoidable mistakes in project management.
4. The audit found that it was possible for VAMCs to use PY funds without requesting OFP approval. During the 3-year period FYs 1993 - 1995, there were 20 VAMCs that never requested

approval to use PY funds. Of the 12 projects we reviewed, 6 were at 2 of these 20 VAMCs. The two VAMCs had used PY funds on all six projects. They were able to do this because they had PY funds in station-level accounts. VAMC staff did not understand that the requirement for OFP approval applied to all PY funds, including those in station-level accounts.

5. On 11 of the 12 projects reviewed, PY funds were used to pay for additional work that was outside the scope of the contracts. On 9 of the 11 projects, VAMCs used PY funds to expand the scope of work covered by the contracts. There were four ways in which PY funds were inappropriately used to expand the scope of projects: (1) constructing unapproved new space; (2) expanding limited renovation projects to include structural remodeling; (3) expanding renovations approved for one area of a building to additional areas; and (4) adding back in work that had been included in the contractor's bid but that had been deleted from the contract because of funding limitations. On the other two projects, the VAMCs requested PY funds for the projects but used the funds for work that was not related to the projects.

6. The audit also found that there was a strong relationship between the high usage of PY funds and inadequate NRM project planning and management. On 7 of the 12 projects reviewed, VAMCs incurred additional costs by using PY funds to address problems that could have been avoided or mitigated if the VAMCs had followed existing NRM project management guidance. We identified three types of project management deficiencies associated with high use of PY funds: (1) beginning construction before project plans were completed; (2) awarding contracts for amounts higher than the funding approved for the projects and then making up the differences by using PY funds; and (3) not adequately testing for potential adverse site conditions that could reasonably be expected to increase project costs.

7. VHA and OPF recently took an important step toward addressing the audit issues by agreeing to transfer responsibility for monitoring PY funds from OFP to the VHA Chief Financial Officer. We recommended that, in addition to following through on this agreement, VHA and OPF work together to: (1) establish effective controls to ensure that VAMCs properly obtain approval to use PY funds and use these funds only for work within the approved scope of projects and contracts; (2) issue policy guidance on the appropriate use of PY funds; and (3) provide VAMC staff with training on PY funds policies and procedures. Implementing the audit recommendations will help ensure that PY funds are used appropriately and will improve the NRM construction program by preventing VAMCs from unnecessarily expanding the scope of projects and by helping to identify projects that might have construction problems that require management attention. We estimate that better controls could reduce PY funds usage by about \$3.81 million a year.

8. The Under Secretary for Health and the Acting Assistant Secretary for Management concurred with the audit recommendation and provided an acceptable implementation plan. We consider all audit issues resolved and we will follow up on the completion of planned corrective actions.

For the Assistant Inspector General for Auditing

*(Original Signed By:)*

DAVID SUMRALL

Director, Seattle Audit Operations Division

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## **Introduction**

The purpose of the audit was to evaluate the effectiveness of VA's management of the use of prior year (PY) funds to pay for work on nonrecurring maintenance (NRM) construction projects. PY funds, which are also called expired funds, are the residual, unobligated funds remaining in an appropriation account at the end of a fiscal year (FY). NRM projects are projects designed to maintain, repair, and modify VA facility buildings and infrastructure.

In November 1990, Congress passed the National Defense Authorization Act of 1991, which in VA is commonly called the Expired Funds Control Act. The purpose of the Act was to address the concern that Federal agencies could accumulate PY funds from several years in accounts called "merged" or "M" accounts and could then use these accounts as "slush funds" that had little Congressional oversight. There was particular concern that PY funds could be used to pay for contract changes that were outside the original scope of contracts as approved and funded by Congress. The Act reiterated the long-standing principle of appropriation law that expired funds from a particular year's appropriation may only be used to increase existing contract obligations to meet valid needs of that year and may not be used for new obligations of a different year. The Act required agencies to phase out M accounts and to establish controls to ensure that PY funds were used only for valid contract obligations of the year covered by the appropriation.

In VA, the Office of Financial Policy (OFP) under the Assistant Secretary for Management was assigned responsibility for implementing the Expired Funds Control Act and for monitoring the use of PY funds to pay for contract changes. OFP determined that the only VA contracts covered by the Act were NRM construction contracts. These were considered to be the only VA contracts that were funded from a single-year appropriation, the Medical Care Appropriation, and that frequently involved the type of contract changes contemplated by the Act. When an NRM contract is awarded, funds to pay for the contract are obligated from a particular year's Medical Care Appropriation. After that appropriation year has ended, the residual PY funds in the expired appropriation may be used to pay for NRM contract changes. However, these changes must be within the scope of the contract -- that is, they must be a valid need of the appropriation year in which contract funds were originally obligated. To monitor the use of PY funds on NRM projects, OFP established procedures under which VA medical centers (VAMCs) were required to obtain OFP approval to use PY funds.

During the 4-year period FYs 1993 - 1996, VA spent about \$878.1 million on NRM projects. Of this amount, \$45.9 million (5.2 percent) was PY funds approved by OFP. The actual amount of PY funds used was higher because, as discussed in this report, it was possible for VAMCs to use PY funds without requesting OFP approval.

### **For More Information**

The Expired Funds Control Act, VA's NRM construction program, and other background information are discussed more fully in Appendix 1, pages 8-13.

## **Results and Recommendations**

### **Improved Controls and Policy Guidance Could Ensure the Appropriate Use of Prior Year Funds and Strengthen the Management of Nonrecurring Maintenance Projects**

The Veterans Health Administration (VHA) and OFP had not established adequate controls to ensure that VAMCs properly obtained approval to use PY funds on NRM projects and then used these funds for work within the scope of contracts. Our review of the use of PY funds on 12 NRM projects at 4 VAMCs identified 3 issues that warrant management attention. First, on all six projects reviewed at two of the four VAMCs, PY funds were used without obtaining OFP approval as required by VA policy. Second, on 11 of the 12 projects VAMCs inappropriately used PY funds for work outside the scope of the contracts. Third, on 7 of the 12 projects, the use of PY funds indicated construction management problems that could have been mitigated or avoided by following existing NRM program policy. To address these issues, OFP and VHA need to better define PY funds oversight responsibilities, establish stronger PY fund controls, and provide VAMCs with better guidance on the appropriate use of PY funds. Based on the audit results, we estimate that improved controls could have reduced inappropriate PY funds usage by \$3.81 million in FY 1995.

#### **VAMCs Have Misunderstood VA Policy on Prior Year Funds**

Since March 1991, OFP has required VAMCs that wanted to use PY funds on NRM projects to request approval by sending an electronic mail message to OFP. The purpose of this requirement was to provide OFP with data to monitor the usage of PY funds. This was necessary because the Expired Funds Control Act required agencies to submit annual reports on the status of expired accounts, including a certification by the agency head that account balances were accurate and obligations from the accounts were proper.

According to OFP and VHA construction program officials, the most important question that VAMCs must answer before requesting PY funds is: Will the proposed work be within the scope of the contract? However, OFP officials acknowledged that they had not made this point explicitly clear in their policy guidance. Instead, they had assumed that VAMC staff understood that PY funds could only be used for within-scope work because this concept was so fundamental to long-standing Federal and VA funds management and construction policies.

To determine whether VAMCs were properly obtaining approval to use PY funds and were using these funds for work within the scope of contracts, we analyzed OFP data on PY fund requests and reviewed 12 NRM projects -- 3 each at VAMCs Castle Point, New York; Reno, Nevada; Chicago West Side, Illinois; and West Los Angeles, California.

**VAMCs Used PY Funds Without Approval.** Many NRM projects, no matter how well managed, will require small amounts of PY funds to pay for minor changes in designs or specifications or for addressing unforeseen minor construction problems. Because of this, it is

reasonable to expect that most VAMCs will occasionally need to request approval to use PY funds. Our analysis of OFP data found that during the 3-year period FY 1993 - FY 1995 most VAMCs had made such requests for small amounts of PY funds. However, our analysis also indicated that it was possible for VAMCs to use PY funds without requesting OFP approval and without reporting the PY fund usage to OFP. During the 3-year period, there were 20 VAMCs that did not request any PY funds. These 20 included several of VHA's largest VAMCs with significant NRM programs.

