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

April 2003

DEFENSE BUDGET

Tracking of Emergency Response Funds for the War on Terrorism

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GAO-03-346

April 2003

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Highlights

Highlights of GAO-03-346, a report to the Chairman and Ranking Minority Member, Subcommittee on Defense, Committee on Appropriations, U.S. Senate

DEFENSE BUDGET

Tracking of Emergency Response Funds for the War on Terrorism

Why GAO Did This Study

As of January 2003, Congress had provided a total of $38 billion to the Department of Defense (DOD) to cover emergency response costs related to the war on terrorism. Appropriated in different ways in fiscal years 2001, 2002, and 2003, these funds are meant to pay for expenses that DOD would not normally incur, such as contingency military operations and Pentagon building repairs.

Because our prior work raised questions about DOD's oversight of contingency fund spending, GAO was asked to review DOD's management of emergency response funds, specifically:

- DOD's adherence to OMB guidance in managing funds and the sufficiency of DOD's guidance on the use of these funds, and
- DOD's ability to track the use of emergency response funds in general.

We limited our review of DOD's guidance to the initial funds placed in the Defense Emergency Response Fund. We did not verify the accuracy of the data contained in DOD's obligation reports or the appropriateness of individual expenditures.

What GAO Recommends

Because DOD is revising its guidance and compiling more data based on our prior work, we are not making a new recommendation.

www.gao.gov/cgi-bin/getrpt?GAO-03-346.

To view the full report, including the scope and methodology, click on the link above. For more information, contact Sharon Pickup at (202) 512-9619 or pickups@gao.gov.

What GAO Found

While DOD followed the Office of Management and Budget's (OMB) guidance in managing the initial $15 billion in war on terrorism funds that were placed in the Defense Emergency Response Fund in fiscal years 2001 and 2002, DOD provided its components with limited guidance on how to use these funds. DOD allocated the funds according to OMB's 10 funding categories. However, DOD's designations of allowable line items for each category were broad and, thus, could be interpreted in different ways. Also, while OMB directed that the funds were to be used for urgent and known needs, DOD did not define those needs further. Finally, DOD directed the components to use an internal financial management regulation for contingency funding to determine if costs were incremental or not; however, as we have reported previously, these regulations are insufficient for this purpose. In the absence of detailed guidance military officials sometimes had to use their best judgment in obligating emergency response funds.

DOD's ability to track the use of emergency response funds has varying limitations depending on the appropriation. For the fiscal years 2001 and 2002 emergency response funds managed separately in the Defense Emergency Response Fund ($15 billion), DOD can report a breakdown of obligations by its 10 funding categories, but cannot correlate this information with its appropriation account structure. For emergency response funds provided in fiscal years 2002 and 2003 ($20.5 billion) that were transferred into or placed directly into DOD's regular appropriations accounts, DOD cannot use its accounting system to track the use of these funds because they are commingled with those appropriated for other purposes. While DOD has an alternative process intended to track obligations for contingency operations related to the war on terrorism, it cannot identify the portion of obligations that are funded with emergency response funds. DOD acknowledged these limitations and, in December 2002, began requiring additional reporting on the use of these funds.

DOD partially concurred with this report, noting it clearly told components to use DOD's financial regulation for guidance and also held meetings for clarification. DOD agreed funds were commingled, but noted it had a process to track incremental costs for the war on terrorism.

DOD Emergency Response Funds (fiscal years 2001 through 2003)

Dollars in billions

Fiscal year	Total	Appropriation type
2001/2002	$17.5	Emergency supplementals ($15 billion Defense Emergency Response Fund, $2.3 billion other accounts, and $0.2 billion rescinded)
2002	13.4	Supplemental
2003	7.1	Annual appropriation
Total	**$38.0**	

Source: DOD.

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Abbreviations

DOD Department of Defense
OMB Office of Management and Budget

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Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

April 30, 2003

The Honorable Ted Stevens
Chairman
The Honorable Daniel K. Inouye
Ranking Minority Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

As of January 2003, Congress had provided a total of about $38 billion to fund the Department of Defense's (DOD) efforts to recover from and respond to the September 11, 2001, terrorist attacks.[1] Following the attacks, Congress initially provided, and the President approved, about $17.5 billion in emergency response funds to DOD through two emergency supplemental appropriations in fiscal years 2001 and 2002. Because of the urgent circumstances, Congress sought an expeditious means to provide funds to DOD and, with the Office of Management and Budget (OMB), agreed that DOD could manage these initial funds in the Defense Emergency Response Fund—an existing account that is separate from DOD's regular appropriations accounts.[2] Of the initial $17.5 billion, DOD received about $15 billion in the Defense Emergency Response Fund, $2.3 billion was provided to other accounts, and $0.2 billion was rescinded. Concerned about dual accounting, Congress provided the remaining $20.5 billion in two subsequent appropriations in fiscal year 2002 and fiscal year 2003 to DOD's regular appropriation accounts either through transfers from the Defense Emergency Response Fund or directly.[3] Among other things, DOD is using emergency response funds to cover the cost of repairs to the Pentagon and contingency operations related to the global

[1] For purposes of this report, we refer to these funds as "emergency response" funds.

[2] This fund was established in 1989 to fund DOD's expenses for supplies and services provided in response to natural or manmade disasters or emergencies. DOD's regular appropriations accounts include operation and maintenance; procurement; research, development, test and evaluation; and military personnel.

[3] For the emergency supplementals of fiscal years 2001 and 2002, Congress specifically designated in statutes the use of appropriated funds for responses to the September 11, 2001, attacks. For the two subsequent appropriations in fiscal years 2002 and 2003, Congress designated funds for responses to the attacks in conference report language rather than in the pertinent statutes.

war on terrorism. In general, applicable OMB and DOD guidance requires funds provided for the war on terrorism to be used for expenses that are emergency and incremental in nature—expenses that DOD would have otherwise not incurred.

