Recommendation 49: Provide increased flexibility to the time periods within which contract obligations are permitted to occur.

Problem

End-year contract obligation surges, spurred by a *use-it-or-lose-it* mentality, can lead to lower-quality requirements and contracts, inefficient allocation of resources, degraded negotiating leverage and pricing power, and a negative effect on workforce morale.

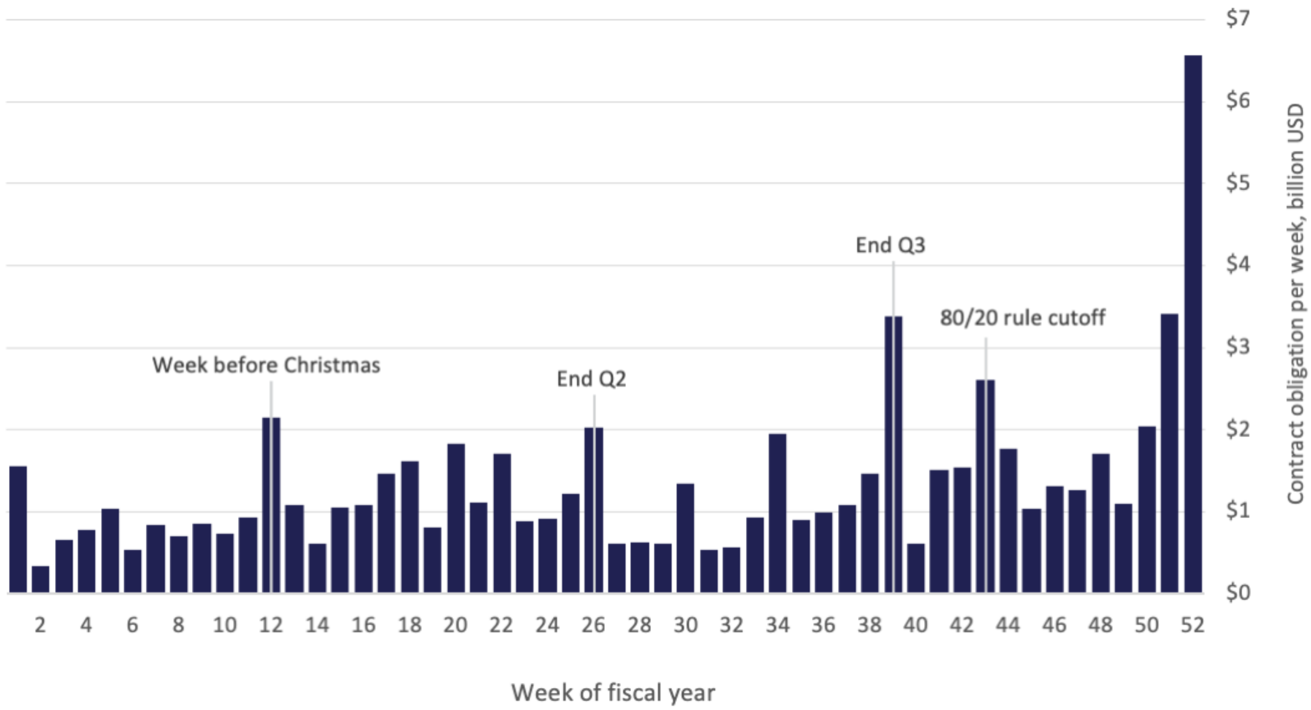
Background

DoD acquisition, like other forms of government spending, is funded through the congressional appropriations process. Each appropriation account has a specific periodicity, or block of time within which DoD has the budget authority to obligate funds to buy products and services.

A key performance metric for DoD's budget execution is its obligation of appropriations within given time periods (obligation rate). The obligation rate measure drives tactical and strategic spending decisions throughout the fiscal year. Throughout the acquisition community there is a strong cultural belief that if funds are not obligated, they will be reallocated to other projects or reduced in future appropriations.

Because of these beliefs, which may in many cases be justified, an obligation surge occurs at the end of each fiscal year. This rush to spend, spurred by a use it or lose-it mentality, can lead to lower-quality requirements and contracts, inefficient resource allocation, degraded negotiating leverage and pricing power, and a negative effect on workforce morale.

Figure 4-7. Weekly Obligations on Contracts under O&M Appropriations Account, FY 2017[1]



End-period defense contract spending is concentrated largely in the O&M appropriations accounts. Although other acquisition-focused appropriations accounts have multiyear obligation authority, O&M funding must be obligated within the span of a single year.

If Congress and other decision makers chose to address end-year obligation surges by mandating their reduction (for instance, by imposing a monthly percentage cap on DoD contract obligations, essentially a much more rigorous version of the 80/20 rule) it would likely eliminate the distorted annual spending patterns seen in acquisition data. It would, however, represent an additional incentive for acquisition personnel to prioritize timing over procurement quality. In this way, such an approach might simply address symptoms rather than problems.

Greater flexibility of DoD's acquisition budget authority across time periods would likely increase the efficiency and effectiveness of contract spending within those time periods. Such changes would also preserve Congress's ability to determine the total, long-term dollar amount spent on individual DoD components, appropriation titles, or programs.

A full expansion of O&M obligation authority to multiple years would limit Congress's ability to control how much is spent from one period of time to the next. Many in Congress clearly view this ability as a core aspect of the oversight process.

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[1] Analysis of FPDS data based on Treasury Account Symbol (TAS) codes, June 8, 2018. See Department of the Treasury, *Federal Account Symbols and Titles (FAST) Book,* March 2018, accessed June 8, 2018, https://www.fiscal.treasury.gov/fsreports/ref/fastBook/fastbook-march-2018.pdf. To ensure comparability of data, each weekly period contains the same days of the week (counted backwards from September 30). The extra day at the beginning of FY 2017 is included in the first week.

A more feasible and low-risk approach would be to permit the obligation of up to 5 percent of O&M funding for 1 year beyond what would normally be the end of its fiscal year availability. This change would allow for a smoothing effect across fiscal years, mitigating the perceived urgency to spend all available funds by end-year.

By law, DoD has set periods of time within which it is required to obligate and disburse appropriated funds. These periods of time are referred to as budget *periodicity*. *Overexecution* and *underexecution* are terms used to describe whether a program obligates and disburses money within set timeframes. These metrics are commonly used as short-term proxies for program success.

Multiple levels of periodicity constraints are applied to DoD spending. The highest-level constraints are those imposed by Congress on a fiscal-year basis. OMB may impose its own periodicity constraints on an annual or quarterly basis. Below this level, DoD and military departments conduct internal reviews of whether funds are on track to be fully executed by the end of the year. PEOs and PMs often self-impose monthly and weekly deadlines to obligate or expend funds.

At any point in the budget and acquisition process, failure to ensure obligation or expenditure at target rates may lead to reductions of future funding. The reduction of future funding as a consequence of failure to obligate current funding serves as a powerful perverse incentive for acquisition personnel to spend money regardless of the return on their investment.[2] This incentive may lead to several negative outcomes:

- **Lower-quality contracts** may result directly from end-period surges. Because of the high workload associated with surges in obligations or disbursements, contract reviews may be less detailed and reviewers may be less likely to detect problems.
- **Inefficient allocation of human capital** may occur when acquisition professionals are focused more on timing of spending and less on value and return on investment.
- **Unnecessary purchases may occur** if acquisition authorities are motivated to obligate excess money purely to avoid future funding reductions.
- **Loss of negotiating power** and **loss of pricing power** may occur when potential vendors know exactly how much money is available to a program office and the precise deadlines by which each portion of that money must be spent. The resulting decrease to return on investment may constitute an inefficient use of taxpayer resources.
- **Lower employee morale** can result from a chaotic end-year workload.[3]

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[2] A 2012 memo by the Under Secretary of Defense (Comptroller) and the Under Secretary of Defense for Acquisition, Technology, and Logistics noted that "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." The memo added that DoD risked "creating incentives to enter into quick but poor business deals or to expend funds primarily to avoid reductions in future budget years." See Robert Hale and Frank Kendall, "Department of Defense Management of Unobligated Funds; Obligation Rate Tenets," September 10, 2012, accessed November 16, 2018, https://www.acq.osd.mil/fo/docs/OSD%20Memo_DoD%20Mgt%20of%20Unobligated%20Funds_Obligation%20Rate%20Tenets_10Sep12.pdf.

[3] Army contracting officers, discussions with Section 809 Panel, September 2017.

- **Auditing may be more complex and difficult** due to the need to track time periods as well as appropriation accounts and budget line items.

Defense Acquisition Budget Terms
Allocation is funding made available by DoD component-level authorities to lower-level authorities.
Allotment is funding made available by lower-level DoD authorities to the operating level.
Apportionment is the distribution of funding from the Office of Management and Budget to DoD.
Appropriations are enacted each year by Congress and provide the legal authority for DoD to spend money.
Budget execution is the process of incurring the funding liabilities needed to move a program forward.
Budget periodicity is the phenomenon of funding accounts being locked to specific spans of time as mandated in annual appropriations laws.
Color of money is a colloquial phrase that can refer to the periodicity requirements, appropriation account, and/or program and purpose of a specific budget line item.
Continuing resolutions (CRs) are stopgap appropriation laws enacted to provide temporary government funding for part of the fiscal year.
The **80/20 rule** is included in annual appropriations bills and generally requires that at least 80 percent of single-year funds be obligated by the end of July.
Obligations are legal commitments to spend money by a U.S. government representative (in DoD acquisition, a contracting officer). Under 31 U.S.C. § 1502, U.S. government appropriation periodicity is defined according to the date on which money is obligated.
Regular appropriations fund DoD for the entire fiscal year and are enacted each year through a standardized committee process.

