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FINANCIAL MANAGEMENT AT THE ENTERPRISE LEVEL: SOME FOUNDATIONAL PRINCIPLES

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In recent years, the DoD's financial management community has taken greater interest in the execution side of the Planning, Programming, Budgeting, and Execution system. Why? Failures to follow through on spending funds that have been obligated means that annually DoD and the services leave considerable amounts of money unspent. This has brought renewed calls for better fiscal stewardship.

Traditionally, matters of budget and execution have fallen on organizational leaders while senior leaders concentrate on planning and programming. With tightening budgets, this is changing, and senior leaders are now having to pay greater attention to all phases of PPBE to ensure the proper use of taxpayer resources. However, execution of budgets at the strategic level is qualitatively different than execution at unit or organizational level. This short paper provides some of the foundational principles that make execution at the enterprise level rather complex. For example, budget cuts in military healthcare or temporary duty (TDY) authorizations might seem small but can have a tremendous impact on the costs of millions of individual transactions. It can influence what services that clinics can provide on-site or must outsource; or influences what approvals and restrictions are in place to allow service members to go TDY. If the hidden costs associated with an enterprise-level execution decision offset the anticipated cost savings, which is a cause for concern. What can senior leaders do to avoid these types of problems?

Execution is a very important part of the Planning, Programming, Budgeting, and Execution system, but it can be overlooked compared to the other phases. First, Planning and Programming decisions consume considerable amount of senior leader time – from determining what capabilities the services need to pursue national strategies to garnering the necessary resources from Congress to develop and employ those capabilities. Execution is less glamorous by comparison.

Unfortunately, failure to perform execution correctly at the enterprise level leads to significant waste of resources and open avenues for fraud and abuse. An internal Army review found that significant obligated funds were left unspent in the out years, causing that money to be returned to the treasury, prompting the institution of a new command accountability program.² The DoD and the services were also unsuccessful in achieving a clean audit despite efforts spanning many years to make the department auditable.³ The second- and third-

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² Jen Judson, "Will the Army's Renewed Stab to Institutionalize Smart Spending Stick?" *DefenseNews*, October 9, 2018, <https://www.defensenews.com/digital-show->

dailies/ausa/2018/10/09/will-the-armys-renewed-stab-to-institutionalize-smart-spending-stick/ (accessed December 6, 2018).

³ See Andrew Wagner, "The Future of DoD Financial Management & Audits," *Government Matters*, September 18, 2018, <https://govmatters.tv/the-future-of-dod-financial-management-audits/> (accessed December 6, 2018).

order effects of financial decisions can also present challenges, for example, in 2017 the Government Accountability Office issued a report questioning the impacts of policies regarding reduced reserve component travel reimbursements on retention.⁴ While certain types of programs such as weapon system acquisitions incur high risk due to the need to develop new technologies, significant DoD spending is on personnel, supplies, transportation, maintenance, facilities and infrastructure, real estate, contracts, and other routine activities. The costs of goods and services in these ordinary activities have routinely been found to be excessive, inviting Congressional scrutiny.⁵ And there is always legitimate concerns about fraud, waste, and abuse.

Army leaders are rightfully concerned that leaders from unit to enterprise level have not devoted enough energy to ensure proper fiscal stewardship. One must ask *what good is putting all the efforts into programming if leaders do not follow through to execution?*

But execution is considerably more complex at the enterprise level than at unit or organizational level. Put simply, it is vastly different than managing a unit budget – which is typically limited to specific named activities such as training and travel. At enterprise level, senior leaders concern themselves with fiscal matters across all programs affecting military personnel and operations—including human resources, healthcare, real estate management & infrastructure, government-wide contracts, and many others. For those with limited experience in these matters, measuring the costs, benefits, and effects of budgetary decisions can seem overwhelming.

The purpose of this introductory paper is to present a few essential questions and key

principles about financial management unique to service or major command levels. It is not intended to provide a whole cloth treatment of enterprise-level financial management. The goal is to help senior leaders new to the enterprise level of financial management build a foundation of knowledge about of making sound budgeting and execution decisions.

This paper has three main sections. First is a quick introduction to the principle of *public sector efficiency*, which is how the public sector measures its fiscal activities (and unfortunately encourages some of the problematic behaviors that prior *cost consciousness* efforts have tried to eradicate⁶). Second is an introduction to principles of budget execution at the enterprise level. What are some of the essential differences from unit-level execution? Finally, how do (or should) the financial management systems and processes help enterprise leaders make sound decisions?

