United States Department of Defense

Agency Financial Report

Fiscal Year 2013

Addendum A

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ADDENDUM A, OTHER INFORMATION

Other Information provides additional details that support the Fiscal Year (FY) 2013 Department of Defense (DoD) Agency Financial Report (AFR). This addendum includes the following sections:

Inspector General's Summary of Management and Performance Challenges for FY 2013

Managers' Internal Control Program

Improper Payment and Payment Recapture Programs

INSPECTOR GENERAL'S SUMMARY OF MANAGEMENT AND PERFORMANCE CHALLENGES FOR FY 2013

INTRODUCTION

The *Reports Consolidation Act of 2000* requires that the Agency Financial Report (AFR) include a statement, prepared by the Department's Inspector General (IG), which 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. In FY 2013, the IG identified the following seven categories of management and performance challenges facing the Department:

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

Chairman of the Joint Chiefs of Staff GEN Martin E. Dempsey talks with U.S. Marine Corps drill instructors at the 4th Recruit Training Battalion, Parris Island, SC, on March 21, 2013. The 4th Recruit Training Battalion is a female-only unit at Parris Island.

DoD photo by Master Sgt. Charles Marsh, U.S. Air Force

SUMMARY OF IDENTIFIED CHALLENGES

The following tables report the IG's summary of the challenges, an assessment of the Department's progress in addressing these challenges, and the Department's response.

1. IG-Identified Challenge: Financial Management	
1-1A. Achieving Financial Statement Audit Readiness	IG Summary of Challenge

The Department's financial management challenges impair its ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting, and policy decisions. Gaps in the financial framework harm the accuracy, reliability, and timeliness of budgetary and accounting data and financial reporting, reducing the effectiveness of decisions made by leaders at all levels. Key to solving the Department's financial management problems is the production of auditable financial statements and receiving unqualified opinions on them.

Achieving auditable financial statements is a longstanding and daunting task. The success of the DoD financial improvement and audit readiness effort depends on the Department's ability to:

- Resolve material internal control weaknesses to ensure internal controls are properly designed, properly implemented, and working effectively.
- Monitor and resolve new material internal control weaknesses identified as part of ongoing readiness efforts.
- Sustain improvement in internal controls and systems to provide consistent and repeatable financial data used in decision making and reporting.
- Effectively develop and implement 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 timely implementation of those efforts.

Congress requires the Department to validate as audit-ready the DoD Statement of Budgetary Resources (SBR) and the other DoD financial statements by September 30, 2014, and September 30, 2017, respectively. Meeting those deadlines will be a significant challenge for the Department. Furthermore:

- *Public Law 111-383, Section 881*, requires the Department to establish interim milestones to achieve audit readiness of its financial statements earlier than 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 funds balance with the Treasury."
- *Public Law 112-81, Section 1003*, requires the Department to 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 of validating the SBR as audit-ready by September 30, 2014. The Department must aggressively pursue the development and implementation of comprehensive improvement initiatives and must monitor progress according to interim milestones. The Department may need to revise these initiatives and milestones as it identifies additional deficiencies and corrective actions, as a result of DoD's iterative Financial Improvement and Audit Readiness (FIAR) process.

- *Public Law 112-239, Section 1005(b)(1)*, requires that the plans to achieve audit readiness of the SBR "by September 30, 2014, include steps to minimize one-time fixes and manual work-arounds, be sustainable and affordable, and not delay the full auditability of financial statements." Meeting the 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 Fund and General Funds. 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 of Public Law 111-383 requires the Department to 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 achieving 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 financial statements, it has made progress. The DoD senior leadership has placed an increased emphasis on achieving this goal. We believe this increased emphasis is essential to the Department's ability to meet its internal milestones, as well as the 2014 and 2017 audit readiness mandates.

Despite pervasive and longstanding Department financial management problems, the Army Corps of Engineers and various Defense agencies, such as the Defense Commissary Agency and Defense Contract Audit Agency, and the Military Retirement Fund, have received unqualified audit opinions. The Department must sustain its achievements as well as advance in the remaining significant areas.

The Department continues to make progress toward 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 Service 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. The USMC is undergoing its third audit, and progress was seen in the Corp's ability to produce supporting documentation on historical transactions within the Schedule of Budgetary Activity (SBA). The USMC, the Navy, and the Department are using this experience to correct weaknesses, as well as prepare the other Military Services for their eventual SBR audit.

The *May 2013 FIAR Plan Status Report* only addresses audit readiness of certain aspects of the SBR and states that the Department does not expect every Component to achieve an SBA clean audit opinion in FY 2015. The Department reported in the November 2011 FIAR Plan update, and continued to report in the May 2013 FIAR Plan update, that it had significantly changed its audit goals to include achieving audit readiness of the General Fund SBR by the end of FY 2014, in addition to achieving audit readiness of all DoD financial statements by the end of FY 2017. However, in the November 2012 FIAR Plan update, the Department reported it would limit first-year SBR audits in FY 2015 to audits of schedules containing only current-year appropriation activity (i.e., a Schedule of Budgetary Activity).

Additionally, in the May 2013 FIAR Plan update, the Department reported that the initial audits of the General Fund Schedule of Budgetary Activity will not include balances from prior year activity. The Department will also begin audits of the complete SBR only after achieving successful audits of current-year appropriation activity. Meaningful progress in FY 2014 for the SBR audit-readiness goal will be critical, and this will continue to be a high-visibility area.

1-1C. Achieving Financial Statement Audit Readiness	**Department Response**

The Department generally agrees with IG's assessment of DoD's progress in achieving audit readiness. Significant progress continues to be made, and the Department is fully committed to achieving audit readiness on its full financial statements by September 30, 2017.

The FIAR Strategy focuses on achieving audit readiness of the Statement of Budgetary Resources (SBR) by September 30, 2014. Audit readiness means the Department has improved financial practices, processes, and systems, and strengthened internal controls so that there is reasonable confidence that the information can withstand an audit by an independent auditor.

The scope of FY 2015 audits will be on current-year information contained in the SBR. The Department refers to current year information of the SBR as the Schedule of Budgetary Activities or SBA. The initial General Fund SBA audits will not include balances from prior year activity. The U.S. Marine Corps audit, which has been audited by the DoD IG, employed this same approach. The Government Accountability Office and the DoD IG have been fully briefed and agree that focusing FY 2015 audits on current year information is a cost-effective and sensible path to full audit readiness. The Department is developing guidance for achieving Wave 4, full financial statement audit readiness.

Achieving auditable financial statements will help the Department improve processes and make better use of resources. More importantly, auditable financial statements will demonstrate to the American public and Congress that the Department is a good steward of government funds. Although the Department is diligently working to achieve SBR audit readiness by the end of FY 2014 and begin SBA audits in FY 2015, several challenges exist outside the Department's control that have the potential to impede progress.

For more information, refer to the *FIAR Plan Status Report*.

1-2A. Modernizing Financial Systems (Enterprise Resource Planning)	IG Summary of Challenge

To develop effective financial-management processes throughout the Department, the Department has begun to implement new financial management systems and business processes. We believe properly planned and integrated systems, with strong internal controls, are critical to providing useful, timely, and complete financial management data and to achieving auditability. Timely and effective implementation of the enterprise resource planning systems (ERPs) is critical for the Department to achieve its financial improvement and audit-readiness goals.

The Department noted in the latest FIAR update that the ERPs continue to be essential to the Department's audit-readiness efforts. However, not all ERPs will be deployed by the 2014 and 2017 readiness deadlines. This will require the Department to continue to rely on legacy systems.

1-2B. Modernizing Financial Systems (Enterprise Resource Planning)	IG Assessment of Progress

The Department plans to spend about $15 billion to develop and implement ERPs. These systems have experienced cost increases and schedule delays. The Department noted that some ERPs will not be fully deployed by the 2014 and 2017 audit-readiness dates, and therefore it must continue to rely on legacy systems. This will increase the risk that the SBR, or a schedule of current year budget activity, will not be auditable by September 30, 2014, and that the Department will not meet the goal of full financial statement audit readiness by September 30, 2017. Reliance on legacy systems, along with schedule delays and poorly developed, poorly implemented ERPs, will diminish the savings expected from transforming operations through business-system modernization.

Furthermore, without fully deployed ERPs, the Department will be challenged to produce reliable financial data and auditable financial statements without resorting to extreme efforts, such as data calls or manual workarounds, to provide financial data on a recurring basis. For example, the Department reported in the May 2013 FIAR Plan Status Report that the Air Force ERPs will not be fully deployed by 2014. As a result, the Air Force will rely on manual controls and legacy system enhancements to meet the goal of SBR audit readiness by September 30, 2014.

The Department has not reengineered its business processes to the extent necessary; instead, it has often customized commercial ERPs to accommodate existing processes. This creates a need for system interfaces and weakens controls built into the ERP system. The ERPs were designed to replace numerous subsidiary systems, reduce the number of interfaces, standardize data, eliminate redundant data entry, and provide an environment for end-to-end business processes, while being a foundation for sustainable audit readiness. However, the numerous interfaces between the ERP system and existing systems may be overwhelming and inadequately defined. Each interface presents a risk that the system might not function as designed, and each prevents the linking of all transactions in an end-to-end process. The Department needs to ensure ERP system development addresses the required business processes and functions.

Without the effective and timely development and implementation of ERP systems, and without senior-level governance, the Department will continue to struggle to improve its financial management processes and provide accurate, timely, and meaningful financial management information for internal and external users and achieve long-term sustainability of the financial-management improvements. Recent audits continue to find that system program managers have not configured systems to report U.S. Government Standard General Ledger (USSGL) financial data using the DoD Standard Financial Information Structure (SFIS).

Additionally, other audits have found that the Department has not sufficiently reengineered its business enterprise architecture processes nor incorporated the functionality in ERP systems. The Department has established certification requirements, and the Deputy Chief Management Officer and Deputy Chief Financial Officer have established validation and certification procedures for implementing SFIS requirements and ensuring business process reengineering has taken place. However, these procedures were not stringent enough to ensure compliance. The Department continues to improve its validation and certification procedures.

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, 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 deployment 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 Components' Financial Improvement Plans incorporate actions necessary to ensure that accurate, reliable financial information is reported.

Modernizing DoD 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 taking pro-active steps to align individual ERP programs with auditability outcomes, we also are 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 the ability to trace 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 its particular business environment. The Department has focused on properly enforcing compliance with the target financial management environment, built on a backbone of the core ERP systems and aligned with the Business Enterprise Architecture's end-to-end processes.

The Department's new investment management process will ensure:

- Investments are aligned to strategies;
- Allow the Department to make more informed investment decisions;
- Eliminate legacy systems that are no longer required;
- Enhance interoperability, and
- Help the Department transform to an environment where business applications can be rapidly deployed on a common computing infrastructure.

The new process also will ensure that each investment is an appropriate use of taxpayer dollars and aligns to the Department's architecture and our shared goal of delivering agile, effective and efficient business solutions that support and enable our warfighters.

To implement this new investment management process, the Deputy Chief Management Officer issued guidance to ensure that the Department continues to treat its business system investments with the firmness of purpose and discipline that will enable cost savings to be redirected to critical operational needs of the warfighter. The guidance, now updated annually, creates an integrated business framework to align broad Departmental strategy with functional and organizational strategy, all the way to system implementations. This framework utilizes new plans, called Functional Strategies and Organizational Execution Plans, to help achieve the Department's target business environment.

The Department's financial management functional strategy includes compliance and standards related to financial management strategic initiatives, such as SFIS/Standard Line of Accounting, US Standard General Ledger, and FIAR audit readiness. As part of each Service or Agency's Organizational Execution Plan-Financial Management, each of the strategic initiatives must be addressed with reference for compliance. Additionally, each system owner is required to update the DoD Information Technology Portfolio Repository with compliance to both the Business Enterprise Architecture and SFIS standards as part of the Investment Review Board process.

1-3A. Improper Payments	IG Summary of Challenge

Improper payments, a longstanding problem in the Department, are often the result of unreliable data and/or a lack of adequate internal controls, which increases the likelihood of fraud. As a result, the Department lacks assurance that billions of dollars of annual payments are disbursed correctly. The Department's inadequate financial systems and controls hamper its ability to make proper payments. In addition, the pace of operations and volume of Department spending create additional risk for improper payments, and both hinder the Department's ability to detect and recover those improper payments.

The Department faces difficulties in the completeness and accuracy of its improper payment reviews and the information reported. However, problems remain, including the auditability of the SBR. This leaves the Department unable to reconcile outlays to the quarterly or annual gross outlays reported in the SBR to ensure all required payments for reporting purposes have been captured. In addition, during a reconciliation of FY 2012 outlays, the Department identified $12.3 billion in outlays that should have been reviewed for improper payments, but were not. These areas require improvement before the Department will be able to provide complete and accurate information on its estimated amount of improper payments.

1-3B. Improper Payments	IG Assessment of Progress

Although 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.

The Department improved its program during FY 2012, including statistically projecting improper-payment error rates for contract and vendor payments, as well as reviewing additional military health benefit programs that previously had not been included in improper-payment reviews. However, there are indications that the amount of estimated improper payments may be understated. For example, a March 2013 audit showed that during a DoD reconciliation of FY 2012 outlays, the Department identified $12.3 billion in outlays that should have been reviewed for improper payments but were not. The $12.3 billion is lower than previous unreconciled amounts, but improper payment reviews of these outlays would likely increase improper payment amounts reported.

Additionally, the estimated amount of improper payments for the Department's commercial pay program for FY 2012 ($100.1 million) is significantly less than the Defense Logistics Agency (DLA) Troop Support's recovery of payments on one subsistence contract from December 2005 through September 2011, which totaled $756.9 million. The DLA said that recoveries had averaged approximately $21 million per month since March 2012. Additional sources included the Defense Contract Audit Agency's audits and contracting officers' subsequent recovery actions. In addition, the April 1, 2012 through September 30, 2012, DoD Inspector General Semiannual Report to Congress, reported that Contracting Officers initiated actions during this period to disallow $692.0 million of costs questioned in Defense Contract Audit Agency (DCAA) contract audits.

We commend the Department on aggressively pursuing recovery of identified improper payments, but unless it continues to improve its methodology for reviewing all its disbursements, it will likely underestimate overpayments and, as a result, miss opportunities to collect additional improper payments.

1-3C. Improper Payments	Department Response

The Department appreciates the DoD IG's 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.

The $12.3 billion in outlays that the IG reports were not reviewed for improper payments, but possibly should have been, has dropped precipitously over the past several years and now represents a very small fraction of Department's total outlays. The Department is marching toward audit readiness for the Schedule of Budgetary Activity by the end of FY 2014 and the longer-term goal of full financial statement audit readiness by the end of FY 2017.

We do not agree with the following information reported by the DoD IG:

- The $756.9 million the IG reported as an improper payment, with recoveries averaging approximately $21 million per month, did not result from an improper payment, but rather is the result of a contract price adjustment.
- The $692 million in contract questioned costs identified by DCAA, or any other audit entity, are not a result of an improper payment, but are decisions made by the Contracting Officer based on audit findings and recommendations driven by contract terms and conditions and Federal Acquisition Regulations.

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

2-1A. Enhancing the Acquisition Workforce	IG Summary of Challenge

The Department senior leadership continues to recognize the importance of fielding a capable acquisition workforce to manage and oversee DoD acquisition and contracting. To accomplish the acquisition mission, the Department is placing greater emphasis on developing a higher-quality workforce with the needed competencies.

Even though the Defense acquisition workforce has grown over the last few years, the Department continues to struggle to rebuild an acquisition workforce that is trained and equipped to oversee DoD acquisitions. The Department should continue to provide developmental opportunities to ensure that acquisition personnel can manage complex programs. Regardless of the looming decline in the Defense budget, the acquisition workforce will continue to be vital in providing the warfighters with new capabilities. Previous Defense budget cuts significantly reduced the capability of the acquisition workforce; the Department should maintain focus on strengthening the acquisition workforce throughout the lean financial years expected ahead.

On April 24, 2013, the Under Secretary of Defense (Acquisition, Technology, and Logistics) (USD(AT&L)) announced Better Buying Power 2.0, aimed at obtaining greater efficiencies and productivity in defense spending. The Better Buying Power (BBP) 2.0 outlined four initiatives to meet the objective of focusing on training and improvement of the acquisition workforce.

These BBP initiatives include:

- Establishing higher standard for key leadership positions
- Establishing stronger professional qualification requirements for all acquisition specialties
- Increasing the recognition of excellence in acquisition management
- Continuing to increase the cost consciousness of the acquisition workforce – change the culture

2-1B. Enhancing the Acquisition Workforce	IG Assessment of Progress

The Department has filled 7,700 new acquisition positions since 2008, and as of the second quarter of 2013, the acquisition workforce comprises more than 152,800 personnel. The Defense Acquisition Workforce Development Fund budget request for $276.2 million in FY 2014 supports the Department's shift from primarily recruiting and hiring to training and improvement in the qualifications and experience of the acquisition workforce. However, budget constraints raise questions as to whether the Department will be able to sustain these initiatives. Sustained commitment and management attention is essential to ensuring the improvements to the acquisition workforce are not lost or diminished.

