



# **DEPARTMENT OF DEFENSE AGENCY FINANCIAL REPORT FISCAL YEAR 2012**

## **ADDENDUM A**

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## **ADDENDUM A, OTHER ACCOMPANYING INFORMATION**

Other Accompanying Information provides additional details that support the Fiscal Year (FY) 2012 Department of Defense (DoD) Agency Financial Report (AFR). This addendum includes the following sections:

- Inspector General Summary of Management and Performance Challenges for FY 2012
- Managers' Internal Control Program
- Improper Payment and Payment Recapture Programs

### **INSPECTOR GENERAL SUMMARY OF MANAGEMENT AND PERFORMANCE CHALLENGES FOR FY 2012**

The Reports Consolidation Act of 2000 requires that the AFR include a statement, prepared by the Department's Inspector General (IG) that summarizes what the IG considers to be the most serious management and performance challenges facing the Department, along with a brief assessment of the Department's progress made in addressing those challenges. The DoD IG identified the following seven management and performance challenges facing the Department in FY 2012:

1. Financial Management
2. Acquisition Processes and Contract Management
3. Joint Warfighting and Readiness
4. Information Assurance, Security, and Privacy
5. Health Care
6. Equipping and Training Iraq and Afghan Security Forces
7. The Nuclear Enterprise

The following tables summarize the seven challenges, the IG's assessment of the Department's progress in addressing these challenges, and the Department's management response.

**1. IG-Identified Challenge: Financial Management**

1-1A. Achieving Financial Statement Audit Readiness

IG Summary of Challenge

The Department financial management challenges adversely affect its ability to provide reliable, timely, and useful financial and managerial data needed to support operating, budgeting, and policy decisions. Gaps in the financial framework impact the accuracy, reliability and timeliness of budgetary and accounting data and financial reporting, thereby reducing the effectiveness of decision making by leaders at all levels. A key effort to addressing the Department’s financial management challenges is its ability to produce auditable financial statements and achieve an unqualified opinion on those financial statements. Achieving auditable financial statements has proven to be a longstanding and daunting task and the success of the DoD financial improvement and audit readiness effort is dependent upon the Department being able to address the following key items:

- Successful resolution of previously identified material internal control weaknesses to ensure that internal controls are properly designed, implemented, and working effectively.
- Successful monitoring and resolution of new material internal control weaknesses identified as part of ongoing readiness efforts.
- Sustained improvement in internal controls and systems to provide consistent and repeatable results regarding financial data used in decision making and reporting.
- Effective development and implementation of the financial improvement effort by monitoring DoD progress in achieving milestones; developing comprehensive improvement initiatives across DoD functional areas; and holding managers accountable for the successful and timely implementation of those efforts.

Congress requires the Department ensure that the DoD financial statements are validated as audit ready by September 30, 2017. The most significant challenge for the Department will be in meeting that date. Further, Public Law 111-383, Section 881, requires the Department to establish interim milestones to achieve audit readiness of its financial statements by September 30, 2017. These interim milestones for Military Departments and Defense Components call for the achievement of audit readiness for each major element of the Statements of Budgetary Resources (SBR), such as civilian pay, military pay, supply orders, contracts, and the entity’s Funds Balance with the Treasury. The Department must aggressively pursue the development and implementation of comprehensive improvement initiatives and monitor progress according to interim milestones. The Department may need to revise these initiatives and milestones as additional deficiencies and corrective actions are identified as a result of DoD’s iterative Financial Improvement and Audit Readiness (FIAR) process.

In October 2011, the Secretary of Defense directed significant changes in the Department’s audit goals, including calling for audit readiness of the SBR in 2014. Additionally, Public Law 112-81, Section 1003, requires that the Department have a plan that includes interim objectives and a schedule of milestones for each military department and for the defense agencies to support the goal to validate the SBR by not later than September 30, 2014. Meeting the Secretary’s accelerated 2014 milestone for auditability of the SBR will be a challenge for the Department. The Department must continue to develop and implement a comprehensive plan that identifies the interim objectives and schedule of milestones to achieve audit readiness of the SBR for the

working capital and general funds. Also, the interim milestones must address the existence and completeness of each major category of DoD assets, which includes military equipment, real property, inventory, and operating material and supplies. Additionally, Section 881 requires the Department examine the costs and benefits of alternative approaches to valuing its assets, develop remediation plans when interim milestones cannot be met, and identify incentives to achieve auditability by September 30, 2017.

**1-1B. Achieving Financial Statement Audit Readiness**

**IG Assessment of Progress**

Although the Department is far from reaching an unqualified opinion on its consolidated financial statements, the Department has demonstrated improvements. Clearly, DoD senior leadership has placed an increased emphasis on and attention to addressing challenges in achieving audit readiness of its financial statements. We believe this increased attention and emphasis are essential to the Department meeting its own internal milestones as well as the 2017 audit readiness mandate.

A significant measure of DoD’s ongoing progress in the area of financial management is the ability to obtain an unqualified opinion on its financial statements. Despite the pervasive and longstanding Department financial management issues, the U.S. Army Corps of Engineers and various Defense agencies, such as the Defense Commissary Agency, Defense Contract Audit Agency, and Military Retirement Fund, have received unqualified audit opinions. While much more work is necessary, it is encouraging that the Department is making progress in meeting its strategic goals, such as in August 2011, when the Army, Navy, and Air Force achieved unqualified opinions from Independent Public Accounting firms on Services Appropriations Received audit readiness assertions. The Department must sustain its achievements as well as advancing in the remaining significant areas. The DoD IG continues to identify and cite the same 13 material internal control weaknesses in its audit opinion on DoD’s consolidated financial statements. These pervasive and longstanding financial management issues directly affect DoD’s ability to obtain an unqualified opinion on its financial statements. These weaknesses affect the safeguarding of assets, proper use of funds, and impair the prevention and identification of fraud, waste, and abuse

The Department continues to make progress towards meeting the 2014 audit readiness goal of the SBR; however, it is still uncertain whether the Department will meet the 2014 goal. The Department continues to learn and improve from the DoD IG audits of the SBR for the U.S. Marine Corps (USMC), the first Military Component to undergo such an audit. The USMC encountered many challenges during this first type of audit, which resulted in disclaimers of opinion in FY 2010 and FY 2011. Although the USMC SBR received disclaimers, the USMC, the Navy, and the Department are using this experience to correct the weaknesses as well as prepare the other Military Components for their eventual SBR audit. The May 2012 FIAR Plan Status Report only addresses audit readiness of the SBR for the general funds. As the Comptroller has indicated, two Military Services will have to accelerate their efforts to achieve audit readiness of their SBR by 2014. For one Service, that acceleration requires a new approach. The Department will also have to accelerate efforts to achieve audit readiness for the Defense Agencies. Department efforts and meaningful progress in FY 2013 for the SBR audit readiness goal will be critical and should be a high visibility area.

1-1C. Achieving Financial Statement Audit Readiness	Department Response
<p>The Department generally agrees with the IG’s assessment of DoD’s progress in achieving audit readiness. Over the last year, significant progress has been made by Military Departments, Defense Agencies, and other Defense organizations in support of audit readiness. At the beginning of FY 2012, Secretary Panetta directed the Department to accelerate several of the FIAR Plan goals with greater emphasis on the overall effort. Specifically, the Secretary directed the Department to:</p> <ul style="list-style-type: none"> <li>• Achieve audit readiness of the SBR by the end of FY 2014.</li> <li>• Increase emphasis on accountability of assets.</li> <li>• Execute a full review of the Department’s financial controls over the next two years and establish interim goals against which to assess progress.</li> <li>• Ensure mandatory training for audit and other key financial efforts and establish, by the end of calendar year 2012, a pilot certification program for financial managers – similar to the one now in place for acquisition managers.</li> <li>• Appropriately resource efforts to meet these goals.</li> <li>• Meet the legal requirements to achieve full audit readiness for all DoD financial statements by 2017.</li> </ul> <p>Achieving the 2014 SBR audit readiness goal will be challenging, but with the Secretary’s involvement, the Department’s ability to achieve this goal has increased significantly. The Secretary’s commitment to and personal involvement in auditability has elevated audit readiness to an “all hands,” DoD-wide effort. The impact can be seen in a variety of ways:</p> <ul style="list-style-type: none"> <li>• Warfighters, from flag officers to enlisted personnel, are more aware, engaged, and committed to audit readiness.</li> <li>• Appropriate senior executives across the Department, including those outside the financial community, have FIAR goals in their performance plans and are being held accountable.</li> <li>• Military Departments, Defense Agencies, and other Defense organizations have refined, modified or developed Financial Improvement Plans (FIPs) that include interim milestones to accomplish SBR audit readiness consistent with the Secretary’s direction for 2014. Progress is monitored and routinely reported in the FIAR governance process.</li> <li>• Component FIPs better conform to DoD FIAR Guidance and provide more detail regarding discovery and corrective actions. The FIPs are reviewed monthly by the Office of the Under Secretary of Defense (Comptroller), and the quality is routinely reported in the FIAR governance process.</li> <li>• Acquisition Decision Memorandums, issued by business information technology (IT) milestone decision authorities, now consistently contain FIAR goals and requirements.</li> <li>• Component commands and subordinate organizations are more actively involved.</li> <li>• Adequate funds for audit readiness activities have been maintained.</li> <li>• Participation in FIAR training courses has significantly increased.</li> </ul>	

Even with the Secretary’s commitment and involvement, the significant challenges to eliminating material weaknesses, strengthening internal controls, modernizing business and financial systems, and producing auditable financial statements remain. However, the Department is now better positioned to make meaningful progress, sustain improvements, maintain a strong control environment, and achieve auditability. In fact, progress has been made since the last AFR, as demonstrated by the following successful audits.

- Defense Information Systems Agency (DISA) received an unqualified opinion on its FY 2011 Working Capital Fund financial statements.
- TRICARE Management Activity – Contract Resource management received an unqualified audit opinion on its FY 2011 financial statements.
- Medicare-Eligible Retiree Health Care Fund received a qualified audit opinion on its FY 2011 financial statements.
- Navy received an unqualified audit opinion on its audit readiness assertion for existence and completeness of its ships and submarines, Trident missiles, and satellites.
- Navy received an unqualified audit opinion on its audit readiness assertion for the E-2D Advanced Hawkeye aircraft acquisition program.
- Air Force received an unqualified audit opinion on its audit readiness assertion for existence and completeness of aircraft, cruise missiles, and aerial targets/drones.

Information on the DoD FIAR Plan can be found in the semi-annual FIAR Plan Status Report.

1-2A. Modernizing Financial Systems  
(Enterprise Resource Planning)

IG Summary of Challenge

In an attempt to standardize and develop an effective financial management process throughout the Department, DoD embarked on various efforts to implement new financial management systems and associated business processes. We believe that properly planned and integrated systems, with strong internal controls, are critical to provide useful, timely, and complete financial management data and to achieve auditability. However, timely and effective implementation of the Enterprise Resource Planning (ERP) systems is also critical for the Department to achieve its financial improvement and audit readiness goals. We believe the Department’s progress in implementing ERPs, especially in FY 2013, is a critical challenge, and any implementation delays or systems that do not meet the intended objectives could jeopardize the Department’s ability to meet its auditability goals.

1-2B. Modernizing Financial Systems  
(Enterprise Resource Planning)

IG Summary of Progress

The Department plans to spend more than \$15 billion to further develop and implement ERP systems. These ERP systems have experienced cost increases and schedule delays ranging up to 13 years. Because of these schedule delays, the Department will continue using outdated legacy systems and diminish the estimated savings associated with transforming business operations through business system modernization. Schedule delays and poorly developed and implemented ERP systems also increase the risks that the SBR will not be auditable by September 30, 2014, and the goal of full financial statement audit readiness by September 30, 2017.

Further, without fully deployed ERPs, the Department may not be able to produce reliable financial data and auditable financial statements without resorting to heroic efforts, such as data calls or manual workarounds, and may not be able to provide consistent and reliable financial and reporting data on a recurring basis. For example, DoD reported in the May 2012 FIAR Plan Status Report that the Air Force ERP systems will not be fully deployed by 2014. As a result, the Air Force will rely on manual controls and legacy system enhancements in order to meet the goal of SBR audit readiness by September 30, 2014. The Department also reported that the accelerated goal for the SBR presents other challenges to the Air Force, such as, the time and resources required to conduct testing will increase because manual controls are generally less reliable and require more testing than system controls. The Department also reported that the difficulty of collecting supporting documents processed in multiple systems and reconciling data as it moves from one system to another is a challenge for the Air Force.

The Department has not reengineered established business processes to the extent necessary; oftentimes, it has customized commercial ERP systems to accommodate existing business practices. This leads to the need for system interfaces and weakens controls built into the ERP system. The Department reported that ERP systems were designed to replace numerous subsidiary systems, reduce the number of interfaces, and standardize and eliminate redundant data entry, while providing an environment for end-to-end business processes and serving as the foundation for sustainable audit readiness. However, the numerous interfaces between the ERP and the existing systems may be overwhelming and currently may not be adequately defined. Each interface presents a risk that the system will not function as designed and prevents linking all transactions in an end-to-end business process. The Department needs to ensure ERP system development addresses required business processes and functions.

Without the effective and timely development and implementation of ERP systems, and appropriate senior level governance, the Department will continue to struggle to improve its processes to ensure accurate, timely, and meaningful financial management information for the users, both internally and externally, and to achieve long-term sustainability of the financial management improvements.

**1-2C. Modernizing Financial Systems (Enterprise Resource Planning)**

**Department Response**

The Department is committed to supporting improvements to financial processes through the implementation of ERP systems. In support of these efforts, the Department has been working diligently to improve business processes and develop its ERPs, improving oversight of the development of the ERPs and implementation of formal business process reviews in support of auditability.

While it is true that legacy systems will continue to be employed during the development and full deployments of the ERPs, the implementations that have already occurred throughout the Department have resulted in the ability to phase out dozens of legacy systems. Several of the Department’s ERPs have been or will be implemented to support the 2017 auditability goal. However, where we are dependent on legacy systems, the Component’s FIPS have incorporated actions necessary to ensure that accurate, reliable financial information is reported. Modernizing the Department’s business systems is a key aspect of our overall effort to achieve and sustain auditability. The Department plans to achieve the audit goals with a combination of both target and legacy systems. While the Department is taking pro-active steps to align individual ERP programs with auditability outcomes, we are also focused on delivering

audit ready processes and controls that will remain outside the ERP systems. This will allow us to develop a sustainable business environment that can be cost-effectively audited.

The ERP programs, by their very nature, are designed to handle transactions in a defined end-to-end process, enforce process and execution standardization among implementing organizations, manage consolidated business data in a single repository that allows centralized access control, and facilitate the flow of information both within an organization and with external stakeholders. These design principles within the ERP directly enable capabilities essential to auditability, such as traceability of all transactions from source to statement; the ability to recreate a transaction; documented, repeatable processes and procedures; demonstrable compliance with laws, regulations and standards; and a control environment that is sufficient to reduce risk to an acceptable level.

Essentially, ERPs are acquired with industry best practices “to-be” processes embedded within them. Each of the Department’s ERP programs went through significant up front blueprinting and gap analysis to determine which configuration or customization was necessary for the system to work within the business environment in which it was to be fielded. The Department has focused on properly enforcing compliance with the target financial management environment, built on a backbone of the core ERP systems, aligned with the Business Enterprise Architecture’s end-to-end processes. In concert with the new Investment Review Board process currently being implemented, as required by the FY 2012 NDAA, these advances will ensure the retirement of legacy systems and the reduction of interfaces and necessary customization as required by the NDAA Business Process Review (BPR) requirement.

The Department’s leadership is fully committed to improving ERP implementation and providing proper oversight of its development. Following the passage of the FY 2010 NDAA, the Department instituted a BPR assessment process updated to comply with new requirements of NDAA FY 2012. A combination of ERP implementation and associated BPR will help ensure the Department achieves its audit objectives.

1-3A. Improper Payments

IG Summary of Challenge

Improper payments have been a longstanding problem within the Department, often the result of unreliable data and/or lack of adequate internal controls which create an environment where fraud is more likely. As a result, the Department lacks assurance that the billions of dollars in payments it disburses annually are made correctly. Simply stated, the Department does not always know that it is paying the right person, the correct amount, at the right point in time.

The Department’s inadequate financial systems and controls impede in making proper payments. In addition, the pace of operations and volume of Department spending creates additional risks for improper payments as well as affects the Department’s ability to detect and recover improper payments. Transactions and processes (business and financial processes, controls, and systems) are neither standard nor sound in all cases. The High Dollar Improper Payment Report was inaccurate and incomplete because the Department did not develop a sound methodology or perform adequate oversight for collecting and reporting comprehensive data.

The Department has challenges with the completeness and accuracy of DoD’s improper payment reviews and the information reported. In the FY 2011 DoD AFR, the Department’s Under Secretary of Defense (Comptroller)/Chief Financial Officer

(USD(C)/CFO)) made significant disclosures about the limited completeness and accuracy of DoD efforts to identify and report on improper payments, including:

- The Department did not statistically sample Defense Finance and Accounting Service (DFAS) commercial payments for its FY 2011 reporting.
- Transactions and processes (business and financial processes, controls, and systems) were neither standard nor sound in all cases.
- The SBR is not auditable and as a result, the USD(C)/CFO cannot reconcile outlays to the quarterly or annual gross outlays reported in the SBR to ensure that all required payments for reporting purposes are captured.

These areas require improvement before the Department will be able to provide complete and accurate information on its estimated amount of improper payments.

The DoD IG has reported previously about the Department’s “pay and chase” practice, where contractors are paid the billed invoice amounts before the Department determines what the correct billing amount should have been. This practice is especially concerning when used to support operations in Southwest Asia. The DoD IG and others have reported on multiple occasions where invoices were paid for work outside the scope of the contract or without adequate support. This type of approach not only increases the risk of improper payments but also increases the risk that the Department will never be able to detect and recover the improper payments. Specifically, over time the condition of contract files and availability of personnel diminishes. The ability to detect and collect on improper payments within aging contract files may diminish over time. The Defense Contract Audit Agency (DCAA) is a key component to identify improper payments in Department contracting. However, there is an emerging concern that the backlog of audits is growing and improper payments are going undetected because the DCAA cannot adequately respond to the growing demand for its services.

**1-3B. Improper Payments**

**IG Summary of Progress**

While the Department made strides to improve the identification and reporting of improper payments and took many corrective actions to implement recommendations made by the DoD IG, more work is needed to improve controls over payments processed throughout the Department. We commend the Department on aggressively pursuing recovery of identified improper payments, but unless the DoD continues to improve its methodology to review all its disbursements, it will understate its estimate of overpayments and will likely miss opportunities to collect additional improper payments.

After initial resistance to the IG assertion that the Department’s methods used to estimate high dollar overpayments resulted in under-reporting the amount of improper payments, the Department recognized it needs to broaden its scope of review for identifying potential improper payments. The USD(C)/CFO asserted that DFAS will begin statistical sampling of commercial payments in FY 2012. The ability of DCAA to provide audit oversight for contract closeouts is critical to the Department’s improper payments efforts. Leadership must maintain awareness on DCAA’s ability to provide this critical service.

**1-3C. Improper Payments**

**Department Response**

The Department concurs with the DoD IG recognition of DoD’s improvements in identifying, reporting, and recovering improper payments and in implementing

corrective actions. The Department is committed to complying with all laws and regulations established to reduce improper payments. As reported in DoD IG Report No. D-2012-065, the Department is compliant with the requirements of the Improper Payments Elimination and Recovery Act (IPERA). Beginning in FY 2012, the Department instituted statistical sampling for commercial payments disbursed by DFAS.

