

Upward and Downward Adjustments Inflation

What are Adjustments?

A decade ago, OMB only required agencies to report the net obligation activity for expired funds. That is, de-obligations, new obligations, expenditures, and vendor refunds were all netted together. Then OMB became concerned that agencies were using expired funds for new spending. In order to track this, OMB required that agencies report downward adjustments (de-obligations and vendor refunds) separately from upward adjustments (increases to obligations or expenditures in excess of the obligation). The Standard General Ledger (SGL) was modified to include separate accounts for this type of activity. For example, obligation activity in the current year's appropriation posts to 4801 (Undelivered Orders - Obligations, Unpaid), while obligation decreases in an expired appropriation post to 4871 (Downward Adjustments of Prior-Year Unpaid Undelivered Orders - Obligations, Recoveries) and increases post to 4881 (Upward Adjustments of Prior-Year Undelivered Orders - Obligations, Unpaid).

What is Adjustment Inflation?

Adjustment inflation occurs when transactions against a single document increase *both* upward and downward adjustments. In the normal course of business, it is possible for an expired fund to build up large balances in both the upward and downward adjustments accounts, when these activities really should be netted against each other. Some example scenarios are:

- ? A new obligation is accidentally entered in an expired fund (causing an upward adjustment), then the mistake is corrected by entering the obligation in a current fund and canceling the obligation in the expired fund (causing a downward adjustment).
- ? Payroll accruals are recorded in September when a fund is current, backed out in October when the fund is expired (causing a downward adjustment), and then the actual payroll is recorded in October (causing an upward adjustment).
- ? An invoice is received against an expired fund's obligation, where the invoice is for less than the outstanding obligation, but the order is liquidated in full (causing a downward adjustment). Later that year, a second invoice is received, and the order is reopened (causing an upward adjustment) and then liquidated for the invoice amount.

Detecting Inflation

The first task is to detect cases where adjustment inflation has occurred. While every system has its own peculiarities, it should be possible to sort through the journal, matching entries where the same document and line posted the same amount as a debit to a downward adjustment account (4871, 4872, 4971, or 4972) and as a credit to an upward adjustment account (4881, 4882, 4981, or 4982). This exercise should locate cases where a document was closed and subsequently reopened, entered and canceled, or an accrual was entered and reversed.

If the same document posted both upward and downward adjustments, but not for the same amount, then it may not be clear if these are instances of inflation, or separate transactions that really should be reported as both upward and downward adjustments. The agency will have to make its own determination. With accrual reversals and actuals, the first task is to match the accrual reversal with the actual spending. It would be best if the agency entered accruals that referenced the spending document, or visa versa, or both reference the same obligating document. Failing that, the agency may be able to link the two transactions by their accounting distribution or vendor (for payroll, SSN).

Correcting Inflation

When making corrections to reduce upward and downward adjustments, it is important to keep in mind the effect the correction will have on auditing these accounts. Where the upward and downward adjustments net to zero at the detail level, it should be possible to segregate these transactions and post a correction at the appropriation level. Segregation could mean flagging these entries in the journal, excluding them from the extract during the audit, or moving them from the regular journal to an auxiliary journal. In systems where segregation is not possible, it may be necessary to record the corrections at the document line level, so the auditors can offset them before they take their sample.

For cases where the upward and downward amounts do not agree, it will not be possible to simply segregate the original transactions, since they do not net to zero and therefore the remaining transactions will not support the amount on the trial balance. In these cases, only the lesser of the upward or downward adjustment will be backed out, and the back out will need to be recorded at the same level of detail as the determination was

made (whether that was at the document line level, accounting distribution level, or vendor level). It is possible to segregate only the back-out transaction and whichever adjustment was the lesser. For example, if an accrual reversal posts a downward adjustment of \$100 and the actual posts an upward adjustment of \$95, then \$95 of both upward and downward adjustments are backed out, and one can segregate out the upward adjustment and the back-out of \$95, but one must leave the downward adjustment of \$100 and its back-out of \$95 (for a net downward adjustment of \$5).

Only like adjustments can be set off against each other, so if an order is canceled posting to 4871, and then restored posting to 4881, the correcting entry is to debit 4881 and credit 4871. However, if a document recorded adjustments in different types of accounts, the adjustments will have to be transferred to the related non-adjustment accounts. So if an invoice was erroneously scheduled for payment a second time, posting to account 4981, and then the check was canceled or returned and deposited into 4972, one cannot correct it by simply posting debit 4981 credit 4972, because this would misrepresent payables and cash in the budgetary accounts. The correct entry is to back out the overpayment adjustment with the entry debit 4981 credit 4901, then back out the cancellation adjustment with the entry debit 4902 credit 4972.

Comments, suggestions, and critiques are welcome. Send them to Simcha.Kuritzky@ams.com, and not to the AGA.