

Maximizing DOD's Potential to Face New Fiscal Challenges and Strengthen Interagency Partnerships

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Introduction

It is a pleasure to be here this morning to participate in the National Defense University's speaker's program. GAO has a long-standing relationship with NDU, one that we are extremely proud of. In fact, several of our senior executives are graduates of the National War College or the Industrial College of the Armed Forces; they have spoken highly of their experiences. GAO's staff includes retired military personnel, reservists, and former employees of the State Department, Agency for International Development (AID) and other agencies. These individuals bring extremely valuable insight and knowledge to GAO's work.

My remarks today will focus on the Department of Defense (DOD) and the challenges it faces given our national government's current long term unsustainable fiscal path and ongoing U.S. commitments in Iraq and Afghanistan. DOD can take steps to better position itself for the future and maximize the use of taxpayer dollars, particularly by improving its business operations. More broadly, I will also offer some thoughts on how the Department can work more collaboratively with other national security agencies, such as State and AID, to build the strong partnerships needed to adapt to the changing complexities of the national security environment. As the next generation of national security leaders, many of you will go on to assignments where you will be directly responsible for key decisions that will affect not only your individual agencies, but the government's collective effort to achieve national goals. My intent today is to stimulate your thinking as you prepare to assume these leadership responsibilities.

To set the context for my remarks, it is clear that the United States faces a complex and rapidly changing national security environment, one characterized by constantly evolving threats, such as cyber attacks on public and private institutions, and increasing global interdependence as vividly demonstrated by the recent global financial crisis and economic downturn. Even before the economic downturn in 2008, the United States faced growing fiscal imbalances, internationally and domestically. A widening gap between U.S. savings and consumption has led to mounting trade deficits and a vulnerable dependence on foreign capital inflows to finance U.S. spending. In the near term, our government continues to face the challenges from the financial system stress and economic downturn. Over the longer-term, we face equally difficult fiscal challenges driven largely by the rising cost of health care and an aging population.

The current unsustainable long term fiscal path of our national government is going to put increasing pressure on the entire federal budget, including the national security side.

Consequently, there will be increasing demand and competition for resources, and policymakers will confront difficult decisions on funding priorities.

In particular, DOD is facing a number of internal fiscal pressures as it tries to support ongoing operations, rebuild readiness, and prepare for the future. To succeed in this era of fiscal constraint, new ways of thinking, constructive change, and basic reforms are essential. Everything must be on the table and subject to scrutiny. This includes the stove-piped approaches to planning and budgeting that have typically led to a mismatch between programs and budgets. It is also time to rethink and act decisively to rectify inefficient ways of doing business that undermine support for our troops on the battlefield.

Let me put this another way. DOD is second to none in warfighting capabilities. But it is a very different story when it comes to issues of economy, efficiency, and accountability on the Department's business side. DOD continues to waste billions of dollars each year that could be used to boost readiness, improve the quality of military life, and address emerging security threats. By taking decisive action now, DOD can avoid a range of unintended consequences and less than optimal performance in the future.

Clearly, the federal budget's structural imbalance affects the entire national security community, not just DOD. As difficult decisions are made about national priorities, all U.S. national security agencies will need to strike an affordable balance between investments in current missions and investments in new capabilities to meet future challenges. Given the complexities of the security environment, they will also need to build stronger partnerships and improve their capability to collaborate on solutions to address interrelated conventional and emerging threats that transcend the scope and authority of any one agency.

Before getting into greater details, let me suggest some resource material you may find useful. To bring Congress and the incoming administration up to speed on major management issues, risks, and challenges, GAO launched a special transition website following the November 2008 elections. We have now moved this information to a permanent spot on GAO's website that highlights major management challenges in the federal government, including areas that we consider to be high-risk due to their greater vulnerabilities to fraud, waste, abuse, and mismanagement or in need of broad based transformation. This site has good descriptions of many of the DOD-related and interagency topics reviewed by GAO. To get there, just go to GAO's home page at <http://www.gao.gov> and, in the upper right hand corner, click on the box marked "GAO High Risk & Other Major Management Challenges."

Fiscal Challenges Facing the Nation and DOD

Before focusing on DOD specifically, I would like to synopsise the broader fiscal situation and outlook for our government's finances. Weaknesses in the economy and the financial markets and the government's response to them have contributed to a significant increase in the federal deficit and debt. As you can see in this table, the fiscal year 2009 deficit reached a record \$1.4 trillion and the debt held by the public exceeded 50 percent of GDP a level not seen since 1956.

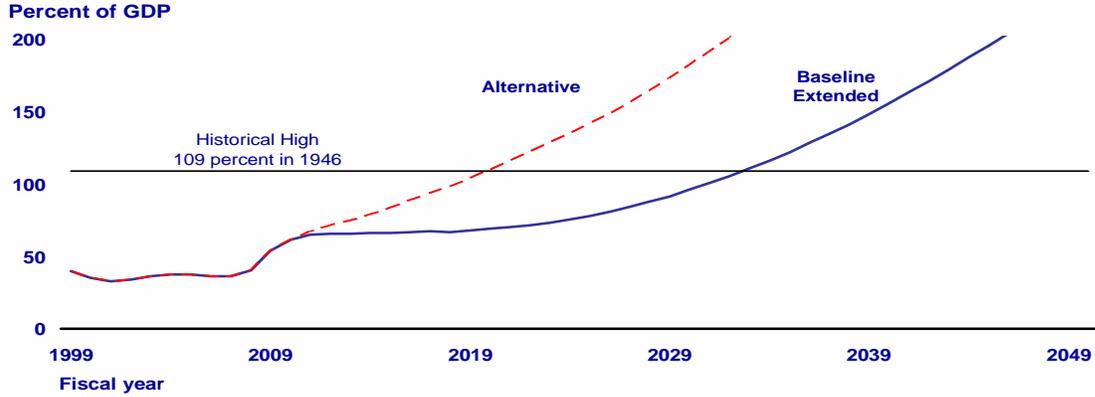
Deficits, Debt Held by the Public and Debt Subject to Limit

| | Actual Fiscal Year 2001 (as of 09/30/01) | Actual Fiscal Year 2005 (as of 09/30/05) | Actual Fiscal Year 2008 (as of 09/30/08) | Estimated Actual Fiscal Year 2009 (as of 09/30/09) | Estimate for Fiscal Year 2010 from President's Midsession Review |
|---|---|---|---|--|---|
| Surplus (+)/ Deficit (-) (trillions of dollars) | \$0.1 | \$-0.3 | \$-0.5 | \$-1.4 | \$-1.5 |
| Surplus (+)/ Deficit (-) (percent of GDP) | 1.3% | -2.6% | -3.2% | -10.0% | -10.4% |
| Debt held by the public (trillions of dollars) | \$3.3 | \$4.6 | \$5.8 | \$7.6 | \$9.6 |
| Debt held by the public (percent of GDP) | 33.0% | 37.5% | 40.8% | 53.1% | 66.3% |
| Debt subject to the limit (trillions of dollars) | \$5.7 | \$7.9 | \$10.0 | \$11.9 | \$14.1 |

Sources: Treasury and OMB.