Since the Department first reported on improper payments in the FY 2004 Performance and Accountability Report, improper payment rates have declined. The Office of Management and Budget (OMB) reported the government-wide FY 2011 error rate for improper payments at 5.49 percent, which is substantially higher than each of DoD's programs<sup>1</sup>. Further, OMB has not designated any of DoD's programs to be a high error program, as shown on the PaymentAccuracy.gov web site.

The Department does not agree with the IG's statement that deficiencies in the Department's initial High Dollar Improper Payment Report, as reported in DoD IG Report No. D-2011-050, present a significant management challenge. The cited report was based on information from Quarter 3, FY 2010 – more than two years ago, and all 13 open recommendations have been successfully closed.

The Department does not have a "pay and chase" practice, as cited above by the DoD IG, where contractors are paid before the Department determines the correct billing. In Audit Report No. D-2011-050, the DoD IG used the phrase, 'pay and chase' when referring to a DFAS review of travel pay among different systems. The DCAA performs risk-based voucher reviews to proactively keep contractor billings aligned with final amounts and rates, not 'pay and chase,' and it is an important part of the Department's audit readiness efforts. The DCAA is diligently working to reduce its current audit inventory and is making progress.

**2. IG-Identified Challenge: Acquisition Processes and Contract Management**

2-1A. Enhancing the Acquisition Workforce	IG Summary of Challenge
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The Department continues to struggle with its efforts to rebuild an acquisition workforce that is sufficient in size and adequately trained and equipped to oversee DoD acquisitions. Even though the Defense acquisition workforce has grown over the last few years, the Department still faces significant challenges in order to sustain a successful and well trained Defense acquisition workforce. These challenges include: 17 percent of the acquisition workforce is eligible for full retirement today; 19 percent are eligible within 5 years; and personnel losses spiked up 3 percent from FY 2010 to FY 2011. The Department needs to continue to provide developmental opportunities to the Defense acquisition workforce to have personnel who can successfully manage complex acquisition programs in the Department. Regardless of the looming decline in the Defense budget, the vital role the acquisition workforce plays in providing the warfighters with new capabilities will remain. Previous Defense budget cuts decimated the capability of the acquisition workforce; a mistake the Department can ill afford to repeat.

<sup>1</sup> The Fiscal Year 2011 DoD Agency Financial Report showed the overall Department error rate at 0.18 percent; however, DFAS commercial payments included in this figure were an actual amount, not a statistical estimate.

2-1B. Enhancing the Acquisition Workforce	IG Assessment of Progress
<p>The Department senior leadership continues to recognize the importance of fielding a capable acquisition workforce to effectively manage and oversee DoD acquisition and contracting. To successfully accomplish the acquisition mission, DoD is placing greater emphasis on developing a higher-quality workforce that has the right competencies and skill sets at the right place at the right time.</p> <p>The Department has filled 6,400 new acquisition positions since 2008 and as of the second quarter 2012, the total acquisition workforce is over 151,000 personnel. The Defense Acquisition Workforce Development Fund budget estimate of \$274.2 million in FY 2013 further demonstrates DoD's sustained commitment to increase the end strength and quality of the acquisition workforce; however, current budget constraints raise questions as to whether the department will be able to sustain this projected growth and support related initiatives. Sustained commitment and management attention is essential to ensure the improvements to the acquisition workforce are not lost or needlessly diminished.</p> <p>The Under Secretary of Defense for Acquisition, Technology and Logistics (USD(AT&amp;L)) emphasized strengthening the acquisition workforce as a priority in his October 7, 2011 initial guidance memorandum. The USD(AT&amp;L) stated that since the levels of the acquisition workforce have grown over the last few years, they will increasingly turn their attention to improving the capability of the workforce they have.</p> <p>The Department continues to use the Defense Acquisition Strategic Workforce Plan, April 2010, which outlines additional strategies the Department is employing to support an acquisition workforce that has the capacity and ability to appropriately manage and oversee acquisitions. They are closely partnering with the Defense Acquisition University and offering several continuous learning and classroom courses. The Defense Acquisition University incorporated better buying power into all of their learning assets, specifically creating a Better Buying Power Gateway on the Defense acquisition portal to serve as a central point of access to the latest information on the Better Buying Power initiatives.</p>	
2-1C. Enhancing the Acquisition Workforce	Department Response
<p>The Department concurs with the IG's assessment.</p>	
2-2A. Weapon System Acquisition	IG Summary of Challenge
<p>The Department remains challenged in its management of major acquisition programs. The number of Major Defense Acquisition Programs (MDAPs) has decreased, from 111 in FY 2011 to 89 in FY 2012. While the performance of no two acquisition programs is the same and a good number of them operate within their cost and schedule constraints, there are still too many programs that are experiencing significant cost growth and delay in delivering capabilities. The Department needs to continue to look for a better balance between its limited resources and the capabilities needed to be successful in current conflicts and to prepare for possible future conflict. As budgets come under increasing scrutiny, including the threat of sequestration in 2013, the Department will be challenged to evaluate the merits of all programs as to their usefulness and the need for further program terminations to remain within budget constraints.</p>	

2-2B. Weapon System Acquisition	IG Assessment of Progress
<p>Through leadership at the highest levels, the Department has demonstrated its commitment to addressing shortcomings identified in the management of weapon system acquisitions. The Department continues to reprioritize and rebalance its investments in weapon systems and has made strides towards improving efficiency.</p> <p>On September 14, 2010, the USD(AT&amp;L) issued a directive geared at obtaining better buying power through greater efficiencies and productivity in defense spending. The Department continues to emphasize the importance of achieving better buying power and has been implementing this initiative to identify efficiencies, increase affordability and determine what goods and services should cost.</p> <p>The USD(AT&amp;L), as part of his Better Buying Power initiative to buy more for less money, established a new position focused on defense pricing. Specifically, with the establishing of this position, the Department will concentrate on the affordability of the goods and services it purchases, looking beyond program cost estimates and determining what a program should cost. All ongoing programs are required to present should cost estimates at each milestone decision point, which will be used as a basis for contract negotiations and determining contract incentives.</p> <p>Audits continue to identify oversight and pricing problems that show the Department's need to prudently evaluate contractors in the fast-paced environment of war. The Department is beginning to apply extra scrutiny to weapon systems that are behind schedule and over cost as it continues the process of making the hard decisions about what is and is not affordable. In recent times, senior leadership has demonstrated sound stewardship by eliminating major acquisition programs that were underperforming, over budget, of questionable continuing investment.</p>	
<b>2-2C. Weapon System Acquisition</b>	<b>Department Response</b>
<p>The Department concurs with the IG's assessment.</p>	
2-3A. Contract Management	IG Summary of Challenge
<p>The Department continues to experience inefficiencies and wasteful use of funds in its contracting efforts. The Department's continuing contracting challenges include obtaining adequate competition in contracts, defining contract requirements, overseeing contract performance, obtaining fair and reasonable prices, and maintaining contract documentation for contract payments.</p> <p>The Department relies heavily on contractors to provide acquisition management and contract support functions, which oftentimes includes acquisition planning, requirement determinations, contract award, performance review, bid analysis, cost assessment, and contract monitoring functions. The Department's increased use of contractors as acquisition support highlights DoD's shortcomings. The Department spends more than \$200 billion annually on services, which amounts to more than 50 percent of the Department's contract spending.</p> <p>The Department faces several challenges when it comes to contract oversight and administration. Our audits continue to identify that without proper oversight, the Department cannot be certain that contractors are performing in accordance with contract requirements, cannot support payments of award or incentive fees, cannot support the certification of invoices for services performed, and cannot ensure that</p>	

services are performed, thus leaving the Department vulnerable to increased fraud, waste, abuse and misuse of taxpayer monies.

The Department continues to face challenges in obtaining fair and reasonable prices for parts. Audits first started identifying problems with price-based acquisition and commercial pricing back in the late 1990's, and it was not until 2008 that legislative changes allowed contracting officers to request information on labor costs, material costs, and overhead rates for commercial items.

More recently, the Department has moved to new performance-based logistics (PBL) or contractor logistics support (CLS) arrangements that have added a new challenge to obtaining fair and reasonable prices for parts, since the Services are now going back to the weapons systems contractors instead of other available sources to procure the parts. Normally, the Services would procure the parts from the Defense Logistics Agency which in turn would procure the parts from the original equipment manufacturer, not the weapons systems contractors. Paying excessive prices for parts procured from the weapons systems contractors that did not manufacture the items was reported back in the 1980's and resulted in the spare parts breakout initiative. Unfortunately, future budget constraints made breakout and cost/price analysis groups targets for workforce reductions. The Department also faces challenges in effectively using existing Government inventories of spare parts before procuring the same parts from private contractors through these PBL or CLS arrangements.

2-3B. Contract Management

IG Assessment of Progress

The Department continues to make efforts to strengthen contracting and has issued policy, procedures, and guidance addressing current contracting challenges. The Department began the Better Buying Power Initiative in 2010 and continues to implement this initiative to improve the way the Department acquires goods and services. In April 2011, the previous USD(AT&L) amplified the focus of the better buying power memorandum to maximize competition in situations where only one offer is received in a procurement utilizing competitive procedures. In his October 2011 initial guidance memorandum, the USD(AT&L) emphasized his commitment to improving efficiency through the Better Buying Power initiative, which he stated they will continue to refine and build upon to reduce costs and provide the highest possible value to the warfighter. The Department has also emphasized "affordability" in review of acquisition efforts and using peer review to improve quality of contracting processes across the Department.

The USD(AT&L) required each Military Department and Defense Component to establish a senior manager for the acquisition of services, who would be responsible for the planning and execution of service contracts. The Department has also organized the procurement of services into six categories in order to make decisions, share lessons learned, and institutionalize strategic sourcing.

In response to audits relating to PBL and CLS strategies, the USD(AT&L) for Logistics and Materiel Readiness issued guidance that created a standard practice of using existing on-hand and due-in government inventory. The guidance also stated that in these arrangements, stocking objectives should be adjusted accordingly when using commercial sources. Further, senior leadership directed that components should perform cost and price analysis on a sample of spare parts before exercising options.

The Department continues its work to improve contingency contracting. Some initiatives include:

- Implementing corrective actions on findings from the Commission on Wartime Contracting.
- Standardizing Contracting Officer Representative (COR) qualifications.
- Providing tools such as the DoD Contingency COR and Contingency Contracting Officer Handbook.
- Creating a 340-person reach-back center to award complex contracts and support contract closeout.

**2-3C. Contract Management**

**Department Response**

The Department agrees with the IG’s summary of challenges and assessment of progress and continues to work aggressively to resolve the long-standing material weaknesses in contract management. The Department continues to implement initiatives designed to improve contract management. These key initiatives include:

- Continued use of “peer reviews” to improve the quality of contracting processes across the Department and facilitate cross-sharing of best practices and lessons learned.
- The Director of Defense Pricing issued a memorandum on August 27, 2012, entitled “Taxonomy for the Acquisition of Services and Supplies & Equipment”. Based on a review of the existing taxonomy and supported by the Senior Service Managers, the Department established a Logistics Management Services Portfolio Group. The revised taxonomy supports the Department’s effort in fostering communication and strategic decisions.
- On August 29, 2012, the Defense Federal Acquisition Regulations Supplement (DFARS) Procedures, Guidance, and Instruction 237.102-77, Automated Requirements Roadmap Tool, was changed to add a link to the tool that enables requiring activities to develop and organize Performance Work Statements and Quality Assurance Surveillance Plans using templates.
- On June 29, 2012, the Defense Procurement and Acquisition Policy (DPAP) Directorate issued the final DFARS rule under the Better Buying Power initiative to promote more effective competition. This DFARS rule requires contracting officers to maximize competition when only one offer is received in competitive procurements. The DPAP Directorate has established a metric to monitor effective competition and is now reporting the data at quarterly competition advocates meetings.
- The Director of DPAP issued a memorandum on July 11, 2012, entitled “Increasing Opportunities for Small Business Set-asides under the Simplified Acquisition Thresholds,” that reminds contracting officers of statutory requirements to set aside contracts for small businesses which play a vital role in contributing to the defense industrial base.
- The Director of DPAP issued a memorandum on July 26, 2012, entitled “Maximizing Small Business Utilization on Multiple Award Contracts.” This memorandum reminds contracting activities to commit to using set-aside procedures, where appropriate, for all prospective new multiple award contracts with small businesses; to identify existing multiple award contracts with small businesses where orders may be appropriate; and to commit to using set asides.

- Published the Department of Defense Contracting Officer Representative (COR) Handbook on March 22, 2012. This handbook addresses key aspects of contract quality surveillance and the roles and responsibilities of the Contracting Officer, the Contracting Officer Representative (COR), and the requiring activity/COR management. It is intended to be a comprehensive resource for the Contracting Officer, COR management, and the first-time or the experienced COR.
- Published the 2<sup>nd</sup> Edition of the Defense Contingency Contracting Officer Representative Handbook on July 11, 2012, for use by CORs who are supporting contingency operations with basic tools and knowledge.
- Published the 4<sup>th</sup> Edition of the Defense Contracting Handbook on July 11, 2012. This pocket-sized handbook provides essential information, tools, and training for DoD Contingency Contracting Officers to meet the challenges they may face, regardless of the mission or environment.

### 3. IG-Identified Challenge: Joint Warfighting and Readiness

#### 3-1A. Joint Warfighting and Readiness

#### IG Summary of Challenge

The Department will face many challenges in the near future in joint warfighting and readiness. Among them are a decreasing budget, a planned drawdown of forces from Afghanistan, the need to reset equipment and personnel across the Services, a return to full-spectrum training, and an enhanced focus on the Pacific theater. But the desired end-state remains the same: provide the right force, the right personnel, and the right equipment and supplies in the right place, at the right time, and in the right quantity, across the full range of military operations. A decrease in DoD's budget will be felt across the Department, especially in areas like training and exercises. The Services and the Combatant Commands need to ensure training and exercises conducted are realistic, providing personnel the skills they will need to respond to threats wherever they occur in the future.

The planned drawdown of forces from Afghanistan will challenge the Department in many areas, simultaneously. The forces will have to be reintegrated into the total force and reset will have to occur; not just to equipment, but also personnel and units. The Services have announced plans to restructure themselves for future conflicts. The Army has announced plans to reduce its forces in Europe while the Air Force has identified a number of units for realignments. The Navy has stated that they plan to move more ships to the Pacific theater and the Marines continue to plan for a drawdown in Okinawa and relocating forces to Guam. The reintegration of forces comes with a continued need to take care of the service members and their families.

Those same units that will be undergoing changes in personnel strength, and possibly locations, will also need to have their equipment requirements addressed. Equipment the units will need to retain will need to be repaired; equipment the units are not retaining will need to be replaced with newer items of equipment. All of these challenges will require management visibility and vigilance to ensure the Department has what it needs, but also identifies excess, so it can be accounted for properly. The enhanced focus on the Pacific will also challenge the Department as it reaffirms existing relationships in the region and looks to establish new ones.

3-1B. Joint Warfighting and Readiness	IG Assessment of Progress
<p>The Department is making progress to address the multitude of situations with drawdown in Afghanistan, resetting equipment, ensuring the long-term viability of the All-Volunteer force, but must also be ready to address new situations that will rise with the expected reduction in available resources and the rebalancing of the force. The National Security Strategy released in January 2012 placed increased emphasis on the Pacific theater. This will present challenges to all of the components of the Department as they shift their focus to the Pacific. The armed forces will have to train to fight conventional and unconventional scenarios, and they will be challenged to do this with diminishing resources while maintaining their readiness status. The Department will have to provide additional oversight to ensure that the equipment reset process is managed so that only unusable equipment is disposed and new equipment is fielded to the intended users. The Department will also have to provide the necessary levels of oversight to ensure that forces returning from Afghanistan, and their families, continue to receive the support they need.</p> <p>As the drawdown continues in Afghanistan, the Department must ensure the reserve components have the equipment and training necessary to ensure readiness and the ability to meet their various missions. The ongoing efforts to relocate service members to Guam and other locations around the globe will enable the armed forces to better shape and focus their force structure in a way that will provide greater flexibility in responding to threats. The realignment of forces from Okinawa, Japan to Guam still faces formidable challenges which have impacted projected costs and schedules to the planned effort.</p>	
<b>3-1C. Joint Warfighting and Readiness</b>	<b>Department Response</b>
<p>Despite our consistently high operations tempo, the Department remains committed to ensuring deployed forces around the globe are trained, equipped, and ready to perform their assigned missions. Deploying capable and ready forces for current operations continues to impact the non-deployed forces' ability to prepare for full spectrum operations. Non-deployed forces are focusing their available training time to prepare for their next mission in support of Operation Enduring Freedom, hedging against execution of other potential contingencies.</p> <p>The withdrawal of forces from Iraq, combined with Presidential directives to reduce deployed numbers in Afghanistan, has reduced the stress on forces in the near term; however, the expected fiscal constraints looming on the horizon that may result in tough decisions on materiel, manpower, and infrastructure could negate the positive aspects expected from the reductions in operational stress. Additionally, even with the reduction of ground forces in the Central Command area of responsibility, it is anticipated the demand for Naval and Air Forces will continue unabated in the near term.</p> <p>The Department is continually developing and refining comprehensive plans for both resetting and rebalancing the total force, which includes all reserve component forces, in the most effective and efficient manner possible. We recognize the most important part of maintaining joint warfighting capability and readiness is caring for the all-volunteer force. Finding the proper balance between maintaining readiness, force structure, modernization, fiscal realities, and future threats remains the highest priority of the Department's leadership.</p>	

**4. IG-Identified Challenge: Information Assurance, Security, and Privacy**

4-1A. Cyber Security

IG Summary of Challenge

Cyber security is the technology, processes, and practices designed to protect networks, computers, programs, and data from attack, damage, or unauthorized access. As identified in the Department’s strategy for operating in cyberspace, the continuing growth of networked systems, devices, and platforms means that cyberspace is an integral part of the capabilities the Department relies upon to complete its mission. The DoD networks are under constant attack from cyber security threats launched from the internet or from malicious software embedded in e-mail attachments, removable media, or embedded in the hardware DoD procures. Every connected device is susceptible to cyber vulnerabilities. According to recent reports from the Department of Homeland Security, reported computer security incidents for Federal agencies have increased from 5,503 in FY 2006 to 43,889 in 2011, an increase of approximately 700 percent over 6 years. As stated in the Department’s cyberspace strategy, foreign nations are working to exploit DoD unclassified and classified networks, and some have already acquired the capacity to disrupt parts of DoD’s information infrastructure. The Department faces significant challenges in three areas of potential adversarial activity: theft or exploitation of data; disruption or denial of access or service that affects the availability of networks, information, or network-enabled resources; and destructive action including corruption, manipulation, or direct activity that threatens to destroy or degrade networks or connected systems.

4-1B. Cyber Security

IG Assessment of Progress

It has been approximately two years since the Secretary of Defense directed the establishment of the U.S. Cyber Command to plan, coordinate, integrate, synchronize, and conduct activities to lead the day-to-day defense and protection of DoD information networks. Additionally, the Army, Navy, and Air Force have also established their own cyber operations commands. In addition, the Department has made progress in implementing its host-based intrusion detection system (HIDS), which is installed at the individual workstation/server level (host) and monitors systems for network based attacks and host-specific events. Phased implementation and evaluation of the Host-Based Security System, which includes DoD’s primary HIDS, is mostly complete and adjustments are being made. The addition of HIDS to DoD systems contributes to DoD’s defense-in-depth strategy, which also is comprised of network and wireless intrusion detection systems.

