



Transforming to Meet
**21ST CENTURY
CHALLENGES**

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of the United States

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Defense Acquisition University
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The Case for Change

- **Government is on a “burning platform,” and the status quo way of doing business is unacceptable for a variety of reasons, including:**
 - A large number of “high-risk areas”
 - 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
 - Government performance/accountability and high risk challenges, including the lack of effective human capital strategies

GAO's High- Risk List

2005

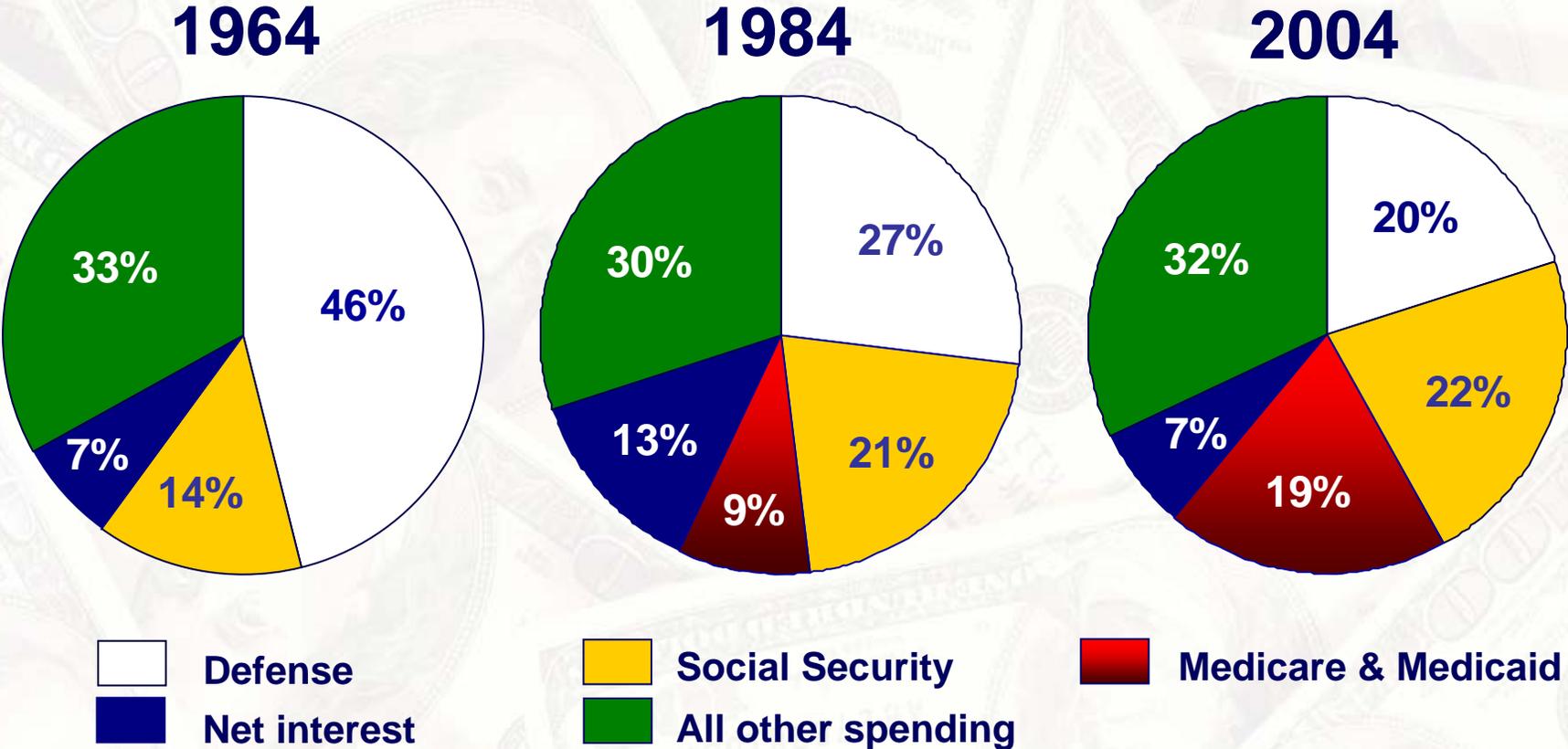
| High-Risk Areas | Designated High Risk |
|--|----------------------|
| Addressing Challenges in Broad-based Transformations | |
| Protecting the Federal Government's Information Systems and the Nation's Critical Infrastructures | 1997 |
| Strategic Human Capital Management ^a | 2001 |
| U.S. Postal 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 |
| 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.