For the past several years, we have been reviewing cost and funding issues associated with overseas contingency operations. Among other things, we have reported about the need to strengthen DOD's oversight of funds appropriated for contingency operations, including improving guidance to clarify incremental costs.[4] In March 2002, you requested that we continue this effort by examining DOD's oversight of the Defense Emergency Response Fund and the cost of contingency operations in the Balkans and Southwest Asia. In June 2002, we briefed your staff on the preliminary results of this work. In September 2002, we reported on the costs associated with operations in the Balkans and Southwest Asia.[5] This report summarizes our observations on (1) the extent to which DOD had adhered to OMB's guidance for managing funds provided separately for the Defense Emergency Response Fund (appropriated in the first two emergency supplemental appropriations), (2) the sufficiency of DOD's guidance to its components on the use of these funds, and (3) its ability in general to track the use of emergency response funds. We are also providing information on DOD's plans to expand its reporting on the use of emergency response funds.

More recently, in February and April of 2003 appropriations, DOD received about $73 billion in additional funding for war on terrorism-related expenses. However, this review is limited to the $38 billion in funds provided under four previous appropriations. In performing our work, we did not verify the accuracy of the data contained in DOD obligation

[4] For example, see U.S. General Accounting Office, *Defense Budget: Need to Strengthen Guidance and Oversight of Contingency Operations Costs*, GAO-02-450 (Washington, D.C.: May 2002).

[5] U.S. General Accounting Office, *Defense Budget: Contingency Operations in the Balkans May Need Less Funding in Fiscal Year 2003*, GAO-02-1073 (Washington, D.C.: Sept. 2002).

reports or the appropriateness of individual expenditures.[6] For details on our scope and methodology, see appendix I.

Results in Brief

DOD adhered to OMB guidance in managing the allocation of the $15 billion in emergency response funds provided to the Defense Emergency Response Fund under fiscal years 2001 and 2002 emergency supplemental appropriations, but provided limited guidance to military components on the use of these funds. In accordance with OMB guidance, DOD allocated funds to its components in 10 funding categories and did not transfer these funds to its regular accounts. These funds were to be used for emergency and incremental needs. While DOD designated allowable line items for each funding category, these designations were broad and subject to interpretation. For example, DOD designated "mobilization of guard and reserves" as an allowable line item. Mobilization involves many factors such as special pay, transportation, and equipment; however, DOD did not specify which could be funded. Furthermore, OMB, among other things, directed that any requirement to be funded must reflect an urgent and known need. However, DOD did not establish any specific parameters to define the meaning of urgent and known. To determine incremental needs, components were to rely on DOD's internal financial management regulation.[7] As we reported in May 2002, this regulation does not provide sufficient guidance on the types of costs defined to be incremental. In the absence of detailed guidance, command officials were sometimes uncertain on whether expenses were allowable and often had to use their best judgment in obligating emergency response funds. Because DOD is in the process of improving its guidance based on recommendations from our prior work, we are not making a recommendation in this report.

DOD's ability to track the use of funds appropriated for the war on terrorism has varying limitations depending on the appropriation. For

[6] We note GAO has designated DOD's financial management area as high risk due to long-standing deficiencies in DOD's systems, processes, and internal controls. Among other things, these deficiencies affect DOD's ability to ensure basic accountability and maintain control of funds. For example, DOD does not have the systems and processes in place to capture the required cost information from the hundreds of millions of transactions it processes each year. (See U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Defense*, GAO-03-98 (Washington, D.C.: Jan. 2003.)

[7] Department of Defense Financial Management Regulation, DOD 7000.14-R, vol. 12, chapter 23 on Contingency Operations, February 2001.

funds provided under the fiscal years 2001 and 2002 emergency supplemental appropriations that were managed separately in the Defense Emergency Response Fund ($15 billion), DOD is able to provide a breakdown of obligations for the 10 funding categories, but reporting proved to be cumbersome because the categories do not correlate with DOD's regular appropriations accounting structure. For funds provided under the two subsequent DOD appropriations in fiscal years 2002 and 2003 ($20.5 billion), DOD is not able to separately track the use of emergency response funds. As generally occurs with funds in any appropriation, these funds are commingled in DOD's regular appropriations accounts with funds appropriated for other purposes. Because DOD's accounting system only captures data on total obligations and does not distinguish sources of funds, DOD is not able to identify those obligations that are funded from emergency response funds. While DOD has an alternative process intended to track incremental costs (obligations) of contingency operations, including operations related to the war on terrorism, these operations are funded from multiple sources. Because of the aforementioned characteristics of its accounting system, DOD cannot identify the portion of contingency operations-related obligations funded with emergency response funds.

During our review, DOD officials acknowledged the limitations in their ability to specifically track the use of emergency response funds and, in November 2002, established additional reporting requirements related to the use of emergency response funds. In general, components will continue to report obligations for funds provided under the first two emergency supplementals that were managed separately in the Defense Emergency Response Fund. DOD will also compile additional data on emergency response funds provided under the two subsequent appropriations, including a more detailed breakdown of incremental costs for contingency operations, obligations from supplemental funds, and obligations from funds borrowed from baseline programs to pay for expenses related to the war on terrorism. According to DOD officials, components will rely on parallel tracking systems at the command and unit level to compile this data. At this point, these officials believe it would be too costly and time-consuming to modify DOD's accounting system to generate more detailed funding and obligation data. Rather, they emphasized the expanded reporting requirements will provide the management information that DOD needs to oversee the obligation of emergency response funds, justify needs for any additional funding, and provide transparency to Congress, OMB, and others. Because the components are still compiling data, we are not making a recommendation

in this report but will monitor DOD's progress in compiling the additional data during our ongoing review of contingency operation costs.

