



# Defense Health Program

★★★ Agency Financial Report ★★★

Fiscal Year 2018



# About the Agency Financial Report

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The Defense Health Program (DHP) Enterprise Agency Financial Report (AFR) provides financial and summary performance results enabling the president, Congress, and the American people to assess its accomplishments, and to understand its financial results and operational functions. This AFR satisfies the reporting requirements of the following:

- Federal Managers' Financial Integrity Act of 1982;
- Chief Financial Officers Act of 1990;
- Government Management Reform Act of 1994;
- Reports Consolidation Act of 2000;
- Office of Management and Budget Circular No. A-136, *Financial Reporting Requirements*;
- Improper Payments Elimination and Recovery Improvement Act of 2012;
- Office of Management and Budget Memorandum M-12-12, *Promoting Efficient Spending to Support Agency Operations*; and
- Fraud Reduction and Data Analytics Act of 2015.

The DHP Enterprise chooses to produce an AFR rather than the alternative Performance and Accountability Report. The Annual Performance Report, with detailed performance information that meets the requirements of the Government Performance and Results Modernization Act of 2010 (GPRAMA), will be provided within the Annual Performance Plan and Report and transmitted with the release of the Fiscal Year (FY) 2019 Congressional Budget Justification. The AFR may be viewed online at [www.health.mil/HealthAffairs](http://www.health.mil/HealthAffairs). The AFR consists of three primary sections:

## Management's Discussion and Analysis

Provides a high-level overview of the DHP Enterprise, including its history, mission, and organizational structure; the DHP Enterprise's overall performance related to its strategic goals and primary objectives; management's assurance on internal controls; and forward-looking information.

## Financial Section

Contains financial statements, accompanying notes, required supplementary stewardship information, required supplementary information, as well as the independent auditor's report on the financial statements and management's response to that report.

## Other Information

Details DHP Enterprise's compliance with, and commitment to, specific regulations, including performance and management analyses and recommendations from the Office of the Inspector General, payment integrity reporting results, and the Combining Statement of Budgetary Resources.

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# **I. Management's Discussion and Analysis**



## Agency Head Message



The Military Health System (MHS) and the Office of the Assistant Secretary of Defense (Health Affairs) serve as the Department of Defense's singular entity responsible and accountable for effectively and efficiently maintaining and advancing our dual missions of readiness and health-care delivery for our 9.4 million service member, retiree, and family member beneficiaries.

The MHS prides itself on its commitment to service, and its corporate culture includes a dedication to transparency, especially as we create a more integrated, higher-performing enterprise in light of our significant reforms directed by the Secretary and Congressionally mandated reforms directed by the FY 2017 and FY 2019 National Defense Authorization Acts. The mission of the MHS remains to support the service member, and care for our service member families. The collective goal of military health reforms is a more integrated, efficient and effective system of readiness and health that best supports the lethality of the force. In order to achieve that goal, the MHS must ensure proper controls are in place, that they are functioning as intended, and that we are maximizing our value to

our beneficiaries and to the Department.

The ongoing auditability of the MHS is a priority for each and every member of our team. Each of us directly contributes to our shared mission, regardless of rank or level, and the entire enterprise is committed to achieving an unmodified opinion. We understand it will take everyone's support to improve the reliability and accuracy of our data to enable informed decisions both now and in the future and make the best use of our available resources in order to achieve our strategic goals and objectives. In order to continue our progress towards this goal, we have undertaken corrective actions based on deficiencies and internal control weaknesses that our team has identified. More information regarding the status of the internal control environment within the DHP Enterprise and the steps we are taking to address these issues can be found in the Management Assurance section of this report.

I encourage all of our stakeholders to read this report. It will be clear that the MHS is committed to transparency, efficiency, and effectiveness as we ensure mission alignment with Secretary Mattis' Department priorities to increase lethality, leverage strategic partnerships, and improve our business processes. I thank the staff of the MHS for their tireless dedication and perseverance in delivering these strategic priorities every day, our beneficiaries for their service and being the most deserving customers in the world, and all our stakeholders for their incredible support as we engage in this endeavor.

A handwritten signature in black ink, appearing to read 'Tom McCaffery'.

Tom McCaffery  
*Principal Deputy Assistant Secretary of Defense for Health Affairs*

# Mission and Organization Structure

## History

In 2011, the Deputy Secretary of Defense's Task Force on Reform of the Military Health System led to the creation of the Defense Health Agency (DHA), a Combat Support Agency (CSA) and a component of the Defense Health Program (DHP) Enterprise.<sup>1</sup> On September 30, 2013, the Department of Defense (DoD or the Department) issued a directive formally establishing the DHA as part of the DHP Enterprise, and on October 1, 2015, the DHA achieved full operating capability.

In early 2017, in response to the FY 2017 National Defense Authorization Act (NDAA), the DHA began preparing to assume responsibility for the administration and management of Military Treatment Facilities (MTFs) worldwide. The assumption of these responsibilities will commence on October 1, 2018 and be phased in over a three-year period. The DHA published the FY 2017 Strategic Plan, to communicate its mission, vision, goals and objectives to best support DHP Enterprise's workforce, patients, services, and Combatant Commands (CCMDs).

The FY 2017 NDAA enacted other significant reforms to the DHP Enterprise, including changes to the TRICARE Health Plan and existing internal management structures within the DHA. The centralized administration of the MTFs under the authority, direction and control of the DHA provided the opportunity to improve readiness, standardize and improve the patient experience and lower costs through the elimination of unnecessary redundancies.

The provisions in the FY 2017 NDAA work together to (1) ensure a trained and ready health team to support the Joint Force, (2) deliver an improved experience to MHS beneficiaries, and (3) enable the DHP Enterprise to act as one. The FY 2017 NDAA intends to improve health care for service members, retirees, and their families, while enhancing medical readiness by:

- Improving and maintaining operational medical force readiness
- Enhancing access to high-quality health care
- Improving beneficiaries' health outcomes
- Creating health value
- Modernizing TRICARE support contracts
- Driving efficiencies and eliminating waste
- Demanding performance accountability

## What is the Defense Health Program?

The Defense Health Program itself is an appropriation from Congress, Apportioned by the Office of Management and Budget to the Office of the Undersecretary of Defense (Comptroller) who then allots these funds to the Assistant Secretary of Defense for Health Affairs. The Assistant Secretary of Defense for Health Affairs then issues Funding Authorization Documents (FADs) to fund the seven financial statement reporting components supporting the Military Health System consisting of: U.S. Army Medical Command, The Navy Bureau of Medicine and Surgery, U.S. Air Force Medical Services, Defense Health Agency (FOD), Contract Resource Management Office, the Uniformed Services University of the Health Sciences, and the National Capital Region Medical Directorate. Based on DoD Directive 5136.01, the Assistant Secretary of Defense for Health Affairs exercises authority, direction and control over these entities and directs the use of the Defense Health Program appropriation. These entities are often collectively known as the entities that comprise the Defense Health Program Enterprise (DHP Enterprise).

<sup>1</sup> This will represent the Defense Health Agency once the changes outlined in the FY 2017 NDAA have been implemented.

## **Mission**

The DHP Enterprise's overarching mission is to support a medically ready force and a ready medical force, supporting a more agile MHS. The DHP Enterprise aims to enhance the DoD and our nation's security by providing health care support for the full range of military operations and sustaining the health of all those entrusted to our care. This includes active duty personnel, military retirees, certain members of the Reserve Component, family members, widows, survivors, ex-spouses, and other eligible members. These beneficiaries receive direct care through MTFs, private sector care through TRICARE's civilian provider networks and other authorized TRICARE providers, and prescription and mail order coverage through the TRICARE Pharmacy Program (TPharm).

## **What We Do**

The DHP Enterprise supports the delivery of integrated, affordable, high-quality health services to DoD beneficiaries and is responsible for driving greater global integration of clinical and business processes by:

- Implementing Enterprise Activities with common measurements of outcomes
- Enabling rapid adoption of proven practices, helping reduce unwanted variation, and improving the coordination of care across treatment venues
- Exercising management responsibility for joint shared services and the TRICARE Health Plan
- Acting as the market manager for the National Capital Region (NCR) enhanced Multi-Service Market, which includes Walter Reed National Military Medical Center (WRNMMC) and Fort Belvoir Community Hospital (FBCH)

In support of a cohesive, globally integrated, affordable, and high-quality health services, the DHP Enterprise directs the execution of eleven joint Directorates and manages and administers the following Enterprise Activities (EAs):

- |                                      |                                       |
|--------------------------------------|---------------------------------------|
| • TRICARE Health Plan                | • Facility Management                 |
| • Pharmacy Programs                  | • Budget & Resource Management        |
| • Health Information Technology (IT) | • Research, Development & Acquisition |
| • Education & Training               | • Procurement & Contracting           |
| • Public Health                      |                                       |
| • Medical Logistics                  |                                       |

## How We Accomplish Our Mission

The MHS is a global, comprehensive, integrated system that provides health care to active duty, retired U.S. military personnel and their families, retirees and their families, and certain other beneficiaries. Army, Navy, and Air Force medical professionals help ensure those in uniform are medically ready to deploy anywhere around the globe on a moment's notice.

With over \$50 billion in the unified medical budget and serving 9.4 million active duty personnel, certain reserve component members, retirees and their eligible enrolled beneficiaries, MHS employs more than 147,000 personnel in 51 hospitals, 381 clinics, and 247 dental clinics at facilities around the globe, as well as in contingency and combat-theater operations worldwide. MHS is more than just combat medicine – it is a complex system that globally integrates:

- Health care delivery
- Public health and medical education
- Private sector partnerships
- Cutting-edge medical research and development

MHS is led by the Office of the Assistant Secretary of Defense for Health Affairs under the Office of the Undersecretary of Defense for Personnel & Readiness.



Those of us who work in military health are justifiably proud of how ready the MHS is to respond, not just to the needs of our service members and our TRICARE beneficiaries, but also to the needs of our entire country. – VADM Bono





Figure 1: The DHP MHS by the numbers- 2017<sup>2</sup>

MILITARY HEALTH SYSTEM BY THE NUMBERS- 2017		
TYPE OF CARE	AVERAGE NUMBER PER WEEK	ANNUAL SUMMARY
Inpatient Admissions	<b>Total: 19,274</b>	<b>Total: 1,005,700</b>
	Military Facilities: 4,337	Military Facilities: 226,300
	Network Facilities: 7,133	Network Facilities: 372,200
	TRICARE For Life: 7,804	TRICARE For Life: 407,200
Outpatient Visits	<b>Total: 2,033,402</b>	<b>Total: 106,100,000</b>
	Military Facilities: 793,429	Military Facilities: 41,400,000
	Network Facilities: 657,358	Network Facilities: 34,300,000
	TRICARE For Life: 582,615	TRICARE For Life: 30,400,000
Births	<b>Total: 2,116</b>	<b>Total: 110,394</b>
	Military Facilities: 789	Military Facilities: 41,164
	Network Facilities: 1,327	Network Facilities: 69,230
Prescription Workload	<b>Total: 2,288,296</b>	<b>Total: 119,400,000</b>
	Military Pharmacies: 860,507	Military Pharmacies: 44,900,000
	Network Pharmacies: 442,710	Network Pharmacies: 23,100,000
	Home Delivery: 155,236	Home Delivery: 8,100,000
	TRICARE For Life: 829,843	TRICARE For Life: 43,300,000

## What is TRICARE

TRICARE is the worldwide DoD health care program serving 9.4 million service members (Active and Guard/Reserve) on Active Duty (greater than 30 days) and their families; as well as retirees, their families, survivors, and certain former spouses (<https://www.tricare.mil>). As a major component of the Military Health System (MHS; [www.health.mil](http://www.health.mil)), TRICARE brings together the military hospitals and clinics worldwide (often referred to as “direct care,” usually in military treatment facilities, or MTFs) with network and non-network TRICARE-authorized civilian health care professionals, institutions, pharmacies, and suppliers (often referred to as “purchased care”) to provide access to the full array of high-quality health care services while maintaining the capability to support military operations.

**Health Care Plans:** Starting in January 2018, the DoD offers two health plan options: Prime and Select. TRICARE Prime features a cost-sharing structure similar to a health management organization (HMO) plan. TRICARE Select is a preferred provider organization (PPO) option with an annual enrollment fee. Co-pays for beneficiaries are streamlined and simplified, which may yield some cost savings to the Department. Individuals have access to different levels and types of benefits depending on their beneficiary status. Active duty service members (ADSMs) generally obtain care from MTFs. When necessary, active duty personnel may obtain care from civilian providers at government expense. Family members of active duty personnel as well as military retirees and dependents who are not eligible for Medicare can choose from one of these main options:

- **TRICARE Prime:** Is a managed care option and an HMO like program. It generally features the use of military hospitals and clinics and reduces out-of-pocket cost for authorized care provided outside military hospitals and clinics by

<sup>2</sup> The Defense Health Agency Stakeholder Report 2017

TRICARE network providers. TRICARE Prime is mandatory for active duty services members (ADSMs) and is an option for their family members and certain TRICARE-eligible beneficiaries located in Prime Service Areas (PSAs) in the U.S.