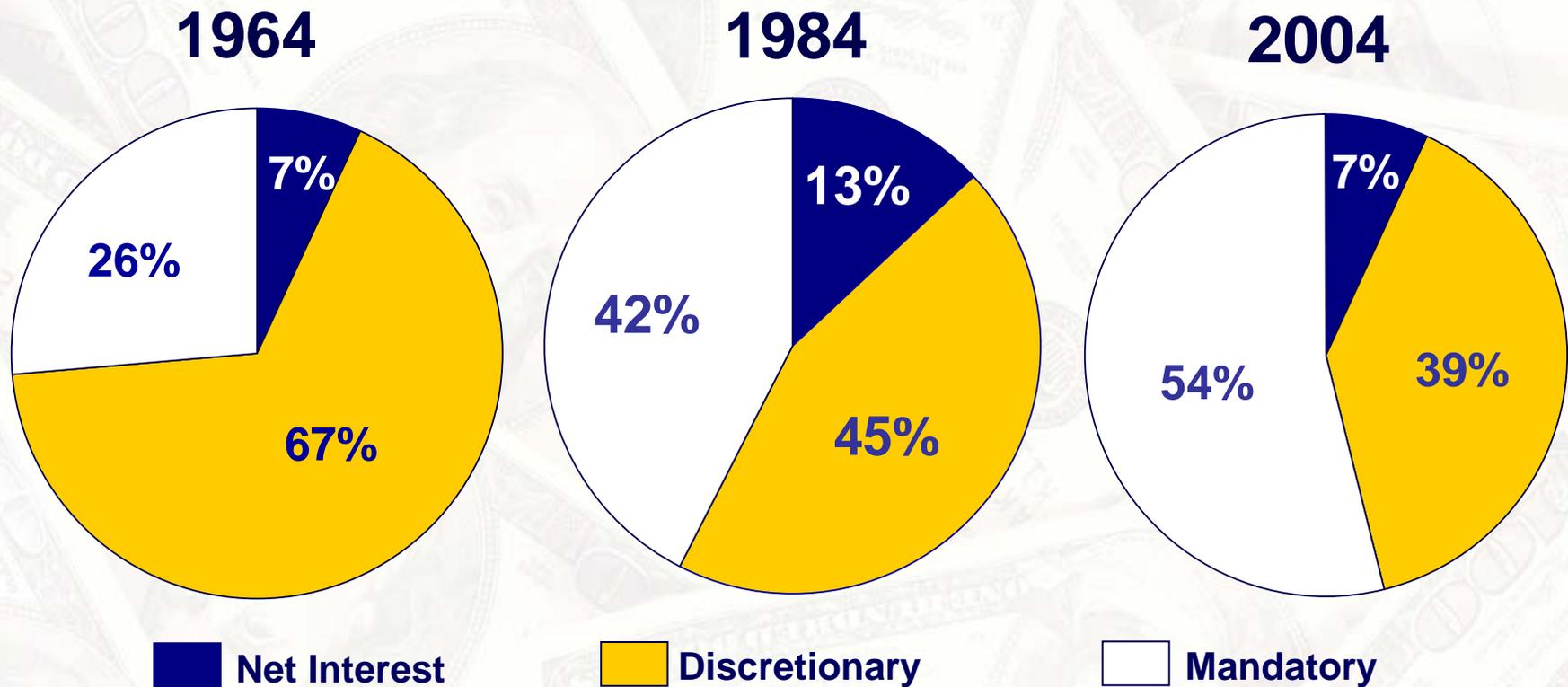
^c The IRS Financial Management high-risk area has been incorporated into this high-risk area.