While the Department has made progress in combating cyber attacks and breaches, it still faces a challenge in recruiting and hiring cyber security personnel. In testimony on March 20, 2012 to the House Committee on Armed Services, Subcommittee on Emerging Threats and Capabilities, the Commander, U.S. Cyber Command, acknowledged that U.S. Cyber Command was critically short of the skilled people needed to manage networks and protect U.S. interests in cyberspace. According to a recent Government Accountability Office (GAO) report, the Department reported a shortage of 9,000 cyber security personnel from a total of 97,000 total positions. The Commander, U.S. Cyber Command, stated that U.S. Cyber Command is reviewing recruitment and incentive programs to build and retain the best cyber defenders. Cyber security personnel are in high demand inside the Government and in private industry.

The Department must continue finding ways to recruit and retain the cyber personnel necessary to defend DoD's networks and the sensitive data contained within.

**4-1C. Cyber Security**

**Department Response**

The Department continues to strengthen cyber security and address the threat posed by network attacks. The establishment of U.S. Cyber Command and the supporting Service Component Commanders has greatly increased the Department's ability to plan, coordinate, integrate, synchronize, and conduct activities to lead the day-to-day defense and protection of DoD information networks. Implementing a Department-wide enterprise Host-based Security System (HBSS), which includes a Host-based Intrusion Prevention (HIPS) module chosen in place of a host-based intrusion detection system, to extend active protection to the desktop level has been a key component of our defense-in-depth strategy as we take steps to effectively isolate the department's official-use networks from the Internet while maintaining connectivity. This has been undertaken in phases, as we first focused on Secret network implementation and then unclassified networks. This implementation has been directed through U.S. Cyber command tasking and fragmentary orders.

Implementation of the HBSS HIPS module has been particularly challenging, as individual Components have had to adapt their HIPS implementation to work with the existing legacy information systems running on their networks. Some of these legacy systems are still vital for warfighting support. The U.S. Cyber Command and the supporting Component Commanders continue to focus on implementation, with DISA's assistance in providing program office and field support to ensure future versions of HBSS and HIPS software are modified, as necessary, to enable more rapid implementation.

In regard to the Department's challenges to recruit and retain cyber personnel, the U.S. Cyber Command is aggressively working through the manning process to fulfill established requirements in a time of shrinking budgets. The 97,000 cyber security positions reported by the IG are based on the 2010 Information Assurance (IA) Workforce Annual Report. We concur that 9,000 positions were not filled across the Department; however, the 2011 report identified 79,691 cyber security positions, of which 93 percent were filled, and 74 percent of those positions were filled with personnel with a current cyber security certification in compliance with the DoD 8570.01-M, "Information Assurance Workforce Improvement Program." Additionally in 2011, 84 percent of all of the personnel in an IA position had a baseline IA certification. The gap between billets/positions and the number of them filled depend on a number of variables, to include the following:

- Lack of funding for the position.
- Training pipeline – lack of school seats may cause a shortage of personnel.
- Using personnel qualified for the position to man other requirements often known as Temporary Duty Assignment (often they are sent to Afghanistan or other operational environments to fill "temporary billets").
- Recruiting and retention programs can cause a lack of personnel availability. However, it does take time to work through the manpower process once a billet/position is identified – to budget, recruit, train, and assign a qualified person to a new position.

<p>4-2A. Information Technology (IT) Acquisition System</p>	<p>IG Summary of Challenge</p>
<p>One of the focus areas of the DoD Chief Information Officer’s (CIO’s) 10-Point Plan for IT Modernization is to strengthen IT investments. Section 804 of the NDAA for FY 2010 required the Secretary of Defense to develop and implement a new acquisition process for information systems. The process was to be based on recommendations from the March 2009 report of the Defense Science Board (DSB) Task Force on Department of Defense Policies and Procedures for the Acquisition of Information Technology. This report concluded that “the conventional DoD acquisition process is too long and too cumbersome to fit the needs of the many systems that require continuous changes and upgrades...” The DoD CIO’s 10-Point Plan will include structuring IT programs, via smaller, frequent deliveries, implement an enterprise approach for the procurement of common IT hardware and software, obtain transparency of IT investments with a full DoD IT investment portfolio, and review major IT investments for performance, funding execution, and enterprise alignment.</p>	
<p>4-2B. IT Acquisition System</p>	<p>IG Assessment of Progress</p>
<p>The Department has recognized that it needs to improve the outcomes of its acquisitions, deliver faster capability, and save billions through cost efficiencies. On June 23, 2011, the USD(AT&amp;L) issued a Directive-Type Memorandum on Acquisition Policy for Defense Business Systems, which sets forth timeline requirements for automated information systems. The memorandum states that when Major Automated Information Systems employ the incremental acquisition approach, all functional capabilities must be achievable within five years of when the funds are first obligated. Additionally, the memorandum provides similar requirements for all other Automated Information Systems. While this memorandum sets more ambitious timelines to acquire automated information systems, the Department must continue to push forward with new IT acquisition process in order to ensure success for its mission and the individual warfighters.</p>	
<p><b>4-2C. IT Acquisition System</b></p>	<p><b>Department Response</b></p>
<p>The Department is committed to the implementation of IT Acquisition Reform and continues to achieve key accomplishments in the overall timeliness and effectiveness of the IT acquisition process. The USD(AT&amp;L) issued acquisition policy in Directive Type Memorandum (DTM) 11-009, “Acquisition Policy for Defense Business Systems,” dated June 23, 2011, and change 1, dated December 9, 2011. This DTM requires the use of the Business Capability Lifecycle (BCL) model as the acquisition process for Defense Business Systems (DBS), assigns responsibilities, and provides procedures for meeting BCL and DBS requirements. The BCL provides a tailored acquisition process with alternative requirements development processes for Defense Business Systems, a major step forward in implementing more flexible and streamlined processes.</p> <p>The BCL is the overarching framework for the planning, design, acquisition, deployment, operations, maintenance, and modernization of DBS, in accordance with Title 10 U.S.C., Section 2222(f). This policy will be incorporated in the next update to DoD Instruction 5000.02, “Operation of the Defense Acquisition System.” Additionally, the Department updated Business Case guidance in May 2012 to enhance business case content. The DTM 11-009 defines a business case as:</p>	

“A summary of essential information necessary to enable effective management decisions resulting from the rigorous analysis and associated documentation produced by the Functional Sponsor and the [Program Manager]. The Business Case clearly defines and articulates the business problem, the desired outcomes, and the holistic plan for delivering the capability. As more knowledge is acquired progressing through the lifecycle, the Business case is updated for ongoing decision making.”

Simply stated, the Business Case is one of the key program documents reviewed at an acquisition milestone for Major Automated Information System programs. The Department currently is working to incorporate BCL policy guidance into the Defense Acquisition University’s Defense Acquisition Guide. Additionally, the Department is collaboratively exploring opportunities to further enhance DBS acquisition processes. An example of this effort is the Deputy Chief Management Officer (DCMO) working with Department-level Test and Engineering organizations to explore ways to improve DBS testing.

On October 6, 2011, the Deputy Secretary of Defense established the Deputy’s Management Action Group (DMAG) to be his mechanism for executing a common management approach across the Departmental topics and processes for which he is responsible. The Deputy Secretary effectively merged a number of senior leadership bodies, including the Defense Business Systems Management Committee discussed in the 2011 response with the DMAG, to create a single body of senior leaders to consider the Department’s wide range of management and business topics. The Department’s senior leaders ensure the successful execution of the Strategic Management Plan and Annual Performance Plan, oversee the defense business systems investment management process, and monitor and take corrective action in the Department’s efforts to improve its defense business operations. This new framework consolidates governance for the Department and creates increased efficiency and effectiveness in the Department’s management processes.

**5. IG-Identified Challenge: Health Care**

5-1A. Medical Readiness

IG Summary of Challenge

In addition to providing health care for Active Duty personnel, managing the overall health of 9.7 million eligible beneficiaries is a continuing challenge for the Military Health System (MHS). Identifying unhealthy behaviors and providing appropriate interventions across the population is a challenge. By reducing obesity and tobacco usage, for example, the long-term health implications of diabetes and chronic obstructive pulmonary disease can be reduced significantly. Preventable conditions such as these are expensive and long term in nature, and could degrade medical readiness of military members.

5-1B. Medical Readiness

IG Assessment of Progress

The MHS management identified the family medical readiness strategic imperative, but the applicable performance measure is in the concept phase. The need to improve the planning for medical needs of family members was discussed in our report on the planning of Guam dental care for Active Duty family members. Specifically, the Navy did not adequately identify and assess the risks associated with not expanding the specialty care in Guam although the beneficiary population was projected to increase substantially.

The MHS is implementing the “medical home” concept throughout the direct care system. With the medical home, the patient will have more direct access to a medical team that is equipped to recognize potentially unhealthy behaviors and has the ability to intervene early. In addition, management needs to ensure nonmedical alternatives such as recreational and athletic facilities are in adequate condition and available to military community as well as cessation programs for unhealthy addictive behaviors such as cigarette smoking and alcohol use. The MHS fully supports the National Prevention Strategy to support better health behaviors and overall fitness. Although the MHS goal was not attained, cigarette use among Active Duty forces decreased from FY 2010 to FY 2011. The MHS has actively committed to supporting the National Partnership for Patients initiative with the Department of Health and Human Services to improve care, transition, and prevention of harm during treatment. The two goals of this partnership are “keeping patients from getting injured or sicker” and “helping patients heal without complication.”

**5-1C. Medical Readiness**

**Department Response**

The Department concurs with the IG’s assessment. Through its initiative process, the MHS has chartered a new population health working group to specifically address the challenges of providing nonmedical alternatives for changing unhealthy behaviors, such as those leading to obesity and tobacco use. Additionally, the workgroup is tasked with the development of an Annual Health Assessment in the form of an intelligent questionnaire integrated into the patient workflow using existing technologies (e.g., Armed Forces Health Longitudinal Technology Application workflows, secure messaging). The health assessment will also draw from available clinical data and will provide quantitative and qualitative data about the wellness state of our beneficiaries. Additionally, the health assessment will support a personal prevention plan, providing specific feedback to the beneficiary to assist in altering unhealthy behaviors and provide an objective measure of the effectiveness of both the nonmedical and medical programs related to the wellness and health of our beneficiary population. The working group also is tasked with developing and monitoring pilot programs to address obesity and tobacco cessation through the expansion of wellness programs delivered on our bases, in facilities such as the recreation centers, and virtually through coaching programs delivered wherever they are required. Through the study of these pilot programs, combined with objective data from the health assessment, we will be able to tailor the most effective solution possible across the entire military health system.

**5-2A. Cost Containment**

**IG Summary of Challenge**

The MHS must provide quality care for approximately 9.7 million eligible beneficiaries within fiscal constraints while facing increased user demands, legislative imperatives, and inflation, which makes cost control difficult in both the public and private sectors. Over the past decade, health care costs have grown substantially, and MHS costs have been no exception. The DoD budget for health care costs was approximately \$53 billion in FY 2012, an increase of approximately 74 percent since FY 2005. The MHS costs have more than doubled, from \$19 billion in FY 2001 to the Department’s request of \$48.7 billion for FY 2013. With these costs increases in mind, the Department proposed to implement a modest increase to enrollment fees while also making small adjustments to retail and mail order pharmacy co-pays. Another part of the challenge in containing health care costs is combating fraud. Health care fraud is among the top five categories of criminal investigations of the DoD IG’s Defense Criminal Investigative Service, representing 12.5 percent of the 1,862 open cases at the beginning of FY 2012.

Increasing health care benefits also provides additional pressure to manage and contain costs.	
<b>5-2B. Cost Containment</b>	<b>IG Assessment of Progress</b>
<p>The Department's efforts in controlling health care costs will continue to be a challenge as early indications are that DoD beneficiary fee increases are not likely to be fully approved. The MHS is focusing on many areas to manage per capita health care costs. Three managed care support contracts are in effect; however, award protests resulted in staggered implementation of the new generation TRICARE contracts. The contracts provide incentives for customer satisfaction and include the managed-care support contractors as partners in support of medical readiness. The Department continues to examine how the MHS purchases health care from the private sector. The guiding principle of the study group is that high-quality; patient-centered care is also cost-efficient care.</p> <p>The Department has identified areas that assist in managing costs, to include fraud management, and pharmaceuticals. Implementing the Quadruple Aim Concept should simultaneously improve quality and reduce costs by focusing on the elimination of unnecessary care, tests, and procedures, and by focusing on delivering health care in the most appropriate setting. Additionally, the MHS identified optimization of the pharmacy practices and implementation of the patient-centered medical home as strategic initiatives, both of which are aimed at increasing the quality of health care services while reducing the cost of providing high quality care.</p>	
<b>5-2C. Cost Containment</b>	<b>Department Response</b>
The Department concurs with the IG's assessment.	
<b>5-3A. Rehabilitation and Transition Care</b>	<b>IG Summary of Challenge</b>
<p>The continued strengthening of comprehensive and integrated health care – from accession through active service, to rehabilitation, and when necessary, the transition to the Department of Veterans Affairs (VA) – is a major challenge for the MHS. In particular, the Department will need to remain focused for future years with providing adequate rehabilitation and transition care for wounded warriors associated with Southwest Asia and other such conflicts.</p> <p>Key areas requiring management attention also include rehabilitation and transition care for those affected with Traumatic Brain Injury, Post Traumatic Stress Disorder, and those in need of prosthetic services.</p> <p>Although a number of objectives have been identified by the Department and the VA and programs have been initiated, the quality and oversight of these programs must be tightly managed. The Department should continue to strive to make the medical care and benefits transition program a streamlined, transparent, and timely process as wounded warriors move from the DoD system to the VA system.</p>	
<b>5-3B. Rehabilitation and Transition Care</b>	<b>IG Assessment of Progress</b>
During this past year, the DoD IG has noted the need to provide timely access to specialty care, improvements in various training programs and plans, as well as improving medication management. While challenges remain, the DoD IG has identified notable initiatives within the Department for supporting the comprehensive care,	

healing, and transition of wounded warriors. Some specific initiatives were recovery team forums to develop individualized courses of action to address each wounded warrior's needs. In addition, another notable initiative addressed reducing the potential for exploitation of warriors, therefore avoiding negative consequences to morale, and the overall health and welfare of the warriors. Also, wounded warrior care centers were developing meaningful programs of constructive activities to assist with warriors' transition. These notable initiatives should continue Department-wide.

<b>5-3C. Rehabilitation and Transition Care</b>	<b>Department Response</b>
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The Department concurs with the IG's assessment.

<b>5-4A. Optimizing Health Care Governance</b>	<b>IG Summary of Challenge</b>
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Ensuring that the MHS is organized in the most effective and cost-efficient manner will continue to be a challenge. Transformation occurred in the MHS over the past years, including the consolidation of medical facilities and functions in the National Capital Region mandated by the 2005 Base Realignment and Closure (BRAC) process. The BRAC also provided the Department with the opportunity to evaluate changes in the MHS governance. In addition to improving the readiness and cost efficiency associated with realigning base structure, a primary objective of the BRAC process was to examine and implement opportunities for greater joint activity among the Military Departments. Considering increased joint activity during recapitalization of aging physical infrastructure will continue to be a challenge.

<b>5-4B. Optimizing Health Care Governance</b>	<b>IG Assessment of Progress</b>
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The Department established governance reforms in March 2012 to explore opportunities to realize savings in the MHS through the adoption of common clinical and business processes and the consolidation of shared services. The TRICARE Management Activity will transition into the Defense Health Agency, a Market Manager will be appointed in each multi-Service market areas, and the Joint Task Force National Capital Region Medical (JTF CAPMED) will transition to a subordinate organization under the Defense Health Agency. The Department will continue to develop and execute the single authority JTF CAPMED and cross-Services San Antonio Military Health System governance models to provide greater insight when considering future governance transformation. Evaluating the variety of governance models may provide innovative solutions that can be used across the MHS.

The BRAC process addressed part of the aging infrastructure, but to fully address the challenge, better standardized data on the condition of facilities is needed. The MHS has begun the multiyear transition and acquisition process of improving capability and access to care in two major and several minor markets. For example, the new Walter Reed National Military Medical Center at Bethesda, merging the now-closed Walter Reed Army Medical Center and the Bethesda National Naval Medical Center, opened in November 2011. In addition, the Tri-Service Medical Education and Training Campus should improve the quality and consistency of training for all enlisted personnel, contributing to a culture of jointness and interoperability and shared purpose.

Several infrastructure issues are addressed through implementation of the American Recovery and Reinvestment Act (ARRA) of 2009. We completed our review of planning

for Phase I of the new hospital being built at Fort Hood and the replacement hospital project at Camp Pendleton. Planning for the facilities was adequate and met the ARRA's goals of transparency and accountability.

**5-4C. Optimizing Health Care Governance**

**Department Response**

The Department concurs with the IG's assessment.

**6. IG-Identified Challenge: Equipping and Training Iraq and Afghan Security Forces**

**6-1A. Iraq Security Forces**

**IG Summary of Challenge**

A major national security goal of the U.S. is the establishment of a sovereign, stable, and self-reliant Iraq that contributes to the peace and security of the region and with which the U.S. can forge a long-term strategic partnership. Supporting the development of a professional Iraq Security Force, capable of providing for its internal and external defense, is essential to achieving these U.S. objectives.

Fundamental to establishing and nurturing this long-term security partnership is the role of the Office of Security Cooperation – Iraq (OSC-I), which was initially established in June 2011, expanded in October 2011, and subsequently transitioned to Chief of Mission and Department of State authority in December 2011. The OSC-I, operating under Chief of Mission authority but administered by DoD personnel, is charged with performing vital bilateral security cooperation and security assistance functions. Comprised of DoD military, civilian, and contractor personnel, the OSC-I represents a cornerstone capability for building an enduring foundation for a long-term security relationship with the Government of Iraq.

To facilitate continued support for developing the Iraq Security Forces, the Department transitioned most remaining essential training, equipping, and mentoring activities from United States Forces-Iraq to the OSC-I. Robust security cooperation and assistance programs, including very significant Foreign Military Sales of U.S. defense technology, are being developed and may be seen as an early indicator of the potential for building a strong, enduring U.S.-Iraq strategic partnership over the longer term.

