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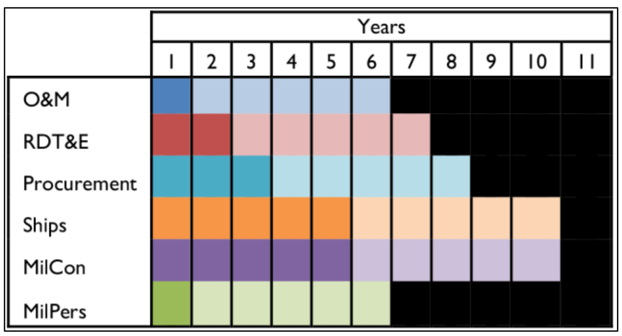
End-Year DOD Contract Spending

Background Information

The Department of Defense (DOD) obligates approximately $300 billion annually on defense acquisitions. These funds, drawn primarily from more than 100 distinct DOD appropriations accounts, can be divided into six major categories (or six 'colors of money'): Operation and Maintenance (O&M); Research, Development, Test, and Evaluation (RDT&E); Procurement; Shipbuilding and Conversion; Military Construction (MilCon); and Military Personnel (MilPers). Funds from these accounts generally must be obligated within specific time periods (see **Figure 1**). When an obligation period ends, unobligated funds generally expire. DOD has a further five years to liquidate (spend) or reprogram already obligated funds.

Figure 1. Appropriation Lifespan ("color of money")



Source: Defense Procurement Acquisition Policy

Notes: Dark colors represent current funds (available for new obligations, obligation adjustments, expenditures, and outlays). Light colors represent expired funds (unavailable for new obligations).

Why the Current System Was Created

In 1956, Congress established *M accounts* and *merged surplus authority accounts*. *M accounts* were agency managed accounts (by appropriation category) into which unused obligated balances were transferred. Funds in these accounts had no expiration date and could be used to pay for prior valid obligations. *Merged surplus authority accounts* were Treasury accounts maintained by the agency where unobligated and deobligated funds were merged. Funds in these accounts had no expiration date and could be transferred into M accounts to pay for prior incurred obligations. The balances in these accounts grew over the years. According to the Government Accountability Office (GAO), in 1989 DOD had approximately $18 billion in M accounts and $25 billion in merged surplus accounts.

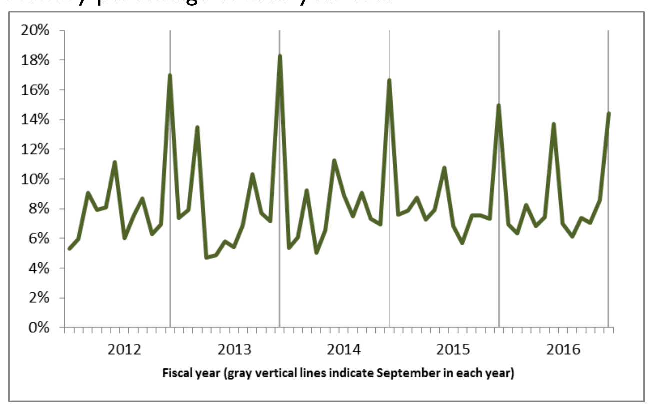
Concerned over DOD's use of these accounts, Congress put restrictions on the use of funds from these accounts in 1989 (P.L. 101-189). The following year Congress abolished both accounts (P.L. 101-510), cancelling balances five years after budget authorities expire—regardless of whether obligated or unobligated. Sections 1551-1557 of P.L. 101-510 imposed a framework for DOD's management of appropriations accounts over multiple fiscal years.

Obligations Increase in September

In FY2016 DOD contract obligations were approximately $298 billion (an average of $25 billion every month). However, obligations increased substantially in the last month of the fiscal year (September), surpassing $43 billion (14% of annual obligations). As **Figure 2** and **Figure 3** indicate, over the last five years, obligations in September have been roughly double those in other months.

Figure 2. DOD Action Obligations, FY2012-FY2016

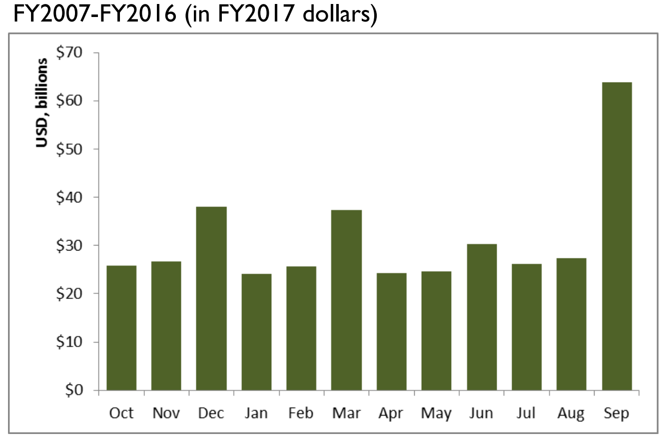
Monthly percentage of fiscal year total



Source: FPDS.gov (Defense Commissary Agency data excluded).