Background

As of January 2003, Congress had provided about $38 billion, through a total of four appropriations, for DOD's emergency response needs related to the war on terrorism. In September 2001 and December 2001, Congress enacted two emergency supplemental appropriations to quickly provide initial funds to meet the emergency needs of DOD and other federal agencies to recover from and respond to the September 11 terrorist attacks.[8] These supplementals, enacted in two separate fiscal years, fiscal year 2001 and fiscal year 2002, provided about $17.5 billion to DOD. Given the urgent circumstances, Congress sought an expeditious mechanism to transfer funds and, therefore, provided funds to DOD through the Defense Emergency Response Fund. This fund is a distinct account and DOD manages it separately from its regular appropriations accounts. Of the initial $17.5 billion, DOD received about $15 billion in the Defense Emergency Response Fund, $2.3 billion was provided to other accounts, and $0.2 billion was rescinded.

Shortly after the September 11, 2001, attacks, OMB and DOD agreed on certain parameters for managing funds placed in the Defense Emergency Response Fund, including that funds would be obligated in 10 funding categories. OMB stipulated that DOD was to manage the allocation of funds within the 10 categories and could not transfer these funds to its regular appropriations accounts. Moreover, OMB used these categories in its reports to Congress on the expenditure of the funds.

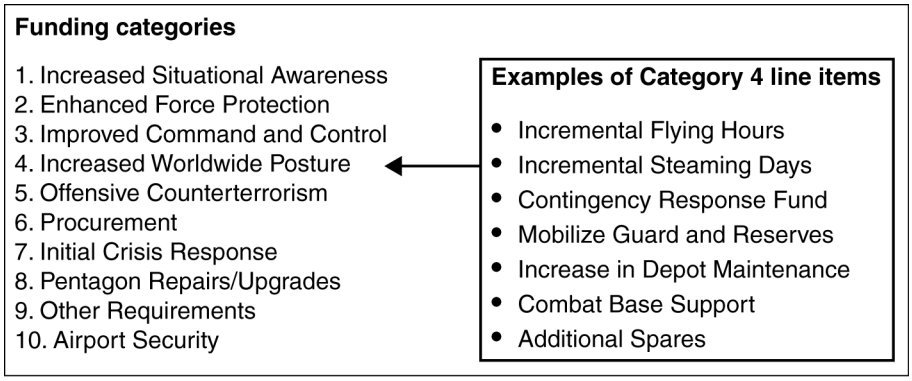
Based on DOD's limited estimates regarding requirements for each category, OMB apportioned funds to the Defense Emergency Response Fund.[9] According to DOD officials, these estimates had to be prepared quickly, within days of the attacks, and reflected the best judgment of DOD's needs at the time without knowing the exact nature of the U.S. response to the attacks. For each category, DOD also identified multiple

[8] 2001 Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Attacks on the United States, Pub. L. No. 107-38 (2001) and Department of Defense and Emergency Supplemental Appropriations for Recovery from and Response to Terrorist Attacks on the United States Act, 2002, Pub. L. No. 107-117 (2002).

[9] Funds under the two initial supplemental appropriations were appropriated to a governmentwide emergency response fund and subsequently apportioned to DOD and other federal agencies.

line items for which expenses could be incurred. Figure 1 identifies the 10 categories and identifies some of the line items that DOD established for one of the categories.

Figure 1: Emergency Response Funding Categories and Sample Line Items



Source: DOD.

The 10 categories do not correlate with DOD's existing appropriation accounts (see app. II). However, the expenses related to a category would be similar to the types of expenses funded under several appropriation accounts. For example, DOD may incur operation and maintenance, and procurement expenses under the categories of improved command and control and enhanced force protection. Because the 10 funding categories established by OMB and DOD did not correlate with DOD's existing appropriation account structure, a dual system of accounting emerged, which some believed to be cumbersome for tracking purposes. Therefore, for subsequent appropriations—a second supplemental appropriation in fiscal years 2002 and DOD's regular appropriation in fiscal year 2003[10]—Congress changed its method of providing funds. Specifically, in these appropriations, DOD received about $20.5 billion in funds either through the Defense Emergency Response Fund (fiscal year 2002) to its regular appropriation accounts or directly to

[10] 2002 Supplemental Appropriations Act for Further Recovery From and Response to Terrorist Attacks on the United States, Pub. L. No. 107-206 (2002) and Department of Defense Appropriations Act, 2003, Pub. L. No. 107-248 (2002).

its appropriation accounts (fiscal year 2003).[11] Appendix II provides additional details on these two appropriations.

On September 14, 2001, OMB issued specific guidelines and criteria for federal departments and agencies to apply in identifying and evaluating requirements to be funded under the initial emergency supplemental appropriations. This guidance covered two areas—response and recovery, and preparedness and mitigation—and outlined 15 conditions to be met. Among other things, these conditions stipulated that requirements must be known, not speculative; urgent, not reasonably handled at a later time; and unable to be reasonably met through the use of existing agency funds. Appendix III lists OMB's guidelines and criteria.

Because expenses related to contingency operations could be funded with emergency response funds, DOD also relied on its existing financial management regulation for guidance. Specifically, volume 12, chapter 23 of this regulation requires that costs incurred in support of contingency operations be limited to the incremental costs of the operation—costs that are above and beyond the baseline costs for training, operations, and personnel. The regulation further states that incremental costs are additional costs that would not have been incurred had the contingency operation not been supported.

DOD Provided Limited Internal Guidance on Use of Initial Emergency Response Funds

DOD adhered to OMB guidance in managing the allocation of $15 billion in initial emergency response funds placed in the Defense Emergency Response Fund after the September 11th attacks. While DOD instructed its components to follow OMB guidelines and internal DOD guidelines and financial regulations in obligating emergency response funds, it did not provide specific internal guidance to assist the components in determining allowable expenses. As a result, command officials were sometimes uncertain on the appropriateness of expenses and often had to rely on their best judgment in obligating these funds.