2-1C. Enhancing the Acquisition Workforce	**Department Response**

The Department concurs with the IG's assessment.

2-2A. Weapon System Acquisition	IG Summary of Challenge

The Department remains challenged in its management of Major Defense Acquisition Programs (MDAPs), which have decreased in number. As of December 2012, the Military Departments reported 78 Acquisition Category I Programs (MDAPs), which is down from the 83 programs reported in December 2011.

Although the performance of no two acquisition programs is the same, and a good number of them operate within cost and schedule constraints, there are still too many programs with significant cost growth and delays in delivering capabilities. Our audits have identified programs that did not complete required testing, identify the correct procurement quantity, or define capability requirements. The Department should continue to look for a better balance between its limited resources and the capabilities needed to succeed in current and future conflicts. As budgets come under increasing scrutiny under sequestration, the Department is challenged to evaluate the merits of all programs as to their usefulness and the need for further program adjustments or terminations to remain within budget constraints.

2-2B. Weapon System Acquisition	IG Assessment of Progress

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 progress in improving efficiency.

The *Department's FY 2014 Annual Performance Plan* goals show the Department's commitment to containing weapon system acquisition program cycle time and cost by assessing the root causes of weapon system acquisition outcomes and monitoring the effectiveness of its acquisition policies.

In BBP 2.0, the USD(AT&L) mandated affordability as a requirement and emphasized the affordability constraints imposed in the first Better Buying Power effort started in September 2010. The BBP 2.0 also states that the Department will focus on controlling costs throughout the product lifecycle, using the following initiatives:

- Implementing "should cost" based management
- Eliminating redundancy within warfighter portfolios
- Instituting a system to measure the cost performance of programs and institutions and to assess the effectiveness of acquisition policies
- Building stronger partnerships with the requirements community
- Increasing the incorporation of defense exportability features in initial designs

The Department, as it continues to make the hard decisions about what is affordable, is beginning to apply extra scrutiny to weapon systems that are behind schedule and over cost. Senior leadership has recently demonstrated sound stewardship by eliminating MDAPs that were underperforming or over budget, or whose value given the continuing investment was in question.

2-2C. Weapon System Acquisition	**Department Response**

The Department concurs with the IG's assessment. In addition to the initiatives discussed by the IG, the Department has taken a number of steps to improve the operation of the defense acquisition system in order to deliver more capability to the warfighter for less than it has in the past. The USD(AT&L) directed a major revision to *DoD Instruction (DoDI) 5000.02*, which describes the operation of the defense acquisition system.

The revision, which is expected to be signed by the end of calendar year 2013:

- Decreases emphasis on "rules" and increases emphasis on process intent and thoughtful program planning.
- Provides program structures and procedures tailored to the dominant characteristics of the product being acquired and to unique program characteristics (e.g., risk and urgency).
- Increases emphasis on planning effective business arrangements and overall program affordability.
- Enhances the discussion of program management responsibility and key supporting disciplines to include systems engineering, developmental testing and cost estimating.

2-3A. Contract Management	IG Summary of Challenge

The Department continues to struggle to consistently provide effective oversight of its contracting efforts. The Department's continuing contracting deficiencies include obtaining adequate competition in contracts, defining contract requirements, overseeing contract performance, obtaining fair and reasonable prices, and maintaining contract documentation for contract payments.

The Department relies heavily on contractors to provide acquisition management and contract support functions, which often includes support to acquisition planning, requirement determinations, contract award determinations, performance reviews, bid analysis, cost assessments, and other contract monitoring functions. The Department's increased use of contractors as acquisition support highlights DoD's shortcomings. Service contracts constitute more than 50 percent of the Department's contract spending.

The Department faces several challenges in 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 services are performed, leaving the Department vulnerable to increased fraud, waste, and abuse.

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 in the late 1990s, 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) arrangements, which have added a new challenge to obtaining fair and reasonable prices for parts, since the Services are now procuring parts from the weapons systems contractors instead of other sources, such as the Defense Logistics Agency. Often these parts are purchased unnecessarily and at higher prices rather than utilizing existing DLA inventory.

2-3B. Contract Management	IG Assessment of Progress

The Department continues to strengthen contracting and has issued policy, procedures, and guidance addressing current contracting challenges. The Department began the Better Buying Power effort in 2010 and continued with the second phase of the initiative, BBP 2.0, in April 2013. The BBP 2.0 has seven areas of focus, and three of them help the Department address contract-management challenges: Promoting effective competition; Improving tradecraft in acquisition of services; and Incentivizing productivity and innovation in industry and Government

To promote effective competition, BBP 2.0 emphasizes competition strategies, creating and maintaining competitive environments and increasing small business roles and opportunities among other initiatives. When competition is applied effectively, it results in lower costs to the Government, greater innovation from industry, and added savings to the taxpayer.

Because service contracts make up so much of the Department's purchases, the BBP 2.0 area of improving tradecraft in the acquisition of services is very important. The Department will focus on assigning senior managers for the acquisition of services, improving requirements definitions and preventing requirements creep, and strengthening contract management outside the normal acquisition chain among other initiatives.

As part of its area of incentivizing productivity and innovation in Industry and Government, BBP 2.0 has an initiative to increase effective use of PBL and states that the history of PBL contracting demonstrates the Department can achieve improved readiness at significant savings if PBL arrangements are properly structured and executed. The success of the PBL arrangement depends on the workforce having the expertise and support to properly develop and implement these arrangements and continued emphasis to utilize lower cost inventory already on hand rather than continuing to purchase parts from contractors.

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. These key initiatives include:

The USD(AT&L) has established a Services Acquisition (SA) Directorate to oversee and improve services acquisitions, which constitute more than half of DoD's contracted obligations. Planning, managing, and overseeing contractors who perform service functions demands a different approach than that used to oversee contractors who are developing our weapon systems. The SA Directorate is leading the improvement of DoD's tradecraft in acquisition of services, which is a key part of the Department's BBP efficiencies initiative. To deliver better value to both the warfighter and the taxpayer while improving the way the Department does business, the Services Acquisition directorate is establishing:

- A stand-alone DoD instruction solely for the acquisition of services.
- Functional Domain Experts to manage services portfolios.
- Better services requirements development processes and tools.
- Service Requirement Review Boards and Tripwires to better manage and validate requirements.
- "Should cost" methodology for services acquisitions.
- Appropriate metrics to actively manage services acquisitions.

Additionally, the Department is working on strengthening services contract management outside of the normal acquisition chain (e.g., installations and commands) as well as developing processes to ensure individuals who are not Defense Acquisition Workforce Improvement Act certified, and who are involved in services acquisitions, are properly trained. This new management structure and training capabilities, coupled with changes in the way the Department analyzes and tracks services acquisitions, will allow us to continuously improve, from requirements definition to closeout, focusing on outcome-based capabilities.

- 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.
- On December 6, 2012, the Director of Defense Procurement and Acquisition Policy issued a memorandum, entitled "Service Acquisition Workshop." This policy requires Senior Officials to immediately ensure that all multi-functional teams that support service acquisition requirements valued at $1 billion or more participate in a Service Acquisition Workshop (SAW) as a prerequisite to Office of the Secretary of Defense (OSD) review/approval of the service acquisition strategy. Additionally, Senior Officials were encouraged to consider mandating SAWs for services acquisitions valued at $100 million or more.
- On January 14, 2013, the USD(AT&L) issued a memorandum, entitled "Traceability of Contract Execution Expenditures for Services," that highlights the importance of tracing contract expenditures for services. To improve tracking of service contract commitments and obligations, all DoD Components must update their acquisition and financial procedures and systems to ensure all purchase requests include a four-digit Product Service Code at a line item level of detail.
- On March 12, 2013, the Director of Defense Pricing issued a memorandum, entitled "Contract Business Analysis Repository," that informs the DoD Components about the capabilities of Contract Business Analysis Repository (CBAR) and instructs them to begin loading business clearance information into CBAR effective June 24, 2013. The CBAR facilitates the sharing of information among DoD contracting officers and assists them during their preparation for negotiations with contractors to support getting the best deal for the warfighters and taxpayers.
- All Components are now participating in using the DoD Contracting Officer Representative Tracking (CORT) tool with over 30,000 active Contracting Officer's Representative (COR) users. In April 2013, the CORT tool was successfully transitioned to the Wide Area Workflow (WAWF) portal as its permanent hosting platform for the CORT. The CORT is a web-based tool that enables military departments and defense agencies to manage nomination, training and tracking of their respective cadres of CORs and the contract(s) assigned to each COR.
- On August 30, 2013, Director, Defense Procurement and Acquisition Policy signed the Services Acquisition Functional Integrated Product Team charter to improve services acquisition via targeted, effective training of services acquisition stakeholders.

3. IG-Identified Challenge: Joint Warfighting and Readiness

3-1A. Joint Warfighting and Readiness	IG Summary of Challenge

U.S. military forces are entering a time of transition. In the years since the terrorist attack on September 11, 2001, the war in Iraq has ended and the lead security responsibility in Afghanistan is transitioning to the Afghan government. Military forces are engaged in a strategic rebalance to the Asia-Pacific region while continuing to maintain enough presence in the Middle East to protect our national interests. At the same time, fiscal deficits and economic problems are driving reductions in Federal spending, including reduced funding for defense programs. It is critical that the Department continually assess warfighter capabilities and readiness and make the necessary adjustments to ensure our military is agile, flexible, and ready for the full range of contingencies.

The Department will face many challenges as it continues force reductions while striving to achieve a modern, ready, and balanced force to meet future requirements. Among these challenges are a decreasing budget, a drawdown of forces from Afghanistan, the need to reset equipment and personnel across the Services, a return to full-spectrum training, and a rebalance of force structure and investments toward the Asia-Pacific and Middle East regions.

The new budget reality is being felt across the Department, especially in areas such as maintenance of existing equipment and systems, the fielding and implementation of new systems, and the frequency and extent of training and exercises. The impact of the sequestration was felt almost immediately as the Navy adjusted repair and overhaul schedules for ships and the Air Force began restricting flying hours for squadrons. The Services and the Combatant Commands need to ensure that the impact of the current sequestration, as well as future budget reductions, has minimal impact on the ability to respond to future threats.

The drawdown of forces from Afghanistan will challenge the Department to transition from counterinsurgency operations to full-spectrum operations elsewhere in the world. Therefore, the Department is refocusing training programs to include joint, interagency, and international training aspects; enhancing knowledge of various languages and cultural, ethnic, and religious sensitivities; and training the reserve forces, whose readiness was impaired for the sake of readiness of the deployed forces. The retrograde and reset for equipment will continue to affect the Services over the next several years, as equipment continues to be returned after seeing utilization rates exceeding many of their designed operating parameters. The enhanced focus on the Pacific and Middle East will also challenge the Department as it reaffirms alliances in the region and looks to establish new ones.

3-1B. Joint Warfighting and Readiness	IG Assessment of Progress

The Department must assess warfighter capabilities and readiness across the full range of strategic, operational, and tactical considerations. This includes large questions, such as whether the joint force is capable of achieving the strategic objectives set forth in the *National Security Strategy*, to the tactical focus on individual unit readiness. The Department is making progress in addressing the many difficulties in the drawdown in Afghanistan, resetting equipment, and ensuring the long-term viability of the all-volunteer force. However, the Department must also be ready to address fiscal challenges, starting with the first round of sequestration. There are already reductions in spending for available training hours and needed maintenance and reset needs.

The National Security Strategy released in January 2012 placed increased emphasis on the Pacific theater. This will present challenges to all the Components of the Department as they shift their focus to the Pacific. The armed forces will have to train to fight in conventional and unconventional scenarios, and they will be challenged to do so with diminishing resources, while maintaining their readiness. 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 must also provide the necessary levels of oversight to ensure that forces returning from Afghanistan, and their families, continue to receive the support they need.

As the drawdown continues in Afghanistan, the Department must ensure the reserve Components have the equipment and training necessary in order to meet their missions. For example, we recently reported that the Army officials did not implement procedures to properly account for the transfer and replacement of 239,332 pieces of Army Reserve Component equipment, valued at $5.8 billion. As a result, Army Reserve Components had lost transparency of their equipment transfers and may experience shortages that could hinder their ability to train soldiers and respond to emergencies.

Efforts to redeploy military units around the globe will enable the armed forces to better shape and focus their force structure to provide greater flexibility in responding to threats. The realignment of forces from Okinawa, Japan, to Guam still faces formidable challenges that have increased projected costs and schedules for the planned effort.

3-1C. Joint Warfighting and Readiness	**Department Response**

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.

The withdrawal of forces from Afghanistan has reduced the stress on forces in the near term; however, fiscal constraints will 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.

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.

4. IG-Identified Challenge: Cyber Security

4-1A. Cyber Security	IG Summary of Challenge

Cyber security will, for the foreseeable future, continue to be a leading challenge for DoD – the United States' largest Government agency, with buildings and structures at more than 5,000 different locations. Cyber security is the prevention of damage to, protection of, and restoration of computers, electronic communication systems, electronic communications services, wire communication, and electronic communication, including information contained therein, to ensure its availability, integrity, authentication, confidentiality, and non-repudiation. Every day, hackers infiltrate key Government and business computer networks. Government estimates indicate American companies lose $250 billion a year in intellectual property through network intrusions.

According to the Defense Science Board Task Force Report, *"Resilient Military Systems and the Advanced Cyber Threat,"* January 2013, U.S. Military forces are critically dependent on networks and information systems to execute missions. The forces are highly vulnerable if threats to those networks and information systems are not mitigated. For example, hackers take advantage of systems that continuously scan address spaces of target organizations, waiting for unprotected systems to be attached to the network. Attackers also look for computers that are not up to date with patches because they are not frequently connected to the network. The DoD Chief Information Officer stated, "There will never be a time that we can assume a 'comfort' posture." Therefore, it is imperative that DoD leadership challenge its personnel to be ever vigilant and to continuously monitor and protect DoD networks and information systems.

4-1B. Cyber Security	IG Assessment of Progress

Over the last three years, the DoD IG has performed a series of audits on DoD's Information Assurance Vulnerability Management (IAVM) Program. The IAVM process provides positive control of the vulnerability notification process for network assets by requiring Components' receipt acknowledgement and giving deadlines for implementing appropriate countermeasures, depending on the criticality of the vulnerability.

Since our involvement in this key area, we have noted continued progress by the Department. For example, the Department issued the *Chairman of the Joint Chiefs of Staff Instruction (CJCSI) 6510.01F* in February 2011, which updated the roles and responsibilities of the Information Assurance Vulnerability Management Program. The CJCSI 6510.01F also stated that detailed processes will be featured in an upcoming manual. To continue this progress, the Department still needs to update DoD Directive (DoDD) 0-8530.1, Computer Network Defense (CND), January 8, 2001, and DoD Instruction (DoDI) 0-8530.2 "Support to Computer Network Defense (CND)," March 9, 2001. As recent as the second quarter of FY 2013, we have seen that the lack of updated guidance, such as that contained in the Chairman of the Joints Chiefs of Staff Manual and DoD Directives, has increased the risk that information assurance vulnerability alerts classified as critical remain unpatched.

4-1C. Cyber Security	**Department Response**

The Department continues to strengthen cyber security and address the threat posed by network attacks. The establishment of the U.S. Cyber Command and the supporting Service Component Commands has 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 Defense Information Systems Agency's assistance in providing program office and fielding 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.

One of the focus areas of the DoD Chief Information Officer's (CIO's) 10-Point Plan for Information Technology (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 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 includes structuring IT programs – via smaller, frequent deliveries – implementing an enterprise approach for the procurement of common IT hardware and software, obtaining transparency of IT investments with a full DoD IT investment portfolio, and reviewing major IT investments for performance, funding execution, and enterprise alignment.

4-2A. Cyber Workforce	IG Summary of Challenge

According to the National Initiative for Cyber Security Education, as the world grows more connected through cyberspace a highly skilled cyber security workforce is required to secure, protect, and defend our Nation's information systems. While the demand for cyber security professionals is high, the supply is low. For example, according to one leading research director, "Top notch cyber threat hunters and tool builders are in short supply. There are probably fewer than 800 of them in the entire country."

In the current environment of budget cuts, pay freezes, and furloughs, the Department faces a significant challenge in filling the multitude of cyber positions it needs to operate, defend, and protect its networks. In January 2013, it was reported that the Department planned to expand its cyber workforce five-fold, to transition from a mainly defensive force to one capable of a wide range of offensive operations. In addition, a June 2013 article on the Navy's U.S. Fleet Cyber Command reported that the Navy Cyber Command, in the next three years, will bring on nearly 1,000 cyber Service members. This is happening at a time when each of the other three Services' Cyber Commands is looking to increase the ranks of its own cyber workforce. In fact, the Government Accountability Office (GAO) issued its current *High Risk Series update in February 2013*, and strategic human capital management remains on the list of high risks. Specifically, GAO identified six Government-wide mission-critical occupations, one of which was information technology management/cyber security. Therefore, it is imperative that the Department develop the capability to recruit, train, and retain a cyber workforce in the competitive national environment.