PUBLIC SECTOR EFFICIENCY

We begin with a discussion of a guiding principle underlying program budgeting and its associated systems like PPBE. As Snider and Matthews commented, military organizations as government bureaucracies emphasize *efficiency*, but efficiency takes many different forms.⁷ The general meaning of efficiency is that goods and services are produced/provided faster, cheaper, and better by the organization.⁸ In the private sector, pursuing efficiency is a factor of competitive advantage. But because the public sector is essentially non-competitive, meaning that it does not compete directly against private sector firms, it uses a different framework for matters of efficiency – dividing it into two forms, *technical efficiency* and *allocative efficiency*.⁹

⁴ U.S. Government Accountability Office, *RESERVE COMPONENT TRAVEL: DOD Should Assess the Effect of Reservists' Unreimbursed Out-of-Pocket Expenses on Retention*, Report #GAO-18-181 (Washington, DC: U.S. Government Accountability Office, 2017).

⁵ For example, see Chuck Grassley, "Grassley, Senate Budget Committee Members Ask GAO to Conduct Study of DoD Accounting Systems," *Senator Chuck Grassley Page on Senate.gov*, July 12, 2018, <https://www.grassley.senate.gov/news/news-releases/grassley-senate-budget-committee-members-ask-gao-conduct-study-dod-accounting> (accessed December 6, 2018).

⁶ For example, Ryan Frazier, "Valuing Cost-Consciousness in Today's Military Culture," *WAR ROOM*, May 11, 2017,

<https://warroom.armywarcollege.edu/articles/valuing-cost-consciousness-todays-military-culture/> (accessed October 23, 2019).

⁷ Thomas P. Galvin, "Centralization and the Inefficient Quest for Efficiency," *Talking About Organizations Podcast*, May 31, 2018, <https://www.talkingaboutorganizations.com/e43x/> (accessed December 7, 2018).

⁸ Robert Swisher, "Fast, Good, or Cheap. Pick Three?" *Business.com*, February 22, 2017, <https://www.business.com/articles/fast-good-cheap-pick-three/> (accessed December 7, 2018).

⁹ See OER Services, "Macroeconomics: Reading – Productive Efficiency and Allocative Efficiency," *LumenLearning.com*, <https://courses.lumenlearning.com/suny->

*Technical Efficiency – Doing Things Right*¹⁰

In the private sector, efficiency is often discussed in terms of production. Are enough goods and services being produced to address demand? Can production be made more *efficient* by speeding up, finding lower-cost materials, addressing quality control issues, and so on – such that the cost to benefit ratio is more favorable? Efficiency may also be addressed in terms of overall operations. When research and development, liabilities, and other costs are considered, is the organization still turning a profit?

A public sector operation is *technically efficient* when it performs government functions at least cost, or to the maximum extent at the same cost, or some combination of the two.¹¹ But the drivers of technical efficiency go beyond cost – they include measures of justice, equity, and fairness. *Justice* is the appropriateness of the government providing the good or service, rather than the government having no involvement whatsoever. *Equity* measures the variance in the supply of the good or service, that everyone eligible gets the same quality good or service. *Fairness* measures variance on the demand side, that everyone has equal access to the good or service, free from corruption, discrimination, or undue preferential treatment. Governments are likely to accommodate higher costs (or higher subsidy of the cost) if it means greater assurance of equitable treatment and fairness.

Consider driver’s licensing at a Department of Motor Vehicles (DMV), technical efficiency would be measured in terms of individual transactions. There is little question that this government activity is just. Public safety is important and driving motor vehicles involves risk that can be mitigated through a training and licensing process. Given this, what is equitable and fair? How many citizens can receive their licenses on a given day and at what cost? Are there ways to speed up the process, or issue the

licenses at less cost to the citizen? How long of a waiting time is considered unreasonable?

Direct changes to what occurs inside the DMV probably will not bring about marked improvements in technical efficiency. Significant improvements may involve deeper change in the organization. Is outsourcing to the private sector a way to reduce costs? What about relying on data technologies, moving all or most of the process online?¹² Of course, all these questions assume that the provision of drivers’ licenses is a suitable and appropriate government function (under the guide of ensuring public safety, which contributions to the notion of it being *inherently governmental*¹³). This assumption relates to the other type of public sector efficiency.