While the current fiscal situation has, understandably, received considerable attention, the fact is that the federal government faces even larger financing challenges that will persist long after the economy recovers and financial markets stabilize. As the following graph shows, recent GAO simulations indicate that, absent major fiscal policy changes, federal debt held by the public will increase dramatically over the next several decades and could trend towards 200 percent of GDP. In GAO's "Baseline Extended" simulation, which reflects current law through 2019 and then holds revenue and spending other than major entitlement programs constant as a share of GDP, discretionary spending is lower as a share of the economy, and revenues are higher, than the 20-year historical average. In the "Alternative" simulation, which reflects historical trends and policy preferences, both discretionary spending and revenue as a share of the economy are nearly at the historical averages. Let me put this into perspective. Under one scenario, in a little over 10 years, debt held by the public as a share of GDP could exceed the historical high reached in the aftermath of World War II.

Debt Held by the Public as a Share of GDP Under Two Different Fiscal Policy Simulations



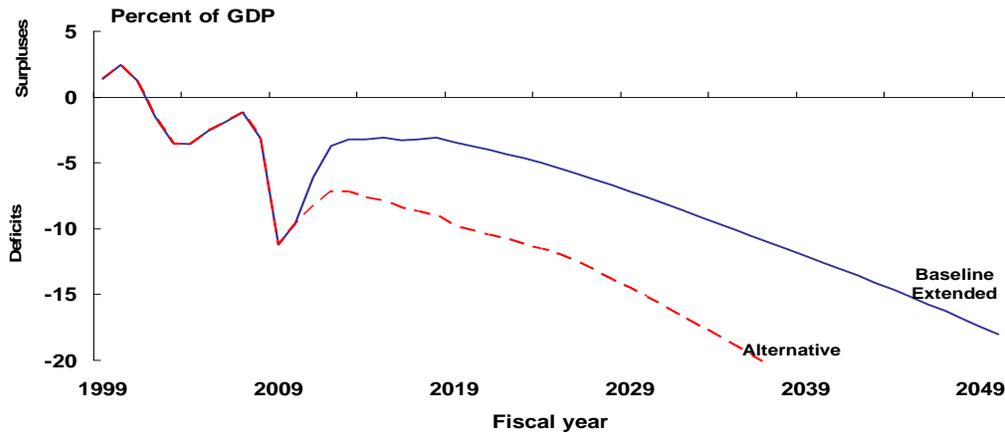
Source: GAO's Fall 2009 analysis based on the Trustees' assumptions for Social Security and Medicare.

Note: The Baseline Extended simulation reflects current law through 2019 and then holds revenue and spending other than major entitlement programs constant as a share of GDP. The Alternative simulation reflects historical trends and policy preferences such as extending expiring tax provisions and holding discretionary spending close to its historical average. Some of the increase in debt has been used to purchase financial assets as part of programs to stabilize financial markets and stimulate the economy. The value of these financial assets has not been subtracted from the total debt held by public in our simulations.

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These debt levels reflect the cumulative effect of growing deficits. While the timing of deficits and the resulting debt buildup varies depending on the assumptions used, both simulations show that the federal government is on an unsustainable path.

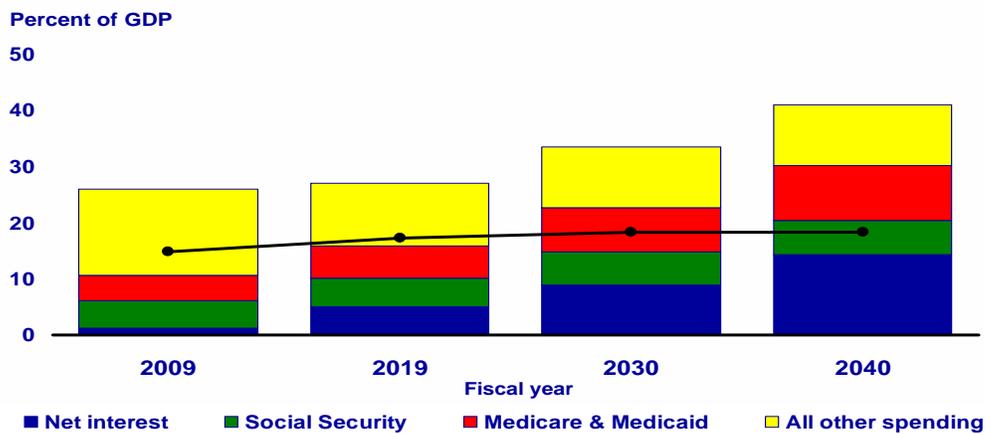
Federal Budget Surpluses and Deficits Under Different Fiscal Policy Simulations



Source: GAO's Fall 2009 analysis based on the Trustees' assumptions for Social Security and Medicare. We also run simulations using CBO's projections for Social Security and Medicare. The results are not materially different.

What drives this outlook? Primarily rising health care costs and an aging population. Assuming no changes in Medicare, Medicaid, or Social Security, spending on those programs and interest on the federal debt will account for an ever-growing share of the economy. This, in turn, will affect the resources available for discretionary spending. If tax revenue remains near the historical average of about 18 percent of GDP for the next few decades, which is shown by the line in this graph, every federal agency, including DOD, will face tighter budgets as discretionary spending is squeezed.

Potential Fiscal Outcomes Under GAO's Alternative Simulation: Revenues and Composition of Spending

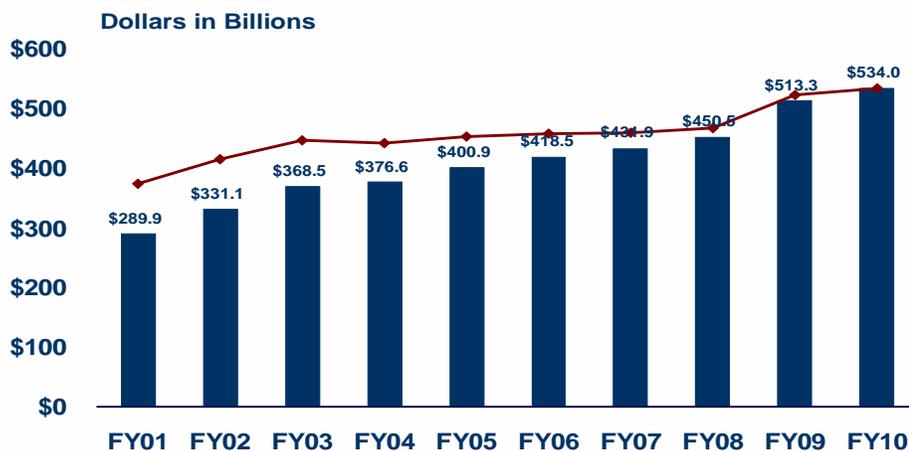


Source: GAO's Fall 2009 analysis based on the Trustees' assumptions for Social Security and Medicare.