4-2B. Cyber Workforce	IG Assessment of Progress

Growing and retaining a skilled cyber force is one of the biggest gaps in the cyberspace mission area. The Department has taken steps recently to build its cyber workforce. The DoD FY 2014 budget submission funds the re-organization of cyber forces into teams that will specialize in three functions: defending networks, degrading adversary cyber capabilities, and supporting defense of national infrastructure. The Department plans to assign more DoD civilians and contractors to this effort. In addition, the 2014 budget adds resources to increase the quality and throughput of DoD's training pipeline. Moreover, in June 2013, the Department coordinated a working draft of a DoD Cyberspace Workforce Strategy. The working draft contained the strategy for transforming DoD cyberspace workforce management and processes to recruit, train, and retain staff. Although the Department has made progress in the planning stages, it must maintain momentum through implementation.

4-2C. Cyber Workforce	**Department Response**

The Department is committed to developing a cyber workforce that is correctly sized and structured to secure, protect, and defend Department networks in the context of this ever-changing domain. This requires a comprehensive strategy for recruitment, training and retention that attracts skilled individuals and delivers training that is adaptable and responsive to evolving security threats. The Department plans to structure its cyber workforce in a way that provides both defensive and offensive capabilities.

The Department has developed a comprehensive strategy that outlines recruitment goals, reorganizes the cyber workforce, and incorporates tools for retention. This plan depends on adequate funding in FY 2014. The Department has developed a strategy providing for a phased cyber workforce development that is large enough and strategically structured to secure, protect, and defend Department networks. Budget constraints, including indiscriminate cuts, put that strategy at risk.

5. IG-Identified Challenge: Health Care

5-1A. Medical Readiness	IG Summary of Challenge

Medical readiness continues to be a challenge for the Department. Maintaining individual readiness for the Reserve Component is particularly challenging, because much of the responsibility for achieving individual medical readiness rests on the reservist. Reservists are responsible for maintaining individual medical readiness but are provided some help by the Department. Additionally, managing the overall health of 9.6 million eligible beneficiaries, which affects medical readiness, is a continuing challenge for the Military Health System (MHS). The MHS must identify unhealthy behaviors and provide interventions across the population. By reducing obesity and tobacco use, for example, the long-term health implications of diabetes and lung disease can be reduced significantly. 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

According to a 2012 RAND Corporation report, the Department is making progress in raising Reserve Component individual readiness percentages. The Department's goal is to have 75 percent of Reservists fully medically ready. At the end of the second quarter of FY 2006, the Reserve Component reported that only 26 percent of its forces were fully medically ready. By the first quarter of FY 2010, 47 percent of Reserve Component forces were fully medically ready. According to the TRICARE Management Activity (TMA)[1], as of March 2013, 60 percent of the Reserve Component forces were fully medically ready. The Department should continue to emphasize improving individual medical readiness and strive to meet its 75 percent goal.

Additionally, the MHS management developed the family medical readiness strategic imperative, but its performance measure is in the concept phase. The MHS continues to implement the "medical home" concept throughout the direct-care system. With the medical home, the patient will have more direct access to a medical team equipped to recognize unhealthy behaviors and intervene early. In addition, line officers need to ensure nonmedical alternatives, such as recreational and athletic facilities, are in adequate condition and available to the military community.

Additionally, evidence-based community cessation programs for addictive behaviors should also be readily accessible. The MHS fully supports the National Prevention Strategy and the transition from a system of sick care to one based on wellness and prevention. One example of this commitment is the reduction in cigarette use among active duty forces from FY 2010 to FY 2011. The MHS has 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.

5-1C. Medical Readiness	**Department Response**

The Department concurs with the IG's assessment.

[1] Effective October 1, 2013, the Department established the Defense Health Agency, which absorbed the functions of the TRICARE Management Activity and assumed responsibility for common clinical and business processes across the Military Health System.

5-2A. Cost Containment	IG Summary of Challenge

The MHS must provide quality care for 9.6 million beneficiaries within fiscal constraints and while facing increased user demand, legislative imperatives, and inflation. These factors make cost control difficult in the public and private sectors. Over the last decade, health-care costs have grown substantially, and MHS costs have been no exception. The DoD budget for health-care costs was $51 billion in FY 2013, an increase of 74 percent since FY 2005. The MHS costs have more than doubled, from $19 billion in FY 2001 to the Department's request of $49.4 billion for FY 2014. The FY 2013 amount does not include reductions due to sequestration.

Another challenge in containing health-care costs is fraud. Health-care fraud is among the top five categories of criminal investigations of the DoD IG's Defense Criminal Investigative Service, representing 15.7 percent of the 1,787 open cases at the beginning of FY 2013. Increasing health-care benefits also provides additional pressure to manage and contain costs.

5-2B. Cost Containment	IG Assessment of Progress

The Department's efforts in controlling health-care costs will continue to be a challenge. 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. These contracts provide incentives for customer satisfaction and include 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 Department has identified areas that assist in managing costs, including fraud management and prescription drugs. The managed-care support contracts have program-integrity units that review claims for indicators of fraud. We reported in December 2012 that these units met the requirements in their contracts. Specifically, the contractors:

- Submitted the required quarterly and annual reports;
- Implemented standard operating procedures for case development;
- Used anti-fraud software; submitted the minimum case referrals to TMA Program Integrity;
- Performed prepayment reviews; and
- Established mandatory fraud and abuse training.

The MHS has attempted to manage costs through increased use of the TRICARE Mail Order Pharmacy program. The TMA has implemented an aggressive communication plan to encourage the increased use of receiving prescription drugs through the mail to reduce costs.

The MHS Quadruple Aim Concept focuses on four factors in providing quality health care to DoD beneficiaries: readiness, population health, experience of care, and cost. Continuing to implement the MHS Quadruple Aim Concept should improve quality and reduce costs by focusing on improved care coordination and delivering care in the 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 aim to increase the quality of health care while reducing its cost.

5-2C. Cost Containment	**Department Response**

The Department concurs with the IG's assessment.

5-3A. Optimizing Health-Care Governance	IG Summary of Challenge

Ensuring that the MHS is organized in the most effective and cost-efficient manner is a major challenge. In March 2013, the Secretary of Defense directed the implementation of MHS reform. The centerpiece of this reform is the establishment of the Defense Health Agency (DHA) to assume responsibility for shared services, functions, and activities of the MHS and other common clinical and business processes. This new agency will operate as a Combat Support Agency and assumed many responsibilities of the TMA, which was disestablished on October 1, 2013. Over the next year, the MHS will face the challenge of transitioning to this new structure while continuing to execute the MHS mission. Additionally, the Secretary of Defense required the implementation of multi-Service market-management authorities for medical treatment facilities (MTFs) in six regions. The management authorities will:

- Manage the allocation of the budget for the market;
- Direct the adoption of common clinical and business functions;
- Optimize readiness to deploy medically ready forces and ready medical forces;
- Direct the movement of workload and workforce between or among the MTFs.

This joint approach to managing health care-related services in geographic markets will be especially challenging, considering that the MTFs in these markets have been managed individually to date by each of the Military Services. The MHS will also be challenged to standardize medical services across the Service Components.

5-3B. Optimizing Health-Care Governance	IG Assessment of Progress

Although the transition to the DHA and the implementation of the multi-Service market management authorities are in their infancy, the Department has made significant strides. The Department issued a draft DoD Directive for comment that establishes the DHA and the details of its mission, sets up the organizational structure, and delegates responsibilities and functions throughout the agency. The draft directive incorporated language consistent with the Secretary's requirement to implement multi-Service market-management authorities. In fact, the draft Directive states that the DHA, as part of its mission, supports coordinated management of the enhanced multi-Service market areas to create and sustain a cost-effective, coordinated, and high-quality health care system in those areas.

Additionally, the directive mandates that the DHA exercise control over the MTFs within the National Capital Region (one of the six market areas identified). The DHA reached its initial operating capability on October 1, 2013, and will achieve full operating capability within two years of the Secretary's memorandum. The Services' potential resistance to relinquishing control over managerial functions of their MTFs may be difficult to fully overcome. Lessons from prior shared-services models should help the Department with this transition.

5-3C. Optimizing Health-Care Governance	**Department Response**
The Department concurs with the IG's assessment.	

5-4A. Rehabilitation and Transition Care	IG Summary of Challenge

The continued strengthening of comprehensive and integrated health care – from accession through active service, to rehabilitation, and when necessary, the transition of our wounded warriors to the Department of Veterans Affairs (VA) – is a major challenge for the MHS. Despite the drawdown in Southwest Asia, the Department must remain focused on providing adequate rehabilitation and transition care for wounded warriors. Key areas requiring management attention include rehabilitation and transition care for those with traumatic brain injuries or mental-health disorders and those in need of prosthetic devices. Access to mental-health care also remains a challenge. Suicide prevention, though not a specific MHS responsibility, confronts the MHS with the need to provide timely and thorough mental-health care for its beneficiaries.

Although the Department and the VA have identified objectives and initiated programs, 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 an efficient, transparent, and timely process, as wounded warriors move from the DoD system to the VA system.

5-4B. Rehabilitation and Transition Care	IG Assessment of Progress

During the last two years, DoD IG has noted the need for timely access to specialty care, improvements in training programs and plans, and improved medication management. Although challenges remain, DoD IG identified initiatives in the Department for supporting the comprehensive care, healing, and transition of wounded warriors. One initiative entailed recovery-team forums to develop individualized treatment for each wounded warrior. Another aimed to reduce the potential for exploitation of warriors, avoiding negative consequences to the overall health and welfare of the warriors. Wounded-warrior care centers were also developing meaningful programs of constructive activities to assist with warriors' transition. These notable initiatives should continue Department-wide.

5-4C. Rehabilitation and Transition Care	**Department Response**

The Department concurs with the IG's assessment.

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

6-1A. Iraq Security Forces	IG Summary of Challenge

With the drawdown of U.S. combat forces from Iraq in 2011 and the establishment of normal diplomatic relations, equipping and training of the Iraq Security Forces no longer is considered to present a significant challenge for reporting. The United States is now represented in Iraq by the U.S. Ambassador, with the Department serving in a supporting role. The Office of Security Cooperation – Iraq (OSC-1), operating under Chief of Mission authority but administered by DoD personnel, is charged with performing vital bilateral security cooperation and security assistance functions. The OSC-1, comprised of DoD military, civilian, and contractor personnel, represents a cornerstone capability for building an enduring foundation for a long-term security relationship with the Government of Iraq.

6-2A. Afghan National Security Forces	IG Summary of Challenge

Between now and the end of 2014, the Department will continue to develop the Afghan National Security Force's (ANSF) capability to take ultimate responsibility for Afghanistan's security. Challenges include:

- Developing ministerial capability to plan and manage resources and human capital;
- Ensuring enabling-force capabilities are fielded prior to withdrawal of Coalition capabilities;
- Measuring and reporting ANSF operational readiness and effectiveness;
- Professionalizing the ANSF;
- Preparing for post-2014 operations.

Coalition force drawdown and retrograde, as well as securing Afghanistan's national elections in April 2014, will add additional challenges as ANSF completes the transition to full responsibility for security.

- **Security Ministries.** The Department must continue its focus on advising and assisting the development of the resource management capabilities of the Ministry of Interior and Ministry of Defense. Budget planning and execution, training and development of human resources, increasing the ranks of civilian professionals, and leader emphasis on command and control of logistics are key areas for continued emphasis. Additionally, coordination between the Afghan National Army (ANA), the Afghan National Police (ANP), and the Afghan Air Force (AAF) will be important to providing adequate support to the 2014 elections as well as to providing a multi-layered, long-term defense against insurgents and criminals.
- **Enabling Force Capabilities.** Completing the fielding of "enablers", or military capabilities essential to building ANSF's capacity to accomplish its missions, is increasingly important. Fielding and integration of combat and support capabilities in the ANA and ANP will remain a priority. As Coalition advisors and trainers are withdrawn, the Department must ensure that capability gaps do not occur. Additionally, the Department must continue to identify, assess, and address the advice, training, and assistance requirements for fielding enabling capabilities beyond 2014.
- **Assessment of ANSF Progress.** Assessing capabilities and capability gaps will become more difficult during Coalition force withdrawal. The Department's visibility of the operational readiness and effectiveness of ANSF units is diminishing as the numbers of

partners and advisors continue to decrease. The challenge is to ensure that sufficient skilled and qualified advisors are in key positions to continue assessing and developing ANSF leadership, command and control, and critical units.

- **Professionalization.** The Department must continue to support ANSF's current efforts to professionalize the force. Command reports show that recruitment and management of initial training at the enlisted and officer levels are becoming ANSF strengths. Developing quality leadership, managing sustainment and professional training, accurate training and personnel records, and providing career development opportunities, have all been identified as areas requiring continued efforts to develop and train professionals in the force.
- **Post-2014 Operations.** Although no decision has been made on the timing of when a transition of DoD's security cooperation and assistance activities to the Department of State will occur, the Department should begin planning for an eventual transition. The size, purpose, and support of Coalition forces and civilians remaining in Afghanistan in 2015 should be determined as soon as possible to facilitate planning and minimize risk of complications for this transition.

6-2B. Afghan National Security Forces	IG Assessment of Progress

Despite the current challenges in Afghanistan, much progress has been made. Most of the challenges above are recognized in Command reports as Coalition and ANSF priorities.

Since force levels are at over 95 percent of personnel end strength objective in both the ANA and ANP, and are approaching 90 percent of personnel end strength objectives in the AAF, the emphasis on ANSF development has shifted from force quantity, or growing the force, to force quality – sustaining and professionalizing the force.

Ministerial development is a primary emphasis, and the Coalition is increasing resource management training for security ministry personnel. Ministerial advisors are delivering assessments of the security ministry departments, reporting departmental setbacks as well as successes, and planning and revising training milestones and objectives as necessary.

With Coalition support, ANSF is committed to fielding a wide array of combat and combat support enablers that will provide ANSF the capability to operate independently and sustainably. Although ANSF logistics and force sustainment is still a primary concern as a force enabler, recent DoD IG assessments have noted some increased understanding and appreciation of the ANSF logistics system at the unit level.

Additionally, the shortage of human capital remains a challenge for ANSF; nevertheless, ANSF continues to support human capital development and training, particularly literacy training. The ANSF is scheduled to begin administering the literacy program by mid-2014.

The ANSF continues to take responsibility for its own training. Coalition reports confirm that the number of Afghan trainers has increased steadily over time, easing the burden on the Coalition Forces to provide military and civilian trainers between now and December 2014. Reportedly, ANSF is also managing its non-commissioned officer (NCO) and officer ranks more aggressively, for example, taking action to meet ANP non-commissioned officer (NCO) shortages by training and promoting qualified and experienced enlisted soldiers and junior NCOs.

Importantly, operational readiness and effectiveness of the ANA, measured by units rated "effective with advisors" or "independent with advisors," reportedly increases with each quarterly assessment. From October 2012 to March 2013, ANP ratings have become more static, and on-site tracking of the readiness and effectiveness of many ANP units has been discontinued due to the shortage of ANP advisors and partner units. To address this reporting gap, the Coalition developed a second rating method in an effort to more accurately capture the readiness of ANSF units losing advisors or partners.

As of June 18, 2013, ANSF had assumed the lead for security nationwide, a significant milestone. Coalition forces have assumed a Train, Advise, and Assist rather than a combat role, except for force protection and certain counter-terrorism operations conducted with ANSF. As a consequence, Coalition casualties have significant reduced and those incurred by ANSF have commensurately increased. The Coalition is providing equipment to mitigate this trend to the extent possible, especially with respect to Improvised Explosive Device attacks, which account for many of the ANSF wounded or killed.

The Coalition is monitoring the performance of ANSF in the current fighting season to determine its strengths and weaknesses. According to the "Report on Progress Toward Security and Stability in Afghanistan", issued in July 2013 by the Secretary of Defense, Afghan forces generally have acquitted themselves well but will continue to face development challenges, including a number that will likely require continued support post-2014 to ensure they subsequently reach full independence and sustainability.

6-2C Afghan National Security Forces	**Department Response**

The Department concurs with the IG's assessment.

7. IG-Identified Challenge: The Nuclear Enterprise

7-1A. Modernizing the Nuclear Force in the Face of Declining Resources	IG Summary of Challenge

Following the Soviet Union's collapse, the U.S. military began to shift from a nuclear centric "Cold War" posture, which had been the foundation of U.S. military strategy since the end of World War II. The new focus is to maintain a smaller, multi-purpose force which can address a larger spectrum of operations with the same weapon systems and personnel. With the start of the Overseas Contingency Operations following the attacks of September 11, 2001, greater focus has been placed on the military's ability to conduct limited armed conflicts and counter-insurgency operations.

During this transformation, each of the various defense programs was forced to redefine their capabilities and display how they meet this new paradigm. The key to a program's survival rests on its ability to validate its flexibility and capability to adapt to wide, multiple-mission roles. Weapon systems and defense programs displaying this capability were able to compete for funding during a time of shrinking budgets. All nuclear programs were perceived as a series of weapon systems rendered obsolete by current events. Those programs were also identified as being single-purpose systems that were inflexible and costly.

The nuclear infrastructure, delivery systems, manning, policies, and acquisition began to suffer. During a time when other countries modernized their nuclear forces, the budget was only sufficient to maintain a force that was 20 – 50 years old. Recently, the Services initiated modernization programs that, if funded, will lead to developing a modernized nuclear force within two decades.

