

UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

DOD TRANSFORMATION

CHALLENGES AND OPPORTUNITIES

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

Department of Defense
FY 2008 Managers' Internal Control
Program Conference
Fort McNair, Washington, D.C.
November 29, 2007



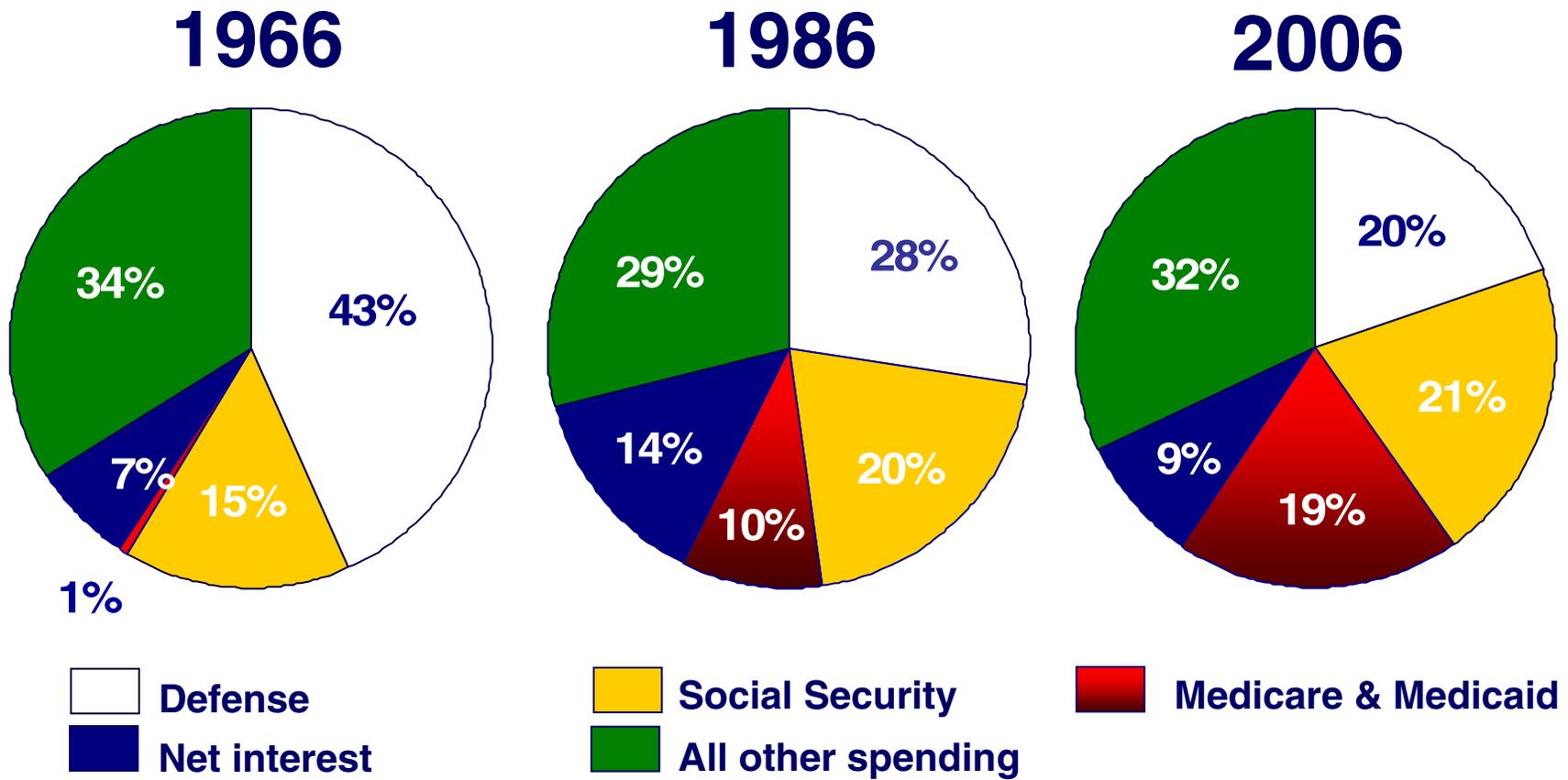
The Case for Change

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
- 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- Outdated federal organizational structures, policies, and practices
- Rising public expectations for demonstrable results and enhanced responsiveness

Any organization is only as good as the people who compose it

Composition of Federal Spending

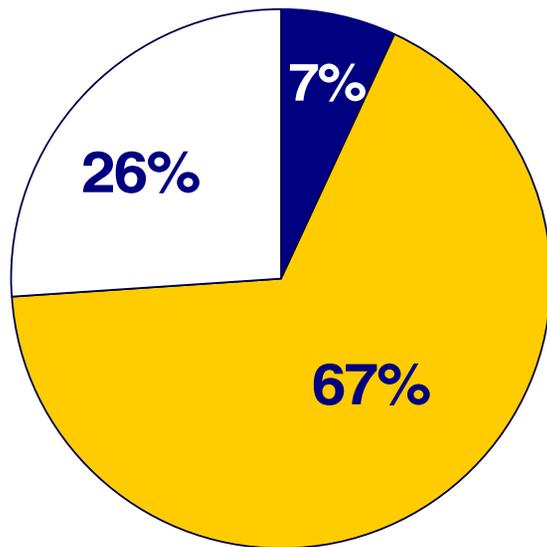


Source: Office of Management and Budget.