*Allocative Efficiency – Doing the Right Things*¹⁴

An organization is *allocatively efficient* when production precisely matches what the consumers want. This is straightforward in the private sector, where the idea is that if demand is for 1000 widgets, and there are precisely 1000 widgets produced, then there is allocative efficiency (assuming that all the widgets are in the customer’s possession). There is no waste or excess. No widgets are sitting on shelves unbought. If the firm is providing services rather than goods, the principle is similar. The firm is allocatively efficient if supply (e.g., open hours) matches demand precisely – there is no time when either the service workers are idle and no time when customers are denied or unduly deferred access to those services. Perfect allocative efficiency is difficult to achieve, as supply and demand are dynamic, even volatile. Customers may have different opinions as to what constitutes reasonable access, and this may be context-dependent. For example, holiday shoppers may tolerate long lines in the stores during December, but are less likely to do so at other times in the year.

[macroeconomics/chapter/reading-productive-efficiency-and-allocative-efficiency/](#) (accessed September 15, 2018).

¹⁰ Stephen Aldridge, Angus Hawkins, and Cody Xuereb, “Improving Public Sector Efficiency to Deliver a Smarter State,” *Civil Service Quarterly* @GOV.UK, January 25, 2016, <https://quarterly.blog.gov.uk/2016/01/25/improving-public-sector-efficiency-to-deliver-a-smarter-state/> (accessed December 7, 2018).

¹¹ Ibid.

¹² Ibid., see Figure 3 on the drivers of efficiency.

¹³ See Congressional Research Service, *Definitions of “Inherently Governmental Function” in Federal Procurement Law and Guidance*, CRS Report #R42325 (Washington, DC: Congressional Research Service, 2014).

¹⁴ Aldridge, et al.

Allocative efficiency works similarly in the public sector. What the citizens want and need is provided precisely by the government. If the annual demand for licenses is 10,000 and the DMV can provide precisely 10,000 licenses a year, then that activity is allocatively efficient. But what if there is a policy change that alters the services provided? For example, perhaps a motor-voter law has been enacted that allows voters to register to vote at DMVs.¹⁵ This incurs additional requirements on the DMV to handle a potentially greater customer load, ensure adequate training of its workers, and have the necessary resources to handle voter registration paperwork. If additional resources are not provided to the DMV, it is possible that the ability to process licenses and voter registration will be degraded. Technical efficiencies may not offset the problem.

Allocative efficiency becomes important when a government must adapt to changes in the society it serves. For example, a younger population may require more investment in education, while an older population needs more healthcare.¹⁶ This may require shifts in public spending between education and healthcare programs.

Allocative Efficiency and Program Budgets

Allocative efficiency takes on a different meaning when applied to government program budgeting. When a government establishes or updates programs, it attempts to pre-determine both the demand and supply (insourced or outsourced, does not matter) and allocates funds accordingly. Programming a DMV's budget for issuing licenses, for example, is a matter of determining how many licenses will be issued and how much each issuance would cost (the *marginal cost* of the transaction), along with how much of that cost will be borne by the licensee.¹⁷ For example, the total cost of issuing a license might be \$50, but public law or policy might require that cost to the consumer for the license

must not exceed \$30, meaning that the government funds the remaining \$20. In theory, the government's burden should determine how much money needs to be programmed into the DMV's budget. So, from a programming and budgeting perspective, the process looks somewhat like this:

- The Commission of the DMV determines that X licenses will be issued, and the government's share of the cost is Y%, totaling Z1 dollars.
- The cost of operating the DMVs (facilities, personnel, etc.) is Z2 dollars.
- Therefore the budget for the next fiscal year is proposed as $Z1 + Z2 = Z$ dollars. Z is therefore passed up to the legislature as the executive branch's request, which is assumed to be allocatively efficient.

Then the legislature takes the budget request of Z. and appropriates what it deems to be the correct answer. Sometimes it is Z. Sometimes it is lower or higher. Assuming no mandated change in the expected levels of service,¹⁸ the change in appropriations immediately renders the program inefficient – there is a delta between the provision of services and the resources available! So what happens?

If lower (let's say 90%), then the Commissioner must decide how the 10% is reduced in execution. Will it reduce services? Will it reduce structure, such as facilities and personnel? Will it attempt cut costs elsewhere? Another option (which can be risky) is not to change anything and use the demand signal to convince the legislature to supplement the other 10%. The risk is running out of money before the end of the year, at which time the services can no longer be provided.

If higher (let's say to 110%), that's not automatically a good thing for the

¹⁵ For example, the National Voter Registration Act of 1993 in the United States (52 U.S.C. Sections 20501-20511).

¹⁶ Aldridge et al., "Improving Public Sector Efficiency."

¹⁷ This may also depend on the licensee's status. States may establish reduced rates or free licensing for various groups (e.g., young drivers, disabled, active military or veterans, first responders, senior citizens, or other categories according to state policy). These

might add to the out-of-pocket costs of other licensees or add to the government's portion of the cost.

