SOURCING AND ACQUISITION

Challenges Facing the Department of Defense

Statement of David M. Walker
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Chairman Ensign, Ranking Member Akaka, and Members of the Subcommittee:

I am pleased to be here today to participate in the Subcommittee’s hearing on the acquisition and sourcing practices of the Department of Defense (DOD). Today’s hearing occurs at a critical time—with DOD on the brink of operations in Iraq while seeking to respond to changes in security threats and still meeting the challenge of transforming the military.

DOD spends an average of $150 billion annually on acquisitions that support these and other missions. Moreover, this investment is expected to grow considerably in the future as DOD works to keep legacy systems while investing in future capabilities such as unmanned aircraft, satellite networks, and information and communications systems.

Such demands clearly require DOD to be as efficient and effective as possible in obtaining the systems, services, and equipment it needs to carry out its mission. But our reviews continue to show that DOD is not carrying out acquisitions cost-effectively and that the acquisitions themselves are not always achieving DOD’s objectives. Pervasive problems persist regarding high-risk acquisition strategies and unrealistic cost, schedule, and performance estimates.

My testimony today will focus on two aspects fundamental to successful acquisitions in DOD.

- The first is the implementation of sound policies for making sourcing decisions. Last April, the congressionally chartered Commercial Activities Panel, which I chaired, and on which I was privileged to serve along with my fellow panelists here today, Angela Styles and Pete Aldridge, made a number of recommendations for improving the policies and procedures governing the competitive sourcing of commercial activities. I welcome this opportunity to discuss the work of the Panel and the progress to date in implementing its recommendations. These recommendations should lay a good foundation for improving sourcing decisions within DOD.

- The second is the adoption of best practices. DOD itself recognizes the need to ensure that it can match its needs to its resources and to follow a knowledge-based acquisition process. It is seeking to adopt practices that have proven successful in the commercial sector in the procurement of both systems and services. It also recognizes the need to reshape its acquisition workforce to meet growing demands. Yet it
still faces a considerable challenge in putting these practices to work and instituting the cultural changes needed for their success. I would like to recognize the Subcommittee’s leadership in sponsoring the work on the best practices used by leading commercial firms in acquiring services, information technology, and major systems, and in working to get them accepted within DOD.

Before I begin my testimony, I would like to note that the environment in which these changes must be made is a challenging one—not just for DOD, but for other agencies as well. It consists of new and changing security threats, the public’s growing expectations for demonstrable results, demographic changes, rapidly evolving science and technology, and serious and growing fiscal constraints. All of these challenges demand that the federal government engage in a fundamental review of its mission and priorities and to consider the long-term impact of the decisions it makes today. The recommendations and practices I will be discussing today, however, should position DOD to meet these broader challenges since they focus on taking a more knowledge-based, and longer-term approach to acquisitions. And they have proved successful in reducing costs.

Improving Sourcing Decisions

Government agencies increasingly are relying on services to accomplish their missions. The Department of Defense now spends more than half its contracting dollars acquiring services, about $77 billion in fiscal year 2001, the latest year for which complete data are available. In addition, the Department reports that it has over 400,000 employees performing commercial-type services. Determining whether to obtain required services using federal employees or through contracts with the private sector is an important economic and strategic decision. In fact, competitive sourcing is a key component of the President’s Management Agenda. But historically, the process for determining whether the public or the private sector should perform services needed by federal agencies—set forth in Office of Management and Budget (OMB) Circular A-76—has been difficult to implement. The impact such decisions have on the federal workforce has been profound, and there have been concerns in both the public and private sectors concerning the fairness of the process and the extent to which there is a “level playing field” for conducting public-private competitions.
Recommendations of the Commercial Activities Panel

It was against this backdrop that the Congress enacted Section 832 of the Defense Authorization Act for fiscal year 2001, which mandated that I establish a panel of experts to study the process used by the government to make sourcing decisions. Given the importance of this issue, I elected to chair this Panel myself and ensured that it was comprised of highly qualified and empowered representatives from the groups specified in the Act and other knowledgeable individuals.