- **TRICARE Select:** Is a self-managed, preferred-provider option for eligible beneficiaries (except ADSMs and TRICARE for Life beneficiaries) not enrolled in TRICARE Prime. TRICARE Select allows beneficiaries to choose their own TRICARE-authorized providers and manage their own health care. (See TRICARE Program Changes below for additional information regarding TRICARE Select).
- **TRICARE Extra:** This is a fee-for-service plan similar to a civilian preferred provider organization (PPO) available to all non-active duty service members. When beneficiaries not enrolled in TRICARE Prime obtain services from TRICARE network professionals, hospitals, and suppliers, they pay the same deductible as TRICARE Standard; however, TRICARE Extra cost shares are reduced by 5 percent. TRICARE network providers file claims for the beneficiary.
- **TRICARE Standard:** This non-network benefit, formerly known as the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS), is open to eligible DoD beneficiaries (except ADSMs). This is a fee-for-service plan that allows beneficiaries to obtain care from any civilian provider and be reimbursed for a portion of the costs after paying co-payments and meeting deductibles. Beneficiaries who are eligible for Medicare Part B are also covered by TRICARE Standard for any services covered by TRICARE but not covered by Medicare.

**Other Plans and Programs:** Some beneficiaries may qualify for other benefit options depending on their location, Active/Reserve status, and other factors. These plans and programs provide additional benefits or offer benefits that are a blend of the Prime and Standard/Extra options with some limitations. Below are the available additional plans:

**TRICARE For Life (TFL):** The TFL was created as wraparound coverage to Medicare-eligible military retirees by Section 712 of the Floyd D. Spence National Defense Authorization Act for FY 2001 (P.L. 106-398). TFL functions as a secondary payer to Medicare, paying out-of-pocket costs for medical services covered under Medicare for beneficiaries who are entitled to Medicare Part A and who have Medicare Part B based on age, disability, or end-stage renal disease (ESRD). TFL serves as the final payer for Medicare Covered Benefits, and first payer for TRICARE benefits that are not covered in the Medicare, or other health care insurance programs.

**TRICARE Prime Remote (TPR) and TRICARE Prime Remote for Active Duty Family Members (TPRADFM):** Provides TRICARE Prime like benefits to ADSMs and family members who reside with the TPR enrolled sponsor in remote location in the U.S, usually more than 50 miles or 1-hour drive, from a military hospital or clinic.

**TRICARE Prime Overseas (Remote/Non-Remote):** A TRICARE Prime option offered in remote and non-remote overseas locations for permanently assigned active duty service members or Guard/Reserve members and their command sponsored dependents to receive care from a network of licensed, qualified physicians. Beneficiaries enrolled in Prime Overseas will be assigned an MTF PCM. There are no out-of-pocket costs as long as care is received from the PCM or with a referral. Care received without a referral is subject to POS fees.

**TRICARE Overseas Program (TOP) Standard:** Provides comprehensive coverage in all overseas areas. This plan allows beneficiaries to seek care from any civilian provider, although prior authorization may be needed from the overseas contractor. Costs vary based on the sponsor's military status. Beneficiaries will be reimbursed for a portion of the costs after paying co-payments and meeting deductibles.

**Effective January 1, 2018, the TOP Standard was replaced by TOP Select, an enrollment-based plan. See below for additional information on the TOP Select plan.**

**TRICARE Reserve Select:** A premium-based TRICARE health plan available for purchase by qualified members of the Selected Reserve and their qualified survivors; delivers the TRICARE Select benefit with cost-sharing at the Group B retiree level.

**TRICARE Retired Reserve:** A premium-based TRICARE health plan available for purchase by qualified members of the Retired Reserve and their qualified survivors; delivers the TRICARE Select benefit with cost-sharing at the Group B active duty family member level.

**TRICARE Young Adult Program (TYA):** A premium-based health plan that implements NDAA of FY 2011, allowing coverage for adult children until age 26 comparable to the Patient Protection and Affordable Care Act of 2010 requiring civilian health plans to offer such coverage.

**Dental Benefits:** Includes the TRICARE Dental Program (TDP), the TRICARE Retiree Dental Program (TRDP), and the Active Duty Dental Program (ADDP). The TDP and TRDP offer access to a worldwide dental benefit to active duty family members and retired service members and their family members. The TDP and TRDP are premium-based programs with the Government contributing a portion of the premium for certain plan types, however, effective December 31,

2018 the TDP and TRDP programs will end replaced by the Federal Employees Dental and Vision Insurance Program (FEDVIP) effective January 1, 2019. <https://www.opm.gov/healthcare-insurance/dental-vision/>

The ADDP provides private sector dental care to ADSMs who are unable to receive required care from a military dental treatment facility in order to ensure dental health and deployment readiness for ADSMs.

**Pharmacy Benefits:** Provides prescription drug coverage through military pharmacies, TRICARE Pharmacy Home Delivery, and TRICARE retail network and non-network pharmacies. The TRICARE Pharmacy Program is available to all TRICARE-eligible beneficiaries registered in the Defense Enrollment Eligibility Reporting System (DEERS), except those enrolled in the Uniformed Services Family Health Plan (USFHP) who are also eligible for the same pharmacy benefits that are provided under the USFHP plan.

**Uniformed Services Family Health Plan (USFHP)/Designated Providers Program (DPP):** Provides the full TRICARE Prime benefit, including pharmacy, under capitated payment to non-Active duty DHP Enterprise enrollees at six statutory specified locations: Washington, Texas, Maine, Massachusetts, Maryland, and New York.

**Clinical and Education Services Demonstration Programs:** Examples include chiropractic care, autism services, and TRICARE Assistance Program.

**Continued Health Care Benefits Program (CHCBP) and Transitional Assistance Management Program (TAMP):** Provides a Consolidated Omnibus Budget Reconciliation Act-like benefit.

### TRICARE Program Changes in 2018

In fulfillment of section 701 of the FY 2017 NDAA, the DoD implemented the most sweeping changes to the TRICARE benefit structure since TRICARE was established in 1995. Contract management adjusted to synchronize these changes with the DoD's transition to the TRICARE 2017 contracts and regional oversight. The TRICARE changes expand beneficiary choice, improve access to network providers, modernize beneficiary cost-sharing, and enhance administrative efficiency.

#### TRICARE Select.

Named by Congress "TRICARE Select", this single plan features an enrollment requirement for purchased care with non-network and network care. All TRICARE beneficiaries in December 2017 were enrolled in their TRICARE plan effective January 1, 2018. TRICARE Prime enrollees remained in TRICARE Prime, while TRICARE Standard and Extra beneficiaries were automatically enrolled in TRICARE Select. No referral or authorization is needed for TRICARE Select enrollees to obtain care from any TRICARE-authorized providers and fixed-fee copayments apply for most network care in TRICARE Select after the annual deductible is met. Fixed-fee copayments apply for most network care in TRICARE Select after the annual deductible is met. Non-enrolled beneficiaries may only receive care at a military clinic or hospital on a space-available basis; non-enrollment means no coverage for civilian care. TRICARE beneficiaries enrolled to TRICARE Select and residing overseas have the same enrollment fees as those TRICARE Select beneficiaries residing in the 50 United States (U.S.) and the District of Columbia.

#### During Calendar Year 2018

Calendar year 2018 has been a transition year with a grace period for enrollment. The first year of TRICARE Select implementation is treated as a transition year with beneficiaries being permitted to make coverage changes from the beginning of the year through the first open season, which is offered fall 2018. An annual open enrollment period (November – December 2018) will be established, when beneficiaries are free to change or enroll in TRICARE Prime or TRICARE Select for coverage effective January 1, 2019.

### How TRICARE Is Administered

As the administrative agency for TRICARE, the DHP Enterprise serves as program manager for the TRICARE health plan. DHP Enterprise manages the execution of policy as issued by Office of the Assistant Secretary of Defense for Health Affairs (OASD (HA)) and the oversight, payment, and management of private sector care administered by contracted claims processors. DHP Enterprise also monitors the identification, recovery, and reporting of improper payments under the TRICARE program as required by Improper Payments Information Act (IPIA) and as amended by the Improper Payments Elimination and Recovery Act (IPERA) and Improper Payments Elimination and Recovery Improvement Act (IPERIA). DHP Enterprise also manages the dental program, Uniformed Services Family Health Plans and pharmacy programs (retail and mail order), and Medicare-Eligible Retiree Health Care Fund (MERHCF).

TRICARE is administered on a regional basis, with two regional private sector contractors in the United States. Outside of the United States, a pharmacy contractor and active duty dental and overseas contractors work with their TRICARE Regional Offices (TROs) to manage purchased care operations and coordinate medical, dental, and pharmacy services available through civilian health care providers within and outside of the MTFs. The TROs and various other DHP Enterprise Program Offices do the following:

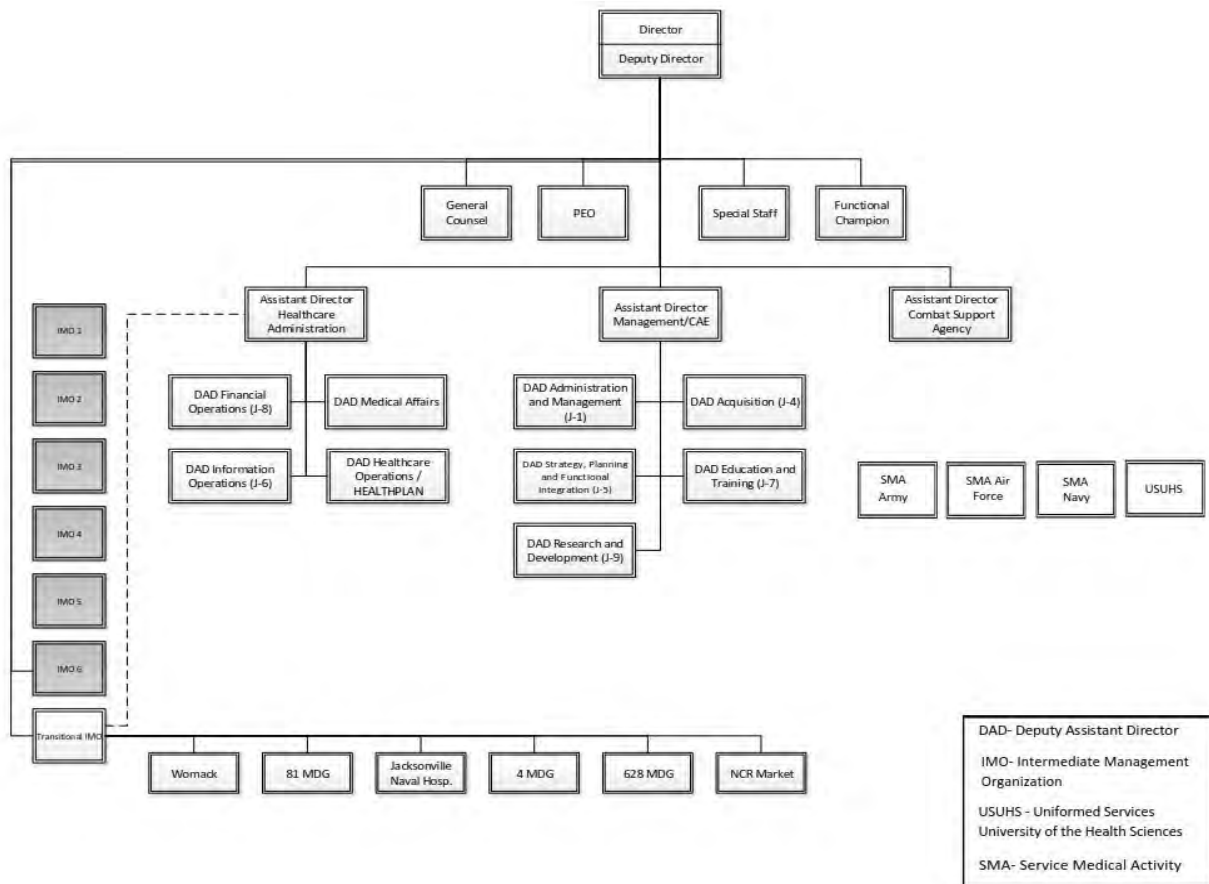
- Provide oversight of regional operations and health plan administration
- Manage the contracts with regional contractors
- Support MTF Commanders
- Develop business plans for areas not served by MTFs (e.g., remote areas)

The DHP Enterprise continues to meet the challenge of providing the world's finest combat medicine and aeromedical evacuation, while supporting the TRICARE benefit to DoD beneficiaries at home and abroad. Since its inception more than a decade ago, TRICARE continues to offer an increasingly comprehensive health care plan to uniformed services members, retirees, and their families. As DHP Enterprise aggressively works to sustain the TRICARE program through good fiscal stewardship, it also refines and enhances the benefits.