¹⁸ Recall that in the U.S. system, authorization and appropriation are separate actions—establishing the requirements and providing the resources, respectively. Thus, the U.S. Congress can, essentially, create its own inefficiencies although the process allows and encourages coordination and negotiation between the respective committees.

Commissioner.¹⁹ The 10% additional funds *must* be spent. Is there a way to increase the supply of services to reach untapped demand? Can the agency invest in facility and infrastructure upgrades? Are there studies needed? Should the agency hire more personnel to improve the technical efficiency of activities?

Thus, with respect to tangible goods and services, determining the allocative efficiency of the program budget is straightforward. *After execution, was the requisite quantity of goods and levels of service provided for the public, and was there nothing left over?* Of course, it is not always this easy. Consider all the dynamics at play – changes in supply and demand within the execution year, fluctuations in cost, disruptions in manpower (e.g., increased turnover, union strike), disruptions in operations (e.g., natural disasters).

But most of all, execution will expose the allocative inefficiencies within the budget upon its formulation. In some government processes, there may be buffering on both the agency's part (to protect against the appropriation being cut too low) and the legislature's part (who must satisfy more programs than possible with the available resources). If the allocative inefficiency is in the agency's favor, then there is leftover money. However, since there is often an extremely high transaction cost associated with transferring these funds, and allocative efficiency still holds as a principle, the agency *must* spend the money any way it can. These contributes to a culture of end-of-year spending sprees.²⁰

Allocative Efficiency in the National Security Context

When the goods and services are more intangible and abstract, such as national security, all the above figures are estimates. Execution becomes much more complicated.

Requirements determination begins with national security documents that (should) inform the capabilities needed in its military to confront internal and external threats. But nations also

faces limits on their abilities to fund all those requirements due to various factors, such as: (a) national debt, (b) requirements for balancing security with other priority government services, and (c) differing perceptions of the threats among national leaders. However, once all the priorities are weighed, the risks articulated, and the budget is set, the program budgeting system goes forward under the general assumption that the funding allocated will generate the specified capabilities at the desired level. The P, P, and B of PPBE should do their jobs.

After that, it is time for the E to do its job!

FINANCIAL MANAGEMENT

Budget Execution at the Enterprise Level

At the execution level, the program budgeting system should reward behaviors that ensure the expenditure of funds across program budgets produce the intended benefits. But sometimes it does not. First, program budgeting enacts heavy transaction costs on any reallocation or reprioritization of programs, even when the initial allocation of resources proves to have been incorrect. Under allocative efficiency, agencies should be able to transfer excess funds in one program to a needier program. However, because the budgets are determined with significant military input, the discovery of misallocation can be interpreted as poor analysis on the part of the military. While some amount of reprogramming is considered ok (and even expected), substantial reprogramming could result in questions about a leader's credibility. Thus, the U.S. system includes an annual timetable for presenting reprogramming needs.

This leads to a misperception that must be addressed – that an agency or organization 'owns' the funds allocated to it. From a technical standpoint, no government agency owns any of their allocated funds – they belong to the taxpayers. Agencies are mere stewards of those funds. However, once funds are allocated, each

¹⁹ For present purposes, let's assume Z was not artificially lowered in the executive branch's own budgetary process. This frequently happens where the actual expected costs are higher than what the executive branch feels comfortable pushing forward.

²⁰ The transaction costs are typically not fiscal – they are more likely expressed in time and political capital. Moving money constitutes the need for a decision that would not have to be made if

the budget was allocatively efficient in the first place, and senior leaders (and legislators) will often place the agency on the defensive for any inefficiencies that appear in execution. Time challenges stem from law, whereby there is a strict fiscal cutoff for spending, with no extensions allowed. Agencies can rely on internal processes for doing this spending at a far lower transaction cost than seeking a reprogramming decision.

agency is granted sufficient autonomy to spend the resources as seen fit to deliver on its mandate. Agency directors will want some degree of flexibility to respond to changes in the environment while avoiding transaction costs. Thus the incentives for leaders is to strive for more resources to retain local flexibility. Related to this is a military culture that views resourcing as a competitive sport, which thus sees reductions of an organization's resources as tantamount to failure on the leader's part. No leader wants to willingly give up its flexibility or prestige associated with larger budgets,²¹ nor does it want to count on the institution providing additional resources when the organization falls short on its mission. This is why the culture of *use it or lose it* is difficult to eliminate.

