UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

DOD TRANSFORMATION

CHALLENGES AND OPPORTUNITIES

The Honorable David M. Walker
Comptroller General of the United States

**Defense Acquisition University's
PEO/SYSCOM
Ft. Belvoir, Virginia
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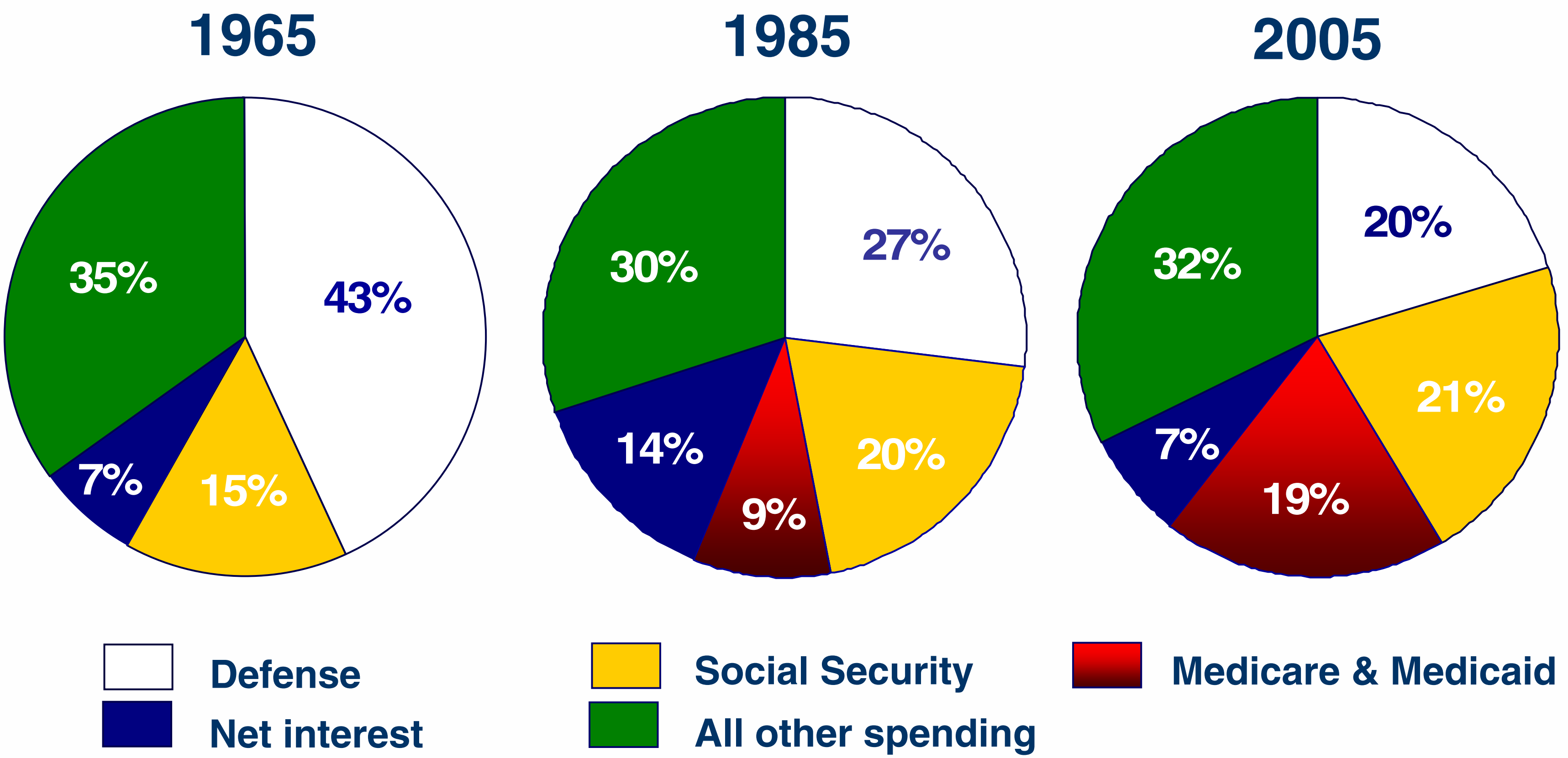
The Case for Change

The federal government is on a "burning platform," and the status quo way of doing business is unacceptable for a variety of reasons, including:

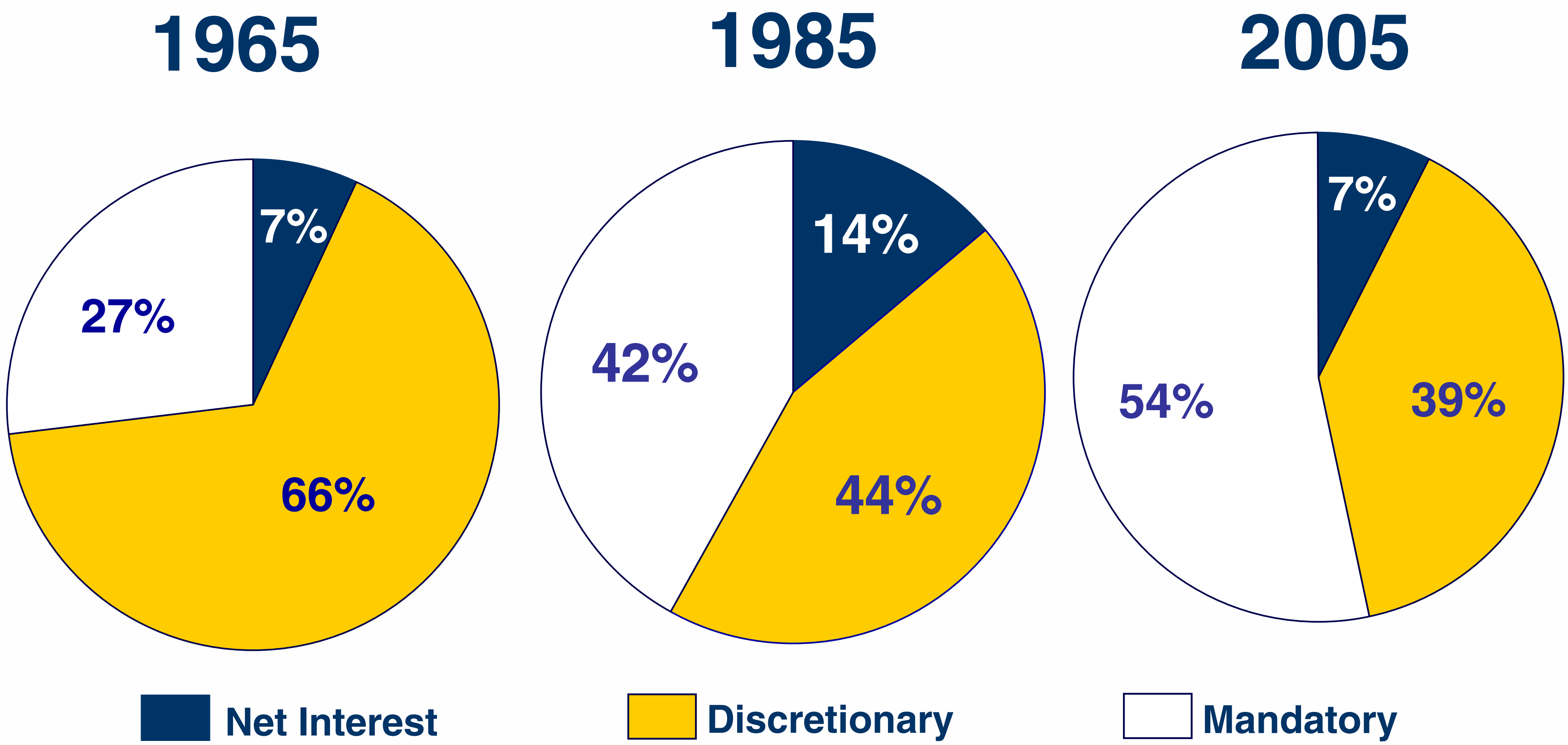
- Past fiscal trends and significant long-range challenges
- Rising public expectations for demonstrable results and enhanced responsiveness
- Selected trends and challenges having no boundaries
- Additional resource demands due to Iraq, Afghanistan, incremental homeland security needs, and recent natural disasters in the United States
- Numerous government performance/accountability and high risk challenges
- Outdated federal organizational structures, policies, and practices