Justifications for such improvements encounter scrutiny because of the basic nature of nuclear weapons and their use as a deterrent. Mandated budget sequestrations may affect current capabilities if age-related issues of the nuclear enterprise are not addressed.

7-1B. Modernizing the Nuclear Force in the Face of Declining Resources	IG Assessment of Progress

The Services have initiated several programs to transform the aging nuclear force into a modern nuclear deterrent arm capable of operating into the latter part of the 21st century. Renovating the nuclear enterprise comprises several programs that will sustain nuclear assets and develop replacement systems integrating the latest technologies. When completed in 2030, almost every component of the strategic nuclear force will be replaced or updated. However, federally-mandated budget cuts could threaten the upgrade and development of programs and extend the possible implementation dates or cancel completely some programs.

In an effort to accurately identify the critical command and control functions which are crucial in a nuclear crisis, the OSD Director of Cost Assessment and Program Evaluation developed a modeling simulation that maps the systems and flow of information used for force direction, force management, and adaptive planning of the nuclear forces. This tool allows planners and acquisition specialists to view the effectiveness of certain command and control systems in performing various tasks in the degraded communications environments expected during a nuclear attack. Using this tool, system users will be able to develop a strategy of how the command and control architecture operates and map out where vulnerabilities could exist and in defining acquisition priorities.

As part of the force modernization efforts to replace both the B-52 and B-2 bomber fleets, the Air Force has begun developmental steps to build the next generation of bombers, known as the Long Range Strike-Bomber. In 2013, senior Air Force officials reaffirmed that the 80 - 100 new bombers will be designed to meet their primary mission as a nuclear-delivery platform. However, the projected deployment date planned for the mid-2020s may be delayed due to the current budget situation.

As part of an on-going sustainment program, the B-2 bomber force is upgrading radar and nuclear command and control communications capabilities. The upgrades should extend for many years the service life of this bomber. Simultaneously, the B-52 fleet has been undergoing upgrades to global positioning systems, on-board computers, and an expansion to the variety of weapons the bomber can carry. These upgrades will ensure that the fleet is viable until the new bomber is operational.

The Air Launched Cruise Missile is the main-stay weapon for the B-52 fleet and allows the crews to strike targets well outside an adversary's defense system. As missile stockpiles age and decline in number, the Air Force is studying various options to replace the current cruise missile fleet. If no delays are encountered, the Air Force estimates a production start in 2025.

The Minuteman III Intercontinental Ballistic Missile (ICBM) fleet was originally fielded in the mid-1970s and has been undergoing several upgrades and corrective maintenance actions. The ICBM Modernization and Replacement Program, the most current of these enhancement plans, will extend the operational life of the ICBMs through 2020 and possibly to 2040. This program modernizes the missile's guidance control and targeting systems and changes the rocket motor propellants.

In FY 2012, the Air Force initiated a two-year study to replace the Minuteman ICBM system. The project will examine the essential capabilities and future technologies that could be available to incorporate into the design of the next generation ICBM. The Air Force will decide the acquisition path at the completion of the study.

The Navy continues developing a follow-on ballistic missile submarine to replace the current 30-year-old Ohio class submarine fleet. Under the management of the Strategic Systems Program office, the Ohio Replacement Program was formed to research and design the next-generation strategic deterrence submarine. This program will deploy 12 submarines, beginning with the lead ship of the class being delivered in 2028, near the projected decommission date for the first of the Ohio class strategic missile boats.

Similar to the Minuteman Ill upgrade program, the Navy has begun carrying out a project to modernize the Trident II sea-launched ballistic missile. This sustainment upgrade is projected to extend the missile's operational life through 2030. Pre-sequester cost reductions have delayed a Trident replacement until at least 2029.

As the Services have initiated a full-scale rejuvenation of all three legs of the nuclear triad, they must balance the various programs against an ever-tightening budget if the nuclear enterprise is to fully benefit from this rejuvenation.

7-1C. Modernizing the Nuclear Force in the Face of Declining Resources	**Department Response**

The Department continues progress with its nuclear weapon systems and platform modernization programs, despite federally mandated budget cuts. The Department is working closely with the National Nuclear Security Administration to address future program gaps. With this modernization effort, the Department is actively sustaining and upgrading existing nuclear forces, ensuring a viable nuclear deterrent until follow-on weapon systems are implemented.

Although faced with significant fiscal challenges, the Department has issued clear guidance that the Nuclear Enterprise is of the highest priority and, as a result, funding levels will be maintained. Progress has been made in improving the morale and proficiency of personnel within the nuclear enterprise, but challenges remain in light of budget cuts and the uncertainty of the career field amidst potential arms control reductions. At the same time, a robust inspection program continues to ensure the highest of standards of performance are maintained. The focused efforts of the Department and the interagency team maintain a safe, secure, and effective nuclear deterrent. The Department will continue to work with the interagency to address the challenges and opportunities presented in this report to maintain a well-managed and efficient nuclear enterprise.

7-2A. Redefining the Importance of the Nuclear Enterprise and Overcoming Past Neglect	IG Summary of Challenge

Several high-profile incidents over the past 10 years highlight the lack of emphasis on the nuclear enterprise. Recent news reports regarding morale and proficiency problems at one of the three Air Force Missile Bases will only continue to make the general public question the nuclear deterrent mission's reliability.

Reestablishing the enterprise's importance and performance will take time, funding, and a fundamental change in attitude by everyone associated with the nuclear weapons community. The nuclear enterprise will face additional challenges to complete this transformation due to mandated funding cuts. These reductions will also negatively affect maintaining the proficiency required for managing the nuclear force.

7-2B. Redefining the Importance of the Nuclear Enterprise and Overcoming Past Neglect	IG Assessment of Progress

While the decline or even the perception of such neglect cannot be corrected overnight, the revamped nuclear enterprise is making headway to address the key problems. The most significant challenge that the enterprise faces is to maintain the nuclear communities' current systems at the highest level of mission capability while meeting public expectations of flawless operations. This must be done despite budget cuts resulting from the government-directed sequester.

The efforts and challenges facing the nuclear community:

DoD. The Deputy Secretary of Defense directed the Defense Information System Agency to stand up an organization to address end-to-end system engineering in the enterprise. This new group will also bridge the nuclear command, control, and communications with the various critical systems that support continuity of government and operations, and presidential/senior leadership communications, in a crisis.

Joint Staff. As the focal point for the oversight of the nuclear enterprise, the Joint Staff's Deputy Directorate for Nuclear Command and Control continues to assess the capabilities of the nuclear command, control and communications systems necessary to ensure both the safeguarding and viability of the nuclear deterrent mission.

- To improve the procedures used for nuclear command and control orders, the Joint Staff has comprehensively evaluated the nuclear command and control guidance and processes it issues to the enterprise. The evaluation was done to ensure that the guidance and doctrines derived from the Joint Staff documents streamline systems' operational capabilities while maintaining the needed nuclear safeguards.

- The Joint Staff continues to expand on the fidelity of its Staff/Command Assistance Visit program. This program measures the level of proficiency with which combatant command centers and certain military nuclear command and control platforms provide the President with control of nuclear forces in a time of crisis. Under a 2012 initiative, the scope of the Joint Staff assessments has expanded to ensure that the evaluations provide a more detailed assessment of the personnel and capabilities of the command locations. These details are provided by presenting more in-depth testing and scenario evaluations to judge operator knowledge and performance of the different systems.
- The Joint Staff is also continuing programs that evaluate the systems used in both the command and control of the nuclear enterprise, the transmission and reception of nuclear control orders. Detailed scenario tests have continued despite federally-mandated budget constraints. The operating constraints thrust on participating units, caused by additional budget reductions, may affect the effectiveness of future assessments.

Navy. Navy E-6 units that support the communications networks will continue to meet their nuclear support requirements, but these units expect the loss of flight hours to affect crew training. While reduced training hours will affect the enterprise's flying component, the budget cuts will not affect the Submarine Ballistic Missile fleet.

Air Force. Despite the mandated sequestrations, the Air Force has given priority to funding the nuclear deterrence mission. However, combat air forces supporting the nuclear mission may be affected if funding is depleted before the end of the fiscal year.

- The Air Force has been forced to reduce the depot level maintenance and engine service sustainment programs for the B-52 and KC-135 fleet. Even with giving priority to the nuclear mission, the Air Force's 18 percent reduction in flight hours will affect the manned bomber force's training proficiency.
- Since its creation in August 2009, Air Force Global Strike Command has brought the Air Force deterrent mission together under one command. However, a 2013 DoD IG audit found that the Air Force Headquarters staff is still struggling to decide where managing some of its nuclear responsibility actually rests. One example identified in a recent IG report found that the nuclear command, control, and communications systems management was alternating between the nuclear directorate. Another example involves stove-piping nuclear communications systems within one command, while another command is responsible for managing overall cyber and cryptographic upgrades.
- The DoD IG examined the Response Task Force program's ability to effectively react to weapon incidents and found that it had made great progress in this area. However, the Department needs to better define the requirements and readiness levels required for the Response Task Forces.

The Military Services continue to emphasize the physical security programs supporting the nuclear forces. The DoD IG will continue to monitor-long term improvements, such as the Air Force's work to field a replacement for the UH-1 "Huey" helicopter.

An Associated Press article about 19 Intercontinental Ballistic Missile crewmembers at Minot Air Force Base, North Dakota, being relieved from missile duty could be negatively perceived by the general public. However, the actions mentioned in the article resulted from proactive leadership trying to ensure that the highest levels of competency exist in the U.S. nuclear force. The Air Force has acknowledged the challenge to improve sagging morale that was identified from this incident. Senior Air Force leaders have acknowledged that morale problems at Minot stem from missile crew members' perception of a lack of communication from higher headquarters about the future of the nuclear force and the crews' concerns that they lack career advancement and diverse assignments. As part of this corrective action, the Air Force will need to address how it will manage nuclear-related career fields to ensure the enterprise has the necessary expertise and leadership through enrichment opportunities and advancement. The Chairman of the Joint Chiefs of Staff personally acted to show that senior leadership was concerned about this issue by visiting Minot in mid-June 2013. He told the troops in an hour-long address that, “As far as I’m concerned, we can’t pay you enough for what you do for our country.” This message to the troops will greatly help if meaningful actions follow to establish challenging career paths.

In response to these problems, national leadership has directed studies to address the causes of missile force deterioration. Once these studies are completed, a course of action will be created to return both the credibility and surety that is essential to maintain an effective deterrence force.

7-2C. Redefining the Importance of the Nuclear Enterprise and Overcoming Past Neglect	**Department Response**

The Department continues progress with its nuclear weapon systems and platform modernization programs, while maintaining close collaboration with the interagency team to make difficult choices in light of fiscal austerity and federally mandated budget cuts. The Department is also working closely with the National Nuclear Security Administration to address future capability gaps. Concurrent with this modernization effort, the Department is actively sustaining and upgrading existing nuclear forces, ensuring a viable nuclear deterrent until follow-on weapon systems are fielded.

Although faced with significant fiscal challenges, the Department has issued clear guidance that the Nuclear Enterprise is of the highest priority and funding levels will be maintained. Progress has been made in improving the morale and proficiency of personnel within the nuclear enterprise, but challenges remain in light of current fiscal challenges and the uncertainty of the career field with regards to potential future arms control reductions. At the same time, a robust inspection program continues to ensure the highest of standards of performance are maintained. The focused efforts of the Department and the interagency team maintain a safe, secure, and effective nuclear deterrent. The Department will continue to work with the interagency to address the challenges and opportunities presented in this report to maintain a well-managed and efficient nuclear enterprise.

MANAGERS' INTERNAL CONTROL PROGRAM

The Department's management has a fundamental responsibility to develop and maintain effective internal controls to ensure Federal programs operate and Federal resources are used efficiently and effectively to achieve desired objectives. As discussed in the Overview section of this report, the OUSD(Comptroller) leads the Department's *Federal Managers' Financial Integrity Act (FMFIA)* program, known 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 identified in the Department's *FIAR Guidance* are required to include assurances over the internal controls related to financial reporting and financial systems.

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, Operational 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 *FIAR Plan Status Report*, the Department's assessment of the effectiveness of its internal controls over financial reporting identified 16 areas of material weakness in FY 2013. Table 1a lists these material weaknesses, captured by end-to-end process and then the area of material weakness, and highlights changes from the weaknesses reported in the FY 2012 Agency Financial Report. Table 1a also includes a column, entitled "Ref Table 2," that crosswalks these 16 weaknesses to those identified by the DoD IG (Table 2).

Table 1a. Effectiveness of Internal Controls over Financial Reporting (FMFIA Section 2)							
Statement of Assurance: No assurance							
End-to-End Process	**Areas of Material Weakness**	**Ref Table 2**	**FY 2013 Beginning Balance**	**New**	**Resolved**	**Reassessed**	**FY 2013 Ending Balance**
Budget-to-Report	Budget Authority – Appropriations Received & Funds Distribution		1		(1)[2]		0
	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	Contract/Vendor Pay	1	1				1
	Reimbursable Work Orders (Budgetary)	1	1				1
	Transportation of People	1	1				1
Acquire-to-Retire	Financial Reporting of Valuation of Equipment[3]	11	2			(1)	1
	Real Property Assets	11	1				1
	Environmental Liabilities	3	1				1
Plan-to-Stock	Inventory	12	1				1
	Operating Materials & Supplies (OM&S)	6	1				1
	Military Standard Requisitioning and Issue Procedures (MILSTRIP)[4]	1	1				1
	Total Financial Reporting Material Weaknesses		**18**		**(1)**	**(1)**	**16**

As reflected in Table 1a, the Department is reporting 16 material weaknesses in internal controls over financial reporting, 2 fewer weaknesses than reported in FY 2012.

[2] As of the third quarter, the Department met its FY 2013 goal by validating 100 percent of the Appropriations Received reported on the Statement of Budgetary Resources as ready for audit.
[3] In a memo issued September 20, 2013, the Department combined the reporting categories of Military Equipment (initially identified as a material weakness in FY 2003) and General Equipment (initially identified as a material weakness in FY 2006). Combining these two categories into one reduced the number of reported material weaknesses.
[4] MILSTRIP was previously reported under the "Procure to Pay" end-to-end process.

- Using a mock audit approach (internal versus independent auditors), the OUSD(C) verified that the previously-reported material weakness in appropriations received for Defense agencies was resolved. The validation testing used in the mock audit confirmed that Appropriations Received for the Defense Agencies was fairly stated in all material respects in the FY 2012 Statement of Budgetary Resources.
- Also in FY 2013, the Department issued policy guidance that combined Military Equipment and General Equipment into one category; previously, these areas were reported separately in the financial statements. Accordingly, the material weaknesses for these areas are now captured in one category, entitled Equipment.

Table 1a-1 provides a brief description of each of the 16 material weaknesses in financial reporting, corrective actions, and the target correction year.

