

**Part 4:**  
**Inspector General Summary  
of Management Challenges**

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# Inspector General Summary of Management Challenges

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The Reports Consolidation Act of 2000, Public Law 106-531, permits the Secretary of Defense to submit a consolidated report to the President, to the Director of the Office of Management and Budget, and to Congress within 150 days of the end of the fiscal year, which “shall include a statement prepared by the agency’s inspector general that summarizes what the inspector general considers to be the most serious management and performance challenges facing the agency, and briefly assesses the agency’s progress in addressing those challenges.” In the 2003 Annual Report to the President and the Congress, the Secretary of Defense described the competing demands among three difficult challenges: winning the global war on terror, preparing for threats that develop in this decade, and continuing to transform for threats that will develop beyond 2010. The Report discusses the difficulty of making choices among the competing challenges and presents a risk management framework to guide DoD decision-making. The management challenges that the Inspector General identified, based on audits, investigations, and inspections, fall into nine major areas. These areas, which were identified in the DoD Performance and Accountability Reports for Fiscal Years 2002 and 2003, remain significant challenges. The challenge areas, summarized here and in past Performance Accountability Reports, are as follows:

- Joint Warfighting and Readiness,
- Homeland Defense,
- Human Capital,
- Information Technology Management,
- Acquisition Processes and Contract Management
- Financial Management,
- Health Care,
- Logistics, and
- Infrastructure and Environment.

These challenge areas fit into the risk management framework described in the 2003 Annual Report, that is, force management risk, operational risk, institutional risk and future challenge risk. The risk framework is further divided as follows:

## Force Management Risk

- *Maintain quality workforce*
- *Ensure sustainable military TEMPO and maintain workforce satisfaction*
- *Maintain reasonable force costs*
- *Shape the force of the future*

## Operational Risk

- *Have the right forces available*
- *Posture the forces to succeed*
- *Provide a ready force*
- *Employ forces consistent with strategic priorities*

## Institutional Risk

- *Streamline the decision process, improve financial management, drive acquisition excellence*
- *Manage overhead and direct costs*
- *Improve the readiness and quality of key facilities*
- *Realign support to the warfighter*

## Future Challenges Risk

- *Drive innovative joint operations*
- *Develop more effective organizations*
- *Define and develop transformational capabilities*
- *Define skills and competencies for the future*

The Department’s risk management framework, and the associated outcome goals were discussed previously in the “Performance Highlights” section. The following discussion of the nine management challenge areas identifies affected outcome goals.

# Joint Warfighting and Readiness

- *Have the right forces available*
- *Posture the forces to succeed*
- *Provide a ready force*
- *Drive innovative joint operations*

U.S. forces continue to transform to meet the new and evolving threats, traditional and asymmetrical. Operations Iraqi Freedom and Enduring Freedom reinforced the need for the Services to continue to train together and in combination to fight as a team. The experiences gained in those operations, together with the ongoing efforts aimed at transforming U.S. forces, create an atmosphere of change and evolution unlike any experienced in a long time. Each factor individually, as well as collectively, challenges the DoD to ensure that U.S. forces are ready to carry out their assigned missions, while addressing their immediate needs. Many of the other management challenge areas encompass those functions that support joint warfighting and readiness issues.

## Discussion

The Office of the Inspector General (OIG) services to the Department included a number of projects in joint warfighting and readiness. The OIG's review of DoD's management of network-centric warfare (NCW) focused on the NCW implementation within the DoD and specific NCW initiatives ongoing within the Services. Although DoD components had undertaken steps to incorporate NCW into DoD, DoD still needed to improve its approach to integrating NCW. DoD can assist the integration of NCW by providing the leadership, direction, and planning that will be required for the successful integration of NCW.

In response to allegations of fraud, waste, and abuse made to the DoD Hotline, the OIG reviewed the use of cargo aircraft in the U.S. Central Command area of responsibility. Although the OIG did not substantiate the allegations, it did identify that external factors that the DoD had no control over directly affected operating efficiencies.

The OIG summarized 27 reports on security controls over biological agents, issues reported by the Offices of the Inspectors General of the Departments of

Agriculture, Army, Defense, Energy, Health and Human Services, and Veterans Affairs. The summary identified nine systemic problems: physical security, personnel access controls, inventory accountability and controls, contingency plans, registration with the Centers for Disease Control and Prevention (CDC), import and export of agents, safety and security training, management oversight, and policies and procedures. Corrective actions, as recommended in the 27 reports, were initiated by those agencies.

The increasing threat of terrorist actions against U.S. military and civilian populations demonstrates the need to enhance the safety of military forces in the United States and overseas. DoD installations at home and abroad must plan for and be prepared to execute the necessary actions to protect U.S. personnel and assets against natural disasters or those of human origin. The OIG visited selected installations and reported that the installations did not have formal force protection programs, and their antiterrorism plans and training did not meet DoD requirements. Another OIG effort identified weaknesses in disaster preparedness and consequence management plans, training and exercise programs, and equipping and host nation support at the installation level in relation to disaster preparedness and consequence management programs. The OIG recommended that the U.S. European Command and the Service components improve installation disaster preparedness and consequence management programs at installations in the U.S. European Command.

## Inspector General Assessment of Progress

The Department has made progress in joint warfighting and readiness. Actions to establish the Office of Force Transformation and to develop transformation plans for each of the Services are commendable. Those efforts look to the future and assist the Department in continuing to address traditional threats while evolving to address non-traditional threats to the United States.