The Commercial Activities Panel conducted a yearlong study, and heard repeatedly about the importance of competition and its central role in fostering economy, efficiency, and continuous performance improvement. The Panel held eleven meetings, including three public hearings in Washington, D.C.; Indianapolis, Indiana; and San Antonio, Texas. In these hearings, Panelists heard first-hand both about the current process, primarily the cost comparison process conducted under Circular A-76, as well as alternatives to that process. Panel staff conducted an extensive amount of additional research, review, and analysis in order to supplement and evaluate the public testimony. Recognizing that our mission was a challenging, complex, and controversial one, the Panel agreed that a supermajority of two-thirds of the Panel members would have to vote for any finding or proposal in order for it to be adopted by the Panel. Importantly, the Panel unanimously agreed upon a set of principles to guide all sourcing decisions:
In addition, a supermajority of the Panel agreed on a package of additional recommendations. Chief among these was a recommendation that public-private competitions be conducted using the framework of the Federal Acquisition Regulation (FAR). Although a minority of the Panel did not support the package of additional recommendations, some of these Panelists indicated that they supported one or more elements of the package, such as the recommendation to encourage high-performing organizations throughout the government. Importantly, there was a good faith effort to maximize agreement and minimize differences among Panelists. In fact, changes were made even when it was clear that some Panelists seeking changes were highly unlikely to vote for the supplemental package of recommendations. As a result, on the basis of Panel meetings and my personal discussions with Panel members at the end of our deliberative process, the major differences among Panelists were few in number and philosophical in nature. Specifically, disagreement centered primarily on (1) the recommendation related to the role of cost in the new FAR-type process and (2) the number of times the Congress should be required to act on the new integrated process.

**Guiding Principles for Sourcing Policy**

The Panel believes that federal sourcing policy should:

1. Support agency missions, goals, and objectives.
2. Be consistent with human capital practices designed to attract, motivate, retain, and reward a high-performing federal workforce.
3. Recognize that inherently governmental and certain other functions should be performed by federal workers.
4. Create incentives and processes to foster high-performing, efficient, and effective organizations throughout the federal government.
5. Be based on a clear, transparent, and consistently applied process.
6. Avoid arbitrary full-time equivalent or other arbitrary numerical goals.
7. Establish a process that, for activities that may be performed by either the public or the private sector, would permit public and private sources to participate in competitions for work currently performed in-house, work currently contracted to the private sector, and new work, consistent with these guiding principles.
8. Ensure that, when competitions are held, they are conducted as fairly, effectively, and efficiently as possible.
9. Ensure that competitions involve a process that considers both quality and cost factors.
10. Provide for accountability in connection with all sourcing decisions.
including whether the Congress should specifically authorize a pilot program that tests that process for a specific time period.

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<th>The Administration’s Proposed Changes</th>
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<td>As part of the administration’s efforts to implement the recommendations of the Commercial Activities Panel, OMB published proposed changes to Circular A-76 for public comment in November 2002. The administration is now considering the comments received as it finalizes the revisions to the Circular.</td>
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I provided comments on the proposal to the Director of OMB this past January. My assessment of the proposed revision concluded that in many ways it is consistent with the sourcing principles and recommendations adopted by the Commercial Activities Panel. In particular, the proposal stresses the use of competition in making sourcing decisions and, through reliance on procedures contained in the FAR, should result in a more transparent, expeditious, and consistently applied competitive process. The proposal should promote sourcing decisions that reflect the best overall value to the agencies, rather than just the lowest cost. Importantly, the proposed revision also should result in greater accountability for performance, regardless of the service provider selected. Of course, successful implementation will require that adequate resources and technical support be made available to federal employees. |

There are several areas, however, where the proposed revisions to the Circular are not consistent with the principles or recommendations of the Commercial Activities Panel. Specifically, these include the absence of a link between sourcing policy and agency missions, unnecessarily complicated source selection procedures, certain unrealistic time frames, and insufficient guidance on calculating savings. I am confident that the administration is carefully considering these and other comments on the proposal, and look forward to reviewing the final product. |

One area of particular importance for all affected parties is how the government’s sourcing policies are implemented. In this regard, one of the Panel’s sourcing principles was that the government should avoid arbitrary numerical or full-time equivalent (FTE) goals. This principle is based on the concept that the success of government programs should be measured by the results achieved in terms of providing value to the taxpayer, not the size of the in-house or contractor workforce. Although the proposed revision of the Circular contains no numerical targets or goals for competitive sourcing, this has been a controversial area in the past. It has been our view that the administration needs to avoid arbitrary targets or
quotas, or any goal that is not based on considered research and analysis. Congress recently put this principle into legislation; a provision in the recent consolidated appropriations legislation requires sourcing goals and targets to be “based on considered research and sound analysis of past activities”. ¹

DOD’s Competitive Sourcing Agenda

DOD has been at the forefront of federal agencies in using the A-76 process in recent years. After several years of limited use of Circular A-76, the deputy secretary of defense gave renewed emphasis to the A-76 program in August 1995 when he directed the services to make outsourcing of support activities a priority in an effort to reduce operating costs and free up funds to meet other priority needs. This effort was subsequently incorporated as a major component of the Defense Reform Initiative, and the program became known as competitive sourcing—in recognition of the fact that either the public or the private sector could win the competitions.