**6-1B. Iraq Security Forces**

**IG Assessment of Progress**

While the OSC-I successfully transitioned from the Department of Defense to the Department of State authority by the end of 2011, the U.S. and Iraq governments did not conclude certain agreements that were envisioned by the command as necessary to enable OSC-I ability to become fully functional within Iraq's dynamic post-2011 operating environment. Senior OSC-I officials indicate that the absence of a post-2011 Security Agreement or Status of Forces Agreement was affecting aspects of their operations. Key areas cited by these officials as being impacted included land use agreements, force protection, passport/visa requirements, air and ground movement, and FMS site stand-up. The precise impact of these command concerns with respect to achieving short- and long-term OSC-I goals is unclear. However, having formal, follow-on Security and Status of Forces agreements was perceived to have potential value in clarifying and stabilizing Iraqi government support for day-to-day OSC-I operations and would benefit longer-term relationship and partnership building. It is imperative,

<p>therefore, that the political and legal framework and authorities necessary be established in a timely manner so that the new OSC-I and its personnel can be in a strong position to operate effectively, safely, and with the necessary legal protections.</p>	
<b>6-1C. Iraq Security Forces</b>	<b>Department Response</b>
<p>The Department acknowledges the IG’s challenge.</p>	
6-2A. Afghan National Security Forces	IG Summary of Challenge
<p>Between now and the end of 2014, U.S. policy and related DoD military strategy in the Afghanistan-Pakistan region will be implemented by high-intensity, complex operations that emphasize:</p> <ul style="list-style-type: none"> <li>• Providing continued training, equipping, partnering and mentoring to enable the ANSF to continue to assume the leading security operations role.</li> <li>• Providing continued training, equipping, partnering and mentoring to professionalize the Afghan National Security Forces (ANSF), ensuring “quality, not just quantity.”</li> <li>• Withdrawing 23,000 U.S. combat forces from Afghanistan in 2012.</li> <li>• Conducting a phased drawdown of U.S. combat forces in 2013 and 2014, and</li> <li>• Continuing to enable the ANSF to assume and sustainably maintain lead responsibility for the security of the Afghan people and its government as International Security Assistance Force (ISAF) withdraws.</li> </ul> <p>The Department must continue its efforts to develop the capability of the Afghan Ministries of Defense and Interior to administratively and logistically sustain the ANSF. These efforts include the capacity to plan, program, budget, and execute the fiscal resources provided by the international community, along with revenue generated by its own government. In addition, there are still certain ANSF combat service support functional capabilities that NATO and U.S. Forces will need to develop for the ANSF to be able to reach its necessary security capability.</p> <p>The extremist force elements based in western Pakistan continue to pose a security threat to the stability of Afghanistan; therefore, the Department will need to continue developing the capacity of the Pakistan Security Forces to maintain internal security and eliminate extremist Taliban and Al-Qa’ida forces in the Northwest Frontier safe haven.</p> <p>A significant challenge will be conducting the phased drawdown of U.S. and Coalition military forces and civilians while physically transporting personnel and equipment out of Afghanistan. The equipment will either have to be airlifted, or flow by land through Pakistan to the Port of Karachi for out-bound transportation by ship or by truck, rail and water links via the Northern Distribution Network in Central Asia.</p>	
6-2B. Afghan National Security Forces	IG Assessment of Progress
<p>The size of the Afghan National Army (ANA) and Afghan National Police (ANP) have grown at a very significant rate over the past two years, and the ISAF command is at or near the end of the expansion of the ANSF to 352,000 personnel. The focus of the train and equip effort has changed from growth to initiatives focused on the sustainment and professionalization of the force, with a priority on development of the officer and non-commissioned corps in the ANA and ANP. The partnering of US and Coalition units and</p>	

training teams has enabled ANA units to accelerate improvement in their operational capability.

The success of the counterinsurgency campaign being conducted against the Taliban and extremist anti-government elements depends on how well the ANSF provides protection for the Afghan people and gains their trust, along with the effectiveness of governance. The responsibility to protect the Afghan people falls most directly on the ANP, which operates as the direct interface with the population in provinces and districts around the country. Of note in this area is the success of the Afghan Local Police initiative, supported by both ISAF and the Afghan Ministry of Interior (MoI), to develop, train, and equip part-time policemen at the village level to provide security in largely rural areas where the presence of the ANSF is insufficiently strong to prevent armed insurgent infiltration and activities. As of April 2012, the Afghan Local Police (ALP) strength was approximately 12,900 and on track to reach the goal of 30,000 at 99 MoI-approved sites across Afghanistan by the end of 2014. However, while the ALP works well when closely monitored by U.S. Special Forces, there is, as of yet, no well-defined plan to transfer control and supervision of the ALP to effective Afghan oversight. Without such a plan, as U.S. forces reduce, the risk that the ALP will dissolve or become abusive militia will increase.

The NATO Training Mission – Afghanistan/Combined Security Transition Command – Afghanistan (NTM-A/CSTC-A) has assisted the Ministry of Defense (MoD) and MoI to achieve considerable progress in increasing its institutional training capacity for specialized skills and leadership development, while continuing to improve training quality, reduce attrition, and improve recruitment.

In addition, U.S. and Coalition forces have implemented an extensive literacy and numeracy program for army and police personnel. Along with pay reform, this has also improved morale as well as personnel effectiveness. This program will become even more essential as security forces continue to enter into more specialized and technical training programs requiring a higher level of comprehension.

Although challenges remain, most notably in the development of a functional and sustainable ANSF logistics/maintenance capability, the transfer of security and governance responsibilities to Afghan lead in provinces and districts across Afghanistan continues in accordance with established ISAF and Afghan government plans.

<b>6-2C Afghan National Security Forces</b>	<b>Department Response</b>
	<p>A key strategic focus remains on training, equipping, and partnering with the ANSF to enable the transition of lead security responsibility to the Government of Afghanistan. As the ANSF is reaching its end-strength of 352,000, redeployments of U.S. combat forces have begun and the transition to ANSF-led security is well underway. Despite the progress of the ANSF, challenges remain, and the focus has shifted to closing remaining ANSF capability gaps by 2015. Training and advising will be critical to the irreversibility of the ANSF lead for nationwide security, and the rolling conversion to Security Force Assistance (SFA) has already begun. Assembling sufficient quantities of SFA teams will be vital to the campaign as we reduce our force numbers, close and transfer bases, and prepare for 2015 and beyond.</p>

<b>7. IG-Identified Challenge: The Nuclear Enterprise</b>	
7-1A. Prior Decline of Focus on the Nuclear Enterprise	<p style="text-align: center;">IG Summary of the Challenge</p> <p>For the past several years, numerous government and non-government organizational reports detailed an environment where the nuclear enterprise in the Department had experienced a marked but gradual decline in focus upon the nuclear enterprise. That decline was characterized by nuclear forces being subordinated to non-nuclear forces in military organizations and not receiving sufficient staffing and funding to perform the nuclear mission according to past standards. Since the last Management Challenge report, fourteen reports were issued that commented on the current state of the nuclear enterprise.</p> <p>During the past fiscal year, the IG issued a classified report detailing the current security environment of the nuclear enterprise. Although the specific findings and recommendations of that report are classified, the report identified continuing weaknesses in security vulnerability analysis and security alert response times. The organizations referenced in the report responded positively to a majority of the findings and recommendations. The IG also issued a restricted report to determine the actions taken to implement the recommendations made in six DoD and Service specific reports regarding the DoD nuclear enterprise. A majority of the recommendations in those six reports have been closed.</p>
7-1B. Prior Decline of Focus on the Nuclear Enterprise	<p style="text-align: center;">IG Assessment of Progress</p> <p><u>DoD Focus on Sustainment Assessment.</u> In the wake of the Minot and Taiwan incidents, numerous reports were issued by DoD and private consulting organizations concerning the current state of the nuclear enterprise, reasons for the decline of the nuclear enterprise, and recommendations to improve that enterprise.</p> <p>During FY 2012, the DoD IG reviewed follow-up progress on a 2002 report on Physical Security of Nuclear Weapons Located in the Continental United States. The U.S. Air Force has made significant progress in implementing corrective actions to correct the deficiencies identified in those reports. The DoD IG is currently reviewing the Cryptographic Modernization program for critical nuclear command and control networks.</p> <p>The following reports were issued either by the DoD IG, the Nuclear Command and Control System (NCCS) Support Staff, the DSB, or the GAO since the issuance of the FY 2011 Management Challenges report.</p> <ul style="list-style-type: none"> <li>• Report to Congress Pursuant to Public Law 110-417, Duncan Hunter National Defense Authorization Act for Fiscal Year 2009, January 2012; "Department of Defense Review of the Findings and Recommendations Applicable to the Department of Defense Made in the Reports of the Commission to Assess the Threat to the United States from Electromagnetic Pulse Attack"</li> <li>• Biennial Assessment and Report on the Delivery Platforms for Nuclear Weapons and the NCCS, National Defense Authorization Act of 2012, Section 1041, January 2012</li> <li>• Report of the Safety, Security, Reliability, Sustainability, Performance, Military Effectiveness of the Trident II (D5) Strategic Weapon System Delivery Platform (National Defense Authorization Act of 2012, Section 1051), December 2011</li> </ul>

- Nuclear Command and Control System Support Staff Assessment report on "NSPD-28 Requirement for Secure and Survivable Head of State Communications With Other Nations," September 2011
- Nuclear Command and Control System Support Staff Assessment report on "The Prime Nuclear Airlift Force," January 2012
- Nuclear Command and Control System Support Staff Assessment report on "Assurance of Security and Reliability of Nuclear Command, Control, and Communications (NC3) Equipment Using Commercial Off the Shelf Software, Hardware, and Firmware," March 2012
- Fiscal Year 2012 Annual Update to the Report Specified in Section 1251 of the National Defense Authorization Act for Fiscal Year 2010, February 16, 2011
- Fiscal Year 2011 Joint Surety Report, April 2012
- Joint Surety 2011 Report on the "Nuclear Weapons Stockpile Assessment"
- US Nuclear Physical Security Collaboration, December 15, 2011
- Interim Report of the Defense Science Board (DSB) Task Force on the Survivability of Systems and Assets to Electromagnetic Pulse (EMP) and other Nuclear Weapon Effects (NWE), August 2011
- Government Accountability Office Report, GAO-12-512T " Further Actions Needed by U.S. Agencies to Secure Vulnerable Nuclear and Radiological Materials," March 14, 2012
- Government Accountability Office, GAO-12-468, "Strategies and Challenges in Sustaining Critical Skills in Federal and Contractor Workforces," April 26, 2012
- Government Accountability Office, GAO-12-577R "Evaluation of Report on Feasibility of Increasing Air Transportation of Nuclear Weapons, Components, and Materials," May 4, 2012

**Joint Chiefs of Staff.** During FY 2012, the Chairman, Joint Chiefs of Staff (CJCS), reported that they have accomplished the following goals:

- The Joint Staff Deputy Directorate for Command, Control, and Nuclear Operations (J-36) continued to focus on oversight and implementation of command and control of nuclear forces and investment in the National Military Command System command centers. This was accomplished with improvements in guidance, training, and inspections.
- In support of these focus areas, J-36 briefed and trained members of the Joint Chiefs of Staff and Secretary of Defense successors to ensure nuclear command and control familiarity within the Department. Annual exercises that focus on nuclear policy and strategic deterrence presented opportunities for senior officials to learn about this unique environment and to contribute their expertise to develop realistic scenarios.

In concert with the Defense Threat Reduction Agency (DTRA), J-36 performed operational and technical assessments of the nuclear enterprise. These assessments are formal reports staffed annually or as directed to support and clarify the Chairman's obligations to the Secretary of Defense and the President. They also provide an end-to-end look at the systems and procedural "health" of the enterprise while giving the Chairman measurable and executable decision tools for command and control of the nuclear mission set. Additionally, CJCS-directed Staff Assessment Visits ensured command center compliance with established Emergency Action

Procedures of the CJCS (EAP-CJCS). Assessment teams visited every Combatant Command Center over the course of the year. These visits focused on procedures, training, and execution within the Commander's battle staff.

J-36 worked with the Force Structure, Resources, and Assessment Directorate (J-8), the Air Force, and the DoD CIO to ensure the long-term viability of technical capabilities within the nuclear command and control system.

**Department of the Air Force.** The Air Force reported that they have accomplished the following goals since the FY 2011 Management Challenges Report:

- The Air Force established goals, objectives, and metrics within the 2012 Air Force Strategic Plan to assess the nuclear enterprise. The metrics create a comprehensive picture of Air Force efforts to achieve specific goals across the nuclear enterprise over the next several years. In addition, these metrics provided source data for the Air Force Enterprise Senior Leader Dashboard and allow for the necessary oversight through measurable and objective measures.
- The Air Force successfully completed the transfer of Continental United States Munitions Squadrons from Air Force Materiel Command to Air Force Global Strike Command on February 29, 2012.
- The Air Force developed an Air Force Nuclear Command, Control, and Communications (NC3) Integration Plan. Key components of this plan include: (1) establishment of a NC3 Community of Interest, a body of NC3 stakeholders across five Headquarters Air Force Directorates and seven Major Commands (MAJCOMs), charged with identifying Air Force NC3 shortfalls and coordinating solutions; (2) establishment of a baseline NC3 architecture, led by the Air Force Global Strike Command as the NC3 Chief Architect; and (3) identification of NC3 capability gaps, leading to MAJCOM prioritized investment.
- The Air Force developed and conducted the first of two in a series of deterrence-focused war games to address operational-level challenges in a multi-polar and proliferated nuclear world. Insights from the war games provided depth to additional joint tabletop exercises, enhanced engagements with key allies and partners, and contributed to deterrence-focused military advice to the Joint Chiefs of Staff.
- The Air Force built a "Human Capital Plan" for the nuclear enterprise consisting of several initiatives to develop personnel with nuclear expertise and ensure the right people with the right skills are assigned to critical positions. The Air Force established an Intercontinental Ballistic Missile (ICBM) weapons school track, creating a corps of personnel with in-depth knowledge and proficiency in ICBM operations. The AF introduced a series of courses to educate Airmen of all grades on nuclear deterrence operations.
- To strengthen positive inventory control of Nuclear Weapons Related Material (NWRM), the Air Force performed an engineering analysis to ensure 100 percent identification of all NWRM components. A robust screening process was developed, utilizing a "score card" evaluation method to standardize and streamline the procedures. The process enabled engineers to refine the list, removing 125 items that did not meet the criteria and adding 15 which did. This effort improved oversight of NWRM by ensuring manpower and resources were focused on items actually requiring these extensive control measures.
- The Air Force has undertaken an effort to revise, clarify, and consolidate guidance for the nuclear enterprise, including drafting a nuclear series of Air Force instructions. There is a plan in place to write or revise over 75 nuclear publications

which will properly align all nuclear enterprise policies and instructions.

The Air Force initiated a comprehensive review of the Air Force nuclear enterprise to assess the progress in completing identified objectives to reinvigorate and strengthen the enterprise and to formulate new objectives for continuous improvement.

**Department of the Navy.** The Navy reported that they have accomplished the following goals since the FY 2011 Management Challenges Report:

- The Navy completed the first-ever Navy Nuclear Weapons Comprehensive Biennial Self-Assessment. This assessment represents a significant first step in establishing a culture of continuous improvement and critical self assessment across the Navy’s nuclear weapons enterprise.
- The Navy assessed all Echelon 1 and 2 fleet and shore commands with nuclear weapons responsibilities – a total of 23 organizations. This report and its findings were endorsed by the Chief of Naval Operations and the Secretary of the Navy.

**7-1C. Prior Decline of Focus on the Nuclear Enterprise**

**Department Response**

The Department’s summary-level response to the IG’s challenges and assessment of the Department’s progress in nuclear enterprise is reported in paragraph 7-2C of this section.

**7-2A. Keys to Improvements in the DoD Nuclear Enterprise**

**IG Summary of Challenge**

As previous Management Challenge reports have stated, the Department needs to sustain its focus on the nuclear enterprise, even in the face of probable funding reductions. The following elements are key to this sustainment:

- Continue to foster an environment that emphasizes the nuclear mission and promotes a reliable, safe, secure, and credible nuclear deterrent. The nuclear deterrent is essential to national security and must remain a high DoD priority.
- Continue reviews and studies of all critical elements of the nuclear enterprise to identify key deficiencies and methods for improvement.
- Monitor corrective action plans made as a result of previous reviews and studies that correct the deficiencies and provide adequate funding and leadership to ensure implementation.
- Ensure adequate funding and resources to effectively implement action plans
- Implement the corrective actions and conduct follow-up reviews to ensure that the action plans are correcting the deficiencies.

**7-2B. Keys to Improvements in the DoD Nuclear Enterprise**

**IG Assessment of Progress**

The DoD CIO’s National and Nuclear Command Capabilities Executive Management Board serves as an advocate, with some enforcement capabilities, to ensure issues are brought to leadership’s attention. Organizations having nuclear command and control responsibilities are represented at the meetings, which include the appropriate

representatives from other departments and agencies involved with the nuclear enterprise.

Continuous monitoring and evaluation of the nuclear enterprise by senior leadership helps sustain the progress. The Air Force Comprehensive Assessment of Nuclear Sustainment is finishing its fourth phase (AFCANS IV). The U.S. Strategic Command's 2010 Crystal Fortress Report, current studies directed by the DMAG, and the Navy's self-assessment, mentioned earlier, are all examples of engaged leadership.

The oversight of the Air Force nuclear enterprise by Air Force Global Strike Command and the Assistant Chief of Staff Strategic Deterrence and Nuclear Integration, U.S. Air Force (AF/A10), continues to be the most effective guarantor of continuing progress in the reliability and safety of the nuclear enterprise. The Air Force Global Strike Command, in particular, provides a more focused and active oversight of nuclear capable bombers and ICBMs than the Major Commands those forces were previously assigned to.

The Navy continues their use of the Nuclear Weapons Oversight Council, which develops Navy nuclear weapons policy for the Ballistic Missile Submarine fleet. The assessment work of the Navy Nuclear Weapons Comprehensive Biennial Self-Assessments may provide a mechanism in future years for evaluating the health of the Navy's nuclear weapons program.

The Administration proposed \$11.6 billion in new budget authority for the National Nuclear Security Administration for FY 2013, a 1.7 percent decrease over the FY 2012 request. The budget request includes \$7.6 billion for Weapons Activities, including the B61 Life Extension Program. Also, with the approval of the New Strategic Arms Reduction Treaty, the reduction of total warheads will increase the importance of the B61 Life Extension Program.

**Continuing Concerns.** The re-vitalization of the nuclear enterprise in recent years has been facilitated by increased funding levels for personnel staffing and training, systems and equipment acquisitions, and materiel maintenance. Continued advancements in these sectors cannot be sustained without sufficient financial commitment. Supply chain management issues, particularly involving the initial source of critical spare parts, could also be an issue of relevance in current and future fiscal years.

Additionally, the nature of deterrence involves a cadre of properly trained personnel in a constant state of readiness. This cadre is often out of the public eye. Potential reductions in funding for these activities can only result in a diminished state of readiness and increases the likelihood for an incident similar to what happened in the Minot and Taiwan incidents. During FY 2011 and 2012, the DoD IG classified audits' problems were noted in funding levels for sustainment activities. Recommendations were made to the appropriate service authority for corrective action.

Properly utilizing the limited existing nuclear expertise and growing more expertise continues to be a concern, especially within the Air Force. Expertise in the nuclear missile crew career field and potentially other career fields may take 5-7 years to reconstitute. In the meantime, actions to hire civilians with the needed nuclear expertise are being impacted by cuts in civilian personnel slots. At the same time, due to the increased emphasis on the nuclear enterprise, the demand for nuclear experience has grown: the Defense Threat Reduction Agency, Air Force Inspection Agency, the Air Staff, Air Force Nuclear Weapon Center, U.S. Strategic Command, and the Joint Staff all have a need for some of the limited existing nuclear expertise.

Finally, a lack of centralized management of nuclear command and control modernization and configuration hinders effectiveness. Some systems lack a program office, some nuclear command and control networks depend on funding from multiple commands within a service or multiple services. Synchronization between these separate organizations with separate priorities must coordinate on a plan to ensure programs remains on track. A single authoritative office with responsibility for configuration control would help alleviate this difficulty.