Table 1a-1. FY 2013 Material Weaknesses in Internal Controls over Financial Reporting

	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
1	FBWT • Ineffective processes and controls to reconcile transactions posted to the Department's FBWT accounts with the Department of Treasury's (Treasury) records. • Disbursements are reported to Treasury but are not recorded in the Department's general ledger. • Ineffective processes to provide sufficient and accurate documentation to support FBWT transactions and reconciling items.	FY 2005	Army; Navy; Defense Agencies	• Develop processes and controls to reconcile transaction level differences in a timely, efficient manner • Improve supporting documentation for disbursements and collections.	FY 2015
2	Financial Reporting Compilation • Ineffective processes and controls to prepare accurate financial statements supported by general ledger balances that align with Department strategic and performance plans.	FY 2007	Department-wide	• Implement a Standard Financial Information Structure (SFIS) to standardize financial reporting that aligns with the Department's mission. • Implement controls that ensure adequate documentation exists to validate and support journal entries.	FY 2015

Table 1a-1. FY 2013 Material Weaknesses in Internal Controls over Financial Reporting					
	Material Weaknesses	**Year Identified**	**DoD Components**	**Corrective Actions**	**Target Correction Year**
	Financial Reporting Compilation (continued) • Inability to reconcile detail-level transactions with the general ledgers and to provide adequate supporting documentation for adjustment entries. • Inaccurate posting of transactions and abnormal account balances due to system interface issues.			• Develop process to: reconcile trial balances (general ledgers) and financial statements (DDRS) accounts; a routine general ledger tie point analysis; identify and address root causes for abnormal balances; and review posting logic to reduce number of unsupported journal entries.	
3	Intragovernmental Eliminations • Ineffective processes and controls to collect, exchange, and reconcile intragovernmental buyer and seller transactions, resulting in unsupported adjustments. • Inability to provide valid and complete supporting documentation in a timely manner	FY 2008	Department-wide	• Implement enterprise resource planning (ERP) systems and SFIS structure to correctly report, reconcile, and eliminate intragovernmental balances. • Develop interfaces between data standardization repositories; • Implement controls to ensure adequate documentation exists to validate and support journal entries.	FY 2017
4	Health Care Liabilities 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	• Implement 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. • Implement SMA ERPs to improve overall financial reporting.	FY 2017
5	Civilian Pay • Ineffective processes and controls to record civilian pay transactions and personnel actions in a timely, complete, and accurate manner.	FY 2011	Department-wide	• Continue evaluating the sufficiency of the current SSAE 16 efforts. This includes determining whether the assessment includes all complete end-to-end processes.	FY 2014

Table 1a-1. FY 2013 Material Weaknesses in Internal Controls over Financial Reporting					
	Material Weaknesses	**Year Identified**	**DoD Components**	**Corrective Actions**	**Target Correction Year**
	Civilian Pay (continued) This includes unreliable supporting documentation for personnel actions and timekeeping, and inadequate reconciliations between Defense Civilian Pay System (DCPS) and the general ledger.			• Reporting entities, in conjunction with Service providers, develop and implement a methodology to reconcile DCPS to the general ledger. • Implement controls to ensure supporting documentation exists, is reviewed, approved, validated, retained, and readily available.	
6	Military Pay Ineffective processes and controls to record military pay transactions and personnel actions in a timely, complete, and accurate manner. This includes unreliable supporting documentation for personnel actions, and lack of reconciliations between Defense Joint Military Pay System (DJMS) and the general ledger.	FY 2011	Department-wide	• Implement control processes that ensure supporting documentation exists, is reviewed, approved, validated, retained, and readily available. • Implement reconciliations to address the completeness of data entered into the Defense Joint Military Pay System.	FY 2014
7	Accounts Receivable Ineffective processes and controls to ensure complete and accurate recording and sufficient documentation to support accounts receivable and related accruals. This includes the inability to accurately record, report, collect, and reconcile accounts receivable due from the public.	FY 2003	Army; Air Force; DLA; SMA	• Continue implementing ERP systems to improve collections of public accounts receivables, aging of receivables, and minimize manual processes. • Implement process improvements, such as training, guidance, and policy changes. • Develop documentation in sufficient detail to address the edit checks and validations performed.	FY 2015
8	Contract/Vendor Pay • Ineffective processes and controls to record transactions and contract actions in a timely, complete, and accurate manner. This includes the inability to reconcile contract balances and transaction details to source systems.	FY 2003	Department-wide	• Implement reconciliations and/or /interface controls between general ledgers and source systems. • Implement improvements and/or methodologies to monitor contract obligation balances, conduct timely deobligations, and estimate and post related accounts payable accruals.	FY 2014

Table 1a-1. FY 2013 Material Weaknesses in Internal Controls over Financial Reporting					
	Material Weaknesses	**Year Identified**	**DoD Components**	**Corrective Actions**	**Target Correction Year**
	• Inability to support the validity of open contract obligations. This includes lack of evidence supporting receipt and acceptance of goods and services.			• Ensure controls designed to account for Contract and Vendor Pay transactions have been implemented, are operating effectively, and are appropriately documented. • Continue SSAE 16 preparation activities.	
9	Reimbursable Work Orders (Budgetary) • Inability to reconcile Reimbursable Work Order buyer and seller balances/transaction details to field activity systems in a complete and timely manner. • Lack of evidence to support receipt and acceptance of goods and services, and the validity of open obligations, • Inability to verify the timely and accurate collection of disbursements, and validate that recorded reimbursable agreements meet the time, purpose, and amount criteria.	FY 2011	Department-wide	• Implement controls to validate receipt and acceptance of goods and services. • Implement training, improved guidance, and management oversight related to Tri-Annual Reviews. • Develop interfaces between data standardization repositories and accounting systems of record.	FY 2014
10	Transportation of People Inadequate controls over transportation of people processes. This includes inadequate segregation of duties, lack of reconciliations, and untimely voucher filing.	FY 2011	Department-wide	• Develop 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. • Monitor open travel obligations and enforce supervisory review to ensure timely submission of travelers' vouchers. • Implement activities to monitor open travel obligations and enforce effective supervisory review.	FY 2014

Table 1a-1. FY 2013 Material Weaknesses in Internal Controls over Financial Reporting					
	Material Weaknesses	**Year Identified**	**DoD Components**	**Corrective Actions**	**Target Correction Year**
11	Financial Reporting of Valuation of Equipment[5] Ineffective processes and controls to account for quantity and value of military and general equipment.	FY 2003	Department-wide	• Continue efforts to ensure that assets are recorded in the appropriate Accountable Property System of Record and can be reconciled to the general ledgers. • Provide field site training and complete inventories. • Apply controls and procedures to manage equipment accountability, including adequate documentation to support ownership.	FY 2017
12	Real Property Assets • Ineffective processes and controls to account for the quantity and value of real property. This includes the consistent reporting of real property records in accordance with accounting standards. Inaccurate and untimely recording of transactions when construction in progress is transferred to real property accounts. • Inadequate real property documentation.	FY 2003	Department-wide	• Implement adequate business processes and management controls to reconcile real property records, and to ensure assets exist and records are complete. • Periodically evaluate the quality of real property data by making comparisons with physical assets and annual reconciliations.	FY 2017
13	Environmental Liabilities 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	Department-wide	• Implement systems, processes, and controls to ensure the accuracy of site-level liability data to report environmental liabilities. • Update cost to complete estimating guidance and training procedures.	FY 2015

[5] Financial Reporting of Valuation of Equipment includes Military Equipment (identified in FY 2003) and General Purpose Equipment (identified in FY 2006), reported as two separate material weaknesses in prior years.

Table 1a-1. FY 2013 Material Weaknesses in Internal Controls over Financial Reporting					
	Material Weaknesses	**Year Identified**	**DoD Components**	**Corrective Actions**	**Target Correction Year**
14	Inventory • Insufficient documentation of business and financial processes and controls. • Tracking value of historical cost of inventory, purchased under legacy systems and transferred to ERPs • Reconciliations to ledgers	FY 2005	Army; Navy; Air Force; DLA	• Execute FIAR Improvement Plans, to include tracking inventory values to historical cost, and reconciliation of inventory to the general ledgers.	FY 2017
15	OM&S • Insufficient documentation of business and financial processes and controls. • Tracking value of historical cost of inventory, purchased under legacy systems and transferred to ERPs. • Government-owned/Contractor managed inventory not accounted for in DoD accountable property system.	FY 2005	Army; Navy; Air Force; USSOCOM	• Document business and financial processes and controls to include tracking inventory values to historical cost. • Develop interim auditable solution for Government owned/Contractor managed inventory.	FY 2017
16	Military Standard Requisitioning and Issue Procedures (MILSTRIP)[6] • Insufficient documentation of business and financial processes and controls to include transactions not accurately reconciled to the financial management systems of record and ineffective reconciliation process for unliquidated obligations (ULO).	FY 2013	Department-wide	• Document business and financial processes to identify root causes, review and prioritize FISCAM control testing, and ensure a comprehensive ULO reconciliation process.	FY 2014

[6] In FY 2012, MIPSTRIP was reported in the Procure-to-Pay category

2. FMFIA Section 2, Non-Financial (Operational) Material Weaknesses. The DoD Components use an entity-wide, risk-based, self-assessment approach to establish and assess internal controls for mission-essential operations. The material weaknesses in operational areas are categorized into one of 17 reporting categories, in accordance with the *DoD Instruction 5010.40*, "Managers Internal Control Program Procedures," revised May 30, 2013.

Table 1b lists the FY 2013 material weaknesses in the internal controls over non-financial operations and highlights changes from the weaknesses reported in the FY 2012 Agency Financial Report. The Department did not identify any new material weaknesses in operations in FY 2013; however, based on the updated procedures in DoD Instruction and re-evaluation of the previously-reported material weaknesses, some changes have occurred. These changes are identified in the footnotes in Table 1b and Table 1b-1.

Table 1b. Effectiveness of Internal Controls over Non-Financial Operations (FMFIA Section 2)

Statement of Assurance: Qualified

	Area of Material Weakness	Beginning Balance	New	Resolved	Reassessed	Ending Balance
1	Acquisition	1				1
2	Security[7]	4			(1)	3
3	Information Technology[7]	0			1	1
4	Comptroller and/or Resource Management[8]	2			1	3
5	Contract Administration	2				2
6	Force Readiness[9]	2		(1)		1
7	Personnel and/or Organizational Management	3				3
8	Property Management	1				1
9	Supply Operations	1				1
	Total Non-Financial/Operational Material Weaknesses	16		(1)	1	16

[7] In FY 2012, four material weaknesses were reported in the category of "Communications, Intelligence, and/or Security." To better align with the updated DoD Instruction 5010.40, one weakness is now reported under the Information Technology category.

[8] In FY 2012, two material weaknesses were reported in the category of Comptroller and/or Resource Management. In FY 2013, one weakness previously reported for unreliable business processes and the need for a well-trained financial management workforce has been separated into two weaknesses.

[9] In FY 2012, two material weaknesses were reported in Force Readiness. In FY 2013, the Air Force assessed and determined that its corrective actions to remediate its material weakness in the timely and accurate reporting of force readiness assessments has been resolved

Table 1b-1, below, provides the description and corrective action plan for each of the material weakness in non-financial operations identified in Table 1b.

Table 1b-1. FY 2013 Material Weaknesses in Internal Controls over Non-Financial Operations

	Material Weaknesses	Year Identified	DoD Components	Corrective Actions	Target Correction Year
1	Acquisition				
	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 decisions through the use of reporting metrics.	Reassessed annually based on incremental improve-ments
2	Security[7]				
a	Weaknesses exist in the Department's management and assurance of the reliability and security of the information technology infrastructures.	FY 2006	Navy; USAFRICOM; Air Force, USFOR-A	• 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 2014
b	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 2014[10]

[10] Target Correction Year was reassessed and extended from FY 2013 to FY 2014

Table 1b-1. FY 2013 Material Weaknesses in Internal Controls over Non-Financial Operations					
	Material Weaknesses	**Year Identified**	**DoD Components**	**Corrective Actions**	**Target Correction Year**
c	Operations Security (OPSEC) controls related to the safeguarding of classified information are not sufficient. As a result, intentional and/or accidental disclosure of classified information by military, civilian and contracted personnel may potentially be accessed by adversaries.[11]	FY 2011	Air Force; DSCA; DTRA; USSOCOM	• DoD Components are developing enhanced Ethics and Security Awareness training at all levels to ensure that personnel are trained to prevent the compromise of classified information.	FY 2016[11]
3	Information Technology[7]				
	Internal assessments have identified weaknesses in the Department's Cyber Security controls, potentially increasing vulnerability of DoD systems.	FY 2010	USAFRICOM	• 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 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 2014, DoD will continue to implement insider threat protection such as Public Key Infrastructure and data access monitoring.	FY 2014

[11] Description expanded from Information Assurance to more broadly capture the material weakness in operational security controls related to safeguarding of classified materials. Target Correction Year extended from FY 2013 to FY 2016.

Table 1b-1. FY 2013 Material Weaknesses in Internal Controls over Non-Financial Operations					
	Material Weaknesses	**Year Identified**	**DoD Components**	**Corrective Actions**	**Target Correction Year**
4	Comptroller and/or Resource Management				
a	The Department's current business processes, systems, and internal controls do not provide reliable, accurate and verifiable financial statements.[8]	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 operating procedures and controls related to producing financial statements by FY 2017.	FY 2017
b	The financial management workforce, which includes civilian, military, and contracted personnel need to be well-trained in all financial management-related functions, and be able to implement effective financial management policies, processes, and procedures.[8]	FY 2011	Department-wide	• The Department is in the process of conducting competency gap analyses of its current and expected future financial management workforce. • The Department is working to develop guidance for strategic workforce planning, and improve the related performance measures.	FY 2017
c	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	JIEDDO; PACOM; 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 2014

Table 1b-1. FY 2013 Material Weaknesses in Internal Controls over Non-Financial Operations					
	Material Weaknesses	**Year Identified**	**DoD Components**	**Corrective Actions**	**Target Correction Year**
5	Contract Administration				
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 2009[12]	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 improve-ments
b	The backlog of contracts to be closed out continues to be a challenge. These delays result in problems with funds reconciliation, delays in final payment and release of excess funds, cancellation of funds, and the inability to close accounting records.	FY 2012	Defense Contract Management Agency (DCMA)	• DCMA and Defense Contract Audit Agency (DCAA) have been partnering and evaluating an option that 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 overage 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.	FY 2014
6	Force Readiness				
	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 2014[13]

[12] Correction from previously-reported date of FY 2006
[13] Target Correction Date extended from FY 2013 to allow additional time to implement training, policies, and procedures related to responding to emergencies

Table 1b-1. FY 2013 Material Weaknesses in Internal Controls over Non-Financial Operations					
	Material Weaknesses	**Year Identified**	**DoD Components**	**Corrective Actions**	**Target Correction Year**
7	Personnel and/or Organizational Management:				
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 also plans to institute peer reviews in order to confirm the progress made towards improving audit quality.	FY 2014[14]
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. With DCMA currently having 72% of the 8,000+ acquisition workforce with less than 5 years with the Agency, the urgency of professionalizing this training is apparent.	FY 2010	DCMA	• DCMA is developing and implementing a formalized education, training, and certification program for all levels of employees.	FY 2014
c	OSD has identified 22 Mission Critical Occupations 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.	FY 2015

[14] Target Correction Date extended from FY 2013 due to a delay in completing external peer reviews.

Table 1b-1. FY 2013 Material Weaknesses in Internal Controls over Non-Financial Operations					
	Material Weaknesses	**Year Identified**	**DoD Components**	**Corrective Actions**	**Target Correction Year**
	Mission Critical Occupations (continued)			• 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.	
8	Property Management				
	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, including government furnished property in the hands of contractors.	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. OUSD (AT&L) will validate accountable property records and supporting documentation through existence and completeness testing.	FY 2016
9	Supply Operations				
	The Department lacks management of supply inventories and responsiveness to warfighters' requirements.	FY 2011	Department-wide	• The Department is improving Supply Chain 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 improve-ments

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.

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

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

TABLE 1c-1. FY 2013 Internal Control over Financial Systems Material Weakness					
	Material Weaknesses	**Year Identified**	**DoD Components**	**Corrective Actions**	**Target Correction Year**
1	Financial Management Systems: 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

Audit Opinion: Disclaimer

Restatement: Yes

	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
	Total Material Weaknesses	**13**				**13**

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
1. System Requirements	Noncompliance noted	Noncompliance noted
2. Accounting Standards	Noncompliance noted	Noncompliance noted
3. U.S. Standard General Ledger at Transaction Level	Noncompliance noted	Noncompliance noted

IMPROPER PAYMENT AND PAYMENT RECAPTURE PROGRAMS

INTRODUCTION

The *Improper Payments Information Act of 2002* (IPIA), as amended by *The Improper Payments Elimination and Recovery Act of 2010* (IPERA) and *The Improper Payments Elimination and Recovery Improvement Act of 2012* (IPERIA), requires agencies to report on its improper payments and payment recapture programs to the President and Congress in the annual Agency Financial Report (AFR). The Department reports improper payments in the following six categories:

- Military Health Benefits – Disbursed by the Defense Health Agency (DHA)
- Military Pay – Disbursed by DFAS
- Civilian Pay – Disbursed by DFAS
- Commercial Pay (vendor and contract payments) – Disbursed by DFAS, the Navy, and the U.S. Army Corps of Engineers (USACE)
- Military Retiree and Annuitant Benefit Payments – Disbursed by DFAS
- Travel Pay – Disbursed by DFAS, the Army, the Navy, the Air Force, and USACE

The DFAS, USACE, and DHA are the primary disbursing components within the Department. The Army, Navy, and Air Force all report travel payments that are not-disbursed by DFAS.

This section explains the Department's improper payments and payment recapture programs in accordance with Office of Management and Budget (OMB) Circular No. A-136, Financial Reporting Requirements.

I. Risk Assessment
II. Statistical Sampling Process
III. Root Causes of Errors and Corrective Actions
IV. Program Improper Payment Reporting
V. Recapture of Improper Payment Reporting
VI. Accountability
VII. Agency Information Systems and Other Infrastructure
VIII. Statutory and Regulatory Barriers
IX. Additional Information

I. Risk Assessment

Since FY 2006, when OMB determined that all DoD payments are risk susceptible, the Department has maintained a more conservative position than required by IPERA and considers all payment categories as high risk. Nonetheless, DFAS performed a risk assessment of its disbursements using OMB criteria as contained in *OMB Circular No. A-123, Appendix C*, Management's Responsibility for Internal Control. 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 unfavorable trends to allow implementation of corrective measures as early as possible.

The USACE risk 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 U.S. Corps of Engineers Financial Management System (CEFMS) provides internal system standards that adhere to U.S. generally accepted accounting principles, as well as process controls that provide the 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 DHA risk assessment process is managed through contracts with an external independent contractor (EIC) to provide an independent, impartial review of reimbursements and claims processing procedures used by DHA's care contractors. The EIC identifies improper payments as a result of contractors' noncompliance with DHA payment/reimbursement policies, regulations, and contract requirements. The risk level of programs is evaluated based on results of these compliance reviews.

II. Statistical Sampling Process

The primary disbursing Components use statistically valid sampling methods designed to meet or exceed OMB's requirements of 90 percent confidence level, ±2.5 percentage points, to estimate and project the Department's annual improper payments for each payment type. The smaller disbursing Components 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. All Department sampling plans were approved by OMB for FY 2013.