Purpose of a Financial Management System

Clearly, the risks and uncertainties affecting programming and budgeting influences the extent to which organizations can execute their budget. However, execution across the defense enterprise is more than just implementing the budget. *Financial management* is about ensuring the proper usage of funds allocated, which includes the following considerations:²²

- Estimating capital requirements (such as facilities, infrastructure, logistics)
- Asset visibility (proper accounting of all assets on-hand and their conditions)
- Redistributions of surplus and reprogramming decisions to address shortfalls in programs
- Managing cash flow and proper rate of expenditures
- Exercising internal financial controls. For example, no dollars should serve any

purpose other than to generate the required government service.

Financial management systems are decision support systems that help organizations satisfy the above needs. They provide the necessary controls, checks and balances, and accountability.

Senior leaders will likely be familiar with how DoD uses its financial management system to ensure the proper rate of expenditures. Throughout a fiscal year, organizations monitor its expenditures to identify early any shortcomings or excess funds that might indicate a need for reprogramming. Assessments of such rates should account for known fluctuations, such as how summer periods incur greater demands for services related to moving service members and their families. Aggregating such data at the enterprise level serves to identify reprogramming needs at Congressional level.

Internal controls are another feature of the system and include recordkeeping and safeguards against fraud and waste. In the U.S. Government, internal controls serve three main purposes: (1) ensuring effectiveness and efficiency of operations, (2) providing for reliable fiscal reporting to stakeholders, and (3) compliance with laws and regulations.²³

Internal controls also help leaders and financial management determine the appropriate use of resources through general *cost principles*. In the U.S. government, the Office of Management and Budget (OMB) establishes cost principles regarding expenditures by both federal government agencies and those organizations using federal funds such as educational institutions and non-profit organizations.²⁴

In the U.S., the Code of Federal Regulations (2 CFR Part 200) establishes what constitutes an *allowable cost* as those necessary for mission performance and therefore suitable for

²¹ In times past, junior officers were encouraged to include \$\$\$ figures of property under their stewardship as a measurable outcome for efficiency report purposes. The obvious fallacy is that the raw dollar amount is not a useful indicator of the business acumen of the leader nor does it allow a fair comparison between leaders of different types of units (in particular, units fielding new equipment tend to have artificially high figures).

²² "Financial Management – Meaning, Objectives, and Functions," *Management Study Guide*, <https://www.managementstudyguide.com/financial-management.htm> (accessed December 7, 2018).

²³ U.S. Government Accountability Office, *FINANCIAL MANAGEMENT: Effective Internal Control is Key to Improving Accountability*, Report #GAO-05-321T (Washington, DC: U.S. Government Accountability Office, 2005).

²⁴ See Office of Management and Budget, *Compliance Supplement*, 2 CFR Part 200, Appendix XI (Washington, DC: The White House, 2019), § 3.1 and 3.2, <https://www.whitehouse.gov/wp-content/uploads/2019/07/2-CFR-Part-200-Appendix-XI-Compliance-Supplement-2019-FINAL-07.01.19.pdf> (accessed October 24, 2019).

government expenditure or reimbursement. Section 403 lists the determining factors, a few of which are highlighted below:

- Consistency with Federal policies and regulations (403c).
- Uniformity of treatment. For example, what is deemed allowable under one circumstance should be deemed allowable among other like circumstances (403c).
- Be determined in accordance with generally accepted accounting principles (403e). Openness and transparency is important.
- Be adequately documented (403g). All claims for federal funding must be thoroughly supported and justified.²⁵

OMB guidelines specify that government-provided funds are allowed to be used by educational institutions for communications, labor relations, and certain administration costs; while commencement costs, alcoholic beverages, and housing and personal living expense are not allowed. Consider government travel.²⁶ DoD policies articulate whether to deem claimed expenses as allowable and therefore reimbursable to the traveler.

An associated cost principle is what constitutes a *reasonable cost*. 2 CFR Part 200, Section 404 defines this as follows, “in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.”²⁷ Some of the factors determining reasonability include:

- Generally recognized as ordinary and necessary among all parties (404a).
- Comparable to market prices for comparable goods or services (404c).

- Based on all parties acting in good faith – that is, the ones receiving the service are not claiming costs incurred due to their own mistakes or omissions (404d).
- Based on all parties acting within established practices (404e). For example, the ones receiving the service are not making outlandish or unusual claims.

The Challenges of Aggregation

It is easy to apply the cost principles to individual transactions. A leader or resource manager can evaluate the individual elements of a travel claim and determine which are reasonable and allowable. But what at the aggregate level? For example, what constitutes a reasonable cost of annual travel incurred by a particular organization?