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Clearly, DOD is unique among federal agencies both because of its size and budget as well as the complexity of its organizational structure and mission. Not only does its budget represent a little over half of the entire federal government's discretionary spending, the level of resources provided to the Department has risen significantly over time, as the following graph shows. For fiscal year 2010, Congress set aside about \$661 billion for DOD, including about \$534 billion for base needs and about \$127 billion for contingency operations. As of December 2009, DOD has received about \$1 trillion since 2001 to support contingency operations, including those in Iraq, Afghanistan, and elsewhere.

DOD Budget Authority FY 2001-2010 (Excluding Contingency Operations)



Note: bars reflect nominal dollars, line reflects constant FY10 dollars.
Source: DOD.

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Notwithstanding the external pressures, the Pentagon faces its own near-term and long-term internal fiscal pressures as it attempts to balance competing demands from within. Let me touch on four areas GAO has highlighted for the Congress and the Administration.

—**First, ongoing operations will continue to require substantial amounts of resources.** The magnitude of costs for operations in both Iraq and Afghanistan will depend on several factors. For example, expenses will be influenced by how the U.S.-Iraq security agreement and associated troop redeployment plans are implemented, the nature and extent of continued U.S. military and civilian presence in Iraq, as well as decisions on the timing and composition of additional forces to be deployed to Afghanistan, the types of facilities needed to support troops remaining in and around Iraq, the amount of equipment to be repaired or replaced, and the health care needs of returning veterans. Although drawing down troop levels in Iraq may on its surface appear to lower costs, previous operations in the Balkans and Kosovo suggest that costs could actually rise in the near term.

—**Second, extended military operations have taken a toll on readiness and rebuilding our force will come with a big price tag.** Since 9/11, U.S. forces have operated at a high pace and gained considerable combat experience. But this high operational tempo has significantly affected the readiness of the force, especially in the Army and Marine Corps. Personnel are deploying frequently and have little time to train for anything other than counterinsurgency missions. Equipment is used repeatedly, causing wear and tear. Units that are not deployed are transferring equipment and personnel to deploying units, causing some shortfalls. Also, the Air Force and the Navy are faced with maintaining aging aircraft and ships. Rebuilding readiness is

a complex and costly effort, but it will be even more challenging at a time when DOD is pursuing broad-based initiatives to grow, modernize, and transform its forces and capabilities.

—**Third, personnel and health care costs are increasing.** DOD’s military personnel outlays have risen significantly since fiscal year 2000, fueled in part by increases in basic pay, housing allowances, recruitment and retention bonuses, incentive pays and allowances, and other special pays. Moreover, a large part of DOD's compensation-related costs is in the form of benefits and deferred compensation, and the cost to provide benefits such as health care continue to spiral upward. In fact, expanded health care to reservists, their families, and retirees has been the primary cost driver in growing benefits costs.

—**Fourth, cost growth in weapon systems programs remains a significant problem.** Total acquisition cost growth on DOD’s fiscal year 2008 portfolio of major programs has reached nearly \$300 billion over initial estimates. The Pentagon’s ability to successfully adapt to budgetary constraints will depend in great measure on its ability to better manage weapon systems acquisition. This is a long-standing challenge at DOD. Back in 1990, GAO first designated DOD's management of major weapon systems acquisitions as a high-risk area. And almost 20 years later, it is still on our high-risk list. The bottom line is that programs continue to take longer, cost more, and deliver fewer quantities and capabilities than originally planned. Why does this happen? It is because at the program level, programs are begun and continued without enough knowledge about system requirements, technology, and design maturity. Lacking such knowledge, managers rely on assumptions that are consistently too optimistic, exposing programs to significant and unnecessary risk, and ultimately cost growth and delays. Cost overruns lead to fewer resources for other priorities and reduced buying power for DOD, and schedule delays mean that the warfighter does not get critical capabilities when needed and therefore relies on legacy systems or goes without. Recent statements and actions by the President, Congress, and the Secretary of Defense to bring greater attention to acquisition reform are encouraging.

Targets of Opportunities for Reform on DOD’s Business Side

The bottom line is that DOD can no longer afford to conduct business as usual. The military has a proven track record in maintaining a highly capable warfighting force. Unfortunately, it has not achieved the same level of effectiveness on its business side. For more than a decade, DOD has dominated GAO’s list of federal programs and operations at high-risk and vulnerable to fraud, waste, abuse, and mismanagement. In fact, all the DOD programs on GAO’s High-Risk List relate to business operations, including systems and processes related to management of contracts, finances, the supply chain, and support infrastructure, in addition to weapon systems acquisition. Inefficiencies and other long-standing weaknesses in these areas lead to challenges in supporting the warfighter, billions of dollars being wasted annually, and missed opportunities to free up resources for higher priority needs.

Clearly, DOD's size and complexity contribute to the challenges it faces in improving business performance. To the Department's credit, top management has put greater emphasis on reform in the past several years and we have seen measurable progress in some areas. It is obvious that this progress would not have been possible without the significant time and efforts of a highly competent, hardworking, and dedicated defense workforce.

With a change in administration, there is always difficulty in sustaining momentum on past initiatives. But a change in administration also presents important opportunities for change. We at GAO have seen a number of indications that the environment may be right for DOD to make great strides.

For example, President Obama has emphasized, publicly and in directives, that the federal government needs to be more transparent and that contracting reforms are needed governmentwide. In developing DOD's fiscal year 2010 budget submission, Secretary Gates indicated a willingness to reevaluate programs and make the hard decisions to eliminate or take other corrective action on those that are not performing well. As a result, programs were adjusted or terminated. In December 2008, DOD revised its acquisition policy in ways that could, if implemented properly, provide a foundation for developing individual acquisition programs with sound, knowledge-based business cases. This revision establishes early milestone reviews, requires completion of key systems engineering activities and competitive prototyping, and emphasizes preliminary design reviews prior to program initiation.