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, DHA can be sure that claims were either paid or denied correctly. The DHA uses a stratified random sample process to select medical, pharmacy or dental claims for review.

Military Pay. On a monthly basis, the Department statistically samples Military Pay accounts sorted by 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). The DFAS selects the accounts for each Component to review and then DFAS produces annual estimates of improper payments.

Civilian Pay. On a monthly basis, DFAS statistically samples Civilian Pay accounts broken out by Army, Air Force, Navy/Marine Corps, and Defense Agencies.

Commercial Pay:

DFAS**.** The DFAS statistically samples commercial pay invoices on a monthly basis for contract and vendor payments. Approximately 2,000 invoices were reviewed each month. Based on a recommendation from a recent GAO report, DFAS is reevaluating its sampling methodology for the FY 2014 commercial pay program.

Navy**.** The Navy samples the contract and vendor payment population computed in its Enterprise Resource Planning (ERP) system. The standardized sampling framework was developed by the Navy's Financial Management Office and approved by statisticians in the Navy's Center for Cost Analysis, as well as by OMB. Trained Navy financial management staff extract data from the ERP and provide payment samples to the Commands. The Commands review the sampled payments to ensure the payments are legal and proper.

For FY 2013, the Navy used a two-stage sampling methodology for Navy ERP commercial payments to ensure coverage for sampling. The Navy reviewed the data from FY 2012 to ensure the six months included for FY 2013 provided an accurate representation of a full year's data in terms of transaction volume and dollar amounts.

- In the first stage of the sampling methodology, the Navy used the RANDOMIZER statistical software to identify the sample size for each Command. This approach provides a uniform number of samples to be drawn from each Command based on the percentage of all payments processed by the Command to the total number of payments processed in the ERP.
- In the second stage, simple random sampling was used to draw a sample of sufficient size to yield an estimate with a 90 percent confidence level and a margin of error of ±2.5 percent. Using this methodology, each payment within a Command has an equal probability of selection from the ERP. A random sample of commercial payments processed was examined. The sample size was designed with a confidence level of 90 percent with a ±2.5 percent confidence interval.

The estimated FY 2013 improper payments for Navy commercial pay did not exceed the IPERA and OMB A-123, Appendix C, reporting thresholds. In fact, the FY 2013 testing for Navy ERP commercial payments identified no improper payments.

The Navy reviews ERP commercial pay disbursements that are computed by the Navy. The Navy's commercial pay sampling and review plan was not in place early enough to report improper payments for the entire fiscal year. Therefore, the Navy is reporting commercial pay improper payment results only for the last two fiscal quarters of FY 2013. The Navy ERP disbursement universe for FY 2013 was approximately $1.2 billion.

USACE. The post-payment reviews were conducted using a statistically valid (95 percent confidence level, ±2.5 percentage points) sample taken from the entire USACE commercial pay universe. In addition, the USACE Finance Center (UFC) used pre-payment controls, post payment contract audits, and data mining to prevent and identify improper payments in commercial pay.

Military Retiree and Annuitant Benefit Payments. On a monthly basis, DFAS statistically samples military retirement payments grouped by the retired and annuitant pay accounts. The reviews for retired and annuitant pay include sampling drilling reserve units, 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, newly established accounts, and other targeted areas.

Travel Pay:

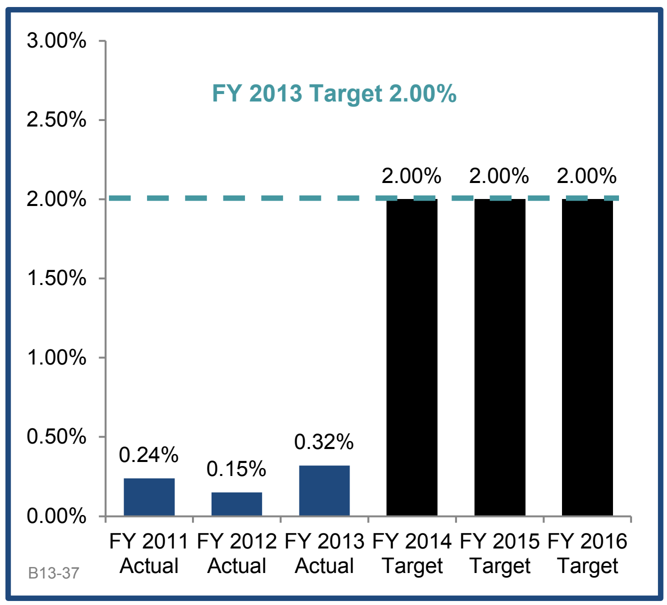
The Department. The Department's total travel payments include those computed, paid, and reported independently by the Military Services and other Defense agencies. Department travel, as depicted in Table 4, represents the combined results of the review of DFAS-disbursed travel payments as well as non-DFAS-disbursed travel payments for Army, Air Force, and Navy.

The DFAS reports the largest portion of the Department's travel payments made by the Defense Travel System (DTS), and Windows Integrated Automated Travel System (WinIATS) for the Department of the Army and select Defense Agencies. On a monthly basis, DFAS statistically samples DTS travel vouchers grouped by Service and the aggregate of the Defense Agency vouchers. The DFAS also statistically samples monthly WinIATS travel vouchers, broken out by Army activity and type of payment, both Temporary Duty Travel (TDY) and Permanent Change of Station (PCS).

USACE. The UFC processes USACE travel payments using the CEFMS and WinIATS. The payment population includes both TDY and PCS travel voucher reimbursements. All PCS and TDY vouchers over $2,500 are 100 percent reviewed for accuracy. The remaining vouchers are statistically sampled at 95 percent confidence level, ±2.5 percentage points.

II. Root Causes of Errors and Corrective Actions

Figure A-1 Improper Payment Rate – Military Health Benefits



Military Health Benefits. As shown in Figure A-1, the Department projects a 0.32 percent error rate for FY 2013 Military Health Benefits improper payments. For ten years, the Department's purchased-care contracts have included payment accuracy performance standards for processing military health benefit claims. Specifically, if improper payments exceed the two percent payment accuracy performance standard during a quarterly or semi-annual performance review, the DHA purchased-care contractor(s) may be subject to financial penalties. Conversely, if improper payments fall below the performance standard, the contractors may receive a financial incentive award. In addition, an external claims contractor conducts annual health care cost audits of payments made by the managed-care support contractors (MCSCs). Confirmed overpayments are projected to the review universe, and the MCSCs are liable for the total unallowed health care amounts paid.

For the past several years, DHA purchased-care contractors have been held to payment accuracy performance standards, with either contract financial penalties or incentives, depending on the contract type and requirement(s). This contract design encourages contractors to keep payment error rates as low as possible to avoid financial penalties, or to achieve increased contract financial 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 curtails improper payments for purchased-care contracts and ensures the Government's risk for improper payments in the military health benefits program is very low.

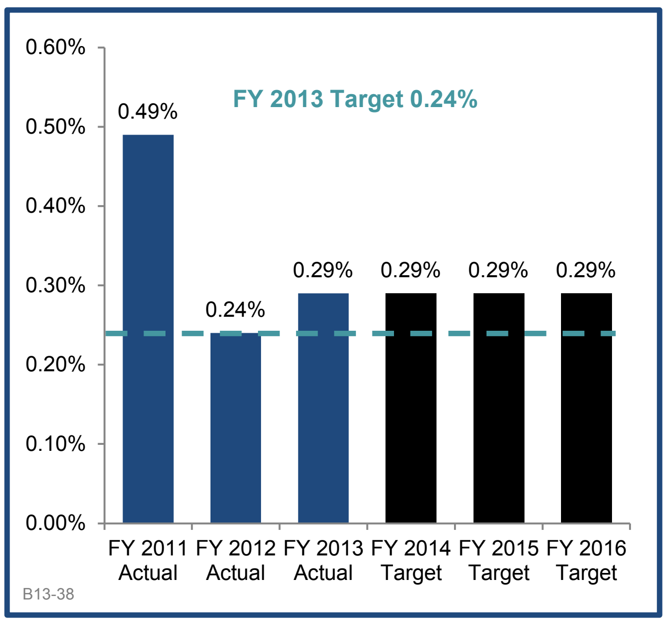
Root Causes. The primary reasons for payment errors in the Military Health Benefits program for this reporting cycle are:

- Incorrect pricing of medical procedures and equipment, 47 percent
- Authorization or Pre-Authorization needed prior to receiving medical care, 14 percent
- Cost-share/deductible miscalculations, 11 percent
- All other causes combined, 28 percent

Corrective Actions. The DHA purchased-care contractors are monetarily incentivized or dis incentivized, through contractual payment accuracy performance standards, to reduce and/or eliminate improper payments. 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 estimates a 0.29 percent error rate in FY 2013 Military Pay improper payments, based on reviews, estimates, and forecasts from October 2012 through September 2013. The error rate increase in FY 2013 from FY 2012 is attributable to an expanded list of entitlement categories from what was historically used.

Figure A-2. Improper Payment Rate – Military Pay



Overpayments comprise 90 percent of the Military Pay improper payments. These overpayments were not found in statistical sampling, but in the separation debts (out-of-service debts established after a member has left the Service) and through in-service debt collections reported by the Military Services.

Root Causes. The primary reason for recurring Military Pay errors is the high turnover in military payroll clerks throughout the Military Services. This primary reason is often the underlying cause of the next most common causes of Military Pay errors – the large amount of untimely or inaccurate information entered into pay systems, and from administrative and documentation errors that occur during and between monthly pay periods (military members are paid just once per month). Entitlement changes, especially for deployed

Service members, can greatly change the amount due. Changes must be corrected in the following month's pay. Nonetheless, nearly 100 percent of improper payments for Military Pay have been recovered or a collection action has been established to recover the amount.

The primary types of Military Pay improper payments result from administrative and documentation errors as described above. These entitlements are:

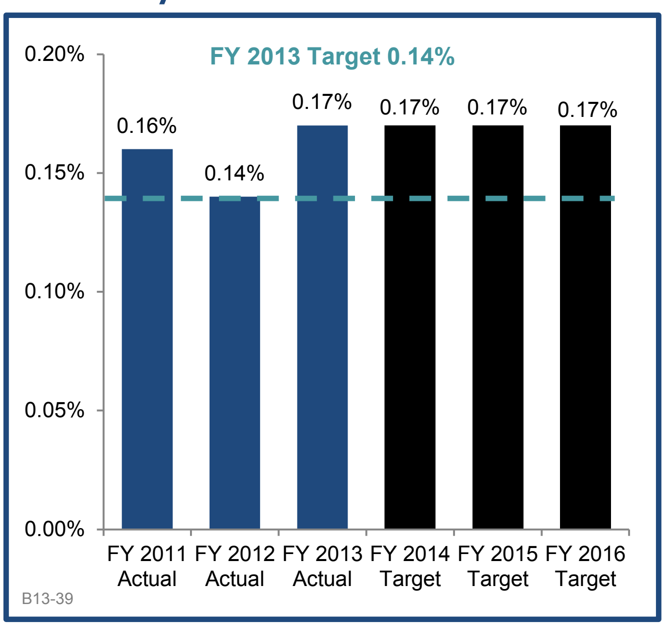
- Basic Allowance for Housing (39 percent) resulting from incorrect reporting of the entitlement.
- Base pay for Active Duty and incorrect Active Duty pay for Reservists (9 percent) resulting from incorrect reporting of the entitlement.
- Hostile fire/imminent danger pay (11 percent) resulting from incorrect reporting of the entitlement.
- Family separation allowance, Active and Reserve, (5 percent) resulting from incorrect reporting of the entitlement.

Miscellaneous categories, including results from underpayments, account for 36 percent of all improper payments. (Miscellaneous categories are comprised of over 25 different entitlements.)

Corrective Actions. Corrective actions taken include instituting more comprehensive training programs with standard desk procedures to provide a reference for new clerks. In addition, the Department, primarily through DFAS, advises the Military Services of the results of payment reviews and the associated root causes of the errors. The DFAS provides the Military Service financial managers with monthly reports on the results of statistical reviews, including the reasons for and dollar value of errors and year-to-date trends, to inform their training plans.

Civilian Pay. As shown in Figure A-3, the Department projects a 0.17 percent error rate for Civilian gross pay payments, primarily overpayments, for FY 2013. The increase in payment errors from FY 2012 is primarily due to an issue with the Living Quarters Allowance (LQA) that surfaced mid-year.

Figure A-3. Improper Payment Rate – Civilian Pay



The LQA is intended as a recruiting incentive for hiring personnel to work overseas. The Department of State guidance states that employees, who are hired overseas after working for more than one overseas employer, are not eligible to receive LQA. An audit of overseas civilian pay accounts revealed that many overseas employees were erroneously paid LQA for an extended period of time. Collection of these overpayments is under review, and where warranted, the repayments may be waived on an individual basis. Improper payments made during FY 2013 ($11.7 million) are reported in Table 4. Overpayments that were not waived are being recaptured and are reported in Table 9.

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

- Time and attendance, 35 percent
- Overseas and other allowances, 44 percent
- Late personnel actions, 21 percent

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

In addition to LQA overpayments, errors in overseas Civilian Pay accounts often occur due to payment of an entitlement that erroneously continued after the employee has returned to the United States. These improper payments often result from 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 is considering conducting pay audits at the time of employee leaves his position. The employee knows that when they return to the United States, they are no longer eligible for the additional money. Instituting a post payment review of employees’ leave and earnings statements might result in the prevention of a number of overpayments and/or may also deter employees from continuing to receive entitlements for which they are no longer eligible.

The 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 also advises Components on best business practices to prevent future improper payments, and it participates at various conferences to instruct personnel on how to correctly submit information to help prevent improper payments.

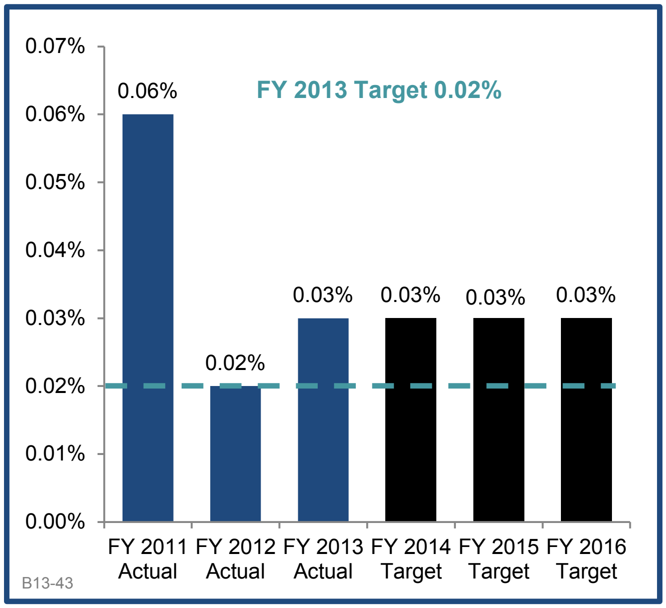
Independent public auditors performed a Statement on Standards for Attestation Engagement No. 16 (SSAE 16) on the effectiveness of select internal controls for DFAS Civilian Pay and Disbursing Operations, and issued an unqualified opinion with no material weaknesses identified.

Commercial Pay

DFAS. The DFAS continues to conduct statistically-valid reviews of DFAS-computed invoices in the Mechanization of Contract Administrative Services (MOCAS) contract payment system, the DFAS legacy commercial pay systems, and the Service Component ERPs. (Beginning in mid-FY 2013, the Navy reviewed and sampled the payments it computed in the Navy ERP.)

As shown in Figure A-4, based on statistical sampling methods, the FY 2013 estimated error rate in total estimated commercial payments is 0.03 percent, for total estimated improper payments of $117.3 million. The DFAS also collects data on contractor-identified improper payments and regularly performs analyses to inform its preventative efforts.

Figure A-4. Improper Payment Rate – DFAS Commercial Pay



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. These systems account for approximately 85 percent of all DoD commercial payment dollars. These types of preventative control activities consistently prove to be the most cost-effective.

Root Causes. The majority of errors in commercial pay improper payments are caused by pay technician input errors.

Reasons for improper payments identified from monthly random sample reviews include:

- Entitlement Errors, 48 percent
- Contract Input Errors, 21 percent
- Missing Documentation, 16 percent
- Miscellaneous, 15 percent

Using BAM, DFAS identifies and prevents improper payments in DoD's five largest commercial payment systems which are MOCAS, CAPS-Windows, IAPS, One-Pay, and EBS. These systems account for 86 percent of all DoD commercial payment dollars.

The DFAS identifies and monitors the root cause for all improper payments by researching supporting documentation and assigning an assessment code that identifies the type and reason for the improper payment. In addition, root causes of improper payments detected by BAM are reviewed and analyzed monthly and through formal bi-annual reviews. Root cause analysis is shared with the DFAS payment offices on a monthly basis and is used to identify areas for operational improvement. The information is also used to implement refinements to BAM and develop new integrity checks.