To determine if VAMCs could use PY funds without obtaining approval, we reviewed 3 NRM projects each at VAMCs Chicago West Side and West Los Angeles, which were 2 of the 20 VAMCs that had not made any PY fund requests during the 3-year period. We found that these VAMCs had used PY funds on all six projects reviewed. The two VAMCs were able to use PY funds because these funds were held in station-level accounts. VAMC staff believed that they were supposed to obtain OFP approval only if they were requesting that PY funds be transferred from other sources, such as VHA Central Office or other VAMCs. They were not aware that the approval requirement applied to all PY funds, including those in station-level accounts. The example of the VAMC Chicago West Side project to renovate Rehabilitation Medicine Service illustrates how a VAMC could use PY funds without obtaining OFP approval:

The contract for this project was awarded at a price of \$475,000, which was the funding available for the project at the time of contract negotiations. To reach this price, the VAMC deducted several nonessential work items from the scope of work shown in the invitation for bids. According to VAMC staff, as the project neared completion they became aware that station-level PY funds were available, so they used about \$33,000 of these funds to add back in some of the work that had been deducted from the scope of work and not included in the contract.

**VAMCs Used PY Funds for Work Outside the Approved Scope of Projects.** We concluded that on 11 of the 12 projects reviewed VAMCs used PY funds for additional work that was outside the scope of the contracts. As discussed below, this additional work fell into two categories: (1) work that expanded the scope of the original contract (nine projects) and (2) work that was unrelated to the contract but that was paid for under the auspices of the contract (two projects).

**PY Funds Used to Expand Project Scope.** We identified four ways in which VAMCs inappropriately used PY funds to expand the scope of projects: (1) constructing unapproved new space; (2) expanding limited renovation projects to include structural remodeling; (3) expanding renovations approved for one area of a building to additional areas; and (4) adding back in work that had been included in the contractor's bid but that had been deleted from the contract because of funding limitations. The example of the Director's conference room at VAMC Castle Point illustrates how a VAMC could use PY funds to expand the scope of a project:

This project was approved as a telephone site preparation project with an approved contract cost of \$1,059,000. The final cost of the project was \$1,181,000, which included about \$122,000 in PY funds. The main reason

for the cost overrun was that in addition to completing the telephone site preparation, the VAMC constructed about 1,375 square feet of unapproved new space. This space was justified as being needed for telephone consoles and operators. However, the space was actually used for a Director's conference room and a general purpose conference room. The total cost of the new space was about \$294,000. (The cost of constructing the 888 square foot Director's conference room portion of this space was \$200,000. The VAMC also spent \$45,000 for furniture and equipment for this room.)

This example shows how the absence of controls on PY funds can allow a VAMC to accomplish construction work that otherwise might not have been approved and funded. If PY funds had not been so easily available, the VAMC would have had to apply for the conference rooms as a separate project and justified the rooms based on need and cost-effectiveness. With this information, VHA approving officials could have determined the relative priority of the conference rooms in comparison to other construction needs.

**PY Funds Used for Work Not Related to the NRM Contract.** On 2 of the 12 projects reviewed, VAMCs used PY funds to pay contractors to do additional work that was not related to the projects for which the contracts were awarded. The following example illustrates this practice:

Under the auspices of a contract to renovate an Engineering Shops Building, VAMC Chicago West Side had the contractor renovate bathrooms on a patient care ward. The VAMC paid for this work with \$12,000 in PY funds.

In both instances identified, VAMC staff acknowledged that it was inappropriate to use PY funds in this way. They told us they took this approach because it was quicker and easier than following the normal procedures of finding current year funds to pay for the work and awarding a contract. In both instances the work was needed, but in our opinion the need was not urgent, and it was not necessary to use PY funds as an expedient means of paying for the work. Although the amounts involved were small, these two instances point up the vulnerability caused by the absence of controls on PY funds -- that is, a VAMC could just as easily use larger amounts of PY funds to pay for unnecessary or low priority work.

**High Use of PY Funds Indicated Problems With NRM Project Management.** There was a strong relationship between the high usage of PY funds and deficiencies in planning and managing NRM projects. On 7 of the 12 projects reviewed, VAMCs incurred additional costs by using PY funds (and other sources of funds) to address problems that could have been avoided or mitigated if the VAMCs had followed existing NRM project management guidance. We identified three types of project management deficiencies associated with high use of PY funds: (1) beginning construction before project plans were completed; (2) awarding contracts for amounts higher than the funding approved for the projects and then making up the differences by using PY funds and other sources of funds; and (3) not adequately testing for potential adverse site conditions (such as asbestos) that could reasonably be expected to exist and to increase project costs.

The relationship between the use of PY funds and deficiencies in project management can be illustrated by the Telephone System Replacement project at VAMC West Los Angeles:

This project consisted of two contracts, a \$1.6 million contract for site preparation and a \$5.0 million contract for equipment installation, for a total expected project cost of \$6.6 million. This project experienced various problems which necessitated 69 change orders that were paid with \$2.3 million in PY funds.

The problems on this project occurred largely because the VAMC awarded the two contracts before project designs were adequately completed. As a result, the site preparation contractor was unable to complete work on schedule. The VAMC allowed the installation contractor to begin work before sufficient site preparation had been done. The installation work eventually overtook the site preparation work, which resulted in delays for the installation contractor. In an effort to address these delays, the VAMC allowed the installation contractor to do some site preparation work at a higher cost than the site preparation contractor would have charged.

By the time the telephone replacement project was completed, costs had increased from the estimated \$6.6 million to \$8.9 million, a 35 percent increase. Most of the \$2.3 million in PY funds was paid to the installation contractor for doing the site preparation work and for adding telecommunications equipment that was not included in the original contract. In addition, the installation contractor has filed delay claims for \$2.2 million. According to the contracting officer's technical representative, VA will probably have to pay these claims, which will increase project costs to \$11.1 million, or 68 percent more than the contracted cost of \$6.6 million.

### **Conclusion -- VHA and OFP Need to Improve Oversight on PY Funds**

VHA and OFP had not established adequate controls to ensure that PY funds were properly requested and used only for work within the scope of contracts. Because of the absence of controls, VAMCs were not adequately complying with VA policy on PY funds, and there was a risk that some VAMCs could be viewed as using PY funds as slush funds for expanding projects without approval, for completing unnecessary or questionable construction, and for correcting avoidable mistakes in project management.

In our opinion, these problems occurred because oversight responsibilities had not been well defined and because VAMCs did not have clear guidance on the appropriate use of PY funds. VHA and OFP recently took the first step toward improving oversight by agreeing that the responsibility for monitoring PY funds will be transferred from OFP to VHA's Chief Financial Officer. In addition to following through on this agreement, VHA should establish controls to ensure that: (1) VAMCs obtain approval to use PY funds; (2) PY funds are used only for work within the scope of contracts; and (3) NRM projects with proposed high usage of PY funds are identified and reviewed to determine if the usage is justified.

We suggest that the responsibility for implementing adequate PY funds control be assigned to the Veterans Integrated Service Networks (VISNs). VAMCs that want to use PY funds should be required to obtain approval from their VISN management and to certify that the proposed additional work will be within the scope of the contract. Not only would this improve controls on PY funds, but it would also enhance VISN construction planning by preventing VAMCs from unnecessarily expanding the scope of projects and by helping to identify projects that might have construction management problems.

VHA and OPF need to work together to develop policy guidance aimed at helping VISN and VAMC staff use PY funds appropriately. Most importantly, the guidance should clearly state that PY funds may only be used for work within the scope of contracts. To assist in the understanding of this requirement, the guidance should provide a definition of “contract scope.” The guidance should explain the procedures VAMCs must follow in obtaining approval to use PY funds and should specify that the approval procedures apply to all PY funds including those in station-level accounts. Because high PY fund usage may be an indicator of construction management deficiencies, the guidance should reemphasize the importance of following existing NRM program policy. In particular, the guidance should make it clear that VAMCs should not: (1) begin construction before designs are completed; (2) award contracts for amounts greater than the approved project funding; and (3) begin work without testing for adverse site conditions that could affect project costs.

### **For More Information**

- The audit objectives, scope, and methodology are discussed in Appendix 2, pages 14-15.
- The results of our onsite project reviews and our suggestions for improving PY funds oversight and guidance are discussed in more detail in Appendix 3, pages 16-26.