**7-2C. Keys to Improvements in the DoD Nuclear Enterprise**

**Department Response**

The Department continues to make significant progress in improving the nuclear enterprise. Specifically, new strategic plans and self-assessments, such as the 2012 Air Force Strategic Plan and the Navy's first-ever Navy Nuclear Weapons Comprehensive Biennial Self-Assessment, are providing measurable oversight. While much work remains, including valuable recommendations provided by oversight reports and independent assessments, the Department continues to work with other Federal agencies, such as the Department of State and the Department of Energy, to provide responsible but innovative solutions through sustainment and modernization programs while still maintaining efficacy of the regimen put in place. The robust efforts of the Department and its interagency partners support a safe, secure, and effective nuclear deterrent.

## **MANAGERS' INTERNAL CONTROL PROGRAM**

The OUSD(Comptroller) leads DoD's [Federal Managers' Financial Integrity Act](#) (FMFIA) program, summarized in the Management Discussion and Analysis (MD&A) section of this report, designated as the Managers' Internal Control Program (MICP). Managers throughout the Department are accountable for ensuring effective internal controls in their areas of responsibility. All Components are required to conduct a robust programmatic approach to establish and assess internal controls for all mission-essential operations. Components that are identified in the FIAR guidance are required to include assurances related to financial reporting and financial systems in their programs.

## **STATEMENT OF ASSURANCE OVER FINANCIAL REPORTING, OPERATIONS AND FINANCIAL SYSTEMS PROCESS:**

The revised [OMB Circular A-123](#) requires an annual Statement of Assurance that provides management's assurances on the effectiveness of internal controls of overall operations, financial reporting, and financial systems. The Department's 33 Component Heads are required to report their respective Component Statement of Assurance to the Secretary of Defense. The Components include the 3 Military Departments, 9 Combatant Commands, the Joint Staff, the Office of Secretary of Defense, the DoD Office of Inspector General, and 18 Department Agencies. Following the submission of the Components' Statements of Assurance, the Secretary of Defense produces an overall Department Statement of Assurance that reports the Department's pervasive material weaknesses. Prior to creating an annual Statement of Assurance, each Component flowcharts its key business processes that impact financial reporting and operations, identifies and assesses risk within the processes, identifies and tests internal controls, establishes controls found to be deficient, and reports on the results of these assessments and tests. The Department asserts that all Components with the exception of one, as prescribed by DoD's regulatory guidelines, have reported their individual statements of assurance over internal controls to the Secretary of Defense. More information concerning DoD's process for developing the Statement of Assurance is available at [Office of the Under Secretary of Defense \(Comptroller\)](#).

## **TYPES OF MATERIAL WEAKNESSES**

The Department's management uses the following criteria to classify conditions as material weaknesses:

- Merits the attention of the Executive Office of the President and the relevant Congressional oversight committees.
- Impairs fulfillment of essential operations or mission.
- Significantly weakens established safeguards against waste, loss, unauthorized use or appropriation of funds, property, other assets, or conflicts of interest.
- Constitutes substantial noncompliance with laws and regulations, or
- Nonconformance with government-wide, financial management system requirements.

Management-identified weaknesses are determined by assessing internal controls, as required by the FMFIA, the [Federal Financial Management Improvement Act](#) (FFMIA), and [OMB Circular No. A-123](#), and fall into one of the following three categories:

1. FMFIA Section 2, Financial Reporting Material Weaknesses (see Table 1a).
2. FMFIA Section 2, Operations Material Weaknesses (see Table 1b).
3. FMFIA Section 4, Financial System Nonconformance Weaknesses (see Table 1c).

### **FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)**

**1. FMFIA Section 2, Financial Reporting Material Weaknesses.** Under the oversight of the DoD Financial Improvement Audit Readiness (FIAR) Governance Board, discussed in the Department's FIAR Plan Status Report, DoD's assessment of its financial reporting identified the areas of material weakness listed in Table 1a. The table includes a column, entitled "Ref Table 2," that crosswalks the manager-identified areas of material weakness to similar areas of weakness identified by the DoD IG in Table 2.

Table 1a lists the DoD's manager-identified 18 categories of material weaknesses in the Department's Internal Control over Financial Reporting. There were no new weaknesses identified in FY 2012.

Table 1a. Effectiveness of Internal Control over Financial Reporting (FMFIA Section 2)							
Statement of Assurance: No assurance							
End-to-End Process	Areas of Material Weakness	Ref Table 2	Beginning Balance	New	Resolved	Reassessed	Ending Balance
Budget-to-Report	Appropriations Received		1				1
	Fund Balance with Treasury (FBWT)	10	1				1
	Financial Reporting Compilation	2, 7, & 8	1				1
	Intragovernmental Eliminations	5	1				1
Hire-to-Retire	Health Care Liabilities		1				1
	Civilian Pay		1				1
	Military Pay		1				1
Order-to-Cash	Accounts Receivable	13	1				1
Procure-to-Pay	Contracts	1	1				1
	MILSTRIP Orders	1	1				1
	Reimbursable Work Orders - Grantor	1	1				1
	Transportation of People	1	1				1
Acquire-to-Retire	Military Equipment Assets	11	1				1
	General Purpose Equipment	4 & 11	1				1
	Real Property Assets	11	1				1
	Environmental Liabilities	3	1				1
Plan-to-Stock	Inventory	12	1				1
	Operating Materials & Supplies	6	1				1
	<b>Total Financial Reporting Material Weaknesses</b>		<b>18</b>				<b>18</b>

Table 1a-1 provides the description and corrective action plan for each material weakness related to internal control over financial reporting.

Table 1a-1. FY 2012 Internal Control over Financial Reporting Material Weaknesses					
	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
1	<u>Appropriations Received</u> : The Defense Agencies' processes do not effectively account for budgetary authority transactions and balances.	FY 2011	Defense Agencies	Components are implementing controls over the apportionment and allotment of funds by identifying the entire transaction population and reconciling the financial statement amount to the general ledger, to the detailed transactions, and to supporting authorizing documents (e.g., public law, OMB apportionments, funding authorization documents). Components are also working with sub-allotees to document and reconcile funds distributed to them.	FY 2013
2	<u>Fund Balance with Treasury (FBWT)</u> : The Department cannot reconcile transactions posted to the FBWT general ledger accounts with transactions reported and posted to the Department of the Treasury's FBWT accounts and ensure adequate support for FBWT transactions.	FY 2005	Army; Navy; DLA; DIA; NSA; SMA; USSOCOM; DTRA	Components are working toward integrating general ledger systems with feeder systems to maintain transaction-level supporting documentation for disbursements and collections. The Components also are developing the processes and controls to reconcile transaction-level differences between DoD and the Department of Treasury accounts in a timely, efficient manner.	FY 2015
3	<u>Financial Reporting Compilation</u> : The Department cannot prepare accurate financial statements supported by general ledger balances and adequately documented and	FY 2007	Army, DLA, TRANSCOM	The Department continues to improve business processes and controls through the implementation of enterprise resource planning (ERP) systems that produce accurate, timely and auditable financial reports. In	FY 2015

Table 1a-1. FY 2012 Internal Control over Financial Reporting Material Weaknesses					
	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
	supported journal entries.			addition, the Department is implementing the Standard Financial Information Structure in systems of original entry and carried through the chain of systems. DFAS and Components are identifying root causes for abnormal balances and taking steps to change business processes to correct the problems. Components and DFAS are working to implement routine general ledger tie point analyses and reconciliations and analyzing general ledger posting logic to reduce the number of unsupported journal entries.	
4	<u>Intragovernmental Eliminations</u> : The Department is unable to collect, exchange, and reconcile buyer and seller intragovernmental transactions, resulting in unsupported adjustments.	FY 2008	Department-wide	The Department is collaborating with the Department of the Treasury, OMB, and Federal partners to develop and implement a government-wide solution to capture the transaction-level detail needed to reconcile intragovernmental transaction activity. It is also developing standard business processes and data to capture trading partner information at the transaction level and support eliminations, as well as implementing replacement systems and a standard financial information structure which will incorporate the necessary elements to enable the Department to correctly report, reconcile, and eliminate intragovernmental balances.	FY 2015

**Table 1a-1. FY 2012 Internal Control over Financial Reporting Material Weaknesses**

	<b>Material Weaknesses</b>	<b>Year Identified</b>	<b>DoD Components</b>	<b>Corrective Actions</b>	<b>Target Correction Year</b>
5	<u>Health Care Liabilities</u> : The current military health system financial processes cannot collect sufficient transaction-level cost and performance information for procedures performed in military treatment facilities.	FY 2003	MERHCF; SMA	Medical Components are implementing procedures to improve coding and financial reconciliations for military treatment facilities' operations as well as developing and implementing a methodology to reimburse military treatment facilities on a per capita basis. This methodology will be similar to arrangements with managed-care providers. Implementation of SMA ERPs will improve overall financial reporting.	FY 2017
6	<u>Civilian Pay</u> : The Department cannot effectively account for transactions and balances in the civilian pay process.	FY 2011	Department-wide	Components are addressing the reliability and existence of supporting documentation retained within the applicable payroll, personnel and time and attendance systems. They also are identifying, assessing, and testing IT general and application controls. In addition, Components are also defining and prioritizing sub-processes into assessable units and evaluating the sufficiency of the current SSAE 16/SAS 70 efforts.	FY 2014
7	<u>Military Pay</u> : The Department cannot effectively account for transactions and balances in the military pay process.	FY 2011	Department-wide	Components are developing processes to reconcile supporting documents to the general ledger on a repeatable basis in order to audit around the numerous micro- applications used to transfer data from the Defense Joint Military Pay System to the general ledgers.	FY 2014

Table 1a-1. FY 2012 Internal Control over Financial Reporting Material Weaknesses					
	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
8	<u>Accounts Receivable</u> : The Department cannot accurately record, report, collect, and reconcile intragovernmental accounts receivable and accounts receivable due from the public.	FY 2003	Army; Air Force; DLA; SMA	Components are continuing to implement ERP systems to improve collections, age receivables, and minimize manual processes. They also are implementing the Standard Financial Information Structure in systems of original entry. This will improve the Tri-Annual Review process (DoD FMR 7000.14-R, Volume 3, Chapter 8) and overall order-to-cash process, and improve reconciliations between entitlement systems and accounting systems, including identification of aging accounts.	FY 2015
9	<u>Contracts</u> : The Department cannot effectively account for transactions and balances supporting the contracts procure-to-pay process.	FY 2003	Department-wide	Components are developing processes to improve timely deobligation of funds upon contract delivery or completion, perform regular reviews of obligation estimates, and require the use of data currently distributed from contract writing systems to support timely and accurately recording of obligations/deobligations of funds. They also are assessing the use and compliance by accounting systems of accounts payable data, ensuring payables and obligation estimates are recorded upon acceptance of goods or services and that accounting systems track obligations and disbursements by contract and line item.	FY 2014

Table 1a-1. FY 2012 Internal Control over Financial Reporting Material Weaknesses					
	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
10	<u>(MILSTRIP Orders)</u> : The Department cannot effectively account for transactions and balances in the Military Standard Requisitioning and Issues Procedures (MILSTRIP) Orders procure-to-pay process.	FY 2011	Department-wide	Components are documenting processes and key controls and identifying and testing key controls in the requisition and issue of material, as well as testing the interfacing data between the logistics receipt processing systems and the financial systems. Components also are verifying the timely recording of accounts payable to ensure the payment does not occur prior to physical receipt of material and validating that returns are authorized and, if appropriate, a financial transaction is recorded.	FY 2014
11	<u>Reimbursable Work Orders (Grantor)</u> : The Department cannot effectively account for transactions and balances supporting the Reimbursable Work Orders – Grantor procure-to-pay process.	FY 2011	Department-wide	Components are identifying and testing key controls related to the process, to include orders accepted; expenses; receivables and collections; recorded manually or automated; and those organizational roles or systems performing these transactions.	FY 2014
12	<u>Transportation of People</u> : The Department cannot effectively account for transactions and balances supporting the transportation of people.	FY 2011	Department-wide	Components are developing plans to address 'segregation of duties' internal control issues within the transaction system due to overlapping permission-level assignments, as well as demonstrating effective information technology general and application controls.	FY 2014

Table 1a-1. FY 2012 Internal Control over Financial Reporting Material Weaknesses					
	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
13	<u>Military Equipment Assets</u> : The Department's financial systems do not support capturing and recording the quantity and historical cost of military equipment in compliance with Federal accounting standards.	FY 2003	Army; Navy; MDA ; USSOCOM	Components are following a strategy to first validate the existence and completeness of mission critical asset records in logistics and accounting systems. They also are developing a methodology to report property values, determine the appropriate property classifications, prepare for site visits to perform inventory counts, and implement property accountability policies and procedures.	FY 2017
14	<u>General Purpose Equipment</u> : The Department's practices do not meet Federal accounting standards for financial reporting of general personal property, specifically in the quantity and value of general equipment.	FY 2006	Army; Air Force; Navy; DLA; DIA; NGA; USSOCOM; NSA; MDA	Components are validating the existence and completeness of general purpose equipment before moving forward to record the valuation of such equipment and identifying property in the possession of contractors and ensuring information in the property management systems is accurately reported.	FY 2017
15	<u>Real Property Assets</u> : The Department cannot provide assurance that real property asset quantities and values reported in the financial reports are accurate.	FY 2003	Army; Navy; DLA; WHS; NGA; USSOCOM; DIA	Components have implemented real property inventory requirements data standards. In addition, Components are implementing sustainable real property accountability and construction in progress (CIP) business processes and management controls; reconciling real property records to ensure assets exist and records are complete; and assessing the effectiveness of management controls.	FY 2017

Table 1a-1. FY 2012 Internal Control over Financial Reporting Material Weaknesses					
	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
				Additionally, the Components will periodically evaluate the quality of real property data by making comparisons with physical assets and annual reconciliation. All stated steps will be validated by OSD(I&E) to ensure completeness of measures effectiveness.	
16	<u>Environmental Liabilities</u> : The Department cannot provide assurance that clean-up costs for all of its ongoing, closed, and disposal operations are identified, consistently estimated, and appropriately reported.	FY 2001	Army; Air Force; USACE	Components are implementing systems, processes, and controls to ensure the accuracy of site-level liability data to report environmental liabilities; updating guidance and training base-level environmental personnel on processes and cost to complete estimating practices; and standardizing cost estimating supporting documentation practices.	FY 2015
17	<u>Inventory</u> : The Department cannot accurately account for the quantity and value of inventory reported in its financial statements.	FY 2005	Army; Navy; Air Force; DLA	Components are developing physical inventory processes, including the reconciliation of quantities of inventory with data recorded in the accounting systems.	FY 2016
18	<u>Operating Material &amp; Supplies (OM&amp;S)</u> : The Department cannot accurately account for the quantity and value of operating material and supplies.	FY 2005	Army; Navy; Air Force; USSOCOM	Components are implementing ERPs that will track OM&S purchases and issuances at a transaction level to address this weakness as well enhancing physical inventory processes to ensure accurate reporting.	FY 2017

**2. FMFIA Section 2, Operational Material Weaknesses.** The Components use an entity-wide, risk-based, self-assessment approach to establish and assess internal controls for mission-essential operations. Table 1b lists the material weaknesses disclosed from these annual assessments. The Department aligns its reported material weaknesses into 17 categories, as outlined in the Department of Defense Instruction (DoDI) Number 5010.40, "Managers Internal Control Program Procedures", dated July 29, 2010.

<b>Table 1b. Effectiveness of Internal Control over Operations (FMFIA Section 2)</b>						
<b>Statement of Assurance: Qualified</b>						
	<b>Area of Material Weakness</b>	<b>Beginning Balance</b>	<b>New</b>	<b>Resolved</b>	<b>Reassessed</b>	<b>Ending Balance</b>
1	Acquisition	1				1
2	Communications, Intelligence and/or Security	4				4
3	Comptroller and/or Resource Management	2				2
4	Contract Administration	1	1			2
5	Force Readiness	2				2
6	Personnel and/or Organizational Management	3	1		1 <sup>2</sup>	3
7	Property Management	1				1
8	Supply Operations	1				1
	<b>Total Operational Material Weaknesses</b>	<b>15</b>	<b>2</b>		<b>1</b>	<b>16</b>

Table 1b-1 provides the description and corrective action plan for each material weakness related to internal control over operations in Table 1b.

<b>Table 1b-1. FY 2012 Internal Control over Operations Material Weaknesses</b>					
	<b>Material Weaknesses</b>	<b>Year Identified</b>	<b>DoD Components</b>	<b>Corrective Actions</b>	<b>Target Correction Year</b>
1	<u>Acquisition</u>				
	The Department lacks processes to maximize the return on weapon system investments. In addition, the Department must find ways to deliver more capability to the warfighter at a lower cost.	FY 2011	Department-wide	The Department is developing an analytical approach to prioritize capability needs, empowering portfolio managers to prioritize needs, make decisions, and allocate resources. This enables programs and individuals to be held accountable for policy implementation within milestone and funding	Reassessed annually based on incremental improvements

<sup>2</sup> Partially resolved resulting in reclassification to Reportable Condition

Table 1b-1. FY 2012 Internal Control over Operations Material Weaknesses					
	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
				decisions through the use of reporting metrics.	
2	<u>Communications, Intelligence and/or Security</u>				
a	Controls related to safeguarding Personally Identifiable Information (PII) are ineffective. Metrics demonstrate a need to strengthen the existing controls or develop new safeguarding policies.	FY 2011	Navy	The Navy plans to implement the use of individual unique identification numbers. In addition, the Navy will continue to monitor statistical data to evaluate whether high-risk breaches continue to decline.	FY 2013
b	Processes are not in place to ensure that military, civilian, and contractor personnel with Information Assurance (IA) duties have the proper certification in their computer network area of responsibility.	FY 2011	Air Force	The Air Force is developing and installing a training and certification system to track IA personnel certifications.	FY 2013 <sup>3</sup>
c	Weaknesses exist in the Department's management and assurance of the reliability and security of the information technology infrastructures.	FY 2006	Navy; USAFRICOM	The Navy is developing and implementing instructions and policies for tracking equipment accounts supporting Navy contracts and a uniform equipment request and loan tracking system for managing and tracking information. USAFRICOM plans to assess its consolidated enterprise and to develop additional requirements; engineer, implement, operate, and maintain a joint enterprise network; and provide additional capabilities for the tactical local area network.	FY 2013 <sup>3</sup>

<sup>3</sup> Target correction date was reported as FY 2012 in the FY 2011 Statement of Assurance. In FY 2012, the target correction date was reevaluated and extended to a future date

**Table 1b-1. FY 2012 Internal Control over Operations Material Weaknesses**

	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
d	Internal assessments have identified weaknesses in the Department's cyber security controls, potentially increasing vulnerability of DoD systems.	FY 2011	OSD; USAFRICOM	The Department will continue ongoing actions to address weaknesses in the complex network of systems referred to as the DoD Information Network Systems. The Department is updating identified security controls to current industry standards. The DoD also is enhancing the system certification and accreditation process to incorporate risk management throughout the systems lifecycle. This includes implementing a continuous risk monitoring program that will identify weak security controls and assess corrections. The Joint Information Environment, scheduled for completion in FY 2018, is creating a shared infrastructure and single security architecture that gives better visibility of network activity at points of vulnerability. In FY 2013, DoD will continue to implement insider threat protection such as Public Key Infrastructure and data access monitoring.	FY 2013 <sup>3</sup>
3	<u>Comptroller and/or Resource Management</u>				
a	The Department's current business processes, systems, and internal controls do not provide reliable, accurate and verifiable financial statements. Further, the financial management workforce needs to be well-trained to	FY 2011	Department-wide	The Department is implementing established guidance that will enable Components to improve their processes, systems and controls. The biannual FIAR Plan Status Report outlines the Department's and Components' progress and future plans for implementing ERPs and improving standard	FY 2017