Note: Numbers may not add to 100 percent due to rounding.

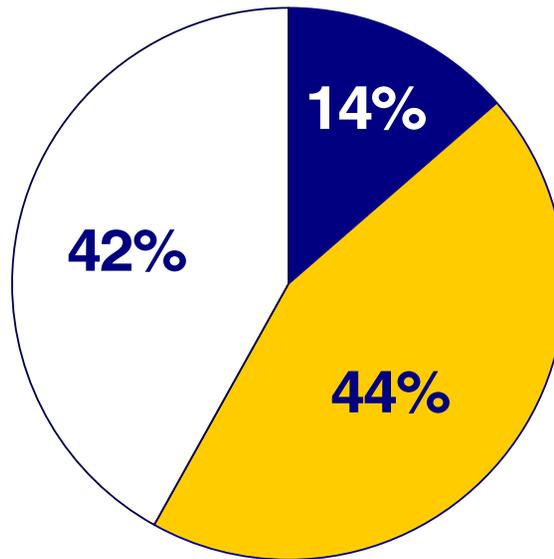
Federal Spending for Mandatory and Discretionary Programs

1966



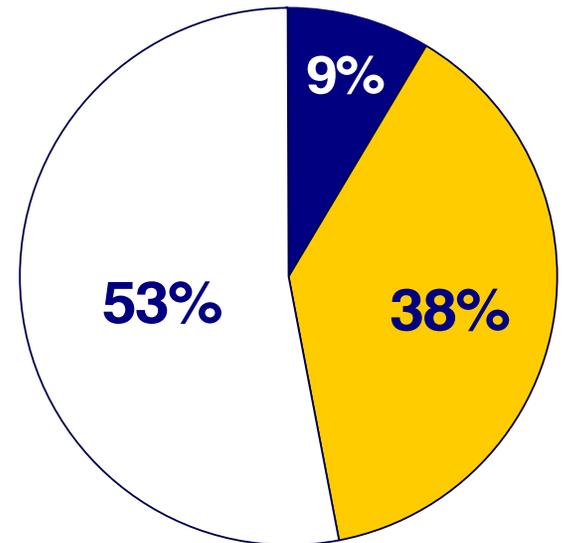
Net Interest

1986



Discretionary

2006



Mandatory

Source: Office of Management and Budget.

Fiscal Year 2005 and 2006 Deficits and Net Operating Costs

	Fiscal Year 2005	Fiscal Year 2006
	(\$ Billion)	
On-Budget Deficit	(494)	(434)
Unified Deficit^a	(318)	(248)
Net Operating Cost^b	(760)	(450)

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

^aIncludes \$173 billion in Social Security surpluses for fiscal year 2005 and \$185 billion for fiscal year 2006; \$2 billion in Postal Service surpluses for fiscal year 2005 and \$1 billion for fiscal year 2006.

^bFiscal year 2005 and 2006 net operating cost figures reflect significant but opposite changes in certain actuarial costs. For example, changes in interest rates and other assumptions used to estimate future veterans' compensation benefits increased net operating cost by \$228 billion in 2005 and reduced net operating cost by \$167 billion in 2006. Therefore, the net operating costs for fiscal years 2005 and 2006, exclusive of the effect of these actuarial cost fluctuations, were (\$532) billion and (\$617) billion, respectively.

Potential Fiscal Outcomes

Under Alternative Simulation

Revenues and Composition of Spending as a Share of GDP

Percent of GDP

50

40

30

Revenue

20

10

0

2006

2015

2030

2040

Fiscal year

■ Net interest

■ Social Security

■ Medicare & Medicaid

■ All other spending

Source: GAO's August 2007 analysis.

Notes: AMT exemption amount is retained at the 2006 level through 2017 and expiring tax provisions are extended. After 2017, revenue as a share of GDP returns to its historical level of 18.3 percent of GDP plus expected revenues from deferred taxes, i.e. taxes on withdrawals from retirement accounts. Medicare spending is based on the Trustees April 2007 projections adjusted for the Centers for Medicare and Medicaid Services alternative assumption that physician payments are not reduced as specified under current law.

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 two 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