Fiscal Law Basics
Anti-Deficiency Act: 31 U.S.C. § 1341 and § 1517: This law prohibits government employees from making or authorizing expenditures and obligations in excess of congressional appropriations or OMB apportionments.
Bona Fide Needs Rule: 31 U.S.C. § 1502(a): Under this section of U.S. Code, obligation authority limited to a specific time period is only available to "complete contracts properly made within that period of availability."
Impoundment Control Act: 2 U.S.C. § 682, §683, and § 684: This law requires government employees to obligate funding that has been appropriated by Congress. To defer budget authority, the president must notify Congress and deferrals "may not be proposed for any period of time extending beyond the end of the fiscal year" in which notification occurs.
Misappropriation Act: 31 U.S.C. § 1301: This law requires that money only be used for the purposes specified in congressional appropriations.
Multiyear Appropriations: 10 U.S.C. § 2306b and § 2306c: This section of U.S. Code provides the legal basis to obligate appropriated money in future years. Depending on the appropriation account, DoD may obligate funding over the course of 1, 2, 3, or 5 years (*color of money*).

Appropriations Law Background

In the annual U.S. federal budget system, Congress appropriates money for agency use within the date-range of a specific fiscal year. This money is not to be used beyond that timespan, or it may lead to an antideficiency violation.[4] Statutory constraints on budget periodicity apply to the dates at which funds are obligated (as opposed to disbursed).[5]

Defense acquisition appropriations can be either single-year or multiyear. Single-year appropriations are typically used for low-risk projects such as service contracting under O&M budget authority. Multiyear appropriations constitute a longer-term form of budget periodicity, in which appropriated dollars may in some cases be used by DoD within a span of multiple years. A shorter-term form of budget periodicity in defense appropriation law is the 80/20 rule for O&M appropriations. Agency processes in both OMB and DoD constitute short-term, nonstatutory forms of budget periodicity.

The main form of periodicity in DoD budgeting is Congress's appropriation of funds for use within a specific fiscal year or specific span of several fiscal years. Annual appropriations and other forms of budget periodicity are relevant to defense acquisition because some observers suggest that periodicity leads to inefficient, low-quality contract outcomes.

Congress imposes time limits on obligation and expenditure of funds for several reasons. These time limits allow for a regular, standardized oversight process to occur by default each year. They also address the concern that if funds do not automatically expire, they will accumulate into large unobligated balances that could be used for purposes unapproved by Congress. This concern appeared

[4] 31 U.S.C. § 1341 lays out timing restrictions on the obligation of funds. 31 U.S.C. § 1350 imposes a criminal penalty of up to two years' imprisonment on government employees who obligate unappropriated funds.
[5] Balances Available, 31 U.S.C. § 1502.

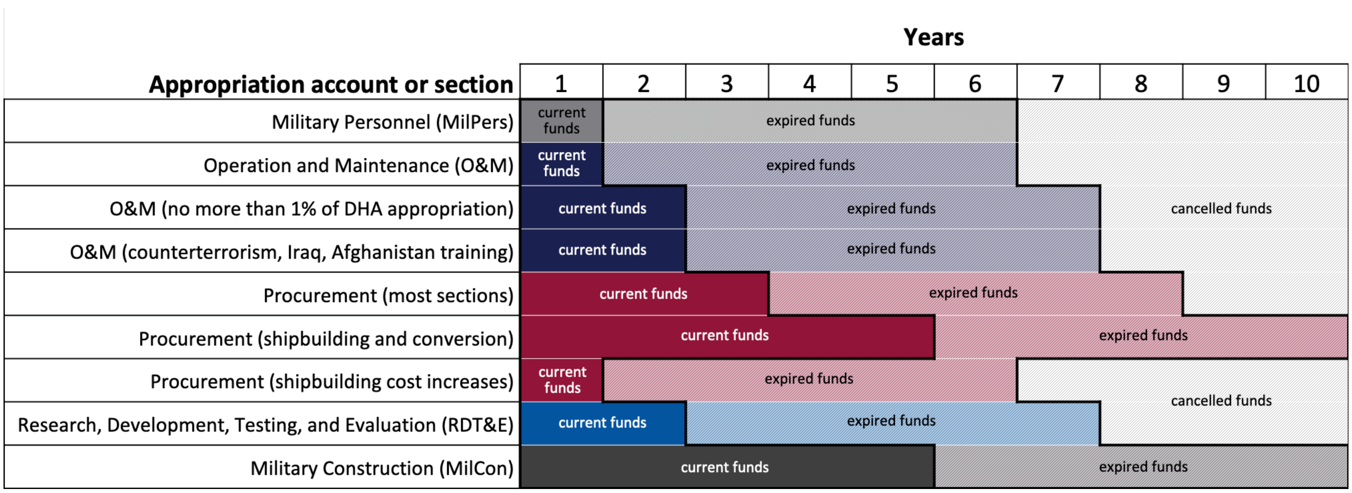
to be implicit in some congressional discourse during the 1980s and 1990s, referring to the flexible budgeting authorities DoD held at the time as slush funds.[6]

Periodicity in Congressional Appropriations

DoD is permitted to enter into contract obligations "for the purchase of property or services for more than one, but not more than five, program years."[7] These varying lengths of funding availability, combined with the specific budget account to which they refer, are informally known as colors of money. Colors of money are written into the individual title authorities in annual defense appropriation laws. In some cases, special color of money provisions are written into individual appropriation law titles and subtitles.

After these periods of obligation authority have elapsed, there are 5 years in which money may be expended on existing obligations before it is canceled (see Figure 4-8).

Figure 4-8. Multiyear Appropriation Examples from FY 2018[8]



Partly in an attempt to mitigate the end-period obligation surges that may be incentivized by a period-based budgeting cycle, Congress regularly incorporates the *80/20 rule* into defense appropriation bills.[9] The 80/20 rule specifies that for single-year appropriation accounts (i.e., Military Personnel and

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[6] See, for example, Representative John Dingell's comment quoted by Ralph Vartabedian, "Fight Brews Over $43 Billion in Unspent Defense Funds," Los Angeles Times, March 9, 1990, accessed April 28, 2017, http://articles.latimes.com/1990-03-09/news/mn-2171_1_pentagon-funds. The carry-over accounts in question were eliminated by the 1991 defense authorization (Pub. L. No. 101-510).
[7] Federal Acquisition Streamlining Act, Pub. L. No. 103-355, Sec. 1022 (1994). Also see 10 U.S.C. §§ 2306b and 2306c.
[8] Division C of Consolidated Appropriations Act, 2018, Pub. L. No. 115-141 (2018). DHA refers to Defense Health Agency. Counterterrorism, Iraq, and Afghanistan training O&M appropriation is from FY 2018 defense appropriation Title IX: Overseas Contingency Operations/Global War on Terrorism, Operation and Maintenance accounts. For duration of obligation authority for prior year shipbuilding cost increases, see Section 8072 of Title VIII: General Provisions. The Military Construction title is not present in the Department of Defense Appropriation Act, but rather in the Military Construction and Veterans Affairs, and Related Agencies Appropriations Act (see Division J in FY 2018 omnibus appropriation).
[9] For the 80/20 Rule as it appeared in the FY 2017 omnibus appropriation, see the Consolidated Appropriations Act, 2017, Pub. L. No. 115-31, Division C, Title VIII, Section 8004 (2017). "No more than 20 percent of the appropriations in this Act which are limited for obligation during the current fiscal year shall be obligated during the last 2 months of the fiscal year: Provided, That this section shall not apply to obligations for support of active duty training of reserve components or summer camp training of the Reserve Officers' Training Corps."

Operation and Maintenance), no more than 20 percent of appropriated funds may be obligated in the last 2 months of the fiscal year.

In the FY 2018 defense appropriations bill, the 80/20 ratio was changed to 75/25 (in other words, DoD was permitted to obligate up to 25 percent of single-year funds in August and September).[10] The House Appropriations Committee noted that the adoption of this 75/25 rule was intended to "apply to fiscal year 2018 only" and was "necessary due to the delay of the final passage of this year's appropriation bill, combined with the large funding increase made possible by the Bipartisan Budget Act of 2018."[11]

Periodicity in OMB

Apportionment is the process by which OMB grants agencies the approval to use appropriated funds. Apportionments are governed by OMB Circular A-11 and are legally binding.[12] They can limit the dollar obligations that DoD is permitted to incur for specified time periods, programs, and activities.[13] The reason apportionment was originally established, according to one scholar of federal and defense budget issues, was that "agencies demonstrated an inability to live within their means if given their entire budget up front, causing Congress to bail them out with deficiency appropriations."[14]

In defense acquisition, apportionments are approved on a quarterly basis. Contracting authorities are constrained in their ability to allocate funding between one quarter and another.[15] In this way, apportionment resembles a smaller-scale version of appropriation-level periodicity, constraining DoD's ability to move resources between quarters in addition to years.

DoD Comptroller Periodicity

The DoD acquisition community broadly believes that if a program's funding is not obligated within the first year of appropriation, program funding will be cut in subsequent budget or reprogramming requests to Congress, a phenomenon known informally as a *budget sweep*, or more formally as *rephasing*. Although the phenomenon is widely and commonly discussed in defense acquisition circles, there does not appear to be an official policy to this effect in any DoD instructions or directives. Midyear and end-year reviews identify inadequately funded current-year needs, which drive this phenomenon.

The DoD Comptroller's office states that DoD rephases future budgets based on prior-year budget execution to "reduce or eliminate the excessive accumulation of unspent funds and… reduce the carryover of funds from one fiscal year to another."[16] A statement from the Comptroller's office suggests that much of this rephasing is done to comply with implicit congressional demands:

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[10] See Section 8004 of Division C of the Consolidated Appropriations Act, 2018, Pub. L. No. 115-141 (2018).
[11] Congressional Record Vol. 164, No. 50, Book II, Explanatory Statement for Pub. L. No. 115-141, Operation and Maintenance Flexibility, March 22, 2018, 113, accessed June 8, 2018, https://www.congress.gov/crec/2018/03/22/CREC-2018-03-22-bk2.pdf.
[12] Prohibited Obligations and Expenditures, 31 U.S.C. § 1517.
[13] OMB Circular A-11, Part 4, Section 120.1, updated 2016, accessed April 27, 2017, https://obamawhitehouse.archives.gov/omb/circulars_a11_current_year_a11_toc.
[14] Naval Postgraduate School budget professor, emails with Section 809 Panel, September 2017.
[15] DoD Financial Management Regulation, Volume 3, Chapter 2, Section 020102, updated February 2009, accessed April 26, 2017, http://comptroller.defense.gov/Portals/45/documents/fmr/archive/03arch/03_02_Feb09.pdf.
[16] DoD Comptroller staff, emails with Section 809 Panel staff, March 2017.

