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United States Government Accountability Office
Washington, DC 20548

March 31, 2010

Congressional Committees

Subject: *Defense Budget: Fourth Quarter Obligation Rates and Contract Obligations for Fiscal Years 2006-09*

This letter formally transmits the enclosed briefing in response to the National Defense Authorization Act for Fiscal Year 2010 (Pub. L. No. 111-84), which requires GAO to review Department of Defense (DOD) policies related to year-end spending and the rate of obligations incurred by DOD in the fourth quarter of fiscal years 2006 through 2009, as compared with the obligations incurred in the first three quarters of those fiscal years for both 1-year and multi-year appropriations. GAO is required to report to the Committees on Armed Services of the Senate and House of Representatives by March 31, 2010. On March 19, 2010, we provided the briefing to staff of your respective committees.

We are sending copies of this report to the appropriate congressional committees. We are also sending copies to the Secretary of Defense and the Under Secretary of Defense (Comptroller) and the Secretaries of the Army, the Air Force, and the Navy. The report also is available at no charge on the GAO Web site at <http://www.gao.gov>.

Should you or your staff have any questions concerning this report, please contact Sharon L. Pickup at (202) 512-9616 or Bill Woods at (202) 512-8214. Contact points for our Office of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report were Donna Evans, Assistant Director; Robert Brown; Jason Jackson; Mae Jones; Julia Kennon; Lonnie McAllister; Charles Perdue; Stephen Pruitt; and Patrick Washington.

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Enclosure

Report Documentation Page

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**DOD's Fourth Quarter Obligation Rates and
Contract Obligations for Fiscal Years 2006-09**

**Briefing for Congressional Committees
March 31, 2010**



Overview

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 - Unfinalized Contract Actions (UCAs)

Objectives

- 1) To what extent has DOD established policies or guidance regarding the obligation of funds in the fourth quarter of the fiscal year?
- 2) To what extent has DOD incurred obligations in the fourth quarter of fiscal years 2006-09 for both 1-year and multi-year appropriations?
- 3) To what extent has DOD incurred contract obligations in the fourth quarter of a fiscal year as compared with obligations incurred in the previous three quarters, and to what extent are those fourth quarter obligations incurred for competitive contracts?



Background

- The Fiscal Year 2010 National Defense Authorization Act requires GAO to review obligations incurred by the DOD in the fourth quarter of fiscal years 2006-09 for 1-year and multi-year appropriations and to
 - compare those obligations with those incurred in the first three quarters of the fiscal year and
 - determine whether DOD's financial execution policies contributed to hastened year-end spending.
- DOD has certain time frames to obligate funds for its various appropriation accounts:
 - For 1-year appropriations such as Military Personnel (MILPERS) and Operation & Maintenance (O&M) accounts, DOD generally has 1 year to obligate funds before they expire and
 - For multi-year appropriations, such as Procurement and Research, Development, Test & Evaluation (RDT&E), DOD generally has 3 and 2 years, respectively, to obligate funds before they expire.

Background (cont.)

- The Conference Report, H. Rept. 111-288, accompanying the Fiscal Year 2010 National Defense Authorization Act noted
 - In 1979 and 1980, the Senate Subcommittee on Oversight of Government Management held hearings and issued a report entitled *Hurry-Up Spending* in which it found that the rush to obligate expiring funds before the end of the fiscal year frequently resulted in lack of competition, poorly defined statements of work, inadequately negotiated contracts, and the procurement of low-priority items or services.
 - The Subcommittee's work contributed to the passage of the Competition in Contracting Act of 1984 (P.L. 98-369, Div. B., title VIII).
- In 1998, GAO reported that systemic procurement reforms, including the Competition in Contracting Act of 1984, had addressed most issues raised in the Subcommittee's report but that some problems persisted (See *Year End Spending: Reforms Underway but Better Reporting and Oversight Needed*, GAO/AIMD-98-185).

Background (cont.)

- Contracts generally must be competed, but there are statutory exceptions (such as urgency) that permit non-competitive awards.
- Agencies also can use undefinitized contract actions (UCAs) when they need to make awards before reaching agreement on all contract terms. GAO has reported that UCAs are considered to be risky for the government because contractors lack incentives to control costs before reaching final agreement on contract terms. (See *Defense Contracting: DOD Has Enhanced Insight into Undefinitized Contract Action Use, but Management at Local Commands Needs Improvement*, GAO-10-299).