Composition of Federal Spending



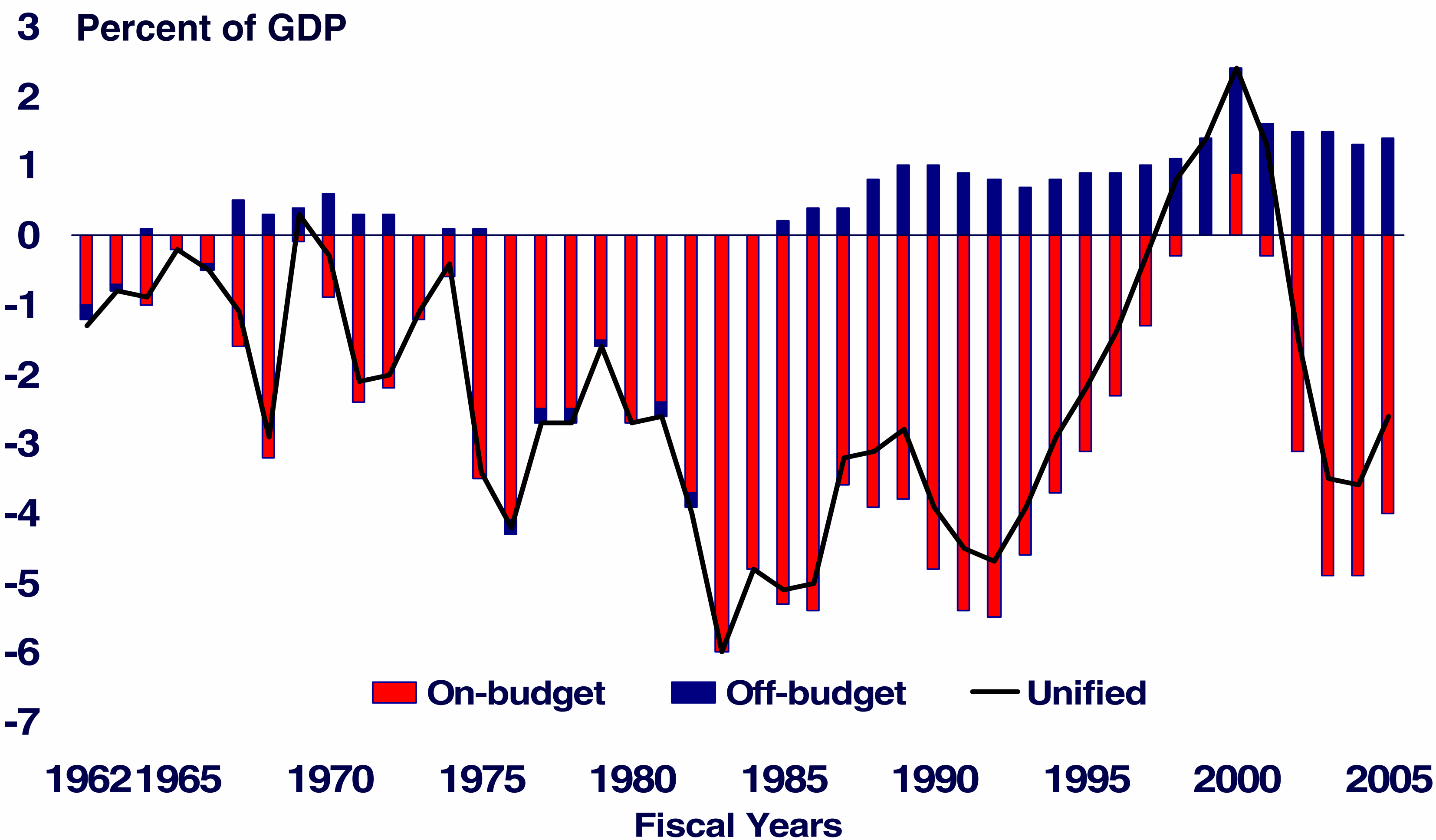
Source: Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

Surplus or Deficit as a Share of GDP
Fiscal Years 1962-2005



Source: Office of Management and Budget

Fiscal Year 2004 and 2005 Deficits and Net Operating Costs

	Fiscal Year 2004	Fiscal Year 2005
	($ Billion)	
On-Budget Deficit	(568)	(494)
Off-Budget Surplus*	155	175
Unified Deficit	(413)	(318)
Net Operating Cost	(616)	(760)

*Includes $151 billion in fiscal year 2004 and $173 billion in fiscal year 2005 in Social Security surpluses and $4 billion in fiscal year 2004 and $2 billion in fiscal year 2005 in Postal Service surpluses.

Sources: The Office of Management and Budget and the Department of the Treasury.

Estimated Fiscal Exposures
($ trillions)

	2000	2005
• **Explicit liabilities**	**$6.9**	**$9.9**
• Publicly held debt • Military & civilian pensions & retiree health • Other		
• **Commitments & contingencies**	**0.5**	**0.9**
• E.g., PBGC, undelivered orders		
• **Implicit exposures**	**13.0**	**35.6**
• Future Social Security benefits	3.8	5.7
• Future Medicare Part A benefits	2.7	8.8
• Future Medicare Part B benefits	6.5	12.4
• Future Medicare Part D benefits	--	8.7
Total	**$20.4**	**$46.4**

Source: U.S. government's consolidated financial statements (CFS).

Note: Estimates for Social Security and Medicare are at present value as of January 1 of each year as reported in the CFS and all other data are as of September 30.

How Big is Our Growing Fiscal Burden?