Recently, DOD’s A-76 study goals have increased because of the President’s Management Agenda, which includes competitive sourcing as one of its five key government-wide initiatives.² Under that program, OMB directed agencies to directly convert or complete A-76 competitions on 15 percent of their 2000 Federal Activities Inventory Reform (FAIR) Act inventories by the end of fiscal year 2003, with the ultimate goal of competing 50 percent of the FAIR Act positions. However, we understand that this broader goal may be subject to negotiations between DOD and OMB. DOD’s ongoing A-76 efforts should permit it to meet OMB’s goal for 2003. However, a greater challenge remains for DOD to complete studies on an additional 158,000 positions in the out-years (FY 2004 through FY 2009). This is double what DOD has been able to accomplish in the past over a similar timeframe. For example, DOD completed studies on 71,000 positions between fiscal years 1997 and 2002, and found it increasingly difficult to identify study candidates over time. DOD hopes to be able to meet this larger goal through a combination of A-76 competitions and other alternatives.

² In addition to competitive sourcing, the other initiatives are strategic management of human capital, improved financial performance, expanded electronic government, and budget and performance integration.
DOD’s experience with competitive sourcing since 1996 contains important lessons for civilian agencies as they implement their own sourcing initiatives. As we have tracked DOD’s progress in implementing its A-76 program since the mid to late 1990s, we have identified a number of challenges and concerns with the program. They include (1) the time required to complete the studies, (2) the resources required to conduct and implement the studies, (3) selecting and grouping positions to compete, and (4) developing and maintaining reliable estimates of projected savings expected from the competitions.

At the request of this Subcommittee, GAO has conducted a number of engagements to identify best practices in the commercial sector for addressing the sourcing and acquisition challenges facing the Department. We believe the Department could significantly improve its performance in a number of areas by adopting some of the best practices we have identified.

For example, we reviewed the practices used by leading companies involved in outsourcing certain information technology (IT) functions. In November 2001, we issued a guide on outsourcing IT services that provides a generic framework of practices from leading commercial organizations that can improve purchasing decisions and manage the resulting government/provider relationship.³


At the further request of this Subcommittee, we have been reviewing the extent to which selected DOD projects are using leading commercial practices laid out in our November 2001 guide. We have shared our draft report with this Subcommittee, which is currently with DOD for comment. In brief, we found that the five projects in our review were generally implementing these practices. This is a positive sign because although implementing these practices does not guarantee the success of an outsourcing project, our November 2001 study reflected a consensus view that these practices were the most critical to success.⁴ Accordingly,

⁴This consensus view was based on interviews with managers in leading commercial organizations, discussions with academic and professional authorities, and extensive research on IT acquisition practices.
application of these practices increases the probability of a successful
outsourcing project.

| Acquiring Information Technology Systems | Since the 1990’s, DOD has spent billions of dollars each year attempting to
leverage the vast power of modern technology to replace outdated ways of
doing business. However, the Department has had limited success in
modernizing its information technology environment, and we have
designated DOD’s systems modernization as high risk since 1995. A major
reason for this designation is DOD’s inconsistent use of best practices for
acquiring IT systems.

We have categorized IT system acquisition practices into three groups and
apply leading practices, as appropriate, in our evaluations of systems
acquisitions within DOD. A brief description of the three categories and
what we have found at DOD follows:

Acquisition of systems in accordance with mature processes. Our work
shows that DOD’s implementation of mature acquisition management
processes is uneven, as are its proactive efforts to improve these
processes. For example, our review of the Defense Logistics Agency’s
system acquisition processes showed that one major system was following
mature processes, while another was not. We made recommendations to
correct these weaknesses, and DOD has generally concurred.

There are also published best practices for acquiring systems that are built
from commercial components. Generally, these practices advocate an
acquisition approach that is not driven primarily by system requirements,
but rather an approach that proactively manages the tradeoff among
various acquisition issues, such as the organization’s system requirements
and the commercially available system components. Accordingly, we have
ongoing and planned work at a number of federal agencies, including
DOD, which includes determining whether these practices are being
employed.

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(Washington, D.C.: January 2003) for our most recent high-risk report.