Now apply the question across all programs, and the challenges facing programmers become apparent. The majority of laws and regulations focus on improving the technical efficiency of each transaction. In the example of travel, updates to the Joint Travel Regulations focused on choices made by the travelers – low costs of local transportation, mandatory usage of government quarters, and addressing cost factors not previously covered in the regulation.²⁸ But the regulation as a whole does not address the strategic question: *for a given command with X personnel spread across Y different locations, how much money is reasonable to allocate for travel in the fiscal year?* There is no easy answer to this question because costs can fluctuate and the mission can change dramatically.

This is true for any DoD activity. For example, consider information technology (IT) and cybersecurity, both of which are very expensive. DoD spending on IT rose incrementally from 2016 to 2018, but a significant portion of the budget is spend on ‘legacy’ systems, that “maintain agencies’ existing IT investments.”²⁹ This does not adequately cover

²⁵ 2 U.S.C. § 403.

²⁶ OMB, *Compliance Supplement* § 3.1.

²⁷ 2 U.S.C. § 404.

²⁸ U.S. Department of Defense, *Joint Travel Regulations: Uniformed Service Members and DoD Civilian Employees* (Washington, DC: U.S. Department of Defense, April 2018), see Cover Letter, <https://www.defensetravel.dod.mil/Docs/perdiem/browse/Travel>

[Regulations/Regulations_Changes/Monthly/2018/JTR\(04-01-18\).pdf](#) (accessed December 10, 2018).

²⁹ The White House, *2018 Federal Budget* (Washington, DC: The White House, 2018), Section 16, https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/budget/fy2018/ap_16_it.pdf (accessed December 10, 2018).

the significant investments needed to modernize IT in the face of ever-growing cyber threats.³⁰ Another example is the increasing costs of natural disasters hitting the U.S. – e.g., hurricanes and storms, wildfires, tornadoes, droughts, and periods of extreme temperature. While federal agencies are budgeted to provide emergency response and disaster relief, these allocations are usually short and supplemental appropriations have been required (\$120B in 2017-2018 alone, including \$17.4B to the Army Corps of Engineers).³¹ Still, some federal agencies including DoD have had to tap into their own budgets to support such relief efforts.

This highlights a persistent challenge of relying on the principle of allocative efficiency for programming, budgeting, and execution. It assumes reliable knowledge of the demand for services in advance so that funding can be applied to match. The complex and dynamic strategic environment makes such knowledge elusive. So, the question becomes how much risk is one willing to take in programming? If too little is allocated, there is risk in having to pursue supplemental appropriations, reallocate within programs, or simply eat emergencies out of one's own budget. If it appears that too much is allocated (e.g., an emergency has not happened during the execution year), there is risk of funds becoming misused or wasted, or of funds being taken away for other programs. Thus, a common approach to budgeting is to baseline the annual costs of a particular activity and adjust it incrementally according to what sounds reasonable given the overall budget. What was allocated last year might be increased to cover costs of inflation, for example. Or, an overall budget cut will result in a reduction of the same percentage across all activity budgets.

The budget levels should cause enterprise leaders to establish and enforce policies and guidelines that govern (or constrain) member actions. One example is an on-going efforts by DoD to enforce stricter controls over conference spending to include reductions in DoD members attending conferences (especially those not hosted by DoD), cancellation or consolidation of non-essential conference events, and mandatory reliance on telecommunication as a substitute means for collaboration and training.³² Policies in effect since 2012 include additional requirements to justify travel authorization requests and elevated approval authorities for conference hosting and attendance.³³

The reasons for imposing such controls included increased budget uncertainty, which necessarily limits how much is allocated to travel and other Department activities, and instances of fraud, waste, and abuse. A prime example of the latter was the aftermath of a 2010 scandal involving members of the General Services Administration who misused government travel funds with respect to an annual convention held in Las Vegas.³⁴ News of lavish meals, excessive gifts, and improper use of contracted services resulted in a one-year investigation that led to the dismissal or resignation of several senior GSA officials, and brought about significant policy changes government-wide.³⁵

Although clearly laudable, policy changes often have side-effects. In the above case, critics have alleged that the second-order effects of stricter travel policies had a significant negative impact on other government employees fulfilling their duties, and the costs of enforcing such policies has more than offset any anticipated cost savings.³⁶ For example, the additional approvals needed can cause delays in finalizing air travel,

³⁰ Charlie Osborne, "Lack of Funding Exposes US Federal Agencies to High Data Breach Risks," *ZDNet*, February 22, 2018, <https://www.zdnet.com/article/us-suffers-highest-data-breaches-of-government-agencies-worldwide/> (accessed December 10, 2018).