<sup>3</sup> Target correction date was reported as FY 2012 in the FY 2011 Statement of Assurance. In FY 2012, the target correction date was reevaluated and extended to a future date

**Table 1b-1. FY 2012 Internal Control over Operations Material Weaknesses**

	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
	ensure the Department's programs and payments comply with financial management laws and regulations.			operating procedures and controls related to producing financial statements by FY 2017.	
b	Weaknesses within the funds control processes result in the inability to adequately track funds consistent with regulations, policies, existing laws, and use fund execution information to support budget requests. The lack of adequate funds control has led to several Anti Deficiency Act violations.	FY 2011	OSD; USSOCOM	The Department is enhancing systems for tracking funds in addition to publishing guidance and scheduling training for personnel related to funding activities. The Department requires Components to review and evaluate training records to ensure personnel certifying and handling funds have financial management and fiscal law training.	FY 2013 <sup>4</sup>
4	<u>Contract Administration</u>				
a	The Department's lack of well-defined requirements, the use of ill-suited business arrangements, and the inadequate number of trained acquisition and contract oversight personnel contribute to unmet expectations and place the Department at risk of potentially paying more than necessary.	FY 2006	Department-wide	The Department is revising guidance on contracting operations, which includes oversight, responsibilities, policy, and defining roles, as well as assessing the effectiveness of efforts to improve competition, contracting arrangements, and incentives. The Department intends to fully integrate operational contract support through education and pre-deployment training in addition to establishing improved processes and procedures.	Reassessed annually based on incremental improvements
b	Clearing the backlog of contracts to be closed out continues to be a challenge for	FY 2012	DCMA	DCMA and Defense Contract Audit Agency (DCAA) have been partnering and evaluating an option that	FY 2014

<sup>4</sup> Target correction date was reported as FY 2012 in the FY 2011 Statement of Assurance. In FY 2012, the target correction date was reevaluated and changed to an earlier date due to a component correcting its material weakness

**Table 1b-1. FY 2012 Internal Control over Operations Material Weaknesses**

	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
	the Department. The number of over-aged contracts increased 28% in FY 2012 (from approximately 28,000 in FY 2011 to 36,000 in FY 2012) and this number is expected to continue to rise. Over 75% of the current over-aged contracts are due to the lack of indirect rates. This causes unspent contract funds to be returned to the Department of the Treasury if not used by the end of the fiscal year.			would allow for a review of a sample of proposals within acceptable risk allowances; this will provide DCMA contracting officers the ability to settle indirect rates and close out overaged contracts. Additionally, DCMA and DCAA are working collaboratively in developing and implementing training, creating a standardized format for more effective and efficient dissemination of information.	
5	<u>Force Readiness</u>				
a	The Air Force has failed to effectively implement a weapons-of-mass-destruction emergency response program, which includes plans, policy, and reporting requirements, in addition to the management of equipment funds and inventory levels.	FY 2011	Air Force	The Air Force is developing a weapons-of-mass-destruction emergency response program, which includes training personnel and ordering necessary equipment to ensure appropriate inventory levels and standardized policies for reporting emergencies exist.	FY 2013 <sup>5</sup>
b	Air and Space Expeditionary Force Unit Type Code Reporting Tool (ART) reporting did not accurately reflect Air Force readiness. Specifically, Air Force officials did not accurately report Unit Type Code	FY 2010	Air Force	Rewrite AFI 10-401 procedures to expand the waiver process and perform validations.	FY 2013 <sup>5</sup>

<sup>5</sup> Target correction date was reported as FY 2012 in the FY 2011 Statement of Assurance. In FY 2012, the target correction date was reevaluated and extended to a future date

**Table 1b-1. FY 2012 Internal Control over Operations Material Weaknesses**

	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
	(UTC) readiness assessments at 12 of 14 wings reviewed. On average for calendar year 2008, commanders either did not report, or did not report in a timely manner, readiness assessments for 12% of 129,000 UTCs in ART. Additionally, Air Force officials did not process 24% of 116 tasking reclaims and 48% of tasking waivers in a timely manner.				
6	<u>Personnel and/or Organizational Management</u>				
a	Audits have found that DCAA personnel lacked sufficient professional judgment and quality to properly plan, execute and report findings due to improper personnel qualifications and organizational mismanagement.	FY 2009	DCAA	DCAA has developed and implemented policies and procedures to ensure auditors receive sufficient training. DCAA plans to institute peer reviews, in order to confirm the progress made towards improving audit quality.	FY 2013 <sup>5</sup>
b	The lack of quality assurance training for the acquisition workforce, along with the increasing complexity of products purchased, inhibits the agency's ability to conduct necessary and critical reviews of contract documentation. DCMA projects that approximately 50% of its 8,000+	FY 2010	DCMA	DCMA is developing and implementing a formalized education, training, and certification program for all levels of employees.	FY 2014

<sup>5</sup>Target correction date was reported as FY 2012 in the FY 2011 Statement of Assurance. In FY 2012, the target correction date was reevaluated and extended to a future date

Table 1b-1. FY 2012 Internal Control over Operations Material Weaknesses					
	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
	workforce will have less than 5 years' experience within the next 5 years.				
c	OSD has identified 28 Mission Critical Occupations and two Mission Critical Function Groups with potential skillset gaps that may impact the ability to meet mission objectives	FY 2006	Department-wide	DoD has implemented a process to identify occupations and function groups with skill gaps and to develop corrective action plans to remediate identified gaps. The process includes conducting internal and external environmental scans of political actions, legal policies, needed workforce skills, organizational goals and constraints, impacts to the workforce, and strategic roles in accomplishing the mission and executing strategy. The scan determines current workforce supply, evaluates future demand for filling current and new positions, analyzes recruitment and retention of data, develops forecasts using data provided by Functional Community Managers, and conducts skill gap analyses to identify strategies for skill gap closure.	FY 2015
7	<u>Property Management</u>				
	The Department has not properly trained staff or enabled sufficient tools to address the accountability requirements in place to adequately oversee and execute personal property transactions.	FY 2011	Department-wide	The Department is establishing procedures and training personnel on property management policies. The Components will establish accountable records that will identify property, to include Government Furnished Property.	FY 2016 <sup>6</sup>

<sup>6</sup> Target correction date was reported as "reassessed annually based on incremental improvements" in the FY 2011 Statement of Assurance. In FY 2012, the target correction date was reevaluated and changed to FY 2016

Table 1b-1. FY 2012 Internal Control over Operations Material Weaknesses					
	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
				OUSD (AT&L) will validate accountable property records and supporting documentation through existence and completeness testing.	
8	<u>Supply Operations</u>				
	The Department lacks management of supply inventories and responsiveness to warfighters' requirements.	FY 2011	Department-wide	The Department is improving Supply Change Management operations through better demand forecasting, asset visibility, and distribution processes including: developing and implementing a comprehensive inventory management plan, expanding automated process to worldwide inventory and linkages to distribution, and executing materiel distribution through stock positioning.	Reassessed annually based on incremental improvements

**3. FMFIA Section 4, Financial System Nonconformance Weaknesses:** The Department requires financial system conformance with federal requirements and reports. The Department reported one weakness that includes a wide range of pervasive problems related to financial systems. Table 1c shows the resulting weakness.

<b>Table 1c. Conformance with Financial Management System Requirements (FMFIA Section 4)</b>						
<b>Statement of Assurance: Systems do not conform to financial management system requirements</b>						
<b>Non-Conformances</b>	<b>Ref Table 2</b>	<b>Beginning Balance</b>	<b>New</b>	<b>Resolved</b>	<b>Reassessed</b>	<b>Ending Balance</b>
1. Financial Management Systems	9	1				1
<b>Total System Conformance Material Weaknesses</b>	<b>9</b>	<b>1</b>				<b>1</b>

Table 1c-1 provides the description and corrective action plan for the material weakness related to internal control over financial systems.

<b>TABLE 1c-1. FY 2012 Internal Control over Financial Systems Material Weakness</b>					
	<b>Material Weaknesses</b>	<b>Year Identified</b>	<b>DoD Components</b>	<b>Corrective Actions</b>	<b>Target Correction Year</b>
1	<u>Financial Management Systems</u> : The Department's financial systems were originally developed to meet the requirements of budgetary accounting and do not provide the capability to record costs and assets in compliance with current accounting standards. Improvements to the current systems environment are complicated by the use of and reliance upon many mixed systems that are not well integrated.	FY 2001	Department-wide	Most DoD Components have embarked on an effort to implement a compliant, end-to-end financial management system, anchored by ERPs that provide the core financial system as well as replacing many of the mixed (feeder) systems.	FY 2017

## SUMMARY OF FINANCIAL STATEMENT AUDIT

The following Table 2 lists the DoD IG's identified 13 areas of material weakness in the Department's financial statement reporting.

Table 2. Summary of Financial Statement Audit						
<b>Audit Opinion: Disclaimer</b>						
<b>Restatement: Yes</b>						
	Areas of Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
1	Accounts Payable	1				1
2	Accounting Entries	1				1
3	Environmental Liabilities	1				1
4	Government Property in Possession of Contractors	1				1
5	Intragovernmental Eliminations	1				1
6	Operating Materials and Supplies	1				1
7	Reconciliation of Net Cost of Operations to Budget	1				1
8	Statement of Net Cost	1				1
9	Financial Management Systems	1				1
10	Fund Balance with Treasury	1				1
11	General Property, Plant & Equipment	1				1
12	Inventory	1				1
13	Accounts Receivable	1				1
	<b>Total Material Weaknesses</b>	<b>13</b>				<b>13</b>

## FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

The DoD IG and the audit agencies within the Military Services have reported on DoD's noncompliance with FFMIA. The DoD's noncompliance is due to its reliance upon legacy financial management systems by the various Components. These legacy financial systems, for the most part, do not comply with the wide range of requirements for systems compliance, in accordance with FFMIA and therefore do not provide the necessary level of assurance that the core financial system data or the mixed systems information can be traced to source transactional documentation. Table 3 reflects DoD's compliance with FFMIA.

Table 3. Compliance with Federal Financial Management Improvement Act		
	Agency	Auditor
Overall Substantial Compliance	No	No
1. System Requirements	No	No
2. Accounting Standards	No	No
3. U.S. Standard General Ledger at Transaction Level	No	No

## **IMPROPER PAYMENT AND PAYMENT RECAPTURE PROGRAMS**

### **OVERVIEW**

This section reports on the Department's compliance with The Improper Payments Information Act (IPIA) of 2002, as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA), that require agencies to report information on improper payments to the President and Congress in the annual Agency Financial Report (AFR) and the Department's payment recapture programs.

Beginning in FY 2006, OMB determined that all DoD payments are susceptible to the risk of error based on the large volume of transactions and high dollar amounts of annual disbursements. Since that time, the Department has reported on the following payment categories:

- (1) Military Health Benefits
- (2) Military Retirement
- (3) Military Pay
- (4) Civilian Pay
- (5) Travel Pay
- (6) Commercial Pay

In the FY 2007 AFR, the U.S. Army Corps of Engineers (USACE) began reporting travel improper payments, and in the FY 2009 AFR, began reporting commercial pay improper payments.

The DFAS, USACE, and TMA are the primary disbursing components within the Department. A few additional DoD disbursement operations also report annually:

- Army-Europe – reports travel improper payments
- Army-Korea – reports travel improper payments
- Department of the Navy reports Civilian Mariner (payroll) improper payments

The following tables, which are required by OMB Circular No. A-136, are included at the end of this section:

- Improper Payment Reduction Outlook (Table 4)
- Payment Recapture Audit Reporting (Table 5)
- Payment Recapture Audit Targets (Table 6)
- Aging of Outstanding Overpayment (Table 7)
- Disposition of Recaptured Funds (Table 8)
- Overpayments Recaptured Outside of Payment Recapture Audits (Table 9)

### **Risk Assessment**

Because OMB determined that all DoD payments are risk susceptible, the Department maintains a more conservative position than required by IPERA and considers all payment

categories as high risk, annually testing and reporting improper payments in all six categories. The DFAS also monitors changes in programs associated with OMB-mandated criteria (e.g., a large increase in annual outlays, regulatory changes, newly-established programs, etc.) to track troubling trends and implement corrective measures, as necessary. Numerous pre-payment and post-payment controls further minimize improper payments as well as improve estimates and identify corrective actions.

The USACE assessments for travel and commercial payments address the effectiveness of internal controls, such as pre-payment reviews, to prevent improper payments as well as system weaknesses identified internally or by outside audit activities. The USACE Financial Management System (CEFMS) provides internal system standards that adhere to U.S. Generally Accepted Accounting Principles as well as process controls, providing the process safeguards to monitor and ensure that pre-payment examination requirements are met. The USACE also monitors changes in programs to track trends and implement corrective actions, as necessary.

The TMA contracts with an external independent contractor (EIC) to provide an independent, impartial review of reimbursement methodologies and claims processing procedures used by TRICARE's purchased care contractors. The EIC's responsibility is to identify improper payments as a result of contractors' noncompliance with TRICARE payment/reimbursement policies, regulations, and contract requirements. The EIC manually reviews medical, Active Duty dental and pharmacy claims documentation and re-adjudicates processed claims submitted by the purchased care contractors to detect errors. Post-payment claims reviews are conducted on a recurring quarterly, semi-annual, and annual basis as contractually defined in the EIC and purchased care contracts. The TMA program managers also complete an annual risk assessment based on the evaluation of the quarterly and semi-annual claim reviews performed by the EIC or based on other reviews.

### **Statistical Sampling Process**

The three primary Defense disbursing components (DFAS, TMA, and USACE) all use statistically valid, random sampling methods designed to meet or exceed OMB's requirements of a 90 percent confidence interval, plus or minus 2.5 percent, for estimating and projecting the Department's annual improper payments for each of the six programs identified in the Overview section. The smaller disbursing components (e.g., Army-Korea travel payments, or USACE travel pay) normally perform 100 percent post-payment reviews or a full review of payments above a certain dollar threshold with random sampling for lower-dollar payments. The TMA uses stratified random sampling for certain health claim categories.

**Military Health Benefits.** There are two types of payment samples: one for denied claims and one for non-denied claims (claims that were paid). In this way, TMA can be sure that claims were either paid or denied correctly. The TMA uses a stratified random sample process to select medical, pharmacy or dental claims for review.

**Military Pay.** The Department randomly samples accounts for the Active Duty (Army, Navy, Air Force, and Marine Corps) and Reserve Components (Army Reserve, Army National Guard, Navy Reserve, Air Force Reserve, Air National Guard, and Marine Corps Reserve) on a monthly basis. The DFAS selects the accounts for each Component to review and produce

annual estimates of improper payments.

**Civilian Pay.** The DFAS randomly samples Civilian Pay accounts from each of the Components (Army, Air Force, Navy/Marine Corps, and Defense Agencies) on a monthly basis. The DFAS processes the largest portion of DoD’s civilian payments; however, both the Navy and Army independently process civilian payments for civilian mariners and local national payrolls in foreign countries. These amounts are reported by Components and included in the total Civilian Pay payments for the Department.

**DFAS Commercial Pay.** In FY 2012, DFAS implemented statistically valid, random sampling for commercial payments by site and system for payments that DFAS computes. Approximately 2,000 invoices were reviewed monthly across the DFAS sites.

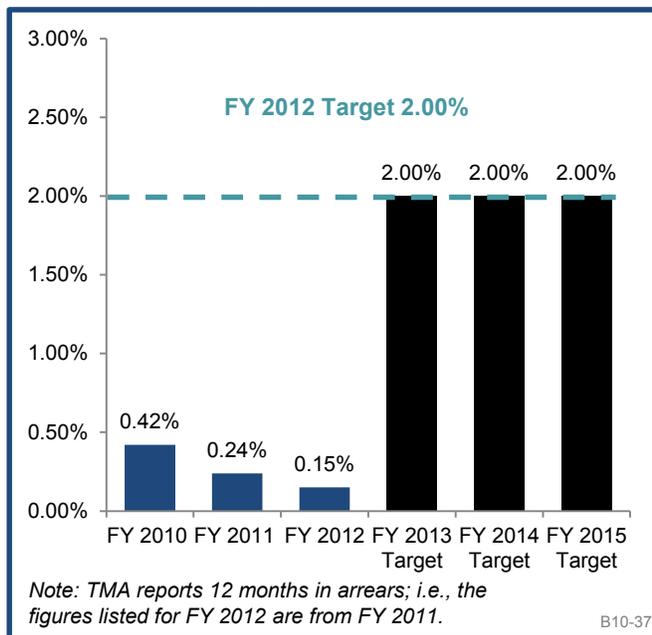
Disbursements in the Navy Enterprise Resource Planning (NERP) System that are computed by the Navy are reviewed by the Navy; however, its sampling and review plan was not in place early enough in FY 2012 to report improper payments in this year’s AFR. The NERP disbursement universe for FY 2012 was approximately \$1.4 billion.

**Military Retirement and Annuitant Benefit Payments.**

The monthly random sampling universe of military retirement payments includes both the retired and annuitant pay accounts. The FY 2012 scope of the pay reviews for retired and annuitant pay was expanded to include drilling reserve retiree offsets, Survivor Benefit Plans, transfers to/from the Temporary Disability Retired List to the Permanent List, and Veterans Affairs offsets. Special reviews continue for Combat Related Special Compensation, Concurrent Receipt of Disability Payment, daily payroll accounts, and other targeted areas.

**Travel Pay.** The DFAS reports the largest portion of the Department’s travel payments made by both the Defense Travel System (DTS) and Windows Integrated Automated Travel System (WinIATS) for the Department of the Army and select Defense Agencies. The DFAS randomly samples travel vouchers from each system on a monthly basis. The Department’s total travel payments include travel payments computed, paid, and reported independently by the Military Services and other Defense agencies. Table 4, included at the end of this section, represents the combined results of the review of DFAS-disbursed travel payments as well as non-DFAS-disbursed travel payments for Army-Europe, Army-Korea, Air Force, and Navy. Both Temporary Duty Travel (TDY) and Permanent Change of Station (PCS) travel vouchers are included in the post-payment reviews.

**Figure A-1. Improper Payment Rate – Military Health Benefits**



## Root Causes of Error and Corrective Actions

**Military Health Benefits.** As shown in Figure A-1, the Department projects 0.15 percent in FY 2012 Military Health Benefits improper payments. The Department’s purchased care contracts have had payment performance standards for processing military health benefit claims in place for many years. Specifically, if improper payments exceed 2 percent of total dollars paid out during the contract period, the contractor is subject to monetary penalties. Annual audits of payments made by managed-care support contracts are conducted. Overpayments discovered are projected to the review universe, and managed-care support contractors are liable for the total unallowed healthcare amounts paid.

The purchased care contracts have a performance standard of 98 percent accuracy, so the contractor is incentivized to keep payment error rates as low as possible to increase contract awards. Actual error rates, however, have been consistently less than ½ of 1 percent. This contract design, combined with numerous pre-payment and post-payment controls, effectively minimizes improper payments for purchased care contracts and ensures the Government’s risk for improper payments in the military health benefits program is minimized.