> *The proper phasing of resources ensures the prudent request and execution of funds. Without this fiscal discipline, programs could accumulate large unobligated cash balances, leading to unfavorable congressional scrutiny… Note that the congressional appropriation committees use identical execution performance metrics annually when they review the Department's funding request. If the Department does not adjust the budget request for actual execution, the congressional appropriation committees will do so, realigning those low executing programs funds toward other programs that are the priorities of the Chairman (which may not be the same as those of the Secretary of Defense).*[17]

Military Service Periodicity

The DoD Comptroller provides rule-of-thumb goals for obligation of certain types of funding by certain points in time.[18] Military Services have also historically provided obligation and expenditure goals according to which their constituent elements are expected to spend money.[19]

These goals are not legally binding and acquisition budget experts state that they are guidelines, not required policy.[20] Comptroller personnel state that obligation and expenditure goals are intended "to identify programs that need to be discussed by acquisition and financial personnel" (in other words, to serve as an advance warning to leadership if something is wrong with a program).[21] These goals may, however, be perceived by acquisition managers as expectations which, if unmet, may result in future funding cuts.

To mitigate this perceived likelihood of future cuts (via congressional appropriations, DoD budget requests, or Comptroller rephasing) PMs may feel great pressure to obligate currently-available funding within fixed periods of time. Despite the fact that spending targets are not legally binding, Military Services may feel compelled to apply targets at least as high as the DoD Comptroller to ensure the DoD Comptroller targets are met at the service level.

DoD and military department memoranda bear out this hypothesis. As of the late 2000s, DoD suggested that 90 percent of RDT&E money should be obligated in the first year of appropriation. As of 2003, an Army memo used 95 percent as its first-year obligation goal, clarifying that

> *Target obligation and disbursement rates are not directive in nature; however, they will be used as a performance indicator to potentially reallocate funding during the year of execution.*[22]

At the lower levels of the acquisition system, some DoD program offices reportedly conduct reviews to ensure full obligation of funds on a weekly or even daily basis.[23]

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[17] DoD Comptroller staff, emails with Section 809 Panel staff, March 2017.
[18] "OUSDC Rule-of-Thumb Acquisition Obligation and Expenditure Rates," as of May 2017, Defense Acquisition University, accessed November 16, 2018, https://www.dau.mil/tools/Lists/DAUTools/Attachments/292/OSD%20(C)%20Color%20Rule-of-Thumb%20Acq%20Obligation%20and%20Expenditure%20Rates.pdf.
[19] DoD Comptroller memorandum, "Budget Execution Measures," obtained from Defense Acquisition University, October 7, 1996.
[20] DAU professor of financial management, conversation with Section 809 Panel, September 2017.
[21] Former DoD Comptroller official, discussion with Section 809 Panel, September 2017.
[22] Department of the Army, Office of the Assistant Secretary (Financial Management and Comptroller), "Obligation/Disbursement Rates for Execution of FY02/03 RDTE Funds," January 17, 2003.
[23] DoD PMs and contracting officers, conversations with Section 809 Panel, May to July 2017.

Table 4-3. Comparison of Spending Targets, DoD and Department of the Army[24]

Spending Target and Timeframe	Obligation Rate		Expenditure Rate	
	DoD	Army	DoD	Army
RDT&E, by end of Y1 Q2	45%	56%	28%	22%
RDT&E, by end of Y1 Q4	90%	95%	55%	56%
RDT&E, by end of Y2 Q2	95%	97%	73%	84%
RDT&E, by end of Y2 Q2	100%	100%	90%	91%

Discussion

End-year federal government contract spending surges have been of concern to Congress for many decades. In 1980, GAO stated that such surges "contribute to increased overtime costs, reduced staff morale, and poorer quality contracts and grants."[25] In 2015 and 2017, Congress investigated the phenomenon of wasteful spending at the end of the fiscal year.[26]

There is almost certainly a causal link between budget periodicity and distortions in contract spending across the fiscal year cycle. Publicly available federal contracting data show a strong and clear correlation between surges in contract spending and the dates that mark the expiration of funding or internal budget reviews.

Senior government officials and independent observers have also suggested that the resulting end-year concentration of contract obligations can in some cases lead to lower-quality contracts, inefficient allocation of human resources, purchase of unnecessary items, poorer bargaining position for federal agencies, lower morale among acquisition employees, and greater difficulty in performing audits.

These problems are exacerbated by the many layers of command that exist between appropriations and the obligations. Each layer may feel compelled to hold a certain amount of funding to address any unanticipated problems late in the fiscal year. A budgeting expert wrote the following:

> *If one assumes four layers in the chain of command and each layer holds back 3%, that means the lowest layer only received 88.5% of the funding and the remaining 11.5% will come cascading down late in the year. In some cases, that last unit—an installation, squadron, or program office may see 10%-15% of its annual budget authority appear in the last few weeks of the year.*[27]

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[24] "OUSDC Rule-of-Thumb Acquisition Obligation and Expenditure Rates," obtained from Defense Acquisition University, December 2009. Department of the Army, Office of the Assistant Secretary (Financial Management and Comptroller), "Obligation/Disbursement Rates for Execution of FY02/03 RDTE Funds," January 17, 2003.

[25] GAO, *Federal End-Year Spending: Symptom of a Larger Problem,* October 23, 1980, 8, accessed May 26, 2017, https://www.gao.gov/assets/140/130983.pdf.

[26] "Prudent Planning or Wasteful Binge? A Look at End of the Year Spending," Senate Homeland Security and Government Affairs Committee, September 30, 2015, accessed September 27, 2017, https://www.hsgac.senate.gov/hearings/prudent-planning-or-wasteful-binge-a-look-at-end-of-the-year-spending.

[27] Philip J. Candreva, *National Defense Budgeting and Financial Management: Policy and Practice* (Charlotte, NC: Information Age Publishing, 2017), 315.

One weapons system acquisition professional said that budget periodicity could cause unnecessary increases to cost and schedule of major acquisition programs, noting that "the time restrictions imposed by not only the appropriation, but also artificially by the Comptroller's obligation and expenditure benchmarks, often force PMs into suboptimal spending decisions."[28] The individual added that the "truly perverse incentive" created by the threat of budget cuts is "exacerbated in larger programs, in which the details of program evolution are more likely to change and the cost impact is magnified."[29]

The effect of periodicity at the working level is allegedly that "current policies… effectively punish programs that reduce cost below the budgeted expenditures."[30]

Figure 4-9. Weekly DoD Contract Obligations over the Course of FY 2017[31]

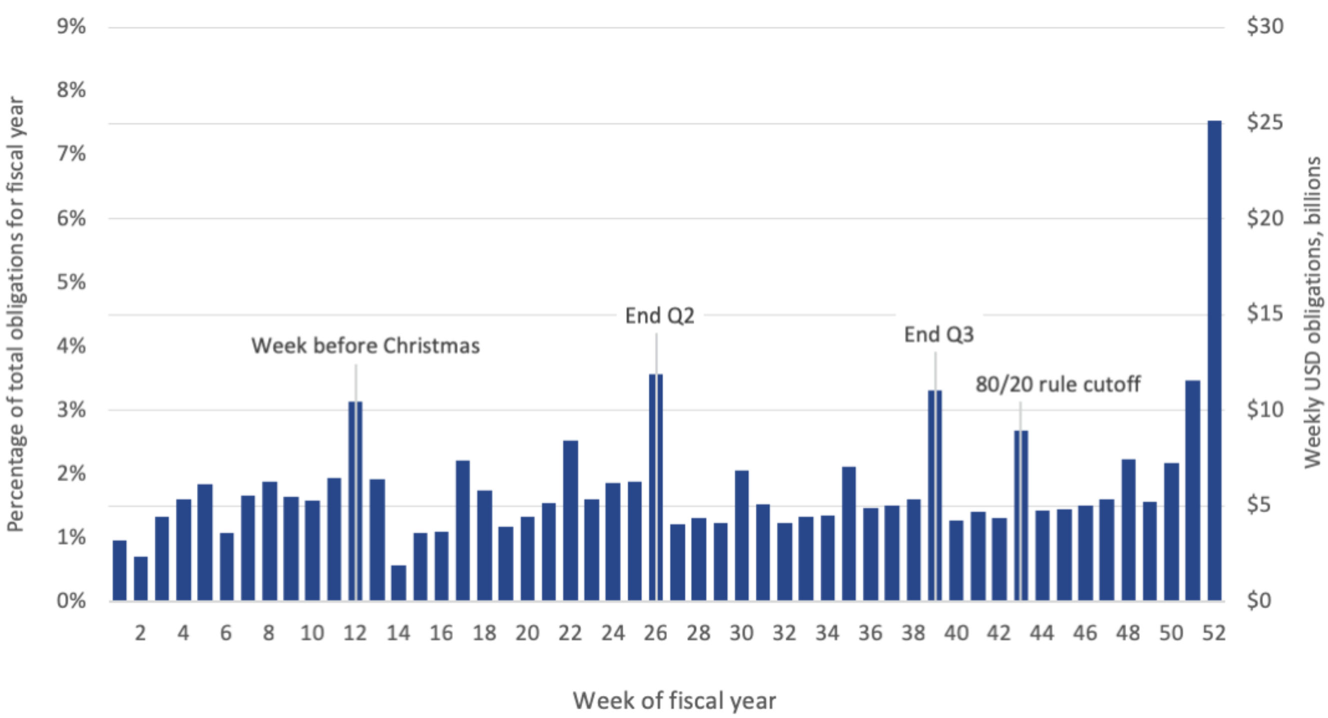


Figure 4-9 shows DoD's weekly contract obligations throughout the fiscal year. In addition to the large peak in contract obligations in the final weeks of September (see rightmost bars of chart), there are smaller peaks visible throughout the fiscal year. Obligation surges occur at the end of December, March, and June. These periods are the end-points of the quarterly blocks within which OMB apportions DoD contract dollars under Circular A–11.

