

GAO

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United States General Accounting Office

Briefing Report to the Chairman,
Subcommittee on Defense, Committee
on Appropriations, U.S. Senate

December 1992

DOD BUDGET

Controls Needed Over Inflation Dividends



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United States
 General Accounting Office
 Washington, D.C. 20548

National Security and
 International Affairs Division

B-248909

December 14, 1992

The Honorable Daniel K. Inouye
 Chairman, Subcommittee on Defense
 Committee on Appropriations
 United States Senate

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Dear Mr. Chairman:

We examined the Department of Defense's key management controls over excess funds that have become available to the Department because actual inflation has been less than it had estimated.

In earlier reports, we estimated that between fiscal years 1982 and 1987 the Department realized about \$55.8 billion in inflation dividends. Subsequently, the Congress reduced, transferred, or reprogrammed over \$7.5 billion of these inflation dividends in fiscal years 1985 through 1987. Our current focus is on the Department's fiscal year 1992 inflation dividend and its fiscal year 1993 budget request.

We provided preliminary results of our review for your Subcommittee's markup of the defense appropriations bill so that the potential reductions and rescissions could be used in your evaluations.

Results in Brief

The Department has overestimated the funds needed for inflation in fiscal years 1992 and 1993 by more than \$3.6 billion. Based on the latest Office of Management and Budget (OMB) economic assumptions, the Department now projects inflation dividends of \$2.8 billion from fiscal year 1992 appropriations and \$837 million from the funds it requested for fiscal year 1993.

Our current and past reviews lead us to believe that if the Department were to improve monitoring of funding needs and periodically report on the impact of changing inflation rates, the Congress would have the information needed to adjust for inflation dividends such as those projected for fiscal years 1992 and 1993.

Department Projects Large Inflation Dividends

Using OMB economic assumptions, the Office of the Secretary of Defense prepares and provides official inflation projections to defense agencies and military services. These projections are used to estimate the defense funding requirements reflected in the appropriation requests. The

Department's budget request for fiscal year 1992 was submitted in February 1991 and included an allowance for inflation of 4.1 percent. By June 1992, OMB's inflation estimate had decreased to 2.7 percent. As shown in table 1, the Department's Office of the Comptroller estimated that the lower inflation rate will result in a potential inflation dividend of about \$2.8 billion for fiscal year 1992.

The Department's fiscal year 1993 budget request was based on fiscal year 1992 dollars (as inflated) and an inflation forecast of 3.3 percent. The fiscal year 1993 request was submitted in January 1992. In June 1992, the fiscal year 1993 inflation forecast was reduced to 3.1 percent. The Department's estimate of the effect of this reduction on the fiscal year 1993 budget is also shown in table 1.

Table 1: Inflation Dividends by Fiscal Year and Appropriation Account

Dollars in millions		
Appropriation account	1992	1993
Procurement	\$1,242	\$313
Research, development, test, and evaluation	564	213
Military personnel	149	0
Military construction	76	32
Family housing	70	22
Operation and maintenance	691	257
Total	\$2,792	\$837

Department Proposes to Retain Inflation Dividends

Officials from the Department's Office of the Comptroller told us that they do not intend to adjust the fiscal year 1992 allocations to accommodate the inflation dividends. They said that once the Congress enacts the Department's appropriation and the funds are allocated to the military services and defense agencies, no adjustments for inflation rate variations are made. These officials said that it would not be practical to rescind fiscal year 1992 funds associated with inflation dividends because once funds are allocated many factors can influence how they are obligated. The Comptroller officials also said that it would be difficult to allocate a rescission of these funds because no specific accounting has been made for how the inflation dividends are used, reserved, transferred, or reprogrammed at the program level.

We believe that the Department would be able to adjust its spending plans in the event the fiscal year 1992 inflation dividend were to be

reprogrammed, transferred, or rescinded because the amount of the fiscal year 1992 funds remaining unobligated at the end of that year is likely to have been several times greater than the \$2.8 billion dividend. For example, at the end of fiscal year 1991 more than \$40 billion of the Department's procurement and research, development, test, and evaluation funds appropriated for that year remained unobligated.