### **Recommendation 1**

We recommend that the Under Secretary for Health and the Acting Assistant Secretary for Management work together to ensure that:

- a. Responsibility for monitoring the use of PY funds is transferred from OFP to VHA.
- b. Effective controls are established to ensure that VAMCs properly obtain approval to use PY funds and use these funds only for work within the approved scope of projects and contracts.
- c. VAMCs are provided with detailed policy guidance on PY funds, with emphasis on the issues identified by this audit.
- d. Responsible VAMC staff are provided training on the new PY funds policies and procedures.

## **Under Secretary for Health Comments**

The Under Secretary for Health concurred with the recommendation and with the estimate of monetary benefit and stated that VHA would work with OFP to better define PY funds oversight responsibilities and to improve PY funds guidance and controls.

## **Acting Assistant Secretary for Management Comments**

The Acting Assistant Secretary agreed with the audit findings and concurred with the recommendation. However, he disagreed with our suggestion that PY funds approval authority be delegated to the VISNs. He expressed concern that VISNs might, in turn, delegate the decision making to VAMCs, which could result in continued inappropriate use of PY funds.

## **Implementation Plan**

Effective October 1, 1997, responsibility for monitoring the use of PY funds will be transferred from OFP to the VHA Chief Financial Officer. VHA will work with OFP and other responsible Assistant Secretary for Management offices to develop improved policy and controls on the use of PY funds. The new policies and procedures will address the issues identified by the audit. On September 30, 1997, the Acting Assistant Secretary sent the Under Secretary a memorandum proposing several actions to strengthen oversight of PY funds.

## **Office of Inspector General Comments**

The Under Secretary and the Acting Assistant Secretary concurred with our recommendation and provided an acceptable implementation plan. We consider all audit issues resolved and we will follow up on the implementation of planned corrective actions.

On the issue of PY funds approval, we suggested that VISN managers have first-level approval authority because they are in the best position to understand their local NRM programs and to know whether the use of PY funds is justified on particular projects. However, we agree with the Acting Assistant Secretary that there is a risk that some VISNs might attempt to delegate PY funds responsibilities back to the VAMCs. Because of this, it is important that VHA make VISN responsibilities explicitly clear, require VISNs to report their use of PY funds, and otherwise establish sufficient oversight to ensure that VISNs meet their responsibilities in managing their NRM programs and controlling PY funds.

## **Background**

### **Definition of Prior Year Funds**

Each fiscal year Congress authorizes the Medical Care Appropriation to provide VA the funds to carry on its medical care operations. The appropriation is time-limited -- that is, VA must use (obligate or expend) the funds within the fiscal year covered by the authorizing appropriation act. PY funds are the residual, unobligated funds remaining in the appropriation account after the end of the fiscal year. These funds are also sometimes called expired funds, and the accounts holding the funds are called expired accounts.

Most funds are spent or obligated within the fiscal year time limitation. However, with large appropriation accounts such as the Medical Care Account there are usually some residual funds that remain unspent. The main reason for this is that obligations are, by definition, estimates of future spending, and during the fiscal year some obligations prove to be higher than actual spending and other obligations turn out to be unneeded and are canceled. This process of reducing and canceling obligations results in residual funds (PY funds) remaining in the expired appropriation accounts. Under the Expired Funds Control Act, these PY funds can be used to increase obligations to meet valid needs of the year covered by the appropriation, but they may not be used for new obligations that are associated with a different appropriation year.

### **Purpose and Intent of the Expired Funds Control Act**

In November 1990, Congress passed the National Defense Authorization Act of 1991 (Public Law (PL) 101-510). Within VA this Act is referred to as the Expired Funds Control Act. The purpose of the Act was to address the possible misuse of PY funds that Federal agencies had accumulated in accounts called merged accounts or M accounts. The practice of using M accounts to hold expired fund balances had been authorized in 1956 to streamline the process agencies used to pay obligations for which no current, unexpired appropriations existed. Agencies were allowed to merge unexpired funds from several fiscal year appropriations into one M account. In 1990, when the Expired Funds Control Act was passed, all agencies had M accounts.

Congress passed the Act because they were concerned that the use of M accounts allowed agencies to accumulate large amounts of expired funds that could be used to pay for modifications to contracts. There was, therefore, a potential for large transactions to occur without Congressional oversight. The thrust of the Expired Funds Control Act was to require agencies to eliminate M accounts and to establish controls to ensure that PY funds were used only to meet valid needs of the year covered by the appropriation. (U. S. House of Representatives Report 101-665)

**M Accounts Phased Out.** The Act changed accounting procedures for expired appropriations by requiring agencies to phase out M accounts and to maintain separate expired accounts for each fiscal year's expired appropriation. An expired account could be kept open for 5 years, and the

funds in the account could only be spent for modifications to contracts awarded during the fiscal year covered by the appropriation. At the end of the 5-year period the account would be closed, with all obligated and unobligated balances canceled. (31 United States Code (USC) 1552 and 1553)

**PY Funds Reporting Requirements.** The Act included specific reporting and approval requirements for using PY funds to pay for “contract changes.” The Act defined “contract change” as “a change to a contract under which the contractor is required to perform additional work.” (31 USC 1553(c)(3)) The Act required agency heads (or their designees) to approve expenditures of PY funds for contract changes if the expenditures for any expired appropriation exceeded \$4.0 million during a fiscal year. If such expenditures for an expired appropriation were expected to exceed \$25.0 million during a fiscal year, the agency head was required to notify the appropriate Congressional authorizing committees. (31 USC 1553(c)(1) and (2))

The Act also included annual reporting requirements on agency use of PY funds. After the close of each fiscal year, each agency head is required to submit to the President and the Secretary of the Treasury a report on the obligations, unobligated balances, canceled balances, and adjustments made to appropriation accounts of that agency during the completed fiscal year. As part of this report, the agency head also must certify that “the obligated balances in each appropriation account of the agency reflect proper existing obligations and that expenditures from the account since the preceding review were supported by a proper obligation of funds and otherwise were proper.” In addition, the Act required agencies to establish internal controls to assure that an adequate review of obligated balances was performed to support the certification. (PL 101-510, Section 1554)

**Office of Management and Budget (OMB) Guidance.** In January 1991, OMB issued Bulletin 91-07, “Budget Execution Procedures for Closing Accounts,” to provide agencies guidance on implementing the Expired Funds Control Act. The bulletin summarized the requirements of the Act; explained the rules for determining the availability of appropriations and fund balances; established procedures for closing appropriation and fund accounts; and established specific reporting and approval requirements for contract changes and increases to obligations where the contractor was required to perform additional work.

Bulletin 91-07 was incorporated as part of OMB Circular A-34 on “Budget Execution.” This circular provided policy guidance on budget execution, monitoring Federal outlays, and associated issues. Financial management reports required by the Circular provide essential information for the review and execution of the Government’s budgetary program. The Treasury Department uses these reports to forecast government cash balances, borrowing requirements, and the Federal debt. OMB also uses the reports to monitor the deficit/surplus and to assess the reliability of each agency’s financial management system. The inclusion of the Expired Funds Control Act requirements in OMB Circular A-34 emphasized the need for agencies to not only control and monitor outlays from current appropriations but also from expired appropriations as part of the agencies’ and the Government’s budget execution process.

## **VA Implementation of the Expired Funds Control Act**

**Program Responsibilities.** In VA, the Office of Financial Policy was assigned responsibility for implementing the reporting requirements of the Expired Funds Control Act. In meeting this responsibility, OFP officials made two important decisions about the Act's applicability to VA financial operations. First, they determined that the Act applied only to VA's Medical Care Appropriation and not to other appropriations, such as the Research or the General Operating Expenses Appropriations. Second, they determined that for the Medical Care Appropriation, the Act applied only to the use of PY funds on NRM construction contracts. OFP officials made this determination because the Act's monitoring and reporting requirements only applied to PY funds used for contract changes as defined by OMB Bulletin 91-07 (see page 9). Given the Act's focus on contract changes, OFP officials concluded that NRM construction would be the only program affected by the Act's requirements, since NRM contracts were believed to be the only VA contracts that typically had changes like those contemplated by the Act.

**OFP Implementing Guidance.** To implement the Expired Funds Control Act, OFP issued guidance in the form of eight teletyped messages (called TWXs) which were sent to all VAMCs between March 1991 and February 1993. Three of the TWXs provided information and directions on implementing the Expired Funds Control Act, and the other five TWXs provided instructions and procedures for obtaining approval to use PY funds.