³¹ Rocio Cara Labrador, "U.S. Disaster Relief at Home and Abroad," *Council on Foreign Relations*, August 15, 2018, <https://www.cfr.org/background/us-disaster-relief-home-and-abroad> (accessed December 10, 2018).

³² U.S. Department of Defense Chief Management Officer, "DoD Conference Policies and Controls," *CMO.Defense.gov*, <https://cmo.defense.gov/Products-and-Services/DoD-Conference-Policies-and-Controls/> (accessed December 10, 2018).

³³ *Ibid.*

³⁴ Lisa Rein and Joe Davidson, "GSA Chief Resigns Amid Reports of Excessive Spending," *Washington Post*, April 2, 2012,

https://www.washingtonpost.com/politics/gsa-chief-resigns-amid-reports-of-excessive-spending/2012/04/02/gIQAblNNrS_story.html?utm_term=.53611a9c3707 (accessed December 6, 2018).

³⁵ Lisa Rein, "What Happened with the GSA in Vegas Stymies Federal Workers," *Washington Post*, February 8, 2015, https://www.washingtonpost.com/politics/clampdown-after-gsa-scandal-puts-some-federal-workers-in-a-pinch/2015/02/08/d8217240-a5a4-11e4-a7c2-03d37af98440_story.html?utm_term=.b0bada30df99 (accessed December 6, 2018).

³⁶ Lisa Rein, "The Federal Government is Spending a Lot of Money Trying Not to Spend Money on Travel," *Washington Post*, March 23, 2015, <https://www.washingtonpost.com/news/federal-eye/wp/2015/03/23/consequences-of-the-federal-travel->

during which time the airfare can dramatically increase, especially if approval comes late.³⁷

Enterprise-level policies can also add hidden costs to individual transactions, essentially shifting the costs in time and money to members. For example, a decision to elevate approval authorities for defense travel can incur hidden costs associated with increased time to process travel authorizations, or a change to acquisition regulations might place additional burdens on vendors, increasing their costs of doing business and therefore passing on higher costs to the government. Or, ineffectiveness of individual transactions (e.g., systemic pay problems) could be underwritten at policy level because they might incur no specific tangible costs, rather the risks (time and money) are passed on to the individual service member. These costs can be overlooked because personnel is viewed as a sunk cost – meaning that the amount of funds spent on manpower does not change no matter how the time is spent. This highlights challenges with allocative efficiency – costs not translating into changes in cash flow are overlooked.

What is the impact? According to a McKinsey and Co. study of government transformation efforts, budget cuts alone do not provide a useful forcing function for change.³⁸ Reliance on cutting budgets can have the opposite effect, where the hidden costs of these cuts eventually emerge as actual costs – which could include offsets to savings realized, increase demands on individual members leading to burnout and turnover, increased errors and associated liabilities, or overuse and degradation of facilities and infrastructure.³⁹ Centralization of an activity for the purposes of increasing efficiency is particularly prone to significant hidden costs, especially when the centralized authority fails to take into account the context of each individual transaction and does not show the same levels of urgency in performing such transactions.⁴⁰

It is therefore important to think critically about claims of cost savings due to a particular proposed policy or programming change. Cost

savings should constitute a net reduction in the overall expenditure of an activity, *including the realization of hidden costs associated with the change*. Again, there is no right answer on how to allocate funds properly given the increasing demand for public services, including national security, against greater budgetary uncertainty. The urgency to take action against a budget may well overcome any efforts at developing prudent solutions for spending challenges.

IMPLICATIONS

Senior leaders must be stewards of taxpayer resources, including the proper and prudent translation of funds, manpower, infrastructure, etc. into trained and ready forces for combatant commanders. Being solid financial managers is a necessary part of this role. Good programs improperly or incompletely executed are no better than poorly designed programs.

See Figure 1 for a table that shows the overall practice of *stewardship* and the *financial management* responsibilities underneath. Note how the descriptions vary as applied to difficult categories of DoD programs. An important takeaway is that decisions that make sense at the enterprise level could be counterproductive at the individual transactional level. Even the general philosophy underpinning government programs – allocative efficiency – can present difficulties for defense management decisions.

Senior leaders should therefore exercise critical thinking about claims of cost savings borne of a policy decision. What are the assumptions built into the claims of savings? What hidden costs might offset any cost reductions? What other effects might the policy have on the force's ability to do its mission?