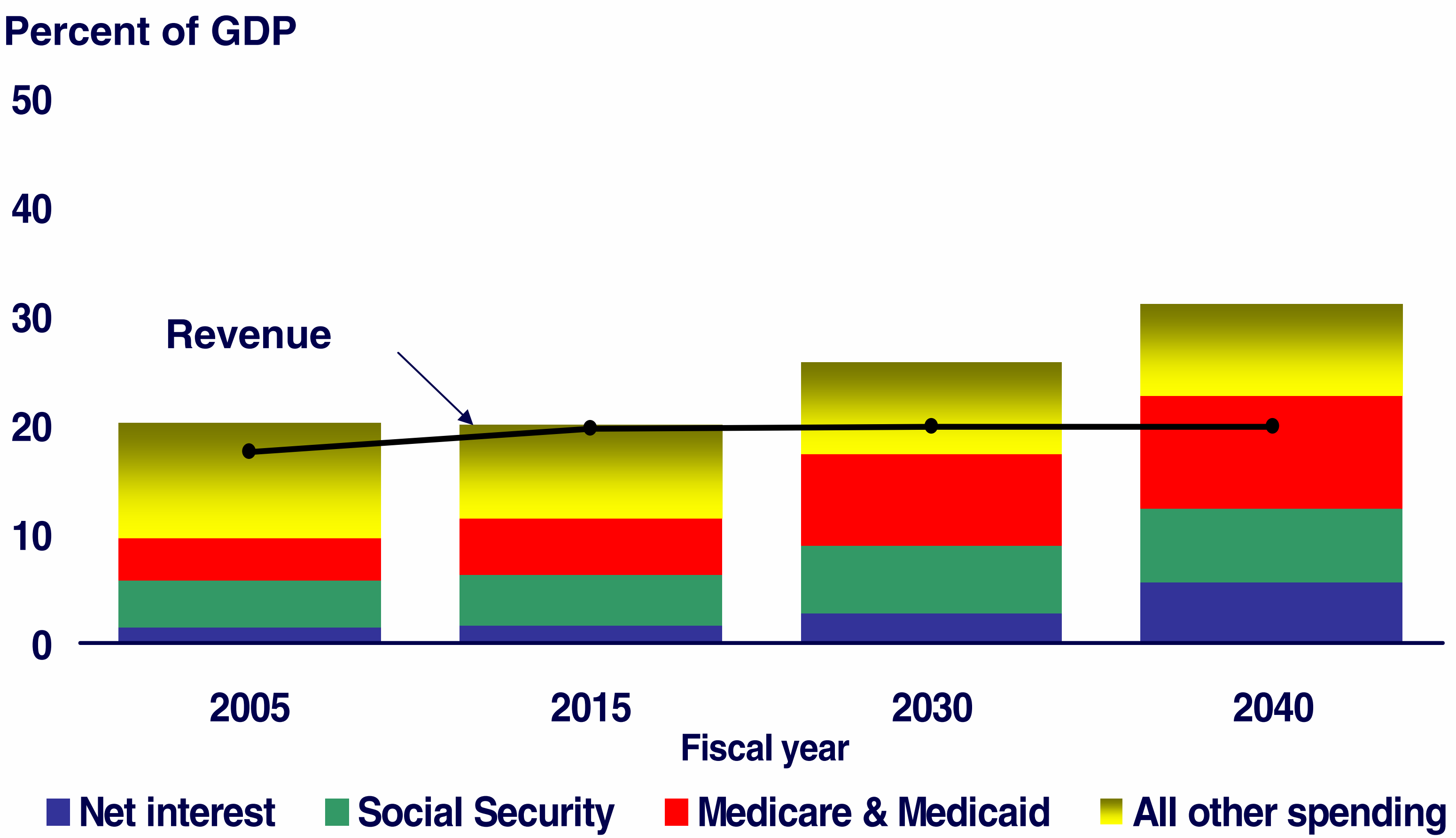
Our total fiscal burden can be translated and compared as follows:

Total fiscal exposures	**$46.4 trillion**
Total household net worth[1]	**$51.1 trillion**
Burden/Net worth ratio	**91 percent**
Burden[2]	
Per person	**$156,000**
Per full-time worker	**$375,000**
Per household	**$411,000**
Income	
Median household income[3]	**$44,389**
Disposable personal income per capita[4]	**$30,431**

Notes: (1) Federal Reserve Board, Flow of Funds Accounts, Table B.100, 2005:Q3 (Dec. 8, 2005); (2) Burdens are calculated using total U.S. population as of 9/30/05, from the *U.S. Census Bureau,* full-time workers for 2004, reported by the Bureau of Economic Analysis, in NIPA table 6.5D (Aug. 4, 2005); and households for 2004, reported by the U.S. Census Bureau, in Income Poverty & Health Insurance Coverage in the US: 2004 (Aug. 2005); (3) U.S. Census Bureau, Income Poverty & Health Insurance Coverage in the US: 2004 (Aug. 2005); and (4) Bureau of Economic Analysis, Personal Income and Outlays: October 2005, table 2, 2005:Q3, (Dec.1, 2005).

Sources: GAO analysis.