The DoD audit community continues to contribute to the Department's efforts to enhance joint warfighting and readiness. The OIG, GAO, the Army Audit Agency, the Naval Audit Service, and the Air Force Audit Agency have each covered topics related to improving the ability of the armed forces to respond to threats to the United States. Topics such as the need for DoD management to establish guidelines and policy for network-centric warfare, the progress on the Army's new Stryker system, the mobilization

and use of Reserve component personnel, and the use and maintenance of pre-positioned materiel have all received coverage. For every report that identified an issue needing attention, the Department is taking positive actions to increase its warfighting ability and readiness posture.

The Inspector General Summary of Management Challenges in the FY 2003 DoD Performance and Accountability Report noted that the Department lacks comprehensive policy, guidance and training concerning the roles, missions, functions, and relationships of Combatant Command Inspectors General. During FY 2004, the OIG DoD worked with the Joint Staff, Combatant Command, and Military Department Inspectors General to begin the development of policy, guidance, and training required by these Inspectors General. These initiatives will greatly enhance the abilities of these Inspectors General to perform their duties in support of the Combatant Commands. A new DoD Directive and Instruction codifying Joint IG authority, policy, and procedures, and Joint Inspector General Orientation Course Charter are being coordinated.

## Homeland Defense

- *Improve readiness and quality of key facilities*
- *Provide a ready force*
- *Employ forces consistent with strategic priorities*

The global war on terror continues to heighten the level of threat from adversaries to the United States. Those adversaries may use weapons of mass destruction, such as chemical or biological weapons or they may attempt to use information warfare to attack the Defense information structure. Because of those threats, homeland defense is a priority across the federal government. The Department established an Assistant Secretary of Defense for Homeland Defense and the U.S. Northern Command as part of an effort to coordinate Departmental homeland defense policy and resources. Additional initiatives with the common goal of protecting the United States work towards coordinating policy and resources at the federal level with the Department of Homeland Security.

## Discussion

The importance of a robust intelligence program within the government and especially within DoD has gained increased visibility. The Department will be particularly challenged during the upcoming year as the Administration and Congress act to implement the recommendations in the Final Report of the National Commission on Terrorist Attacks Upon the United States. During FY 2004, the OIG increased the size of its Office of Deputy Inspector General for Intelligence in recognition of the increased importance of this critical area. Classified reports issued by this office and the defense intelligence agencies' Inspectors General have made recommendations to improve the responsiveness of DoD intelligence to the terrorist threat.

Guarding against the threat to critical DoD information systems remains a significant challenge. In September 2003, the Assistant Secretary of Defense for Homeland Defense (ASD(HD)) assumed responsibility for Critical Infrastructure Protection (CIP) oversight. Subsequently, the ASD(HD) requested the Office of the Inspector General to evaluate the CIP organization and policy; validate the efficiency and effectiveness of vulnerability assessment methodologies; and review procedures related to vulnerability assessments for data collection and analysis. The OIG Inspections and Evaluations Directorate began an evaluation of the Defense Critical Infrastructure Program in 2004 with emphasis on assets exposed to high risk.

The OIG conducted an evaluation of installation disaster preparedness and consequence management that focused on the ability of installations in the European theater to deter, recover from, and protect critical operations and personnel from natural and created disasters. The OIG reported opportunities to improve theater-level monitoring programs and Service component planning, training, exercises, and equipment related to the program.

For FY 2004, the annual statutory requirement to audit export controls focused on the Department's policies and procedures for preventing the transfer of technologies and technical information with potential military application to countries and entities of concern. The OIG reported that the Department needs to improve its policies and procedures for identifying unclassified export-controlled technology and preventing unauthorized disclosure to foreign nationals at contractor, university, and federally funded research and development centers. The report

disclosed weaknesses on exporting technology that underscore the need for continued emphasis in this area.

The Cooperative Threat Reduction Program was initiated to reduce the threat posed by weapons of mass destruction in the former Soviet Union by providing assistance to former Soviet states in building facilities and operating programs to safeguard, transport, and ultimately destroy chemical, biological, and nuclear weapons, delivery systems, and infrastructure. Adequate controls for the program are vital to ensuring that the limited program funds are used effectively. The OIG identified that a facility constructed with Department funds might not be fully used because implementing agreements between the United States and Russia do not clearly address the amounts and types of fissile material to be stored at a facility. In addition, construction delays for the chemical weapons destruction facility may result because the implementing agreement did not require Russia to obtain the necessary construction permits in a timely manner and there are risks that the land allocation for the destruction facility may be rescinded due to violations of Russian environmental laws. The Department reviewed and renegotiated, when appropriate, implementing agreements with Russia to ensure that controls are in place for Department-funded construction and use of facilities.

In conjunction with the Inspectors General of the Defense Intelligence Agency, the National Geospatial-Intelligence Agency, the National Reconnaissance Office and the National Security Agency, the OIG also assessed the adequacy and effectiveness of the DoD intelligence agencies' information assurance policies and procedures. We have made numerous recommendations to improve their information assurance programs. Each of the DoD intelligence agencies has taken aggressive steps to improve its information assurance posture, but more improvements are needed.

### **Inspector General Assessment of Progress**

The Department has made progress improving homeland defense. Establishing the Assistant Secretary of Defense for Homeland Defense and the U.S. Northern Command to execute the mission of homeland defense and civil support are laudatory actions. Those new organizations seek appropriate avenues to address threats to the United States. The DoD audit community and the criminal investigative community have contributed to the Department's efforts to enhance homeland security. OIG, GAO,

and Army Audit Agency reported on topics such as the need for changes in DoD management style to effectively transform the department, the challenges of implementing a secure global information grid, the challenges of implementing the Federal Information Security Management Act of 2002, and changes necessary to implement installation antiterrorism and consequence management programs at installations. The Department responded to the reports with positive actions to better protect American installations within the United States and abroad.