[28] Naval Air Systems Command personnel, communications with Section 809 Panel, September 2017.
[29] Ibid.
[30] Ibid.
[31] Contract obligation data from FPDS, https://www.fpds.gov, accessed June 8, 2018. To ensure comparability of data, each weekly period contains the same days of the week (counted backwards from September 30). The extra day at the beginning of FY 2017 is included in the first week.

A small surge in obligations is also visible in the 43rd week of the fiscal year (at the end of July). This observation overlaps with the deadline imposed under the 80/20 rule, which mandates that at least 80 percent of certain types of obligation occur between the months of October and July. Correlation is not causation, but there is clearly an overlap between surges in DoD contract spending and the end-points of important budgeting periods.

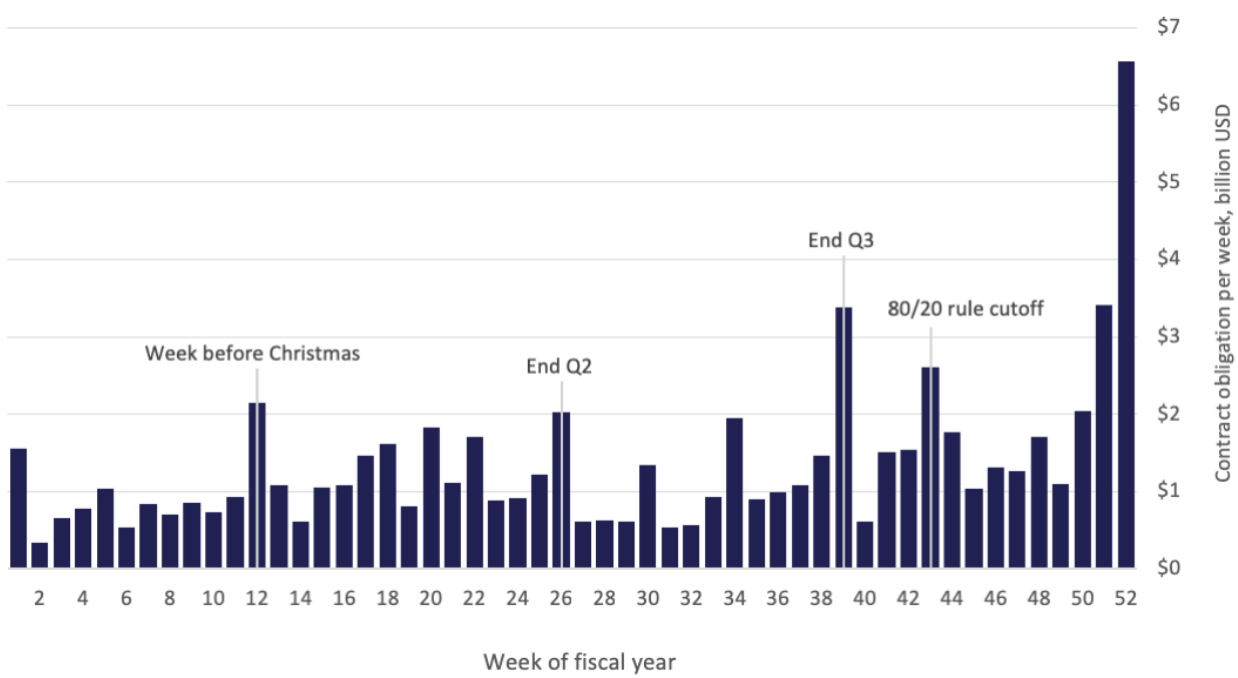
Although this overlap is not conclusive proof, it provides strong evidence that the end-year *use it or lose it* rush to obligate funding is quite real and is driven by the annual periodicity of the U.S. federal budget.

Periodicity-based budgeting practices within Congress, OMB, and DoD appear to be the core cause of end-period obligation surges. Looking in more detail at DoD's contract obligations over the course of the fiscal year can elucidate areas of contracting on which periodicity-based budgets have the greatest effect.

Appropriation Accounts

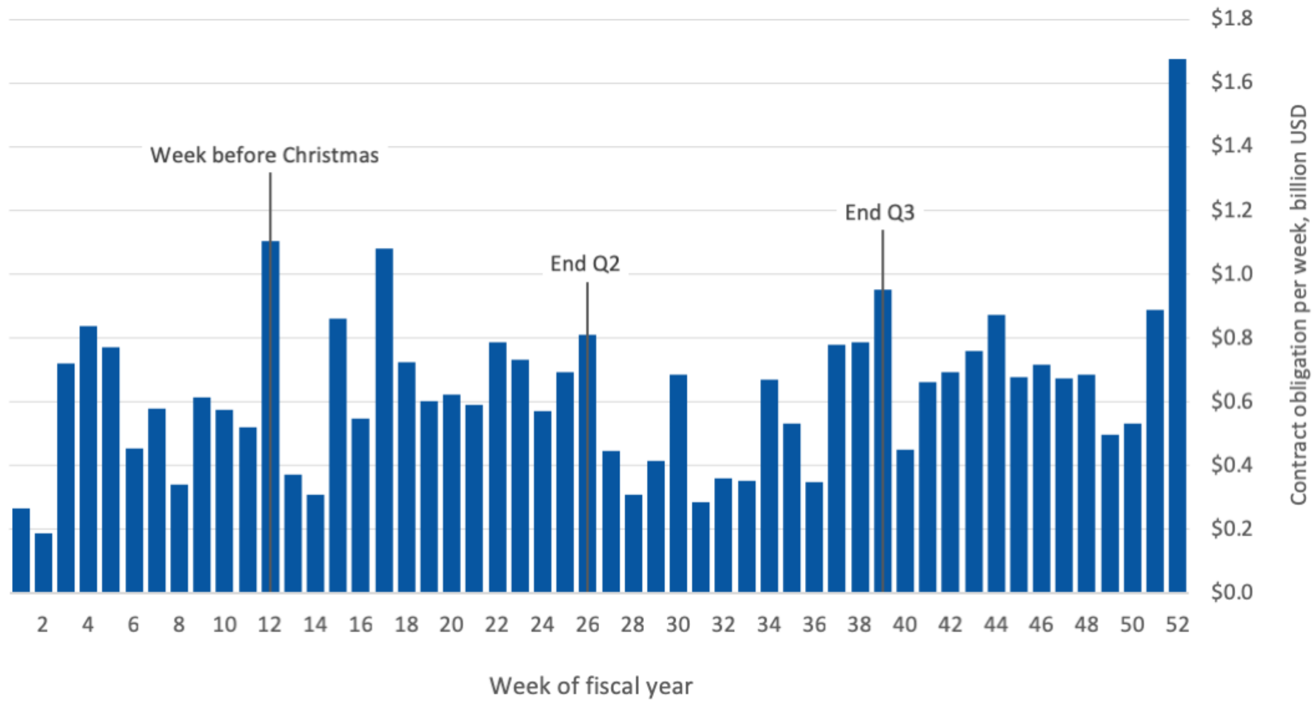
DoD's end-year obligation surges are concentrated in the O&M appropriations account. Other accounts, such as RDT&E, show larger obligation concentrations at midyear. This pattern suggests that during midyear reviews of multi-year appropriation accounts, investment funding is seen as a potential source of money for inadequately funded needs. This phenomenon may drive annual patterns more directly than the periods of appropriation themselves. These periods of appropriation, however, may in turn drive DoD's adherence to midyear obligation targets.

Figure 4-10. Weekly Obligations on Contracts under O&M Appropriations Account, FY 2017[32]



[32] Analysis of FPDS data based on Treasury Account Symbol (TAS) codes, June 8, 2018. See Department of the Treasury, *Federal Account Symbols and Titles (FAST) Book*, March 2018, accessed June 8, 2018, https://www.fiscal.treasury.gov/fsreports/ref/fastBook/fastbook-

Figure 4-11. Weekly Obligations on Contracts under RDT&E Appropriations Account, FY 2017[33]



Military Departments

All DoD service components experience substantial surges in obligation rates during the midyear and end-year months. Not all components, however, experience peaks of the same amplitude.

The Department of the Army, for instance, obligated more than 20 percent of its reported FY 2017 contract obligations in September of that year. The Army's end-year peak exceeded the peaks for the Air Force, Navy, or other DoD components by about 10 percentage points.[34]

In FY 2017, Army contract obligations in September were more than 2.5 times the Army's average monthly obligations during that year. For the other two Military Services, the analogous metric was only about 1.6 times average monthly obligations.[35] This observation could suggest the Army is particularly prone to the expectation of budget cuts as a consequence of unobligated end-year balances.

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march-2018.pdf. To ensure comparability of data, each weekly period contains the same days of the week (counted backwards from September 30). The extra day at the beginning of FY 2017 is included in the first week.

[33] Analysis of FPDS data based on Treasury Account Symbol (TAS) codes, June 8, 2018. See Department of the Treasury, *Federal Account Symbols and Titles (FAST) Book,* March 2018, accessed June 8, 2018, https://www.fiscal.treasury.gov/fsreports/ref/fastBook/fastbook-march-2018.pdf.To ensure comparability of data, each weekly period contains the same days of the week (counted backwards from September 30). The extra day at the beginning of FY 2017 is included in the first week.

[34] According to FPDS data extracted June 8, 2018, the Army obligated $17.2 billion in September 2017 out of $78.3 billion for the entire fiscal year. The Air Force obligated $8.0 billion in September out of $60.8 billion for the entire year. The Navy obligated $15.1 billion out of $109.5 billion for the full year. Other defense agencies combined obligated $8.4 billion in September out of $71.9 billion for the year.

[35] According to FPDS data extracted June 8, 2018, the Army's September obligations were 2.6 times higher than average monthly obligations of $6.5 billion. The Air Force's September obligations were 1.6 times higher than the monthly average of $5.1 billion. The Navy's September obligations were 1.7 times higher than the monthly average of $9.1 billion.