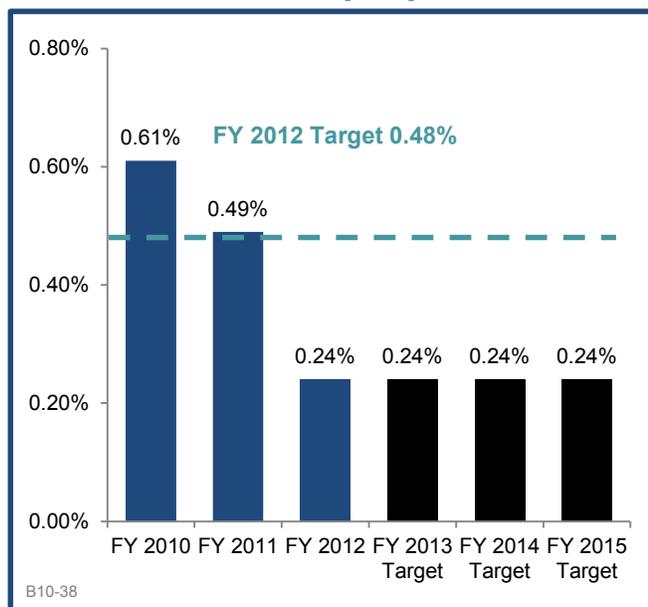
**Root Causes.** The primary reasons for payment errors in the Military Health Benefits program are:

- Incorrect pricing of medical procedures and equipment, 30 percent
- Cost-share/deductible miscalculations, 17 percent
- Other Health Insurance/government pay miscalculations, 13 percent
- All other causes combined, 40 percent.

**Corrective Actions:** TRICARE's third-party contractors are monetarily incentivized to reduce and eliminate improper payments through contractual performance standards. The fewer improper payments the contractors make, the less money is deducted from their contractual reimbursements.

**Military Pay.** As shown in Figure A-2, the Department projects 0.24 percent in Military Pay improper payments based on reviews, estimates, and forecasts for October 2011 through September 2012. The decrease from FY 2011 is attributed to a change in DoD regulations (DoD Instruction (DODI) 1327.06)) that authorized Reservists the opportunity to carry forward accumulated leave from one period of Active Duty service to another, which had been the primary cause of underpayments in FY 2011.

**Figure A-2. Improper Payment Rate – Military Pay**



Overpayments comprised 88 percent of the Military Pay improper payments, with less than 0.3 percent of the errors found through random reviews. These overpayments were reported as a result of separation debts (“out-of-service” debts, established after a member has left the service) and through collections reported by the Military Services.

Root Causes. The primary reasons for improper payments (mostly overpayments) identified through all procedures (random reviews, out of service debts, and collections) result from administrative and documentation errors:

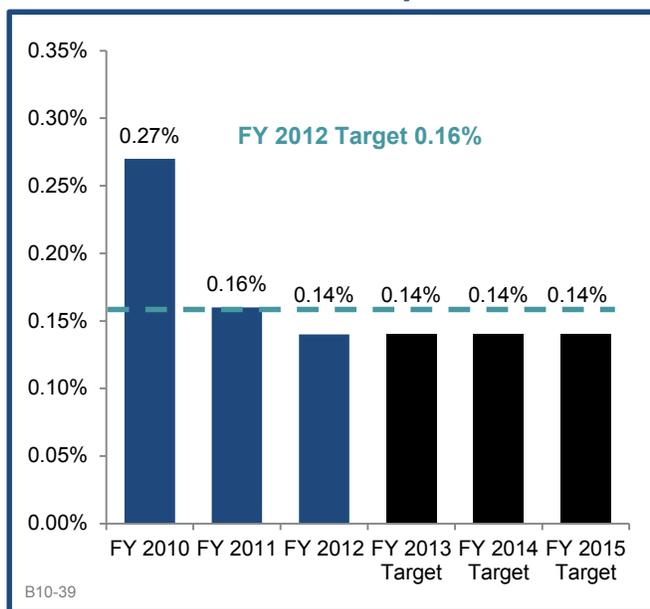
- Basic Allowance for Housing (38 percent) resulting from incorrect reporting of the entitlement.
- Base pay for Active Duty and incorrect Active Duty pay for Reservists (16 percent) resulting from incorrect reporting of the entitlement.
- Hostile fire/imminent danger pay (10 percent) resulting from incorrect reporting of the entitlement.
- Family separation allowance, Active and Reserve, (7 percent) resulting from incorrect reporting of the entitlement.
- Miscellaneous categories, including results from underpayments, account for 29 percent of all improper payments. (Miscellaneous categories are comprised of over 25 different entitlements.)

Nearly 100 percent of overpayments for Military Pay either were recovered or have an action in place to recover the overpayment. Collections for overpayments from current service members amounted to 61 percent of total recoveries with additional amounts identified through review of out of service debts (debts established and recovered after separation).

Corrective Actions. The Department, primarily through DFAS, continues to work with the Military Services to advise them of the results of payment reviews and the associated reasons for the errors. Of specific interest, DFAS provides the Military Service financial managers with monthly reports on the results of random reviews, reasons for and dollar value of errors, and year-to-date trends.

**Civilian Pay.** As shown in Figure A-3, the Department projects 0.14 percent improper payments in Civilian gross pay, primarily overpayments, for FY 2012. Nearly 100 percent of the overpayments were identified through review of the accounts receivable due from current civilian employees. Because the

**Figure A-3. Improper Payment Rate – Civilian Pay**



employees remain employed with the Department, there is an action in place to recover the overpayment, generally through payroll offset.

Root Causes. The Civilian Pay improper payments are primarily caused by untimely or inaccurate entry of information into the pay systems.

- Time and attendance, 45 percent
- Overseas and other allowances, 32 percent
- Late personnel actions, 23 percent

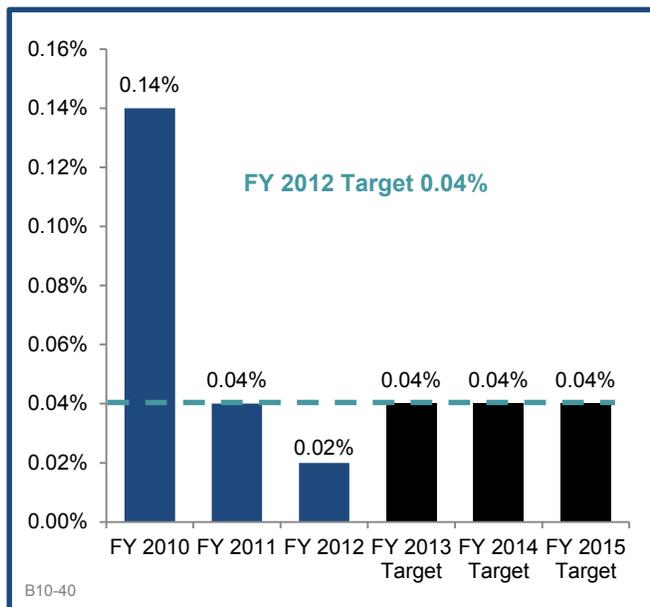
Because most government payroll systems base their time and attendance submissions on anticipated versus actual hours worked, the Department must correct overpayments and underpayments in a subsequent pay period.

Collections of overpayments in the overseas Civilian Pay accounts often are attributed to repayment of overseas pay allowances that continued after the individual returned to the United States. These improper payments often result from initial inaccurate personnel actions generated by human resources offices. Corrections subsequently are generated by human resource offices and transmitted to the civilian payroll system. These corrections result in re-computing pay and allowances and creating a collection (Accounts Receivable) action to offset the overpayment. The initial improper payments are discovered through various sources, such as agency reviews, bi-weekly exception reports, and employee or supervisor notification.

Corrective Actions. The Department, primarily through DFAS, continues to advise Components of the results of payment reviews and the associated reasons for errors that result in improper payments to civilian employees. The DFAS advises Components on best business practices to prevent future improper payments and participates at various conferences to instruct personnel on how to correctly submit information, such as changes to entitlements and to travel vouchers.

**Military Retirement.** Based on FY 2012 reviews, DFAS projects approximately 0.02 percent in improper payments for the total outlays in the Military Retirement program (refer to Figure A-4), with almost the entire amount related to payments made to deceased retirees and annuitants. The primary reason for the decrease from 0.14 percent in FY 2010 to 0.02 percent in FY 2012 is due to DFAS re-

**Figure A-4. Improper Payment Rate – Military Retirement**



establishing a formal post-pay review section for Retired and Annuitant Pay, insourcing the function from a private sector contractor. This action enabled DFAS to expand reviews and

identify processes needing additional attention or correction. The added reviews, coupled with ongoing review of deceased retiree and annuitant accounts, has allowed DFAS to provide a more comprehensive and concise accounting of outlays in military retirement.

**Root Causes.** Eligibility for military retired pay ends on the retiree’s date of death. Prompt reporting of a deceased retiree's death can help avoid delay and possible financial hardship to surviving beneficiaries, family members or executors, who are required to return any unearned payments of the decedent's military retired pay. The delay in notifying the payroll activity of the death of a Military Retiree results in unavoidable overpayments to deceased retirees. Our review of confirmed overpayments to deceased retirees in FY 2012 disclosed that the Department recovered approximately 96 percent of the overpayments within 60 days, demonstrating the effectiveness of controls within the retired pay system once the Department is notified of a retiree’s death.

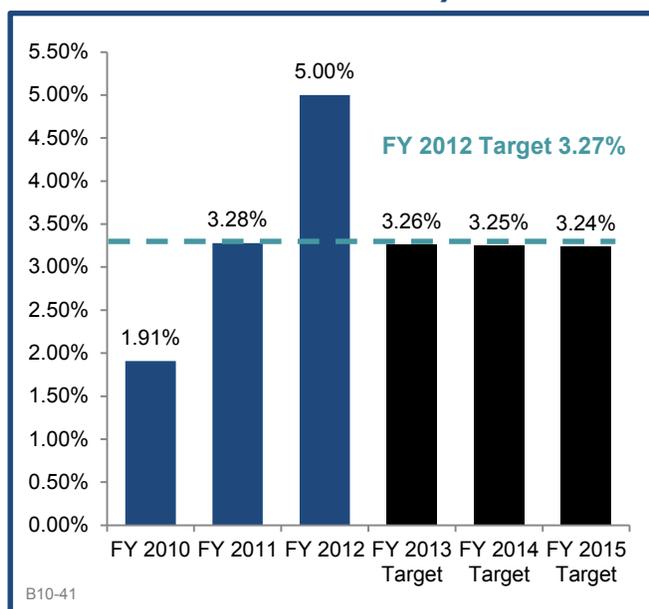
**Corrective Actions.** The Department’s control processes to prevent, identify, and reduce overpayments to deceased retirees and annuitants include:

- Validating existence of retiree and/or annuitant, if living outside the United States;
- Annual certification of existence for all annuitants
- Periodic random certifications for retirees over a certain age;
- Validating Military Retiree existence if payments are returned and/or if account was suspended for several months due to bad check/correspondence address.

Early detection and data mining efforts, along with partnerships with other Federal and state entities, also are used. The Department takes a proactive approach to ensure the accuracy of Military retiree payments, routinely comparing retired and annuitant payroll master file databases with the Social Security Administration’s death master file and periodically comparing records with the Office of Personnel Management’s deceased files, Department of Veterans Affairs’ database, and with individual states with sizable retiree and annuitant populations (e.g., Texas, California, and Florida). Payments for Military retirees identified as deceased are suspended pending validation of death or validation of continued eligibility. The Department's expanded definition of acceptable source documents for notice of death has allowed DFAS to initiate earlier reclamation actions, thereby increasing faster recovery of funds paid after date of death.

**DFAS Travel Pay.** The FY 2012 projected improper payment rate of 5.0 percent, shown in Figure A-5, includes random reviews of DTS trip records for the Military Services and

**Figure A-5. Improper Payment Rate – DFAS Travel Pay**



WinIATS TDY and PCS for both civilian and military vouchers computed and disbursed by DFAS. (Travel disbursements made outside of DTS are also included in Table 4 footnotes.)

The DFAS Travel Pay improper payment rate increased from FY 2010 primarily due to (1) improvements in the DFAS post-pay review process, and (2) a WinIATS processing error for Military PCS vouchers that truncated social security numbers. The latter are considered “technical” improper payment errors, because travel reimbursements are not to be made without a complete social security number. The cause of the WinIATS errors is under review.

Errors in the traveler’s request for reimbursement and Approving Official (AO) lack of proper review and approval of such requests resulted in nearly all of the errors detected during the random reviews of travel payments.

DTS Root Causes. The primary reasons for DTS improper payments include:

- Per Diem (40 percent): The Department paid lodging incorrectly, reimbursed the traveler lodging expenses not validated by receipts, and/or paid meals at an incorrect rate.
- Reimbursable Expense (35 percent): The Department incorrectly paid airfare, non-travel related expenses, and/or rental car expenses.
- Missing Documentation (25 percent): The Department reimbursed lodging, airfare or rental car expenses without a receipt.

DTS Corrective Actions. On a quarterly basis, DFAS provides the Defense Travel Management Office and DoD Components with error trend reports. The DFAS post-payment review personnel give presentations at various DTS training sessions and brief senior service executives on these post-payment review statistics, trends, and input errors. In addition, any improper payments identified are forwarded to the appropriate Debt Management Monitor for establishment of debt and recovery of overpayments.

WinIATS Root Causes. The primary reasons for WinIATS improper payments:

- Improperly completed travel voucher (82 percent): Claim paid with incomplete information to include missing Approving Official (AO) signature or social security number (SSN) on DD Form 1351-2.
- Per Diem (11 percent): Per Diem/Meals & Incidental Expenses and Lodging paid at the incorrect rate, not at all, or when unauthorized.
- Reimbursable Expense (4 percent): Airfare, household goods storage, and lodging tax paid incorrectly or not at all.
- Other miscellaneous (3 percent.)

WinIATS Corrective Actions. The DFAS has established an extensive set of preventative and monitoring actions to prevent improper payments, including:

- Post-payment reviewers meet monthly with travel pay operations personnel to discuss findings and preventative measures.

- Travel Pay examiner training programs, based on post-payment review findings and recommendations, have been implemented.
- Pre-payment validations and cross checks have been implemented to ensure the traveler was not previously reimbursed for the same trip, therefore avoiding a duplicate payment.
- WinIATS fielded a system update containing edits for the listing of invalid social security numbers (SSN), provided by the Social Security Administration, to mitigate invalid SSNs.

**USACE Travel Pay.** As shown in Figure A-6, USACE projects 0.06 percent of improper payments in Travel Pay. The USACE continues to educate travelers and travel Approving Officials (AO) through required training, as well as refresher training for seasoned travelers and approving officials. Additionally, all AOs are required to complete Fiscal Law training and the refresher course, as required, to maintain their certification eligibility

The USACE Finance Center (UFC) also performs a 100 percent audit of all airline credits issued against traveler's individually billed travel card accounts to ensure airline credits, issued as a result of flight changes, are properly recouped.

**Root Causes.** Travel pay errors generally occur for two reasons:

- Travelers make mistakes when completing their travel vouchers; and/or
- AOs fail to properly review travel vouchers before approval.

**Corrective Action.** When improper payments are identified, the UFC notifies the parties involved with the payments to determine the circumstances surrounding the error and to assist them in identifying business process improvements to prevent future recurrences.

**DFAS Commercial Pay.** In order to be fully compliant with IPERA, in FY 2012 DFAS began statistically sampling the contract and vendor pay systems to further ensure proper identification and recovery of improper payments and to publish a statistically valid improper payment estimate for Commercial Pay. The random review included DFAS computed payments entitled in the MOCAS contract payment system, the DFAS legacy commercial pay systems, and the Service Component ERPs. Fiscal Year 2012 is the first year that DFAS will report improper payments identified in the ERP systems.

As shown in Figure A-7, based on statistical sampling methods the FY 2012 estimated improper payment rate is 0.02 percent for total commercial payments; the dollar amount is

**Figure A-6. Improper Payment Rate – USACE Travel Pay**



\$100.1 million. In past years, DFAS reported actual improper payments in Commercial Pay and did not use a statistically valid estimation process. The actual Commercial Pay improper payments are \$318.3 million, versus the estimated \$100.1 million in improper payments derived from statistical sampling methods.

The main reason for the difference between the FY 2012 actual amount of \$318.3 million in improper payments and the \$100.1 million in improper payments derived from statistical sampling is due to the sample design. The statistical sampling was based on the number of invoices processed, in compliance with OMB guidance, but the sample was not stratified by invoice amount; therefore, a \$10 million invoice has the same chance

of being sampled as a \$100 invoice. Also, vendors are required by law to return overpayments, and large overpayments are always noticed more quickly than immaterial overpayments.

The DFAS identifies and prevents improper payments in DoD's five largest commercial payment systems through use of the pre-payment Business Activity Monitoring (BAM) tool, initially deployed in August 2008. These systems, which account for 91 percent of all DoD commercial payment dollars, include MOCAS, CAPS-Windows, IAPS, One Pay, and EBS. These types of preventative program activities consistently prove to be the most cost effective.

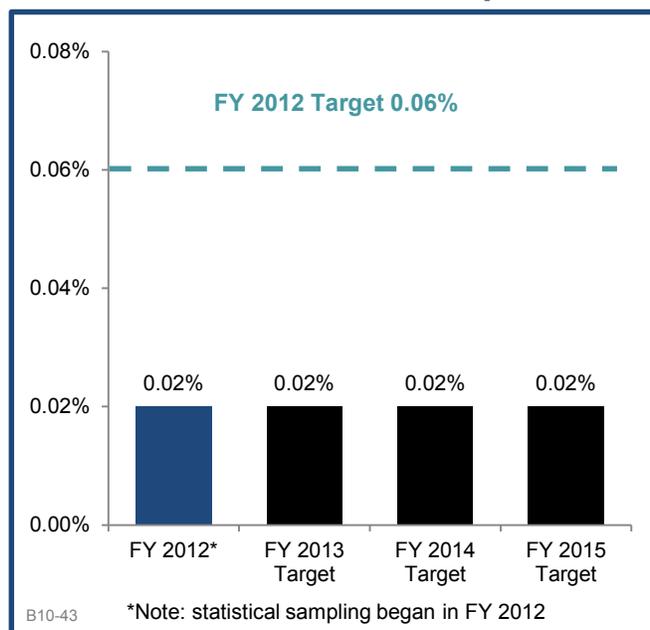
The DFAS identifies and monitors the root cause for all improper payments by researching supporting documentation and assigning a code that identifies the type of improper payment. In addition, improper payments detected by BAM in the pre-payment environment are reviewed and analyzed along with development of new integrity checks. Corrective action plans are developed through collaboration and monitored through DFAS post pay reviews and DFAS Site operational reviews. Developed project plans include testing and tracking of each individual Site plan.

Root Causes. The majority of errors in commercial pay improper payments are caused by input errors into the payment systems.

Corrective Actions. The ongoing corrective actions include:

- BAM refinements that reduce payments to the wrong vendor, which is the cause for approximately 3.2 percent of overall commercial pay improper payments.
- Continued analysis of DoD's legacy system Wide Area Work Flow rejections will increase electronic commerce and minimize manual intervention.

**Figure A-7. Improper Payment Rate – DFAS Commercial Pay**



- Continued work with Contracting Officers to simplify contract terms and eliminate the need for manual calculations.

The Department is very pleased with the continuing success of its pre-payment review using BAM. Since its initial roll out in August 2008, more than \$4.5 billion in improper payments have been prevented. The ongoing payment error analyses allow for the continual enhancement of BAM logic and improved disbursement accuracy.

Another initiative to reduce improper payments includes outreach to reduce vendor billing errors caused by duplicate manual and electronic submission of invoices. In addition, the Department conducts manual reviews to ensure it meets all Certifying Officer Legislation requirements prior to certifying payment, such as ensuring proper documentation and correct payment amounts before disbursement.