In March 1991, OFP issued TWX Message Number 6421, "Approving and Reporting Obligation Adjustments to Expired, Closed, and 'M' Appropriations," which contained the primary guidance for the VAMCs to follow if they wanted to use PY funds to pay for work on NRM construction projects. The TWX required that VAMCs request approval to use PY funds by sending an electronic mail message to OFP. OFP was responsible for controlling the use of all PY funds, including those held in station-level accounts. However, the TWX did not make it explicitly clear that VAMCs had to request OFP approval to use these station-level funds. Before requesting approval to use PY funds, responsible VAMC staff (typically the Chiefs of Fiscal, Acquisition and Materiel Management, and Engineering Services) were supposed to make a determination that PY funds were necessary to pay the contractor for performing "additional work" on an existing contract.

VAMC staff were also supposed to ensure that the additional work was within the scope of the contract. This requirement ensured that the requested use of PY funds was for a valid need incurred within the period of the affected appropriation and not for new work that was not covered by the original contract. OFP officials told us that they did not explicitly state this requirement in the TWXs because they considered it basic fiscal operating policy and they assumed VAMCs understood that PY funds should only be used for work that was within scope.

As of May 1997, OFP staff routinely approved almost all VAMC requests for approval to use PY funds. To illustrate, during the 16-month period February 1996 through May 1997 OFP disapproved only one request because the work appeared to be outside the scope of the contract:

VAMC Topeka had a contract to design window replacements for two buildings. In April 1996, the VAMC requested \$16,800 in PY funds to include a third building in the design project. OFP denied the request, stating

that since the contract only covered two buildings adding a third building would not be within contract scope.

## VA's Nonrecurring Maintenance Construction Program

**Purpose of NRM Program.** As the name implies, the purpose of the NRM construction program is to maintain, repair, or modify existing buildings, not to construct new buildings. There are five categories of NRM projects:

- **Capitalized Maintenance and Repair** -- These are projects that replace all or major parts of utility systems (such as telephone systems), building components (such as windows and floors), patient support systems (such as nurse call and medical gases), and protection systems (such as fire alarms and sprinklers). This category is considered to be “capitalized” maintenance and repair because the work extends the useful life of the real property and thus increases its value.
- **Noncapitalized Maintenance and Repair** -- These projects are intended to prevent the deterioration of or to repair facility buildings and infrastructure. Typical projects in this category include work such as painting and limited replacement of electrical and plumbing fixtures. This category is considered to be “noncapitalized” because the work is intended to maintain or restore the property to its original condition but is not intended to increase its value by extending the useful life.
- **Building Service Equipment Replacement** -- These projects replace building utility systems with equipment of like capacity and utility (such as boilers, electrical systems, air conditioning equipment, etc.).
- **Building Service Equipment Additions** -- These are projects that either add new building utility systems or make significant additions to existing systems.
- **Minor Improvements** -- These are small projects to add space to existing buildings or to make other minor structural changes to buildings or infrastructure.

**NRM Project Justification and Approval Process.** The NRM projects reviewed by our audit were started when VAMCs were organizationally aligned under four VHA Regions. Each Region had staff who were responsible for construction activities in the Region. This staff worked with VAMCs to determine Regional NRM needs, to set priorities, and to recommend individual projects for funding.

In FY 1996, VHA reorganized from the four Regions to 22 Veterans Integrated Service Networks. This reorganization has brought some change to the NRM approval process. The major change is that the VISNs have more flexibility and local autonomy in deciding how to use NRM funds. The purpose of this change is to improve the effectiveness of NRM planning and management by making local managers more accountable.

Under the new NRM approval process, each VISN receives a NRM budget that covers all the VAMCs within the VISN. The VISN then allocates NRM funds to each VAMC. This allocation

is based on several factors, such as the size of the VAMC and the condition of the buildings and infrastructure needing maintenance and repair.

The new VISN process is similar to the Region process in that VAMCs must still determine their NRM needs and submit a priority list of proposed projects. However, it appears that the new process, which is still in development, will allow VISNs to have flexibility in determining how much oversight to give VAMC NRM projects. For example, it appears that some VISNs will approve or disapprove NRM projects on a project-by-project basis, whereas other VISNs will provide advice and guidance, but will normally allow VAMC managers to determine how to best meet their local NRM needs, so long as they live within their budgets.

NRM projects are funded from VA's Medical Care Appropriation. Until FY 1997, the NRM budget was based on needs identified by VAMCs and communicated to VHA Regions through Project Applications (VA Form 1193). Each application provided a description, justification, and cost estimate for the proposed project. The scope of the project was determined by the information in the project application and by the amount of funding approved for the project.

The VHA Regions were responsible for reviewing and screening projects, developing a listing of high priority projects, and preparing a list of projects recommended for funding. Each Region's recommended projects were then submitted for approval to the Associate Chief Medical Director for Operations.

The Regions provided the VAMCs funding for approved projects. The approved funding typically included construction contingency factors of 5 percent for new construction and 7.5 percent for remodeling. These contingency factors established the amount of funds to be set aside to pay for contract changes.

After NRM projects were approved and funded, VAMCs were expected to design the projects within the approved funding level and not with an expectation that project scope expansions or cost increases would be approved by the Regions. VAMC requests for additional funding (called cost limit increases) would be considered only under extenuating circumstances. If anticipated project costs increased, VAMCs were expected to explore options to additional funding, such as alternative construction methods or reductions in the scope of the project. The Region was responsible for determining the option to be used, and the VAMC was supposed to implement the Region's decision. If the Region approved a cost increase, additional funding was transferred to the VAMC. If the requested increase was disapproved, the work was supposed to be accomplished by some other means (such as another project) or not accomplished at all.

**NRM Program Costs.** In FY 1996, the NRM construction program budget was \$184.2 million. Our audit covered the use of PY funds during FY 1995, when the NRM budget was \$208.5 million and final actual NRM costs were \$294.9 million.

There is no cost limitation on individual NRM projects, except that for any project the portion designated as "minor improvement" cannot exceed \$150,000. This limitation is designed to ensure that the NRM program is used as a maintenance program and not as a capital expansion program. The VHA "Guide for Delegated Facilities Project Management" (commonly called the

“Red Book”) suggests that as a rule “NRM funding will be used more effectively system-wide if the maximum project cost does not exceed \$700,000.” (Red Book 4 A.2.a) Most NRM projects cost less than this. However, it is not unusual to find projects costing much more, especially if they involve the replacement of building service systems or major building components.

**Amount of PY Funds Used on NRM Projects.** During the 4-year period FY 1993 - FY 1996, OFP approved the use of \$45.9 million in PY funds for NRM projects:

	<b>FY 1993</b>	<b>FY 1994</b>	<b>FY 1995</b>	<b>FY 1996</b>	<b>Total</b>
VAMCs Making Requests	124	97	116	113	N/A
Number of Approved Requests	1,154	677	1,098	767	3,696
Value (Millions) of Approved Requests	\$10.3	\$9.1	\$14.5	\$12.0	\$45.9

It should be noted that the data shown in the table reflects only the PY funds requests approved by the OFP. As discussed on pages 2-3, our audit found that VAMCs could access and use PY funds without requesting OFP approval. When such usage occurred, it is not captured by OFP’s monitoring process.

**Unobligated PY Fund Balances.** As of the end of FY 1996, the following amounts were available in prior fiscal year expired appropriations:

<b>FY 1993</b>	<b>FY 1994</b>	<b>FY 1995</b>	<b>FY 1996</b>
\$61.6 million	\$79.5 million	\$33.8 million	\$8.3 million

These amounts change as obligations from the expired appropriations are reduced or canceled and other obligations from the period of the expired appropriation are increased. For example, the FY 1996 expired appropriation had \$8.3 million available at the end of FY 1996. However, by March 31, 1997, the end of the second quarter of FY 1997, the available funds in the FY 1996 expired appropriation had increased to about \$42.3 million because of obligations being canceled and actual costs being less than estimated.

## **Objectives, Scope, and Methodology**

### **Objectives**

The purpose of the audit was to evaluate the effectiveness of VA's management of the use of PY funds to pay for work on NRM construction projects. The objectives were to determine if:

- OFP and VHA had established adequate controls to ensure that VAMCs properly requested approval to use PY funds so that this usage could be accurately monitored by OFP.
- VAMC managers ensured that PY funds were used only for additional work that was within the scope of projects as described in the project applications and/or construction contracts.
- VHA and VAMC managers ensured that NRM projects were properly planned and managed so that projects were completed within budget and the use of PY funds was minimized.

