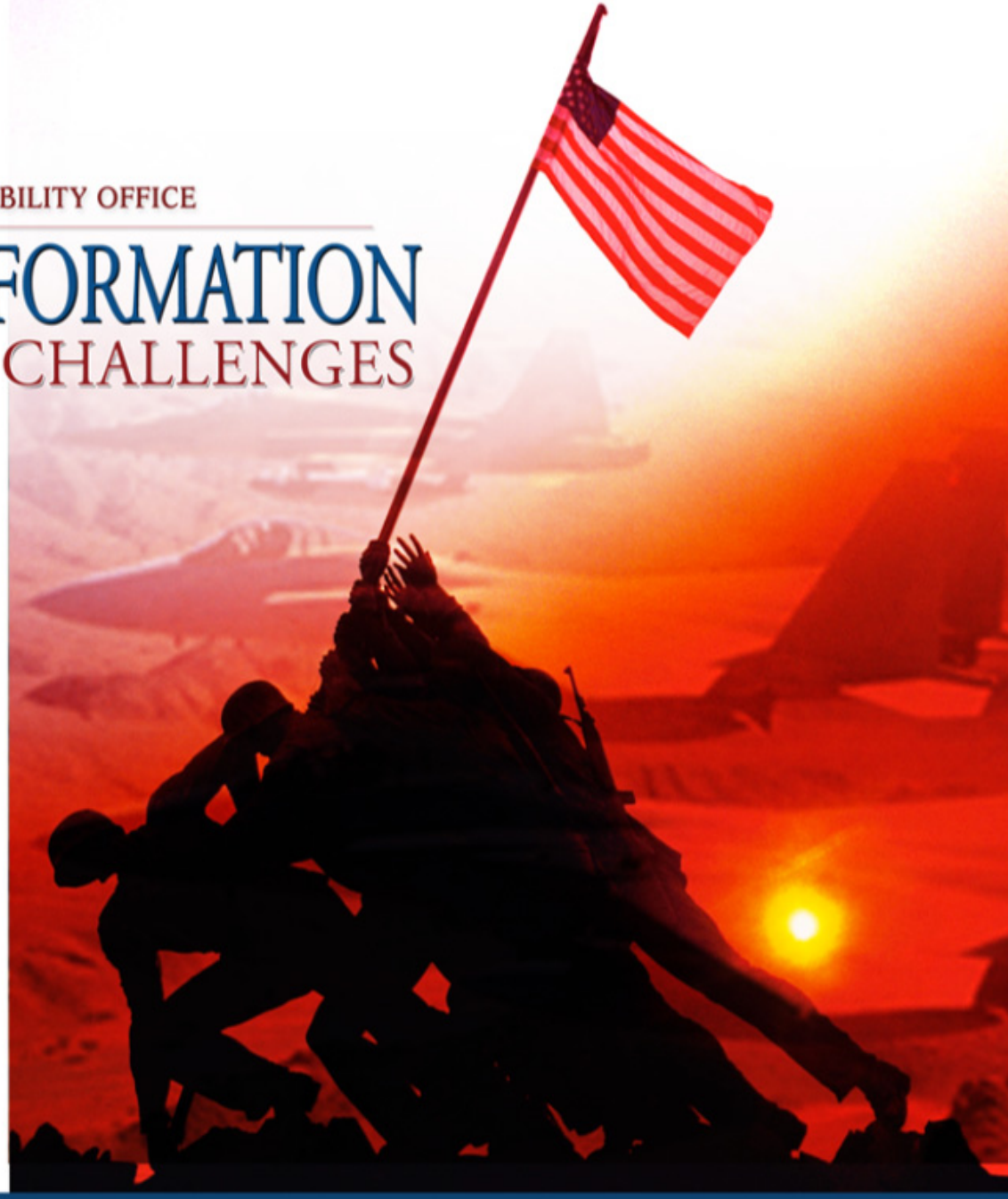
UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