Finally, Congress passed legislation to add further discipline and accountability to the acquisition system. This legislation, named the Weapon System Acquisition Reform Act of 2009, contains several requirements, including that DOD develop mechanisms to consider trade-offs among cost, schedule, and performance in establishing program requirements and to certify that trade-offs have been made.

Before discussing specific ways DOD can capitalize on this renewed emphasis and take decisive action to achieve greater fiscal discipline, accountability, and effectiveness, let me highlight some key elements that must be present to achieve tangible near-term results.

Clearly, sustained and focused top-level leadership and sound plans to guide transformation efforts are essential. For the first time, DOD has a Chief Management Office position, established in law as part of the Deputy Secretary of Defense's responsibilities. As the Chief Management Officer, the Deputy Secretary is responsible, with assistance from the Deputy Chief Management Officer, for developing a strategic management plan for business operations, and integrating efforts to transform business operations. And the military departments are also statutorily required to have chief management officers, business transformation offices, and business transformation plans. At this point, DOD has taken some positive steps to institutionalize these positions and organizations, although in some cases, decision-making authority and relationships are not yet well defined.

But creating positions and offices is not enough. Success will depend on how effectively the department and the military departments can institutionalize these positions and organizations. This would include defining and clarifying the respective authorities, roles, and responsibilities. To do so will afford senior leaders, and those responsible for implementation such as you, the authority and means to become advocates for transformational change.

Getting leaders and organizations in place and developing sound plans is a good start. But to achieve real reform, the Department needs to set priorities, strengthen management accountability, execute its plans, gauge actual progress against goals, and make adjustments as needed. As part of GAO's broad body of defense-related work, we have routinely seen that there is a lack of focus on developing and using interim performance measures to measure progress and the impact of actions taken. Everyone here has probably seen DOD improvement initiatives that looked great on paper, but failed or fell to the wayside due to a lack of sustained focus. Transformation initiatives need to be set forth into measurable steps toward a long-term goal, and then interim measures used to gauge progress and adjust strategy if needed. This approach is key to solving many of these long-standing problems.

Now let me turn to a few key areas where DOD can better tap its potential to improve business operations, save money, and optimize support to the warfighter.

Weapon systems acquisition management

Arguably, one of the best examples of an area where DOD could make real progress in the near-term is in improving its approach to acquiring major weapon systems. Since 2003, DOD's portfolio of major defense acquisition programs has grown from 77 to 96 programs. And its investment in those programs has grown from \$1.2 trillion to \$1.6 trillion (fiscal year 2009 dollars).¹ This chart shows the change in the size and performance of DOD's portfolios of major acquisition programs.

¹GAO, *Defense Acquisitions: Assessments of Selected Weapon Programs*, GAO-09-326SP (Washington, D.C.: Mar. 30, 2009).

Analysis of DOD Major Defense Acquisition Program Portfolios

Fiscal year 2009 dollars

| | Fiscal year | | |
|--|-----------------|------------------------------|-----------------|
| | 2003 | 2007 | 2008 |
| Portfolio size | | | |
| Number of programs | 77 | 95 | 96 |
| Total planned commitments | \$1.2 trillion | \$1.6 trillion | \$1.6 trillion |
| Commitments outstanding | \$724.2 billion | \$875.2 billion | \$786.3 billion |
| Portfolio indicators | | | |
| Change to total RDT&E costs from first estimate | 37 percent | 40 percent | 42 percent |
| Change to total acquisition cost from first estimate | 19 percent | 26 percent | 25 percent |
| Total acquisition cost growth | \$183 billion | \$301.3 billion ^a | \$296.4 billion |
| Share of programs with 25 percent increase in program acquisition unit cost growth | 41 percent | 44 percent | 42 percent |
| Average schedule delay in delivering initial capabilities | 18 months | 21 months | 22 months |

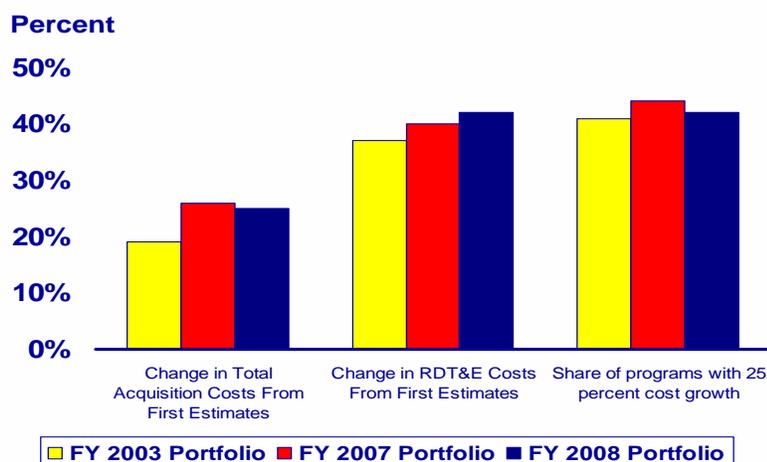
Source: GAO analysis of DOD data.

^aThe total acquisition cost growth for the 2007 portfolio was \$295 billion in 2008 constant dollars.

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The next graph indicates that over 40 percent of all the major programs in DOD's fiscal year 2008 portfolio are about 25 percent over budget compared to initial estimates.

DOD Cost Outcomes

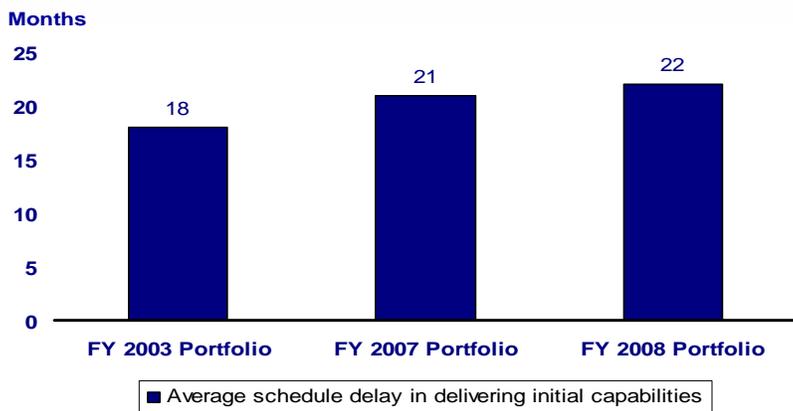


Source: GAO analysis of DOD data.

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Complicating matters, the average delay in delivering initial capabilities in DOD's portfolio of weapon systems programs has increased over time to 22 months, as this graph shows. DOD's performance in some of these areas is driven by older programs, as newer programs, on average, have not shown the same degree of cost and schedule growth.