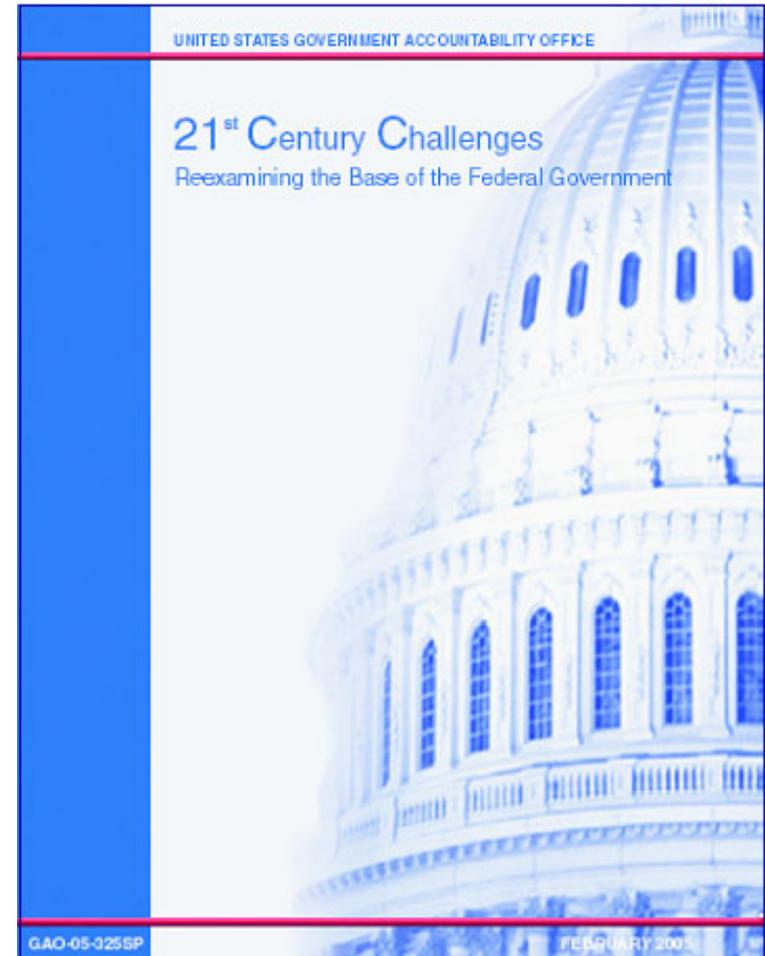
The Way Forward: A Three-Pronged Approach

1. Improve Financial Reporting, Public Education, and Performance Metrics
2. Strengthen Budget and Legislative Processes and Controls
3. Fundamentally Reexamine and Transform for the 21st Century (i.e., entitlement programs, other spending, and tax policy)

*Solutions Require Active Involvement from
both the Executive and Legislative Branches*

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



Source: GAO.

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

National defense questions relate to such issues as:

- The allocation of resources across services and programs to reflect threat/risk assessments
- Investments in transformational systems and legacy systems, considering cost growth and historic schedule delays
- Identification and protection of critical technologies
- Recruitment, retention, and compensation strategies to ensure that DOD maintains a total military and civilian workforce with the right mix of skills
- The role, size, and structure of forces and capabilities comprising the strategic triad
- The creation of a CMO

GAO's High-Risk List

- Started in 1990 with focus on fraud, waste, abuse, and mismanagement
- Evolved to include major economy, efficiency, effectiveness, and broad-based transformations needed to address 21st century challenges
- Current focus is on identifying inherent risks, systemic problems, or key management functions
- Updates issued at the start of each new Congress

GAO's High- Risk List 2007

Addressing Challenges in Broad-based Transformations

	Year Designated
• Strategic Human Capital Management ^a	2001
• Managing Federal Real Property ^a	2003
• Protecting the Federal Government's Information Systems and the Nations' Critical Infrastructures	1997
• 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 Business Systems Modernization	1995
• DOD Personnel Security Clearance Program	2005
• DOD Support Infrastructure Management	1997
• DOD Financial Management	1995
• DOD Supply Chain Management	1990
• DOD Weapon Systems Acquisition	1990
• FAA Air Traffic Control Modernization	1995
• Financing the Nation's Transportation System ^a (New)	2007
• Ensuring the Effective Protection of Technologies Critical to U.S. National Security Interests ^a (New)	2007
• Transforming Federal Oversight of Food Safety ^a (New)	2007

Managing Federal Contracting More Effectively

• DOD Contract Management	1992
• DOE Contract Management	1990
• NASA Contract Management	1990
• Management of Interagency Contracting	2005

Assessing the Efficiency and Effectiveness of Tax Law Administration

• Enforcement of Tax Laws ^a	1990
• IRS Business Systems Modernization	1995

Modernizing and Safeguarding Insurance and Benefit Programs

• Modernizing Federal Disability Programs ^a	2003
• Pension Benefit Guaranty Corporation Single-Employer Pension Insurance Program	2003
• Medicare Program ^a	1990
• Medicaid Program ^a	2003
• National Flood Insurance Program ^a	2006

DOD's High Risk Areas

(see GAO-07-310)

Assessing Challenges in Broad-based Transformation

- DOD Approach to Business Transformation
 - Business Systems Modernization
 - Personnel Security Clearance Program
 - Support Infrastructure Management
 - Financial Management
 - Supply Chain Management
 - Weapon Systems Acquisition