DEFENSE TRANSFORMATION
ACCOUNTABILITY CHALLENGES



Association of Defense Auditors
August 22, 2006

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

GAO-06-1083CG

Evolving Challenges for SAIs and OIGs

- Public expectations of government are changing:
  - Zero tolerance for corruption
  - Desire for enhanced results and improved responsiveness
  - Selected trends and challenges that have no boundaries
    - Long-Term Fiscal Imbalance
    - National Security
    - Global Interdependence
    - Changing Economy
    - Demographics
    - Science and Technology
    - Quality of Life
    - Governance

Three Key Elements for Success

Incentives

Transparency

Accountability

Contributing Elements

	Government Examples
Incentives	▪ Rule of law ▪ Professional Civil Service ▪ Checks and balances
Transparency	▪ Financial disclosure ▪ Due process ▪ Free press
Accountability	▪ Enforcement of laws ▪ Oversight ▪ Independent judiciary

Contributing Elements

	SAI / IG Examples
Incentives	▪ Independence ▪ Resources
Transparency	▪ Protocols ▪ Public reporting
Accountability	▪ Enforcement of access rights ▪ Peer review

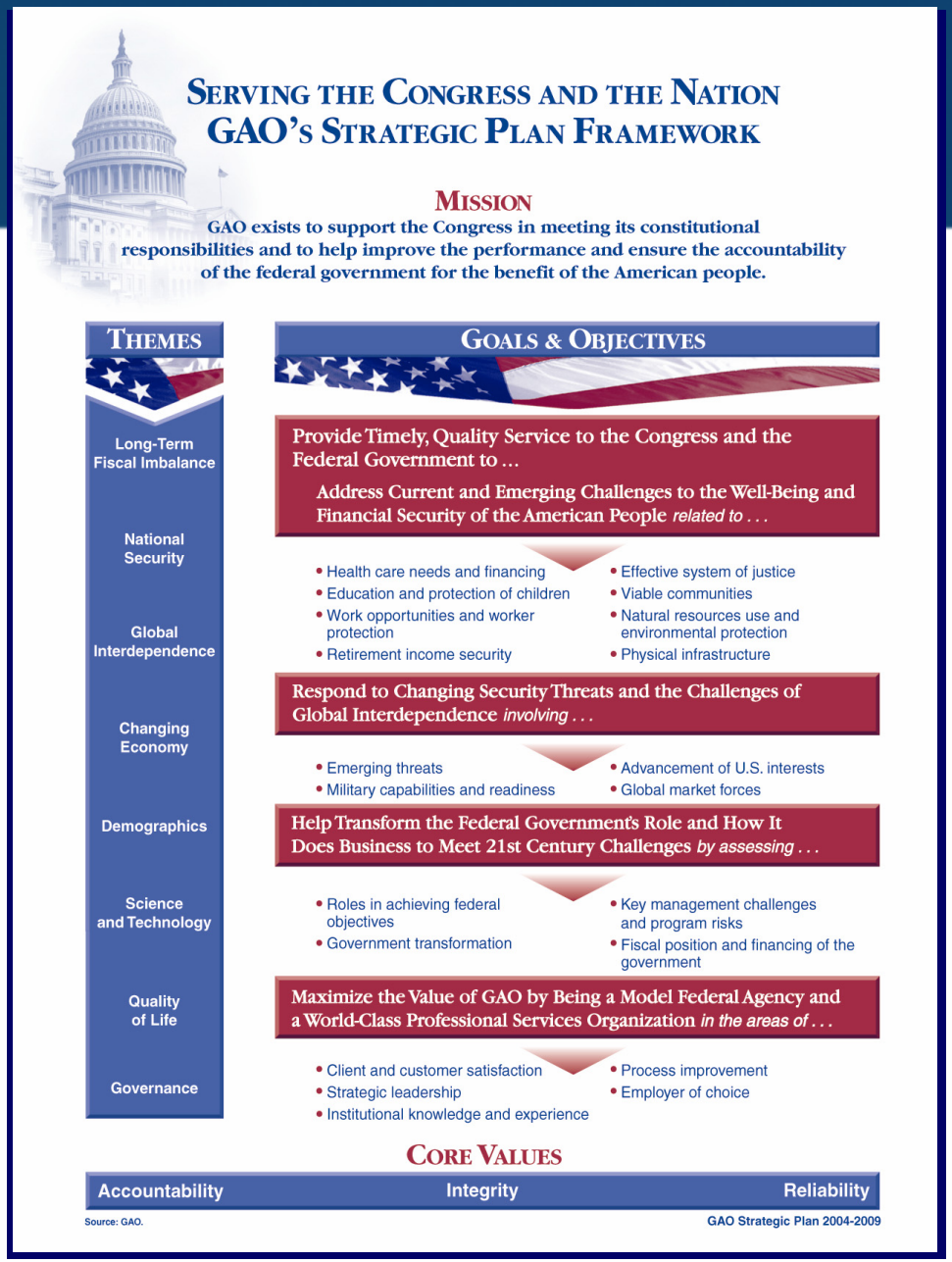
Possible SAI / IG Roles

GAO's Role

- GAO's role has been to support the Congress in carrying out its constitutional responsibilities and to help improve the performance and assure accountability of government for the benefit of the American people

- We do this in four fundamental ways:
  - **Oversight**–preventing and detecting fraud, waste, and abuse
  - **Insight**–making government more efficient and effective
  - **Foresight**–examining the role of government
  - **Adjudication**–bid protest resolution, legal opinions (e.g. appropriations law)