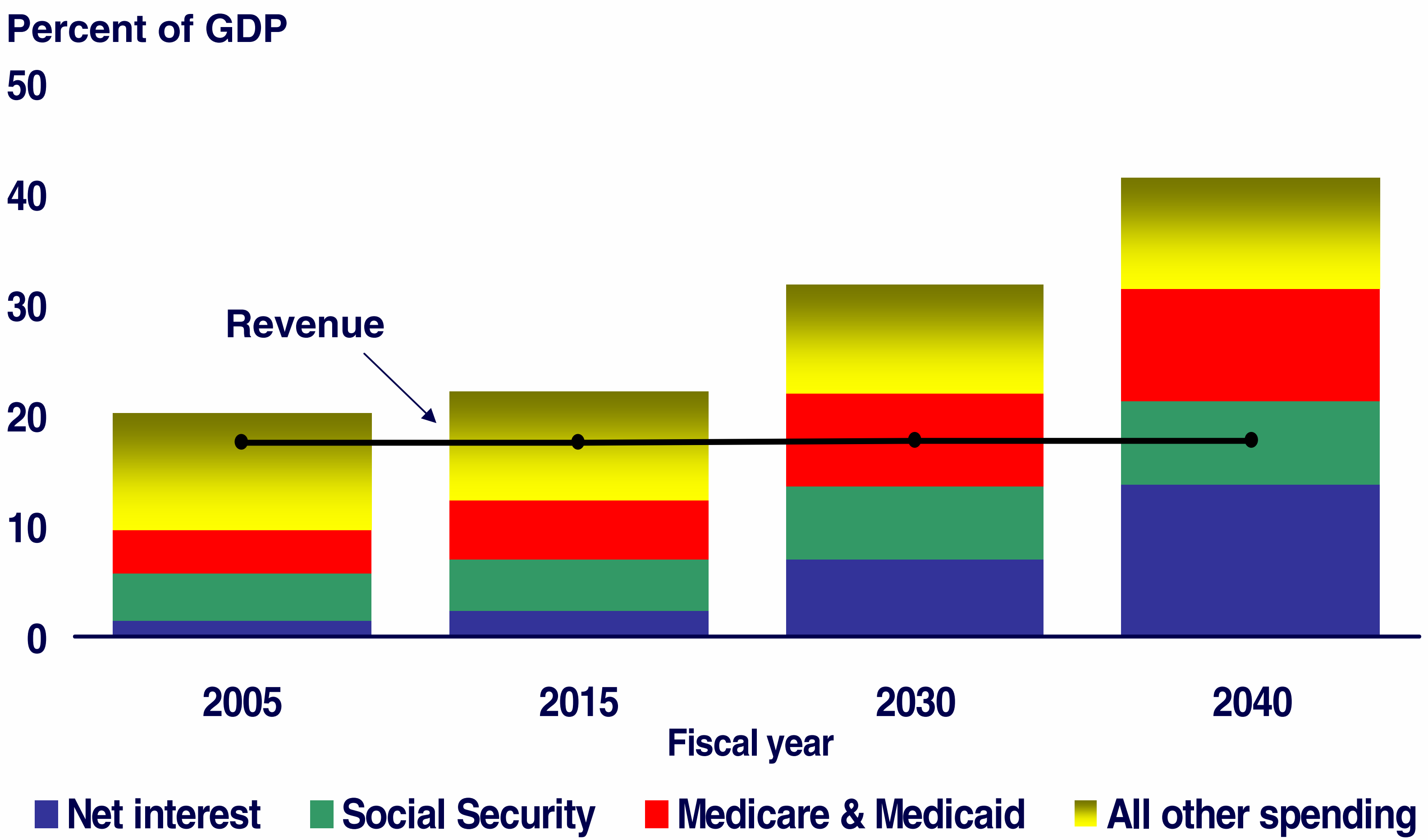
Composition of Spending as a Share of GDP
Under Baseline Extended



Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2016 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2016, revenue as a share of GDP is held constant.

Source: GAO's August 2006 analysis.

Composition of Spending as a Share of GDP
(Assuming Discretionary Spending Grows with GDP After 2006 and All Expiring Tax Provisions are Extended)



Source: GAO's August 2006 analysis.

Current Fiscal Policy Is Unsustainable

- **The "Status Quo" is Not an Option**
  - We face large and growing structural deficits largely due to known demographic trends and rising health care costs.
  - GAO's simulations show that balancing the budget in 2040 could require actions as large as
    - Cutting total federal spending by 60 percent or
    - Raising federal taxes to 2 times today's level
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
  - Closing the current long-term fiscal gap based on reasonable assumptions would require real average annual economic growth in the double digit range every year for the next 75 years.
  - During the 1990s, the economy grew at an average 3.2 percent per year.
  - As a result, we cannot simply grow our way out of this problem. Tough choices will be required.

The Way Forward:
A Three-Pronged Approach

1. Strengthen Budget and Legislative Processes and Controls

2. Improve Financial Reporting and Performance Metrics

3. Fundamental Reexamination & Transformation for the 21st Century (i.e., entitlement programs, other spending, and tax policy)

Solutions Require Active Involvement from both the Executive and Legislative Branches

Key National Indicators

- **WHAT**: A portfolio of economic, social, and environmental outcome-based measures that could be used to help assess the nation's and other governmental jurisdictions' position and progress
- **WHO**: Many countries and several states, regions, and localities have already undertaken related initiatives (e.g., Australia, New Zealand, Canada, United Kingdom, Oregon, Silicon Valley (California) and Boston)
- **WHY**: Development of such a portfolio of indicators could have a number of possible benefits, including
  - Serving as a framework for related strategic planning efforts
  - Enhancing performance and accountability reporting
  - Informing public policy decisions, including much needed baseline reviews of existing government policies, programs, functions, and activities
  - Facilitating public education and debate as well as an informed electorate
- **WAY FORWARD**: Consortium of key players housed by the National Academies domestically and related efforts by the OECD and others internationally.

Key National Indicators:
Where the World's Sole Superpower Ranks

The United States may be the only superpower, but compared to most other OECD countries on selected key economic, social, and environmental indicators, on average, the U.S. ranks

16 OUT OF 28

OECD Categories for Key Indicators (2006 OECD Factbook)			
• Population/Migration	• Energy	• Environment	• Quality of Life
• Macroeconomic Trends	• Labor Market	• Education	• Economic Globalization
• Prices	• Science & Tech.	• Public Finance	

Source: 2006 OECD Factbook

GAO's Strategic Plan

Serving the Congress and the Nation
GAO's Strategic Plan Framework

Mission

GAO exists to support the Congress in meeting its constitutional responsibilities and to help improve the performance and ensure the accountability of the federal government for the benefit of the American people.