[11] Of the $20.5 billion, $11.3 billion was provided to the Defense Emergency Response Fund and subsequently most has been transferred as needed to DOD's regular appropriation accounts. The remainder was appropriated directly to appropriation accounts. The fiscal year 2003 Appropriations Act provided DOD's regular appropriation and did not specifically identify emergency response funds. Rather, the related conference report, H.R. 107-732, shows how Congress designated funds to be used for emergency response including dollar amounts and specific purposes within DOD's regular appropriation account.

DOD Adhered to OMB Guidance Managing Emergency Response Funds

In accordance with OMB guidance, DOD reported on its allocation of funds to its components in 10 funding categories and did not transfer these funds into its regular appropriation accounts. As of December 2002, DOD reported it had obligated about $14 billion of the $15 billion provided in the emergency supplementals of fiscal years 2001 and 2002 (see table 1).

Table 1: Status of Funds in the Defense Emergency Response Fund as of December 2002

Dollars in billions

Funding category	Allocation	Obligated	Unobligated
Increased Situational Awareness	$3.531	$3.301	$0.230
Enhanced Force Protection	1.349	1.310	0.039
Improved Command and Control	1.391	1.351	0.040
Increased Worldwide Posture	4.894	4.836	0.058
Offensive Counterterrorism	1.821	1.741	0.080
Procurement[a]	0	0	0
Initial Crisis Response	0.489	0.460	0.029
Pentagon Repairs/Upgrades	0.563	0.563	0
Other Requirements	0.216	0.191	0.025
Airport Security	0.225	0.217	0.007
Unallocated	0.526	0	0.526
Total[b]	**$15.006**	**$13.970**	**$1.036**

Source: DOD reported data as of December 31, 2002.

[a]Although funding was not allocated to the Procurement category, procurements were funded under other categories.

[b]Figures may not add due to rounding.

The data shown in table 1 are based on monthly obligation reports from DOD's defense financial accounting system database. These funds do not expire and, therefore, are available until used. We did not verify the accuracy or completeness of this data.

As table 1 shows, as of December 31, 2002, DOD reported data shows over $1 billion of the funds in the Defense Emergency Response Fund remains unobligated. Over half of that amount, $526 million, had not been allocated to the 10 funding categories. According to DOD officials, in March 2003, DOD plans to review the status of the unobligated funds and validate whether requirements for the funds continue to exist.

DOD Provided Limited Internal Guidance for Specific Use of Funds

For each of the 10 funding categories established by OMB and DOD, DOD identified line items that could be funded under the 10 categories. However, these line items were broad in nature and DOD did not identify the specific types of expenses that could be funded within each line item. In addition, OMB, among other things, directed that any requirement to be funded must reflect an urgent and known need. However, DOD did not establish any specific parameters to define the meaning of urgent and known. Also, in the event that funds in the Defense Emergency Response Fund would be needed to meet the requirements of contingency operations, DOD stipulated that funds would be used to cover the incremental costs of contingency operations. DOD directed components to use its existing financial management regulation in reporting incremental costs, but it did not offer any further guidance as to how commands were to distinguish incremental from baseline costs. In May 2002, we reported that DOD's financial management regulation did not provide sufficient information on what types of costs met DOD's definition of incremental costs, which resulted in various interpretations among the services—and even among units within a service—as to appropriate and proper expenditures.[12] As a result, we recommended that DOD expand its financial management regulation to include more comprehensive guidance governing the use of contingency funds. DOD agreed with our recommendation and, as of April 2003, is still working on revisions to its guidance. Because DOD is in the process of improving its guidance based on recommendations from our prior work, we are not making a new recommendation in this report.

In the absence of detailed guidance, command officials often had to use their best judgment in deciding how to spend the defense emergency response funds, and we found the same type of uncertainty among commands as we reported in May 2002. For example, command officials told us that determining what could be purchased from each category and line item was often difficult because the categories and line items were broad and generally differed from DOD's regular appropriation accounts. For example, DOD designated mobilization of guard and reserves as an allowable line item for the category of increased worldwide posture. Mobilization involves many factors, such as special pay, transportation, and equipment, but DOD did not specify which could be appropriately funded.

[12] GAO-02-450.

We also found differing interpretations existed as to whether requirements were urgent or known. Some commands used emergency response funds on items that could not be delivered in a reasonable time frame to be considered urgent. For example, one command purchased a RC-135 Rivet Joint aircraft for intelligence, communications, and reconnaissance. Typically, this aircraft would not be fielded for 8 years because it needed multiple contractors to install and test its integrated electronics suite. In another example, one command, before it knew its specific role in supporting the war on terrorism, obligated $52 million for spare parts based on an analysis of prior usage. By contrast, another command was reluctant to obligate funds until its specific role had been determined. Moreover, in some cases, command officials were unclear about how to determine the incremental costs to their regular appropriations. For example, commands used emergency response funds to pay for accelerated ship maintenance that was already planned for future budgets and to purchase computer and communication upgrades that were previously unfunded from the regular appropriation.

DOD officials told us that they had to quickly develop funding requirements after the terrorists attacks and used OMB guidance and available DOD instructions to instruct their components on how the funds could be used. The officials said that obligating funds in 10 categories and related line items that were not directly related to their appropriation accounts was confusing. In recognizing the lack of detailed guidance, DOD officials also told us that they maintained constant communication among all levels of DOD, especially at the command and unit levels, in order to review and clarify the use of emergency response funds. Furthermore, the officials said that they believe most of the funds were obligated for appropriate purposes.