GAO's Strategic Plan

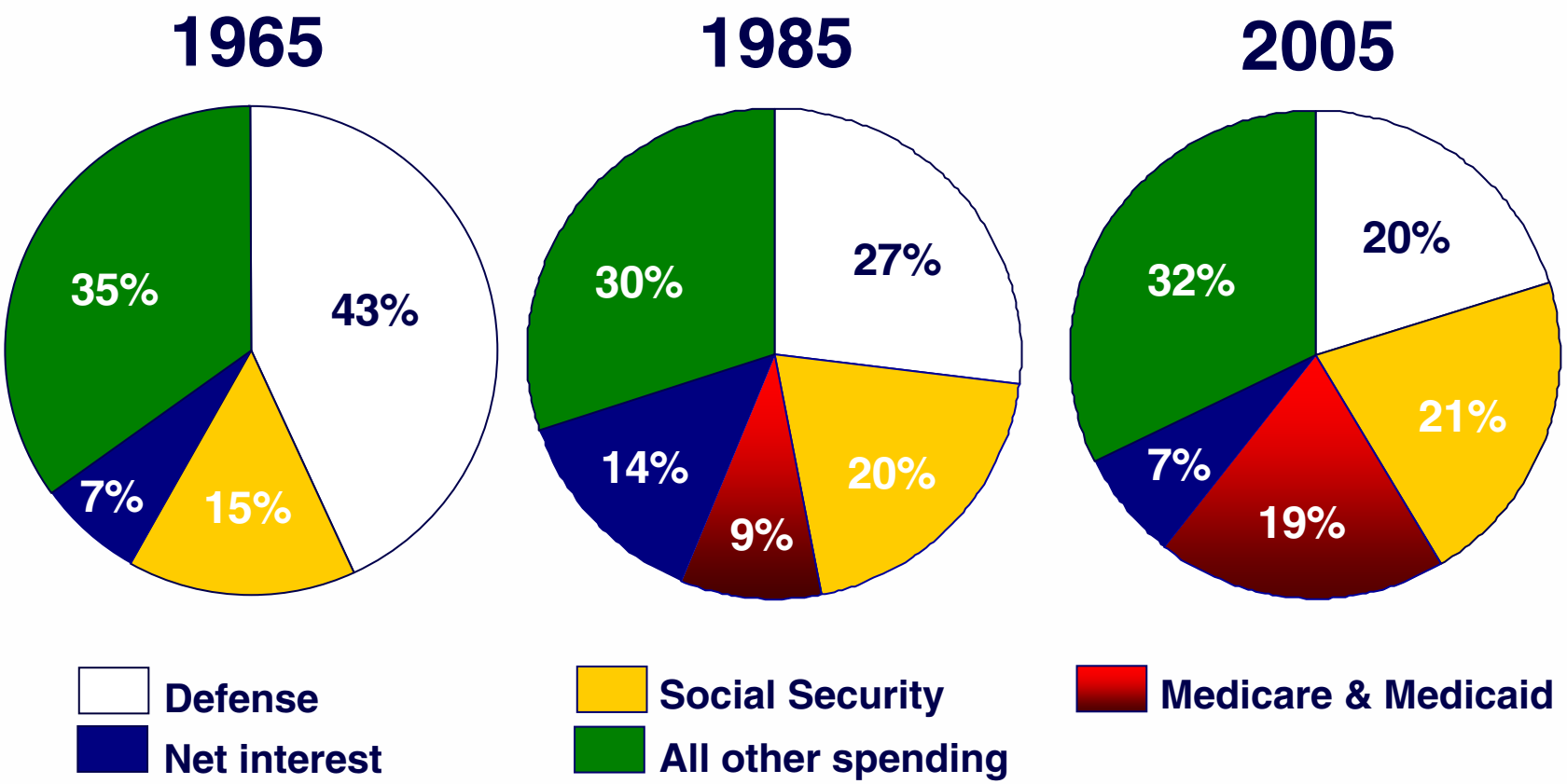


The Case for Change

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

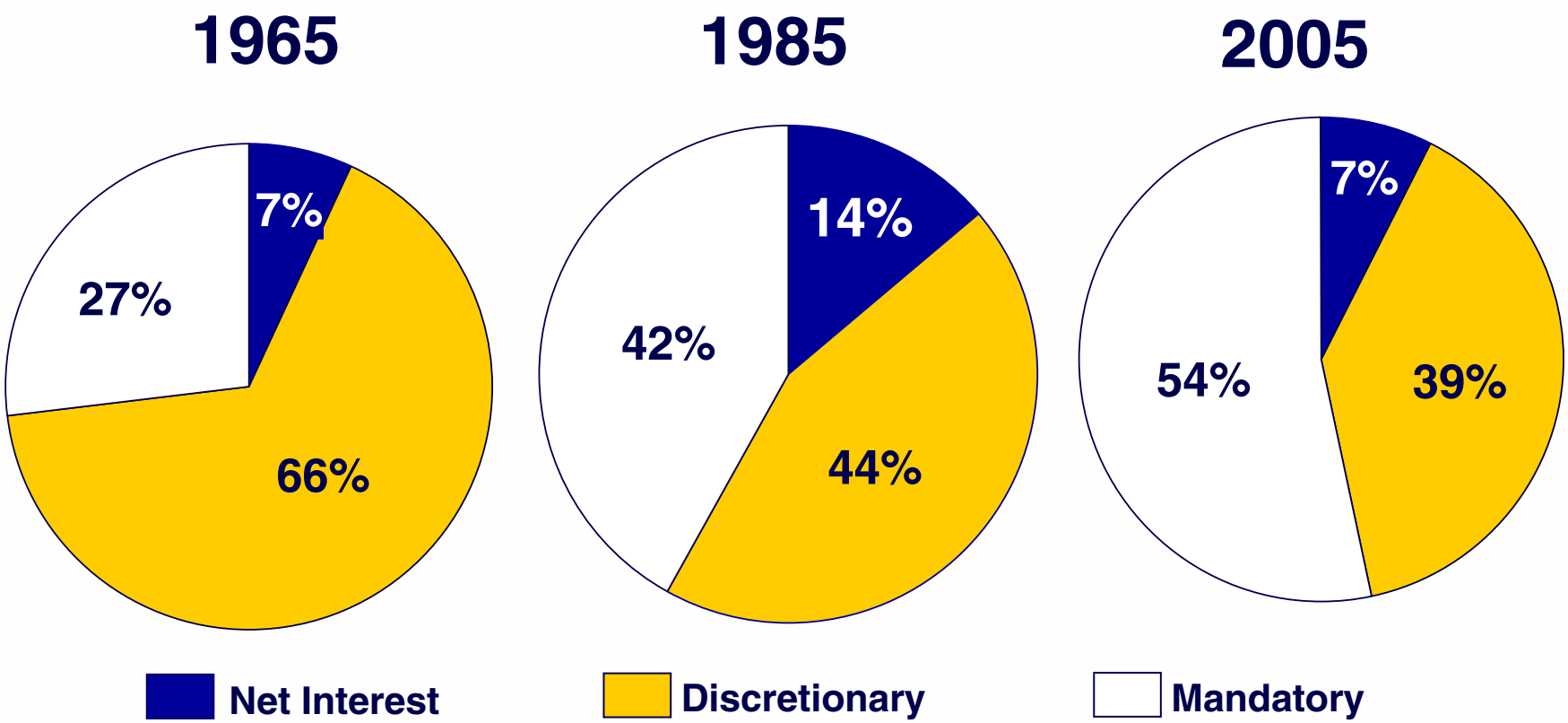
- Past fiscal trends and significant long-range challenges
- Rising public expectations for demonstrable results and enhanced responsiveness
- Selected trends and challenges having no boundaries
- Additional resource demands due to Iraq, Afghanistan, incremental homeland security needs, and recent natural 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.