DOD Program Schedule Outcome



Source: GAO analysis of DOD data.

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Over the next 5 years, DOD expects to invest more than \$357 billion on major defense acquisition programs. To put this number into perspective, \$357 billion is nearly half of what Congress has provided to support overseas contingency operations over the past 8 years. Much of this investment will be used to address cost overruns due to shortcomings in planning, execution, and oversight. These types of problems have plagued DOD's weapon systems portfolio for the past 30 years. We see these problems as being at odds with the very capable and dedicated people we deal with frequently in the program offices and other key organizations. So, why aren't good people getting better outcomes? Based on a large body of work in this area, GAO has come to see these recurrent problems as not due primarily to mistakes, lack of expertise, or unforeseeable events. Rather it is the outgrowth of a system in which key processes and incentives are better at saying "yes" than "no" to programs that fail to measure up. The challenge is to change the dynamics of this culture.

Because of the magnitude of the investment and the current fiscal environment, DOD can no longer afford to let cost growth go unchecked and programs inch towards completion. On a positive note, Secretary Gates has identified the need for weapon systems acquisition reform as chief among DOD's institutional challenges. And our sense is that DOD is off to a good start. Last December, DOD made major revisions to its acquisition policies, which address many of the problems that can be traced back to the acquisition system. And, based on the Weapon System Acquisition Reform Act of 2009, DOD is continuing to review and revise its policies.

The revisions, which are in line with past GAO recommendations, aim to provide key department leaders with the knowledge they need to make informed decisions before a program starts and to maintain discipline once it begins. To improve outcomes on the whole, though, DOD must ensure that these policy changes are immediately and consistently put into practice and reflected in decision-making on individual acquisitions. It must also clearly assign accountability to an individual or individuals for implementation.

Secretary Gates has also identified programs that should either be adjusted or terminated, based in large part on their performance, cost-effectiveness, and ultimate value to the war fighter, which is an encouraging sign of change. But process reforms, funding cuts, and cancellations are not enough to change organizational culture. Mission-essential programs with executable strategies, regarding the technology, design, test, and overall cost, must win the budget battles. Tough choices will need to be made about specific weapon systems. Key stakeholders from the military services to industry to the Congress will have to play a constructive role in this process.

GAO has noticed progress on new programs. For example, since 2006, programs entering system development have done so with higher levels of technology maturity, a key indicator of program success. Additionally, in our last comprehensive review of 47 major acquisition programs, there were a few modest indications of improvement within the portfolio from 2007 to 2008, such as the fact that the total percentage of programs with 25 percent or more increases in program unit costs decreased by a few percentage points.

DOD still has work to do in this area; there are ample opportunities for reform and improvement that can yield tangible results in the near-term and free up resources. For a start, DOD should continue to review existing and planned programs to

- determine the right mix of programs to invest in by making better decisions as to which programs should be pursued or not pursued given evolving mission needs and both existing and expected funding,
- ensure that programs are executable by matching requirements with resources and locking in those requirements, and
- make it clear that programs will then be executed based on actual knowledge and mature technology, and not assumptions that are often overly optimistic, and that program managers and senior leaders will be held responsible for expected results.

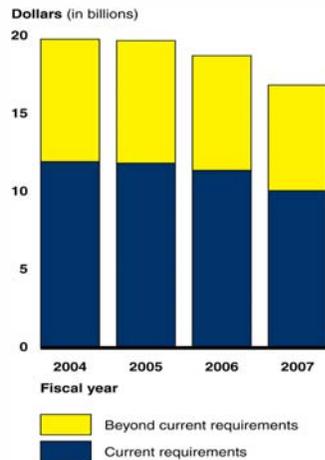
Inventory management

Improving DOD's approach to inventory management is another area with ample opportunities. Reform could yield significant savings now, and free up resources for other priorities. For example, DOD officials have estimated that the level of investment in the department's supply chains is more than \$150 billion a year, and the value of its spare part inventories has grown by tens of billions of dollars in recent years. Yet, the department continues to have substantial

amounts of secondary inventory that are in excess to requirements. For example, in its last review of the Air Force’s inventory, GAO reported that more than half of its secondary inventory, valued at about \$31 billion, was not needed to support required inventory levels from 2002 through 2005.

More recently, in our review of the Navy’s secondary inventory, we found that, on average for fiscal years 2004 through 2007, about \$11 billion, or around 60 percent, of the total annual inventory value of \$18.7 billion was needed to meet current requirements, but \$7.5 billion, or about 40 percent, exceeded current requirements. The graph explains, by fiscal year, the dollar amount of inventory that met and exceeded current requirements.

Navy Secondary Inventory Meeting and Exceeding Current Requirements (Fiscal Years 2004-2007)



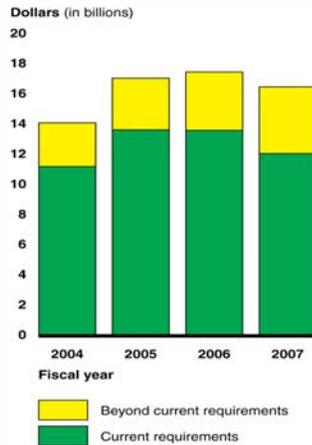
Source: GAO analysis of Navy data.

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The Army is also retaining too much inventory that is not needed to meet requirements. Our review of the Army’s secondary inventory showed that, on average, about \$12.7 billion, or about 78 percent, of the total annual inventory value of \$16.3 billion was needed to meet current requirements, whereas \$3.6 billion, or around 22 percent, exceeded current requirements.² Similar to the Navy, this graph illustrates the Army’s trend of retaining excess inventory has remained relatively stable from fiscal years 2004 through 2007.

²Our analysis included secondary inventory from the U.S. Army Aviation and Missile Lifecycle and Management Command and the U.S. Army TACOM Life Cycle Management Command, but did not include the Army’s Communication and Electronics Command because the information system used to manage secondary inventory was not able to provide item-specific data for the period of our review.

Army Secondary Inventory Meeting and Exceeding Current Requirements, (Fiscal Years 2004-2007)



Source: GAO analysis of Army data

Note: Values are expressed in constant fiscal year 2007 dollars. Analysis includes AMCOM- and TACOM-managed items.

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A major cause for the accumulation in excess inventories is weaknesses in the military services' approach to forecasting demand as well as a lack of metrics and targets focusing on the cost efficiency of inventory management. More effective processes that identify and manage acquisition lead times are of critical importance to maintaining cost-effective inventories, budgeting, and having materiel available when it is needed. Overestimates and underestimates of acquisition lead time contribute to inefficient use of funds and potential shortages or excesses of spare parts.