This interpretation is supported by analyses from Army leadership. In April 2016, the Acting Secretary of the Army issued a memo stating, "we often focus on budget execution independent of outcomes," an approach that "leads to bad business practices… 'use or lose' fund execution, and harvesting savings from commands who find new and innovative ways to operate."[36] Lt. Gen. Tom Spoehr, director of the Army's Business Transformation Office, has emphasized the importance of ensuring that "a unit's budget will not be decremented for the sole reason that they failed to expend their money."[37] A 2017 GAO report cited a recent Deputy Assistant Secretary of the Army for Procurement claiming "if the Army does not obligate all of its appropriations before they expire because it could appear that the Army was appropriated more funding than it needed," a perspective that "increases the risk that contractors will not provide the government goods and services in an efficient or effective manner."[38]

For the Air Force and Navy, September obligation surges in FY 2017 were lower than for the Army. Substantially higher obligation surges were observed for the Navy, however, in the final month of the second quarter (at the end of March 2017).[39] Policies implemented at levels below DoD may push back the dates at which end-period surges occur. These surges may not be problems in themselves, but rather indicators of the incentives produced by tiered periodicity requirements embedded in the acquisition funding system.

Products and Services

If contract obligations were distributed with perfect evenness throughout the fiscal year, about 2 percent of all product and service contract obligations would occur each week.[40] DoD-reported contract obligation data, however, show that some products have much higher obligations in the final week of September.[41]

For DoD IT equipment contracts, about 14 percent of obligations occur in the final week of the fiscal year.[42] For the category training aids and devices, which include certain types of computers, about 23 percent of obligations occurred in the final week.[43] Communications equipment contract obligations

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[36] Secretary of the Army memorandum, *U.S. Army Directive 2016-16 (Changing Management Behavior: Every Dollar Counts),* April 15, 2016, accessed May 30, 2017, https://www.army.mil/e2/c/downloads/431118.pdf.
[37] "End-of-year 'use it or lose it' budget mindset to get tossed," David Vergun, U.S. Army, April 18, 2016, accessed May 30, 2017, https://www.army.mil/article/166098.
[38] GAO, *Army Contracting: Leadership Lacks Information Needed to Evaluate and Improve Operations, GAO-17-457,* June 2017, 10, accessed November 15, 2017, http://www.gao.gov/assets/690/685425.pdf.
[39] According to FPDS data extracted June 8, 2018, the Navy obligated $13.2 billion in March 2017, about $4 billion higher than the average monthly obligation rate.
[40] Perfectly even weekly percentage distribution of obligations across a non-leap fiscal year = 1 / (365 / 7) = 0.0192.
[41] Product and Service Codes (PSCs), the main U.S. government-administered system for categorizing goods and services purchased under federal contracts, are reported in FPDS at the four-digit level. They are produced by GSA and DLA. For the purposes of this paper, "major categories" are defined as those two-digit product PSCs (or 1-digit service PSCs) with more than $1 billion in total DoD obligations for FY2016. See a machine-readable list of PSCs at "PSC Manual," Acquisition.gov, accessed May 31, 2017, https://www.acquisition.gov/PSC_Manual.
[42] Analysis of FY 2017 FPDS data using PSC group 70 ("automated data processing equipment, software, supplies, and equipment"), accessed June 11, 2018. For contract awards in this category, roughly $900 million was obligated in the last week of September 2017, compared to $7.0 billion for the full fiscal year.
[43] Analysis of FY 2017 FPDS data using PSC group 69 (training aids and devices), accessed June 11, 2018. For contract awards in this category, roughly $350 million was obligated in the last week of September 2017, compared to $1.5 billion for the full fiscal year.

are also highly concentrated at end-year.[44] All of these categories contain at least some IT products, suggesting that IT acquisition may be particularly prone to end-year spending surges.

Service-coded PSCs also show a pattern of IT services being concentrated at end-year. More than 7 percent of IT service contract dollars were obligated in the final week of September.[45]

The most extreme examples of end-year spending concentration, however, are in service contracts related to construction and building maintenance.[46] For maintenance, repair, and alteration of buildings, roughly one-quarter of contract dollars were obligated in the final week of the fiscal year (more than a dozen times what would be expected with even distribution).[47]

Information Technology

The end-year surges in DoD IT contracting may have a variety of immediate causes, some unrelated to budgeting. For example, acquisition personnel may in some cases be unable to award large IT service contracts until the end of the fiscal year, due to the need to clear a variety of slow-functioning approval hurdles.[48]

In other cases, contracting personnel may find themselves with extra money at year end and obligate money to IT support services to avoid expiration of funds. Regular inventory turnover, relatively high per-unit prices, and nonperishability in storage may make IT hardware an attractive commodity for an acquisition professional seeking to expend funds in the short term on products that will be useful in the medium or long term.

One DoD IT acquisition professional suggested that allocation of funding to IT may be "artificially suppressed in favor of core mission requirements."[49] In other words, non-IT needs receive priority over IT needs, and funding is only provided to IT offices at the end of the year once other stakeholders "let the chance to spend money go by."[50]

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[44] Analysis of FY 2017 FPDS data using PSC group 58 (communication, detection, coherent radiation equipment), accessed June 11, 2018. For contract awards in this category, roughly $1.4 billion was obligated in the last week of September 2017, compared to $12.3 billion for the full fiscal year.

[45] Analysis of FY 2017 FPDS data using PSC group D (IT services), accessed June 11, 2018. For contract awards in this category, roughly $900 million was obligated in the last week of September 2017, compared to $13.4 billion for the full fiscal year.

[46] Analysis of FY 2017 FPDS data using PSC groups Y and Z (building construction and building maintenance), accessed June 11, 2018. For contract awards in these categories, roughly $4.5 billion was obligated in the last week of September 2017, compared to $19.6 billion for the full fiscal year.

[47] Analysis of FY 2017 FPDS data using PSC group Z (building maintenance), accessed June 11, 2018. For contract awards in this category, roughly $2.4 billion was obligated in the last week of September 2017, compared to $9.6 billion for the full fiscal year.

[48] Army software IT program staff, communications with Section 809 Panel, May-July 2017.

[49] Acquisition expert in Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics (AT&L), emails with Section 809 Panel, September 2017. The individual specified that Army defense business systems operating in sustainment may be particularly susceptible to this scenario.

[50] AT&L expert, emails with Section 809 Panel, September 2017.

A 2013 study measured the correlation between U.S. federal government IT project quality and timing of obligations. The analysis found that there was a statistically significant negative correlation between quality of IT projects and spending at the end of the fiscal year.[51]

Building Construction and Maintenance

For building construction and maintenance, end-year surges are among the highest of any major product or service procured by DoD. More than one-third of contract spending has been obligated in September of recent fiscal years, and about one-fifth in the final week.[52]

At the installation level, there is generally a long wait list for contracted building construction and maintenance work. Many facilities are in need of repair and some contracting professionals keep an informal list of projects listed by priority. Funding is often held until the end of the fiscal year and then released in large quantities once resource managers are certain it will no longer be needed to meet unforeseen emergencies. With this large end-year release of funds, contracting officers set about contracting for as much work as they can afford on their list.[53]

One side effect of this end-year construction surge is that contracting personnel must prepare a large number of solicitations and other documents to deploy as soon as funding is released. Because there is uncertainty about how much funding will be released, there is some guesswork involved in determining which projects to prepare for. This situation can lead to problems with contract quality. One contracting officer, speaking at the end of the fiscal year, acknowledged that "this time of year, instead of doing the A-plus contracting, we're doing the C contracting."[54]

Other Factors in End-Period Surges

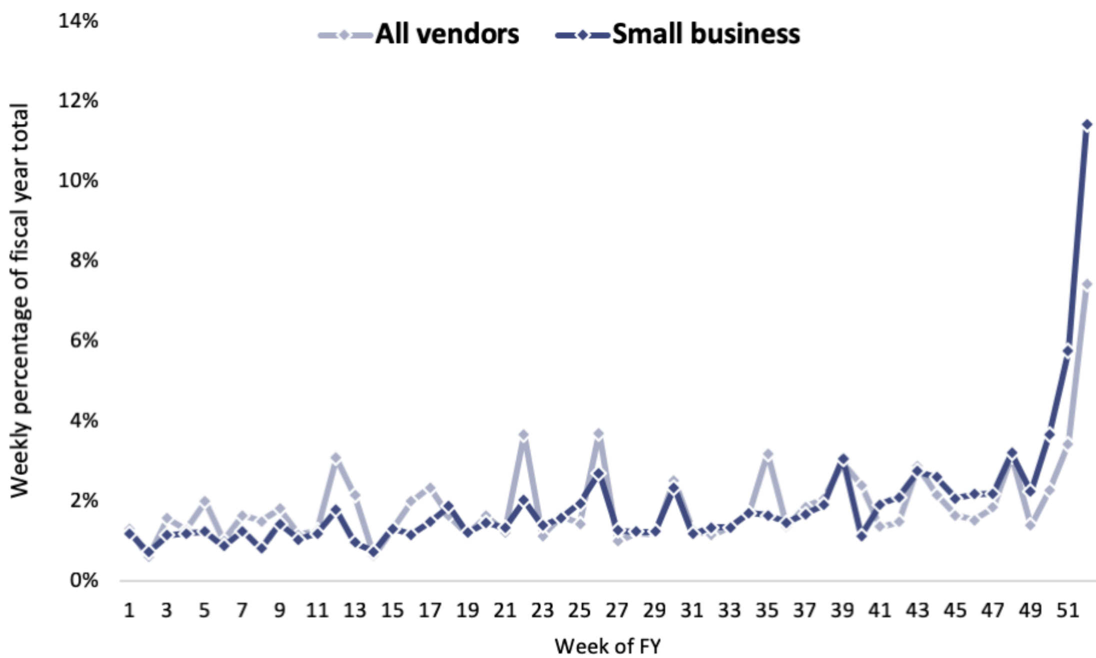
All major types of DoD contracts show higher rates of obligation at end-year than in the rest of the year. Not all contract types, however, show the same degree of disparity. In FY 2017, 7.4 percent of all DoD contract dollars were obligated in the final week of September. By contrast, 9.8 percent of DoD's firm fixed-price contract obligations occurred in the final week.[55]

Fixed-price contracts allow for the obligation of a specific and fixed quantity of funds with a high degree of certainty. They may be highly useful to contracting officers who seek to obligate a set amount of money on a short timeframe to ensure full obligation by the end of a specific period.

Obligations on contracts awarded under small business or other socioeconomic policies also appear to be particularly concentrated at the end of the fiscal year.