DOD's Ability to Track the Use of Emergency Response Funds Has Varying Limitations

DOD's ability to track funds appropriated for the war on terrorism has varying limitations depending on the appropriation. For funds provided under the two emergency supplemental appropriations of fiscal years 2001 and 2002 and managed out of the Defense Emergency Response Fund, DOD is able to report a breakdown of obligations by the 10 categories, but found that tracking these obligations was cumbersome because the categories do not correlate with its regular appropriations account structure. For the two subsequent appropriations in fiscal year 2002 and 2003, DOD cannot separately identify obligations funded with emergency response funds because these funds are commingled with funds appropriated for other purposes, and DOD's accounting system does not distinguish among obligations. For example, in its fiscal year 2003

appropriation, Congress appropriated about $3.7 billion for the Air Force's operation and maintenance subactivity group related to primary combat forces, including about $389 million in emergency response funds for expenses related to the war on terrorism, and about $3.3 billion for expenses not related to the war on terrorism. All of these funds were commingled in the Air Force's operation and maintenance account. Within DOD's accounting system, DOD records obligations, but does not identify the source of funds. Therefore, at any given time, DOD is only able to track and report total obligations for operation and maintenance purposes and cannot separately identify obligations funded from emergency response funds.

DOD officials agreed that DOD's accounting system does not separately track obligations funded with emergency response funds, but they emphasized that DOD has established procedures intended to track obligations for contingency operations, including operations associated with the war on terrorism such as in Afghanistan. Under DOD's financial management regulation, DOD components are required to track and report the incremental costs (obligations) for each contingency operation. DOD established a special code for each operation, and components track obligations in a management tracking system separate from DOD's accounting system. The components report the total obligations for each contingency operation according to four specific cost categories: personnel, personnel support, operating support, and transportation—and by appropriation account. This information is reported monthly and is provided to Congress. However, the contingency cost categories do not correlate with DOD's appropriation accounting structure. Also, funding for contingency operations comes from both special funding sources such as emergency response funds, as well as, the regular peacetime appropriations given to components. Because DOD's accounting system does not separately track obligations by funding source, DOD's reporting does not identify the portion of contingency operations-related obligations funded with emergency response funds.

DOD Sets Up Additional Reporting Requirements Intended to Improve Tracking

During our review, DOD acknowledged the limitations of its ability to track the war on terrorism obligations and acknowledged the continued interest of Congress, OMB, GAO, and other organizations regarding the use of the funds. Starting in December 2002, DOD expanded its reporting on obligations associated with the war on terrorism and contingency operations. Specifically, in addition to continuing the separate tracking of fiscal year 2001 and fiscal year 2002 emergency supplemental funds contained in the Defense Emergency Response Fund, components are

now required to report more detailed data on obligations associated with the two subsequent appropriations in fiscal year 2002 and 2003. The additional reporting requirements are as follows:

- For the fiscal year 2002 supplemental, components are, on a monthly basis, to describe the purpose of the obligation, provide the amount, and identify the appropriation account.
- For the fiscal year 2003 appropriation, components are, on a monthly basis, to identify which funds they are obligating from their peacetime budget to directly support the global war on terrorism, i.e., components are using their baseline budget for the war on terrorism obligations. The report is to describe the purpose of the obligation and the amount and identify what activities were not being accomplished and the appropriation account affected. This is referred to as "cash flowing."

Furthermore, components are to start compiling and reporting on four additional cost categories for contingency operations: reconstitution of forces and capability, recapitalization, classified programs, and working capital fund. DOD officials stated the data are compiled from individual command and unit management tracking systems, which are not linked with DOD's accounting system, referred to as parallel tracking.

According to DOD officials, the additional reporting is expected to provide the management information that DOD needs to better manage and oversee the war on terrorism obligations and that Congress and others need to exercise oversight responsibilities. Officials believe that requiring components to provide additional data on obligations is preferable to modifying the accounting system to distinguish war on terrorism-related obligations from other obligations. Officials told us that modifying the accounting system would be too costly, time consuming, and the effort would not justify the value added at this time. Also, officials point out that the additional work involved and learning curve associated with a modified accounting system would pose problems because of the complexity involved with additional reporting, the time involved with obtaining staff competency, and the need to retrain staff due to assignment rotations. As of February 2003, components were still compiling data; therefore, we are not making a recommendation in this report, but will continue to review DOD's expanded reporting efforts in our ongoing review of contingency operations costs.

Agency Comments and Our Evaluation

In written comments on a draft of this report, DOD partially concurred with the report (see app. IV). Specifically, DOD disagreed that guidance provided to components on how to use emergency response funds was not sufficient. DOD stated that components were clearly instructed to treat expenses as incremental costs as defined in DOD's financial management regulation and that subsequent meetings were held to clarify this guidance. DOD also noted that, because the category structure used for emergency response funds was unique, some confusion existed among the components. DOD stated that the confusion dissipated as the components became more familiar with the structure.

In our report, we recognized that DOD directed components to rely on the financial regulation, as well as other guidelines, and acknowledged DOD's view that it maintained constant communication to review and clarify the use of emergency response funds. However, in our May 2002 report, we noted that the financial regulation does not provide sufficient guidance on the types of costs that are defined as incremental, which resulted in various interpretations among the services. DOD agreed with the recommendation made in that report that the regulation be expanded to include more comprehensive guidance. During our work conducted for this report, we found that command officials were sometimes uncertain about whether certain expenses were allowable, including how to determine incremental costs, and sometimes had to use their best judgment in obligating emergency response funds. We continue to believe that more comprehensive guidance is warranted. Because DOD is still revising the guidance based on prior GAO work, we are not making a new recommendation in this report.