Finally, it is imperative that senior leaders at all levels ensure that the processes and systems in place are used to their fullest. A great example is the problem of wasted resources due to not de-obligating funds that will be left unspent. Although individual transactions may only see

[clampdown-more-costs/?utm_term=.59e8bcb059ef](#) (accessed December 6, 2018).

³⁷ Ibid.

³⁸ Tera Allas, Roland Dillon, and Vasudha Gupta, "A Smarter Approach to Cost Reduction in the Public Sector," *McKinsey & Company*, <https://www.mckinsey.com/industries/public>.

[sector/our-insights/a-smarter-approach-to-cost-reduction-in-the-public-sector](#) (accessed December 10, 2018).

³⁹ For example, see Robert S. Kaplan and Derek A. Haas, "How Not to Cut Health Care Costs," *Harvard Business Review* 92, no. 11 (November 2014): 116-122.

⁴⁰ Galvin, "Centralization."

hundreds or thousands of dollars lost this way, when aggregated across the defense force the numbers could reach tens or hundreds of millions of dollars, funds needed to help improve training; pursue additional modernization; recapitalize materiel, facilities, and infrastructure; or satisfy any number of other DoD priorities. The goal is to waste no resources. The public expects this of senior leaders.

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Decision Space	Meanings of “Stewardship” and “Financial Management”	Among the Greatest Challenges
National Policy	<p>Stewardship = <i>Achievement of national objectives</i> within national ethics and norms and without unnecessary waste of resources Fin. Mgmt. = Annual execution of budgets as specified</p>	<p>Debt and deficits Political division, changes in priorities from one administration to next Federal, state, local policies/budgets</p>
Readiness Footprint <i>Unit of Analysis = Base</i>	<p>Stewardship = <i>Preparedness for national response</i> through facilities, infrastructure, global posture, energy, sustainment, mobilization, without unnecessary waste of resources Fin. Mgmt. = Allocative efficiency (annual execution of budgets as allocated and specified) plus overall cost containment</p>	<p>Real-estate management, costs and risks of overseas presence, latency in MILCON, deterioration, meaning of “excess,” training requirements</p>
Modernization <i>Unit of Analysis = Program</i>	<p>Stewardship = <i>Successful fielding of modernized systems</i> with respect to all of DOTMLPF without unnecessary waste of resources Fin. Mgmt. = Allocative efficiency plus overall cost containment</p>	<p>Too many to list: technical readiness, political uncertainties, resource certainty, changes in global environment, defense industrial base</p>
Personnel <i>Unit of Analysis = Individual</i>	<p>Stewardship = <i>Spaces and faces in all the right places</i> such that service members are recruited, trained & educated, equipped, stationed, and fully ready to accomplish missions; families are provided for Fin. Mgmt. = Allocative efficiency plus overall cost containment</p>	<p>Too many to list: costs of recruitment & turnover, bonuses, incentives, costs of healthcare (SMs, families, veterans), mil-civ-contract mix</p>
Theater Strategies <i>Unit of Analysis = Bilateral relation</i>	<p>Stewardship = <i>Accomplishment of theater goals in support of national security objectives</i> which encouraging partner development of security capacity and assumption of full responsibilities for their own security, providing access and opportunity for other US agencies or entities Fin. Mgmt. = Cost containment, maximize benefit-cost ratio</p>	<p>Risks and uncertainties associated with bilateral relations, and their aggregation to theater level; artificial capping of resources for palatability; (too) easy acceptance of risk</p>
Campaigns (“Big War”) <i>Unit of Analysis = Campaign</i>	<p>Stewardship = <i>Accomplishment of campaign objectives in support of national security objectives</i> under the laws of warfare while avoiding the unnecessary waste or misuse of resources Fin. Mgmt. = Overall cost containment, maximize cost certainty</p>	<p>Lowballing the resource requirements for palatability; accepting too much risk; high uncertainty of outcome; resource decisions tied to political will</p>
Other Ops (e.g., PK, stability ops) <i>Unit of Analysis = Operation</i>	<p>Stewardship = <i>Accomplishment of military objectives in support of national security objectives</i> while avoiding the unnecessary waste or misuse of resources Fin. Mgmt. = Overall cost containment, maximize cost certainty</p>	<p>Same as campaigns, but risk tolerance decreases faster over time; political will more fragile; premature reductions could lead to costly requirements to surge</p>

Service-level efforts that provide trained and ready forces to enable...

...joint and combined military operations and activities

Figure 1. Categories of Defense Enterprise Activities and Meanings of Financial Management (by author)