Managing Federal Contracting More Efficiently

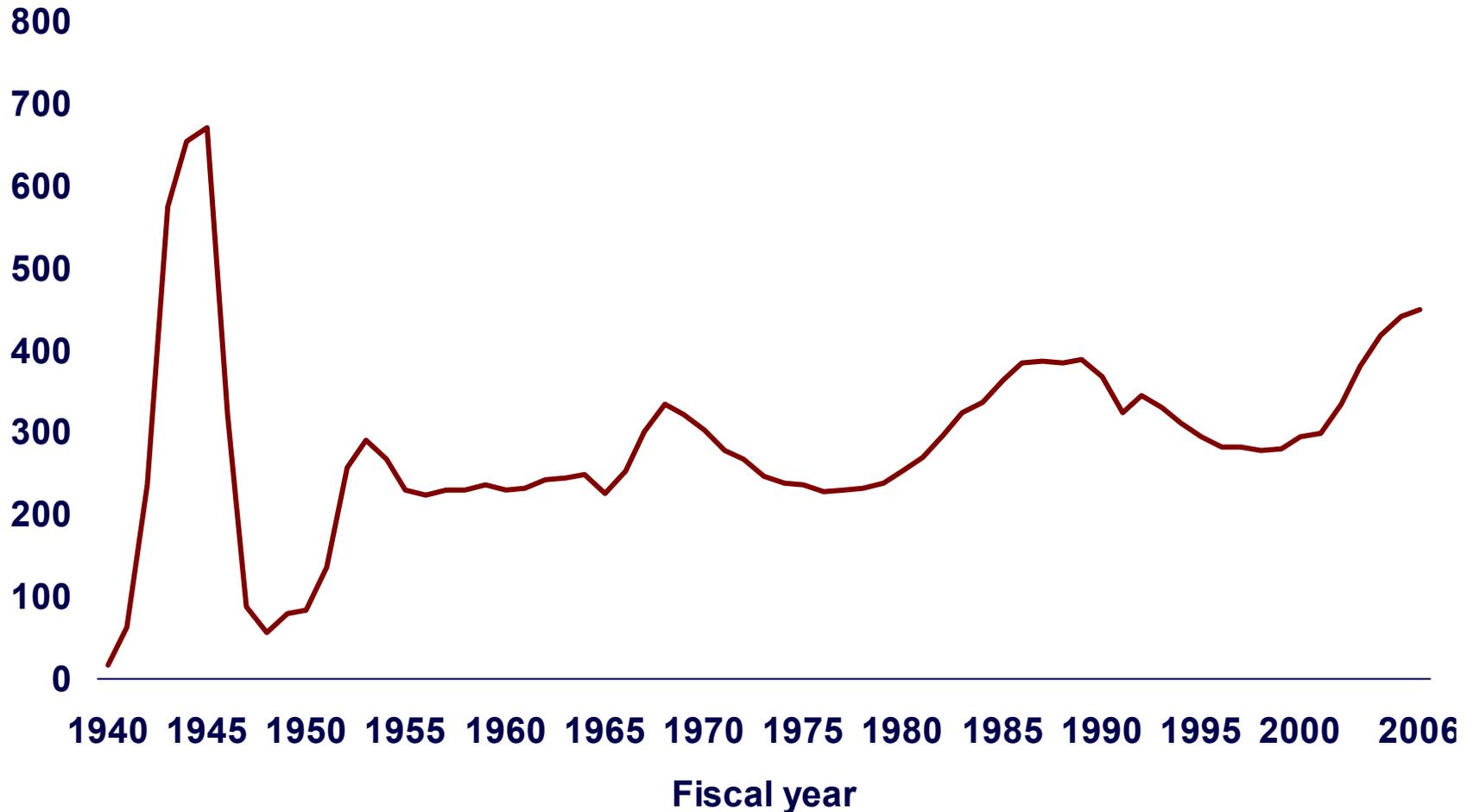
- Contract Management

DOD Faces the Challenge of Balancing Near Term and Long Term Wants, Needs, Sustainability, and Affordability

- DOD's regular budget has grown from about \$296 billion in FY 2001 to about \$460.3 billion in FY 2008. Funding for the Global War on Terrorism (GWOT) has added hundreds of billions of dollars to DOD's available budgetary resources
- Near term, DOD is paying for the GWOT and facing challenges in maintaining readiness
- Long term, DOD must address military pay and benefits and weapons modernization and force transformation, which may not be affordable or sustainable
- DOD's efforts to transform its business systems and processes will take many years to achieve, but could free up resources through efficiencies and reduction in waste

Inflation Adjusted Spending on National Defense (in 2000 Dollars)