While DOD stated our report correctly said that DOD cannot correlate the funding categories for emergency response funds with its appropriation accounts, it believed we were only partially accurate in stating that DOD is unable to track all emergency response funds in its accounting system. DOD noted that it had implemented a process to track incremental costs related to the war on terrorism and, in particular, the Defense Finance Accounting Service collects cost information on contingencies from components. DOD also noted that it is implementing procedures to capture the incremental costs of Operation Iraqi Freedom. Our report specifically recognizes DOD has established procedures intended to track incremental costs for contingency operations including operations associated with the war on terrorism, and that the components report this type of information. However, we note that this information is compiled in a management tracking system separate from DOD's accounting system. Furthermore, funding for contingency operations comes from both special

funding sources such as emergency response funds, as well as regular peacetime appropriations. Because DOD's accounting system does not separately track obligations by funding source, DOD's reporting does not identify the portion of contingency-operations related obligations funded with emergency response funds.

Further, DOD partially agreed that its accounting system cannot report on the $20.5 billion in emergency response funds provided for the war on terrorism in fiscal years 2002 and 2003. DOD noted that it received only $13.5 billion and that, except for $305 million appropriated for Pentagon repairs, these funds went directly to component accounts and their execution is captured in accounting reports. DOD noted that components report separately on obligations of these funds. In subsequent discussions, a DOD comptroller official confirmed the accuracy of our calculation that DOD had received a total of $20.5 billion. As discussed previously, our report recognizes that components report separately on obligations related contingency operations, but that these reports do not distinguish the portion of contingency operations-related operations funded with emergency response funds.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of this report to interested congressional committees with jurisdiction over DOD's budget.

Also at that time, we will send copies of this report to the Secretary of Defense; the DOD Comptroller; the Secretaries of the Army, the Navy, and the Air Force; the Director of the Defense Finance and Accounting Service; the Director of the OMB, and others upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov/.

If you have any questions regarding this report, please contact me at (202) 512-9619 or pickups@gao.gov, or Gary Billen, Assistant Director, at (214) 777-5703 or billeng@gao.gov. Major contributors to this report are acknowledged in appendix V.

Sharon L. Pickup
Director, Defense Capabilities and Management

Appendix I: Scope and Methodology

To determine the extent that the Department of Defense (DOD) adhered to the Office of Management and Budgets (OMB) guidance for managing funds provided separately for the Defense Emergency Response Fund (appropriated in the first two emergency supplemental appropriations) and the sufficiency of DOD's guidance to its components on the use of these funds, we reviewed the guidance provided by OMB to federal government departments and agencies and the guidance provided by DOD to its defense components for justifying their obligations funded through the emergency supplementals of fiscal years 2001 and 2002. We interviewed knowledgeable DOD officials responsible for implementing this guidance, obtained DOD reports of emergency response fund allocations to DOD component commands, and used these reports to select sites for our subsequent visits. At DOD's component commands, we interviewed officials and obtained reports or examples of obligations (purchases). We compared selected examples of obligations to OMB and DOD guidance. We also relied on prior GAO work regarding DOD's guidance and reporting for contingency operations.

To assess DOD's ability to track the use of emergency funds provided to DOD in the emergency supplementals of fiscal years 2001 and 2002, the supplemental for fiscal year 2002, and the DOD appropriation for fiscal year 2003, we analyzed relevant DOD financial documents, including the Office of the Secretary of Defense monthly reports allocating the funds to services and commands and the Defense Finance and Accounting Service monthly obligation reports and accounting manuals. We did not verify the accuracy and completeness of this data. We also reviewed budget and accounting procedures and documents and interviewed knowledgeable DOD officials.

We performed our work at the Office of the Secretary of Defense; the Office of the Comptroller; the headquarters of the Army, the Army Reserve, the Army National Guard, the National Guard, the Navy, and the Air Force; and the following commands and centers:

- Transportation Command, Scott Air Force Base, Ill.
- Army Forces Command, Fort McPherson, Ga.
- Army Central Forces Command, Fort McPherson, Ga.
- Air Force Aeronautical Services Center, Wright-Patterson Air Force Base, Ohio
- Air Force Air Armament Center, Eglin Air Force Base, Fla.
- Air Force Air Combat Command, Langley Air Force Base, Va.
- Navy Atlantic Fleet Command, Norfolk Naval Base, Va.
- Army Tank-Automotive and Armaments Command, Warren, Mich.

- Army Materiel Command, Alexandria, Va.
- Air Force Materiel Command, Wright-Patterson Air Force Base, Ohio
- Air Mobility Command, Scott Air Force Base, Ill.
- Special Operations Command, MacDill Air Force Base, Tampa, Fla.
- Pacific Command, Pearl Harbor, Hawaii
- Air Force Special Operations Command, Hurlburt Field, Fla.
- Army Special Operations Command, Fort Bragg, N.C.

We performed our review between March 2002 and February 2003 in accordance with generally accepted government auditing standards.

Appendix II: Appropriation of Emergency Response Funds to DOD for Fiscal Years 2001, 2002, and 2003

As of January 2003, Congress appropriated a total of about $38 billion in fiscal years 2001, 2002, and 2003 to fund DOD's expenses related to the war on terrorism. As table 2 shows, Congress provided these emergency response funds in four appropriations—two emergency supplementals (fiscal years 2001 and 2002), a fiscal year 2002 supplemental, and the fiscal year 2003 Defense appropriation—and used different methods to transfer funds to DOD.

Table 2: Transfer of Emergency Response Funds to DOD (fiscal years 2001 through 2003)

Dollars in billions

Fiscal year	Amount	Appropriation type	Method of funds transfer
2001/2002	$17.5	Emergency supplementals[a]	Funds appropriated to a governmentwide emergency response fund and then apportioned by OMB. DOD's funds were primarily apportioned to the Defense Emergency Response Fund.[b]
2002	13.4	Supplemental[c]	Funds primarily appropriated to the Defense Emergency Response Fund and subsequently transferred, as needed, to DOD's regular appropriation accounts.[d]
2003	$7.1	Regular appropriation[e]	Funds appropriated directly to DOD's regular appropriation accounts.