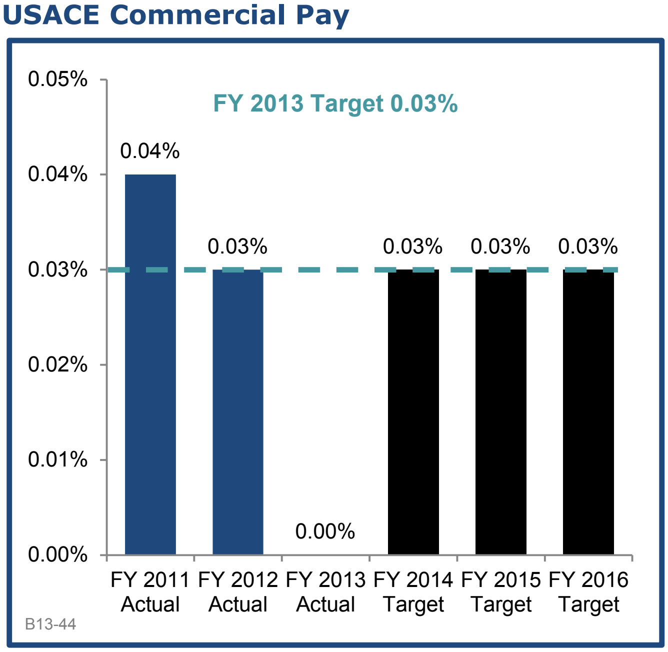
Corrective Actions. Corrective actions include:

- Ongoing training for pay technicians to increase their ability to compute and input accurately.
- The MOCAS payment office conducted a series of all-hand and classroom training session throughout FY 2013 to address liquidation and recoupment errors.
- The MOCAS databases began to receive automated special pay instructions in the fourth quarter, FY 2013, which will help reduce progress payment recoupment errors by facilitating standardization and reducing manual intervention by pay technicians.
- Continued work with Contracting Officers to simplify contract terms and eliminate the need for manual calculations.
- Increased trend analysis over individual improper vendor payments, to include actual BAM improper payment (normally referred to as true positives) data used to conduct vendor outreach on proper billing methods.
- Continued electronic commerce improvement initiatives, such as the automation of third party payments, aimed at minimizing manual intervention and improving quality.

The Department is very pleased with the continuing success of its pre-payment review using BAM. Since its initial roll out in August 2008, BAM has prevented more than $7 billion in improper payments. 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.

Figure A-5. Improper Payment Rate – USACE Commercial Pay



USACE**.** As shown in Figure A-5, USACE projects a zero percent error rate in improper payments for Commercial Pay. The USACE functions as the real estate agency for the Department, with responsibility for leasing office space for all military recruiters. This responsibility applies to small offices in rural and semi-rural areas as well as larger spaces in more urban areas.

Navy. Preventing, detecting, and correcting improper payments is a top priority for the Navy. The Navy's commitment to compliance with IPIA and its amendments include activities such as:

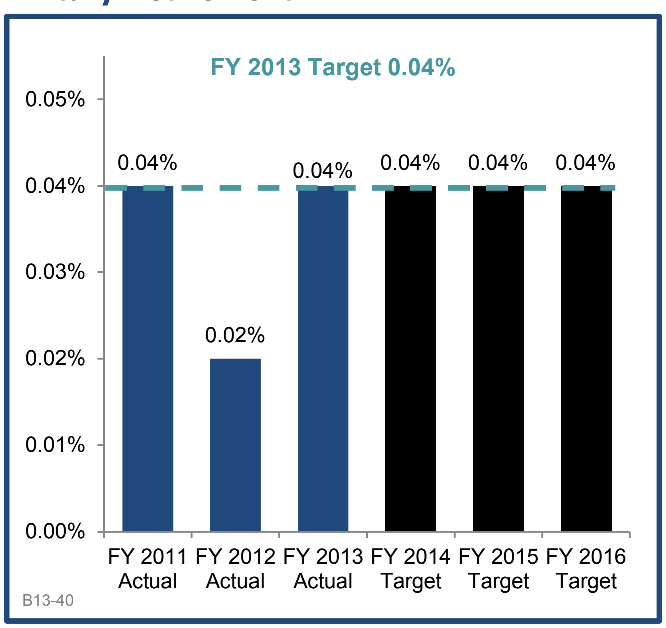
- Reconciling the payment universe to ensure all programs are captured for review;
- Reviewing programs to identify additional corrective actions to achieve reduction targets;
- Identifying and designating Senior Accounting Officials at the Military-Service level for the Navy and the Marine Corps to oversee and report on their improper payment programs.

The Navy's continuing emphasis on accountability and integrity, at every level, underscores its commitment to achieve the goals set forth in IPERA. The Navy continues to report progress through monthly performance reviews with the Assistant Secretary of the Navy for Financial Management and Comptroller as well as through monthly financial operations metrics meetings with the OUSD(C) Deputy Chief Financial Officer.

Management has taken several additional steps to ensure its ERP adheres to IPIA and IPERA requirements.

- Assigned responsibility for monitoring oversight of the Navy's IPERA Program.
- Identified Oversight Officials, responsible for preparing and updating the Navy's annual IPERA sampling plans, drawing monthly samples, and reviewing and monitoring IPIA test results.
- Issued desk procedures and provided training to staff that identifies step-by-step instructions on how to conduct IPIA reviews, and in the event that improper payments are identified, how to identify root causes and corrective actions to address them.
- Issued the Navy ERP Compliance Guide to the Commands in the Navy ERP in June 2013. The handbook defines and standardizes procedures associated with IPERA requirements.

Figure A-6. Improper Payment Rate – Military Retirement



Military Retirement. Based on FY 2013 reviews, DFAS projects a 0.04 percent error rate for improper payments in the Military Retirement program (refer to Figure A-6), with almost the entire amount related to payments made to deceased retirees and annuitants.

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 possible financial hardship to the Service member's annuitant by expediting the correct calculation and processing of the monthly benefit. Family members or executors are required to return any overpayments 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 2013 disclosed that the Department recovered approximately 95 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 benefit account was suspended for several months due to bad check/correspondence address

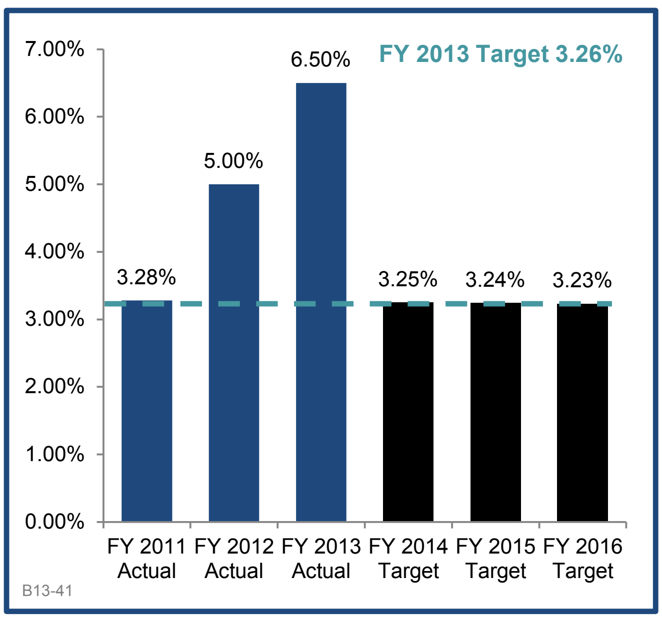
Early detection and data mining efforts, along with partnerships with other Federal and state entities, also are used. The Department takes a proactive approach to ensure the accuracy of Military Retiree payments by routinely comparing retired and annuitant payroll master file databases with the Social 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 enhancing faster recovery of overpaid funds.

Travel Pay.

The Department**.** The FY 2013 projected 6.5 percent error rate for travel improper payments, shown in Figure A-7, represents Military DTS trip records and WinIATS TDY and PCS vouchers for both civilians and military members, which are computed and disbursed by DFAS. In addition, this figure also includes travel reimbursements disbursed outside of DFAS by the Army, Navy, and Air Force.

DTS Root Causes. The primary reasons for DTS improper payments are voucher input error by the traveler and/or approving official failure to catch the error(s) before reimbursement occurs.

Figure A-7. Improper Payment Rate – DoD Travel Pay



The error types include:

- Per Diem (61 percent): The Department incorrectly reimbursed the traveler for lodging expenses without validating the claim with receipts, and/or reimbursed for meals at an incorrect rate.
- Reimbursable Expense (28 percent): Because of traveler mistakes when completing vouchers in DTS, the Department incorrectly reimbursed airfare, non-travel related expenses, and/or rental car expenses.
- Missing Documentation (11 percent): The Department reimbursed claimed lodging, airfare or rental car expenses not supported with 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. Any improper payments identified are forwarded to the appropriate Debt Management Monitor to establish a debt and recover the improper payment. Also, the Department has implemented a Defense Travel Management Office Compliance Tool (details discussed later in this section).

WinIATS Root Causes. The primary reasons for WinIATS improper payments are voucher input errors by the traveler and/or approving official failure to catch the error(s) before reimbursement occurs. The error types include:

- Per Diem (85 percent): Per Diem/Meals & Incidental Expenses and Lodging paid at the incorrect rate, not at all, or when unauthorized.
- Reimbursable Expense (9 percent): Airfare, household goods storage, and lodging tax paid incorrectly or not at all.
- Other miscellaneous (6 percent).

WinIATS Corrective Actions. The DFAS implemented several steps to prevent improper payments, including:

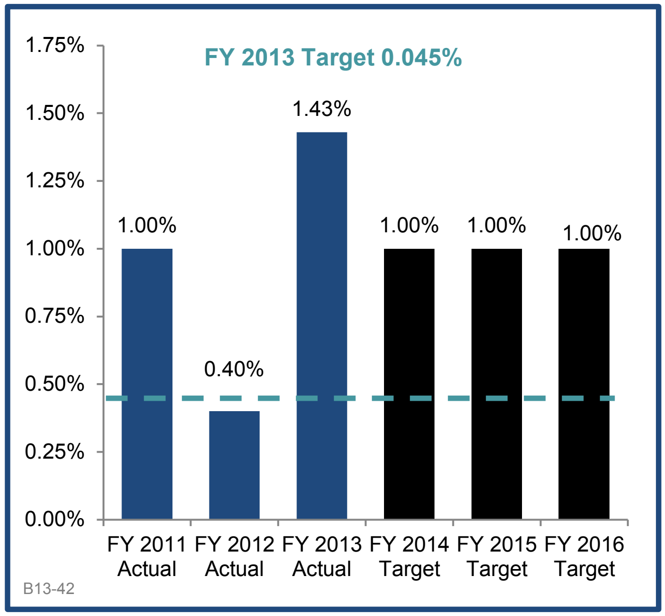
- Post-payment reviewers meet monthly with travel pay operations personnel to discuss findings and preventative measures. Travel Pay examiner training programs, based on post-payment review findings and recommendations, are ongoing.
- Pre-payment validations and cross checks have been implemented to ensure the traveler was not previously reimbursed for the same trip through this or another travel system, therefore avoiding a duplicate payment.

USACE**.** The UFC performs a 100 percent audit of all airline credits issued against travelers' individually billed travel card accounts. This ensures that all 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
- Approving Officials (AO) fail to properly review travel vouchers before approval

Figure A-8. Improper Payment Rate – USACE Travel Pay



Corrective Actions. The USACE continues to educate travelers and travel AOs through required training, including refresher training for seasoned travelers and AOs. Additionally, all AOs are required to complete fiscal law training every three years to maintain their certification eligibility.

When improper payments are identified, the UFC notifies the parties involved to determine the circumstances surrounding the error and to assist them in identifying business process improvements to prevent future recurrences. These areas are also covered thoroughly in refresher training.

DoD's Participation in Do Not Pay

Effective June 1, 2013, all Federal agencies are required to use the "Do Not Pay" (DNP) initiative. Specifically, in a Presidential Memorandum, entitled *Enhancing Payment Accuracy Through a Do Not Pay List,* the President directed that agencies review current pre-payment and pre-award procedures and ensure that a thorough review of available databases, with relevant information on eligibility, occurs before the release of any Federal funds, to the extent permitted by law. Treasury is implementing these databases on an ongoing basis. Agencies are screening against databases that are currently available, which includes the Excluded Parties List and the Public Death Master File.

This network of databases, and additional databases designated by the Director of OMB in consultation with agencies, are collectively known as the Do Not Pay List. The DFAS implemented DNP in its prepayment environment for 99 percent of all invoices received 60 days before the deadline. The DFAS sends a weekly file to the DNP database and receives results the following day. The DFAS then researches these results to determine if the proposed payment is proper. To date, DFAS has not yet identified any potential improper payments using the DNP list. On a monthly basis, DFAS shares this information with its payment offices to identify areas for operational improvement.

The USACE also participates in the DNP initiative. On a daily basis, USACE sends 100% of its pending commercial payments to match against the Death Master File and the Excluded Parties List. To date, no improper payments have been identified.

The Navy has implemented controls to meet the DNP requirement. Specifically, on a weekly basis, the Navy sends its ERP payment files (both internally and externally entitled) to the DNP portal to identify criteria that may indicate that the payment may not be legal and/or valid. Invoices that match with the database are reviewed to ensure that payment and vendor data is correct. Thus far, no potential improper payments have been identified.

Ongoing Improper Payment Prevention Efforts

The DFAS analyzes improper payments detected by BAM in the pre-payment environment. This year, DFAS refined or developed new system edits (also called integrity checks) to improve BAM's ability to identify improper payments before disbursement. Examples of the success of these integrity checks in preventing improper payments in FY 2013 include:

- A Wrong Vendor Paid edit detected over $96 million in potential improper payments.
- A modification to the Invoice Outlier edit broadened the scope for detecting potential overpayments. Since July 2013, over $2.8 million in potential improper payments were identified that, without this modification, might not have been identified.
- The $100 Million Threshold integrity check detected over $861 million in potential improper payments.

The DFAS currently is adding vendor data to the BAM exception queries. This will designate vendors that have been identified multiple times with improper payment exceptions, allowing for vendor outreach and further training on proper billing.

IV. Program Improper Payment Reporting

Table 4 below summarizes DoD's improper payment reduction outlook and total program outlays (payments) from FY 2012 through FY 2016.

Table 4. Improper Payment Reduction Outlook

	FY 2012					FY 2013					FY 2014 Estimate			FY 2015 Estimate			FY 2016 Estimate		
Program	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)
Military Health Benefits [1,2]	$ 20.9	0.15	$ 22.5	$ 8.8	$ 31.3	$ 20.5	0.32	$ 60.3	$ 7.3	$ 67.6	$ 21.2	2.00	$424.0	$ 21.9	2.00	$438.0	$ 22.7	2.00	$454.0
Military Pay[3]	$ 95.5	0.24	$197.8	$ 29.0	$226.8	$ 98.7	0.29	$258.5	$ 28.1	$286.6	$ 95.0	0.29	$275.5	$ 94.0	0.29	$272.6	$ 93.5	0.29	$271.2
Civilian Pay[3]	$ 59.0	0.14	$ 81.8	$ 0.0	$ 81.8	$ 57.0	0.17	$ 96.4	$ 0.0	$ 96.4	$ 57.5	0.17	$97.8	$ 57.0	0.17	$96.9	$ 56.5	0.17	$ 96.1
Military Retirement[3]	$ 55.1	0.02	$ 12.8	$ 0.3	$ 13.1	$ 56.6	0.04	$ 19.9	$ 0.01	$ 19.9	$ 42.9	0.04	$ 17.2	$ 43.5	0.04	$ 17.4	$ 44.1	0.04	$ 17.6
DoD Travel Pay[4,5,6]	$ 8.4	5.0	$363.9	$ 55.4	$419.3	$ 7.3	6.5	$421.1	$ 53.7	$474.8	$ 8.5	3.25	$276.3	$ 8.5	3.24	$275.4	$ 8.5	3.23	$274.6
DFAS Commercial Pay[3,6]	$ 408.7	0.02	$ 89.6	$ 10.5	$100.1	$ 352.6	0.03	$ 49.4	$ 67.9	$117.3	$ 400.5	0.03	$120.2	$ 392.5	0.03	$117.8	$ 384.7	0.03	$115.4
USACE Travel Pay	$ 0.19	0.4	$ 0.76	$ 0.0	$ 0.8	$ 0.16	1.43	$ 2.1	$ 0.175	$ 2.28	$ 0.13	1.00	$1.3	$ 0.09	1.00	$0.9	$ 0.07	1.00	$0.7
USACE Commercial Pay	$ 30.1	0.03	$ 8.8	$ 0.0	$ 8.8	$ 21.7	0.0	$ 0.0	$ 0.0	$ 0.0	$ 30.0	0.03	$ 9.0	$ 30.0	0.03	$ 9.0	$ 30.0	0.03	$ 9.0
Navy ERP Commercial Pay[7]	N/A	N/A	N/A	N/A	N/A	$1.2	0.0	$0.0	$ 0.0	$ 0.0	$ 2.9	TBD	TBD	$ 2.9	TBD	TBD	$ 2.9	TBD	TBD

Note 1: DHA reports 12 months in arrears; therefore, FY 2013 reporting represents FY 2012 data. The error rate increase resulted from a small number of high-dollar claim errors assessed that significantly affected the annual error rate.