Scope & Methodology

- Reviewed legislation, DOD's *Financial Management Regulation*, and internal budget guidance and policies from the Office of the Under Secretary of Defense, Comptroller and service components.
- Interviewed officials from the Office of the Under Secretary of Defense, Comptroller and service components to determine whether DOD had established guidance or policies concerning the obligation of funds in the fourth quarter.
- Obtained data on obligation rates from Under Secretary of Defense, Comptroller and Defense Finance and Accounting Service data for 1-year appropriations (MILPERS and O&M) and multi-year appropriations (Procurement and RDT&E) for fiscal years 2006-09. For purposes of this analysis, we reviewed active and reserve component obligations for each of the military services, which include both base and supplemental funding for each fiscal year.
 - For 1-year appropriations, we compared obligation rates incurred in the fourth quarter to obligation rates incurred in the total remaining three quarters.



Scope & Methodology (cont.)

- For multi-year appropriations, we identified total obligation rates for each year of the appropriated funds' availability and for the fourth quarter of the last year of availability.
- To analyze appropriations whose last year of availability fell in fiscal years 2006-09, the time period specified in the mandate, in some cases, we had to obtain obligation data from fiscal years prior to 2006. For example:
 - For Procurement appropriations, which have 3 years of availability, we reviewed fiscal years 2004-09 data.
 - For RDT&E appropriations, which have 2 years of availability, we reviewed fiscal years 2005-09 obligation data.

Scope & Methodology (cont.)

- Since 1995, GAO has designated DOD's financial management as a high-risk area due to, among other things, DOD's pervasive financial and related business management system deficiencies. For example, we have reported on the unreliability of DOD's financial transaction data, including accounting for obligations, and the lack of reasonable assurance over DOD's compliance with legal limitations on the use of appropriated funds. Consequently, we are unable to ensure that DOD's reported obligations are complete, reliable, and accurate, and they should therefore be considered approximations. For the purposes of our review, we verified that the data we collected were consistent with the data recorded in source documents, but we did not independently assess the reliability of the data.
- We used unaudited Federal Procurement Data System-Next Generation (FPDS-NG) data to identify both the percentage and dollar amounts obligated for competed and non-competed contracts in fiscal years 2006 through 2009. The system does not break down contracting data by appropriation. We believe that the system's data used for these analyses are sufficiently reliable for the purposes of this review. However, the data on UCAs were not sufficiently reliable.

Scope & Methodology (cont.)

- We conducted this performance audit from November 2009 to March 2010 in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.
- DOD provided technical comments on a draft of this product, which we incorporated.

Objective 1

Policies and Guidance for Obligating Funds

- Neither DOD nor the military services have policies or guidance that specifically address the obligation of funds in the fourth quarter of the fiscal year. However, the Air Force has developed guidance that discourages spending resources at the end of the fiscal year merely because they are available, and encourages reporting unused funds to headquarters.

- DOD is subject to a statutory limitation (the 80/20 rule) that states: *not more than 20 percent of 1-year appropriations may be obligated during the last 2 months of the fiscal year.*
 - A passage in the DOD *Financial Management Regulation* refers to the 80/20 rule and states: *Each year, the general provisions of the DOD Appropriations Act require a certification that not more than 20 percent of the appropriations in that act, which are limited for obligation during the current fiscal year, shall be obligated during the last 2 months of the fiscal year (i.e. the “80/20 rule). Supplemental funds are not subject to the 80/20 rule.*
 - The Office of the Under Secretary of Defense, Comptroller and the service components create annual spending plans to monitor obligations throughout the year and use this information to certify whether the 80/20 rule was addressed.