[51] Jeffrey B. Liebman and Neale Mahoney, *Do Expiring Budgets Lead to Wasteful Spending? Evidence from Federal Procurement,* National Bureau of Economic Research, September 2013, accessed April 26, 2017, http://www.nber.org/papers/w19481.pdf.
[52] Analysis of FPDS data extracted June 11, 2018.
[53] Installation contracting officials, conversation with Section 809 Panel, September 2017.
[54] Ibid.
[55] Analysis of FPDS data extracted June 11, 2018.

Figure 4-12. FY 2017 Weekly DoD Contract Obligations, as Percentage of Fiscal Year Total[56]



Summary Findings

A broad array of factors appears to affect, either directly or indirectly, DoD's pattern of contract obligations over the course of the fiscal year.

- These factors include the contracting component. The Department of the Army, for instance, shows much steeper end-year obligation surges than the other military departments. Senior Army leaders have indicated that they perceive these surges as a problem and are taking measures to mitigate them.
- Information technology contracts also show high end-year surges. There may be different root causes in different industries. With IT contracts, for example, hardware purchases may be delayed due to either short-term funding unavailability or due to the durability, interoperability, commercial availability, and continued utility of IT hardware years into the future.[57]
- With building construction and maintenance contracts, the large observed end-year surges may be more a product of inability to reprogram and long project wait lists.

Possible Effects on Acquisition Efficiency

DoD policymakers and independent observers have suggested that the incentives created by budget periodicity may diminish the efficiency of the defense acquisition process. By constraining DoD's

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[56] Analysis of FPDS data extracted June 11, 2018. To ensure each period contains the same days of the week, Week 1 omits the first day of the fiscal year.
[57] One IT acquisition expert, discussing reasons why resource managers might wait until the last minute to make funding available, stated "because business IT is a bottom feeder." AT&L expert, emails with Section 809 Panel, September 2017.

ability to move money back and forth from one time-period category to another, the appropriation system may inhibit the flexibility of DoD contracting and program management.

Inability to move money from one time period to another may also reduce the negotiating leverage of PMs and contracting officers. Companies may, in some cases, put forth an artificially high bid simply because they know that a particular office has a short-term deadline by which they must obligate funds. One contracting officer claimed "I think there's a bit of inflation going on" with pricing of end-year awards.[58]

Another concern is that periodicity-based budgets may incentivize resource managers and acquisition professionals to hoard O&M money until the end of the fiscal year out of fear that they may be faced with a sudden and expensive emergency. Then as the end of the fiscal year nears, a *rush to spend* may include some projects that have been approved without sufficiently thorough review.[59] Former DoD Comptroller Robert Hale has written that end-year spending "pays for lower-quality and lower-priority projects."[60]

According to a 2013 study, for recent U.S. government information technology (IT) contracting projects there was a statistically significant correlation between funding obligated at the very end of the fiscal year and comparatively low contract quality.[61] A 2014 analysis suggested that rephasing could lead to "delayed delivery of needed capability, uncertainty introduced in planning for program execution, and a possible mismatch between the revised funding profile and the program's needs in upcoming years."[62] A 2016 paper reiterated the "perceived pressure to spend resources at the end of the fiscal year to protect their budgets from cuts and… wasteful expenditures associated with that pressure."[63]

End-year spending also may affect the quality of the acquisition workforce. One contracting professional spoke of "kids running through the hallways" on Saturdays during the end of the fiscal year because employees were working overtime through the weekends and there were no on-base daycare services available.[64] High levels of employee stress are common and overtime compensation takes the form of additional vacation time, because no additional money is budgeted. In such an environment, recruitment and retention of high-quality workers proves challenging.

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[58] Installation contracting officer, conversation with Section 809 Panel, September 2017.

[59] One (possibly exaggerated) story told by a Navy Reserve acquisition officer claims that a former special operator working in a contracting office was signing contracts late at night on September 30, when the office's wall clock was about to reach midnight. The contracting officer allegedly took a Bowie knife from his office, stabbed it into the clock to prevent the minute hand from reaching the twelve, and returned to his desk to continue signing contracts. Regardless of the story's veracity, it illustrates that the budget periodicity-driven "use it or lose it" narrative is so broadly accepted that it has become the subject of jokes among military personnel.

[60] See Robert Hale, "Why DoD's Year-End Spending Needs to Change," *Breaking Defense*, September 23, 2016, http://breakingdefense.com/2016/09/why-dods-year-end-spending-needs-to-change, accessed April 26, 2017.

[61] Jeffrey B. Liebman and Neale Mahoney, *Do Expiring Budgets Lead to Wasteful Spending? Evidence from Federal Procurement,* National Bureau of Economic Research, September 2013, accessed April 26, 2017, http://www.nber.org/papers/w19481.pdf.

[62] Kathleen M. Conley et al., *Implications of DOD Funds Execution Policy for Acquisition Program Management,* Institute for Defense Analyses, August 2014, accessed April 27, 2017, www.dtic.mil/get-tr-doc/pdf?AD=ADA613958.

[63] Jason Fichtner and Adam Michel, *Curbing the Surge in Year-End Federal Government Spending: Reforming "Use It or Lose It" Rules – 2016 Update,* Mercatus Research, September 2016, 23, accessed September 11, 2017, https://www.mercatus.org/system/files/mercatus-fichtner-year-end-spending-v1.pdf.

[64] Installation contracting officer, conversation with Section 809 Panel, September 2017.

Conclusions

The preponderance of evidence suggests that (a) the incentives associated with budget periodicity lead directly to large surges in end-period contract obligations and (b) these surges lead to lower-quality or lower-efficiency contract outcomes. This situation raises concerns about the utility of budget periodicity as applied to DoD budgeting by Congress, OMB, and the DoD Comptroller, as well as in lower levels of DoD resource management.

When Congress limits DoD's contract obligations to specific date ranges via appropriation periodicity, it constrains DoD's ability to transfer funding across years, potentially limiting adaptability. It also may create incentives to obligate large amounts of money at the end of the fiscal year, which may result in lower contract quality.

The 80/20 rule, OMB apportionment processes, and DoD Comptroller rephasing create similar, smaller-scale incentives across quarters and months. These incentives, however, are all driven by the year-based periodicity structure of annual appropriations.

Proposed Solutions

Several measures have been proposed for addressing the end-year spending surges observed in DoD contracting. Some of these, however, may not fully address the underlying, root causes behind end-year spending surges. In some cases, they may in fact exacerbate those core problems.

Solutions that have been proposed (and, in some cases, implemented) include carryover budget authority, the 80/20 rule, *no-year money* (often described as *colorless*), working capital funds, biennial appropriations, and bonuses for cost-cutters.

80/20 Rule

The 80/20 rule specifies that for single-year appropriation accounts, no more than 20 percent of appropriated funds may be obligated in the final 2 months of the fiscal year (August and September). This rule has been incorporated into defense appropriation bills dating back to at least the 1950s.[65] Congress continues to regularly incorporate the 80/20 rule into defense appropriation bills.[66] In the FY 2018 appropriations law, citing the late date of enactment, Congress approved an increased flexibility for that year in the form of a 75/25 rule.[67]

Unintended Consequences of the 80/20 Rule

In 1980, when several variations of the 80/20 rule were under discussion in Congress, the Comptroller-General of the United States testified that adopting any of the proposed versions would result in

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[65] See, for example, Section 625 of An Act Making appropriations for the Department of Defense for the fiscal year ending June 30, 1956, and for other purposes, Pub. L. No. 84-157 (1955).

[66] For the 80/20 Rule as it appeared in the FY 2017 omnibus appropriation, see Section 8004 of the Consolidated Appropriations Act, 2017, Pub. L. No. 115-31 (2017). "No more than 20 percent of the appropriations in this Act which are limited for obligation during the current fiscal year shall be obligated during the last 2 months of the fiscal year: Provided, That this section shall not apply to obligations for support of active duty training of reserve components or summer camp training of the Reserve Officers' Training Corps."

[67] Congressional Record Vol. 164, No. 50, Book II, Explanatory Statement for Pub. L. No. 115-141, March 22, 2018, Operation and Maintenance Flexibility, H2157, accessed June 8, 2018, https://www.congress.gov/crec/2018/03/22/CREC-2018-03-22-bk2.pdf.

constraints that were "difficult to administer" at the agency-level and failed to "address the real problem."[68]

The key concern is that the 80/20 rule specifically targets end-year spending surges, instead of the periodicity-based constraints that incentivize such surges. By requiring an agency to limit its August and September obligations to 20 percent or less, Congress by definition compels agencies to obligate at least 80 percent of appropriations in the preceding 10 months. In this way, the 80/20 rule may simply create a new, less noticeable obligation surge in July.

The 80/20 rule may, in fact, exacerbate the negative effects of periodicity-based budgeting. It not only adds a new constraining period in which funds must be obligated (the period from October to July), but also fails to address the initial constraining period of the regular fiscal year (from October to September).

The Comptroller General added in his 1980 testimony, however, that to "establish a sense of priority and clearly demonstrate that a change is needed," a temporary adoption of some version of the 80/20 rule would be "desirable."[69]

No-Year Money

With many of the annual defense appropriation accounts, Congress makes funding available to DoD for multiple years. The term *N-year* is colloquially used to refer to these periods of time. Procurement appropriations, for example, are made available for obligation during the three fiscal years following an appropriation law's enactment. They are informally described in the acquisition community as *3-year money*.

No-year appropriations are those without any time restrictions. A no-year appropriation may be accessed by an agency in any time period. This flexibility is generally indicated in law using the phrase "to remain available until expended" or "to remain available until transferred."[70] Unlike the 80/20 rule or other proposed constraints on periodicity, there is no concern that additional no-year appropriations would exacerbate end-year obligation surges. There is, however, concern that Congress would limit oversight capabilities if it made more no-year money available to DoD.