Figure 3. Mean Average Monthly Obligations

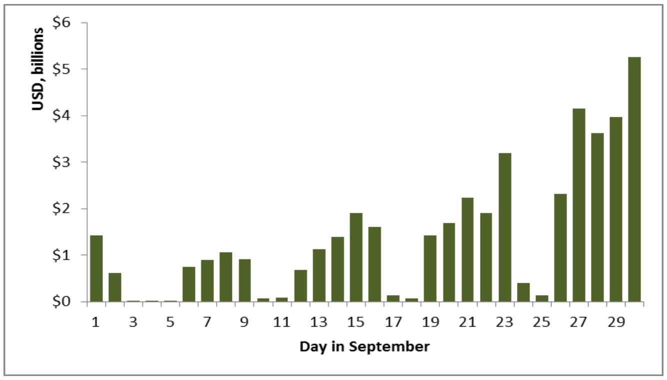
FY2007-FY2016 (in FY2017 dollars)



Source: FPDS.gov (Defense Commissary Agency data excluded).

September obligation trends over the last five fiscal years indicate that weekly obligations increase substantially at the end of a fiscal year (see **Figure 4**). In FY2016, weekly obligations averaged $5.7 billion, compared to $19.8 billion in the last week of September. This compared to $26 billion for the entire month of August and $21 billion for July.

Figure 4. September FY2016 DOD Action Obligations



Source: FPDS.gov (Defense Commissary Agency data excluded).

Why Obligations Increase in September

A 1998 GAO report defined "wasteful year-end spending" as when "agencies rush to use funds at the end of the fiscal year...often an attempt to spend funds that would otherwise expire, meaning they would no longer be available for new obligations after the fiscal year ends." Later reports had similar findings, including a 2013 study by the National Bureau of Economic Research that found federal IT information technology contracts with end-of-year obligations to generally be "lower quality" acquisitions.

Numerous factors can contribute to increased end-of-year spending. Many analysts consider it a best practice to reserve some funds for unforeseen events or cost increases. Another factor could be DOD reprogramming requests, many of which are submitted to Congress late in the fiscal year. For example, in June 2016, DOD submitted an omnibus request to reprogram $1.2 billion in the FY2016 budget. The process of submitting the request, Congress reviewing and respond to the request, and DOD reprogramming funds (including placing such funds on contracts), can push the obligation date into late September. Continuing Resolutions may similarly contribute to end of year spending increases (see CRS Report R44636, *FY2017 Defense Spending Under an Interim Continuing Resolution (CR): In Brief*, by Lynn M. Williams and Sean I. Mills).

Some analysts believe these factors do not explain the full extent of end-of-year spending, arguing that funds are often obligated at year-end to protect future budgets, often resulting in the purchase of goods and services that are not needed. As then-Senator William Cohen stated in 1980

> Federal program managers and budget personnel are faced with a Catch-22 situation. They're supposed to spend the public's money as carefully as possible, but if they plan effectively ... spend less, and manage to return tax dollars to the Treasury, they face the prospect of having their budgets slashed for the next year. There is simply no incentive for prudent management, no regard for the savings of tax dollars. The system is commonsense turned upside down.

In 2012, then-DOD Comptroller Robert Hale and Under Secretary of Defense (AT&L) Frank Kendall co-authored a memo aimed at addressing the "problem" of end-of-year spending. The memo acknowledged "the threat that funding will be taken away or that future budgets can be reduced unless funds are obligated on schedule is a strong and perverse motivator. We risk creating incentives to enter into quick but poor business deals or to expend funds primarily to avoid reductions in future budget years." The memo sought to alter these negative incentives, stating "managers who release unobligated funds to higher priorities will not automatically be penalized in their next year's budget with a lower allocation and may be candidates for additional funding to offset prior year reductions."

Efforts to Curb End-of-Year Spending

In 1979, the Senate Subcommittee on Oversight of Government launched an investigation into the subject, culminating in a bipartisan committee report entitled *Hurry-Up Spending*. The report analyzed prior congressional and DOD efforts to rein in such spending, including appropriating no-year or multi-year funding mechanisms (such as M accounts), and limiting the percentage of funds that could be obligated in the last two months of a fiscal year (routinely enacted for DOD since 1953). Despite these efforts, the report found that "the amount of waste that can be attributed to year-end spending is immense."

DOD appropriations generally include a provision known as the "20 percent rule," requiring that no more than 20 percent of one-year appropriations be obligated in the final two months of the fiscal year (P.L. 114-113, sec. 8004). (Some have argued that such a limitation simply encourages rushed spending right before the cap takes effect.) In 2010, GAO reported that DOD implemented programs to "monitor obligations throughout the year" to track whether the 20 percent rule was followed.

Despite these efforts to reduce possible wasteful end-of-year spending, spikes continue. In part to address this issue, a bill was introduced in both the House and the Senate aimed at giving bonuses to federal employees who identify wasteful spending (Bonuses for Cost-Cutters Act of 2017, H.R. 378; S. 1830). Other proposed options include allowing some funds to roll over into the next year or reexamine budget and obligation processes within DOD.

Some of options were discussed at the September 2017 hearing of the Senate Subcommittee on Federal Spending and Emergency Management, *Prudent Planning or Wasteful Spending? Another Look at End of Year Spending*. One witness suggested a pilot program granting select agencies limited "authority to roll over up to 5%" of appropriation into the next year. Such authority could, for example, be limited to certain O&M accounts and/or only roll over funds for the first three months of the next year.

Congress has, in limited cases, approved roll-over authority. In the FY2017 Consolidated Appropriations Act (P.L. 115-31), the Defense Health Program received O&M appropriations "of which not to exceed one percent shall remain available for obligation until September 30, 2018."

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