6U.S. General Accounting Office, Information Technology: Inconsistent Software
Acquisition Processes at the Defense Logistics Agency Increase Project Risks (GAO-02-9,
Jan. 10, 2002).
Use of an enterprise architecture to guide and constrain system acquisitions. Effectively managing a large and complex endeavor requires, among other things, a well-defined and enforced blueprint for operational and other technological change, commonly referred to as an enterprise architecture. In May 2001, we reported that DOD had neither an enterprise architecture for its financial and financial-related business operations, nor the management structure, processes, and controls in place to effectively develop and implement one. In addition, the National Defense Authorization Act for Fiscal Year 2003 required DOD to develop such an architecture by May 1, 2003, along with a transition plan for its implementation. At the request of this Subcommittee, we reported last month that DOD had taken a number of steps to address this issue, such as establishing a program office responsible for managing the enterprise architecture effort. However, the Department had yet to implement some of the recommendations from our May 2001 report and commercial leading practices for developing and implementing architectures. Accordingly, we made additional recommendations related to DOD’s architecture effort, with which DOD concurred.

Acquiring systems in a series of economically justified incremental builds. Both federal law and guidance advocate the use of incremental investment management when acquiring or developing large systems. Using these system investment practices helps to prevent discovering too late that a given acquisition/development effort is not cost beneficial. We have previously reported that certain DOD system acquisitions were not utilizing incremental management best practices or were just beginning to do so. For example, in July 2001 we reported that although DOD had divided its multi-year, billion-dollar Standard Procurement System into a

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9Incremental management involves three fundamental components: (1) acquiring a large system in a series of smaller increments; (2) individually justifying investment in each separate increment on the basis of cost, benefits, and risks; and (3) monitoring actual benefits achieved and costs incurred on ongoing increments and applying lessons learned to future increments.

series of incremental releases, it had not treated each of these increments as a separate investment decision.\textsuperscript{11}

**Acquiring Services**

With respect to services acquisitions generally, we found that the experiences of leading private-sector companies to reengineer their approach to acquiring services offer DOD both valuable insights and a general framework that could serve to guide DOD’s efforts. In January 2002, we reported that our work at six leading companies found that each had reengineered its approach to acquiring services to stay competitive, reduce costs, and improve service levels. These changes generally began with a corporate decision to pursue a strategic approach to acquiring services. Taking a strategic approach involve a range of activities from developing a better picture of what a company was spending on services to taking an enterprise-wide approach to procuring services and developing new ways of doing business. Pursuing such an approach clearly paid off, as the companies found that they could save millions of dollars and improve the quality of services received.

DOD already has in place certain elements critical to taking a strategic approach, such as the commitment by senior DOD leadership to improve practices for acquiring services and to adopt best commercial practices. Moreover, the fiscal year 2002 national defense authorization legislation directs DOD to improve its management and oversight of services acquisitions. To implement these requirements, DOD issued new policy in May 2002 that was intended to elevate major purchases of services to the same level of importance as purchases of major defense systems. The Department still faces a long journey, however, as it begins to take on the more difficult tasks of developing a reliable and accurate picture of service spending across DOD.

**Major Weapon Systems Acquisitions**

DOD relies heavily on its major weapons acquisitions to modernize its forces and expects to spend on average about $150 billion annually over the next 5 years for the research, development and procurement of weapon systems. However, its history of acquiring major weapon systems all too frequently has been characterized by poor cost, schedule, and performance outcomes that have delayed delivery of new capabilities to

the warfighter and created significant opportunity costs that have slowed the Department’s overall modernization efforts.

Because of the pressures in DOD’s acquisition environment to get new acquisition programs approved and funded, many programs are initiated with requirements that make a proposed weapon system stand out from others. The systems engineering necessary to identify gaps between requirements and resources is often not accomplished until after the program is started. In these cases, performance requirements can outstrip the resources—technologies, funding, time, and expertise—available to meet them. This creates a need for immature, fledgling technologies that are difficult to develop and usually results in unstable and incomplete a product design for which there is insufficient time to mature before starting production. Sufficient time or effort may not be available during product development to understand the product’s critical characteristics or to bring key manufacturing processes in control to meet cost, schedule, and quality targets. In addition, there is not enough emphasis on building in reliability and reducing total ownership cost.

Typically, the results of this process are weapons that have superior performance, but that create longer-term collateral consequences such as:

- Higher acquisition costs that reduce buying power and force tradeoffs in other acquisitions,
- Increased costs to operate and support weapon systems at required readiness rates,
- Significant delays in getting weapon systems to warfighters,
- Reduced quantities,
- Early obsolescence, and
- A diminishing supply base for critical parts and components.