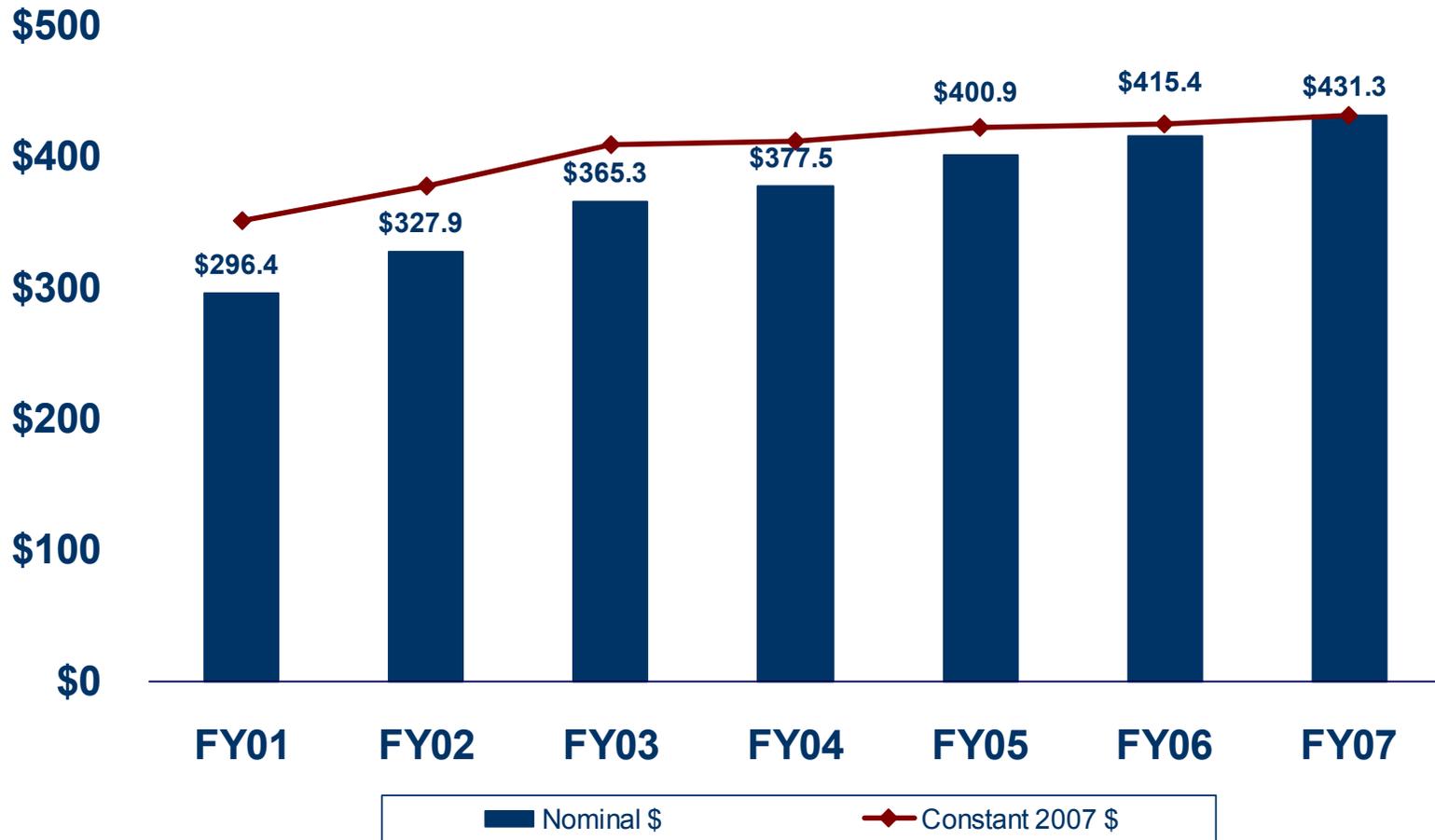
Dollars in Billions



DOD's Regular Budget

DOD Regular Appropriation FY 2001-2007 (Excluding GWOT)