Composition of Federal Spending



Source: Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

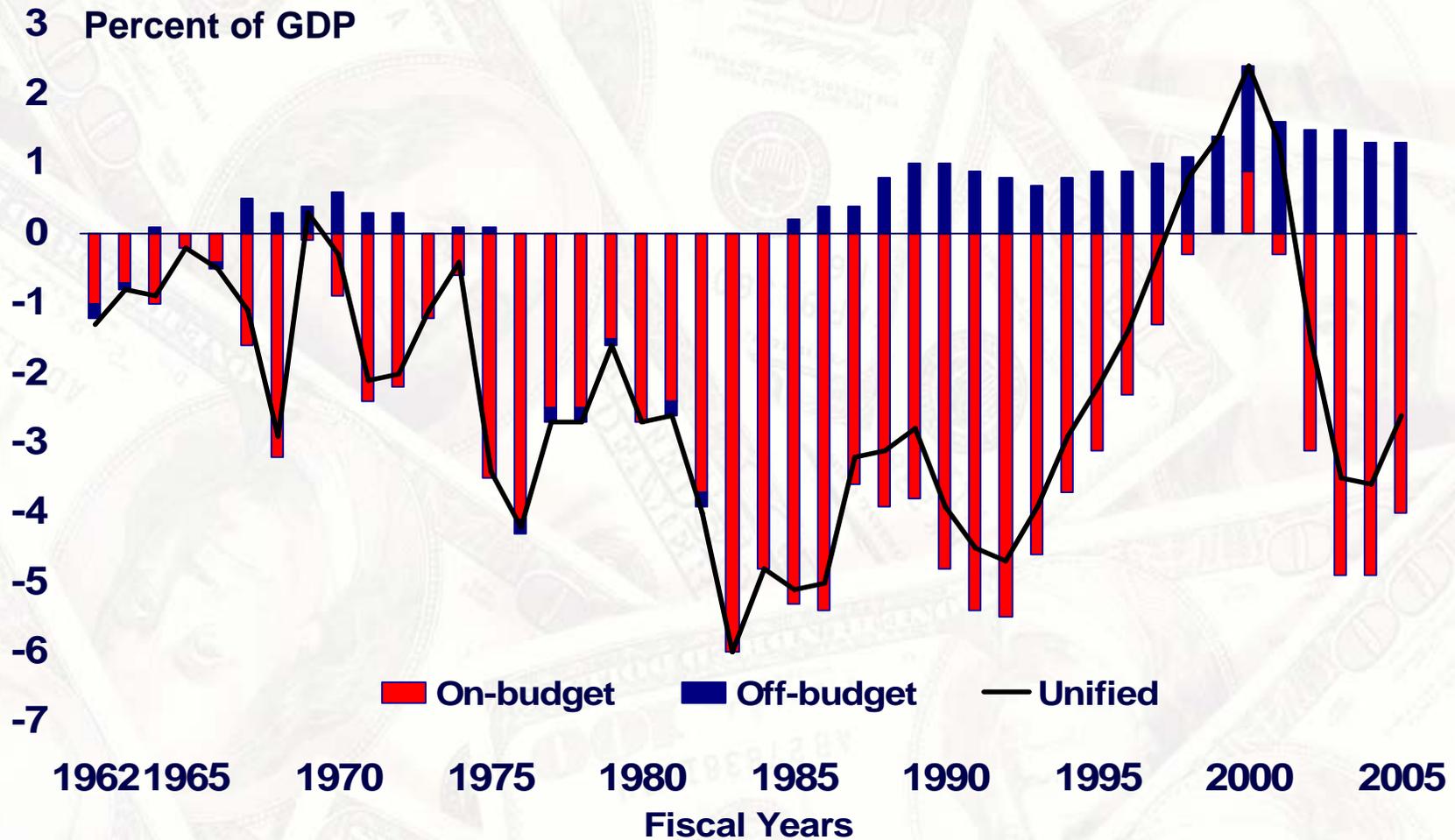
Fiscal Year 2004 and 2005 Deficits

| | Fiscal Year 2004 | | Fiscal Year 2005 | |
|---------------------|------------------|----------|------------------|----------|
| | \$ Billion | % of GDP | \$ Billion | % of GDP |
| On-Budget Deficit | (567) | (4.9) | (494) | (4.0) |
| Off-Budget Surplus* | 155 | 1.3 | 175 | 1.4 |
| Unified Deficit | (412) | (3.6) | (319) | (2.6) |

*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.

Surplus or Deficit as a Share of GDP

Fiscal Years 1962-2005



Source: Office of Management and Budget and Congressional Budget Office.

Estimated Fiscal Exposures

(in \$ trillions)

| | 2000 | 2002 | 2004 |
|--|---------------|---------------|---------------|
| • Explicit liabilities | \$6.9 | \$7.8 | \$9.1 |
| <ul style="list-style-type: none"> • Publicly held debt • Military & civilian pensions & retiree health • Other | | | |
| • Commitments & Contingencies | 0.5 | 0.8 | 0.9 |
| <ul style="list-style-type: none"> • E.g., PBGC, undelivered orders | | | |
| • Implicit exposures | 13.0 | 17.8 | 33.3 |
| <ul style="list-style-type: none"> • Future Social Security benefits | 3.8 | 4.6 | 5.2 |
| <ul style="list-style-type: none"> • Future Medicare Part A benefits | 2.7 | 5.1 | 8.5 |
| <ul style="list-style-type: none"> • Medicare Part B benefits | 6.5 | 8.1 | 11.4 |
| <ul style="list-style-type: none"> • Medicare Part D benefits | -- | -- | 8.1 |
| Total | \$20.4 | \$26.4 | \$43.3 |

Sources: Consolidated Financial Statements.

Note: Estimates for Social Security and Medicare are PV as of January 1 of each year as reported in the Consolidated Financial Statements and all other data are as of September 30. The 2005 Trustees Reports issued in March of this year show that the Social Security and Medicare exposures have increased as follows: Social Security increased to \$5.7 trillion, Medicare Part A increased to \$8.8 trillion, Medicare Part B increased to \$12.4 trillion and Part D increased to \$8.7 trillion. Totals may not add due to rounding.

How Big is Our Growing Fiscal Burden?