The Department can strengthen the accountability and management of its secondary inventory by changing inventory management policies and practices that contribute to excess inventories. For example, we have recommended that the services evaluate why they experience decreases in demand for supplies, which contribute to having excess inventories; determine what actions are needed to better forecast demand; and take steps to implement these actions. Furthermore, we have made recommendations to develop performance goals and metrics to assess and track the cost efficiency of the services' inventory management practices and to provide for a greater oversight role to the service chief management officers for improving inventory management. Lastly, DOD needs to implement effective processes to identify or manage acquisition lead times in order to maintain cost-effective inventories, budget wisely, and have materiel available when needed. Taking steps such as these to transform the way in which DOD manages its supply chain and inventory supplies will result in better mission-essential support to the warfighter and will free up resources wasted or tied up in unneeded spare parts for higher priority needs.

DOD has generally concurred with our recommended actions and has taken some steps to improve inventory management. For example, the Air Force has made some needed policy changes, and the Army has directed that more up-to-date operational information be provided to inventory managers so they can make more informed purchase decisions. Furthermore, we understand that the Office of the Secretary of Defense has initiated a study to develop options for improving demand forecasting of spare parts.

Recently, the Congress has also shown increased interest in reforming DOD's inventory management practices. For example, the House, as part of its report accompanying the fiscal year 2010 National Defense Authorization Act, encouraged DOD to improve its ability to forecast demand by adopting an advanced modeling and simulation methodology that incorporates factors influencing demand, such as time, usage, aging of parts, origin of critical parts, and maintenance, and logistics support. Similarly, the conference report accompanying the Act called for DOD to submit a comprehensive plan for improving its overall inventory management practices, from improving demand forecasting to reducing current excess inventory stocks.

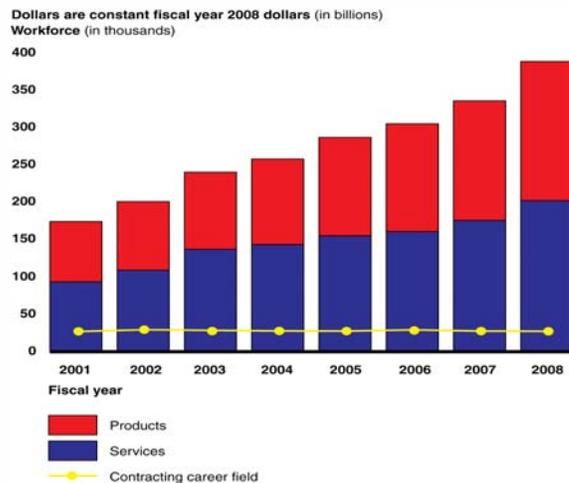
Contract management

DOD's management of contracts for goods and services, and the use of contractors in general, is another area that needs greater scrutiny and offers potential for saving money. Unfortunately, DOD's contracts have not always led to the desired outcomes and it is not always clear that DOD has been using sound business practices to acquire goods and services. On a positive note, the Secretary of Defense and other senior leaders have acknowledged these weaknesses and the need for reform, which has begun to prompt action within the Department.

Taking deliberate action now is critical because DOD has become reliant on contractors to meet critical missions, including those related to ongoing operations, and to support acquisition functions. For example, DOD reported that, as of the second quarter of 2009, over 200,000 contractor personnel were working in Iraq and Afghanistan.³ To put the level of contracting activity into perspective, between fiscal years 2001 and 2008, DOD obligations on contracts when measured in real terms have more than doubled to over \$387 billion in total, and to more than \$200 billion just for services. At the same time, DOD's acquisition workforce, responsible for contract management, has not similarly grown. In fact, during that same time period, DOD's contracting career field grew by only about 1 percent. The graph below clearly illustrates the problem that the size of the contracting workforce has not kept pace with level of contracting activity.

³GAO, *Contingency Contracting: DOD, State, and USAID Continue to Face Challenges in Tracking Contractor Personnel and Contracts in Iraq and Afghanistan*, GAO-10-1 (Washington, D.C.: Oct. 1, 2009).

Changes in DOD's Contract Obligations and Contracting Workforce, Fiscal Years 2001 through 2008



Source: GAO analysis, Federal Procurement Data System-Next Generation, DOD.

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To its credit, DOD has issued guidance to address contracting weaknesses and encourage the use of sound business arrangements. For example, consistent with congressional direction and GAO's recommendations, DOD established a process for reviewing major services acquisitions; issued regulations to better manage its use of contracting arrangements that can pose additional risks for the government, including time-and-materials contracts and undefinitized contracting actions; and has efforts under way to identify and improve the skills and capabilities of its workforce. For example, in November 2008 we reported that DOD has been developing, revising, and finalizing new joint policies and guidance on the department's use of contractors to support deployed forces and has begun developing training programs for personnel that do not work in the acquisition field to provide information necessary to operate effectively on contingency contracting matters and work with contractors on the battlefield.⁴

But there is still a lot to be done. GAO has recommended that DOD (1) assess the risks that its increasing reliance on contractors poses, (2) determine the appropriate mix of contractor, civilian, and military personnel in shaping its total force for the future, including the role and use of contractors to support deployed forces, and (3) ensure that it maintains an acquisition workforce that is adequately sized, trained, and equipped, so that it can effectively plan, negotiate, award, and manage the range of contracts needed to meet the department's needs.⁵ In

⁴GAO, *Contract Management: DOD Developed Draft Guidance for Operational Contract Support but Has Not Met All Legislative Requirements*, [GAO-09-114R](#) (Washington, D.C.: Nov. 20, 2008).

⁵GAO, *Defense Acquisitions: Fundamental Changes Are Needed to Improve Weapon Program Outcomes*, [GAO-08-1159T](#) (Washington, D.C.: Sept. 25, 2008) and *GAO, A Knowledge-Based Funding Approach Could Improve Major Weapon System Program Outcomes*, [GAO-08-619](#) (Washington, D.C.: July 2, 2008).

addition, because DOD has paid billions in award and incentive fees to contractors regardless of acquisition outcomes, GAO has also recommended ways that DOD can continue to strengthen the link between contractor monetary incentives, such as award and incentive fees, and acquisition outcomes, which has started to show positive returns. Lastly, we believe DOD should continue to focus attention on higher risk contracting strategies, such as the use of time-and-materials contracts and undefinitized contract actions, to ensure effective management of these approaches. Such efforts would also be consistent with recent direction from the Administration to reduce the use of high risk contracting strategies.