Themes	Goals & Objectives
Long-Term Fiscal Imbalance National Security Global Interdependence Changing Economy Demographics Science and Technology Quality of Life Governance	**Provide Timely, Quality Service to the Congress and the Federal Government to ...** **Address Current and Emerging Challenges to the Well-Being and Financial Security of the American People** *related to . . .* • Health care needs and financing • Education and protection of children • Work opportunities and worker protection • Retirement income security • Effective system of justice • Viable communities • Natural resources use and environmental protection • Physical infrastructure **Respond to Changing Security Threats and the Challenges of Global Interdependence** *involving . . .* • Emerging threats • Military capabilities and readiness • Advancement of U.S. interests • Global market forces **Help Transform the Federal Government's Role and How It Does Business to Meet 21st Century Challenges** *by assessing . . .* • Roles in achieving federal objectives • Government transformation • Key management challenges and program risks • Fiscal position and financing of the government **Maximize the Value of GAO by Being a Model Federal Agency and a World-Class Professional Services Organization** *in the areas of . . .* • Client and customer satisfaction • Strategic leadership • Institutional knowledge and experience • Process improvement • Employer of choice

Core Values

Accountability | Integrity | Reliability

Source: GAO.

GAO Strategic Plan 2004-2009

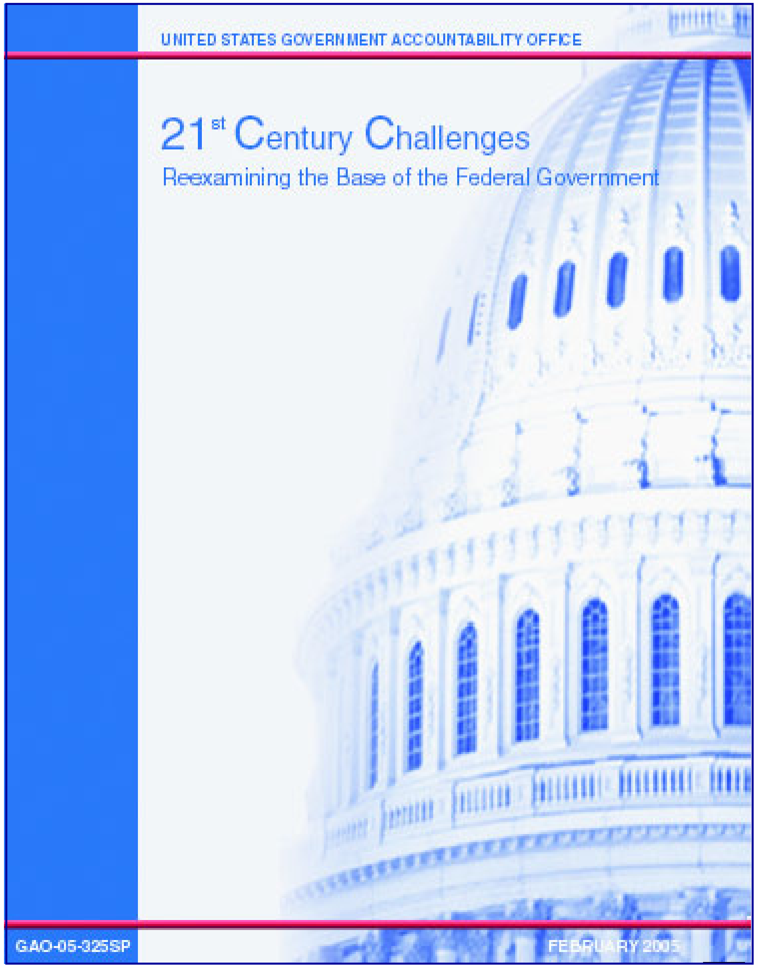
GAO's High-Risk List 2006

High-Risk Areas	Designated High Risk
Addressing Challenges in Broad-based Transformations	
Protecting the Federal Government's Information Systems and the Nation's Critical Infrastructures	1997
Strategic Human Capital Management[a]	2001
U.S. Postal Service Transformation Efforts and Long-Term Outlook[a]	2001
Managing Federal Real Property[a]	2003
Implementing and Transforming the Department of Homeland Security	2003
Establishing Appropriate and Effective Information-Sharing Mechanisms to Improve Homeland Security	2005
DOD Approach to Business Transformation[a]	2005
DOD Supply Chain Management (formerly Inventory Management)	1990
DOD Weapon Systems Acquisition	1990
DOD Business Systems Modernization	1995
DOD Financial Management	1995
DOD Support Infrastructure Management	1997
DOD Personnel Security Clearance Program	2005
Managing Federal Contracting More Effectively	
DOE Contract Management	1990
NASA Contract Management	1990
DOD Contract Management	1992
Management of Interagency Contracting	2005
Assessing the Efficiency and Effectiveness of Tax Law Administration	
Enforcement of Tax Laws[a, b]	1990
IRS Business Systems Modernization[c]	1995
Modernizing and Safeguarding Insurance and Benefit Programs	
Medicare Program[a]	1990
HUD Single-Family Mortgage Insurance and Rental Housing Assistance Programs	1994
Medicaid Program[a]	2003
Modernizing Federal Disability Programs[a]	2003
Pension Benefit Guaranty Corporation Single-Employer Insurance Program[a]	2003
National Flood Insurance Program	**2006**
Other	
FAA Air Traffic Control Modernization	1995

[a] Legislation is likely to be necessary, as a supplement to actions by the executive branch, in order to effectively address this high-risk area.
[b] Two high-risk areas—Collection of Unpaid Taxes and Earned Income Credit Noncompliance—have been consolidated to make this area.
[c] The IRS Financial Management high-risk area has been incorporated into this high-risk area.