The safeguarding and control of U.S. nuclear weapons is a key area associated with Homeland security. The OIG has initiated a series of projects to assess the policies, practices, and capabilities for security control over and access to U. S. nuclear weapons. During FY 2004 the OIG issued two reports on the need to make improvements in this critical area. As a result of these reports the Department has initiated actions to increase security over nuclear weapons and better monitor the reliability of U. S. personnel with access to the weapons.

## **Human Capital**

- *Maintain quality workforce*
- *Ensure sustainable military TEMPO and maintain workforce satisfaction*
- *Maintain reasonable force costs*
- *Shape the force of the future*

The challenges in human capital are multifaceted. The Department must ensure that civilian and military workforces are appropriately sized, well trained and motivated, held to high standards of integrity, encouraged to engage in intelligent risk taking, and capable of functioning in an integrated work environment and handling the emerging technologies and threats of the 21<sup>st</sup> century. Those challenges involve ensuring the Department's workforce planning is focused on acquiring, developing, and retaining a total workforce to meet the needs of the future, to include the contractor workforce. Additionally, as one of the nation's largest employers, the Department has a responsibility to promote a safe workplace.

The Department employs more than 3.38 million civilian and military personnel, with an annual financial investment of more than \$100 billion. Managing such a large workforce plus contractor personnel confronts the Department with the need to identify and maintain a balanced level of skills to maintain core defense capabilities and meet increasing challenges and threats. Without focused recruiting, knowledge management programs, and a transparent personnel system, DoD may have difficulty hiring, developing, training, and retaining high quality people to become skilled soldiers, workers, managers, and leaders. In June 2004, Secretary Rumsfeld identified the need for shifting to a more joint training environment to ensure that all individuals, units, staffs and organizations - civilian and military - receive timely and effective joint education and training to accomplish the joint tasks that support operational needs.

### Discussion

Recent evaluations conducted by the OIG assessed DoD efforts to combat trafficking in persons in Bosnia-Herzegovina and Kosovo and in Korea. Trafficking in Persons (TIP) is a global problem that enslaves thousands of people. The Department faces a significant challenge to develop and implement training and awareness programs that will ensure both military and contractor personnel fully understand, recognize, and take appropriate action in regard to this serious crime. In accordance with the National Security Presidential Directive (NSPD-22), DoD IG is assisting the Under Secretary of Defense for Personnel and Readiness to develop an awareness and training campaign for all DoD personnel on trafficking in persons that clearly explains the worldwide problem of TIP as it relates to DoD. As a continuing effort, the Inspector General of the Department of Defense will be conducting evaluation visits to various regions of the world to assess DoD's efforts to combat the trafficking in persons challenge.

The Department needs to develop uniform policies, guidelines, and standards for sexual assault prevention, reporting, response, and accountability. In February 2004, in response to reports of alleged sexual assaults on service members in Iraq and Kuwait, the Secretary of Defense directed the Under Secretary of Defense for Personnel and Readiness (USD(P&R)) to undertake a 90-day review of all DoD and Service sexual assault policies and programs, and recommend changes necessary to increase prevention, promote reporting, enhance the quality and support provided to victims, and improve accountability of offender actions. To accomplish

this task, the USD(P&R) established the Department of Defense Care for Victims of Sexual Assaults Task Force. In April 2004, the Task Force published their report, identified 35 key findings, and proposed 9 broad recommendations for immediate, near-term, and long-term corrective actions. In September 2004, the USD(P&R) convened the DoD Care for Victims of Sexual Assault Conference, which is tasked to develop action plans to implement the Task Force recommendations. As requested by Conference organizers, OIG representatives were invited as observers. The OIG will continue to monitor the progress of implementing the Task Force recommendations and suggest a program evaluation process.

During fiscal year 2004, the GAO issued 14 reports addressing Human Capital issues including the use of new hiring flexibilities, assessing training and development programs, and performance management. Of particular interest to DoD was an assessment of civilian personnel planning. The report found that despite DoD's efforts to take steps in developing and implementing civilian workforce needs, the DoD strategic plans generally lacked some key elements essential to successful workforce planning. The plans did not include a gap analysis between critical skills and competencies currently needed by the workforce and those needed in the future. According to its strategic plan for fiscal years 2004-2009, the GAO plans to continue reviewing DoD human capital, focusing on readiness; military training; human capital management of civilians, Active duty, and Reserve components; and the potential for the Services to more efficiently and effectively organize and deploy forces.

The DoD audit community issued 16 reports addressing the management of human capital. The OIG reported that the Marine Corps staffing levels for enlisted warfighting positions remained vacant upon deployment, putting Marines at higher risk because of increased demands on limited personnel resources. In another report, the OIG discussed the DoD reporting on the President's Management Agenda initiative for strategic management of human capital to the Office of Management and Budget. Although adequate documentation existed to support DoD progress against the DoD Civilian Human Resources Strategic Plan, DoD did not have complete supporting documentation for DoD progress against the DoD Restructuring Plan.

In one effort pertaining to workforce satisfaction the OIG reported on DoD implementation of the Voting Assistance Program, as directed in Section 1566,

chapter 80 of title 10, United States Code. The Federal Voting Assistance Program Office continued to provide a variety of valuable resources and assistance to voting assistance officers and uniformed absentee voters in 2003. However, opportunities exist to improve the DoD voting assistance program. The OIG recommended expediting revisions to DoD guidance, providing command emphasis, and improving oversight of the program.

The Military Department audit agencies issued reports concluding that although Air Force civilian personnel officials generally filled non-competitive requests for personnel fills, untimely fills of competitive actions resulted in prolonged vacancies of up to 132 days that hindered mission accomplishment and contributed to workforce stress. Another report concluded that the Navy had been unable to develop or field integrated information systems necessary to support the Navy's future human capital needs due in part to the lack of an overarching human resources management strategic plan for the Navy.