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

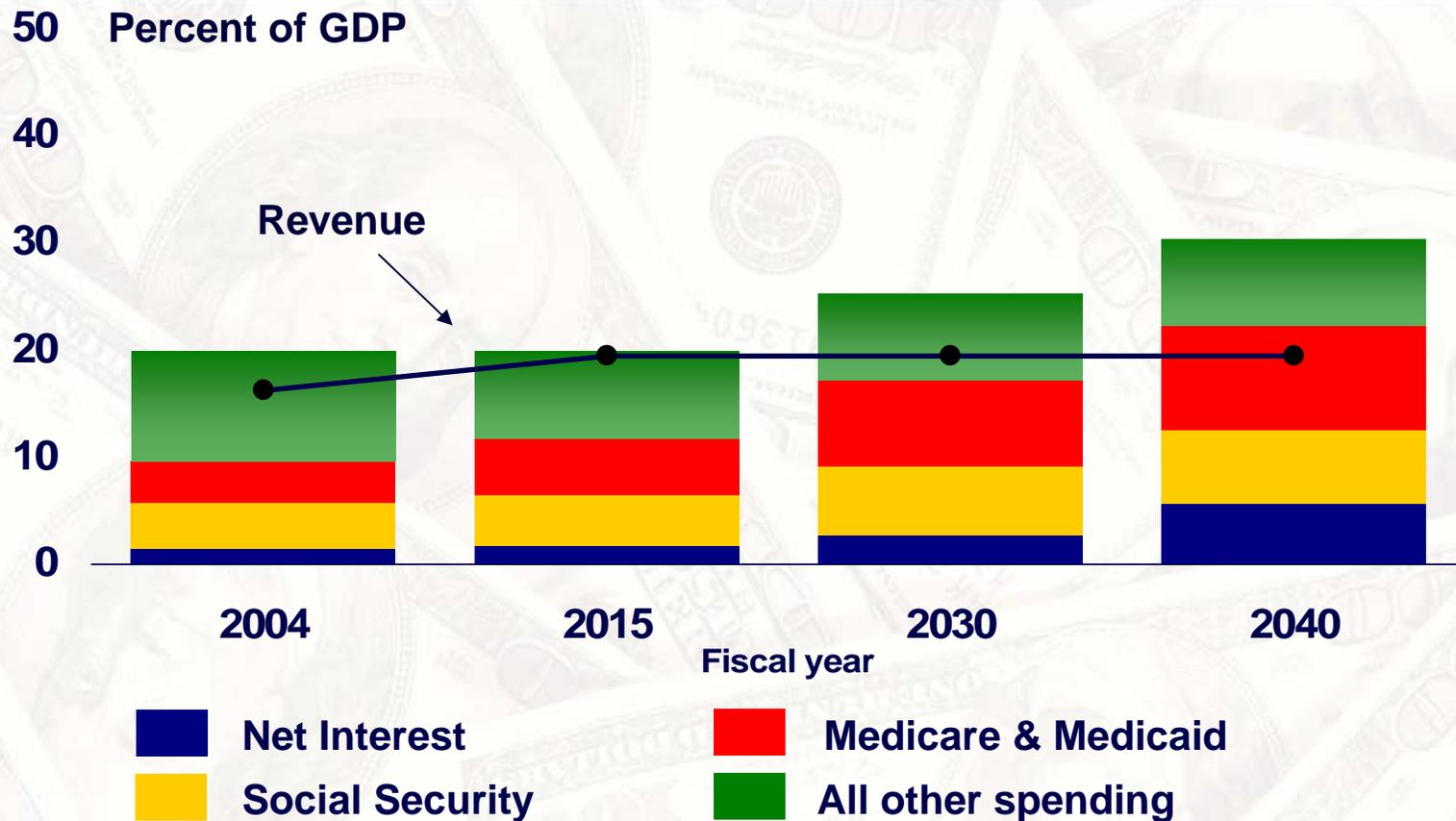
| | |
|--|------------------------|
| Total fiscal exposures | \$43.3 trillion |
| Total household net worth | \$48.5 trillion |
| Burden/Net worth ratio | 89 percent |
| Burden | |
| Per person | \$147,000 |
| Per full-time worker | \$350,000 |
| Per household | \$383,000 |
| Income | |
| Median household income | \$44,389 |
| Disposable personal income per capita | \$29,475 |

Note: Net worth and income data are calendar year 2004 levels.

Sources: Federal Reserve Board for household net worth; Census Bureau for median household income; and the Bureau of Economic Analysis for disposable personal income per capita.