### **Scope and Methodology**

To meet the audit objectives, we analyzed OFP data on VAMC usage of PY funds and we evaluated the use of PY funds on NRM projects at four VAMCs: Castle Point, New York; Reno, Nevada; Chicago West Side, Illinois; and West Los Angeles, California. The audit covered the use of PY funds during FY 1995, the most recent full year for which records were available when we began the audit.

We selected VAMCs Castle Point and Reno for review because the available data indicated that these two VAMCs were high users of PY funds. Both VAMCs had NRM construction contracts on which the use of PY funds significantly exceeded 10 percent of the original contract prices. We selected VAMCs Chicago West Side and West Los Angeles because these were two large VAMCs that had never reported any usage of PY funds, either in FY 1995 or in earlier years. At these two VAMCs we wanted to determine if it was possible for VAMCs to access and use PY funds without OFP approval. (See pages 2-3 for a discussion of this issue.) We had originally planned to evaluate the use of PY funds at other VAMCs. However, during the audit OFP and VHA officials agreed that the results of our reviews at the four VAMCs were reasonably representative of the overall status of controls on the use of PY funds and that there was no need to review this issue at other VAMCs.

At each of the four VAMCs, we judgmentally selected for review three NRM construction contracts on which the VAMCs had used PY funds. The main factor in selecting contracts for review was that the amount of PY funds used was equal to 10 percent or more of either the approved project funding or the contract price, whichever was less. We considered the 10 percent threshold to be reasonably indicative of projects that might involve questionable use of PY funds. The rationale for this approach was that minor contract changes are to be expected on NRM projects, and the use of PY funds for such minor changes is likely to be appropriate.

However, a cost increase of 10 percent or more indicates the possibility of significant contract changes that might involve major project scope modifications and therefore questionable use of PY funds. VHA Engineering Service staff agreed with our use of the 10 percent threshold.

Our reviews of the 12 selected NRM projects focused on 2 questions:

- Did the VAMC properly request approval to use PY funds?
- Did the VAMC use PY funds for work that was within the scope of the contract, as required by VA policy?

In evaluating the use of PY funds on the 12 projects, we reviewed pertinent VAMC Engineering Service project files, Acquisition and Materiel Management Service contract files, and Fiscal Service financial records. We discussed the NRM projects with appropriate VAMC management and staff and we inspected the completed projects to determine how the finished work conformed to the intent of the project as expressed in the project application and/or construction contract.

We also reviewed the legislative history of the Expired Funds Control Act, OMB Bulletins and Circulars that provided implementation instructions for the Act, GAO Principles of Federal Appropriation Law, Comptroller General appropriation law decisions pertaining to PY funds, VA policy on PY funds, and NRM program management guidance contained in VA manuals and in the VHA “Guide for Delegated Facilities Project Management.” We discussed NRM program operations and VA policy on PY funds with former officials of VHA’s Eastern and Western Regions and with current officials of OFP and VHA’s Engineering Management and Field Support Office and Financial Management Office.

The audit included evaluations of PY funds internal controls and of compliance with applicable laws, regulations, and VA policies. We performed the audit in accordance with generally accepted government auditing standards.

## Details of Audit

### **Audit Approach for Evaluating the Use of PY Funds on NRM Projects**

We based our audit approach on the principle that PY funds should only be used to pay for work that is within the scope of the NRM construction contract. In attempting to apply this criterion to the projects we reviewed, we encountered two difficulties. First, the OFP policy on the use of PY funds did not define “scope,” and this term is not defined elsewhere in VA construction policy. Second, the OFP policy applied only to the scope of contracts; however, we found that in some cases VAMCs had awarded contracts that differed in scope from the projects that the VAMCs had applied for and that the VHA Regions had approved and funded.

To address these two issues, we used a reasonable, common sense approach to defining “scope” and “scope changes.” The thrust of our approach was that to be within scope the additional work paid for with PY funds must have been required by the original intent of the project as described in the project application, the project approval and funding documents, and/or the project contract. If the contract differed significantly from the project application and approval documents, then we based our review on the intent of the project as described in those documents. In doing this, we followed the principle that, under the policy in effect during the period covered by the audit, a VAMC should not have awarded a contract for a NRM project at a higher cost than the approved funding or have awarded a contract for a project that had not been approved (Red Book 6.3.d and 4.A.3.c).

We considered additional work to be within scope and an appropriate use of PY funds if:

- It conformed to the general purpose or intent of the NRM project as specified in the project application, approval and funding documents, and/or the construction contract.
- It did not significantly increase the amount of space (square footage) to be built or remodeled above the amount specified in the project application and/or the construction contract.
- It was for routine, minor modifications of the type that is likely to occur on any project as a result of minor changes in designs or specifications or minor unforeseen construction problems.

We considered additional work to be outside of scope and an inappropriate or questionable use of PY funds if:

- It increased the cost of the approved project and/or the construction contract by 10 percent or more. (It should be understood that the approved funding for an NRM project typically includes a contingency allowance to cover unforeseen cost increases. The normal contingency allowances are 5.0 percent for new construction and 7.5 percent for remodeling.)

- It significantly increased the amount of space to be built or remodeled.
- It was done in a different building or location than that specified in the contract and the work had no reasonable relationship to the approved project.

## Results of Review -- VAMCs Used PY Funds for Work Outside the Scope of Contracts

We concluded that PY funds were inappropriately used to pay for work outside the contract scope on 11 of the 12 projects reviewed.<sup>1</sup> In addition, on 7 of the 12 projects VAMCs used PY funds to address deficiencies in project management. The following table summarizes the results of our project reviews. A brief discussion of each project follows the table.

### NRM Projects with PY Funds Used for Work Outside Scope of Contract

<u>NRM Project</u>	<u>Amount of PY Funds Used for Work Outside Contract Scope</u>	<u>PY Funds Associated with Project Management Deficiency</u>
<b><u>VAMC Castle Point</u></b>		
Telephone Site Preparation	\$122,120	Yes. New space constructed without approval.
Education Building Renovation	\$82,518	Yes. Design exceeded approved project application; contract award exceeded approved funding.
Ward D-1 Renovation	\$370,356	Yes. Different project substituted for approved project; inadequate testing for adverse site conditions.
<b><u>VAMC Reno</u></b>		
Refurbish Halls and Walls	\$446,153	No.
Modular Buildings Wheelchair Access Ramps	\$45,801	Yes. Functional use of modular buildings not decided before construction.
Reinsulate Steam Chill Piping	\$32,960	No.

<sup>1</sup> Of the 12 projects, the only one that did not involve the use of PY funds to pay for work beyond the scope of the contract was a VAMC Chicago West Side project to upgrade electrical systems in the main hospital building. The use of PY funds on this project was largely a financial management mistake. The VAMC used about \$208,000 in PY funds on this project. However, this was unnecessary because VHA Central Region had already provided current year funds for the additional work. The VAMC lost track of these funds and mistakenly used PY funds. We did not consider this an inappropriate use of PY funds because the Central Region had approved the additional work and provided funding.

<u>NRM Project</u>	<u>Amount of PY Funds Used for Work Outside Contract Scope</u>	<u>PY Funds Associated with Project Management Deficiency</u>
<b><u>VAMC Chicago West Side</u></b>		
Rehabilitation Medicine Renovation	\$33,347	No.
Engineering Shops Renovation	\$12,276	No.
<b><u>VAMC West Los Angeles</u></b>		
Replace Underground Fuel Storage Tanks	\$251,095	Yes. Testing for adverse site conditions not done.
Telephone System Replacement	\$2,322,280	Yes. Equipment installation started before site preparation completed.
Install Advanced Food Preparation System	\$90,205	Yes. Project designs exceeded approved funding.

### **VAMC Castle Point**

**Telephone Site Preparation (Director's Conference Room).** The purpose of this project was to do necessary preparation for installing a new telephone system. The construction contract was awarded in February 1993 at a cost of about \$1,059,000. The project was completed in March 1995 at a final cost of \$1,181,000, of which \$122,000 were PY funds. As discussed on pages 3-4, the main reason for the cost increase was that the VAMC used PY funds and other funds to construct 1,375 net square feet (NSF) of new space that was used for conference rooms. This new space was constructed even though the VHA Eastern Region and VHA Telecommunications Support Service had told VAMC management not to build new space unless absolutely necessary.