In May 2003, the Secretary of Defense challenged the Department's leadership to reduce the number of preventable mishaps and accidents by "at least 50% in the next two years." In response to this challenge, the USD(P&R) created the Defense Safety Oversight Council. This forum meets regularly and reviews safety initiatives, metrics, and best practices of the military departments and OSD. The OIG participates in this forum as an advisor. In August 2004, the USD(P&R) requested Inspector General assistance to evaluate the DoD safety program, to include such considerations as policies, organizational structure, culture, and safety programs at the installation level. In response to this request, the OIG Inspections and Evaluations Directorate is assembling a team of safety experts that will evaluate the Department's safety program and recommend best practices that may be used to help achieve the Secretary's accident reduction goal.

### **Inspector General Assessment of Progress**

Overall, the Department has improved management of human capital. The Department is developing the National Security Personnel System (NSPS), the system designed to change how the Department hires, pays, promotes, disciplines, and fires its civilian workforce. The NSPS establishes personnel practices in DoD that parallel personnel practices in the private sector. The Department appointed a senior executive and Program Executive Officer to oversee NSPS design, planning, assessment, and implementation.

Representatives from the Department have met with employees, unions, and other affected parties and have formed working groups to identify and develop options and alternatives for NSPS. The Department also developed a military training plan to transform from a deliberative, risk-averse culture to a more adaptive, risk-mitigating culture. In June 2004, DoD published the DoD Training Transformation Implementation Plan. The plan provides a dynamic, capabilities-based training program that emphasizes crisis-action planning, joint force organization, and mission rehearsal.

Recognizing that human capital is a crucial area for the Department, the OIG dedicated an audit team to focus on this area and, along with the Service audit agencies, established the Human Capital Joint Audit Planning Group. In May 2004, the OIG announced a review of the Enterprise Management of DoD Human Capital, a top-down look at human capital management in the Department.

With regard to improving awareness within DoD of the importance in combating Trafficking in Persons, the Department has initiated aggressive efforts to address this issue. During the course of the OIG assessment in Korea, the Commander of U.S. Forces Korea responded promptly to OIG recommendations to improve its training program. On January 30, 2004, the Deputy Secretary of Defense sent a memorandum throughout the Department of Defense emphasizing the President's call that "all Departments of the United States Government will take a 'zero tolerance' approach to trafficking in persons." This memo was augmented by the September 16, 2004, memorandum from Secretary Rumsfeld directing "commanders at all levels to ensure their units are trained to understand and recognize indicators of this serious crime."

## **Information Technology Management**

- *Streamline the decision process, improve financial management, drive acquisition excellence*

The key to success on the modern battlefield and in internal business activities is the ability to produce, collect, process, and distribute information. Data must be accurate, timely, secure, and in usable form.

The huge scale, unavoidable complexity, and dynamic nature of DoD activities make them heavily dependent on information technology. That dependence has proven to be a major challenge because DoD management techniques have not kept pace with the continual growth in information user requirements and the shortened life spans of technologies before obsolescence. Much of the DoD success in meeting the Secretary of Defense's priorities and the major management challenges will depend on effective and efficient information technology management.

### Discussion

During fiscal year 2004, 24 audits indicated a wide range of management issues in systems selected for review. The important systems for which management improvements were recommended included the U.S. Army Corps of Engineers Financial Management System and the U.S. Army Corps of Engineers Enterprise Infrastructure Services.

In addition, auditors reported that the Department made progress developing the DoD business enterprise architecture necessary to respond to Office of Management and Budget and congressional requirements and to support DoD transforming initiatives. The OIG reported that DoD did not adequately report information technology investments to the Office of Management and Budget in support of the DoD Budget Request for FY 2005. The component Chief Information Officers and Chief Financial Officers did not always include required information in submitted reports. For example, Capital Investment Reports did not completely respond to one or more required data elements addressing security funding, certification and accreditation, training, and security plans. Consequently, the quality of the DoD information on security reported to the Office of Management and Budget had limited value and did not demonstrate that DoD was effectively managing its proposed information technology investments for FY 2005.

An OIG report on the Collaborative Force-Building, Analysis, Sustainment, and Transportation System discussed that management control documentation was not prepared to justify the initiation of the system, compare budgeted and actual costs, measure performance requirements, track scheduled and actual timelines, or ensure that existing system capabilities were considered. The U.S. Joint Forces Command is conducting a "Quick Look and Final Capability Needs Analysis" to determine the

appropriate documentation requirements for the system.

### Inspector General Assessment of Progress

The Department has made progress addressing the information technology management challenge. The Business Management Modernization Program was established in 2003 in recognition of the need to manage information technology systems acquisitions and modernization from an enterprise perspective. That program has provided oversight to instill discipline in the acquisition and modernization process. Further, in response to the President's Management Agenda initiative on Expanded Electronic Government, the Department has also increased the quality of business cases and visibility into its information technology portfolio. The Department received audit reports issued by OIG on Information Technology Management in a positive manner and made changes to areas needing attention.

## Acquisition Processes and Contract Management

- *Streamline the decision process, improve financial management, drive acquisition excellence*

The DoD buys the most numerous and various goods and services in the world. In FY 2003, DoD spent \$231 billion on acquisitions. On average, every working day DoD issues more than 22,000 contract actions valued at \$841 million and makes more than 140,000 credit card transactions valued at \$37 million. The Department has approximately 1,500 weapon acquisition programs with a collective life value of \$2.1 trillion. Department spending to procure services from the private sector grew to \$123 billion in FY 2003 and continued to expand in FY 2004. The management challenge is to provide required materiel and services that are superior in performance, high in quality, sufficient in quantity, and reasonable in cost despite this enormous scale. Every acquisition dollar that is not prudently spent results in a dollar that is not available to fund the top priorities of the Secretary of Defense.