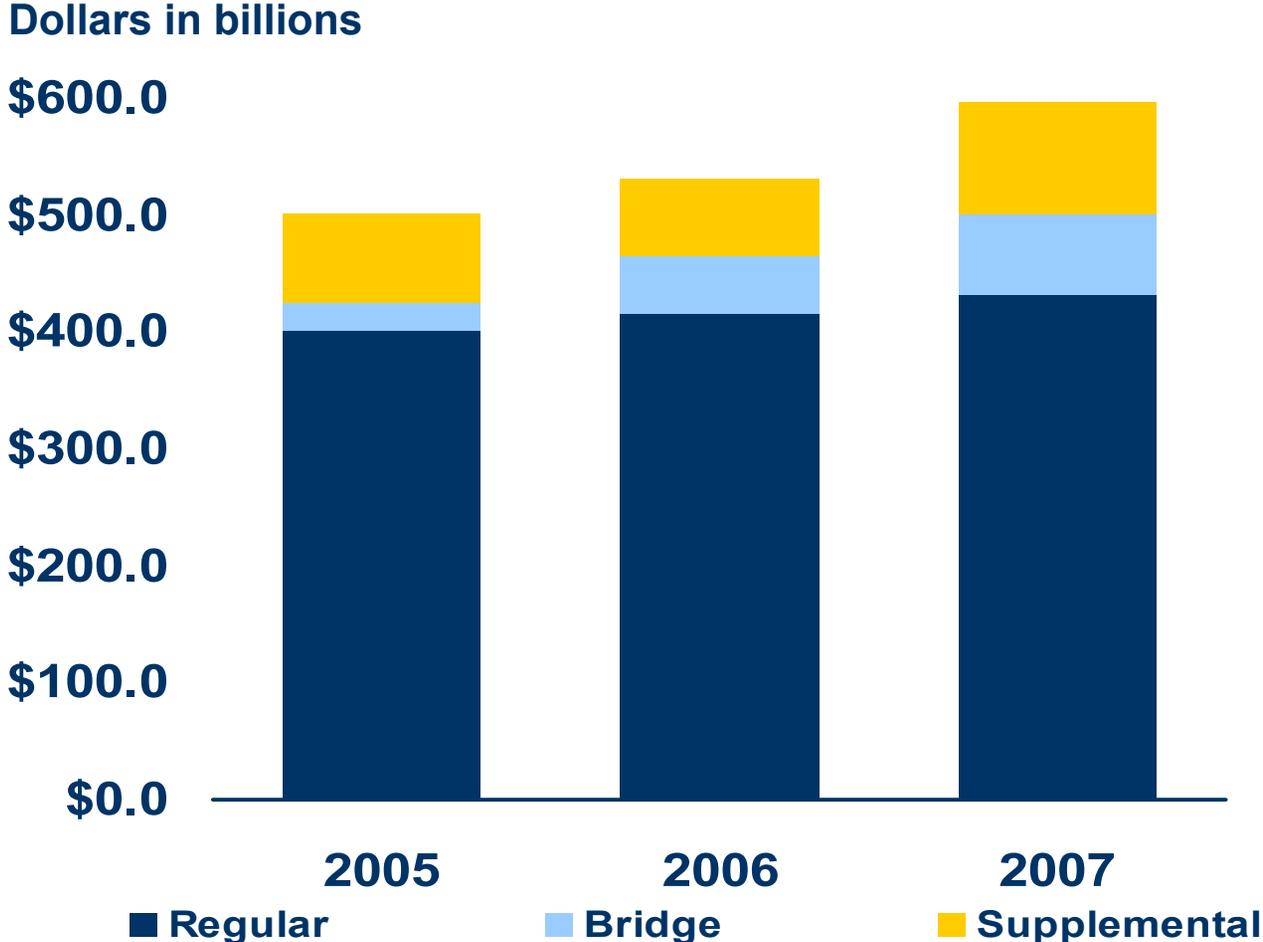
Dollars in Billions



Source: GAO analysis of Congressional Research Service and appropriations data.

Total Budgetary Resources Provided to DOD

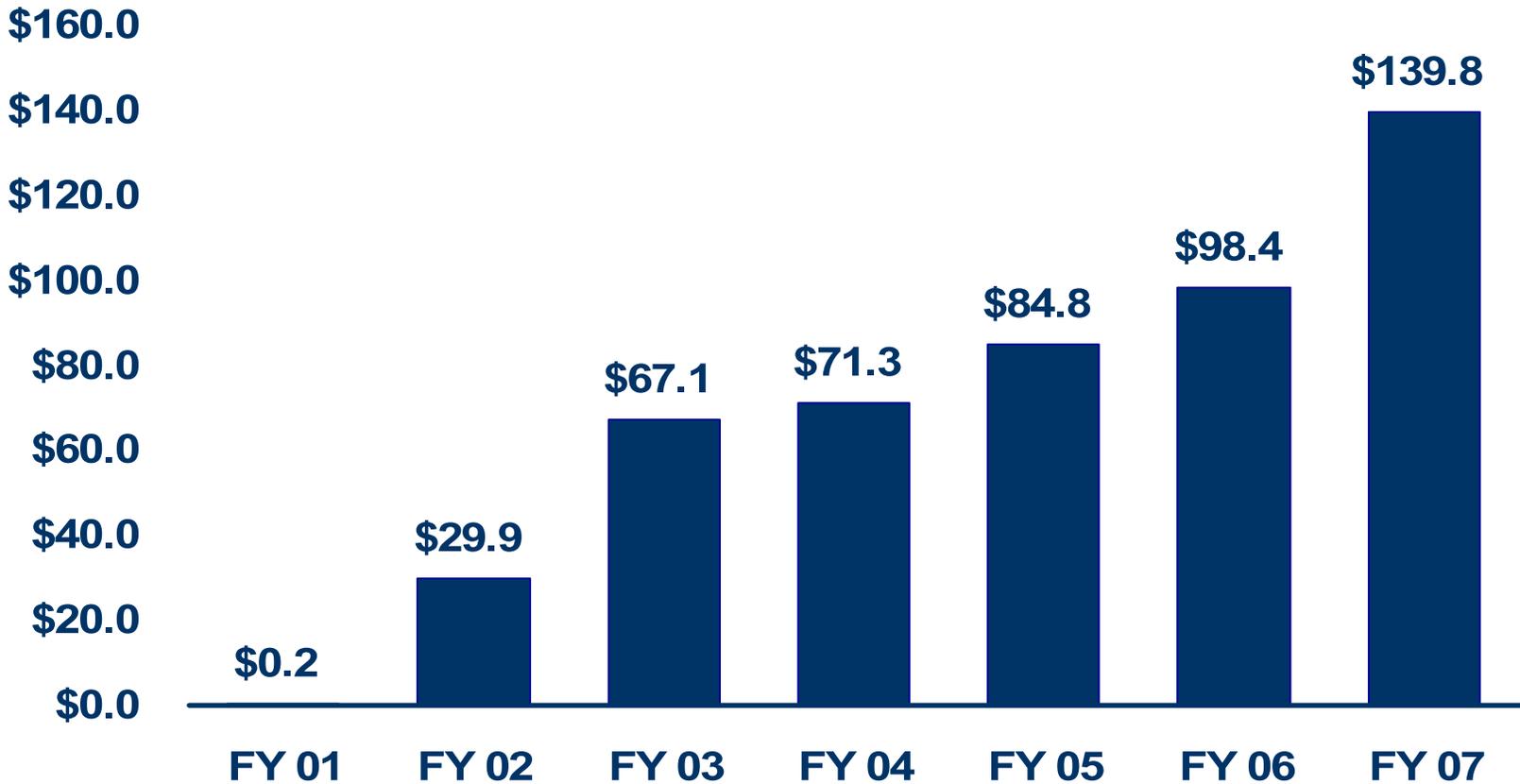
Total Defense Resources FY 2005 - FY 2007



Source: GAO analysis of Congressional Research Service and appropriations data.
Notes: Bridge, or Title IX, is the section of DOD's regular defense appropriation that outlines emergency spending provisions for operations in support of GWOT.

DOD's Reported GWOT Obligations for FY 2001 thru FY 2007

Dollars in billions



Source: GAO analysis of DOD data.