## Organizational Structure

Figure 2: DHP Enterprise organization chart<sup>3</sup>



<sup>3</sup> SMAs are still direct reports to the Military Departments.

Figure 3: Defense Health Program O&M DHP Enterprise

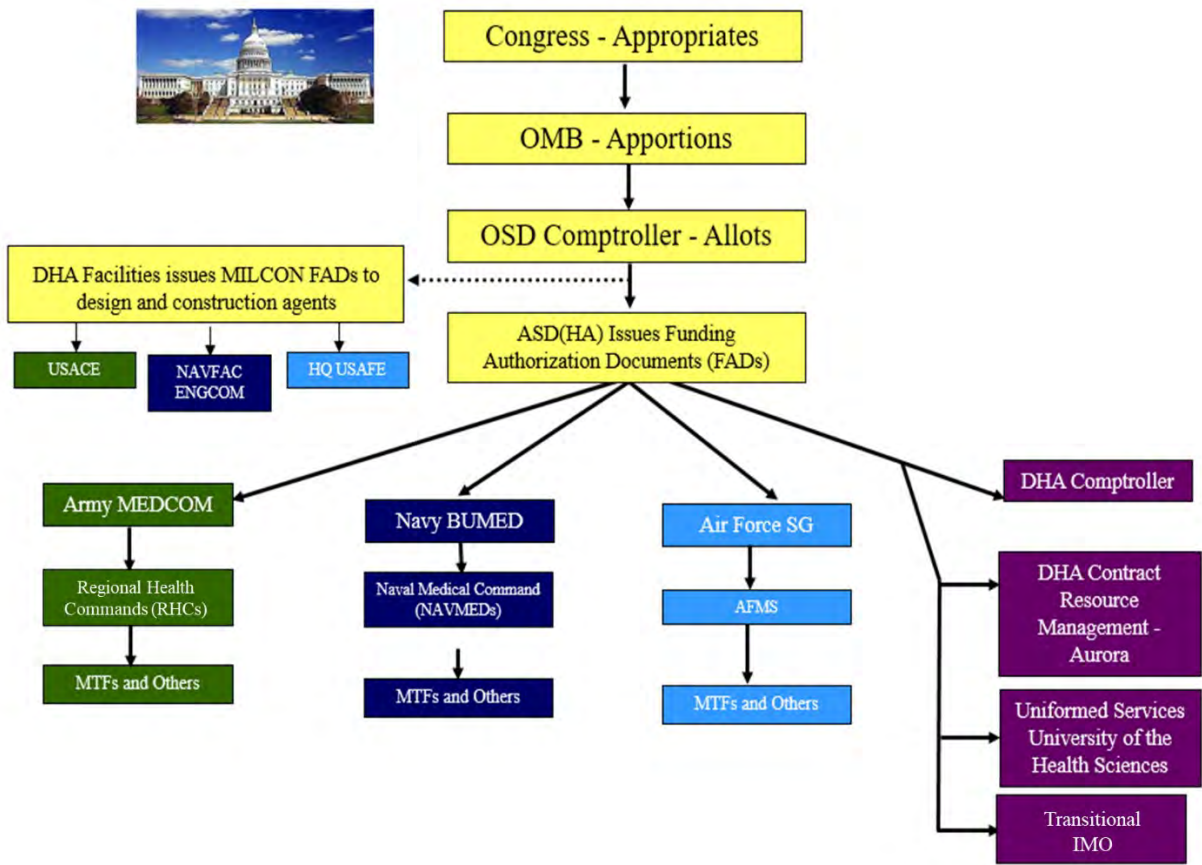
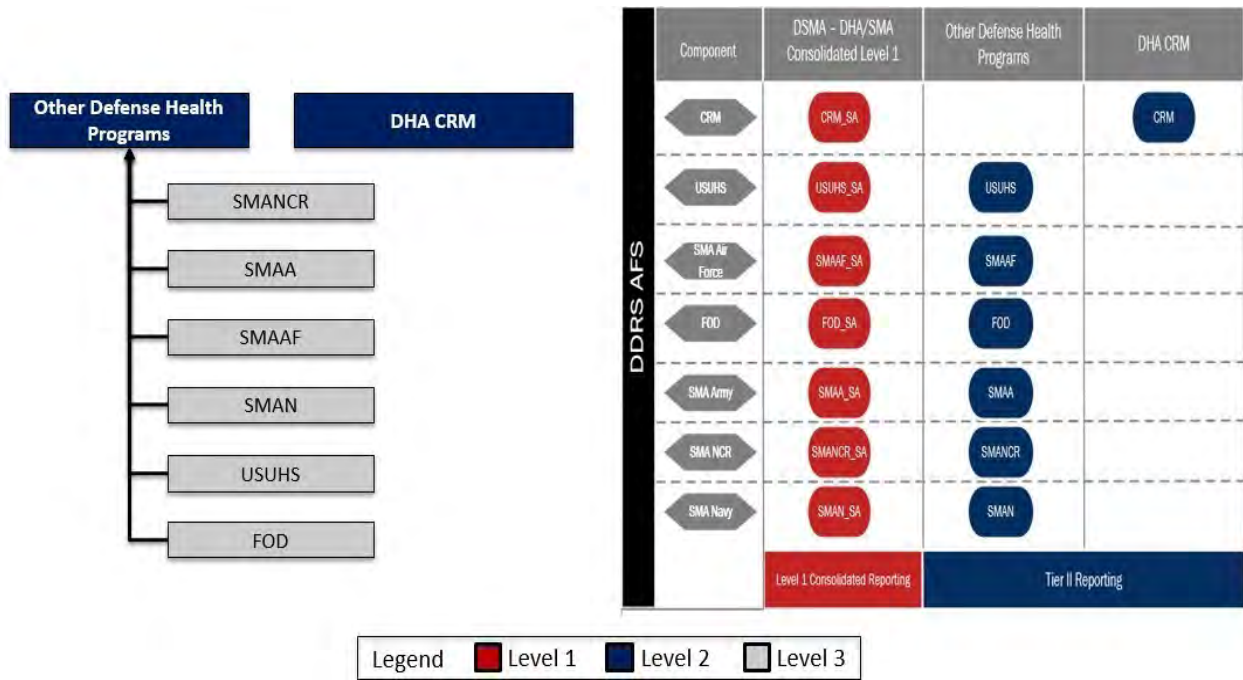


Figure 4: DHP Enterprise Defense Department Reporting System (DDRS) Audited Financial Statement (AFS) Compilation Structure



## Integrated Components of DHP Enterprise

DHP Enterprise is made up of seven components:

- **U.S. Army Medical Command (Army MEDCOM):** Army MEDCOM provides sustained health services and research in support of the total force to enable readiness and conserve the fighting strength while caring for soldiers for life and their families. As the Army is foundational to the Joint Force, Army MEDCOM is foundational to the Joint Health Services Enterprise. Army MEDCOM maintain the diversity and depth to respond to our nation's most demanding expeditionary missions. Army MEDCOM must ensure the health readiness of the force and maintain responsive medical capabilities to support the Army's three strategic roles: preventing conflict, shaping the strategic security environment, and winning in ground combat.
- **The Navy Bureau of Medicine and Surgery (Navy BUMED):** Navy Medicine is a global health care network of 63,000 personnel who provide health care support to the U.S. Navy, Marine Corps, their families, and veterans in high operational tempo environments, at expeditionary medical facilities, medical treatment facilities, hospitals, clinics, hospital ships, and research units around the world. Navy Medicine is led by the Navy Surgeon General, with headquarters in the Navy BUMED in Falls Church, Virginia. The Navy Medicine team of physicians, dentists, nurses, corpsmen, allied health providers, and support personnel also work in tandem with the Army and Air Force medical personnel and coalition forces to ensure the physical and mental well-being of service members and civilians. This care is provided via the Defense Health Program and coordinated by the Office of Assistant Secretary of Defense (Health Affairs) with support from the Defense Health Agency.
- **U.S. Air Force Medical Service (AFMS):** The AFMS mission is to ensure medically fit forces, provide expeditionary medics, and deliver trusted care to all it serves. The AFMS vision is for its supported population to be the healthiest and highest-performing segment of the U.S. population. Air Force Medics work for Line of the Air Force, which entails them to be mission-focused. AFMS supports benefit execution and readiness to provide: Healthy/fit force, resilient families, and trained medics. Air Force Warrior Medics...Mission Focused, Excellence Driven.
- **Defense Health Agency (DHA or the Agency):** The DHA was formed October 1, 2013, as a joint, integrated combat support agency to enable the Army, Navy, and Air Force medical services to provide a medically ready force and ready medical force to CCMDs in both peacetime and wartime. DHP Enterprise leads the MHS integrated system of readiness and health to deliver the MHS Quadruple Aim: increased readiness, better health, better care, and lower cost. The DHA oversees the execution of the \$33.4 billion Defense Health Program to support the delivery of integrated, affordable, and high-quality health services to the DoD's 9.4 million eligible beneficiaries. The DHA is responsible for driving greater integration of clinical and business processes across the contracted health care networks and MTFs. The DHA respects the core values its staff brings to the Agency while upholding an organizational culture that operates by six guiding principles of transparency, accountability, leading change, empowerment, nurturing, and being team oriented.
- **Uniformed Services University of the Health Sciences (USUHS):** The mission of USUHS is to educate, train, and comprehensively prepare uniformed services health professionals, scientists, and leaders to support the Military and Public Health Systems, the national security and national defense strategies of the United States, and the readiness of our Uniformed Services. Located in Bethesda, Maryland, USUHS educates and trains outstanding physicians, advanced practice nurses, dentists, allied health professionals, scientists, administrators, and military leaders who are dedicated to career service and leadership in the DoD, United States Public Health Service, and across the U.S. government. By the end of calendar year (CY) 2021, the vision for the Uniformed Services University of the Health Sciences will be widely recognized as the pre-eminent national educational institution for the creation of career uniformed services leaders in the health sciences who are prepared to serve the nation. USUHS will be a focal point for the Uniformed Services in health-related education and training, research and scholarship, leadership development, and support to operational military units around the world. Each USUHS graduate will be a health professional and leader prepared with an outstanding health education, inter-professional health training, leadership training, and a deep and abiding commitment to selfless service, the uniformed services ethos, and the security of the United States.
- **National Capital Region Medical Directorate (NCR MD):** The NCR MD is a Joint Tri-Service network of healthcare facilities that provide a medically ready force and ready medical force to CCMDs in both peacetime and wartime. The NCR MD supports the delivery of integrated, affordable, and high-quality health services and is responsible for driving greater integration of clinical and business processes across the national capital region. NCR MD is a subordinate organization of the DHP Enterprise and was officially established as a Financial Statement Reporting Entity (FSRE) on October 1, 2013. The FSRE combines the funding activity of FBCH, WRNMMC, Joint Pathology Center (JPC), and various

other clinics within the Greater Washington D.C. Area. The NCR MD mission proudly states they are the Flagship of our MHS. They ensure patient friendly access to high quality health care for all they are privileged to serve, while setting the standard in Readiness, Education and Research. The NCR MD vision leads them to believing the patient will be at the center of all that they do. The extraordinary will be ordinary and the exceptional routine in serving the physical, behavioral, social, and spiritual needs of their patients and of their people.

- **Contract Resource Management Office (CRM):** The CRM Office in Aurora, Colorado, is responsible for the accounting, financial support, and financial reporting for TRICARE's centrally funded private sector care programs and the TRICARE Retail Pharmacy Refunds Program. The CRM provides budget formulation input, carries out budget execution, and prepares component financial statements and footnotes. In addition, CRM is responsible for processing invoices received electronically from its contractors and through the TRICARE Encounter Data Set (TEDS), and reporting these transactions through accessible electronic media. CRM provides funding availability certification and financial program tracking for the centrally funded private sector care programs and monitors budget execution through analysis of current year and prior year's spending and program developments. It also assists DHP Enterprise's Contract Management, Program Integrity (fraud), and Case Recoupment division activities related to private sector care. CRM uses DHP funds provided by annual appropriations from the Congress of the United States to reimburse private sector health care providers for services rendered to TRICARE beneficiaries and funding from MERHCF for the health care provided through TRICARE For Life programs.

The DHP Enterprise audit opinion includes the results of CRM's audit. CRM has maintained an unmodified audit opinion as a result of the audit of its FY 2018 financial statements.



# Analysis of Performance Goals, Objectives, and Results

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## Overview

The Defense Health Program funds the MHS under the policy direction and guidance of the Assistant Secretary of Defense for Health Affairs. In 2009, the MHS adopted the Quadruple Aim of increased readiness, better health, better care, and lower cost for all components funded by the program. The Quadruple Aim provides direction for each of the MHS components and ensures alignment to the National Defense Strategy. The MHS, including DHA, the Service Medical Departments, and USUHS develop strategies within their organizations to achieve these four aims. The Quadruple Aim is defined as:

- **Increased Readiness** means ensuring that the total military force is medically ready to deploy and that the medical force is ready to deliver support health services anytime and anywhere in support of the full range of military operations, including on the battlefield or disaster response and humanitarian aid missions.
- **Better Health** is realized by reducing the generators of disease and injury, encouraging healthy behaviors, increasing health resilience, decreasing the likelihood of illness through focused prevention, and improving the health of those with chronic illness.
- **Better Care** advances health care services that are safe, timely, effective, efficient, equitable, and patient and family centered. Better care focuses on the health outcomes that matter to patients and their families.
- **Lower Cost** is achieved by focusing on quality, eliminating waste, and reducing unwarranted variation.