**Education Building Renovation.** This project was approved as part of a VHA Office of Academic Affairs (OAA) program to support NRM projects for VAMC Learning Resource Centers. In December 1991, VAMC Castle Point submitted a proposal to renovate its Education Building at an estimated cost of \$300,000. In March 1993, OAA approved the project and provided the requested funds. After receiving the funds, the VAMC made several changes in the project's scope before issuing an invitation for bids on a construction contract. When bids were received, the lowest bid was \$520,000.

At this point VAMC staff requested additional funds, apparently without fully explaining to the Region that the higher bids resulted from the scope changes the VAMC had made. The Region provided \$176,000 in additional funds, for a total of \$476,000 in authorized funding. In September 1993, the VAMC awarded the contract for \$520,000, intending to make up the \$44,000 shortfall by transferring funds from other sources.

The project was completed in February 1995 at a cost of about \$602,000, which was 100.6 percent more than the \$300,000 originally estimated cost of the project, 26.5 percent more than the \$476,000 in authorized funding, and 15.8 percent more than the \$520,000 contract price. Of the \$602,000, about \$83,000 was PY funds.

In our opinion, the cost increases on this project occurred largely because the VAMC expanded the scope of the originally approved project. As approved, the main purpose of the project was to upgrade the building electrical, mechanical, and air conditioning systems and to generally refurbish the building to make a more aesthetically pleasing educational environment. The VAMC went beyond this and developed plans to reconfigure the classrooms, which involved making structural changes in the building, thereby increasing costs. To accomplish this scope expansion, the VAMC awarded a contract for an amount larger than the funding provided and used PY funds for work that was beyond the scope of the approved project.

In this case, the appropriate course of action for the VAMC was either: (1) to redesign the project so that the work could be done within the authorized funding, or (2) to submit a new project application so that Region approving officials could determine the priority of the expanded Education Building project in relation to the Region's other construction needs.

Furthermore, in our opinion the reconfiguration of the classrooms was not necessary and did not justify spending double the originally estimated cost of the project. The reconfiguration could have been deleted from the project without significantly affecting the VAMC's training capability. Before the renovation, the Education Building had four rooms that could be divided into six classrooms with a total of 2,756 NSF of space. The reconfiguration resulted in two rooms that could be divided into six classrooms with 2,428 NSF, a decrease of 328 NSF (12.0 percent). The main perceived advantage of the reconfiguration was that one of the new rooms could accommodate a larger group (96 persons) than could the previous largest room (78 persons). However, the VAMC's conference scheduling records indicated that for the almost 2 years from the completion of the project through December 1996 the largest group using the new room was 50 persons.

**Ward D-1 Renovation.** On this project the VAMC used PY funds for work that was outside the scope of both the approved project and the construction contract. The VAMC submitted, and the VHA Eastern Region approved, a project application which stated that the VAMC intended to refurbish the third floor of Ward D. The proposed work included remodeling the ward nursing station and replacing wall coverings, handrails, ceilings, and portions of the flooring. Once the VAMC received funding for the project it used these funds for a different project, the renovation of the first floor (not the third floor) of Ward D. We could find no evidence that the VHA Eastern Region had approved this different project.

The first floor project was of significantly larger scope than the approved third floor project. It included major remodeling to convert clinic space into patient care rooms and to remodel bathrooms. To pay for this work the VAMC used \$178,000 provided for the Ward D-3 project, \$98,000 transferred from another of the VAMC's NRM projects, and \$370,000 in PY funds.

The final cost of the project was about \$644,600, or 262.1 percent above the approved project funding of \$178,000 and 133.6 percent more than the contract price of \$276,000.

An issue of particular concern was the VAMC's use of \$192,172 in PY funds to replace the ward flooring. The VAMC justified its request for these funds on the basis that during the construction process it had encountered an unforeseen problem or "differing site condition," namely that the floor tiles contained asbestos, which necessitated replacing the entire floor, as opposed to certain sections as originally planned. In our opinion, it was not reasonable to use "differing site conditions" as a justification for obtaining PY funds. VAMC Engineering staff should have had the floor tiles tested for asbestos before the contract was awarded and should have built the cost of floor replacement into the contract, instead of relying on the availability of PY funds to address this problem.

## **VAMC Reno**

**Refurbish Halls and Walls on First Floor of Building 1.** The purpose of this project was to upgrade the appearance of the first floor of Building 1, which houses inpatient treatment facilities and administrative offices. The originally planned work included replacing ceiling tiles, flooring, windows, and light fixtures and covering exposed electrical and telephone cables. On this project the VAMC inappropriately used PY funds to expand the scope of the renovation work to include an adjoining building.

In November 1994, the VAMC awarded a contract for the project at a cost of \$718,122, the amount of funding that the VHA Western Region had provided based on the VAMC's project application and subsequent project design work. The project was scheduled to be completed by September 1995. However, the project was not completed until September 1996, and by then project costs had escalated to about \$1,269,000 (a 76.7 percent increase) through the addition of about \$551,000 in PY funds.

Based on our review of project administration documents, we concluded that the VAMC properly used about \$105,000 in PY funds to complete necessary work that was within the scope of the contract. The remaining \$446,000 in PY funds was used for work outside the scope of the contract, with most of these funds (\$376,756) being used to expand the renovation work into the adjoining Building 1A. This work was not included in either the project application or the construction contract.

Under the auspices of this project the VAMC also inappropriately used about \$15,000 in PY funds to install sinks in patient rooms on the second floor of Building 1. While this work was desirable, it was not related to the first floor halls and walls project and was not part of the contract.

**Modular Building Wheelchair Access Ramps.** In reviewing this project, we concluded that the VAMC used PY funds for work that was needed. However, the work was outside the scope of the contract, and the use of PY funds could have been avoided through better project planning. The purpose of the project was to do site preparation for the installation of two

modular buildings (trailers) and to improve handicapped access to the main patient care building and two existing modular building complexes.

VAMC management allowed work on this project to begin before they had decided how the new modular buildings would be used. About 4 months after construction began, a decision was made to use the buildings as outpatient clinics. This use necessitated the construction of an additional access ramp that was not included in the contract. The VAMC used about \$45,800 in PY funds to pay for this work. The cost of constructing the ramp should have been paid out of the VAMC's current operating funds, since the ramp was a valid need of the current year because the decision to use the trailers for outpatient care, which necessitated construction of the ramp, was a current year decision.

**Reinsulate Steam Chill Piping.** The purpose of this project was to replace various steam traps, valves, strainers, fittings, and pumps, and to reinsulate steam and water pipes to prevent energy loss. The contract price for this project was \$154,187. The project was completed in June 1995, and the VAMC took custody of the project in July 1995. However, the contract was not officially closed until December 1995, at which time project costs totaled \$202,752, of which \$48,565 was PY funds.

We concluded that \$15,605 in PY funds was appropriately used to pay for additional work that was within the scope of the contract. The remaining \$32,960 was used for work that was reasonable, but the use of PY funds to pay for this work was not appropriate. There were two problems with this use of PY funds. First, the VAMC used PY funds to pay for work that was included as bid alternates in the contractor's proposal but that was not included in the final contract and was therefore outside the scope of the contract. Second, in December 1995, 5 months after the project was completed, the VAMC used PY funds to pay the contractor to correct a condensation problem. The VAMC was able to use PY funds for this purpose because they had inappropriately kept the contract open even though the project was complete. The December repair work should have been paid with current year funds.

## **VAMC Chicago West Side**

**Rehabilitation Medicine Renovation.** The purpose of this project was to renovate the space occupied by the VAMC's Rehabilitation Medicine Service. The work included constructing a new chest/cardiac clinic and replacing floors, ceilings, lighting, medical gas lines, and plumbing fixtures. The contract was awarded in September 1993 at a cost of \$475,000. The project was completed in July 1995 at a cost of \$530,753.

The final cost included \$33,347 in PY funds that were inappropriately used to add back work that was included in the contractor's bid but that had been deducted from the contract. VAMC staff told us that the additional work had been added back in toward the end of the project simply because the PY funds were available.