These critical contracting reforms, if successfully implemented, should strengthen the credibility of DOD's contracting processes. This will not only help ensure that that desired outcomes are achieved, but will also enhance the return on the significant investments of taxpayer dollars for the contracting of goods and services.

Financial management

DOD must have more reliable financial information to help achieve needed reforms. While DOD represents a big share of the federal budget, it is one of the few federal entities that cannot accurately account for its spending or assets. It is one of only 3 entities in the entire government that cannot pass the test of an independent audit. Without accurate financial information, DOD is severely hampered in its ability to make sound budgetary and programmatic decisions, monitor trends, make adjustments to improve performance, and reduce operating costs or maximize the use of resources.

Since the first financial statement audit was attempted at DOD nearly 20 years ago, GAO has consistently called for actions to address weaknesses in DOD financial management.⁶ DOD has launched several reform efforts over the years, but these have met with little success. Continued financial management and related deficiencies hinder DOD's ability to control costs, ensure basic accountability, anticipate future costs and claims on the budget, measure performance, and maintain control over funds. Problems with asset accountability further complicate critical functions, such as supporting the current plans to withdraw troops and equipment from Iraq.

DOD's new comptroller hopes to increase the program's chances for success by improving budgetary information and asset accountability. As shown in this slide, the emphasis will be on two areas. First, strengthening information and processes supporting the Department's Statements of Budgetary Resources. Second, verifying the existence and completeness of mission critical assets, from weapons systems to real property to general equipment.

⁶GAO, *Defense Business Transformation: A Full-time Chief Management Officer with a Term Appointment Is Needed at DOD to Maintain Continuity of Effort and Achieve Sustainable Success*, GAO-08-132T (Washington, D.C.: Oct, 16, 2007).

Current Focus of DOD's Financial Management Efforts

- **Improve budgetary information and asset availability**
 - Strengthen information and processes, and achieve an auditable Statement of Budgetary Resources
 - Verify the existence and completeness of mission critical assets
 - Components must ensure records accurately capture the number of each type of weapon system, real property, inventory, and operating materials and supplies

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Budgetary and asset-accountability information is widely used by DOD managers at all levels, so its reliability is vital to daily operations and management. The Marine Corps has just begun an audit of its fiscal year 2010 Statement of Budgetary Resources, and DOD is treating this as a test case. If the Marine Corps audit is successful, it will be used as a model for the other services.

We and the comptroller agree that DOD's current financial management priorities are necessary and critical to improving accountability and information for operations. When it comes to assets, DOD certainly needs to provide accountability over the existence and completeness of those items. GAO believes it may be worthwhile to revisit the question of how DOD reports assets in its financial statements because the traditional financial reporting model was not designed to address the unique aspects of military assets.

DOD components are developing detailed plans to support efforts to improve financial management in budgetary reporting and related operational processes and accountability for asset existence and completion. Based on what we have seen of the plan so far, we believe this prioritization is a reasonable approach for now. A consistent focus may increase the Department's ability to show incremental progress toward achieving auditability in the short term. In response to GAO's recommendations, the department has also put in place a process to improve standardization and comparability across components. The success of this process will depend on top management support, as well as high-quality planning and effective implementation at all levels.

Overall, we are encouraged by DOD's renewed attempt to improve its financial management and achieve accountability for its expenses and assets. GAO will continue to monitor progress and provide feedback on the status of those efforts. Among other things, we will seek to determine the reasonableness of efforts to achieve stated objectives and identify any gaps in strategic planning and coordination among the components. We will also track the progress of DOD's remediation plans for the remaining financial management areas. At some point down the road, I expect GAO and others will become involved in discussions about how DOD should be recording assets for financial statement purposes.

Financial management improvement efforts are pivotal to achieving broader business transformation goals. Accurate, timely, and useful financial management information is essential for sound management analysis, decision making, and reporting.

Opportunities for Strengthening Interagency Collaboration

DOD and other national security agencies can and must work more collaboratively together to strengthen the interagency process and advance U.S. national security efforts. The National Defense University plays a significant role in strengthening interagency partnerships in the national security community. In bringing agency personnel together through its various programs and events, the University offers a valuable forum for the national security community to network and build relationships, as well as to learn more about the organizational structures, processes, and other aspects of their respective agencies.

As the events of September 11, 2001, and other terrorist attacks have made clear, the challenges to national security have expanded significantly beyond the traditional state-based threats of the Cold War era to unconventional threats from nonstate actors. The new threats are diffuse and ambiguous and include terrorist threats from extremist groups, cyber attacks, drug trafficking, infectious diseases, and energy threats. They arise from multiple sources and are interrelated, which makes it difficult, if not impossible, for any single agency to effectively address them alone. In that sense, effective collaboration among multiple agencies and across federal, state, and local governments as well as with internal partners is critical.

Not only have the threats evolved, but so have the agencies involved in national security issues. Beyond the traditional agencies of the Departments of Defense and State, and the U.S. Agency for International Development, the Departments of Homeland Security, Energy, Justice, the Treasury, Agriculture, Commerce, and Health and Human Services are now a bigger part of the equation. What has not yet evolved are the mechanisms that agencies use to coordinate national security activities such as developing overarching strategies to guide planning and execution of missions, or sharing and integrating national security information across agencies. In the absence of effective mechanisms, collaboration suffers, and in some cases, can be a hindrance to achieving national security objectives.

It is encouraging that Congress is focused on this topic and has recently taken steps to strengthen interagency collaboration for national security issues. For example, in the fiscal year 2008 National Defense Authorization Act, Congress directed the Secretary of Defense to submit a plan to improve and reform DOD's participation in and contribution to the interagency coordination process on national security issues. Similarly, in the fiscal year 2009 National Defense Authorization Act, Congress gave authority to the Secretaries of Defense and State and the Administrator of AID to jointly establish an advisory panel to advise, review, and make recommendations on ways to improve coordination among the agencies on national security issues, including reviewing their respective roles and responsibilities.

Based on GAO's work, along with others, we have identified a number of challenges that hinder the ability of agencies to improve coordination mechanisms and work collaboratively in responding to national security issues.⁷ As the following graphic shows, we have highlighted four specific areas for the Congress and administration, including some thoughts on actions that agencies can take to enhance collaboration.