Strategic performance against each of the four aims is described below. Performance assurance, plans to achieve missed targets, reporting limitations, and the future state of performance measurement follow.

## Increased Readiness

The MHS exists to provide medical and health support to the Uniformed Service Members of the United States for war, combat, humanitarian aid, and disasters. A medically ready fighting force is physically ready to go into combat or support a full range of military operations across the world. A ready medical force has the knowledge, skills, and abilities to provide combat casualty care and other military-relevant health services, anytime and anywhere.

During the Global War on Terror and resulting wars in Afghanistan and Iraq, the MHS made tremendous improvements in combat casualty care. Since 2001, investment in research and clinical care, "produced the lowest case-fatality rate among combat casualties in the history of armed conflict." At the beginning of Operations Enduring Freedom and Iraqi Freedom, the combat-injuring case fatality rate was 18 percent. That rate steadily decreased to 5 percent while injury severity increased,<sup>4</sup> helped in part by a Joint Trauma System that accelerated the pace of learning across the MHS. Lessons learned were translated to the civilian community.

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<sup>4</sup> "The Laboratory Of War: How Military Trauma Care Advances Are Benefiting Soldiers And Civilians," *Health Affairs Blog*. 2013. DOI: 10.1377/hblog20131218.035947

In April 2018 the Assistant Secretary of Defense for Health Affairs determined critical readiness measures (Table 1). These measures will be developed, tested, and implemented for FY 2019.

**Table 1:** FY 2019 Military Health System core measures, readiness subset, current as of May 7, 2018

Quadruple Aim	Measure	Development Status
Readiness	Individual medical readiness	Currently used
Readiness	Percent of providers meeting knowledge, skills, and abilities for general surgery	In testing
Readiness	Percent of providers meeting knowledge, skills, and abilities for orthopedic surgery	In testing
Readiness	Active duty access for primary and specialty care	Under development
Readiness	Success in meeting request for forces rate and other validated service personnel requirements	Under development
Readiness	Percent of fill against authorized billets	Under development
Readiness	Base or Operating Commander assessment of health services support	To be developed
Readiness	Defense Readiness Reporting System	To be developed
Readiness	Residency review committee (Accreditation Council for Graduate Medical Education (ACGME)) pass rate	To be developed
Readiness	Integrated disability evaluation system cycle time	To be developed

## Better Health

Measuring health outcomes is a newer, less developed field across the health care industry. The MHS is exploring the applicability of patient-reported outcomes. New evidence illuminates the power of patient-reported health outcomes to inform clinical decisions and processes that are more patient-centric than traditional process measures.<sup>5</sup>

The DoD fielded the Centers for Disease Control and Prevention's Health-Related Quality of Life measure in 2016 beneficiary survey. This metric measures self-reported well-being and number of days lost of illness or injury. The measure data is collected annually and will be ready for use by FY 2019 after three years of data collection to establish a baseline for the military.

Tobacco use and obesity are leading drivers of early mortality and poor health in the United States, potentially decreasing the medical readiness of the military force. The DoD developed health-related measures associated with tobacco use, cessation, and obesity for use in FY 2019. The medical community provides tools and programs to help patients achieve an optimal weight and live tobacco-free.

<sup>5</sup> Weldring T, Smith SMS, "Patient-Reported Outcomes and Patient-Reported Outcome Measures," *Health Serv Insights*. 2013; 6:61-68. DOI: 10.4137/HSI.S11093

## Better Care

Patient-centric improvements were made to health care delivered by TRICARE programs. There were specific improvements in access, evidenced-based quality of care, and preventable harm events. The measures and longitudinal performance are presented in Table 2, below.<sup>6</sup>

**Table 2:** Quality of health care services performance in the Military Health System as of September 2017

Measure Name	Current Performance	Refresh Date	Performance	Longitudinal Time Period
Risk-adjusted mortality	0.97 standard mortality ratio	December 2017	0.99 to 0.97; positive improvement	September 2016 to December 2017
Recommend hospital	77.57% recommend	December 2017	75.43% to 77.57%; positive improvement	June 2016 to December 2017
Provider communication	85.93% satisfaction with outpatient provider	December 2017	79.00% to 83.14%; positive improvement	June 2014 to December 2017
Diabetes A1c testing	92.30% 18–75 with diabetes tested	March 2018	89.71% to 92.30%; positive improvement	January 2013 to March 2018
Low back pain	82.53% with low back pain not imaged	November 2017	75.13% to 82.53%; positive improvement	January 2016 to March 2018
Children with pharyngitis appropriate testing	92.41% 3–18-year-olds tested and prescribed an antibiotic	March 2018	82.55% to 92.41%; positive improvement	January 2016 to March 2017
Breast cancer screening	76.76% 52–74-year-old women with screening in past 27 months	March 2018	73.91% to 76.76%; positive improvement	January 2013 to March 2018
Cervical cancer screening	80.77% 24–64-year-old women with screening in past 3 years	March 2018	83.17% to 80.77%; declining performance	January 2013 to March 2018
Colon cancer screening	76.21% 51–75-year-old screened past 2 years	March 2018	72.78% to 76.21%; positive improvement	January 2013 to March 2018
Seven-day mental health follow-up	77.66% seen within 7 days post-discharge	October 2017	64.25% to 77.66%; positive improvement	January 2013 to October 2017
All cause readmissions	0.87 out of 1.00; benchmarked to HEDIS	February 2018	0.92 to 0.87; positive improvement	June 2014 to February 2018
Well child	89.36% at 15 months with 6+ well child visits	March 2018	77.03% to 89.36%; positive improvement	January 2013 to March 2018
IQI #33 primary cesarean section	13.09% first-time delivery without hysterectomy	September 2017	16.05% to 13.09%; positive improvement	March 2016 to September 2017
Postpartum hemorrhage	2.85% women who delivered, diagnosed with hemorrhage	September 2017	2.43% to 2.85%; declining performance	March 2016 to September 2017
Unexpected newborn complication	4.23% of babies without pre-existing conditions with complications	September 2017	5.34% to 4.23%; positive improvement	March 2016 to September 2017

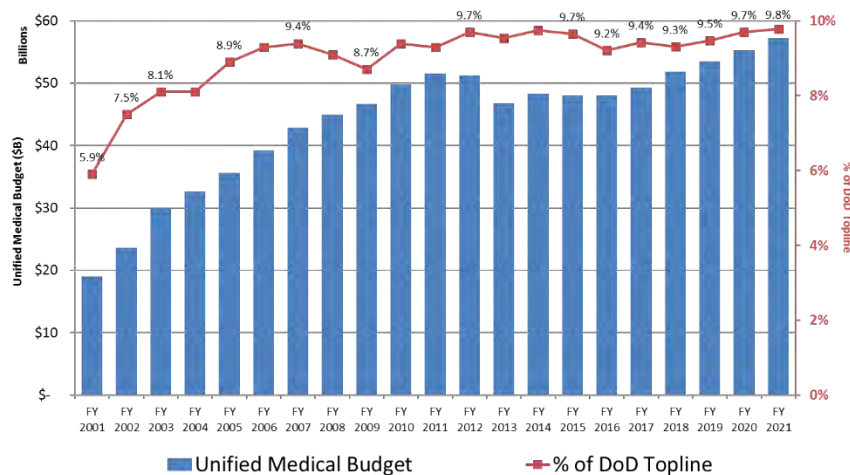
Red denotes significantly below target, yellow/amber below target, green on target, and blue exceeding target. For more information about measures, methodology, and performance visit <https://carepoint.health.mil>.

<sup>6</sup> Performance data presented from FY 2017 is as of September 2017.

## Lower Cost

The U.S. Department of Health and Human Services reports that health care expenditures rose from 5.0 percent of GDP in 1960 to 17.4 percent of GDP in 2013.<sup>7</sup> The rise in health care costs to the DoD is commensurate with the private sector in the United States. The Unified Medical Budget as a total percent of the total Defense budget is 9.3 percent for FY 2018 (Figure 5). The MHS managed to slow the accelerating rate of health costs with greater centralization of processes and decision-making, including more robust enterprise-supporting shared services. Health care cost containment is a priority for the DoD. However, Defense Health Program activities are inextricably linked to the civilian health care market.

**Figure 5: Military medical costs as a percentage of the Department of Defense budget**



*In Fiscal Year 2018, the Unified Medical Budget topped US \$50 billion. These costs include health care for active duty service members, reservists, activated guard, family members, military retirees, and other secretarial designee.*

The Military Health System tracks monthly per member per month costs. The goal is a 2.0 percent increase per year, a target benchmarked against the Henry J. Kaiser Family Foundation's optimal rate of health care cost increase year over year in the United States. Per member per month rate increase for beneficiaries was 1.25 percent in 2017. Total cost per member per month is \$346.65 as of September 2017.

Pharmaceutical costs drive a considerable portion of health care spending in the United States. As with overall expenditures as a percent of GDP, the DoD is comparable with regard to this. The Department measures pharmaceutical costs from inpatient facilities, retail pharmacies, and mail-order pharmacies, with retail pharmacies being the primary drivers of spending. Retail pharmacies are a primary driver of the increased cost of health care and 24.1 percent of pharmaceuticals were filled in retail pharmacies in January 2018, exceeding performance targets of a 43 percent decrease in retail pharmacy costs.

## Performance Information Assurance

The MHS performance data is stored and retrieved in a standardized, controlled process from the MHS Data Repository. The repository, in turn, is accessed through the MHS Mart (M2). These systems are automated with data pushed directly from the legacy electronic health records such as Composite Health Care System and Armed Forces Health Longitudinal Technology Application. MHS GENESIS, the new commercial off the shelf Cerner electronic health record, will integrate with the repository or another platform with similar functionality.

<sup>7</sup> Caitlin AC, Cowan CA. *History of Health Spending in the United States, 1960-2013*. US Department of Health and Human Services/Centers for Medicare and Medicaid. 2015.



Strategic data, trends, and information are populated on an interactive, web-based platform called CarePoint, accessible at <https://carepoint.health.mil>. Data is available to all with a DoD Common Access Card. The data cannot be altered by those viewing the dashboards. The Partnership for Improvement Steering Committee controls the algorithms and benchmarks developed against standard best practices in the health care industry (e.g., Healthcare Effectiveness Data and Information Set, National Surgical Quality Improvement Program).

Analysts in the field also pull data from the M2, although it is for specific data calls at the request of their commands. M2 training is centralized by the DHP Enterprise, ensuring a common lexicon and data dictionary across the MHS.

Three measure sets represent current strategic performance: (1) Fiscal Year 2018 MHS Core Measures; (2) Quadruple Aim Performance Plan Measures; and (3) National Defense Authorization Act for Fiscal Year 2017, Section 702-related Transition Measures. In FY 2019, the strategic measure sets will merge into one core dashboard, streamlining decision-making and decreasing potential for performance data misinterpretation. The single set will be the Fiscal Year 2019 MHS Core Measures.

The Assistant Secretary of Defense for Health Affairs hosts an MHS Review and Analysis meeting on a recurring basis, analyzing performance trends across the enterprise with representation from the Army, Navy, Air Force, DHP Enterprise, Joint Staff, and Uniformed Services University of the Health Sciences. Monthly, the Military Deputies Action Group with senior leader representation from each component and the Office of the Secretary of Defense review enterprise performance. A full evaluation of the program is delivered to Congress annually.

### **Plans to Achieve Missed Targets**

In June 2016, the Assistant Secretary of Defense for Health Affairs issued policy to improve in four domains, referred to as MHS Process Improvement Priorities: (1) achieve zero patient harm, (2) improve condition-based quality care, (3) improve access, and (4) increase effectiveness and efficiency of the direct care platform. The MHS continues to work towards achieving targets in the Process Improvement Priorities (Table 3).