**Engineering Shops Renovation.** The purpose of this project was to renovate a building that housed various engineering shops and offices for Engineering Service supervisors. The contract was awarded at a cost of \$410,210. The final project cost was \$452,286, of which \$42,076 was PY funds.

We concluded that \$29,800 of the PY funds were appropriately used to pay for necessary additional work on the engineering shops project. The remaining \$12,276 was inappropriately used, under the auspices of the engineering shops contract, to have the contractor do some remodeling work on a patient care ward. While this work was desirable, it was unrelated to contract in question. In addition, the work was a need of the current year and therefore should have been paid for with current year funds.

### **VAMC West Los Angeles**

**Replace Underground Fuel Storage Tanks.** On this project the VAMC used PY funds to pay for additional work that was outside the scope of both the approved project and the contract. In September 1992, VAMC West Los Angeles awarded a contract to remove and replace underground fuel storage tanks at a cost of \$329,000. The approved project application indicated that if contaminated soil were found during the tank removal then the VAMC would request approval for another project for soil remediation. However, instead of requesting a second project the VAMC made changes to the original contract and, without obtaining approval from OFP, used \$251,000 in station-level PY funds for soil removal. By the time final payment was made in July 1995, the total cost of the project was \$580,000, or 76 percent higher than the original contract award. This unauthorized use of PY funds occurred because VAMC staff did not understand that they were supposed to request approval to use station-level funds.

In our opinion, on this project the VAMC should have tested for soil contamination before submitting the project for approval. This would have allowed a more accurate estimate of the project's cost, which in turn would have allowed VHA Western Region planners to better determine the relative priority of this project versus other construction needs. Furthermore, a better estimate of the true cost of the project might have prompted a search for less costly options. For example, because several of the tanks apparently had been empty for as long as 20 years it may not have been necessary to remove them.

**Telephone System Replacement.** As discussed on page 5, the large amount of PY funds used on this project indicated significant construction planning and management deficiencies. On this project the VAMC used \$2.3 million in PY funds. Most of these funds were used to pay the installation contractor to do work that the site preparation contractor was unable to complete on schedule. For example, the VAMC deleted about \$337,000 in cable routing work from the site preparation contract and allowed the installation contractor to do temporary cable routing at a cost of \$461,000. VAMC staff told us that another NRM project with an estimated cost of at least \$150,000 will be needed to make the work permanent. This means that work originally contracted to cost \$337,000 will ultimately cost \$611,000.

On this project the VAMC used about \$465,000 in PY funds to purchase and install local area networking equipment that was not included in the original contracts. The equipment was installed in several of the VAMC's outlying buildings. According to VAMC staff, the networking capability was not being used and was unlikely ever to be used. In addition, the contracting officer's technical representative told us that the networking equipment had been purchased even though a VA Central Office technical review had advised against it.

Our review noted another construction management problem that was not related to the use of PY funds. The telephone replacement project included an intercom paging system at a cost of \$300,000. The system was installed in all but three of the VAMC's buildings. The VAMC paid the contractor for installing the system even though it was functional only in the main hospital building and did not work in the outlying buildings. As of May 1997, the VAMC did not have a plan to address this problem. Furthermore, we identified at least \$52,000 in excess intercom equipment that was ordered by the installation contractor and paid for by the VAMC. The equipment was in storage and, according to VAMC staff, will probably never be installed. Staff could not explain why so much excess equipment was purchased.

**Install Advanced Food Preparation System.** The purpose of this project was to install a "cook-chill" food preparation system and to do various remodeling in the Dietetic Service space that would house the system. In January 1993, the VAMC submitted a project application showing an estimated cost of \$330,000 (\$307,000 for construction and \$23,000 for contingencies). VHA Western Region approved the project and provided the requested funding. In March 1994, the VAMC awarded the contract at a cost of \$321,805. When the project was completed in September 1995, the final cost was \$419,391. This cost included \$90,205 in PY funds, or 28 percent more than the contract price.

The PY funds were used primarily to install new air conditioning ductwork and to renovate Dietetics Service office space. None of this work was included in the project contract. The cost overrun on this project occurred primarily because the VAMC planned a larger project than was approved, with the expectation that the additional costs would be met with PY funds or other sources of funds.

### **VAMCs Need Better Guidance on Prior Year Funds**

At all four VAMCs audited, the staff responsible for issuing contract changes and requesting PY funds were not knowledgeable about VA's PY fund policies. As discussed on page 11, OFP had issued eight TWXs with guidance on PY funds. However, we found that none of the four VAMCs had a full set of the eight TWXs. In fact, VAMC staff requested copies of these TWXs from us. We concluded that the absence of clear guidance was the main reason that VAMCs used PY funds without approval and used these funds to pay for work outside the approved scope of contracts.

To address this problem VHA and OFP should work together to issue clear, consolidated guidance on PY funds policies and on the procedures for requesting and using PY funds. The guidance should cover the following issues:

**Oversight Responsibilities.** During the audit VHA and OFP officials agreed that responsibility for monitoring and reporting PY fund usage would be transferred from OFP to the VHA Chief Financial Officer (CFO). This is a good first step toward improving oversight, since VHA is the predominant user of PY funds within VA. However, stronger oversight is also needed at the local level. In our opinion, the new guidance should make the VISNs responsible for ensuring that their VAMCs properly request and use PY funds. We suggest that the new guidance require that VAMC requests to use PY funds be submitted to VISN management for approval before forwarding to the VHA CFO. The VISNs could establish dollar thresholds for approving PY fund requests -- that is, requests for small amounts could be routinely approved, but requests for large amounts or frequent requests for small amounts would receive closer scrutiny. The requirement to obtain VISN approval would deter VAMCs from inappropriately using PY funds to expand the scope of projects, and it would help VISNs identify projects that might have construction planning or management problems that need to be addressed.

**Station-Level PY Funds.** The new guidance should make it clear that the requirement to obtain approval to use PY funds applies to all PY funds, including those held in station-level accounts.

**Definition of Project Scope.** At the VAMCs audited, staff told us that they sometimes had difficulty in determining whether proposed additional work on NRM projects was within project or contract scope and therefore could properly be paid for with PY funds. Our review of OFP records pertaining to PY fund requests indicated widespread misunderstanding of the term “contract scope.” The following example illustrates this:

From October 1992 through September 1996, VAMC St. Louis requested and obtained approval to use PY funds 167 times (\$590,000 in PY funds). In September 1996, a Fiscal Service employee sent OFP an electronic message asking: “Do you have a manual reference relating to ‘Scope of Work’ that you could share with me?” OFP was not able to provide an answer.

To address this issue, the new guidance should provide VAMC staff with an understandable definition of “scope.” In our opinion, the thrust of this definition should be:

- If the contractor could refuse to do the proposed work on the basis that it was not required under the terms of the contract, the work is not within scope and should not be paid for with PY funds.
- If the proposed change or additional work is so essential to the accomplishment of the contract that the contractor cannot proceed unless it is completed, or if the desired work could not be accomplished as a separate item, the work is within scope and PY funds may be used.

**Equipment Installation Projects.** As discussed on page 10, OFP made a determination that PY funds approval requirements should apply only to NRM projects since NRM contracts were believed to be the only VA contracts on which PY funds would typically be needed and used. However, our audit found that VAMCs were also using PY funds to perform additional work on projects classified as equipment installation or equipment replacement projects and technically not considered NRM projects. In our opinion, the Expired Funds Control Act would cover the use of PY funds used on equipment installation projects. During the audit we discussed this issue with OFP officials and they agreed that equipment installation projects should be included in the new PY funds policy guidance.

**Differing Site Conditions, Design Omissions, and Design Errors.** Our review of PY funds requests submitted to OFP during FYs 1996 and 1997 found that VAMCs frequently justified their requests by using the terms “differing site conditions,” “design omissions,” and “design errors.” We recognize that many NRM projects will require minor additional work because of minor design mistakes or minor unforeseen adverse site conditions. However, in our opinion the use of these terms implies that better project planning might have avoided the need for the additional work. Because of this, we believe that requests for large amounts of PY funds justified by the use of these terms should receive closer scrutiny. This would help identify problematic projects that might require closer management attention to hold down project costs and complete the project on time. In addition, closer scrutiny will help prevent similar construction management deficiencies on future projects.