Note 2: DHA uses 2% as its out-year target because that is the contractual performance standard. The FY 2014-2016 outlays estimates were calculated using the OMB CPI-U Annual Averages and Percent Change Table. As DHA reports 12 months in arrears the FY 2013 CPI-U medical percent change was used to calculate the FY 2014 outlay estimates, while the FY 2014 and 2015 medical percent changes were used to calculate the FY 2015 and 2016 outlay estimates respectively.

Note 3: Out-year reduction targets for Mil Pay, Civ Pay, Mil Retirement, and DFAS Commercial Pay represent a continuation of the very low IP rates experienced in FY 2013.

Note 4: DoD Travel Pay includes travel data from DFAS and for the Army, Navy, and Air Force for vouchers paid outside of DTS. Out-year projections reflect the FY 2014 travel pay remediation plan rate further reduced in FY 2015 and FY 2016.

Note 5: DoD Travel Pay represents DFAS and Navy travel vouchers settled from July 2012 through June 2013; for Army and Air Force, there is no quarter lag.

Note 6: Estimated improper payments due to insufficient or missing documentation for the DFAS portion of DoD Travel Pay was 14.4% and for DFAS Commercial Pay was 25%.

Note 7: This is the first year that Navy ERP is reporting for commercial pay; only six months of data is included. Since no improper payments were identified for FY 2013, out-year reduction targets are not applicable.

V. Recapture of Improper Payment Reporting

DTS Compliance Tool

The Department has entered the realm of recapture auditing again in the form of an internally developed tool by the Defense Travel Management Office (DTMO).

In December 2012, the Department established the Travel Policy Compliance Program, mandated by the National Defense Authorization Act for Fiscal Year 2012. Managed by the DTMO, the program was established to ensure travel claims do not exceed reasonable or actual expenses as well as to minimize inaccurate, unauthorized, overstated, inflated, or duplicate travel claims. The Travel Policy Compliance Tool, an automated application, reviews DTS travel vouchers in near real time and identifies potential improper payments. If a potential improper payment is identified, travelers and their AOs are notified via e-mail to either submit a corrected claim or explain why the claim is correct. Service administrators can run reports to review all identified errors and track corrections.

The DTMO Compliance Program not only ensures travel claims are paid in accordance with regulations and assists in recouping funds, but it also mitigates budget cuts for travel, improves post-pay audits, educates travelers and administrators on travel policy, and identifies travel trends, training needs, and opportunities for greater controls in the future.

In December 2012, certain organizations from all four Military Services selectively used the Travel Policy Compliance Tool in a pilot that included three areas of inquiry. In FY 2013, the compliance tool identified 9,746 potential errors totaling $1.5 million. As of September 30, 2013:

- $125,000 in errors were corrected without any funds due back to the Government
- $300,000 in errors were corrected and are awaiting collection
- $140,000 in errors were corrected and the funds have been recovered

The balance of the reimbursement errors (approximately $935,000) was still awaiting re-work by travelers, approving officials, or DTMO on September 30, 2013.

The Department currently is working to expand queries and implement the tool Department-wide. In a July 18, 2013 memorandum, entitled Implementation of the Department of Defense Travel Pay Remediation Plan, the use of the Travel Policy Compliance Tool was mandated for all DTS users. Use of the Compliance Tool provides a mechanism to greatly facilitate DoD's collections and improve our recovery rate. Funds recovered from prior years can be re-allocated for use in current year appropriations in accordance with Public Law 111-204, The Improper Payments Elimination and Recovery Act of 2010.

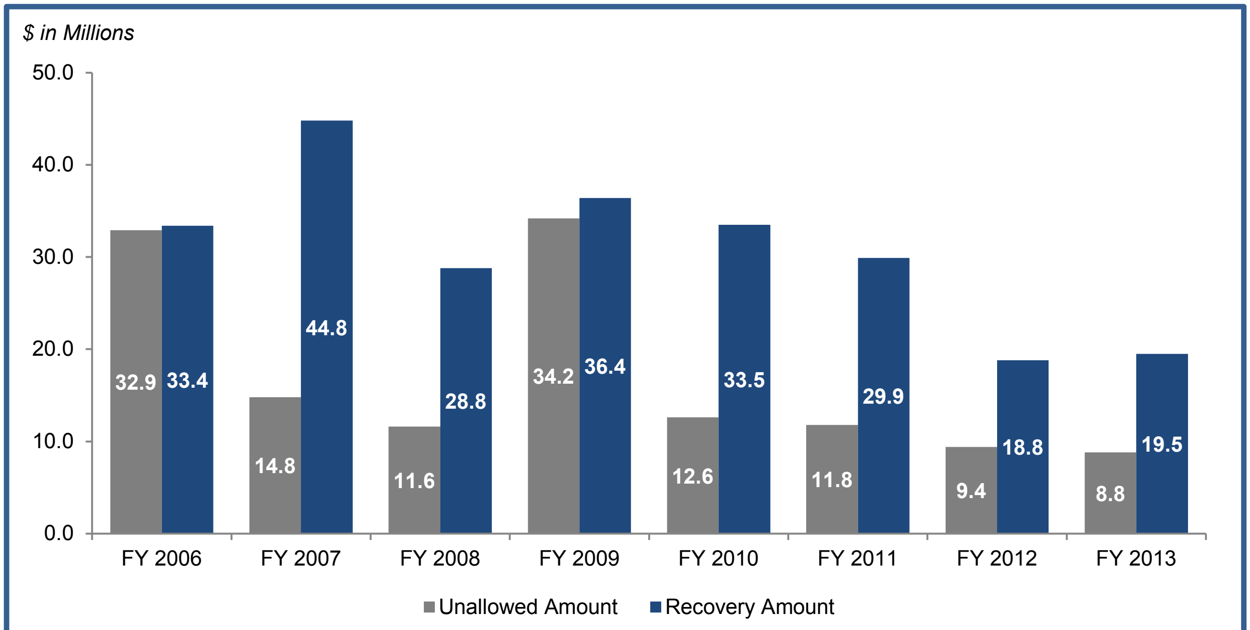
DFAS. In compliance with IPERA, as well as the *Debt Collection Improvement Act of 1996*, the Department uses a number of other methods to prevent, identify, and collect improper payments. For example, DFAS has implemented a Centralized Offset Program (COP) to look across the Defense agencies for opportunities 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 2013, the COP requested and confirmed nearly 800 offsets totaling approximately $10 million.

USACE. The UFC utilizes a data mining tool as part of its post-payment/payment recapture program. This tool searches for 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 searches 100 percent of all USACE commercial payments. The use of a data-mining tool complements the pre-payment system edits built into CEFMS. Payment safeguards include a requirement to match a receiving report with an invoice and thereby prevent use of duplicate invoice numbers for the same obligation.

DHA. The DHA uses a number of different mechanisms to prevent, identify, and collect improper payments, to include claims auditing by an EIC and internal DoD agencies for all private-sector payments. This process utilizes post-payment review techniques, performed internally and by external contractors, paid from the proceeds of recovered funds.

Contract payments comprise a large volume of transactions with high dollar values. Therefore, DHA is vigilant to ensure payment accuracy. In addition to the post-payment reviews, the DHA also utilizes various internal manual and automated prepayment initiatives to prevent overpayments and underpayments. Refer to Figure A-9 to view historical recovery amounts for DHA contractors.

Figure A-9. Historical Recovery Amounts for DHA Contractors



Note: DHA reports 12 months in arrears.

The DHA currently is conducting a pilot study to evaluate its ability to identify and recover funds that are owed from private health care providers, resulting from overpayments that occurred as a result of secondary insurance payment errors. The pilot study will provide an accurate assessment of the potential recoveries and cost effectiveness if a full recovery audit is initiated, and will review ten of the largest-volume institutional providers. The results of the pilot, expected by the end of December 2013, will allow DHA to determine if a full-scale credit balance audit, where the contractor retains a fixed percentage of the recoveries as its fee, would be feasible to award in FY 2014.

Table 5 below summarizes DoD's payment recapture audit efforts from FY 2009 through FY 2013.

Table 5. Payment Recapture Audit Reporting

Program	Type of Payment	Amount Subject to Review (CY)	Actual Amount Reviewed and Reported (CY)	Amount Identified for Recovery (CY)	Amount Recover-ed (CY)	% of Amount Recover-ed out of Amount Identified (CY)	Amount Outstand-ing (CY)	% of Amount Outstand-ing out of Amount Identified (CY)	Amount Determi-ned Not to be Collectab-le (CY)	% of Amount Determi-ned Not to be Collectab-le out of Amount Identified (CY)	Amounts Identified for Recovery (PYs)	Amounts Recover-ed (PYs)	Cumulati-ve Amounts Identified for Recovery (CY+PYs)	Cumulati-ve Amounts Recove-red (CY+PYs)	Cumulati-ve Amounts Outstandi ng (CY+PYs)	Cumulati-ve Amounts Determi-ned Not to be Collectab-le (CY+PYs)
DTMO Compliance Tool (pilot)[1]	Travel	$ 5.3M	$ 5.3M	$ 1.5M	$ 0.44M	29%	$ 1.06M	71%	$0.13M[2]	N/A	N/A	N/A	N/A	N/A	N/A	N/A
USACE[3]	Comm-ercial	$ 21.7B	$ 21.7B	$ 0.0M	$ 0.0M	0%	$ 0.0M	0%	$ 0.0M	0%	$ 59.4M	$ 58.8M	$ 59.4M	$ 58.8M	$ 0.6M	$ 0.0M

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

Note 1: The Defense Travel Management Office's (DTMO) Compliance Tool is in its first year of recovery auditing. It began as a pilot program in December 2012. The tool works strictly with the Defense Travel System (DTS).

Note 2: $125,000 (rounded to $0.13M) in errors were accounted for through voucher correction; therefore, no overpayment had actually occurred and no collection was necessary.

Note 3: USACE uses the Oracle data-mining tool within CEFMS to perform its recovery audit on contract payments.

Table 6 below summarizes DoD's annual targets related to its payment recapture audit efforts for FY 2013 through FY 2016.

Table 6. Payment Recapture Audit Targets

Program	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
DTMO (DTS)[1]	Travel	$ 1.5	$ 0.6[2]	37.7%	TBD	TBD	TBD
USACE	Commercial	$ 0.0	$ 0.0	0.0%	100.0%	100.0%	100.0%

Note 1: DTMO's Compliance Tool was only online part of FY 2013.

Note 2: This amount (rounded) is equal to $.44M recovered + $0.13M that subsequently was substantiated with additional supporting documentation.

Table 7 below presents an aging schedule of overpayments collected outside of efforts of payment recapture audits.

Table 7. Aging of Outstanding Overpayments

Program	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)
DFAS	Commercial[1,2]	$ 3.1	$ 1.3	$ 0.0
Military Retirement	Pension	$ 1.6	$ 0.0	$ 0.0

Note 1: Figures based on overpayments identified and paid during FY 2013.

Note 2: After 120 days, most debts are transferred to Treasury for collection.

Table 8 below presents a summary of how cumulative amounts recaptured have been utilized.

Table 8. Disposition of Recaptured Funds

Program	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
USACE[1]	Commercial	$ 20,000	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0
DTMO (DTS)[2]	Travel	$ 0	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0

Note 1: No overpayments identified; therefore, no funds recovered in FY 2013.

Note 2: As of fiscal year end, no recoveries had been re-allocated to the categories shown in Table 6.

Table 9 below summarizes improper payments identified and recovered outside of payment recapture audits.

Table 9. Overpayments Recaptured Outside of Payment Recapture Audits

Source of Recovery	Amount Identified (CY)	Amount Recovered (CY)	Amount Identified (PY)	Amount Recovered (PY)	Cumulative Amount Identified (CY+PYs)	Cumulative Amount Recovered (CY+PYs)
DFAS Commercial Pay[1]	$ 141.6M	$ 137.2M	$ 156.7M	$ 153.6M	$ 1.7B	$ 1.6B
Military Retirement[2]	$ 19.9M	$ 18.3M	$ 67.4M	$ 63.8M	$ 262.6M	$ 245.6M
Military Pay[3, 4]	$ 258.5M	$ 219.3M	$ 197.3M	$ 146.8M	$ 780.9M	$ 668.8M
Civilian Pay[3]	$ 96.4M	$ 96.4M	$ 81.8M	$ 81.8M	$ 428.5M	$ 428.5M
DoD Travel Pay[5]	$ 3.7M	$ 0.1M	$ 1.9M	$ 0.1M	$ 7.2M	$ 0.3M
USACE Travel Pay[6]	$ 0.7M	$ 0.5M	$ 0.8M	$ 0.8M	$ 1.5M	$ 1.3M
Defense Health Agency (DHA) Health Benefits Contracts[7]	$ 8.7M	$ 19.5M	$ 127.4M	$ 225.6M	$ 136.1M	$ 245.1M

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

Note 1: Overpayments are based on the date payment was made or debt incurred. Prior year amounts shown in the OMB Max database do not reflect further collections or adjustments made in subsequent fiscal years.

Note 2: FY 2013 amounts identified and recovered are based on 100 percent review of deceased retiree and annuitant accounts. Recoveries normally run 90 days behind; therefore, FY 2013 recoveries will not be completed until December 31, 2013.

Note 3: In-service collection dollars are used as a proxy for recovery amounts because actual results from statistical reviews are negligible.

Note 4: Recoveries provided in CY for Military Pay include out-of-service debt collections. Because debt recoveries are tracked for 12 months for AFR purposes, collections may not be realized until the end of FY 2014.

Note 5: $569K in overpayments are not collectible as they were paid to foreign military students or represent individual debts of < $10.

Note 6: The balance of USACE Travel Pay recoveries are in the process of collection through salary offset or have been appealed to the Civilian Board of Contract Appeals for final determination.

Note 7: DHA contract improper payments and recoveries are reported 12 months in arrears to accommodate its 100 percent post-payment review.

VI. Accountability

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

Certifying Officer Legislation, *10 U.S.C. 2773a,* holds Certifying and Disbursing Officers accountable for government funds. In accordance with this law, 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 captured in the *DoD Financial Management Regulation, Volume 5, Chapter 33*, entitled "Certifying Officers, Accountable Officials, and Review Officials." The Department's 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".

The DoD FMR contains other policies that specifically address Improper Payments (*Volume 4, Chapter 14*) and Recovery Auditing (*Volume 10, Chapter 22*). Beginning in Quarter 3, FY 2013, all reporting DoD Components were required to download their improper payment reports to the DFAS ePortal. This centralized electronic system allows the reporting Components to access improper payment information without regard to the time zone in which they are located. More importantly, it allows management to ensure all Components' submissions are timely and accurate.

Travel Pay Improper Payment Remediation Plan. The Department lost its IPERA compliance determination, conferred by the DoDIG for the FY 2011 Improper Payment Reporting (*DoDIG Report No. D-2013-054*), because DoD did not meet its FY 2012 Travel Pay improper payment reduction target. In accordance with IPERA requirements, the Department developed a remediation plan to help Components significantly reduce erroneous travel voucher submissions and associated approving official errors. All Defense Components submitted training plans to the Deputy Chief Financial Officer for approval, as he serves as the DoD Senior Accountable Official for Travel Pay improper payment remediation. Because the vast majority of travel pay errors result from travelers incorrectly completing their vouchers and approving officials failing to catch these errors, which comprise a substantive portion of the errors detected in DFAS' statistical sampling of FY 2012 travel payments, training is now required for all travelers and approving officials every two years.

VII. Agency Information Systems and Other Infrastructure

The Department has much of the information and infrastructure needed to reduce improper payments. The Department uses the BAM tool and the Do Not Pay portal to identify potential improper payments prior to disbursement.

The Department's ongoing migration from a legacy system environment to new ERP systems presents a number of challenges, as well as opportunities, to prevent and detect improper payments. This migration also can enhance the Department's ability to improve its debt collection and recovery auditing abilities. The Department is addressing these areas both from a payment integrity as well as audit readiness perspective.

VIII. Statutory and Regulatory Barriers

The primary barriers in preventing improper payments in Military Pay are the statutory entitlements and regulatory monthly pay scheduled. For DHA collections, there are contractual requirements that allow up to 270 days instead of the standard delinquency deadline of 180 days to be transferred to the Treasury under the Debt Collection Improvement Act of 1996. Other than these, the Department has not identified any further statutory or regulatory barrier to improper payments identification, reporting, reduction, or collection.

IX Additional Information

The Department is positioning itself to be fully compliant with additional elements required by the Improper Payments Elimination and Recovery Improvement Act (IPERA) for FY 2014 reporting. As previously discussed in this report and as reported in the DoD Financial Improvement and Audit Readiness Plan Status Report for November 2013, the Department is working hard to become fully auditable by 2017. As part of this effort, each of the Defense disbursing Components is diligently reviewing and reporting on all payments that are subject to IPERA, and ensuring the processes used are compliant with laws and regulations.

The Department continually looks for opportunities to improve its methodologies, and the post-payment review teams are far from complacent. The Department is implementing recommendations from both the DoD Inspector General's IPERA Compliance Review for FY 2012 (*DoDIG Report No. D-2013-054*) and from the *GAO Report No. GAO-13-227* on improper payments, to guide our progress in our future improper payment efforts.

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