**Table 3.** MHS Process Improvement Priorities and associated performance measures. Measures are reviewed monthly by the Medical Deputies Action Group

Quadruple Aim	Process Improvement Priority	Measure
Better Care	Achieve Zero Patient Harm	Central line-associated bloodstream infection standardized infection ratio
		Wrong site surgery
		Unintended retained foreign objects
	Improve Condition Based Quality Care	Diabetes A1c Testing
		Low back pain
		Children with pharyngitis
	Improve Access	24-hour appointments
		Future appointments
		Secure messaging enrollment
		Getting care when needed
		Specialty referral to book
		Specialty booked to appointment
Lower Cost	Increase effectiveness and efficiency of the direct care platform	Active duty specialty care provider efficiency

Process Improvement Priorities will be folded into Quadruple Aim Performance Plans as the DHP Enterprise assumes management and administration responsibilities for military medical treatment facilities. DHP Enterprise management echelons will create and execute an annual plan (i.e., Quadruple Aim Performance Plans) to achieve the MHS Quadruple Aim using seven critical initiatives directed by the DHP Enterprise:

1. Increase deployability
2. Improve medical force readiness
3. Encourage healthy behaviors
4. Optimize and standardize access
5. Improve condition-based quality of care
6. Achieve zero patient harm
7. Improve effectiveness and efficiency of the direct care platform

The Department is transforming the management of the delivery of health care service to the Clinical Communities model, comprising thirteen clinical domains. Clinical Communities will improve the processes within their respective domains to increase the quality, safety, and outcomes to achieve high reliability.

### Performance Measurement Limitations

A work group, called the Partnership for Improvement, was established following the 90-Day MHS Review in 2014. The group is coordinated by the DHP Enterprise with representation from each MHS component. The group maintains a common platform for enterprise measurement across the MHS. This performance management dashboard became operational in 2015.

The Department is striving to standardize measures across the three military services. Challenges include different measure definitions, difficulty reaching consensus on single measures, and data quality and timeliness. Health care measures in general are often lagging, sometimes outside of the current fiscal year, due to limitations in survey data gathering. Measures from the TRICARE network are limited by availability of data other than claims-based administrative data.

### **Future Performance Management and Accountability**

The NDAA for FY 2017 directs the DoD to streamline the TRICARE health plan for Active Duty, Reservists, and military retirees; transfer authorities related to the management and administration of MTFs to the DHP; and determine an optimal footprint.<sup>8</sup> This transition is expected to reduce the management headquarters burden across the system.

For FY 2019, the MHS core dashboard consists of sixty-four strategic measures, forty of which are retained from the previous iteration of the strategic dashboard and twenty-four of which are new performance measures. Measures remain aligned to the Quadruple Aim. The core dashboard includes Quadruple Aim Performance Plan measures, DoD Reform Management Group measures, and transition measures related to the transition of military medical treatment facility administration and management to the DHP. The new measures are listed below (Table 4).

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<sup>8</sup> Public Law 114-328, Title VII, Health Care Provisions. 114<sup>th</sup> Congress of the United States. 2016.

The Quadruple Aim will not change. The four aims are broad and will stand the test of time; there will always be opportunities to improve readiness, health, care, and cost. The same is true of any health system anywhere in the world, albeit without the added challenge of medical readiness.

**Table 4:** New strategic measures for FY 2019 per the memorandum, "Way Forward for Military Health System Measures for Fiscal Year 2019," signed by the Acting Assistant Secretary of Defense Mr. Thomas McCaffery on May 4, 2018

Quadruple Aim	Measure Name
Increased Readiness	Percent of providers meeting Knowledge, Skills and Abilities (KSAs) for general surgery
	Percent of providers meeting KSAs for orthopedic surgery
	Active duty non-deployability
	Capacity to provide health services for validated request for forces ISO conventional force requirements*
	Capacity to provide health services for validate request for forces ISO non-conventional force requirements*
	Percent of fill against authorized billets
	Defense Readiness Reporting System (DRRS)
Better Health	Health related quality of life (HRQOL)
	Obesity prevalence in adults
	Obesity prevalence in children
	Overweight prevalence in adults
	Overweight prevalence in children
	Smoking cessation
	Tobacco use rate
Better Care	Active duty access for primary care
	Active duty access for specialty care
	Base/operating commander assessment of health services support
	Integrated disability evaluation system (cycle time)
	Residency review committee (ACGME) pass rate
	Joint Commission (accreditation)
	College of American Pathologists (CAP)
Lower Cost	PCM empanelment
	Savings from enterprise shared services and reform initiatives
	Average daily patient load
	Intensive care unit bed days

Measures marked with an asterisk (\*) are counted as one measure, "Request for forces." New measures are expected to be reported, at least in draft, by October 1, 2018. There are twenty four new measures.

## Analysis of Financial Statements and Stewardship Information

The financial statements of DHP Enterprise reflect and evaluate its execution of its mission to provide a medically ready force and a ready medical force to CCMDs in both peacetime and wartime. This analysis summarizes the DHP Enterprise's financial position and results of operations and addresses the relevance of major types and/or amounts of assets, liabilities, costs, revenues, obligations, and outlays.

The principal statements include a consolidated balance sheet, a consolidated statement of net cost, a consolidated statement of changes in net position, and a combined statement of budgetary resources. These principal statements are included in the "Financial Section" of this report. The DHP Enterprise also prepares a combining schedule of budgetary resources within required supplementary information.

### Overview of Financial Position

**Table 5:** Summary of DHP Enterprise's major financial activities in FY 2018.

<b>DHP Enterprise Major Financial Activities</b> <i>(dollars in thousands)</i>	
<b>Net Financial Condition</b>	<b>FY 2018</b>
Fund Balance with Treasury	\$ 20,533,206
Accounts Receivable, Net	1,165,538
Inventory and Other Assets	64,003
Property, Plant, and Equipment, Net	<u>3,725,741</u>
<b>Total Assets</b>	<b><u>\$ 25,488,488</u></b>
Accounts Payable	\$ 1,001,187
Military Retirement and Other Federal Employment Benefits	251,338,190
Accrued Unfunded Annual Leave	335,237
Accrued Funded Payroll and Benefits	215,602
Environmental, Disposal & Other Liabilities	<u>148,617</u>
<b>Total Liabilities</b>	<b><u>\$ 253,038,833</u></b>
Unexpended Appropriations	\$ 19,243,749
Cumulative Results of Operations	<u>(246,794,094)</u>
<b>Total Net Position</b>	<b><u>\$ (227,550,345)</u></b>
<b>Net Program Cost</b>	<b><u>\$ 29,521,822</u></b>
<b>Net Cost of Operations</b>	<b><u>\$ 29,242,709</u></b>
<b>Budgetary Resources</b>	<b><u>\$ 44,101,975</u></b>

Preparing the DHP Enterprise financial statements is a vital component of sound financial management and provides information that is useful for assessing performance, allocating resources, and targeting areas for future programmatic emphasis. The DHP Enterprise's management is responsible for the integrity of the financial information presented in its financial statements. The DHP Enterprise is committed to financial management excellence and maintains a rigorous system of internal controls to safeguard its widely dispersed assets against loss from unauthorized acquisition, use, or disposition. As the DHP Enterprise broadens its global relevance and impact, it will continue to promote local partnerships through delivering assistance by hosting government systems and community organizations.

A summary of the DHP Enterprise's major financial activities in FY 2018 is presented in table 5 at the left. This table represents the resources available, assets on hand to pay liabilities, and the corresponding net position. The net cost of operations is the cost of operating the DHP Enterprise's lines of business, less earned revenue. Budgetary resources are funds available to the agency to incur obligations and fund operations.

## Balance Sheet Summary

### Assets – What We Own and Manage

Total assets were \$25,488,488 thousand as of September 30, 2018. The most significant assets are the fund balance with treasury (FBwT) and property, plant, and equipment, net, which represent 95 percent of total DHP Enterprise's assets. The largest, FBwT, consists of cash appropriated to DHP Enterprise by Congress or transferred from other federal agencies and held in the U.S. Department of Treasury's accounts that are accessible by DHP Enterprise to pay the obligations it incurs.

### Liabilities – What We Owe

Total liabilities of \$253,038,833 thousand as of September 30, 2018, of which \$251,338,190 thousand, or 99 percent, comprises military retirement and other federal employment benefits. These liabilities represent funds calculated by the DoD's Office of the Actuary at the end of each FY using the current active and retired military population plus assumptions (inflation, discount rate, and medical trend) about future demographic and economic conditions.

### Net Position – What We Have Done Over Time

Net position represents the DHP Enterprise's net results of activity over the years and includes unexpended appropriations and the cumulative net earnings. The DHP Enterprise's net position is shown on the *Consolidated Balance Sheet* and the *Consolidated Statement of Changes in Net Position*. The reported net position balance as of September 30, 2018, was \$(227,550,345) thousand.

## Results of Program Cost

### Net Costs – What Cost We Incurred for the Year

The net results of operations are reported in the *Consolidated Statement of Net Cost* and the *Consolidated Statement of Changes in Net Position*. The *Consolidated Statement of Net Cost* represents the cost of operating (net of earned revenues) the DHP Enterprise's programs. In FY 2018, the DHP Enterprise contains the following four programs:

- **Operations, Readiness, and Support:** Support the total military force by ensuring the medical force is medically ready and prepared to deliver health care anytime, anywhere in support of the full range of military operations, including humanitarian missions.
- **Procurement:** The DHP Enterprise appropriation procurement program funds acquisition of capital equipment in MTFs and other selected health care activities.
- **Research, Development, Test, and Evaluation (RDT&E):** Aid medical force through effective and accountable investments in education and research to establish sustainable improvements in the well-being and productivity of the MHS.
- **Family Housing & Military Construction:** Assist military force on the basis of need according to principles of universality, impartiality, and human dignity to save lives, alleviate suffering, and minimize the economic costs of conflict, disasters, and displacement.



**Figure 6:** Summarizes total net program cost by the DHP Enterprise's programs.

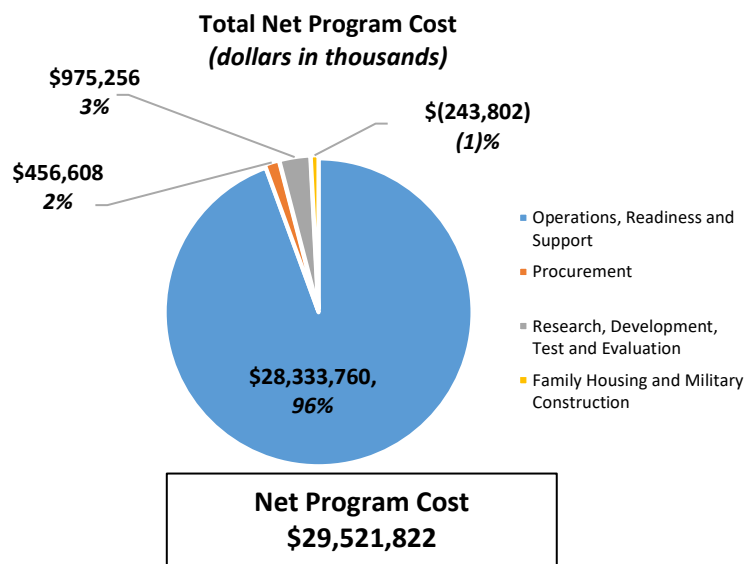


Figure 6 to the left shows the total net program cost of operations of \$29,521,822 thousand to operate each of these DHP Enterprise's program. These costs do not include the gain from actuarial assumption changes.

## Budgetary Resources

### Our Funds

The *Combined Statement of Budgetary Resources* provides information on the budgetary resources that were made available to DHP Enterprise during the fiscal year and the status of those resources at the end of the fiscal year. The DHP Enterprise receives most of its funding from general government funds administered by Treasury and appropriated by Congress for use by DHP Enterprise. Budgetary resources consist of the resources available to the DHP Enterprise at the beginning of the year, plus the appropriations received, spending authority from offsetting collections, and other budgetary resources received during the year.

**Figure 7:** Summarizes obligations incurred, unobligated balances, and total budgetary resources for the DHP Enterprise for FY 2018.

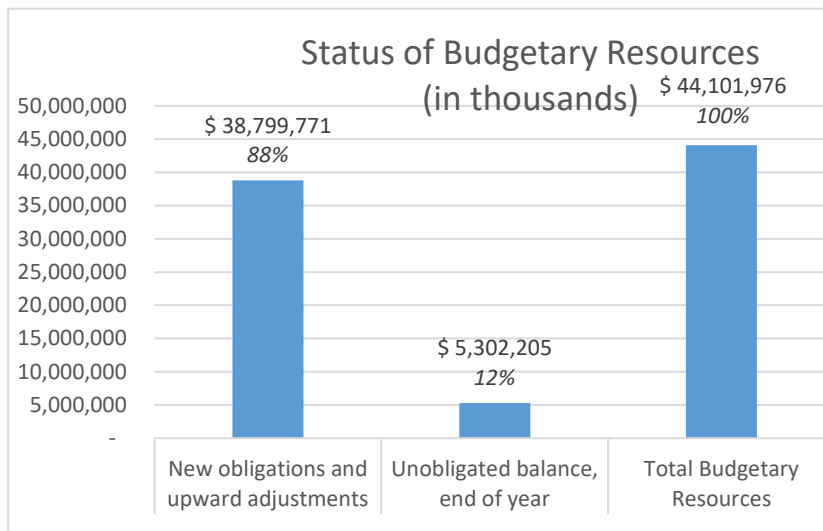


Figure 7 to the left shows the obligations incurred, unobligated balances, and total budgetary resources for DHP Enterprise for FY 2018. The DHP Enterprise received \$44,101,975 thousand in cumulative budgetary resources in FY 2018, of which it has obligated \$38,799,770 thousand.