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.

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

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

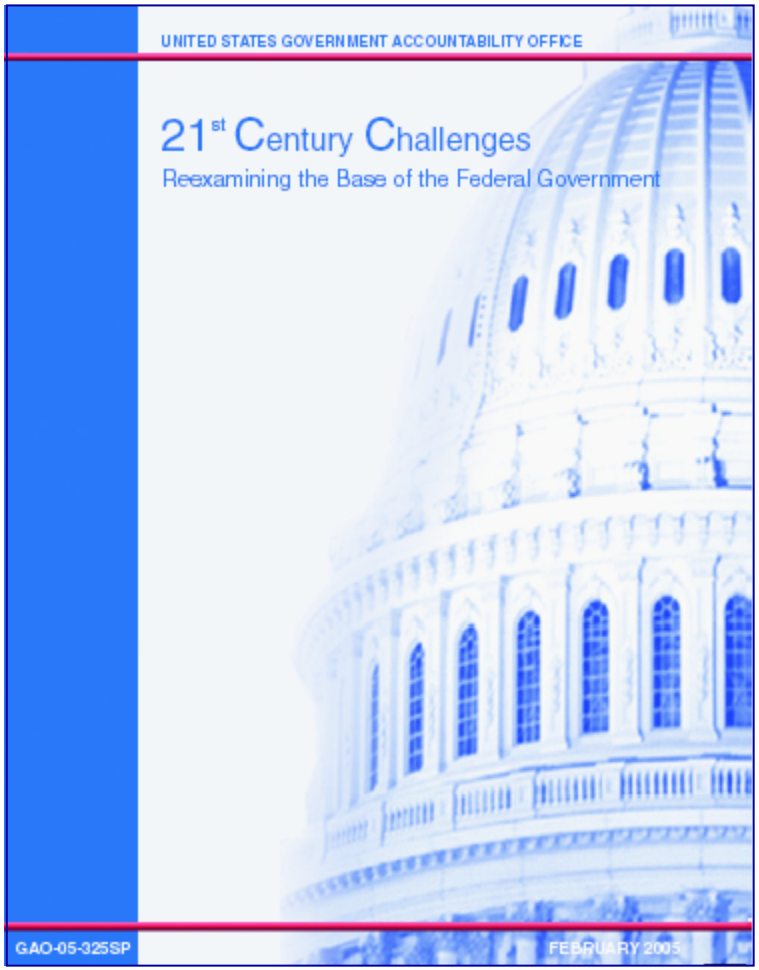
GAO's High-Risk List 2006

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

Relevance 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?