21st Century Challenges Report

- Provides background, framework, and questions to assist in reexamining the base
- Covers entitlements & other mandatory spending, discretionary spending, and tax policies and programs
- Based on GAO's work for the Congress
- Issued February 16, 2005



Twelve Reexamination Areas

MISSION AREAS

- Defense
- Education & Employment
- Financial Regulation & Housing
- Health Care
- Homeland Security
- International Affairs
- Natural Resources, Energy & Environment
- Retirement & Disability
- Science & Technology
- Transportation

CROSSCUTTING AREAS

- Improving Governance
- Reexamining the Tax System

Generic Reexamination Criteria and Sample Questions

elevance of purpose and the federal role

- Why did the federal government initiate this program and what was the government trying to accomplish?
- Have there been significant changes in the country or the world that relate to the reason for initiating it?

leasuring success

- Are there outcome-based measures? If not, why?
- If there are outcome-based measures, how successful is it based on these measures?

argeting benefits

- Is it well targeted to those with the greatest needs and the least capacity to meet those needs?

ffordability and cost effectiveness

- Is it using the most cost-effective or net beneficial approaches when compared to other tools and program designs?

est practices

- Is the responsible entity employing prevailing best practices to discharge its responsibilities and achieve its mission?

Illustrative 21st Century Questions:
National Defense

- How should the historical allocation of resources across services and programs be changed to reflect the results of a forward-looking comprehensive threat/risk assessment as part of DOD's capabilities-based approach to determining defense needs?

- Can DOD afford to invest in transformational systems such as the Future Combat System and national missile defense at the same time it continues to pursue large investments in legacy systems such as the F-22A and new systems like the Joint Strike Fighter, especially if cost growth and schedule delays continue at historical rates?

- Given the global availability of rapidly advancing technology, does DOD need to reconsider its approach for identifying critical technologies and protecting those technologies from being exploited in order to maintain its military superiority?

Illustrative 21st Century Questions:
National Defense

- Given the growing encumbrance of pay and benefit costs, especially health care, within DOD's budget, how might DOD's recruitment, retention, and compensation strategies (including benefit programs) be reexamined and revised to ensure that DOD maintains a total military and civilian workforce with the mix of skills needed to execute the national security strategy while using resources in a more targeted, evidence-based, and cost-effective manner?

- Do the role, size, and structure of forces and capabilities comprising the strategic triad need to be adjusted to meet the challenges of providing strategic deterrence in the new security and fiscal environment?

- Does DOD need to create a senior management position responsible and accountable for taking a strategic, integrated, and sustained approach to managing the day-to-day business operations of the department, including ongoing efforts to transform DOD's business operations and address the many related and longstanding high-risk areas? Should specific qualifications requirements and periods of tenure or terms be established for selected DOD positions related to key business operations?

DOD Lacks An Affordable Plan to Balance Current Requirements With Investments in New Capabilities

- **DOD needs to reexamine its force strategies as well as its structure and business processes to meet 21st century challenges**

- **DOD's plans to transform its military capabilities may not be affordable or sustainable**

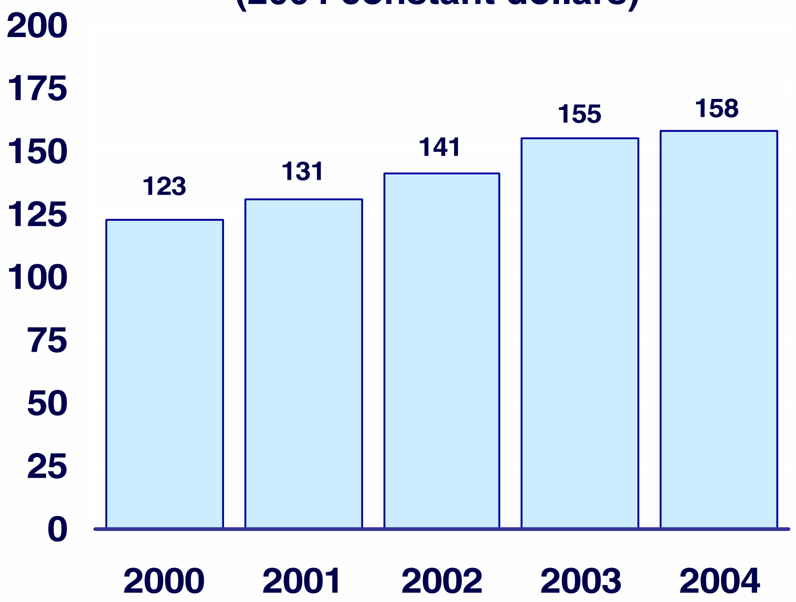
- **DOD's efforts to transform its business systems and processes will take many years to achieve**

Active Duty Personnel Pay and Benefits Need To Be Reexamined and Revised

- The cost of active duty pay and benefits was $158 billion in fiscal year 2004 and growing.
- Enhanced pay and benefits, including health care costs, increased costs to an average of $111,783 per person.
- DOD needs to assess the affordability and sustainability of the compensation system and the reasonableness and appropriateness of the allocation to cash and benefits and whether changes could more efficiently achieve recruiting and retention goals.