Note: Reported GWOT obligations include Operation Noble Eagle, Operation Enduring Freedom, and Operation Iraqi Freedom. Figures include about \$19.4 billion obligated in FY 2002 – FY 2003 that DOD did not include in its cost reports. Figures do not include any obligations for classified activities. GAO has assessed the reliability of DOD's obligation data and found significant problems, such that they may not accurately reflect the true dollar value of GWOT obligations.

Increased Budget Transparency Needed

- Changes in DOD's funding guidance have resulted in billions of dollars being added to GWOT requests for what DOD calls the "longer war against terror," making it difficult to distinguish between incremental costs to support specific contingency operations and regular budget costs
- As a result, FY 2007 and 2008 GWOT requests include funding for items generally requested in the regular budget, such as future weapons systems, transformation, and increases in end strength
- Similarities between DOD's GWOT and base funding requests, along with the duration of GWOT operations, indicate that DOD has reached the point where it should build more funding into its base budget to increase transparency (between incremental and regular budget costs) and to facilitate trade-off decisions
- DOD needs to take stronger actions to control GWOT costs by setting general parameters to guide commanders' and services' cost control efforts
- GAO has found significant reliability problems with the GWOT cost data, which impedes the ability of Congress and others to make informed decisions about GWOT costs and related funding needs

Balancing Wants, Needs, Sustainability, and Affordability: Maintaining Near Term Readiness

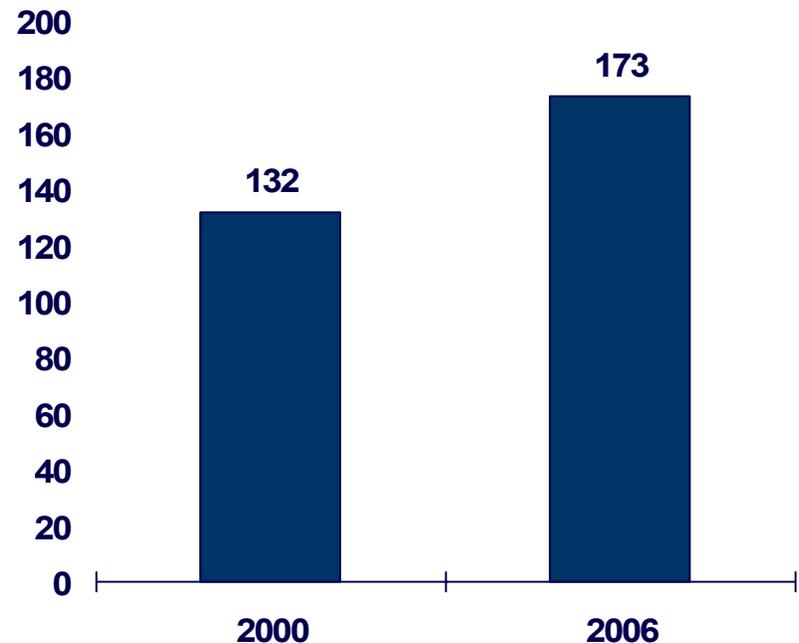
- Readiness is being measured against two different standards 1) the traditional war time missions that units are expected to undertake based on their structure, and 2) their currently directed missions—primarily, supporting operations in Iraq and Afghanistan
- Although there are some concerns with deployed units, the deployed units are in better shape to undertake the currently directed missions than non-deployed units because they receive priority for personnel and equipment
- When measured against traditional war time missions, there are readiness concerns (equipment, personnel, and training) for both deployed and non-deployed units

Balancing Wants, Needs, Sustainability, and Affordability: Reexamining Active Duty Personnel Pay and Benefits

- The cost of active duty pay and benefits was \$173 billion in fiscal year 2006
- Enhanced pay and benefits, including health care costs, increased costs to an average of \$126,239 per person in FY 2006 from \$95,971 in FY 2000
- 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 and 2006

(FY 2006 constant dollars)



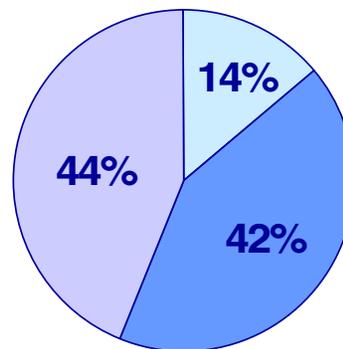
Source: GAO-07-828.

Note: Our calculations include supplemental funding for the Global War on Terrorism. Our calculations do not take into account 95,000 mobilized reservists who were paid out of active duty costs in fiscal year 2006. The per capita costs would be lower if these reservists are taken into consideration.