### Obligations and Net Outlays

The status of budgetary resources (Figure 7) shown above shows the overall total budgetary resources received and whether obligations were incurred or the funding remains unobligated balances at FY 2018. As shown in the chart, the DHP Enterprise's total budgetary resources for FY 2018 was \$44,101,975 thousand. The net outlays for the DHP Enterprise for FY 2018 is \$32,921,290 thousand.

# Analysis of Systems, Controls, and Legal Compliance

The DHP Enterprise management is required to comply with various laws and regulations in establishing, maintaining, and monitoring internal controls over operations, financial reporting, and financial management systems as discussed below.

## Management Assurances

The Assurance Statements below were provided for FY 2018 Federal Manager's Financial Integrity Act for FY 2018 (FMFIA).



OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE  
1200 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1200

September 28, 2018

SUBJECT: Annual Statement of Assurance Required Under the Federal Managers' Financial Integrity Act for Fiscal Year 2018

As Acting Deputy Assistant Secretary of Defense, Health Resources Management and Policy of the Defense Health Program (DHP), I recognize that the DHP is responsible for managing risks and maintaining effective internal control to meet the objectives of Sections 2 and 4 of the Federal Managers' Financial Integrity Act (FMFIA) of 1982. The DHP conducted its assessment of risk and internal control in accordance with the Office of the Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* and the Green Book, *Government Accountability Office (GAO)-14-704G, Standards for Internal Control in the Federal Government*. Based on the results of the assessment, the DHP can provide reasonable assurance, except for the 59 material weaknesses reported in the "Material Weakness and Significant Deficiencies Template" that internal controls over operations, reporting, and compliance were operating effectively as of September 30, 2018.

The DHP conducted its assessment of the effectiveness of internal controls over operations in accordance with OMB Circular No. A-123, the GAO Green Book, and the FMFIA. The "Internal Control Evaluation" section provides specific information on how the DHP conducted this assessment. Based on the results of the assessment, the DHP can provide reasonable assurance, except for the 23 material weaknesses reported in the "Material Weakness and Significant Deficiencies Template" that internal controls over operations, reporting, and compliance were operating effectively as of September 30, 2018.

The DHP conducted its assessment of the effectiveness of internal controls over reporting (including internal and external financial reporting) in accordance with OMB Circular No. A-123, Appendix A. The "Internal Control Evaluation" section provides specific information on how the DHP conducted this assessment. Based on the results of the assessment, the DHP can provide reasonable assurance, except for the 35 material weaknesses reported in the "Material Weakness and Significant Deficiencies Template" that internal controls over operations, reporting (including internal and external reporting), and compliance were operating effectively as of September 30, 2018.

The DHP also conducted an internal review of the effectiveness of the internal controls over the integrated financial management systems in accordance with Federal Financial Management Improvement Act (FFMIA) of 1996 (Public Law 104-208) and OMB Circular No. A-123, Appendix D. The "Internal Control Evaluation" section provides specific information on how the DHP conducted this assessment. Based on the results of this assessment, the DHP can

provide reasonable assurance, except for one nonconformance reported in the "Significant Deficiencies/Material Weaknesses and Corrective Action Plans Template" that the internal controls over the financial systems are in compliance with the FFMIA and OMB Circular No. A-123, Appendix D, as of September 30, 2018.

If there are any questions regarding this Statement of Assurance for Fiscal Year 2018, my point of contact is Ms. Candace Farrow. She can be reached at (703) 681-6757 or [Candace.P.Farrow.civ@mail.mil](mailto:Candace.P.Farrow.civ@mail.mil).

Darrell W. Landreaux 28 September 2018

Darrell W. Landreaux  
Acting Deputy Assistant Secretary of Defense  
Health Resources Management and Policy

#### Attachments:

1. Appendix B - Material Weakness Removal Memorandum
2. Appendix D - Internal Control Evaluation
3. Appendix E - Risk Assessment
4. Appendix F - Material Weaknesses and Significant Deficiencies
5. Appendix G - Reportable Anti-Deficiency Act Violations
6. Appendix H - Significant Manager's Internal Control Program Accomplishments
7. Appendix I - DHP Component Organizations/Service Medical Activities Statement of Assurance

2

## Summary of Internal Control Assessment

The DHP Enterprise conducted its assessment of the effectiveness of internal controls over operations (ICO) in accordance with the FMFIA and the Office of Management and Budget (OMB) Circular No. A-123 *Management's Responsibility for Enterprise Risk Management and Internal Control*. Each evaluation occurred at the component level and was reported to the DHP Enterprise with the results and testing methodology used to evaluate the status of the control. Based on the results of the assessment, the DHP Enterprise can provide reasonable assurance, except for the twenty three material weaknesses<sup>9</sup> reported in the "Material Weaknesses and Significant Deficiencies Template" that internal controls over operations, reporting, and compliance were operating effectively as of September 30, 2018.

The DHP Enterprise assessed the effectiveness of internal controls over financial reporting (ICOFR), including external financial reporting, in accordance with OMB Circular No. A-123, Appendix A, *Internal Control over Financial Report*. Each

<sup>9</sup> Total material weakness reported include nineteen material weaknesses and 4 significant deficiencies.

evaluation occurred at the component level and was reported to the DHP Enterprise with the results and testing methodology used to evaluate the status of the control. Based on the results of the assessment, the DHP Enterprise can provide reasonable assurance, except for the thirty five material weaknesses<sup>10</sup> reported in the "Material Weaknesses and Significant Deficiencies Template" that internal controls over reporting were operating effectively as of September 30, 2018.

The DHP Enterprise also conducted an internal review of the effectiveness of internal controls over the integrated financial systems (ICOFs) in accordance with FFMIA of 1996 (Public Law 104-208) and OMB Circular No. A-123, Appendix D. Each evaluation occurred at the component level and was reported to DHP Enterprise with the results and testing methodology used to evaluate the status of the control. Based on the results of the assessment, the DHP Enterprise can provide reasonable assurance, except for the one material weaknesses reported in the "Material Weaknesses and Significant Deficiencies Template" that internal controls over the financial systems are in compliance with FFMIA and OMB Circular No. A-123, Appendix D, *Compliance with the Federal Financial Management Improvement Act of 1996* as of September 30, 2018.

Management's assessment of FFMIA compliance was completed prior to the results of the FY 2018 financial statement audit. Our auditor has noted the DHP Enterprise financial management systems did not comply substantially with the Federal financial management system's requirements, applicable Federal accounting standards, or application of the United States Standard General Ledger (USSGL) at the transaction level, as a result of material weaknesses noted in the Independent Auditor's Report on Internal Control over Financial Reporting. The DHP Enterprise is in process of evaluating the FY 2018 audit findings contributing to noncompliance to begin the process of remediation plans necessary to bring the financial managements systems into substantial compliance.

## Compliance with Laws and Regulations

### **Anti-Deficiency Act, 31 U.S.C. §§ 1341, 1342, 1350, 1351, 1517: ANTI-DEFICIENCY ACT**

The Anti-deficiency Act (ADA) prohibits federal employees from obligating in excess of an appropriation, before funds are available or from accepting voluntary services. As required by the ADA, DHP Enterprise notifies all appropriate authorities of any ADA violations. The DHP Enterprise management has taken and continues to take necessary steps to prevent ADA violations. Investigations of any violations will be completed in a thorough and expedient manner. DHP Enterprise remains fully committed to resolving ADA violations appropriately and in compliance with all aspects of the law.

### **Pay and Allowance System for Civilian Employees as provided in 5 U.S.C. Chapters 51–59**

5 U.S.C. Chapters 51–59 codify the statutory provisions concerning the pay and allowances afforded federal employees. DHP Enterprise is fully committed to complying with these provisions, periodically reviewing its compliance with them, and taking appropriate action to achieve compliance if and when any errors are identified. [Link to 5 U.S.C Chapter 51:](#)

<https://www.gpo.gov/fdsys/granule/USCODE-2011-title5/USCODE-2011-title5-partIII-subpartD-chap51/content-detail.html>

### **Prompt Payment Act, 31 U.S.C. §§ 3901–3907**

In 1982, Congress enacted the Prompt Payment Act (PPA) to require federal agencies to pay their bills on a timely basis, to pay interest penalties when payments are made late, and to take discounts only when payments are made by the discount date. DHP Enterprise uses the Invoice Receipt, Acceptance and Property Transfer (iRAPT) (formerly Wide Area Workflow) system to ensure compliance with this statutory requirement.

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<sup>10</sup> Total material weakness reported include thirty one material weaknesses and 4 significant deficiencies.

**Provisions Governing Claims of the United States Government as provided in 31 U.S.C. §§ 3711-3720E (including provisions of the Debt Collection Improvement Act of 1996, (DCIA), as amended by the Digital Accountability and Transparency Act of 2014)**

The Debt Collection Improvement Act of 1996 (DCIA), as amended by the DATA Act, requires that Federal agencies refer delinquent debts to Treasury within 120 days and take all appropriate steps prior to discharging debts. DHP Enterprise follows applicable requirements for establishing and collecting validated debts, ensuring compliance with Debt Collection statutes and regulations.

**Government Charge Card Abuse Prevention Act of 2012, Pub. L. No. 112-194; Public Law 112-194 (Government Charge Card Abuse Prevention Act of 2012)**

The Charge Card Abuse Prevention Act (Charge Card Act) requires agencies to establish and maintain safeguards and internal controls for purchase cards, travel cards, integrated cards, and centrally billed accounts. Furthermore, the Charge Card Act requires agencies to report purchase card violations, and the Inspector General to conduct periodic risk assessments of government charge card programs. DHP Enterprise, through implemented internal controls, is committed to continued compliance with all aspects of the public law.

**Federal Information Security Modernization Act of 2014, 44 U.S.C. § 3551 et seq.; FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT OF 1996**

The FFMIA requires agencies to implement and maintain financial systems that comply substantially with Federal Financial System (FFS) requirements, applicable federal accounting standards, and the U.S. Standard General Ledger (USSGL) at the transaction level.

**Digital Accountability and Transparency Act of 2014 (DATA Act), 31 U.S.C. § 6101 note. The DATA Act amended the Federal Funding Accountability and Transparency Act of 2006 (FFATA). DIGITAL ACCOUNTABILITY AND TRANSPARENCY ACT OF 2014**

The Digital Accountability and Transparency Act of 2014 (DATA Act) expands the Federal Funding Accountability and Transparency Act of 2006 to increase accountability and transparency in federal spending, making federal expenditure information more accessible to the public. It directs the Federal Government to use government-wide data standards for developing and publishing reports and to make more information, including award-related data, available on the USASpending.gov Web site. The standards and Web site allow stakeholders to track federal spending more effectively. Among other goals, the DATA Act aims to improve the quality of the information on USASpending.gov, as verified through regular audits of the posted data, and to streamline and simplify reporting requirements through clear data standards. DHP Enterprise complies with the DATA Act; making its expenditures accessible to the public on USASpending.gov.

**Grants Oversight and New Efficiency Act**

The Grants Oversight and New Efficiency (GONE) Act requires the head of each agency to submit to Congress, in coordination with the Secretary of Health and Human Services, a report on Federal grant cooperative agreement awards that have not yet been closed out and for which the period of performance, including any extensions, elapsed for more than two years. The GONE Act also sets forth follow-on reporting and analysis requirements by various entities."

## Financial Systems Framework

### Financial Management Systems Strategy

The NDAA FY 2017 has called for the reform of the DHP Enterprise and military medical treatment facilities. According to Section 702 of the FY 2017 NDAA, "Beginning on October 1, 2018 the Director of the Defense Health Agency shall be responsible for the administration of each military medical treatment facility, including with respect to budgetary matters, IT, health care administration and management, administrative policy and procedure, military medical construction, and any other matters the Secretary of Defense determines appropriate." The rationale behind this legislation revolves around the strength of a centralized organization serving the medical needs of all branches of the military. In the prior state, despite having a common funding source, the individual MHS components operated on separate accounting systems. This arrangement made it difficult to get comparable financial data and hindered leadership from making well-informed decisions. It also complicates audit preparation, as the DHP Enterprise is undergoing audit as a single entity. In an effort to adhere to the FY 2017 NDAA, to enhance auditability, and provide seamless medical care across all services, the Assistant Secretary of Defense – Health Affairs office (ASD(HA)) has decided to work towards a single accounting system solution.

MEDCOM implemented the General Funds Enterprise Business System (GFEBS) in FY 2010, and in FY 2015, a proof of concept GFEBS deployment to the NCR MD, to include WRNMMC was executed. The notable factor of this implementation was WRNMMC's classification as a Navy chassis. This implementation effectively illustrated the ability of a non-Army entity to successfully deploy GFEBS. With MEDCOM and NCR MD on GFEBS, roughly 50 percent of the DHP Enterprise funding was accounted for in this single system. Following the resounding success of this proof of concept, leadership became interested in pursuing a system-wide deployment in a realistic, sequential manner that would bring the remaining balance of the DHP on GFEBS.