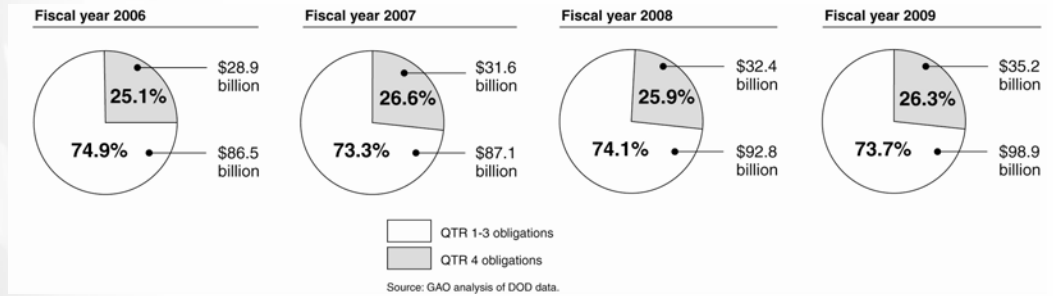
Objective 2

**Fourth Quarter Obligation Rates for MILPERS---
Active and Reserve Components**

- For fiscal years 2006 through 2009, the active and reserve components obligated between 25.1 percent and 26.6 percent of its MILPERS appropriations in the fourth quarter, as shown on the following slide.
- DOD officials explained that obligation rates may appear higher in the fourth quarter because, for example, of cyclical occurrences, such as a summer surge in recruiting, an increase of troop end-strength, and an increased availability of reserve component members for annual training during the summer months. DOD officials also explained that other factors, such as a higher rate of permanent change of station actions may affect fourth quarter obligation rates as well.

Objective 2

Fourth Quarter Obligation Rates for MILPERS--Active and Reserve Components



Objective 2

Fourth Quarter Obligation Rates for MILPERS by Service Component--Active

- Fourth quarter MILPERS obligation rates for the active service components ranged from 24.2 percent to 27.3 percent for fiscal years 2006 through 2009, as shown on the following slide.
- DOD officials explained that obligation rates may appear higher in the fourth quarter because, for example, of cyclical occurrences, such as a summer surge in recruiting, an increase of troop end-strength. DOD officials also explained that other factors, such as a higher rate of permanent change of station actions may affect fourth quarter obligation rates as well.

Objective 2

Fourth Quarter Obligation Rates for MILPERS by Service Component--Active

Fourth Quarter MILPERS Obligation Rates by Active Service Component (FY 2006-09)

Active service component	2006	2007	2008	2009
Army	24.2%	27.3%	25.6%	26.6%
Air Force	25.7%	26.6%	26.4%	25.8%
Navy	25.3%	25.4%	24.9%	25.0%
Marine Corps	24.9%	25.4%	25.7%	26.3%

Source: GAO analysis of DOD data.

Objective 2

Fourth Quarter Obligation Rates for MILPERS by Service Component--Reserve

- Fourth quarter MILPERS obligation rates for the reserve service components ranged from 17.9 percent to 30.4 percent for fiscal years 2006 through 2009, as shown on the following slide.
- DOD officials explained that obligation rates may appear higher in the fourth quarter because, for example, of cyclical occurrences, such as a summer surge in recruiting, an increase of troop end-strength, and an increased availability of reserve component members for annual training during the summer months.

Objective 2

Fourth Quarter Obligation Rates for MILPERS by Service Component--Reserve

Fourth Quarter MILPERS Obligation Rates by Reserve Service Component (FY 2006-09)

Reserve service component	2006	2007	2008	2009
Army Reserve	29.2%	27.2%	27.9%	29.5%
Army Guard	27.9%	30.4%	28.4%	29.4%
Air Force Reserve	19.5%	20.6%	20.7%	17.9%
Air Guard	22.3%	23.8%	26.9%	25.0%
Navy Reserve	24.8%	28.1%	27.4%	26.8%
Marine Corps Reserve	23.7%	23.4%	22.2%	30.0%

Source: GAO analysis of DOD data.

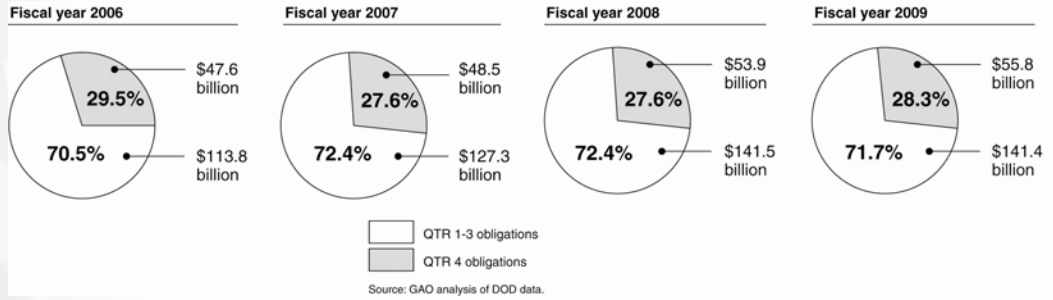
Objective 2

Fourth Quarter Obligation Rates for O&M--Active and Reserve Components

- For fiscal years 2006 through 2009, the active and reserve components obligated between 27.6 percent and 29.5 percent of its O&M appropriations in the fourth quarter, as shown on the following slide.
- DOD officials explained that obligation rates may appear higher in the fourth quarter because, for example, DOD received supplemental funding late in the fiscal year.