Balancing Wants, Needs, Sustainability, and Affordability: Reexamining Health Care Benefits

- The cost of TRICARE more than doubled from FY01 to FY05
- Costs have grown due to increases in enrollment, benefits, medical inflation, and GWOT
- TRICARE does not fully utilize market incentives to shape utilization
- TRICARE has low enrollment fees, deductibles, and other beneficiary expenses compared to other plans

TRICARE Beneficiaries in Fiscal Year 2005

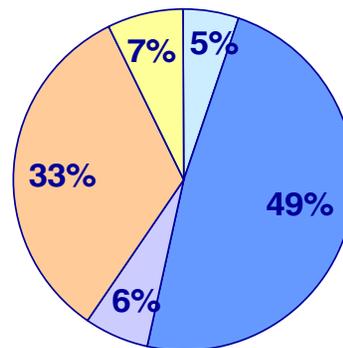


14%: TRICARE for Life retirees and dependents (generally age 65 and older)

42%: Active duty personnel and dependents

44%: Retirees and dependents (generally under age 65)

DOD Estimates of Factors Contributing to Increases in DOD's Health Care Costs, 2001-2005



5%: Other Congressionally-Mandated Benefit Changes

49%: TRICARE for Life

6%: GWOT

33%: Medical Inflation

7%: Increase in Retirees and Dependents Under 65

Source: GAO-07-48 (top pie), GAO analysis of DOD data (bottom pie).

Balancing Wants, Needs, Sustainability, and Affordability: Funding Weapons Modernization and Force Transformation

- From fiscal years 2001 to 2006, DOD has doubled its planned investments in new systems from about \$700 billion to nearly \$1.4 trillion, but this has not produced more stability or better outcomes
- DOD is also restructuring forces to execute operations in the new security environment more effectively. Although the Army originally estimated it could largely equip and staff modular units by spending \$52.5 billion through fiscal year 2011, the Army now believes it will require additional funding to equip modular units through fiscal year 2017.

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)**

Systemic Defense Acquisition Challenges (cont'd)

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**
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**

DOD Contract Management Challenges

- DOD continues to experience poor acquisition outcomes and missed opportunities to improve its approach to buying goods and services. For example, DOD did not:
 - Employ a strategic approach to acquiring services that enabled it to determine whether investments were achieving desired outcomes
 - Always make sound use of various techniques to acquire goods and services (i.e. award and incentive fees, competitive acquisition approaches)
 - Have a comprehensive plan to ensure its workforce had the right skills and capabilities to manage and assess contractor performance

Determining the Appropriate Role of Contractors in Meeting DOD's Needs

- Contractors have an important role to play in the discharge of the government's responsibilities, and in some cases the use of contractors can result in improved economy, efficiency, and effectiveness
- There may be occasions when contractors are used to provide certain services because the government lacks another viable and timely option. In such cases, the government may actually be paying more and incurring higher risk than if such services were provided by federal employees
- Examining the appropriate role for contractors is among the challenges in meeting the nation's defense and other needs in the 21st Century

Definition of Waste

Waste involves the taxpayers as a whole not receiving reasonable value for money in connection with any government funded activities due to an inappropriate act or omission by players with control over or access to government resources (e.g., executive, judicial, or legislative branch employees, contractors, grantees, or other recipients)

Importantly, waste represents a transgression that is less than fraud and abuse and most waste does not involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, or inadequate oversight

Examples of Waste

Illustrative examples of underlying causes of waste in the acquisitions and contracting area could include:

- Unreasonable, unrealistic, inadequate, or frequently changing requirements
- Failure to use competitive bidding in appropriate circumstances
- Failure to engage in selected pre-contracting activities for contingent events (e.g., hurricanes, military conflicts)
- Congressional directions (e.g., earmarks), and agency spending actions where the action would not otherwise be taken based on an objective value and risk assessment and considering available resources

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 for DOD

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 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 (CMO) to drive the business transformation process

Transformation is a Long-Term Process

- DOD is perhaps the largest and most complex organization in the world
- Many of the department's weaknesses are decades in the making and solutions are not easy
- Hundreds of dedicated and hardworking DOD employees are focusing on these issues
- The establishment of the Defense Business Systems Management Committee and the Business Transformation Agency are good first steps
- A comprehensive strategic planning process and a full-time CMO are necessary next steps

Effective Management of Services Requires Both Strategic and Transactional Efforts

Strategic Level

Effective service acquisition requires the leadership, processes, and information necessary for mitigating risks, leveraging buying power, and managing outcomes

Transactional Level

Individual service transactions must focus on buying the right thing, the right way, while getting the desired outcomes

A comprehensive approach would use the strategic and transactional factors in a complementary manner to tailor management activity to ensure preferred outcomes

Source: GAO (analysis).

GAO's Recommendation for a CMO at DOD

- **GAO has recommended that DOD establish a CMO to provide strong and sustained leadership over all major business transformation efforts. The CMO should be:**
 - Experienced with a proven track record as a business process change agent in a large, complex, and diverse organization
 - Codified in statute as a separate and full-time position
 - Designated an Executive Level II appointment that reports directly to the Secretary of Defense
 - Subject to an extended term (e.g., 5 to 7 years) that spans administrations
 - A single point within the department with the perspective and responsibility, as well as authority, to develop an overall and integrated business transformation plan and help to ensure the effective implementation of related functional management and business transformation efforts

Key Leadership Attributes Needed for These Challenging and Changing Times

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

UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

DOD TRANSFORMATION

CHALLENGES AND OPPORTUNITIES

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

**Department of Defense
FY 2008 Managers' Internal Control
Program Conference
Fort McNair, Washington, D.C.
November 29, 2007**



On the Web

Web site: www.gao.gov/cghome.htm

Contact

Chuck Young, Managing Director, Public Affairs
YoungC1@gao.gov (202) 512-4800
U.S. Government Accountability Office
441 G Street NW, Room 7149
Washington, D.C. 20548

Copyright

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.