Composition of Spending as a Share of GDP

Under Baseline Extended

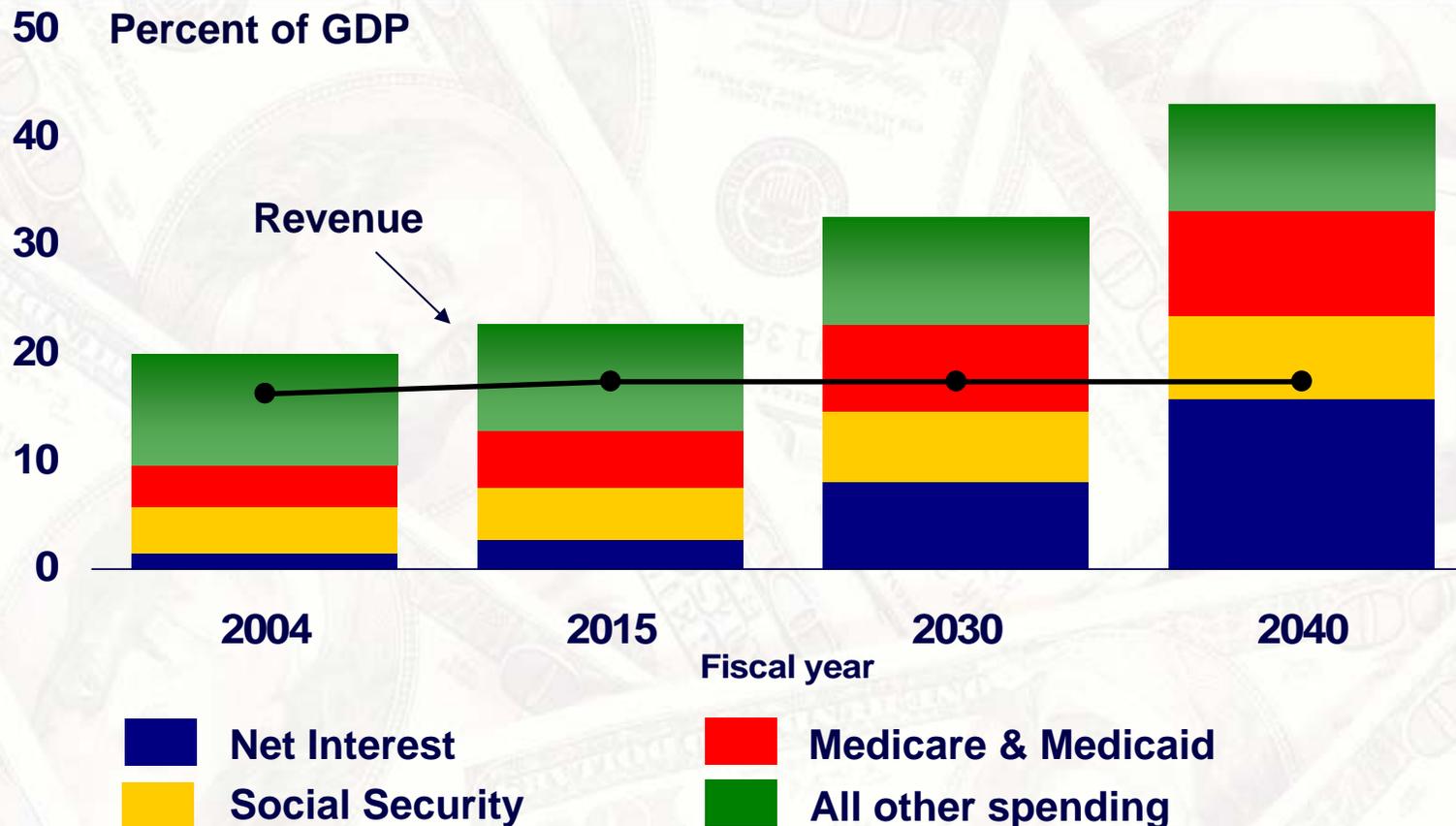


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

Source: GAO's August 2005 analysis.

Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP after 2005
and All Expiring Tax Provisions are Extended



Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

Source: GAO's August 2005 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 2.5 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: Three Pronged Approach

Re-impose Budget Controls

- Discretionary spending caps
- PAYGO rules on both sides of the ledger
- Mandatory spending triggers

Improve Accounting and Reporting and Metrics:

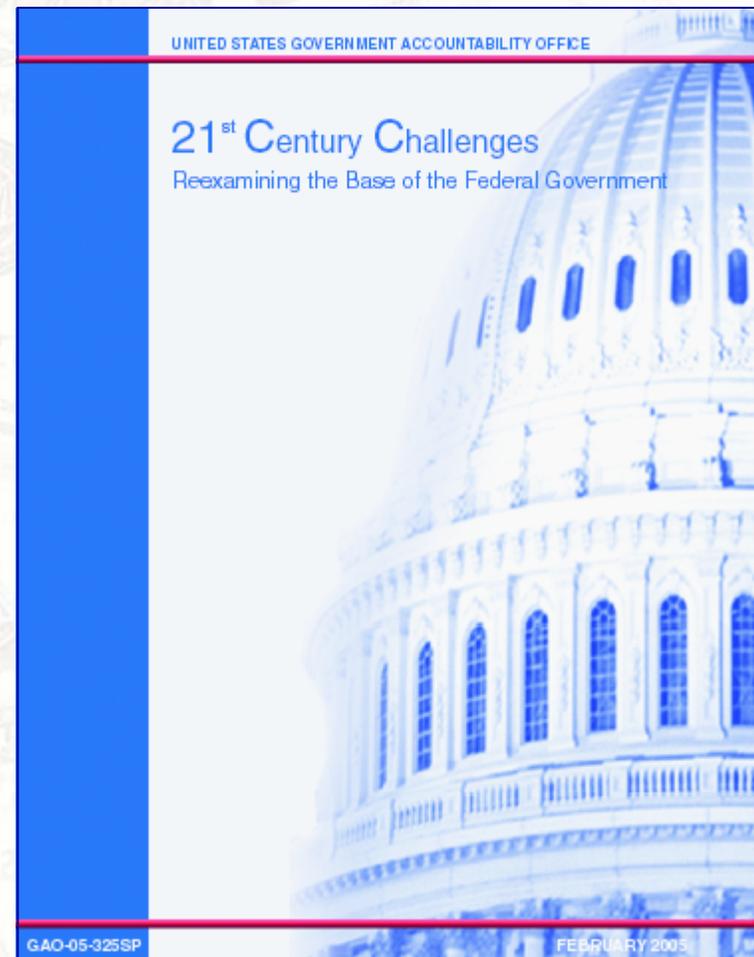
- Enhanced financial statement presentation
- Automatic present value disclosures for legislative debate on major tax and spending bills
- Develop key national (outcome-based) indicators

Re-examine Policies and Programs:

- Restructure existing entitlement programs
- Reexamine the base of discretionary and other spending
- Review and revise existing tax policy, including tax preferences and enforcement programs

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



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

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 FA-22 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?

Trans ***FORMATION***

Webster's definition

**An act, process, or instance of
change in structure appearance,
or character**

**A conversion, revolution,
makeover, alteration, or
renovation**

The Objective of Transformation

To create a more positive future by maximizing value and mitigating risk within current and expected resource levels

Transformation Has Different Dimensions

DOD

DHS

U. S. Postal Service

IRS

DOE

NASA

Information Sharing
Human Capital Strategy
Financial Management
Information Technology
Sourcing Strategy
Disability Programs
Real Property Management

Note: All of the above are on GAO's High Risk List to one extent or the other.

Transformation: A New Model for Government Organizations

Government organizations will need to:

- Become less hierarchical, process-oriented, stovepiped, and inwardly focused.
- Become more partnership-based, results-oriented, integrated, and externally focused.
- Achieve a better balance between results, customer, and employee focus.
- Work better with other governmental organizations, non-governmental organizations, and the private sector, both domestically and internationally, to achieve results.
- Focus on maximizing value, managing risk and enhancing responsiveness within current and expected resource levels.

Keys to Making Change Happen

- Commitment and sustained leadership
- Demonstrated need for change (i.e., burning platform)
- Start at the top and with the new people (transformation takes 7+ years)
- Process matters (e.g., employee involvement)—Don't fight a two-front war
- 15-percent rule
- Identifiable and measurable progress over time
- Communication, communication, communication
- Figure out what's right versus what's popular
- Patience, persistence, perseverance to pain before you prevail

Keys to Making Change Happen

Several other actions needed:

- Strategic Plan
- Core values
- Organizational alignment
- Recruiting, development, and succession planning strategies
- Modernizing and integrating institutional, unit and individualized performance measurement and reward systems
- Employee empowerment and effective communications

What Is DOD Transformation?

Creating the future of warfare and protecting our national security while improving how the department, including all of its various component parts, does business in order to support and sustain our position as the world's preeminent military power within current and expected resource limits.