Objective 2

Fourth Quarter Obligation Rates for O&M--Active and Reserve Components



Objective 2

Fourth Quarter Obligation Rates for O&M by Service Component--Active

- Fourth quarter O&M obligation rates for the active service components ranged from 23.3 percent to 32.2 percent for fiscal years 2006 through 2009 as shown on the following slide.
- DOD officials explained that obligation rates may appear higher in the fourth quarter because, for example, DOD received supplemental funding late in the fiscal year.

Objective 2

Fourth Quarter Obligation Rates for O&M by Service Component--Active

Fourth Quarter O&M Obligation Rates by Active Service Component (FY 2006-09)

Active service component	2006	2007	2008	2009
Army	31.0%	25.6%	27.1%	31.0%
Air Force	31.9%	32.1%	30.2%	29.0%
Navy	25.7%	27.1%	25.6%	23.3%
Marine Corps	32.0%	27.1%	32.2%	31.9%

Source: GAO analysis of DOD data.

Objective 2

Fourth Quarter Obligation Rates for O&M by Service Component--Reserve

- For fiscal years 2006 through 2009, fourth quarter obligation rates for the reserve component ranged from 19.6 percent to 41 percent as shown on the following slides.
- DOD officials explained that obligation rates may appear higher in the fourth quarter because, for example, DOD received supplemental funding late in the fiscal year.

Objective 2

Fourth Quarter Obligation Rates for O&M by Service Component--Reserve

Fourth Quarter O&M Obligation Rates by Reserve Service Component (FY 2006-09)

Reserve service component	2006	2007	2008	2009
Army Reserve	27.7%	30.0%	30.6%	28.8%
Army Guard	26.0%	26.5%	21.9%	25.2%
Air Force Reserve	27.3%	28.5%	25.3%	25.6%
Air Guard	21.9%	25.0%	26.5%	22.8%
Navy Reserve	25.7%	26.2%	26.1%	19.7%
Marine Corps Reserve	38.8%	19.6%	41.0%	22.7%

Source: GAO analysis of DOD data.

Objective 2

Obligation Rates for Procurement for Service Components--Active

- For procurement, the active service components obligated 75.3 percent or more of the appropriation in the first year that funding was available and then significantly smaller percentages in the second and third years.
- For the fourth quarter of the third year of funding availability, obligation percentages were 1.9 percent or less, as shown on the following slide.

Objective 2

Obligation Rates for Procurement for Service Components--Active

Procurement Obligation Rates by Year of Funding Availability (FY 2006-09)

Funding availability by fiscal year	1st year	2nd year	3rd year	Fourth quarter 3rd year
2004-06	89.9%	7.7%	2.4%	1.0%
2005-07	86.9%	10.5%	2.5%	0.8%
2006-08	80.8%	15.7%	3.5%	1.5%
2007-09	75.3%	19.3%	5.4%	1.9%

Source: GAO analysis of DOD data.

Objective 2

Obligation Rates for Procurement

- For procurement, the active service components obligated 70.8 percent or more of the appropriation in the first year that funding was available and then obligated significantly smaller percentages in the second and third years.
- For the fourth quarter of the third year of funding availability, obligation rates were 2.7 percent or less, as shown on the following slide.

Objective 2

Obligation Rates for Procurement

Procurement Obligation Rates by Year of Funding Availability by Service (FY2009)

Service	1st year FY 2007	2nd year FY 2008	3rd year FY 2009	Fourth Quarter 3rd year FY 2009
Army	75.5%	20.2%	4.3%	1.1%
Air Force	75.1%	18.6%	6.3%	2.7%
Navy	76.7%	17.6%	5.7%	2.2%
Marine Corps	70.8%	23.1%	6.1%	1.4%

Source: GAO analysis of DOD data.

Objective 2

Obligation Rates for RDT&E

- For RDT&E, the active service components obligated 86.5 percent or more of the appropriation in the first year that funding was available and then significantly smaller percentages in the second year.
- For the fourth quarter of the second year of funding availability, obligations rates were 2.7 percent or less, as shown on the following slide.