Measuring success

Are there outcome-based measures? If not, why?

If there are outcome-based measures, how successful is it based on these measures?

Targeting benefits

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

Affordability and cost effectiveness

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

Best 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?

Selected Potential DOD Related Actions: Transformation Strategy

- 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, wants vs. needs)
- Employ a total force management approach to planning and execution (e.g., military, civilian, contractors)
- Create a Chief Management Officer to drive the business transformation process
- 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)

Selected Potential DOD Related Actions: Business Operations and Human Capital

- Focus on achieving real success in connection with financial management efforts (e.g., systems, controls, information, compliance and opinions)
- Differentiate between war fighting and business systems development, implementation and maintenance (e.g., resource control, project approval)
- Employ a more reasonable, strategic, and integrated approach to business information system efforts and financial audit initiatives
- Recognize the difference between approving and informing
- 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
- Provide for longer tours of duty in connection with key acquisitions and operations positions to strengthen responsibility and enhance (e.g. program manager)

Selected Potential DOD Related Actions: Acquisitions and Contracting

- Reconcile the difference between wants and needs, and affordability and sustainability on an enterprise-wide basis considering current and future threats and resource levels
- Nail down system requirements and ensure the maturity of technology in order to improve performance and enhance accountability (don't let the perfect be the enemy of the good)
- Employ spiral development and plug and play concepts to technology
- Streamline yet strengthen current commercial contracts (e.g., performance and outcome-based, appropriate risk-sharing, including cancellation clauses
- Pay performance-based contract incentives for positive outcomes
- Make it okay to pull the plug or reduce quantities of weapon systems and information systems projects when the facts and circumstances warrant it

GAO's Work to Modernize the Accountability Profession

GAO is actively working to modernize and transform the accountability profession, both inside the government and in the private sector, and to lead by example in this area:

- Strengthening the independence of the FASAB
- Revitalizing the JFMIP principals' efforts, including definitions of success, accelerated reporting, etc.
- Creating of the U.S Auditing Standards Coordinating Forum (i.e., GAO, PCAOB, ASB)
- Leading strategic planning and coordination efforts with major accountability organizations around the world (e.g., INTOSAI, IGAF) that includes oversight, insight, and foresight dimensions
- 2003 revision of *Government Auditing Standards* (2006 revision is in process)
- Modernizing of the accounting/reporting and audit models (e.g. IFAC, IAASB, FASB, GASB, FASAB, etc.)
- Enhancing federal financial reporting and pursuing publication of a summary annual report
- Assuring appropriate treatment of restatements by auditors and others
- Monitoring implementation of the Sarbanes-Oxley Act, including providing suggestions for possible actions by the PCAOB and the SEC in connection with the internal control reporting requirements under Section 404
- Considering whether reform elements similar to those in Sarbanes-Oxley make sense for the federal government
- Exploring additional opportunities for employing more frequent reporting and continuous auditing approaches
- Exploring revised approaches to quality assurance programs, including internal inspections and peer reviews

Selected Government Accountability Issues

Leading by Example

- **Definition of success in financial management**
  - Clean opinion on financial statements
  - No major control weaknesses
  - No major compliance issues
  - Systems that produce timely, accurate, and useful financial and management information
- **Scope of audit**
  - Internal controls (GAO's audit and selected others currently)
  - Compliance matters (all currently)
  - Performance and projection information (future)
- **Additional issues**
  - Accelerated and enhanced financial reporting (all agencies)
  - Audit/financial management committees (GAO and selected other agencies)

The Federal Financial Audit Environment

The federal financial audit environment is evolving:

- Closer to an opinion on the consolidated financial statements of the U.S. government (CFS), but DOD is the key challenge
- GAO, as the auditor of the CFS, needs to be able to use the work of the auditors of the agency financial statements
- Agencies need to meet accelerated due dates, minimize restatements, maintain unqualified opinions, and address their internal control and financial management system deficiencies
- Performance and projection reporting need to expand over time
- More timely financial and performance reporting should not come at the price of less reliable reporting