## Discussion

During FY 2004, the DoD internal audit community and the GAO issued 154 reports that addressed a range of continuing acquisition problems. The Defense Contract Audit Agency continued to assist contracting officers through contract audits that identified more than \$7 billion of questioned costs and funds. In FY 2004, savings from these questioned costs helped to reduce the program costs and the need for additional appropriations.

The Department must be vigilant in investigating procurement fraud and violations of procurement integrity rules to optimize the financial resources appropriated for national defense. The investigations of violations of the Procurement Integrity Act by the former Principal Deputy Secretary of the Air Force for Acquisition and Management and the former Chief Financial Officer for the Boeing Company and their impact on acquisition programs highlight the need for continued training for acquisition professionals. Adverse actions taken by very few people can cause delay for major acquisition programs, impede quick delivery of new capabilities to the warfighter, and adversely affect the public perception of the integrity of the acquisition process.

The OIG reviewed the Air Force planned acquisition of 100 Boeing KC-767A Tanker aircraft. The report identified a variety of shortcomings in the approach the Air Force used to reach a multi-billion dollar agreement to acquire the aircraft and recommended various changes before DoD allows the program to proceed. The report identified statutory requirements and other issues pertaining to the current program structure and procurement strategy that required resolution before continuing the acquisition. An overarching problem was that the Air Force did not properly execute its fiduciary responsibility to ensure that a fair and reasonable price was achieved and that warfighter needs were met.

The OIG reviewed the negotiations by the former Principal Deputy Assistant Secretary of the Air Force for Acquisition and Management for the North Atlantic Treaty Organization Airborne Warning and Control Systems Mid-Term Modernization Program, "Global Solution." The report identified that senior-level Air Force managers did not use appropriate business and contracting procedures during negotiations with The Boeing Company. The Air Force awarded a contract modification without knowing whether the \$1.32 billion cost was fair and reasonable. Air Force actions to renegotiate the contract should result in a substantial price reduction.

The DoD audit community continued to identify ways that the Department could improve acquisition of weapon system programs, including the following examples:

- Better negotiate contract terms (OIG audit of Air Force C-130J aircraft contract with a cost of \$2.6 billion);
- Update acquisition program baselines, obtain satisfactory operational test results, and prepare life cycle cost estimates before making investment decisions (OIG audits of the CH-47F Improved Cargo Helicopter and the Joint Chemical Agent Detector);
- Develop better processes and controls for cost estimating (Naval Audit Service audits of 18 programs' cost estimate increases at Naval Air Systems Command and Naval Sea Systems Command for a total of \$15 billion during the life cycles); and
- Implement effective management controls (OIG audits of 27 acquisition category II and III programs valued at \$18.3 billion).

Military conflicts have almost always resulted in unforeseen contracting problems that compel contract policy and procedural changes. An example from the current conflict is the planning for acquisition support that the Office of Reconstruction and Humanitarian Assistance (replaced by the CPA) required to perform its mission. A review of 24 contracts, valued at \$122 million, showed that supplies and services were quickly acquired but that contracting rules were either circumvented or liberally interpreted. Lack of attention to proper contracting procedures resulted in less than the best contracting solution or price for post-war occupation and humanitarian relief operations. The Deputy Secretary of Defense responded to the situation by designating an office to study post-war strategy and to establish responsibilities, policies, and procedures for acquisitions to support future post-war occupations and relief operations.

Improving management of the growing volume of service contracts is a challenge. An OIG review of purchases on 113 contracts valued at \$17.8 billion for professional and management support services identified inadequate competition (28 percent), inadequate contract surveillance (67 percent), and inadequate basis for price reasonableness determinations (88 percent). The report highlighted that little had improved since a review in FY 2000 identified similar problems. The Acting Under

Secretary of Defense for Acquisition, Technology, and Logistics and the Services responded by initiating numerous corrective actions to ensure that future acquisitions for services are properly awarded and administered. An OIG review of \$415 million of task orders for the Cooperative Threat Reduction Program and the Defense Threat Reduction Agency identified \$78 million of task orders associated with the Defense Threat Reduction Agency's Cooperative Threat Reduction (CTR) program had been awarded without citation of an exception to the fair opportunity to compete. The CTR program office adopted procedures to ensure that exceptions are cited for all task orders wherein contractors will not be allowed to compete.

The Inspectors General of the General Services Administration and Department of Interior identified task orders that DoD activities improperly issued against information technology supply schedule contracts. Defense activities issued task orders on General Services Administration contracts valued at about \$150 million to information technology contractors with no expertise in the required services. Work was actually performed by subcontractors at an additional cost of \$10 million.

The Defense auditing community has significantly contributed to the Department's aggressive pursuit of savings through use of credit cards and reduced vulnerability to misuse. In reports and testimony, the OIG and GAO identified a need to increase focus on negotiating discounts and leveraging its \$7.2 billion in DoD purchase card spending to achieve savings. Efforts of the OIG data mining group and purchase card program office of DoD have increased senior leadership involvement and improved management controls over the purchase card program. The Department has reduced the number of purchase cards 47 percent, from 214,000 to 114,000.