Oversight and Scope of No-year Money

Partly due to the challenges in applying oversight to no-year money, it is relatively uncommon in current appropriation law. The four main sections of the annual defense appropriations do not

[68] Comptroller-General of the United States Elmer B. Staats, *Federal Year-end Spending: Symptom of a Larger Problem,* October 23, 1980, accessed July 5, 2017, http://www.gao.gov/assets/140/130983.pdf.
[69] Ibid.
[70] For examples in the FY 2018 defense appropriation, see purchases under the Defense Production Act of 1950, for which $67 million was appropriated "to remain available until expended," or Army environmental restoration, for which $236 million was appropriated "to remain available until transferred." Consolidated Appropriations Act, 2018, Pub. L. No. 115-141 (2018).

typically contain no-year money. A notable exception is the O&M accounts, of which a small percentage has been granted no-year money status in recent appropriation laws.[71]

Other recurring no-year appropriations (such as Environmental Restoration, Defense Production Act Purchases, or several funding categories associated with the U.S. Merchant Marine Academy) tend to be limited in scope, targeted at a specific policy area, and sometimes represent constituencies of particular congressional interest.

For these reasons, it is uncertain whether no-year money is a scalable way of addressing the problems of budget periodicity.

Working Capital Funds

Working capital funds (WCFs) are budget tools intended to "control and account more effectively for the cost of programs and work performed in the Department of Defense."[72] Rather than annual appropriations, WCFs rely on a model akin to a commercial company, effectively selling goods and services to customers (other parts of DoD). Unlike a commercial company, a WCF is not intended to make a profit, but rather achieve zero net income in the long term.

WCFs are designed to receive funding primarily from other parts of DoD, not directly from appropriation bills.[73] Because a majority of the money they receive is indirectly appropriated, they are not subject to the same periodicity-based legal provisions as regular appropriations.[74] The core concept behind WCFs is to ensure full funding for support activities of appropriated fund programs by letting those programs buy what they need, "resulting in the support functions being only as big as the primary customers need them to be."[75] Support activities contracted through WCFs must "only be for a bona fide need of the period for which the ordering activity's financing appropriation is available."[76]

In recent years, Congress has shown an increasing interest in using WCFs and experimenting with different funding models to achieve acquisition objectives. In 2008, Congress created the Defense Acquisition Workforce Development Fund (DAWDF). Throughout the early 2010s, DAWDF primarily used indirectly appropriated funding, obtained through an effective tax on service contracts applied to DoD components.[77] In subsequent years, DAWDF was funded mainly through transfers of O&M

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[71] Under Section 8069 of the FY 2017 defense appropriation (Pub. L. No. 115-31), for example, the Army was permitted to retain $76 million of its Operation and Maintenance funding as no-year money, roughly 0.2 percent of the Army's total Operation and Maintenance appropriation for that year ($32.7 billion).
[72] Working-Capital Funds, 10 U.S.C. §2208(a).
[73] WCFs that have been authorized by law are explicitly permitted to use appropriated funds "for the purpose of providing capital." See Working-Capital Funds, 10 U.S.C. § 2208(d).
[74] For example, the Defense-Wide Working Capital Fund (DWWCF, comprising six activities managed under the Defense Logistics Agency, Defense Information Systems Agency, and Defense Finance and Accounting Service) disbursed a reported $42.1 billion in FY 2016 but received only $45.1 million in direct appropriations. DWWCF took in $42.4 billion in revenue that year. See DoD Comptroller, *Defense Working Capital Fund: Defense-Wide FY 2017 Budget Estimates, Operating and Capital Budgets,* February 2016, accessed July 12, 2017, http://comptroller.defense.gov/Portals/45/Documents/defbudget/FY2017/budget_justification/pdfs/06_Defense_Working_Capital_Fund/PB17_DWWCF_Operating_Budget.pdf.
[75] Naval Postgraduate School budget professor, emails with Section 809 Panel, September 2017.
[76] DoD Financial Management Regulation, Volume 3, Chapter 8, Section 080901.
[77] See Section 852 of FY 2008 NDAA, Pub. L. No. 110-181 (2008).

funding for which normal obligational authority had expired.[78] The FY 2018 NDAA funded DAWDF via a direct, single-year appropriation of $500 million.[79]

In December 2017, the Modernizing Government Technology Act of 2017 (MGT Act) was enacted into law as part of the FY 2018 NDAA. The MGT Act created a WCF dedicated to funding the modernization of government IT upgrades.[80]

Biennial Appropriations

Biennial budgeting is a separate and distinct concept from the 2-year budget cycle on which some DoD appropriations accounts operate (such as RDT&E). In existing RDT&E accounts, appropriations are made every year, but are legally accessible for 2 years (although observers have noted that RDT&E funding is not, in effect, available for more than a single year at the program level).

In a biennial budget cycle, appropriations would be made every 2 years and made available for obligation under the same system of periodicity that currently exists. It would essentially be the same appropriation process Congress uses today, but drawn out over 2 years instead of just one.

Proponents of biennial appropriations advocate for this change arguing it would eliminate the need for repeated congressional review of routine spending issues every year.[81] By encouraging the development of spending strategies on a 2-year timeframe rather than a one-year timeframe, biennial appropriations could also allow for longer-term thinking by ground-level acquisition professionals. A downside to biennial appropriations is that Congress and DoD would lose flexibility to adjust amounts in the second year.

Because it would have little or no effect on the annual cycle of appropriation availability, biennial appropriations may not be an ideal way of addressing the skewed incentives related to periodicity in the DoD acquisition budget.

Cash Bonuses for Reporting Waste

Another proposal for addressing periodicity-based budget constraints involves awarding incentive payments to government employees who identify wasteful spending. Several legislators have supported such an idea in recent years in various versions of a Bonuses for Cost-Cutters Act.[82]

An incentive payment system would have the advantage of directly targeting wasteful spending, rather than end-period spikes themselves. This approach would presumably address the concern that other solutions may focus on symptoms instead of root problems.

To make such a system effective, however, several concerns would need to be addressed. One potential problem is that employees could find themselves incentivized to adopt overly-generous definitions of

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[78] GAO, *Defense Acquisition Workforce: DOD Has Opportunities to Further Enhance Use and Management of Development Fund, GAO-17-332,* March 2017, 9, accessed July 30, 2018, https://www.gao.gov/asset/690/683748.pdf.
[79] Division C, Title II (Operation and Maintenance) of the Consolidated Appropriations Act, 2018, Pub. L. No. 115-141 (2018).
[80] See Title X, Subtitle G of FY 2018 NDAA, Pub. L. No. 115-91 (2018), 304.
[81] Jessica Tollestrup, *Biennial Budgeting: Options, Issues, and Previous Congressional Action,* Congressional Research Service, February 2, 2015, accessed November 4, 2018, https://fas.org/sgp/crs/misc/R41764.pdf.
[82] See, for example, the Bonuses for Cost-Cutters Act of 2017, H.R. 378, introduced January 9, 2017.

what constitutes waste in the hope of a cash bonus. Another potential problem could be misaligned incentives and counterproductive friction between program leadership and lower-level employees.[83]

Carryover Authority

Carryover refers to the practice of permitting annual appropriations to be used in the subsequent year or years. Carryover is also sometimes referred to as *rollover* or *carry forward* authority.

Upward Adjustment Carryover Authorities

DoD is permitted to engage in a limited form of carryover in accordance with OMB Circular A–11, which states that "you may adjust apportioned amounts upwards without submitting a reapportionment request by up to $400,000 or 2 percent of the amount of total budgetary resources, whichever is lower, to reflect upward adjustments in the amount of unobligated balances brought forward."[84]

DoD's Financial Management Regulation provides greater detail on this *upward adjustment* capability: "All accounts which must be apportioned must also be reapportioned for any upward adjustment of budgetary resources greater than $400,000 or 2 percent (whichever is less) before the increased resources may be obligated. The unobligated balances brought forward in unexpired accounts must also be reapportioned annually… Expired accounts are not apportioned. Transfer-only accounts are exempt from apportionment."[85]

GAO characterizes expired balances as remaining available "to make legitimate obligation adjustments, that is, to record previously unrecorded obligations and to make upward adjustments in previously under recorded obligations."[86]

Full Unlimited Carryover

Unlimited, full carryover for an entire appropriation account could result in an unacceptable degradation of the legislature's oversight capabilities. It would also almost certainly prove politically unfeasible. Congress could choose, however, to apply a variety of conditions through which carryover authority could provide programs with needed flexibility while still allowing for robust oversight by appropriators.

Conditional Carryover

There are several ways in which legislators could mitigate concerns about weaker oversight capacity by applying added conditions and constraints to carryover authority. A 2009 paper published by the

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[83] Jason Fichtner and Adam Michel, *Curbing the Surge in Year-End Federal Government Spending: Reforming "Use It or Lose It" Rules – 2016 Update,* Mercatus Research, September 2016, 23, accessed September 11, 2017, https://www.mercatus.org/system/files/mercatus-fichtner-year-end-spending-v1.pdf.
[84] OMB Circular No. A–11, Part 4: Instructions on Budget Execution, Section 120.49, accessed June 27, 2017, https://obamawhitehouse.archives.gov/sites/default/files/omb/assets/a11_current_year/s120.pdf.
[85] DoD Financial Management Regulation, Volume 3, Chapter 2: Apportionment/Reapportionment and Funds Distribution, Section 020202: Accounts Requiring Reapportionment."
[86] GAO, *Principles of Federal Appropriations Law, Third Edition, Volume I, GAO-04-261SP,* January 2004, 5-72, accessed June 27, 2017, https://www.gao.gov/assets/210/202437.pdf.

International Monetary Fund provides a detailed overview of several ways in which limitations could be applied to DoD carryover authority.[87]

One option would be capping the amount that could be carried over in each year at a relatively small percentage of annual appropriations. This option would ensure that acquisition officials were incentivized to obligate nearly all of the annual funding appropriated by Congress, but with a small amount of flexibility in case some funds could not be obligated usefully by September 30.

Another option would be to impose a cap on the total unobligated funds permitted to accumulate in the carryover account, rather than the annual carryover amount. Stakeholders in Congress and DoD might find this constraint desirable to address the prospect (either real or perceived) of a carryover account growing into a *slush fund* over time.[88]

These conditions applied to carryover authority would not be mutually exclusive. If Congress were to grant carryover flexibilities to DoD or other agencies, it could choose to concurrently adopt all or none of these constraints.