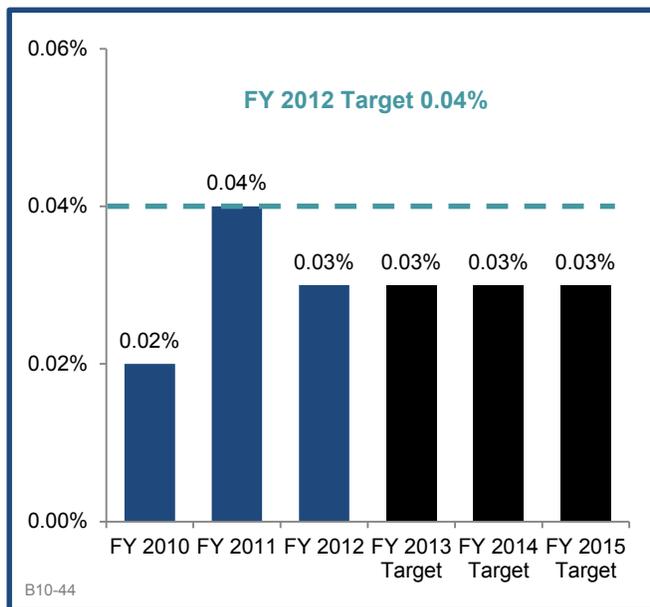
**USACE Commercial Pay.** As shown in Figure A-8, the USACE projects 0.03 percent in improper payments for Commercial Pay. The USACE functions as the real estate agency for the Department, as they have responsibility for leasing office space for all military recruiters. This applies to small offices in rural and semi-rural areas as well as larger spaces in more urban areas.

**Root Cause.** Commercial rental properties change hands fairly frequently; however, USACE is often not informed of the change in ownership. Therefore, improper payments occur as a result of the wrong lessor being paid (or an incorrect property manager). In these instances, staff is counseled to immediately notify the appropriate individuals when ownership or property management companies have changed to prevent future payment errors of this type.

In addition, some overpayments are identified during contract close-out. When an overpayment is identified, the final invoice is offset and/or an account receivable is established with a demand letter sent to recover the amount. Other errors are caused by input errors, such as improper identification of the Commercial Activity Government Entity (CAGE) code when establishing contracts in CEFMS. Many corporations have multiple CAGE codes.

**Corrective Actions.** When improper payments are identified, the USACE Finance Center notifies the parties involved with the payments to determine the circumstances and to assist in identifying business process improvements to prevent recurrences.

**Figure A-8. Improper Payment Rate – USACE Commercial Pay**



## **Recoveries of Improper Payments**

In compliance with IPERA as well as the Debt Collection Improvement Act of 1996, the Department uses a number of methods to prevent, identify, and collect improper payments, to include contract claims auditing by an EIC utilized by TMA and internal DoD staff to recapture overpayments and manage debt collection. For example, DFAS has implemented a Centralized Offset Program (COP) to look across the Defense agencies for opportunities to offset debts within the first 90 days of delinquency. Once this deadline passes, DFAS transfers the debts to the Treasury Department, no longer waiting until day 180, as allowed by statute, to utilize all debt collection tools available earlier in the debt lifecycle to increase the likelihood of collecting the debt. During FY 2012, COP requested and confirmed nearly 1,200 offsets totaling approximately \$13 million.

The Department also is working on initiatives to standardize Treasury FedDebt profiles for all DoD programs and establish new cross-servicing programs for many of our medical installations that are operated by TMA and the Army Medical Command. Referrals to Treasury for delinquent debt collection in these categories should increase dramatically during FY 2013.

The USACE Finance Center utilizes a data mining tool as part of its post-payment/payment recapture program. This tool searches to identify potential errors such as duplicate, missing, or suspicious invoices, as well as specific types of recurring payments. There are ten scenarios built into the data mining tool, which processes 100 percent of all contract payments. The use of a data-mining tool complements the pre-payment system edits built into CEFMS. Safeguards include a requirement for matching a receiving report with an invoice and prevent use of duplicate invoice numbers for the same obligation.

## **Program Improper Payment Reporting**

Table 4, below, summarizes DoD's improper payment reduction outlook and total program outlays (payments) from FY 2011 through FY 2015.

**Table 4. Improper Payment Reduction Outlook**

Program	FY 2011					FY 2012					FY 2013 Estimate			FY 2014 Estimate			FY 2015 Estimate		
	Outlays (\$B)	IP (%)	IP Over (\$M)	IP Under (\$M)	IP Total (\$M)	Outlays (\$B)	IP (%)	IP Over (\$M)	IP Under (\$M)	IP Total (\$M)	Outlays (\$B)	IP (%)	IP (\$M)	Outlays (\$B)	IP (%)	IP (\$M)	Outlays (\$B)	IP (%)	IP (\$M)
<b>Military Health Benefits</b> <sup>7,8</sup>	\$ 12.6	0.24	\$ 21.2	\$ 9.0	\$ 30.2	\$ 20.9	0.15	\$ 22.5	\$ 8.8	\$31.3	\$ 20.3	2.00	\$ 406.0	\$ 20.6	2.00	\$ 412.0	\$ 21.6	2.00	\$ 432.0
<b>Military Pay</b> <sup>1,5</sup>	\$ 96.0	0.49	\$ 209.1	\$ 265.2	\$ 474.3	\$ 95.5	0.24	\$ 197.8	\$ 29.0	\$226.8	\$ 95.0	0.24	\$ 228.0	\$ 94.0	0.24	\$ 225.6	\$ 93.5	0.24	\$ 224.4
<b>Civilian Pay</b> <sup>2,5</sup>	\$ 58.2	0.16	\$ 90.8	\$ 0.1	\$ 90.9	\$ 59.0	0.14	\$ 81.8	\$ 0.04	\$81.8	\$ 57.5	0.14	\$ 80.5	\$ 57.0	0.14	\$ 79.8	\$ 56.5	0.14	\$ 79.1
<b>Military Retirement</b>	\$ 42.2	0.04	\$ 18.8	\$ 0.05	\$ 18.9	\$ 55.1	0.02	\$ 12.8	\$ 0.3	\$13.1	\$ 42.9	0.04	\$ 17.2	\$ 43.5	0.04	\$ 17.4	\$ 44.1	0.04	\$ 17.6
<b>Travel Pay</b> <sup>3,4,5</sup>	\$ 8.7	3.28	\$ 238.2	\$ 48.4	\$ 286.6	\$ 8.4	5.0	\$ 363.9	\$ 55.4	\$419.3	\$ 8.5	3.26	\$ 277.1	\$ 8.5	3.25	\$ 276.3	\$ 8.5	3.24	\$ 275.4
<b>DFAS Commercial Pay (Statistical Reviews)</b> <sup>6,9</sup>	NA	NA	NA	NA	NA	\$ 408.7	0.02	\$ 89.6	\$ 10.5	\$100.1	\$ 400.5	0.02	\$ 80.0	\$ 392.5	0.02	\$ 78.5	\$ 384.7	0.02	\$ 76.9
<b>USACE Travel Pay</b>	\$ 0.212	1.00	\$ 2.0	\$ 0.1	\$ 2.1	\$ 0.19	0.04	\$ 0.76	\$ 0.04	\$0.80	\$ 0.13	0.045	\$ 0.1	\$ 0.09	0.045	\$ 0.04	\$ 0.07	0.045	\$ 0.03
<b>USACE Commercial Pay</b>	\$ 30.5	0.04	\$ 11.9	\$ -	\$ 11.9	\$ 30.1	0.03	\$ 8.8	\$ -	\$8.8	\$ 30.0	0.03	\$ 9.0	\$ 30.0	0.03	\$ 9.0	\$ 30.0	0.03	\$ 9.0

Note 1: Reduction in underpayments from FY11 to FY12 (\$265.2M to \$29.0M) primarily was due to leave accounting within the National Guard and Reserve components. Accounting instructions were changed/clarified by DoDI 1327.06, which allowed leave for National Guard/Reservists to be carried from one period of active service to another. This change alleviated the need to liquidate leave at the end of each period of Active Duty.

Note 2: Civilian Pay represents data from DFAS and Navy Civilian Mariner Pay.

Note 3: Travel Pay: DFAS Travel Pay represents travel vouchers settled from July 2011 through June 2012.

Note 4: Travel Pay includes travel data from Army, Navy, and Air Force for vouchers paid outside of DTS.

Note 5: Out-year projections for Travel, Civilian Pay, and Military Pay represent input from DFAS only. USACE computed its own out-year projections.

Note 6: Statistical sampling of commercial payments was initiated in FY 2012. In prior years, actual improper payments were reported.

Note 7: TMA reports 12 months in arrears; therefore, FY 2012 reporting represents FY 2011 data.

Note 8: TMA uses 2% as its out-year target because that is the contract performance standard.

Note 9: A description of the dollar amount of actual improper commercial payments identified during FY 2012 is on page A-61 of Addendum A.

Note 10: Because the Department does not currently have an auditable SBR, it is not possible for the Department to reconcile outlays to the quarterly or annual gross outlays reported therein; therefore, it is not yet possible to ensure all required payments for reporting purposes are captured. DoD is working hard to have an auditable SBR by 2014.

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The Department utilizes internal payment recapture auditing processes to identify and recover outstanding overpayments. The Department's collections are shown in Tables 5 and 9.

**Table 5. Payment Recapture Audit Reporting**

	Amount Identified (CY)	Amount Recovered (CY)	% of Amount Recovered out of Amount Identified (CY)	Amount Outstanding (CY)	% of Amount Outstanding out of Amount Identified (CY)	Amount Determined Not to be Collectable (CY)	% of Amount Determined Not to be Collectable out of Amount Identified (CY)	Amount Identified (PYs)	Amount Recovered (PYs)	Amount Identified (CY+PYs)	Amount Recovered (CY+PYs)	Amount Outstanding (CY+PYs)
<b>Military Pay<sup>1,2</sup></b>	\$197.3M	\$146.8M	74%	\$50.5M	26%	\$0.0M	0%	\$325.1M	\$302.7M	\$522.4M	\$449.5M	\$72.9M
<b>Civilian Pay<sup>1</sup></b>	\$81.8M	\$81.8M	100%	\$ 0.0M	0%	\$0.0M	0%	\$250.3M	\$250.3M	\$332.1M	\$332.1M	\$0.0M
<b>Military R&amp;A<sup>3</sup></b>	\$67.4M	\$63.8M	95%	\$3.6M	5%	\$0.0M	0%	\$175.3M	\$163.5M	\$242.7M	\$227.3M	\$15.4M
<b>Travel Pay<sup>4,6</sup></b>	\$1.9M	\$0.1M	4%	\$1.8M	96%	\$0.0M	0%	\$1.6M	\$0.1M	\$3.5M	\$0.2M	\$3.3M
<b>DFAS Commercial Pay<sup>5</sup></b>	\$125.8M	\$114.2M	91%	\$11.1M	9%	\$0.5M	0%	\$1.5B	\$1.3B	\$1.6B	\$1.4B	\$0.2B
<b>USACE Travel Pay</b>	\$0.8M	\$0.8M	100%	\$ 0.0M	0%	\$0.0M	0%	\$1.1M	\$1.1M	\$1.9M	\$1.9M	\$0.0M
<b>USACE Commercial Pay</b>	\$ 8.6M	\$8.6M	100%	\$0.0M	0%	\$0.0M	0%	\$50.8M	\$50.2M	\$59.4M	\$58.8M	\$0.6M

"M" represents millions. "B" represents billions.

Note 1: In-Service collection dollars are considered as recovery amounts. Actual results from random sample overpayments are negligible.

Note 2: Recoveries provided in the CY Military Pay includes collections reported in "Out of Service Debts", through the DFAS Debt Management Program. Debt recoveries, for purposes of the AFR, are tracked for twelve months from the time the debt is established. Resulting impact is that recoveries for collections and random review findings will not be realized until the end of FY13. Out of Service Debts account for \$59.8M identified and \$9.3M collected.

Note 3: FY 2012 amounts identified and recovered are based on 100 percent review of deceased retiree and annuitant accounts. FY 2012 recoveries will not be completed until December 31, 2012, as they are tracked for 120 days.

Note 4: Amounts for Current Year (CY) only include overpayments identified in the sampling of travel vouchers settled April 2011 through March 2012, as DFAS allows 120 days for the Service and Defense Components to resolve improper travel payments. The amount includes \$624K in duplicate payments from FY 2011 to FY2012 in addition to the statistical sampling amount identified; however, the total excludes \$341K in improper payments to foreign military students and amounts of \$10 or less, both of which are non-recoverable pursuant to Regulation. It also excludes amounts recovered by Army Europe and Army Korea.

Note 5: Commercial Pay improper payments are based on date of payment. The Prior Years (PYs) data shown remains unchanged as these figures were reported to the OMB MAX database and previously published. Prior Years (PYs) amounts in the OMB MAX database does not reflect collections and adjustments in subsequent fiscal years.

Note 6: Travel Pay also includes travel data from Army, Navy, and Air Force for vouchers paid outside of DTS.

Note 7: As of September 30, 2012, for debts caused by improper payments incurred during FY 2011, collections from offsets totaled \$6.03M; for debts caused by improper payments incurred during FY 2012, collections from offsets totaled \$0.88M.

Table 6 shows the dollar amounts and percentage of overpayments the Department recovered during FY 2012. As reflected in Table 6, the Department has exceeded the OMB-established FY 2013 threshold to recover 85 percent of overpayments.

<b>Table 6. Payment Recapture Audit Targets</b>						
Type of Payment	CY Amount Identified (\$M)	CY Amount Recovered (\$M)	CY Recovery Rate (Amount Recovered/ Amount Identified)	CY + 1 Recovery Rate Target	CY + 2 Recovery Rate Target	CY + 3 Recovery Rate Target
<b>DoD-Wide<sup>1,5</sup></b>	\$427.9	\$360.2	84.2%	93.0%	93.0%	93.0%
<b>DFAS<sup>2,3</sup></b>	\$419.3	\$351.6	83.9%	92.5%	92.5%	92.5%
<b>USACE<sup>4</sup></b>	\$8.6	\$8.6	99.4%	99.0%	99.0%	99.0%
<p>Note 1: The values shown in this table are not strictly "payment recapture" targets, as DoD performs the functions of recapture auditors internally and/or through the Department of Treasury's Debt Management Services. A more appropriate term would be collection targets, but they are listed here to ensure inclusion for government-wide reporting.</p> <p>Note 2: The DFAS commercial improper payments are identified by date paid.</p> <p>Note 3: The DFAS values include Military Pay, Civilian Pay, Military Retirement and Annuitant Pay, Travel pay, and Commercial Pay amounts.</p> <p>Note 4: The USACE values include Travel Pay and Commercial Pay amounts.</p> <p>Note 5: See Table 9 for Tricare Management Activity (TMA) health benefit recoveries. The TMA third party payer contracts require reimbursement to the Government of an extrapolated sampling amount, and therefore are not deemed collections against a debt.</p>						

Table 7 shows the dollar amount of DFAS overpayments outstanding as of September 30, 2012.

<b>Table 7. Aging of Outstanding Overpayments</b>			
Type of Payment	CY Amount Outstanding (0 – 6 Months) (\$M)	CY Amount Outstanding (6 Months – 1 Year) (\$M)	CY Amount Outstanding (Over 1 Year) (\$M)
Commercial <sup>1</sup>	\$91.2	\$3.5	\$-
<p>Note 1: The aging schedule is based on overpayments identified and paid from October 1, 2011 through September 30, 2012 and applies to DFAS only.</p>			

Table 8 shows that virtually all recovered FY 2012 funds were returned to the original appropriation and/or used for the original purpose.

Table 8. Disposition of Recaptured Funds						
Type of Payment	Agency Expenses to Administer the Program	Payment Recapture Auditor Fees	Financial Management Improvement Activities	Original Purpose (\$M)	Office of Inspector General	Returned to Treasury
All	\$-	\$-	\$-	\$360.9M <sup>1</sup>	\$-	\$-

Note 1: Dollar amount represents the sum of Column 3 from Table 5 (Amount recovered (CY)).

The Department does not currently utilize external payment recapture auditors to identify and recover outstanding overpayments. The Department’s collections are shown in Tables 5 and 9.

Table 9. Overpayments Recaptured Outside of Payment Recapture Audits						
Agency Source	Amount Identified (CY)	Amount Recovered (CY)	Amount Identified (PYs)	Amount Recovered (PYs)	Amount Identified (CY+PYs)	Amount Recovered (CY+PYs)
TRICARE Management Activity (TMA) Health Benefits Contracts <sup>1</sup>	\$4.3M	\$2.2M	\$57.0M	\$41.2M	\$61.3M	\$43.4M

<sup>1</sup>“M” represents millions. “B” represents billions.

Note 1: TMA Contract improper payments and recoveries are reported 12 months in arrears to accommodate its 100 percent post-payment review.

## Accountability

The Under Secretary of Defense (Comptroller)/Chief Financial Officer is the Accountable Official for the Department, and accordingly, this individual ultimately is responsible for ensuring that, to the greatest extent possible, all DoD disbursements are made correctly and accurately.

Certifying Officer legislation holds Certifying and Disbursing Officers accountable for government funds. In accordance with [10 U.S.C. 2773a](#), pecuniary liability attaches automatically when there is a fiscal irregularity, i.e., (1) a physical loss of cash, vouchers, negotiable instruments, or supporting documents, or (2) an improper payment. This is further codified in [DoD Financial Management Regulation \(DoD FMR\), Volume 5, Chapter 33](#), “Certifying Officers, Accountable Officials, and Review Officials.” Efforts to recover overpayments from a recipient must be undertaken in accordance with the debt collection procedures outlined in the [DoD FMR, Volume 5, Chapter 28](#), “Management and Collection of Individual Debt,” and [DoD FMR, Volume 10, Chapter 18](#), “Contractor Debt”.

## **Agency Information Systems and Other Infrastructure**

The Department has much of the information and infrastructure needed to reduce improper payments in each of its six improper payment programs. The Department uses the BAM tool to identify potential improper commercial payments prior to disbursement.

The Department's ongoing migration from the legacy environment to ERP systems presents a number of challenges and opportunities to prevent and detect improper payments, as well as debt collection for recapturing overpayments. These issues are being addressed by stakeholders, though initially the new systems will add additional complexity, especially in terms of the audit readiness efforts currently at full throttle.

### **Barriers**

With the advent of The Do Not Pay List, the Privacy Act can be a barrier in terms of the information that is legally allowed to be shared among federal agencies. Computer matching agreements can take months and sometimes years to finalize and therefore delay the ability to prevent improper payments based on information the Federal Government has access to but cannot legally share. However, there is legislation pending that may be able to address some of these delays without gutting the very necessary protections afforded by the Privacy Act. In the interim, the Department will continue using the means it currently has, including The Do Not Pay List, to prevent, detect, and recover improper payments.

### **Additional Comments**

Because the Department currently does not have an auditable SBR, it is not possible for the Department to reconcile outlays to the quarterly or annual gross outlays reported in the SBR to ensure all required payments for reporting purposes are captured. The Department is working hard to become fully auditable by 2017. As part of this effort, each of the Defense disbursing components is working diligently to review and report on all payments that are subject to IPERA and ensure the processes used are compliant with laws and regulations. Nevertheless, the Department continually looks for opportunities to improve its methodologies, and the post-payment review teams are far from complacent. The Department looks forward to receiving recommendations from the DoD Inspector General's IPERA Compliance Review for FY 2012 as well as from the GAO's ongoing engagement on improper payments, as we move forward with FY 2013 corrective actions.