Total Compensation Costs for Fiscal Years 2000-2004

(2004 constant dollars)



Source: GAO-05-798

[1]Our calculations include supplemental funding for the Global War on Terrorism. Since fiscal year 2002 over 100,000 mobilized reservists were paid out of the cash compensation. If you considered these personnel, the average costs to provide compensation would be about $5,000 per capita lower.

DOD Continues to Confront Pervasive, Longstanding Management Problems Related to Its Business Operations

- **Management weaknesses cut across all of DOD's major business areas, and its approach to business transformation was designated as high risk in 2005**
- **Examples of longstanding issues include:**
  - Supply chain management has been designated high risk since 1990
  - Weapons System Acquisition was also designated high risk in 1990
  - Financial Management has been designated as high-risk since 1995

Selected Potential DOD Transformation Related Actions

- Revise the current approach to developing national military strategy (e.g., order, integration)
- Take a longer range, and more enterprise-wide approach to program planning and budget integration (e.g., life cycles, opportunity costs)
- Employ a more strategic and integrated approach to business information system efforts and financial audit initiatives
- Differentiate between war fighting and business systems development, implementation, and maintenance (e.g., resource control, project approval)
- Focus on achieving real success in connection with financial management efforts (e.g., systems, controls, information, compliance and opinions)
- Employ a total force management approach to planning and execution (e.g., military, civilian, contractors)

Selected Potential DOD Transformation Related Actions (cont'd)

- Get the design and implementation of the NSPS right, including modernizing and integrating the DOD, Service, domain, unit, and individual performance measurement and reward systems
- Revise the process for developing and communicating key changes (e.g., DOD transformation, NSPS)
- Reduce the number of layers, silos, and footprints
- Recognize the difference between approving and informing
- Review and revise current military compensation policies and practices (e.g., more targeted and market-based)
- Strengthen emphasis on horizontal and external activities (e.g., partnerships)
- Create a Chief Management Officer to drive the business transformation process

Systemic Defense Acquisition Challenges

1. **Service budgets are allocated largely according to top line historical percentages rather than Defense-wide strategic assessments and current and likely resource limitations.**

2. **Capabilities and requirements are based primarily on individual service wants versus collective Defense needs** (i.e. based on current and expected future threats) that are both affordable and sustainable over time.

3. **Defense consistently over-promises and under-delivers in connection with major weapons, information, and other systems** (i.e. capabilities, costs, quantities, schedule).

4. **Defense often employs a "plug and pray approach" when costs escalate** (i.e. divide total funding dollars by cost per copy, plug the number that can be purchased, then pray that Congress will provide more funding to buy more quantities).

5. **Congress sometimes forces the department to buy items** (e.g. weapons systems) **and provide services** (e.g. additional health care for non-actives) **that the department does not want and we cannot afford.**

Systemic Defense Acquisition Challenges (cont'd)

6. **DOD tries to develop high risk technologies after programs start instead of setting up funding, organizations, and processes to conduct high risk technology development activities in low cost environments** (i.e. technology development is not separated from product development). **Program decisions to move into design and production are made without adequate standards or knowledge.**

7. **Program requirements are often set at unrealistic levels, then changed frequently as recognition sets in that they cannot be achieved.** As a result, too much time passes, threats may change, and/or members of the user and acquisition communities may simply change their mind. The resulting program instability causes cost escalation, schedule delays, fewer quantities and reduced contractor accountability.

8. **Contracts, especially service contracts, often do not have definitive or realistic requirements at the outset in order to control costs and facilitate accountability.**

9. **Contracts typically do not accurately reflect the complexity of projects nor appropriately allocate risk between the contractors and the taxpayers** (e.g. cost plus, cancellation charges).

10. **Key program staff rotate too frequently thus promoting myopia and reducing accountability** (i.e. tours based on time versus key milestones). **Additionally, the revolving door between industry and the Department presents potential conflicts of interest.**

Systemic Defense Acquisition Challenges (cont'd)

11. **The acquisition workforce faces serious challenges** (e.g. size, skills, knowledge, succession planning).

12. **Incentive and award fees are often paid based on contractor attitudes and efforts versus positive results** (i.e. cost, quality, schedule).

13. **Inadequate oversight is being conducted by both the Defense Department and the Congress which results in little to no accountability for recurring and systemic problems.**

14. **Some individual program and funding decisions made within the Department and by the Congress serve to undercut sound policies.**

15. **Lack of a professional, term-based CMO at DOD serves to slow progress on defense transformation and reduce the chance of success in the acquisitions/contracting and other key business areas.**

Key Leadership Attributes Needed for These Challenging and Changing Times

- ***Courage***
- ***Integrity***
- ***Creativity***
- ***Stewardship***

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