Office of the Comptroller officials also believe that the fiscal year 1993 appropriations request should not be adjusted because the latest 3.1 percent projection could change. Since the original budget request was based on a higher and less current estimate, we believe an adjustment should be made before the requested level of funding is made available for obligation. If the actual inflation rate for fiscal year 1993 exceeds the current estimate, the Department can adjust its funding through transfers and reprogramming or request a supplemental appropriation. Correspondingly, if the Department anticipates an inflation dividend, adjustments can be made in allocating the amount of funding that was requested.

In enacting the Department of Defense Appropriation Act for 1993, the Congress reduced the Department's request by \$611.5 million for adjustments in the Department's inflation estimates. Prior to the enactment of the appropriation, the Department was projecting an inflation dividend of \$837 million as shown on table 1.

Monitoring and Reporting Requirement Was Repealed

In 1986 the Congress established a requirement for the Department to report to the Committees on Armed Services three times each year on unobligated balances, including inflation dividends, and to explain annually what might be done to adjust for variances between amounts appropriated to offset anticipated inflation and more current estimates of amounts necessary to carry out the programs for which the appropriations were made.

About 1 year after the 1986 law was enacted, the Department agreed with us that a system that monitors inflation and includes regular reports was the best way to provide the Congress with the information needed to facilitate funding adjustments. The Department stated that it had demonstrated the feasibility of implementing the reporting requirements in the 1986 legislation and could continue to provide this information.

In the late 1980s, inflation dividends began to decline and this reporting requirement was repealed in 1989. According to a Defense Comptroller official, this reporting requirement, along with a number of others, was repealed in an effort to reduce administrative burdens on the Department.

Although the projected inflation dividends in fiscal years 1992 and 1993 may not be as large as those that led to enactment of the 1986 law, we believe they certainly must far exceed the administrative cost of compliance with a similar requirement. Moreover, reestablishing a similar monitoring and reporting requirement would afford the Congress oversight information needed to ensure that (1) it has a reasonably up-to-date projection of needed appropriation levels and (2) the Department is executing its programs in accordance with the plans it used to justify its appropriations.

The Department's ability to produce such reports in a timely fashion was clearly evident to us in the ease with which the Department was able to produce for us the additional information that is reflected in table 1. Therefore, in our view, implementation of a similar monitoring and reporting requirement should not be a particularly burdensome administrative function.

Recommendations

We recommend that the Secretary of Defense monitor and report on inflation amounts, changes, and revisions promptly as the Congress considers appropriation requests, rescission proposals, and reprogramming plans advanced by the Department.

We also recommend that the Secretary of Defense determine the amount of the fiscal year 1992 inflation dividend that should be proposed to the Congress for rescission and the amount that can be used to offset funding requirements in subsequent years.

Department of Defense Comments and Our Evaluation

The Department disagreed with our findings and recommendations but agreed that the total cumulative impact of the administration's report of actual and current projections of inflation dividends for fiscal years 1992 and 1993 is \$3.6 billion as shown in table 1. (The Department's comments are included in app. I.) However, the Department disagrees with us that any adjustments are warranted.

The Department stated that there is no need for the periodic reporting we recommend because the information is routinely provided to the congressional staffs in the course of daily interaction with the Office of the Comptroller. The Department suggested that OMB's Midsession report¹ to the Congress is a more appropriate vehicle for providing information to the Congress. We found that the appropriation-level information that the Comptroller's office developed for us provided a level of detail most appropriate for the Subcommittee's analysis and deliberation and that the Midsession report does not presently provide equivalent detail. If the format of the Midsession report is changed to provide that detail, we believe it will give the Congress a more reliable indication of changes in funding requirements as a result of inflation rate adjustments.

The Department did not agree that the Secretary of Defense should determine the extent to which the 1992 inflation dividend should be proposed to the Congress for rescission. The Department argued that the projected inflation dividend in the 1992 appropriation was subsumed in intervening rescission and reprogramming actions. We realize that rescissions and reprogrammings have been made, but we found that these actions were based on programmatic adjustments and program cancellations, not on inflation estimates. Therefore, at most these actions seem likely to have eliminated only the small fraction of the total inflation dividend that had been allocated to those specific programs.