**Compliance with the Red Book.** In 1994, the VHA Office of Facilities Engineering and Construction issued the “Guide for Delegated Facilities Project Management,” known as the Red Book, which provides detailed guidance on the principles, policies, and procedures that VAMCs should follow in planning, contracting for, and managing NRM projects. In our opinion, the construction planning and management problems identified by the audit could have been avoided or mitigated if VAMCs had followed the Red Book guidance. Because of this, the new PY guidance should emphasize the need for responsible VAMC staff to understand and to comply with the Red Book. In particular, the policy should address the more significant construction management deficiencies by making it clear that VAMCs should not:

- Begin work on NRM projects before the scope of the project has been defined and project designs completed.
- Award contracts for amounts greater than the approved funding. (That is, VAMCs should not award contracts based on the assumption or expectation that PY funds or other funds will be available to make up for shortfalls.)
- Award contracts before adequately testing for site conditions that could reasonably be expected to exist and to increase project costs.

## **Improved Controls Will Reduce the Use of PY Funds**

Implementing the audit recommendations should significantly reduce the use of PY funds on NRM projects. The audit found that on the 12 NRM projects reviewed, the 4 VAMCs inappropriately used a total of \$3.81 million in PY funds. In our opinion, this \$3.81 million amount represents a reasonable estimate of the reduction in PY fund usage that should result from improving guidance, oversight, and controls on PY funds.

The \$3.81 million is reasonable because it represents only a small proportion of total PY fund usage as compared to the high rate of inappropriate usage for the projects reviewed. On the 12 projects the 4 VAMCs used a total of \$4.20 million. Of this amount, \$3.81 million, or 90.7 percent, was inappropriately used for work outside the scope of contracts. The total amount of PY funds used in FY 1995 is unknown because VAMCs could use these funds without obtaining approval. However, FY 1995 PY fund usage was at least \$17.45 million (\$14.50 million approved plus the \$2.95 million in unapproved usage that the audit found at VAMCs Chicago West Side and West Los Angeles). The \$3.81 million equates to only 21.8 percent of the \$17.45 million, as compared to the 90.7 percent rate of inappropriate use found on the 12 projects.

**Monetary Benefits**  
**In Accordance With IG Act Amendments**

**Report Title:** Audit of VA Medical Center Use of Prior Year Funds for Nonrecurring Maintenance Construction Projects

**Project Number:** 6R8-105

<b><u>Recommendation Number</u></b>	<b><u>Category/Explanation of Benefits</u></b>	<b><u>Better Use of Funds</u></b>	<b><u>Questioned Costs</u></b>
1a-d	Better use of funds by improving oversight, controls, and guidance to ensure that VAMCs obtain approval to use PY funds and do not use PY funds to pay for work outside the scope of contracts.	\$3.81 million	

**Under Secretary for Health Comments****Memorandum****Department of  
Veterans Affairs**

Date: August 27, 1997

From: Under Secretary for Health (10/105E)

Subj: OIG Draft Report, *Audit of VA Medical Center Use of Prior Year Funds for Nonrecurring Maintenance Construction Projects*, Project No. 6R8-105

To: Assistant Inspector General for Auditing (52)

1. The appropriate Veterans Health Administration (VHA) program offices reviewed this report and we concur with the recommendation. We also concur with the estimate of monetary benefits. VHA will work with the Assistant Secretary for Management's Office of Financial Policy (047G) to address the issues of better defining prior year funds oversight responsibilities and fund controls, and providing improved guidance on the appropriate use of funds, which you identified in the report.

2. Attached is a detailed action plan outlining our plans to implement the recommendation. Thank you for the opportunity to review the draft report. If you have any questions, please contact Paul C. Gibert, Jr., Director, Management Review and Administration Service (105E), Office of Policy, Planning and Performance, at 273.8355.

*(Original signed by:)*  
Kenneth W. Kizer, M.D., M.P.H.

Attachment

**Under Secretary for Health Comments, Continued**

Action Plan in Response to OIG/GAO/MI Audits/Program Evaluations/Review

Name of Report: *Audit of VA Medical Center Use of Prior Year Funds for Nonrecurring Maintenance Construction Projects*

Project No.: Project No. 6R8-105

Date of Report: Undated draft report

Recommendations/ Actions	Status	Completion Date
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Recommendation 1: We recommend that the Under Secretary of Health and the Assistant Secretary for Management work together to ensure that:

- a. Responsibility for monitoring the use of PY funds is transferred from OFP to VHA.
- b. Effective controls are established to ensure that VAMCs properly obtain approval to use PY funds and use these funds only for work within the approved scope of projects and contracts.
- c. VAMCs are provided with detailed policy guidance on PY funds policies and procedures.
- d. Responsible VAMC staff are provided training on the new PY funds policies and procedures.

Concur

Effective October 1, 1997, responsibility for monitoring the use of prior year funds will be transferred to the VHA Chief Financial Officer's (CFO) Accounting/Reports and Systems Service from the Office of the Assistant Secretary for Management's Office of Financial Policy. The Chief Network Officer, VHA CFO and Assistant Secretary for Management offices will work together to develop policy, procedures and guidance to ensure the proper and effective use of prior year funds. The issues identified in the report and the recommendations will be addressed in the new policies and procedures.

In process

12/31/97

## Acting Assistant Secretary for Management Comments

### Department of Veterans Affairs

### Memorandum

Date: September 30, 1997

From: Acting Assistant Secretary for Management (004)

Subj: OIG Draft Report, Audit of VA Medical Center Use of Prior Year Funds For Non-Recurring Maintenance (NRM) Construction Projects

To: Inspector General for Auditing (52)

1. I have reviewed the subject report and am extremely concerned about the findings regarding the inappropriate use of prior year (PY) funds in the non-recurring maintenance (NRM) program. The report states that because of the absence of controls, and in some cases VAMCs' non-compliance with VA policy, there was a risk that some VAMCs could be viewed as using PY funds as for expanding projects without approval, for completing unnecessary or questionable construction, and for correcting avoidable mistakes in project management. This situation further demonstrates the need for VA to establish a capital policy and program where decisions are made based on Agency mission and priorities. Capital decisions should never be based solely on the availability of funds. In addition, I agree with the recommendation that the oversight function be transferred from the Office of Financial Policy (047G) to VHA's Chief Financial Officer (17). I also agree that there should be stronger controls on the use of prior year funds and that better guidance should be given VAMCs on the appropriate use of these funds.

2. Although I concur that better guidance should be provided, I believe that some of the violations presented in the paper were caused by VA personnel simply choosing not to follow established rules and regulations. In the audit, some VAMC personnel "acknowledged that it was inappropriate to use PY funds" in the way they had, but that "it was quicker and easier" than following normal procedures for obtaining current year funds to pay for the work and awarding a contract. The report also contains examples of VAMCs using prior year funds that are clearly outside the scope of the project. This includes VAMCs using prior year funds on additional work (such as construction on a different floor) that was not in the contract or on work in an entirely different building. The report also states that some VAMCs are awarding contracts that are larger than the funding provided and paying for this work from the prior year accounts. These situations clearly show that increased monitoring of prior year funds is needed.

3. I do not agree with the IG report suggestion that the VISNs should be the sole approving official for the use of PY funds, because as the report states, the VISNs normally allow VAMC managers to determine how best to meet their NRM needs. Delegating this responsibility to the VISNs, who would, in turn, most likely let VAMCs make decisions, would most likely not prevent VAMCs from continuing to use prior year funds inappropriately. Because of the poor management of PY funds described above and throughout the IG audit, I believe that improved oversight and increased monitoring over these funds is necessary. Therefore, I have recommended actions to the Under Secretary for Health that would create a multi-level approval process and increase reporting requirements in order to minimize such a reoccurrence.

**Acting Assistant Secretary for Management Comments, Continued**

4. In conclusion, I agree with many of the report's findings and recommendations. I concur with the recommendation that there should be stronger controls on the use of prior year funds and that better guidance be given to VAMCs on the correct use of these funds. Furthermore, I firmly support the reports' three recommendations that would correct the planning and management deficiencies that significantly increased the cost of some NRM projects. However, I strongly believe that the control of prior year funds needs to be more stringent than what the IG report recommends. If you have any questions or comments regarding this matter please have a member of your staff call James M. Sullivan at 273-5254.

*(Original signed by:)*  
D. MARK CATLETT

Attachment

cc: (10)  
(17)  
(18)  
(047G)

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