Key Leadership Attributes Needed for These Challenging and Changing Times

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

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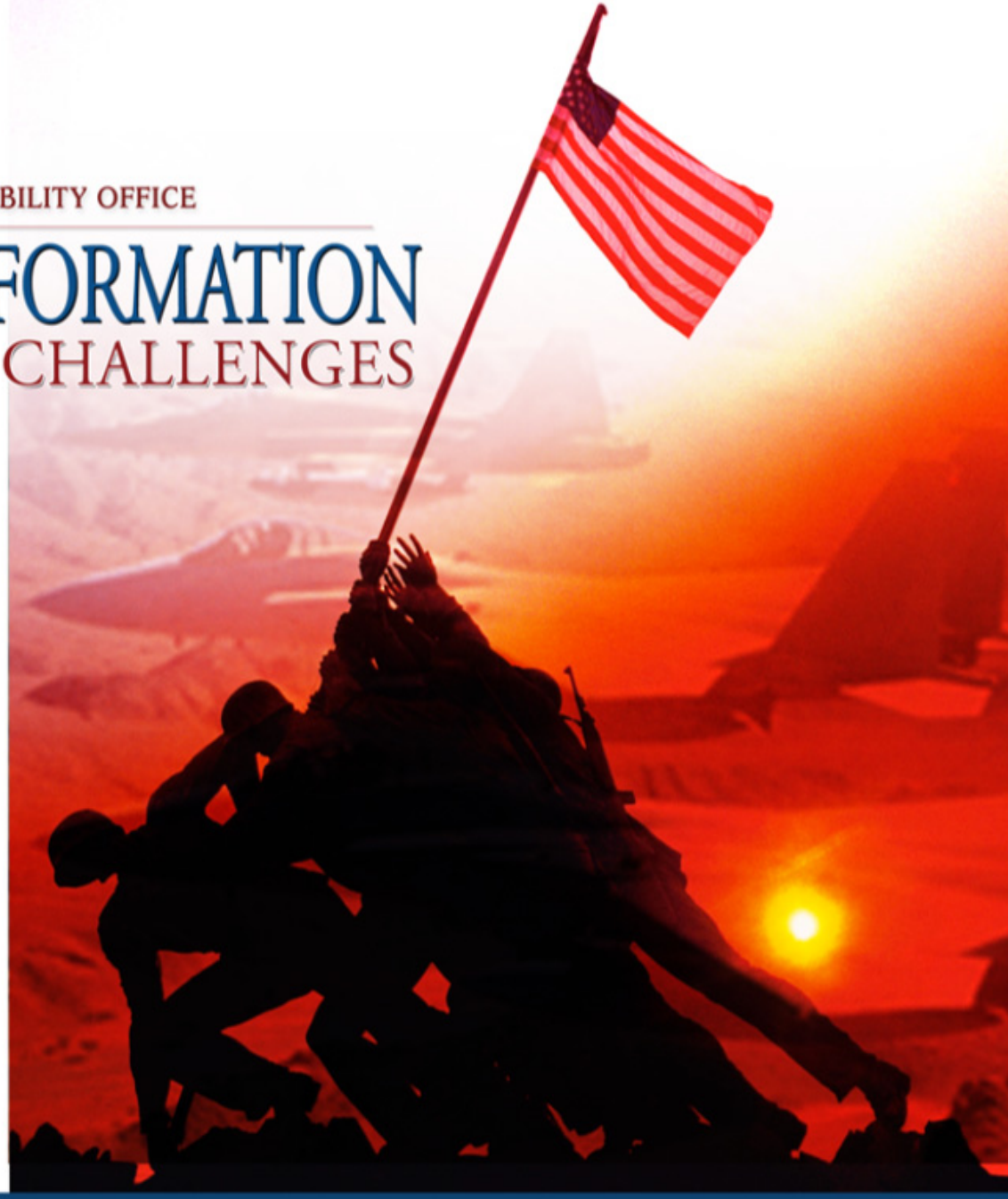

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On the Web

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