Opportunities for Strengthening Interagency Collaboration

- **Developing and implementing overarching, integrated strategies to achieve national security objectives**
- **Formalizing coordination mechanisms to overcome organizational differences**
- **Developing a well-trained workforce**
- **Sharing and integrating national security information across agencies**

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First, developing and implementing overarching, integrated strategies. Leadership and strategic direction is required as the foundation for collaboration. Defining organizational roles and responsibilities and mechanisms for coordination can help agencies clarify who will lead or participate in which activities and how decisions will be made. It can also help them organize their individual and joint efforts, and address how conflicts would be resolved. Although some U.S. agencies have developed or updated overarching strategies on national security-related issues, GAO's work has identified some cases where U.S. efforts have been hindered by the lack

⁷ GAO, *Interagency Collaboration: Key Issues for Congressional Oversight of National Security Strategies, Organizations, Workforce, and Information Sharing*, GAO-09-904SP (Washington, D.C.: Sept. 25, 2009).

of information on roles and responsibilities of organizations involved or the lack of mechanisms to coordinate their efforts. For example, since 2005, multiple U.S. agencies, including the State Department, AID, and DOD, led separate efforts to improve the capacity of Iraq's ministries to govern, without overarching direction from a lead entity to integrate their efforts. Since that time, we have testified and reported that the lack of an overarching strategy contributed to U.S. efforts not meeting the goal for key Iraqi ministries to develop the capacity to effectively govern and assume increasing responsibility for operating, maintaining, and further investing in reconstruction projects.⁸

Second, formalizing coordination mechanisms to overcome organizational differences.

Agencies have different organizational structures, planning processes, and funding sources to plan for and conduct their national security activities, which can hinder interagency collaboration. This can result in a patchwork of activities that waste scarce funds and limit the overall effectiveness of federal efforts. For example, agencies involved in national security activities define and organize their regions differently. A good example involves DOD's regional combatant commands and the State Department's regional bureaus which are aligned differently in terms of the geographic areas they cover. As a result of differing structures and areas of coverage, coordination becomes more challenging and the potential for gaps and overlaps in policy implementation is greater. Moreover, funding for national security activities is budgeted for and appropriated by agency, rather than by functional area (such as national security), resulting in budget requests and congressional appropriations that tend to reflect individual agency concerns.

Given the differences among agencies, developing adequate coordination mechanisms is critical to achieving integrated approaches. While, in some cases, agencies have established effective mechanisms, in others, challenges remain. For example, DOD has taken some steps to involve other agencies in its strategic planning processes. As we reported in February 2009, DOD's U.S. Africa Command was one of the first combatant commands to employ DOD's new planning approach, which called for collaboration among federal agencies to ensure activities are integrated and synchronized in pursuit of common goals. More specifically, in developing its theater campaign plan, the command met with 16 agencies at the beginning of its planning process to gain interagency input on its plan. While the process has yet to mature, we believe involving other agencies at the beginning may result in a better informed plan for DOD's activities in Africa.

We have also seen instances in which mechanisms are not formalized or fully utilized. For example, we found that collaboration between DOD's Northern Command and an interagency planning team on the development of the command's homeland defense plan was largely based on the dedicated personalities involved and informal meetings. Without formalizing and institutionalizing the interagency planning structure, we concluded efforts to coordinate may not continue when personnel move on to their next assignments.

⁸ GAO, *Interagency Collaboration: Key Issues for Congressional Oversight of National Security Strategies, Organizations, Workforce, and Information Sharing*, GAO-09-904SP (Washington, D.C.: Sept. 25, 2009).

Third, developing a well-trained workforce. Collaborative approaches to national security require a well-trained workforce with the right number of people with the right skills and experience to integrate the government's diverse capabilities and resources, but some federal government agencies lack the personnel capacity to fully participate in interagency activities. Moreover, some agencies do not have the necessary capabilities to support their national security roles and responsibilities. For example, we reported that, as of September 2009, 31 percent of State's generalist and specialists in language-designated positions did not meet the language requirements for their position, an increase from 29 percent in 2005. Also, agencies' personnel systems do not always provide positive incentives because interagency assignments are often not considered to be career enhancing or recognized in performance management systems. Various tools can be useful in helping agencies to improve their ability to more fully participate in collaboration activities. For example, increasing training opportunities can help personnel develop the skills and understanding of other agencies' capabilities. The National Defense University plays an important role and makes a valuable contribution in this area. Also, focusing on strategic workforce planning can support agencies' efforts to secure the personnel resources needed to collaborate in interagency missions.

Finally, sharing and integrating national security information across agencies. Information is a crucial tool in national security and its timely dissemination is critical for maintaining national security. More than 8 years after 9/11, federal, state, and local governments and private-sector partners are making progress in sharing terrorism-related information. For example, we reported in October 2007 that most states and many local governments had established fusion centerscollaborative efforts to detect, prevent, investigate, and respond to criminal and terrorist activityto address gaps in information sharing. However, agencies do not always share relevant information with their national security partners due to a lack of clear guidelines for sharing information and security clearance issues. For example, GAO found that non-DOD personnel could not access some DOD planning documents or participate in planning sessions because they may not have had the proper security clearances. Moreover, because of concerns about agencies' ability to protect shared information or use that information properly, other agencies and private-sector partners are sometimes hesitant to share information. For example, we have reported that Department of Homeland Security officials expressed concerns about sharing terrorism-related information with state and local partners because such information had occasionally been posted on public Internet sites or otherwise compromised. To facilitate information sharing, it is important to establish clear guidelines, agreements, and procedures that govern key aspects, such as how information will be communicated, who will participate in interagency information sharing efforts, and how information will be protected.

Concluding Remarks

In closing, I want to reiterate that DOD has a real opportunity in the days ahead to set a new course for the future, take concrete steps to correct long-standing problems, and achieve meaningful results that can better position the Department to respond to changing economic conditions and future threats. Given our nation's growing fiscal and other challenges, the Department cannot afford to delay addressing inefficiencies in its business operations and freeing

up resources for higher priorities. The old ways of doing business, without enough attention to cost or outcome, are truly unsustainable.

In many areas, DOD has untapped potential to achieve tangible and sustainable outcomes that will ultimately provide better support to the warfighter. Success will require strong leadership that sets the tone, takes decisive action, and assumes accountability for results. Success will also depend on sound plans that set clear priorities and measurable goals as well as results-oriented performance measures that can be used to gauge progress and make adjustments. Truly, DOD will need to approach the transformation of its business operations with the same level of intensity as it plans and carries out its military operations. And all of the national security agencies will need to make concerted efforts to forge strong and collaborative partnerships, and seek coordinated solutions that leverage the expertise and capabilities across the community. This too will take committed and effective leadership from all levels of an organization to overcome the many barriers to working across agency boundaries. Without people willing to make it happen, transformation and integration is just talk. There are countless ways that each of you, as future leaders, can make a real difference in how DOD does business, and in how the interagency process works.

It has been a pleasure to speak to you today. I wish you the best in your future endeavors.