Source: DOD.

[a]2001 Emergency Supplemental Appropriations Act for Recovery From and Response to Terrorist Attacks on the United States, Pub. L. No. 107-38 (2001), and Department of Defense and Emergency Supplemental Appropriations for Recovery from and Response to Terrorist Attacks on the United States Act, 2002, Pub. L. No. 107-117 (2002).

[b]Of this amount, DOD was apportioned $15 billion that was placed into the Defense Emergency Response Fund. The remainder was transferred to other DOD appropriations accounts or rescinded.

[c]2002 Supplemental Appropriations Act for Further Recovery From and Response to Terrorist Attacks on the United States, Pub. L. No. 107-206 (2002).

[d]Of the $13.4 billion, DOD received $11.9 billion for the Defense Emergency Response Fund but only $11.3 billion was placed into the fund. The remainder of $2.1 billion was appropriated to other DOD appropriation accounts.

[e]Department of Defense Appropriation Act, 2003, Pub. L. No. 107-248 (2002).

Fiscal Years 2001 and 2002

Congress appropriated about $17.5 billion to fund DOD's emergency needs in the aftermath of the September 2001 terrorist attacks during fiscal years 2001 and 2002. Of this amount, about $15 billion was eventually transferred to DOD's Defense Emergency Response Fund. OMB, in conjunction with DOD, identified 10 broad funding categories to govern the use of these funds. While funds in the Defense Emergency Response Fund were obligated for similar types of requirements funded under several of DOD's regular appropriations account, such as for operation and maintenance and military personnel expenses, the 10 categories do not directly correlate with DOD's existing appropriation account structure. Figure 2 lists the Defense Emergency Response funding

categories and provides examples of DOD's regular appropriation accounts.

Figure 2: Comparison Between Defense Emergency Response Funding Categories and DOD Appropriation Accounts

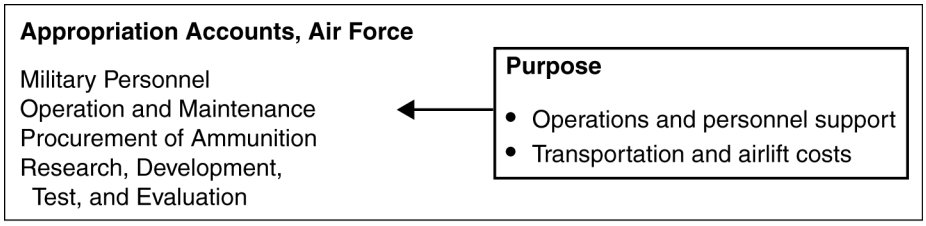
Funding categories	Examples of DOD's regular appropriation accounts
• Increased situational awareness • Enhanced force protection • Improved command and control • Increased worldwide posture • Offensive counterterrorism • Procurement • Initial crisis response • Pentagon repairs/upgrades • Other requirements • Airport security	• Military Personnel • Operation and Maintenance • Procurement • Research, Development, Test, and Evaluation • Military Construction

Source: DOD.

Fiscal Year 2002

In an emergency supplemental appropriation for fiscal year 2002, Congress appropriated $13.4 billion in emergency response funds, of which $11.3 billion was placed in the Defense Emergency Response Fund for subsequent transfer to DOD's regular appropriation accounts. Furthermore, Congress designated the distribution of these funds by DOD component, appropriation account, and purpose. Figure 3 provides an example of how Congress designated the use of fiscal year 2002 emergency response funds for the Air Force.

Figure 3: Congressional Designation of Fiscal Year 2002 Emergency Response Funds for the Air Force

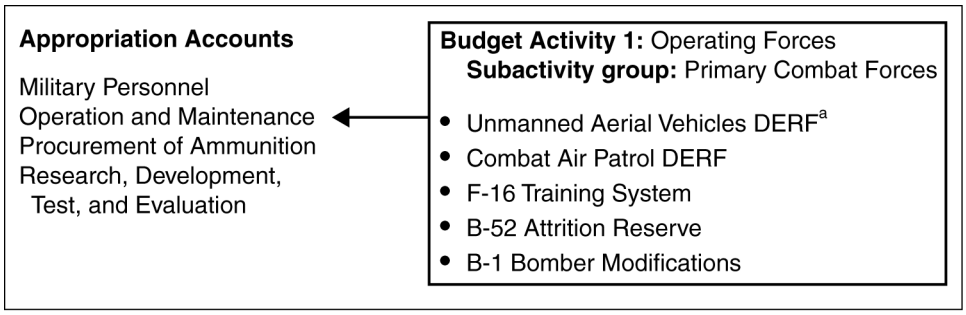


Source: Making Supplemental Appropriations for Further Recover From and Response to Terrorist Attacks on the United States for the Fiscal Year Ending September 30, 2002, and for Other Purposes, H.R. 107-593, July 19, 2002.

Fiscal Year 2003

In fiscal year 2003, Congress appropriated $7.1 billion in emergency response funds to DOD as part of DOD's regular appropriation, and these funds were appropriated directly to DOD's regular appropriation accounts. In contrast to the fiscal year 2002 emergency supplemental, Congress provided more detail in designating the distribution of fiscal year 2003 emergency response funds. In the conference report accompanying the fiscal year 2003 appropriation act, Congress designated specific funding levels by appropriation account, DOD component, budget activity, and subactivity group. Figure 4 provides an example of how Congress designated funding for the Air Force.

Figure 4: Congressional Designation of Fiscal Year 2003 Emergency Response Funds for the Air Force



Source: Making Appropriations for the Department of Defense for the Fiscal Year Ending September 30, 2003, and for Other Purposes, H.R. 107-732, October 9, 2002.