Objective 2

Obligation Rates for RDT&E

RDT&E Obligation Rates by Year of Funding Availability (FY 2006-09)

Funding availability by fiscal year	1st year	2nd year	Fourth quarter 2nd year
2005-06	91.0%	9.0%	1.6%
2006-07	88.6%	11.4%	1.9%
2007-08	88.7%	11.3%	2.3%
2008-09	86.5%	13.6%	2.7%

Source: GAO analysis of DOD data.

Objective 2

Obligation Rates for RDT&E

- For RDT&E, the active service components obligated 84 percent or more of the appropriation in the first year that funding was available and then significantly smaller percentages in the second year.
- The percentage of RDT&E funds obligated in the fourth quarter of the last year of funding availability was 2.9 percent or less, as shown on the following slide.

Objective 2

Obligation Rates for RDT&E

RDT&E Obligation Rates by Service by Year of Funding Availability (FY 2009)

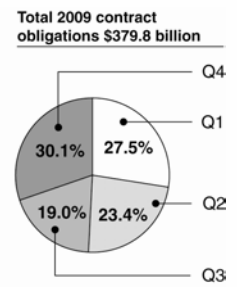
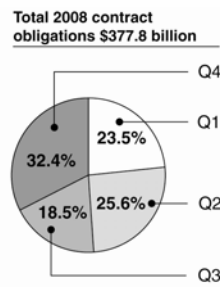
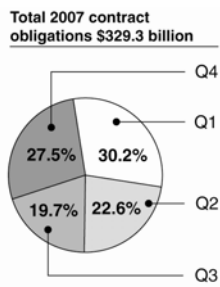
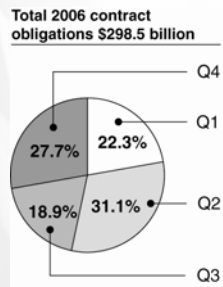
Service	1st year FY 2008	2nd year FY 2009	Fourth quarter 2nd year FY 2009
Army	88.3%	11.7%	2.5%
Air Force	84.0%	16.0%	2.9%
Navy	88.7%	11.3%	2.4%

Source: GAO analysis of DOD data.
Note: The Marine Corps is included in the Navy's RDT&E appropriation.

Objective 3

Fiscal Years 2006-2009 Contract Obligations

Contract obligations by quarter for fiscal years 2006 through 2009 vary and show no consistent pattern.

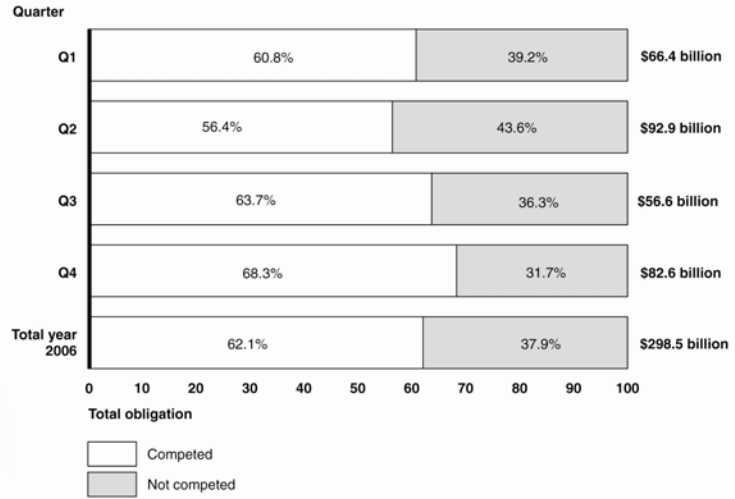


Source: GAO analysis of Federal Procurement Data System-Next Generation data.

Objective 3

**Fiscal Year 2006 Contract Obligations:
Competed vs. Non-Competed**

The percentage of contract obligations competed was highest (68.3%) in the fourth quarter.

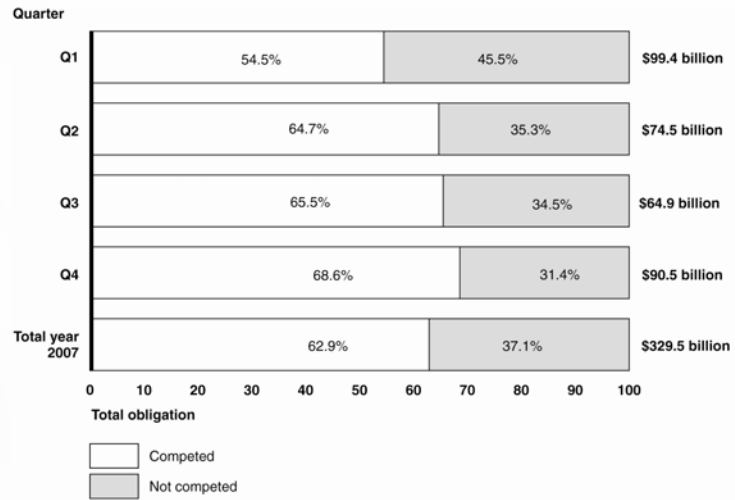


Source: GAO analysis of Federal Procurement Data System-Next Generation data.