### **Inspector General Assessment of Progress**

Overall, the Department has made progress over the past decade in improving the acquisition process toward achieving acquisition excellence. The OIG has contributed to Department efforts to improve acquisition processes through numerous recommendations. Despite progress, the growing volume of acquisitions, the decrease in the number of acquisition personnel, and the numerous annual changes in regulations and processes for the acquisition professional make this a long-term challenge. During the past year, the Department has had to react to previously unidentified problems related to: acquisition of major systems such as the

KC-767A Tanker aircraft and C-130J aircraft, contracting for Operation Iraqi Freedom, and use of multiple-award schedule contracts from other Federal agencies.

## **Financial Management**

- *Streamline the decision process, improve financial management, drive acquisition excellence*

The Department's financial statements are the most complex and diverse in the world. Its FY 2003 financial statements included \$1.1 trillion in assets and \$1.6 trillion in liabilities. In FY 2004, the Defense Finance and Accounting Service (DFAS) processed the following payments on behalf of the Department: 12.6 million contractor invoices, 6.9 million travel payments, payments to 5.9 million people (including benefits to retirees and families), \$127.3 million in accounting transactions, \$455 billion in disbursements, and \$13.5 billion in foreign military sales. In addition, DFAS managed \$226.5 billion in military retirement trust fund. The Department prepares and obtains an audit opinion for the Department-wide financial statements and nine component financial statements. It also prepares the financial statements for three intelligence agencies.

### **Discussion**

The Department faces financial management challenges that are complex, long-standing, and pervade virtually all its business operations, affecting the ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting and policy decisions. The challenges have obstructed the Department from receiving an unqualified opinion on its financial statements. The Office of Management and Budget anticipates that the Department would be one of three agencies that will not receive an unqualified opinion in FY 2004. In its June 30, 2004, Executive Branch Management Scorecard, the Office of Management Budget gave the Department an unsatisfactory rating for financial performance.

The GAO identified three high-risk areas in the Department (financial management, systems modernization, and inventory management) that directly affect the Department's ability to attain an unqualified audit opinion on its financial statements. The OIG identified 11 material control weaknesses that also directly impact the Department's ability to

attain an unqualified opinion including: financial management systems; fund balance with treasury; inventory; operating material and supplies; property, plant and equipment; government-furnished material and contractor-acquired material; environmental liabilities; intragovernmental eliminations; accounting entries; statement of net cost; and statement of financing. The Department's high-risk areas and material control weaknesses will prevent the federal government from achieving an unqualified opinion on the FY 2004 consolidated financial statements.

Of the high-risk areas and material control weaknesses, the most significant is the Department's financial management systems. The Department currently relies on an estimated 4,000 systems, including accounting, acquisition, logistics, personnel, and management systems, to perform its business operations. Many financial management systems do not comply substantially with Federal financial management system requirements. The systems have little standardization across the Department, multiple systems perform the same task and identical data is stored in multiple systems. The systems are inefficient because personnel must manually enter data into multiple systems and execute many work-arounds and off-line records to translate data from one system to another.

In the National Defense Authorization Act for FY 2003, Congress required the Department to develop a business enterprise architecture and a transition plan to implement it. The Act requires the business enterprise architecture to describe an information infrastructure that would enable the Department to achieve specific capabilities such as complying with Federal accounting, financial management, and reporting requirements; integrating accounting, budgeting, and information systems; and routinely providing timely, accurate, and reliable financial and management data for management decision making. The Department has delivered several versions of the business enterprise architecture and transition plan but much work remains. For example, GAO reported that documentation describing the rationale for business enterprise architecture choices, and acquisition and portfolio investment management decisions is inadequate.

The President's Management Agenda also contains initiatives for improving the Department's financial performance. The President's Management Agenda directs the Office of Management and Budget to work with the Department to provide reliable, timely,

and useful information to support operating, budgeting, and policy decisions. The initiatives to ensure reliability include obtaining and sustaining unqualified audit opinions for the Department and its components. Timeliness initiatives include re-engineering reporting processes, instituting quarterly financial statements, and accelerating end-of-year reporting. Initiatives for enhancing usefulness include requiring comparative financial reporting, and reporting specific financial performance measures.

The OIG provided audit service and advice to the Department with the goal of improving financial performance and obtaining an unqualified opinion on financial statements. The OIG is an independent advisory member on the Financial Improvement Executive Steering Committee (the Committee) that monitors and directs the Department's Financial Improvement Plan process.

Examples of specific audit services that the OIG provided in FY 2004 include the following.

The OIG reviewed Comptroller reimbursement procedures of coalition support funds expended to support the global war on terror. Management controls were not adequate to support coalition countries' reimbursement requests and determine whether requests were reasonable and claimed costs were in the context of U.S. National Security Strategy. The Comptroller issued guidance clarifying the documentation required and established procedures to coordinate reimbursement requests with the Department of State to confirm that proposed reimbursements are consistent with the U.S. National Security Strategy.

The OIG studied the Department costs incurred for monitoring satellite launches and contractor reimbursement. The Department did not adequately adjust estimates given to the satellite contractors to reflect actual costs or allocate indirect costs among all Departmental services rendered. In addition, costs to monitor satellite launches did not always match supporting documentation. The Office of the Under Secretary of Defense for Policy adjusted satellite contractor billings to reflect actual costs and established procedures to ensure that supporting documentation matches those costs incurred.

### **Inspector General Assessment of Progress**

The Department's progress in financial management is demonstrated by its emphasis on developing effective, efficient financial systems that produce

accurate, timely, and reliable financial statements. The Department has very ambitious goals for improving its financial performance and reporting. The Office of the Under Secretary of Defense (Comptroller) Chief Financial Officer established 22 independent financial statement audit committees to oversee the annual audits and to provide a forum to discuss and resolve accounting and auditing issues. An OIG representative is an advisory (nonvoting) member on the committees.