[a]DERF refers to the Defense Emergency Response Fund.

Appendix III: OMB Guidelines and Criteria for Emergency Funding Requests Related to the Terrorist Attacks of September 11, 2001

In a September 14, 2001, memorandum, OMB provided the heads of federal departments and agencies with the following guidelines and criteria for requesting emergency funding related to the terrorist attacks of September 11, 2001.

Response and Recovery

(1) The damage to be repaired must have been directly caused by the terrorist acts.

(2) The absence of funding, and consequently a delay in damage repair, protection or other activities, would result in significant economic loss/hardship, attack risk or human endangerment/suffering, including the cost of enhanced security and relocation of employees to secure sites.

(3) Any action ordered by the President to respond to the national security consequences of the events of September 11, 2001.

(4) The requirement is known, i.e., not a speculative need.

(5) The requirement is urgent, i.e., could not reasonably be handled at a later time.

(6) The activity to be performed is an appropriate federal role and reflects an appropriate sharing of responsibility among state, local, private, and federal entities.

(7) The level of funding is limited to the amount necessary to restore the entity/facility to current standards and requirements (e.g., damage to a 1950s building would be repaired using current building codes and standards and guidelines for counter-terrorism defense).

(8) The requirement is not competitive with or duplicative of activities of other agencies with statutorily mandated disaster assistance programs such as Small Business Administration and Federal Emergency Management Agency.

(9) The requirement cannot reasonably be met through the use of existing agency funds, e.g., through reprogramming actions or the use of other emergency funds.

Preparedness and Mitigation

(10) Funds should address specific deficiencies, encountered or identified to prevent events such as those that occurred on September 11, 2001, and may include expenditures for: law enforcement and investigative activities; general preparation and response (planning, training, equipment, and personnel); physical protection of government facilities and employees; physical protection of the national populace and infrastructure; and governmental awareness of potential threats.

(11) Funds can be used to enhance U.S. abilities to interdict terrorist threats.

(12) The activity to be performed is an appropriate federal role and reflects an appropriate sharing of responsibility among state, local, private, and federal entities.

(13) The requirement is urgent, i.e., could not reasonably be handled at a later time.

(14) Activities are not competitive with or duplicative of activities of other agencies with statutorily mandated preparation programs such as DOD and Federal Emergency Management Agency.

(15) The requirement cannot reasonably be met through the use of existing agency funds, e.g., through reprogramming actions or the use of other emergency funds.

Appendix IV: Comments from the Department of Defense

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

APR 15 2003

Ms. Sharon L. Pickup
Director, Defense Capabilities and Management
United States General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Pickup:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report GAO-02-450 "DEFENSE BUDGET: "Tracking of Emergency Response Funds for the War on Terrorism" dated March 7, 2003 (GAO Code 350254). The Department of Defense partially concurs with the general comments contained in the draft report. However, I would like to make several comments regarding the funding and recording of obligations as it pertains to the global war on terrorism (GWOT).

In the report, GAO states that insufficient guidance was provided to the Components on how the Defense Emergency Response Fund (DERF) funds were to be used. That is not accurate. The Components were clearly instructed to treat these expenses as incremental costs as defined in Volume 12, Chapter 23 of the Financial Management Regulation (FMR). While not all subordinate components of the Services and the Defense Agencies were initially familiar with the contingency operations section of the FMR, the guidance as to what is an incremental cost was promulgated throughout the DoD in subsequent meetings. The DERF category structure was developed shortly after the September 11, 2001 attack, and reflects the appropriation structure and financial management strategy directed by the Office of Management and Budget (OMB) and subsequently approved by the Congress. Given that the DERF was a new appropriation structured unlike any other DoD appropriation, many DoD Components were unfamiliar with it and there was some confusion early on. However, as the Components became more familiar with the DERF category structure, the confusion dissipated.

The report also states that the DoD cannot correlate the DERF categories into DoD appropriations. That is correct, but as noted in the report, the DERF funding was derived from the OMB managed Emergency Response Fund account, which has no correlation with existing DoD accounting structure. The GAO finding that the DoD is unable to track all the funds appropriated for GWOT in the "official" accounting system is partially correct. Those funds transferred from the DERF into the Components' baseline appropriations from the FY 2002 Supplemental lost their "GWOT" designation once the funds were incorporated. However, foreseen this situation, the DoD implemented a process to track incremental costs that are related to the GWOT. In addition, the Defense Finance and Accounting Service (DFAS) already collects the cost of contingency operations from the DoD Components, a major portion of the cost for GWOT. Furthermore, the

DoD is in the process of implementing accounting procedures to capture the incremental costs for Operation Iraqi Freedom.

The statement that the DoD accounting system does not report on the $20.5 billion provided for GWOT is partially correct. The DoD received only $13.5 billion, not $20.5 billion. With the exception of the $305 million appropriated for Pentagon repairs, the Congress appropriated the funds directly into the Components' baseline accounts, where the execution of these funds are being captured in the accounting reports. The DoD has also directed the Components to separately report on obligations of these GWOT funds.

Lastly, the report points out that the DoD has no plans to modify the existing DFAS accounting system to generate more detailed funding and obligation data. This is correct, the DERF (execution account) is, in our view, a one-time anomaly that will not be repeated, thus not worth incorporating into the permanent accounting structure.

Sincerely,

Dov S. Zakheim

Enclosure:
As stated

Appendix V: GAO Contacts and Staff Acknowledgments

GAO Contacts

Sharon Pickup (202) 512-9619
Gary Billen (214) 777-5703

Staff Acknowledgments

In addition to the names above, the following individuals made significant contributions to this report: Nancy Benco; Bruce Brown; George Duncan; Harry Jobes; Tom Mahalek; Charles Patton, Jr.; Kenneth Patton; and James Reid.

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