Objective 3

**Fiscal Year 2007 Contract Obligations:
Competed vs. Non-Competed**

The percentage of contract obligations competed was highest (68.6%) in the fourth quarter.

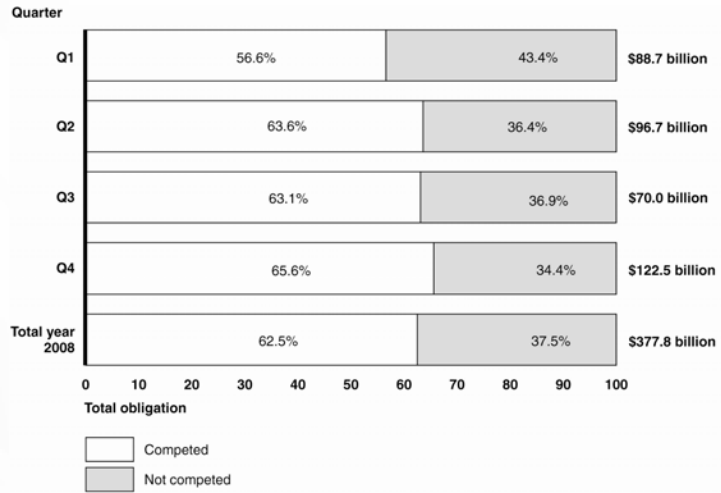


Source: GAO analysis of Federal Procurement Data System-Next Generation data.

Objective 3

**Fiscal Year 2008 Contract Obligations:
Competed vs. Non-Competed**

The percentage of contract obligations competed was highest (65.6%) in the fourth quarter.

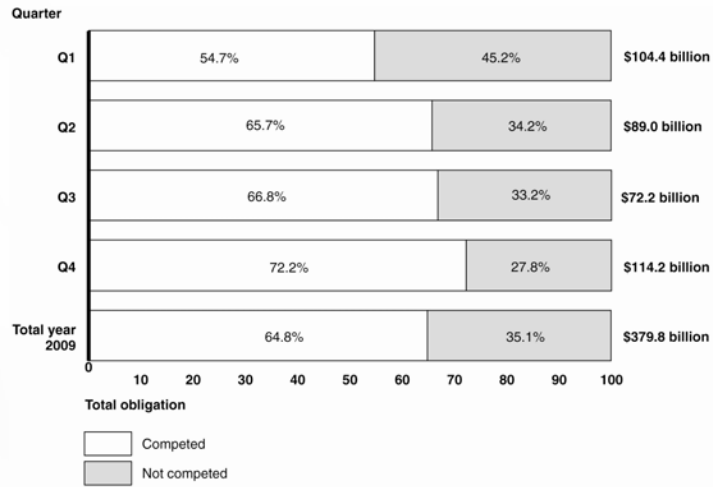


Source: GAO analysis of Federal Procurement Data System-Next Generation data.

Objective 3

**Fiscal Year 2009 Contract Obligations:
Competed vs. Non-Competed**

The percentage of contract obligations competed was highest (72.2%) in the fourth quarter.



Source: GAO analysis of Federal Procurement Data System-Next Generation data.

Objective 3

Undefinitized Contract Actions (UCAs)

- Available data show that obligations for UCAs are about 5 percent of total contract spending: \$18 billion in potential obligations out of \$378 billion in total contract spending in fiscal year 2008.
- Data limitations prevented us from analyzing spending on UCAs by quarter.
- As we have previously reported,* data limitations also hinder DOD's full understanding of the extent to which UCA's are used. For example,
 - Eight of the 24 contract actions that should have been included in a required DOD report on UCA's were omitted.
- DOD reporting requirements are still in flux, i.e., DOD has proposed including unpriced change orders in UCA reporting.

*Defense Contracting: DOD Has Enhanced Insight into Undefinitized Contract Action Use, but Management at Local Commands Needs Improvement, GAO-10-299 (Washington, D.C.: Jan. 28, 2010).

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