Carryover in Practice

In recent years' defense appropriations, Congress has approved a small, 1-year, carryover authority for O&M spending by the Defense Health Program (DHP). The purpose of this carryover was to facilitate the execution of DHP's large drug and medical services indefinite-quantity contracts, for which precise obligations cannot be predicted to the date due to varying patient and facility needs.[89]

Some DoD acquisition personnel strongly advocate for a form of departmentwide carryover, claiming that it could reduce program budgets substantial amounts. One illustrative example recounted by an acquisition professional involved a program's purchase of computer hardware earlier than needed due to appropriation constraints: "If such funding could be carried several months deeper into the program, better equipment could be purchased at lower cost."[90]

Carryover in State Governments

According to analysis by the National Association of State Budget Officers, more than half of U.S. state governments practiced some form of carryover as of 2015.[91] These state-level carryover practices vary in size and scope. South Carolina, for example, permits relatively broad carryover authority. Agencies are authorized to carry forward up to 10 percent of their annual appropriation to the following fiscal

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[87] Ian Lienert and Gösta Ljungman, *Carry-Over of Budget Authority,* International Monetary Fund, Fiscal Affairs Department, January 2009, accessed July 12, 2017, http://blog-pfm.imf.org/files/carry-over-of-budget-authority.pdf.
[88] In the past, carryover measures and similar budgeting flexibility measures have been permitted to exist for periods of time, but eventually characterized as "slush funds" after accumulating sufficiently large unobligated balances. The history of congressional concern over "slush funds" at DoD goes back several decades, spurred in many cases by flexibility authorities similar to carryover. See, for example, Senator Alfonse D'Amato's 1985 letter to the U.S. Comptroller General on this issue and the accompanying report: Comptroller General of the United States, *Potential for Excess Funds in DOD, GAO/NSIAD-85-145,* September 3, 1985, accessed June 27, 2017, http://archive.gao.gov/d11t3/127859.pdf.
[89] Defense Health Agency personnel, conversation with Section 809 Panel, October 2017.
[90] Naval Air Systems Command personnel, communication with Section 809 Panel, September 2017.
[91] National Association of State Budget Officers, *Budget Processes in the States, Spring 2015,* Table 17: Unspent Appropriations, 92, accessed November 4, 2018, https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/Budget%20Processess/2015_Budget_Processes_-_S.pdf.

year.[92] In Hawaii, however, only the department of education is granted carryover authority, and it is limited to no more than 5 percent of each annual appropriation.[93]

States that have adopted carryover laws report positive experiences, with one Washington state budget official reporting that the state's carryover law definitely resulted in more efficient agency purchases.[94] Washington, however, encountered a problem that could eventually affect DoD if Congress opted to grant DoD some form of carryover authority. In the wake of economic downturn and the resulting exogenous fiscal constraints, there was a strong incentive for Washington state lawmakers to locate and use unspent funds within agencies. Perhaps for this reason, shortly after the start of the late-2000s global financial crisis, the legislature repealed Washington's carryover authority.

Some states, such as California, also practice both multiyear and no-year appropriations on a limited scale.[95]

Carryover in Foreign Governments

Many foreign governments practice some form of carryover in their budgeting systems. The International Monetary Fund (IMF) suggests that carryover provisions are best-suited for countries with high-quality rule of law and institutional development, where "the prime objective is ensuring the most efficient and effective use of government resources."[96]

Table 4-4. Carry-Over Authority in Selected Countries[97]

Country	Carryover Authority
United States	Carryover requires specific legislative approval, multiyear appropriations in some cases
Canada	Maximum threshold and approval required
Mexico	None
United Kingdom	Maximum threshold and approval required
France	Maximum threshold and approval required, exceeding thresholds subject to approval

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[92] South Carolina Comptroller General, *State of South Carolina Policy for Use of Purchasing/Payment Document Type,* June 30, 2016, accessed July 5, 2017, http://www.cg.sc.gov/guidanceandformsforstateagencies/Documents/CGsAPP/06-30-16/POLICYONUSEOFPURCHASEORDERSANDDIRECTEXPENDITURES_%206-30-16.pdf.
[93] "About State Budgeting," State of Hawai'i Department of Budget and Finance, accessed July 5, 2017, http://budget.hawaii.gov/budget/about-budget.
[94] Washington State budget official, discussion with Section 809 Panel, June 2017.
[95] See California Department of Finance, *Finance Glossary of Accounting and Budgeting Terms,* accessed July 5, 2017, http://www.dof.ca.gov/budget/CA_budget_information/budget_faq/GlossaryofBudgetTerms.pdf. "Appropriations made by the Budget Act are available for encumbrance for one year, unless otherwise specified. Appropriations made by other legislation are available for encumbrance for three years, unless otherwise specified, and appropriations stating 'without regard to fiscal year' shall be available from year to year until fully expended."
[96] "Guidelines for Public Expenditure Management, Section 4: Budget Execution," International Monetary Fund, accessed July 5, 2017, https://www.imf.org/external/pubs/ft/expend/guide4.htm.
[97] Data based on responses to 2012 OECD survey question "for discretionary spending, can line ministers carry over unused funds or appropriations from one year to another?" See "About the International Budget Practices and Procedures Database," Organisation for Economic Cooperation and Development, accessed July 5, 2017, http://qdd.oecd.org/subject.aspx?Subject=7F309CE7-61D3-4423-A9E3-3F39424B8BCA.

Country	Carryover Authority
Germany	2-year carryover allowed, subject to restrictions
Spain	Maximum threshold and approval required
Italy	None
Norway	Maximum threshold and approval required
Sweden	Maximum threshold and no approval required, exceeding thresholds subject to approval
Greece	None
Israel	No threshold and no approval required
Japan	No threshold but approval required
Korea	Carryover requires specific legislative approval
Australia	Appropriations do not lapse at end of year

Difficult Trade-offs

Congress faces difficult trade-offs in determining how to address this issue. If legislators chose to decentralize budget authority among lower-level decision makers (for instance, by allowing PMs and contracting officers greater access to no-year money) the result could limit oversight capabilities.

If Congress opted to pursue alternative forms of the current periodicity-based budget system (for example, switching to biennial appropriation cycles) the effect might be limited. The incentives that cause obligation surges will not be erased by simply switching federal appropriations to a 2-year cycle instead of a 1-year cycle, as some members of Congress have proposed in recent decades.[98]

If Congress opted to provide cash bonuses as a reward for government employees who identified waste, it could lead to mismatched goals between program management and staff, as well as other unintended issues.

If Congress and other decision makers chose to directly target end-year obligation surges (for instance, by imposing a monthly percentage cap on DoD contract obligations, essentially a much more rigorous version of the 80/20 rule) it would likely eliminate the distorted annual spending patterns seen in acquisition data. It would, however, represent an additional incentive for acquisition personnel to prioritize timing over contract quality. In this way, such an approach might simply address symptoms rather than problems.

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[98] For examples of members of Congress who have supported biennial appropriations, see Jessica Tollestrup, *Biennial Budgeting: Options, Issues, and Previous Congressional Action,* Congressional Research Service, February 2, 2015, accessed November 4, 2018, https://fas.org/sgp/crs/misc/R41764.pdf.

Problem Complexity

Effectively addressing the perverse incentives created by periodicity-based budgeting requires acknowledgment of the problem's complexity. There are many stakeholders involved in DoD acquisition budgeting. They include U.S. taxpayers, congressional authorizers, congressional appropriators, OMB, DoD functional sponsors, the DoD acquisition community, the DoD resource management community, and the defense contractor community. It may not be possible to develop a budgeting mechanism that could appease all these groups' interests while also allowing DoD to flexibly allocate funding where and when it is needed.

Even if all stakeholders were to reach a mutually acceptable solution, there would be trade-offs involved in switching to a more flexible budgeting system. Periodicity-based budgeting may allow for flexibility to changing economic conditions. In other words, if an unexpected recession occurs, appropriators have the option to respond with immediate cuts to defense spending. This type of fiscal flexibility might be less feasible if, for example, DoD retained more of its spending authority from prior years through carryover provisions.

Greater flexibility of DoD's acquisition budget authority across time periods would likely increase the efficiency and effectiveness of contract spending within those time periods. Such changes would also preserve Congress's ability to determine the total, long-term dollar amount spent on individual DoD components, appropriation titles, or programs. They would, however, limit Congress's ability to modify how much is spent within specific periods of time. Many in Congress clearly view this ability as a core aspect of the oversight process.

Best Solution

As demonstrated above, there may be no perfect solution to the problematic incentives created by periodicity-based budgeting constraints. The most appropriate way of mitigating end-period spending surges, however, would be to create a mechanism allowing for a small percentage of single-year funding to cross fiscal years. Such a mechanism could be accomplished by allowing the obligation of up to 5 percent of O&M funding for 1 year beyond what would normally be the end of its availability. This approach would allow for a smoothing effect across fiscal years, mitigating the perceived urgency to spend all available funds by end-year by creating a funding bridge across fiscal years, allowing for DoD's single-year funding accounts to more easily meet the legislature's antideficiency and impoundment control requirements.

Implementation

Note: The Section 809 Panel considered many congressional options for addressing periodicity problems, including multiyear appropriations, cash bonuses for waste reporting, and increasing the rigor of the 80/20 rule. There are problems associated with each of these options. For this reason, the panel recommends congressional approval of a simple, small-percentage carryover authority for DoD's O&M accounts. This proposal offers the best opportunity to deal with periodicity-related problems as a first step.

Legislative Branch

- Permit 5 percent of appropriated O&M funding to be obligated up to 1 year beyond what would normally be the end of their availability for obligation. This change would fall within the jurisdiction of the appropriations committees. It would likely be implemented via the addition of standard *to remain available for obligation until* language to the Operation and Maintenance title accounts in a regular defense appropriations law.

Executive Branch

- Modify business processes, financial management defense business systems, and acquisition policies to extend funding availability for the congressionally authorized percentage of the O&M accounts.
- Current policies for obligating Defense Health Program funding may be used as a template. Congress regularly grants Defense Health Agency a one-year capped carryover on 1 percent of each year's O&M funds.

Implications for Other Agencies

- The proposed carryover pilot programs could serve as a model for acquisition budget reform in other agencies.