ASD (HA)'s FY 2017 NDAA compliance strategy is being executed by using a single accounting solution, GFEBS. This commercial, off the shelf Enterprise Resource Planning (ERP) software implemented by the U.S. Army provides financial information in real time and reveals cost drivers to provide decision support information for leadership, in turn enabling a sustained warfighting capability for the Army. GFEBS also provides analytics data and tools, reduces the cost of business operations, and improves accountability. The system has enabled the Army to meet congressional mandates, requiring audit compliance and an accurate accounting of all financial transactions, and will allow the MHS to meet similar requirements and needs.

The DHA/FOD and USUHS deployed GFEBS on April 2, 2018, resulting in approximately 66 percent of the DHP funds in GFEBS. Plans are currently in place to transition the BUMED next, with a phased implementation set to be begin during FY 2020. Once BUMED's migration to GFEBS is complete, an estimated 85 percent of MHS will be executing within GFEBS. For these and other future deployments, ASD (HA) has agreed to deploy GFEBS "as-is" with basic Army functionality.

### Current and Future Financial Management Systems Framework

Due to the FY 2017 NDAA's intent in driving the DHP Enterprise towards standardized business practices to help achieve auditability through a single, system-wide accounting solution, it is important that the MHS aligns common interests and interacts with Army as "one voice." This new protocol will apply to communication with Army in regard to the GFEBS Functional Governance Board (FGB) for requesting system enhancements, the Army GFEBS Process Owners Group (POG) and audit support requests from Army. As MHS's use of GFEBS matures, the one-voice protocol may expand into additional areas. It is important to note here that this will be a marked departure from the previous "way of life" for organizations such as MEDCOM and NCR MD and an entirely new process for DHA/FOD, USUHS, and BUMED.

Prior to the one-voice initiative, MEDCOM was one of the commands represented as a stand-alone advisory member at the Army FGB; however, MEDCOM and all other organizations under the purview of the DHP Enterprise per the 2017 NDAA will



now be represented by ASD(HA)'s designated department defined below. To cover the requirements in this new environment, organizations such as NCR MD, MEDCOM, and others must speak with one voice when submitting requests to Army in regard to GFEBS.

In the concerted effort to consolidate the varying voices of MHS into a single, focused entity, the Health Affairs Functional Champion (HAFC) will represent MHS at GFEBS FGB meetings as an FGB Advisory Member and at POG meetings. Prior to the escalation of issues to GFEBS FGB's Voting Members for official consideration, an internal DHP Enterprise process will be established to identify, validate, and set priorities for GFEBS enhancements for the MHS. This process will identify MHS priorities while also highlighting audit compliance and cost savings/avoidance where applicable. The process will be initiated through HAFC's own Governance Board as the first step in submission to GFEBS FGB. Once the prioritization is made within HAFC and an FGB Voting Member has sponsored the case (by Army FGB rules, all cases brought forth require sponsorship by a GFEBS FGB Voting Member), the various MHS cases from the field will exit HAFC's vetting process and officially enter GFEBS FGB's consideration phase for discussion and an eventual vote.

This consolidation of MHS as required by the FY 2017 NDAA will strengthen MHS as a whole by uniting such a large, joint force community with uniquely converging interests into one focused voice. Prior to the legislation, MHS faced potential challenges as voices of the MHS community could be overlooked as the requirement would impact fewer users. With this new measure, however, MHS will now make up approximately 10 percent of GFEBS's total user base. With a united voice, MHS will be able to clearly and effectively organize and effect change when necessary and to obtain clear guidance from HAFC when needed, while eliminating the risk of duplicated work efforts of a fragmented MHS community.

## Forward-Looking Information

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### Changes and the Future of DHP Enterprise

In December 2016, the 114<sup>th</sup> Congress of the United States of America passed the National Defense Authorization Act for FY 2017. Title VII contains fifty-one provisions intended to fundamentally transform military health care management. Three of the most important transformations are Sections 701, *TRICARE Select and other TRICARE reform*; 702, *Reform of administration of the Defense Health Agency and military medical treatment facilities*; and 703, *Military medical treatment facilities*. These sections modernize the military's health plan, health care management, and the footprint of military hospitals and clinics, respectively.

Section 701 simplifies the TRICARE health plan options and increases the beneficiary pool to include military reservists. Starting in January 2018, the DoD offers two health plan options: Prime and Select. TRICARE Prime is similar to an HMO plan. TRICARE Select is a PPO option with an annual enrollment fee. Co-pays for beneficiaries are streamlined and simplified, which may yield some cost savings to the Department.

Section 702 is the most complex section of the law. The late Senator John McCain (R-AZ) called the legislation, "The most sweeping overhaul of the MHS in a generation."<sup>11</sup> The DHP Enterprise is given responsibility for the administration and management of all military medical treatment facilities beginning October 1, 2018. The Armed Services Committees of Congress intend to reduce management complexity and costs associated with operating four health systems within the same federal department. Doing so requires careful analysis of all the processes and procedures associated with managing and administering hospitals and clinics and removing unnecessary redundancy.

Section 703 directs the Department to study the footprint of military hospitals and clinics to optimize their utilization while fully supporting the readiness mission. In response, criteria were developed to designate medical centers, hospitals, and ambulatory care centers. Continued analysis may result in services at some facilities being changed.

The DHP Enterprise is establishing a value-based health care program informed by best practices across the global health care industry. Value-based care efforts in other American health systems have shown some success in reducing costs, although starting such a program often requires an up-front investment to improve long-term gains. The Agency plans to use a variety of payment methods (e.g., global capitation, bundled payments) to move away from legacy fee-for-service models that predominate the TRICARE health plan. As Section 702 is implemented, there may be further opportunities to explore value-based budgets for the Department's military medical treatment facilities.

The Undersecretary of Defense (Comptroller) and Defense Chief Information Officer took a \$1.5 billion decrement against the Department's health IT program over the Future Year Defense Program (FY 2019 – FY 2023). As the new electronic health record rolls out across the military medical treatment facilities, legacy IT systems will wind down. However, electronic health record implementations are extremely difficult. Some of the legacy systems may remain active for longer than intended. The Department may have to determine which non-critical systems could be disabled in order to meet the required budget savings.

As a result of the secretary's 90-day review of the MHS in 2014, the system is transforming into a high-reliability organization. In 2016, the DHP Enterprise and Military Departments determined that a Clinical Communities model of health care delivery focusing on clinical process improvements would best support the principle of high reliability.

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<sup>11</sup> McCain J. Remarks by Senate Armed Services Committee Chairman John McCain on the National Defense Authorization Act for FY17. Washington, DC: Brookings Institution; May 19, 2016

The Department's Reform Management Group targeted health care management as a business function within military in need of modernization and reform to reduce costs. The group supports the various reforms and savings already targeted by the Department and Congress while seeking out additional opportunities.

The MHS Quadruple Aim will endure. Based on the Institute for Healthcare Improvement's Triple Aim architecture, the four aims of improved readiness, better care, better health, and lower cost provide a unifying vector for the various reform efforts and clearly articulates value. These aims underpin all of the health strategies within the military and are best achieved by an integrated system of readiness and health.

## Limitations of the Financial Statements

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These financial statements have been prepared to report the financial position and results of operations of the DHP Enterprise, as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and 31 U.S.C. § 3515(b). The DHP Enterprise is unable to fully implement all elements of U.S. generally accepted accounting principles (U.S. GAAP) as promulgated by the Federal Accounting Standards Advisory Board (FASAB) and the form and content requirements for federal government entities specified by the OMB in Circular A-136, *Financial Reporting Requirements*, due to limitations of financial and nonfinancial management processes and systems of certain component entities that support the financial statements.

The DHP Enterprise derives reported values and information for major asset and liability categories largely from nonfinancial systems, such as logistical systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with U.S. GAAP. The DHP Enterprise continues to implement process and system improvements addressing these limitations.

In addition, the financial management systems used by the DHP Enterprise are unable to meet all full accrual accounting requirements as many of their component's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of U.S. GAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by U.S. GAAP, and most of the financial management systems used by the components of the DHP Enterprise were designed to record information on a budgetary basis.

These financial statements have been prepared from the books and records of the DHP Enterprise. The accompanying financial statements account for all resources for which the DHP Enterprise is responsible for unless otherwise noted.



## II. Financial Section



## Office of the Inspector General Transmittal

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**INSPECTOR GENERAL**  
DEPARTMENT OF DEFENSE  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500

November 9, 2018

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF  
FINANCIAL OFFICER, DOD  
ASSISTANT SECRETARY OF DEFENSE (HEALTH AFFAIRS)  
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Transmittal of the Independent Auditor's Report on the Defense Health  
Program Enterprise Financial Statements and Related Notes for FY 2018  
(Project No. D2017-D000FT-0180.000, Report No. DODIG-2019-008)

We contracted with the independent public accounting firm of Kearney & Company to audit the Defense Health Program (DHP) Enterprise FY 2018 Financial Statements and related notes as of September 30, 2018, and for the year then ended, and to provide a report on internal control over financial reporting and compliance with laws and regulations. The contract required Kearney & Company to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/President's Council on Integrity and Efficiency, "Financial Audit Manual," July 2008.<sup>1</sup> Kearney & Company's Independent Auditor's Reports are attached.

Kearney & Company's audit resulted in a disclaimer of opinion. Kearney & Company could not obtain sufficient, appropriate audit evidence to support the reported amounts within the DHP financial statements. As a result, Kearney & Company could not conclude whether the financial statements and related notes were presented fairly in accordance with Generally Accepted Accounting Principles. Accordingly, Kearney & Company did not express an opinion on the DHP FY 2018 Financial Statements and related notes.

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<sup>1</sup> In June 2018, the Government Accountability Office issued an updated Financial Audit Manual. Kearney & Company updated its audit procedures to be in accordance with the updates issued in the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency, "Financial Audit Manual," June 2018.

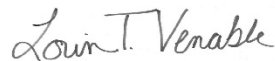


Kearney & Company's separate report on "Internal Control Over Financial Reporting" discusses 13 material weaknesses related to the DHP's internal controls over financial reporting. Specifically, Kearney & Company found material weaknesses related to: Entity-Level Controls; Financial Reporting; Fund Balance With Treasury; Accounts Receivable; Property, Plant, and Equipment; Inventory and Related Property; Accounts Payable and Related Liabilities; and Information Technology. Kearney & Company's additional report on "Compliance with Laws, Regulations, Contracts, and Grant Agreements" discusses four instances of noncompliance with applicable laws and regulations.

In connection with the contract, we reviewed Kearney & Company's reports and related documentation and discussed the audit results with Kearney & Company representatives. Our review, as differentiated from an audit in accordance with GAGAS, was not intended to enable us to express, and we did not express, an opinion on the DHP FY 2018 Financial Statements and related notes, conclusions about the effectiveness of internal control, conclusions on whether the DHP's financial systems substantially complied with the "Federal Financial Management Improvement Act of 1996," or conclusions on whether the DHP complied with laws and regulations.

Kearney & Company is responsible for the attached reports, dated November 9, 2018, and the conclusions expressed in these reports. However, our review disclosed no instances in which Kearney & Company did not comply, in all material respects, with GAGAS.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945.



Lorin T. Venable, CPA  
Assistant Inspector General  
Financial Management and Reporting

Attachments:  
As stated

# Independent Auditor's Report



1701 Duke Street, Suite 500, Alexandria, VA 22314  
PH: 703.931.5600, FX: 703.931.3655, www.kearneyco.com

## INDEPENDENT AUDITOR'S REPORT

To the Assistant Secretary of Defense for Health Affairs and Inspector General of the Department of Defense

### Report on the Financial Statements

We were engaged to audit the accompanying consolidated financial statements of the Defense Health Program (DHP) Enterprise (hereinafter referred to as the DHP), which comprise the consolidated balance sheet as of September 30, 2018, the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources (hereinafter referred to as the "financial statements") for the year then ended, and the related notes to the financial statements.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted the audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 19-01, *Audit Requirements for Federal Financial Statements*. Because of the matters described in the Basis for Disclaimer of Opinion section below, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### Basis for Disclaimer of Opinion

We were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion that the financial statements are free from material misstatements when taken as a whole. The DHP disclosed in Note 1, *Summary of Significant Accounting Policies*, instances where its current accounting and business practices represent departures from accounting principles generally accepted in the United States of America. As a result, the DHP was unable to assert that the financial statements are presented fairly in accordance with accounting principles generally accepted in the United States of America. The DHP asserted to the following departures from accounting principles generally accepted in the United States of America:



- Accrual accounting requirements per Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, and SFFAS No. 5, *Accounting for Liabilities of The Federal Government*
- Recognition and valuation requirements set forth in SFFAS No. 3, *Accounting for Inventory and Related Property*
- Liability requirements set forth in SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, and SFFAS No. 12, *Recognition of Contingent Liabilities Arising from Litigation*
- Recognition and valuation requirements set forth in SFFAS No. 6, *Accounting for Property, Plant, and Equipment*
- Revenue recognition requirements set forth in SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*
- Recognition and valuation requirements set forth in SFFAS No. 8, *Supplementary Stewardship Reporting*
- Recognition and valuation requirements set forth in SFFAS No. 10, *Accounting for Internal Use Software*
- Reporting and valuation requirements set forth in SFFAS No. 29, *Heritage Assets and Stewardship Land*
- The full cost provisions of SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, as amended by SFFAS No. 30, *Inter-Entity Cost Implementation* and SFFAS No. 55, *Amending Inter-Entity Cost Provisions*
- Accounting and reporting requirements associated with restatements per SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, and OMB Circular A-136, *Financial Reporting Requirements*
- Reporting requirements set forth in SFFAS No. 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29, and 32*
- Recognition and reporting requirements set forth in SFFAS No. 47, *Reporting Entity*.