## Health Care

- *Maintain quality workforce*
- *Ensure sustainable military TEMPO and maintain workforce satisfaction*
- *Maintain reasonable force costs*

The DoD military health system challenge is to provide high quality health care in peacetime and wartime. The DoD military health system must provide quality care for approximately 9.2 million eligible beneficiaries within fiscal constraints and price growth pressure that have made cost control difficult in the public and private sectors. The DoD challenge is magnified because the military health system must also provide health support for the full range of military operations. The DoD military health system was funded at \$29.8 billion in FY 2004, including \$17.3 billion in the Defense Health Program appropriation, \$6.9 billion in the Military Departments' military personnel appropriations, \$.2 billion in military construction, and \$5.4 billion in the DoD Medicare-Eligible Retiree Health Care Fund to cover the costs of health care for Medicare-eligible retirees, retiree family members and survivors.

### Discussion

The primary peacetime challenges for the DoD military health system in FY 2005 will be completing the transition to the new TRICARE managed care contracts, completing the Base Realignment and Closure process, and ensuring compliance with the Health Insurance Portability and Accountability Act (HIPAA).

By removing the retail pharmacy program from the new TRICARE managed care support contracts and consolidating the program into a single pharmacy benefits manager, DoD continues its progress toward developing a fully integrated pharmacy program.

A challenge this year will be implementing federal ceiling prices and federal supply schedule prices, using electronic data interchange technology in the retail pharmacy program. The federal ceiling prices and federal supply schedule prices, currently available for the military treatment facility and mail order pharmacy programs, should allow DoD to realize millions of dollars of savings in retail pharmacy costs. To make the pharmacy benefit more cost effective and to comply with the FY 2000 National Defense Authorization Act, the Department is implementing a uniform formulary process.

The results of the Base Realignment and Closure initiative will affect the numbers and types of medical facilities in the DoD military health system. The ongoing evaluation of transformational options may result in a realignment of capabilities and resources to increase the effectiveness of the military health system. HIPAA includes provisions for privacy and security of patient health information. Those provisions will be implemented in two phases. HIPAA required that procedures to ensure the privacy of patient health information be implemented by April 2003. Compliance with the requirement to safeguard patient health information requires completing tasks in FY 2004 in order for safeguards to be in place by the spring of FY 2005.

A major challenge in medical readiness will be completing a medical readiness review overseen by a steering group co-chaired by the offices of the USD(P&R) and the Director, Program Analysis and Evaluation. The review will identify medical readiness capabilities required by the National Security Strategy and warfighting transformation and examine delivery procedures for wartime and peacetime. Ongoing readiness challenges include readiness of the forces and readiness of the medical staff and units. Readiness of the forces means ensuring that all deployable forces are individually medically ready to perform their missions before deploying, while deployed, and upon their return. Readiness of the medical staff and units means ensuring that medical staff can perform at all echelons of operation and the units have the right mix of skills, equipment sets, logistics support, and evacuation capabilities. The Department developed six key elements for measuring individual readiness and the Military Departments are implementing systems to report on those elements.

The health care system also faces the challenge of increased joint operations. The FY 2004 National Defense Authorization Act authorized temporary provisions to expand TRICARE health and dental

coverage for Reserve component members and families. The temporary health care benefits are scheduled to end December 31, 2004. The new benefits presented a significant implementation challenge to the Department. If the benefits are continued, the Department will face a peacetime challenge due to the increased number of beneficiaries. The readiness challenge of keeping reservists medically ready to deploy continues due to the frequency and duration of reserve deployments.

The President's Management Agenda for FY 2002 identified nine agency-specific initiatives. One of the specific initiatives was the coordination of the DoD and the Department of Veterans Affairs medical programs and systems. Effective October 1, 2003, DoD and Veterans Affairs each must contribute \$15 million to the DoD-Veterans Affairs Health Care Sharing Incentive Fund to finance future sharing initiatives. In addition, DoD was required to contribute \$3 million in FY 2003, \$6 million in FY 2004, and \$9 million in later years to cover a "health care resources sharing and coordination project." We believe the sharing requirement will benefit both agencies and reduce costs.

### **Inspector General Assessment of Progress**

The Department has made progress improving health care while attempting to control costs. The Department made significant progress implementing new TRICARE contracts. TRICARE is transitioning from 12 regions and 7 contracts in the United States to 3 regions and 3 contracts. Contracts for all three regions, valued at \$6.4 billion, were awarded in August 2003. The transition is scheduled for completion in November 2004. The contracts provide incentives for customer satisfaction and include the contractors as partners in support of medical readiness.

The Department also made progress toward a fully integrated pharmacy program. The Medical Joint Cross Service Group made significant progress in developing the base realignment and closure process for medical facilities.

The Department also made progress implementing HIPAA. A military health system-wide training program was developed and a working group was established to address HIPAA requirements for contractors.

During FY 2004, the DoD audit community issued 26 reports on health care issues such as medical goods and services contracts, pharmaceutical

inventory management, information security, government purchase cards, military eyewear costs, DoD/VA sharing agreements, third party collections, medical readiness reporting, marketing, military treatment facility downsizing, and physician productivity.

## **Logistics**

- *Streamline the decision process, improve financial management, drive acquisition excellence*
- *Manage overhead and direct costs*

The purpose of logistics is to reliably provide the warfighter the right materiel at the right time to support continuous combat effectiveness of the deployed force. DoD logistics support operations for supplies, transportation, and maintenance cost more than \$90 billion annually. Logistics support involves approximately 700,000 military and civilian personnel and several thousand private sector firms to maintain more than 300 ships; 15,000 aircraft and helicopters; 330,000 ground combat and tactical vehicles; and hundreds of thousands of additional mission support assets. In addition, the Department maintains an inventory of such items as clothing, engines, and repair parts valued at an estimated \$67 billion to support the warfighter.