Scope and Methodology

To conduct our review, we interviewed budget officials and reviewed pertinent budget documents and budget support data from the Department of Defense and the Office of Management and Budget. We did not verify the inflation dividend information calculated by the Department's Comptroller.

We conducted our review from May to September 1992 in accordance with generally accepted government auditing standards.

We are sending copies of this report to other appropriate congressional committees; the Secretaries of Defense, the Army, the Navy, and the Air Force; the heads of defense agencies; and the Director of the Office of Management and Budget. We will also make copies available to others on request.

¹Mid-Session Review: The President's Budget and Economic Growth Agenda, Executive Office of the President, Office of Management and Budget, Washington, D.C. (July 24, 1992).

This report was prepared under the direction of Richard Davis, Director, Navy Issues, who may be reached on (202) 275-6504 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix II.

Sincerely yours,



Frank C. Conahan
Assistant Comptroller General

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

OCT 26 1992

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report entitled, "DOD BUDGET: Potential Reduction or Rescission Because of Lower Inflation" (GAO Code 394494/OSD Case 9204). The Department does not agree with the principal report findings, recommendations or matter for congressional consideration.

The DoD agrees with the impact of the Administration's revised inflation assumptions on FY 1992 appropriations and the budget request for FY 1993. However, the GAO report does not take into consideration the FY 1992 rescissions or the reprogrammings approved by the Congress. The fact that the Congress reduced the FY 1993 Defense budget request by the total amount associated with the revised economic assumptions in the Mid-session Review takes care of any so-called inflation dividends in FY 1993.

Detailed DoD comments on the draft report and recommendations and matter for congressional consideration are provided in the enclosure. The Department appreciates the opportunity to respond to the draft report.

Sincerely,

Donald B. Shycoff
Donald B. Shycoff
Acting Comptroller

Enclosure

Appendix I
Comments From the Department of Defense

GAO DRAFT REPORT - DATED SEPTEMBER 16, 1992
(GAO CODE 394494) OSD CASE 9204

"DOD BUDGET: POTENTIAL REDUCTION OR RESCISSION
BECAUSE OF LOWER INFLATION"

DEPARTMENT OF DEFENSE COMMENTS

FINDINGS

Finding: DoD Projects Large Inflation Dividends. The GAO found that the DoD has over estimated the funds it will need for inflation in FY 1992 and FY 1993 by more than \$3.6 billion. (pp. 1-3/GAO Draft Report)

DoD COMMENT: Nonconcur. The DoD does not project large inflation dividends. Based on the Administration's report of actual and current projections of inflation, the cumulative impact on FY 1992 appropriations and the President's budget request for FY 1993, is \$3.6 billion.

Of this amount, \$2.8 billion was identified in January 1992 when the Administration issued its economic assumptions for preparation of the FY 1993 budget. Although the DoD did not explicitly adjust the FY 1992 column of the FY 1993 budget for the revised inflation estimate, the DoD did include a rescission package totaling nearly \$8 billion and later submitted an omnibus reprogramming package to the Congress of over \$1 billion. Reprogramming sources, by definition, are from low priority programs or programs with assets generated from lower pricing or execution performance to higher priority programs. Reprogrammings are accomplished only with the approval of Congress.

The remaining \$0.8 billion reflects the Administration's revised inflation projections for the Midsession Review of the FY 1993 budget. Since the revision involved a rate change for FY 1993 and was based on preliminary information for just two quarters of the fiscal year, OMB did not ask any federal agency to reprice the budget for the Midsession review. However, DoD was subsequently asked and provided the impact of the revision to the staff of the Senate Defense Appropriations Subcommittee. The DoD appropriations bill for FY 1993 was signed on October 6, 1992, and reflected this pricing change. Therefore, the DoD does not project large inflation dividends and it is the Department's position that there are no excess funds in FY 1992 or FY 1993 appropriations as a result of changes in inflation.