DOD understands that it must get better outcomes from its acquisition process if it is to modernize its forces quickly within projected resources. To that end, it is currently revising acquisition policies to emphasize an evolutionary, knowledge-based process that incorporates best practices proven by successful companies in developing complex new products. We believe the policy changes, while not yet finalized, promise to be a good first step in changing DOD’s acquisition outcomes. If implemented properly, programs would face less pressure to deliver all of the ultimate capabilities of a weapon system in one “big bang.” The new policy has many positive features. For example, it:
Separates technology development, which is unpredictable by nature, from product development, which requires major investments and is delivery-oriented;

Articulates the concept of a knowledge-based approach, providing guidelines for achieving knowledge of technologies prior to beginning product development, stability of the system’s design by about midway through product development, and control over critical manufacturing processes for building a weapon system prior to a production decision;

Places a greater emphasis on evolutionary product development, which provides a more manageable environment for achieving knowledge; and

Recognizes the benefits of best practices for product development from leading companies in capturing knowledge at critical junctures during product development.

While these policy changes represent tangible leadership action for getting better weapon system acquisition outcomes, unless the policies are implemented through decisions on individual programs, outcomes are not likely to change. Both form and substance are essential to getting desired outcomes. At a tactical level, we believe the policies could be made more explicit in several areas to facilitate such decisions. First, the regulations provide little or no controls at key decision points of an acquisition program that force a program manager to report progress against knowledge-based metrics. Second, the new regulations, once approved, may be too general and may no longer provide mandatory procedures. Third, the new regulations may not provide adequate accountability because they may not require knowledge-based deliverables containing evidence of knowledge at key decision points.

At a strategic level, some cultural changes will be necessary to translate policy into action. At the very top level, this means DOD leadership will have to take control of the investment dollars and to say “no” in some circumstances, if programs are inappropriately deviating from sound acquisition policy. In my opinion, programs should follow a knowledge-based acquisition policy—one that embraces best practices—unless there is a clear and compelling national security reason not to. Other cultural changes instrumental to implementing change include:

- Keeping key people in place long enough that they can affect decisions and be held accountable;
- Providing program offices with the skilled people needed to craft acquisition approaches that implement policy and to effectively oversee the execution of programs by contractors;
• Realigning responsibilities and funding between science and technology organizations and acquisition organizations to enable the separation of technology development from product development;
• Bringing discipline to the requirements-setting process by demanding a match between requirements and resources;
• Requiring readiness and operating cost as key performance parameters prior to beginning an acquisition; and
• Demanding reliability testing early in design.

Ultimately, the success of the new acquisition policy will be seen in individual program and resource decisions. Programs that are implementing knowledge-based policies in their acquisition approaches should be supported and resourced, assuming they are still critical to national needs. Conversely, if programs that repeat the approaches of the past are approved and funded, past policies—and their outcomes—will be reinforced.

**Acquisition Workforce Challenges**

To effectively implement best practices and properly manage the goods and services it purchases each year requires that DOD have the right skills and capabilities in its acquisition workforce. This is a challenge given decreased staffing levels, increased workloads, and the need for new skill sets. Procurement reforms and the ongoing technological revolution have placed unprecedented demands on the workforce, and contracting personnel are now expected to have a much greater knowledge of market conditions, industry trends, and technical details of the commodities and services they procure.

In response to these challenges, DOD has made progress in laying a foundation for reshaping its acquisition workforce. The agency has initiated a substantial long-term strategic planning effort to identify the competencies needed for the future and to address what reshaping of the workforce will be needed to achieve the desired mix. DOD is continuing with an effort to test various human capital innovations and has begun making significant changes to its acquisition workforce-training program. Part of this long-term effort will involve making a cultural shift as well as developing better data to manage risk by spotlighting areas for attention before crises develop and to identify opportunities for improving results.

**Conclusion**

The continuing war on terrorism, regional instability, demographic and technological changes, as well as the federal government’s short-and long-term budget pressures have created a challenging environment for the
Department of Defense. It faces a number of difficult missions that will put its strategies, personnel, and resources under enormous strains. Consequently, it is important for the Department to adopt business practices that will enable it to acquire the systems and services to allow it to operate effectively in this environment. Doing so will help ensure that its resources are used in the most efficient manner possible. I am confident that the leadership of the Department is committed to that objective. Success over the long term will depend on the leadership sustaining its commitment to improving business practices through a strategic, integrated, and DOD-wide approach to ensure that these efforts achieve their intended results.

Mr. Chairman, this concludes my statement. I will be pleased to respond to questions from the Subcommittee.