### **Discussion**

During FY 2004, the DoD audit community reported a broad range of logistics issues. Topics included asset visibility, performance-based logistics, maintenance depot materiel control, and inventory requirements determination.

In one report, the OIG discussed improving the controls over materiel designated for or sent to disposal. Materiel that was reported as shipped to disposal was not recorded as received at the Defense Reutilization and Marketing Service or accounted for on inventory records. Navy disposal transactions valued at \$134.3 million had \$39 million worth of transactions that were not recorded on accountable supply records and were vulnerable to loss and undetected theft.

DoD guidance requires that each Military Department aggressively pursue performance based logistics and submit a plan outlining their strategies. The OIG reported that the Military Departments' implementation of performance based logistics might

not be achieving goals to improve readiness for weapon systems or to reduce logistics support costs. Overall, the Military Departments were implementing performance based logistics strategies for weapons systems, sub-systems, and components; however, with the exception of Navy headquarters, their efforts were inconsistent, processes were inadequate and uncoordinated, and results were undeterminable.

### Inspector General Assessment of Progress

The Department has made progress towards being a superior logistics provider through numerous initiatives to improve logistics. That progress is tempered by the sheer magnitude of logistics operations that makes it a long-term challenge. The DoD audit community continually provides services to the Department in evaluating new business processes and identifying processes for reform.

Major logistics initiatives include Force-centric Logistics Enterprise, DoD Business Management Modernization Program, Performance Based Logistics, and Base Realignment and Closure. The Force-centric Logistics Enterprise initiative is a comprehensive program to integrate logistics with operational planning and to meet warfighter requirements for more agile and rapid support. Force-centric Logistic Enterprise is focused on near-term collaborative initiatives that directly improve warfighter support, address known structural problems, and accelerate achieving the Department's long-range vision of Focused Logistics. The primary objective of the DoD Business Management Modernization Program is to change DoD business processes in logistics and financial systems to achieve efficiencies, and in the process to eliminate redundant and non-compatible systems. The objectives of the Performance Based Logistics initiative are to compress the supply chain, eliminate non-value-added steps, and improve readiness for major weapons systems and commodities. The objective of the Base Realignment and Closure initiative is to realign the DoD military base structure and examine and implement opportunities for greater joint activity. The OIG is providing audit services to evaluate the logistics initiatives and to support Base Realignment and Closure Joint Cross Service Groups that are analyzing common business-oriented functions for supply, storage, and industrial functions.

## Infrastructure and Environment

- *Improve readiness and quality of key facilities*
- *Manage overhead and direct costs*
- *Realign support to the warfighter*

The challenge in managing approximately 4,700 military installations and other DoD sites is to provide modern, habitable, and well-maintained facilities, which cover a spectrum from test ranges to housing. The Department's review of our defense and security needs resulted in transforming our force structure and prompting a corresponding new base structure.

The challenge of a new base structure is complicated by the need to minimize spending on infrastructure so funds can be used instead on defense capability. Unfortunately, the Department has an obsolescence crisis in facilities and environmental requirements have continually grown. Furthermore, the Department maintains an estimated 25 percent more base capacity than needed to support its forces which diverts scarce resources from critical areas.

### Discussion

Transformation through Base Realignment and Closure poses a significant challenge and opportunity for the Department. Base Realignment and Closure 2005 should eliminate excess physical capacity and transform DoD infrastructure into a more efficient structure for greater joint activity. As part of the challenge, the Department must meet the timelines established in law and use certified data that are accurate and complete to develop recommendations. Another critical aspect of the Base Realignment and Closure is to have a fair and accurate process that will withstand GAO, Base Realignment and Closure Commission and public scrutiny.

The Department is the largest steward of properties in the world, responsible for more than 29 million acres in the United States and abroad with a physical plant of 586,000 buildings and other structures valued at approximately \$646 billion. Those installations and facilities are critical to supporting our military forces and must be properly sustained and modernized to be

productive assets. The goal of the Department is a 67-year replacement cycle for facilities and the current program would achieve that level in FY 2008. The replacement cycle was reduced from a re-capitalization rate of 192 years in FY 2001 to 136 years in FY 2004.

As of the 2nd Quarter, FY 2004, the Military Departments owned 1,867 electric, water, wastewater, and natural gas systems worldwide. The Department has implemented an aggressive program to complete privatization decisions on all the water, sewage, electric, and gas utility systems by September 2005. In addition, although installation commanders must strive to operate more efficiently, they must do so without sacrificing their ability to operate in the event of a terrorist attack on our homeland. Comprehensive plans for preventing sabotage and responding to attacks on water and power at military installations will be complicated by civilian control of utilities.

As of June 30, 2004, DoD has an estimated \$61.1 billion in environmental liabilities. The Department continues to correct past material control deficiencies in identifying and tracking sites with environmental liabilities and maintaining audit trails for financial liability estimates. The Department needs to improve documentation and supervisory review of environmental liability estimates.

The DoD audit agencies issued 24 reports on infrastructure and environmental issues during FY 2004. The agencies reported on topics such as military construction projects, residual value of facilities at overseas bases, Base Realignment and Closure, recycling operations, energy management, and land use controls and monitoring at formerly used defense sites.

### **Inspector General Assessment of Progress**

The Department has made progress this year in defining all of the infrastructure problems as it works toward making recommendations for realignment and closure in the Base Realignment and Closure 2005 process. That progress comes after decades of struggle with aging and excess infrastructure. The oversight and breadth of Base Realignment and Closure 2005 far exceeds prior Base Realignment and Closure efforts in 1989, 1991, 1993, and 1995.