Finding: DoD Proposes to Retain Inflation Dividends. The GAO reported that the DoD Comptroller officials indicated that the Department does not intend to adjust the FY 1992 allocations to accommodate the inflation dividends. The GAO concluded that the

Enclosure

Appendix I
Comments From the Department of Defense

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3 comment 1.
w on pp. 2-3.

Congress might want to make the adjustment in the levels it appropriates for FY 1993. (pp. 4-5/GAO Draft Report)

DoD COMMENT: Nonconcur. Although the DoD does not intend to recommend further rescissions or adjustments to the FY 1992 appropriations at this time, the Department disagrees that the Congress should adjust the levels it appropriates for FY 1993. Since appropriations were enacted for FY 1992, the Congress has already approved a rescission package of about \$8 billion and the Department's request to reprogram over \$1 billion. At this time, a large percentage of the amounts appropriated for FY 1992 are already obligated. If the Department should identify any excess funds in the execution of the programs approved by the Congress, such amounts could become the source of future reprogramming requests.

Finding: Continuing Need for Monitoring and Reporting on Inflation. The GAO reported that, although the projected inflation dividends for FY 1992 and FY 1993 may not be as large as those that led the Congress, in 1986, to require the DoD to report three times a year on inflation savings--the reestablishment of such a monitoring and reporting requirement would afford the Congress assurance that it has current information on appropriation levels and that the DoD is executing its programs as planned and justified. (pp. 6-8/GAO Draft Report)

w on pp. 3-4.

DoD COMMENT: Nonconcur. The Administration issues economic assumptions twice each year--once when the annual budget is submitted to the Congress in January or February and for the Midsession review in July or August. The DoD calculates the impact of changes in the economic assumptions to previous assumptions. The DoD reflects the impact of revised inflation rates in its annual budget submission and reports to OMB any changes due to inflation in the Midsession review. OMB, in turn, makes its Midsession report to the Congress. These are the appropriate vehicles for providing information to the Congress. The notification should be made for all federal agencies and not just for DoD. It is an unnecessary burden on the Department and the Congress to make reports to the Congress three times a year.

RECOMMENDATIONS

Recommendation 1: The GAO recommended that the Secretary of Defense monitor and report on inflation amounts, changes, and revisions promptly and periodically throughout the course of the year as the Congress considers appropriation requests, rescission proposals and reprogramming plans advanced by the Department. (p. 8/GAO Draft Report)

w on p. 4.

DoD COMMENT: Nonconcur. The DoD Comptroller staff is in daily contact with the congressional staff and routinely provides this information to the DoD oversight committees as the Congress

considers appropriation requests and reprogramming plans. Additional reporting requirements are not necessary.

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Recommendation 2: The GAO recommended that the Secretary of Defense determine the extent to which the FY 1992 inflation dividend should be proposed to the Congress for rescission and the amount of the dividend that can be used as an offset against the FY 1993 budget request. (pp. 8-9/Draft Report)

DoD COMMENT: Nonconcur. There is no inflation dividend in FY 1992 appropriations. Any further rescissions at this time from FY 1992 appropriations would cut programs already approved by the Congress.

MATTER FOR CONGRESSIONAL CONSIDERATION

Suggestion: The GAO suggested that the Congress consider reducing the Department's FY 1993 request by \$837 million, the Department's current estimate of the inflation dividend it will realize if appropriations are made at the levels requested last February. (p. 9/GAO Draft Report)

DoD COMMENT: Nonconcur. This discussion is moot because, although the Department believes that it was premature to cut the FY 1993 Defense budget based on a preliminary estimate of inflation, the Congress cut the FY 1993 budget request by the full amount as reflected in the DoD appropriations bill signed October 6, 1992.

np. 4.

comment 2.

Appendix I
Comments From the Department of Defense

The following are GAO's comments on the Department of Defense's letter dated October 26, 1992.

GAO Comments

1. We deleted this suggestion because the 1993 appropriations were enacted while the Department was commenting on this report.
2. We deleted the matters for consideration contained in the draft report because the Congress reduced the Department's 1993 appropriation by \$611.521 million.

Major Contributors to This Report

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