Selected Cultural Challenges At DOD

- Past vs. future (e.g., threats)
- Today vs. tomorrow (e.g., budgets)
- Too many silos, layers, and players
- Get the money and spend the money (e.g., use it or lose it)
- Plug-and-pray approach to weapons acquisitions
- Too many outdated and non-integrated information systems
- Me vs. we (e.g., services)
- Approve vs. inform (e.g., deployments)

The Way Forward: Selected Potential DOD Related Actions

- Revise the current approach to developing national military strategy (e.g., order, integration)
- Take a longer range approach to program planning and budget integration (e.g., life cycles, opportunity costs)
- Employ a total force management approach to planning and execution (e.g., military, civilian, contractors)
- Revise the process for developing and communicating key changes (e.g., DOD transformation, NSPS legislative proposal)
- Reduce the number of layers, silos, and footprints
- Strengthen emphasis on horizontal and external activities (e.g., partnerships)
- Differentiate between war fighting and business systems development, implementation and maintenance (e.g., resource control, project approval)
- Make it okay to pull the plug or reduce quantities of weapon systems and information systems projects when the facts and circumstances warrant it

The Way Forward: Selected Potential DOD Related Actions

(cont.)

- Recognize the difference between approving and informing
- Create a Chief Management Officer to drive the business transformation process
- 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
- Employ a more targeted and market based approach to compensation and other key human capital strategies
- Streamline yet strengthen current commercial contracts (e.g., incentives, transparency and accountability mechanisms)
- Provide for longer tours of duty in connection with key acquisitions and operations positions (e.g., responsibility and accountability)
- Focus on achieving real success in connection with financial management efforts (e.g., systems, controls, information, compliance and opinions)
- Employ a more reasonable, strategic, and integrated approach to business information system efforts and financial audit initiatives

Fiscal Challenges Confronting DOD Necessitate Better Acquisition Outcomes

- In DOD, competition increasing between ongoing operations, transformation efforts, and desire to sustain current investments
- Cost increases could be tolerated in the past, but future military capability is increasingly defined by mega-systems whose problems have a much larger fiscal impact
- In 2001, a 10% increase would cost \$70B; in 2005, a 10% increase would cost \$144B

Investment Levels Have Doubled

| | 2001 | 2005 |
|-----------------|--------|---------|
| Top 5 Programs | \$281B | \$521B |
| All SAR Systems | \$700B | \$1.44T |

Unwanted Outcomes of Acquisition Process

- 12 to 15 year development cycle times
 - Requirements creep
 - Technology obsolescence
 - Opportunity for cost overruns
 - Programs subject to and cause of funding instability
 - Program manager/leadership turnover
 - Contractors cannot get into production
- ***Good and dedicated people are not put in a position to succeed***

Acquisition Practice Has Not Followed Policy

- While policy has been strengthened, controls are still lacking to ensure decisions made throughout product development are informed by demonstrated knowledge. Programs that don't measure up are approved.
- Despite the evolutionary acquisition policy, approved solutions favor grand designs and complex systems of systems with accelerated schedules.

Defense Acquisition Barriers: Processes Create Pressures for Managers

Requirements Process

**Promise High
Performance**

Budgeting Process

**Promise Low
Resource Demands**

Acquisition Process

**Move Forward,
Catch Up Later**

Defense Acquisitions: The Next Steps

- Rationalize needs versus wants (e.g., platforms and systems) across as well as within the various services and DOD units
- Be more disciplined in defining and sticking to realistic requirements
- Move to clearer and more performance-based contracting approaches
- Use commercial best practices in design, development, and production decision-making (i.e., actual and planned)
- Provide for more transparent controls over waivers from established acquisitions policies and practices
- Establish more continuity in key positions (e.g., program executive positions)
- Provide adequate staffing for contractor oversight (e.g., high quality and performance)
- Strengthen services acquisitions manuals and processes

Three Key Ingredients Needed for These Challenging and Changing Times

- ***Courage***
- ***Integrity***
- ***Innovation***



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