We were unable to obtain sufficient appropriate evidential matter as to the completeness of the financial statements reported as of September 30, 2018. This includes \$20.5 billion of Fund Balance with Treasury (FBWT), \$1.0 billion of Accounts Payable (\$325.0 million Federal and \$676.2 million Non-Federal), \$133.0 million in Other Liabilities (\$98.9 million Federal and \$34.1 million Non-Federal), and \$15.6 million in Environmental and Disposal Liabilities balances on the balance sheet.

We were unable to obtain sufficient appropriate evidential matter to enable us to perform audit procedures to support the completeness and accuracy of the financial statements in accordance with accounting principles generally accepted in the United States of America and Department of the Treasury (Treasury) standard general ledger reporting requirements. The DHP is unable to reconcile its financial statements to supporting general ledger (GL) system trial balances and GL system transaction details without material variances. The DHP has also not completed an assessment to define its financial reporting entity to evidence completeness of its financial statements and related disclosures, including beginning balances, at the Enterprise or component levels.





We were unable to obtain sufficient appropriate evidential matter as to the existence, completeness, and accuracy of the DHP's stockpile material reported within the Inventory and Related Property line item of the balance sheet. As of September 30, 2018, the DHP reported approximately \$32.5 million of Inventory and Related Property on the balance sheet, consisting solely of stockpile material. The DHP did not record stockpile material in accordance with SFFAS No. 3. The DHP was unable to provide sufficient data to allow audit procedures to be performed over the existence, completeness, and valuation of stockpile material. In addition, the DHP has not performed the required assessment for Operating Materials and Supplies (OM&S) to support its accounting treatment selected under SFFAS No. 3. The DHP did not report OM&S within the Inventory and Related Property line item of the balance sheet, directly expensing OM&S upon purchase. The DHP was unable to provide sufficient evidence to support this method of accounting was appropriate based on prescribed conditions within SFFAS No. 3.

We were unable to obtain sufficient appropriate evidential matter to enable us to perform audit procedures to satisfy ourselves that the Property, Plant, and Equipment (PP&E) opening balances as of October 1, 2017 or ending balance balances as of September 30, 2018 were free of material misstatements. Our work identified issues related to existence, completeness, valuation, and disclosure of real property (including real property construction-in-progress), internal use software (including internal use software in development), and general equipment. As of September 30, 2018, the DHP reported \$3.7 billion in net PP&E on its balance sheet.

We were unable to obtain sufficient appropriate evidential matter as to the completeness of revenue and associated accounts receivable. The DHP does not account for all revenue and accounts receivable transactions using the accrual basis of accounting, recording certain activity on the cash basis of accounting. As of September 30, 2018, the DHP reported \$1.2 billion of accounts receivable (\$463.6 million Federal and \$701.9 million Non-Federal), net on its balance sheet and \$3.7 billion of earned revenue on its statement of net cost.

The effects of the conditions described in the preceding paragraphs cannot be fully quantified, nor was it practical, given the available information, to extend audit procedures to sufficiently determine the extent of the misstatements to the financial statements. The effects of the conditions in the preceding paragraphs and overall challenges in obtaining sufficient audit evidence also made it impractical to execute all planned audit procedures. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary for the elements making up the DHP's financial statements.

#### **Disclaimer of Opinion**

Because of the significance of the matters described in the Basis for Disclaimer of Opinion section above, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.



## Other Matters

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, other Required Supplementary Information, and Required Supplementary Stewardship Information (hereinafter referred to as the "required supplementary information") be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by OMB and the Federal Accounting Standards Advisory Board (FASAB), who consider it to be an essential part of the financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America because of matters described in the Basis for Disclaimer of Opinion section above. We do not express an opinion or provide any assurance on the information.

### *Other Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. Other Information as named in the Agency Financial Report is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements; accordingly, we do not express an opinion or provide any assurance on it.

### *Other Reporting Required by Government Auditing Standards*

In accordance with *Government Auditing Standards* and OMB Bulletin No. 19-01, we have also issued reports, dated November 9, 2018, on our consideration of the DHP's internal control over financial reporting and on our tests of the DHP's compliance with provisions of applicable laws, regulations, contracts, and grant agreements, and other matters for the year ended September 30, 2018. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance and other matters. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 19-01 and should be considered in assessing the results of our audit.

A handwritten signature in blue ink, appearing to read "Kearney &amp; Company", is positioned above the typed name and date.

Alexandria, Virginia  
November 9, 2018





1701 Duke Street, Suite 500, Alexandria, VA 22314  
PIT: 703.931.5600, FX: 703.931.3655, www.kearneyco.com

## INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Assistant Secretary of Defense for Health Affairs and Inspector General of the  
Department of Defense

We were engaged to audit, in accordance with the auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 19-01, *Audit Requirements for Federal Financial Statements*, the financial statements of the Defense Health Program (DHP) as of and for the year ended September 30, 2018, and we have issued our report thereon dated November 9, 2018. Our report disclaims an opinion on such financial statements because we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. The DHP also asserted to departures from generally accepted accounting principles.

### Internal Control over Financial Reporting

In connection with our engagement to audit the financial statements, we considered the DHP's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the DHP's internal control. Accordingly, we do not express an opinion on the effectiveness of the DHP's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 19-01. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies; therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings to be material weaknesses.





A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance. We noted certain additional matters involving internal control over financial reporting that we will report to the DHP's management in a separate letter.

#### **The DHP's Response to Findings**

The DHP's response to the findings identified in our engagement is described in a separate memorandum attached to this report in Section 2, *Financial Section*, of the Agency Financial Report. The DHP's response was not subjected to the auditing procedures applied in our engagement of the financial statements; accordingly, we do not express an opinion on it.

#### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of the DHP's internal control. This report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* and OMB Bulletin No. 19-01 in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in blue ink that reads "Kearney &amp; Company". The signature is stylized and cursive.

Alexandria, Virginia  
November 9, 2018



## Schedule of Findings

### Material Weaknesses

The Military Health System (MHS), which is the global health system of the Department of Defense (DoD), is composed of medical personnel, infrastructure, and resources from the Departments of the Army, Navy, and Air Force, the Defense Health Agency (DHA), and the Office of the Assistant Secretary of Defense (Health Affairs). The Defense Health Program (DHP) appropriation serves as a funding source for the MHS. The DHP Enterprise financial statements are composed of the following component reporting entities:

- DHA Financial Operations Division (FOD)
- DHA Contract Resource Management (CRM)
- Uniformed Services University of Health Sciences (USUHS)
- Service Medical Activity (SMA) – Army/Army Medical Command (MEDCOM)
- SMA – Navy/Navy Bureau of Medicine and Surgery (BUMED)
- SMA – Air Force (AF)/Air Force Medical Service (AFMS)
- SMA – National Capital Region Medical Directorate (NCR-MD).

Throughout the course of our audit work with each DHP component reporting entity, internal control deficiencies were encountered which were considered for the purposes of reporting on internal control over financial reporting for the DHP. The material weaknesses presented in this Schedule of Findings have been formulated based on our determination of how individual control deficiencies, in aggregate, affect internal controls over financial reporting. The table below presents the material weaknesses identified during our audit:

Accounting Area	Material Weakness
Entity-Level Controls (ELC)	I. Governance Structure and Entity-Level Controls
Financial Reporting	II. Financial Reporting III. Universe of Transaction Reconciliations IV. Internal Controls over Defense Departmental Reporting System Journal Vouchers
Fund Balance with Treasury (FBWT)	V. Fund Balance with Treasury
Accounts Receivable (AR)	VI. Medical Revenue and Associated Receivables
Property, Plant, and Equipment (PP&E)	VII. General Equipment Existence and Completeness VIII. Valuation of Property, Plant, and Equipment IX. Real Property X. Internal Use Software and IUS In-Development
Inventory and Related Property	XI. Operating Materials and Supplies and Stockpile Material
Accounts Payable (AP) and Other Liabilities	XII. Liabilities
Information Technology (IT)	XIII. Information Systems



## **I. Governance Structure and Entity-Level Controls (*New Condition*)**

Deficiencies in two related areas define this material weakness:

- A. Accounting and Financial Reporting Governance Structure
- B. Entity-Level Control Design and Operation.

**Background:** Entity-level internal controls relate to an entity's control environment, risk assessment processes, information and communication, and monitoring of control effectiveness over time. They are enterprise-wide and have a pervasive effect on an entity's internal control system. The Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires each Executive agency to establish and implement controls in accordance with standards prescribed by the Comptroller General of the United States, as codified in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* (the Green Book).

Agencies respond to these requirements by implementing Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. In addition, components within the Department of Defense (DoD) use the Managers' Internal Control Program (MICP) to support their responses to these requirements.

Beginning October 1, 2018, the National Defense Authorization Act for Fiscal Year (FY) 2017 (NDAA) consolidated the administration of more than 400 hospitals and clinics currently run by the Army, Navy, and Air Force into a centralized management structure within the DHA. The transition of administrative responsibility of the Military Treatment Facilities (MTF) to the DHA was in process during FY 2018.

### **A. Accounting and Financial Reporting Governance Structure**

**Condition:** The DHP does not have an effective enterprise-level accounting and financial reporting governance and oversight organization to achieve its accounting and financial reporting objectives and responsibilities.

The organizational hierarchy for the DHP components is unclear as it pertains to accounting and financial reporting governance. Specifically, SMA components align themselves with their respective Military Departments and have adopted department-specific accounting policies and procedures accordingly. The DHP components were not always responsive to requests made by the DHP or its senior leadership group to provide documentation to support the DHP MICP.

Further, the DHP does not have entity-wide accounting policy in significant accounting areas, including:

- FBWT
- General PP&E
- Inventory and Related Property





- AR and Associated Revenue
- Financial Reporting.

**Cause:** The DHP financial management organization is evolving and does not yet have the ability to exercise authority and oversight over DHP components. The DHP did not have effective oversight structure in place to monitor components' accounting and financial reporting. The individual management of the DHP components, which are responsible for the execution of the DHP funding across the Army, Navy, Air Force, DHA, and Health Affairs, operate independently and have not yet effectively merged into a cohesive formalized accounting and financial reporting governance structure within the DHP.

**Effect:** Without an effective enterprise-wide financial management governance and oversight organization, inconsistent policies and procedures can lead to unreliable and inaccurate financial information. Further, SMA components frequently revert to guidance from their respective Military Departments, creating greater ambiguity and confusion.

Unclear delegation of authority and lack of organizational structure between the DHP and components results in ineffective monitoring, which may lead to control failures and potential misstatements to the financial statements. Without the ability to implement an effective internal control assessment program, the risk of producing inaccurate financial statements increases.

The lack of comprehensive enterprise accounting policy for significant business operations of the DHP contributed to departures from Federal Accounting Standards issued by the Federal Accounting Standards Advisory Board (FASAB), including:

- Accrual accounting requirements per Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, and SFFAS No. 5, *Accounting for Liabilities of The Federal Government*
- Recognition and valuation requirements set forth in SFFAS No. 3, *Accounting for Inventory and Related Property*
- Liability requirements set forth in SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, and SFFAS No. 12, *Recognition of Contingent Liabilities Arising from Litigation*
- Recognition and valuation requirements set forth in SFFAS No. 6, *Accounting for Property, Plant, and Equipment*
- Revenue recognition requirements set forth in SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*
- Recognition and valuation requirements set forth in SFFAS No. 10, *Accounting for Internal Use Software*
- The full cost provisions of SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, as amended by SFFAS No. 30, *Inter-Entity Cost Implementation*
- Recognition and reporting requirements set forth in SFFAS No. 47, *Reporting Entity*.



**Recommendations:** Kearney & Company, P.C. (Kearney) recommends that the DHP:

1. Develop and distribute a DHP governance policy that establishes formalized governance for all components of the DHP financial reporting entity.
2. Perform a gap analysis between current policy and procedures and the GAO Green Book standards. Address the gaps identified to strengthen financial management capabilities and oversight at the Enterprise level.

**B. Entity-Level Control Design and Operation**

**Condition:** The DHP did not meet the standards for an effective internal control system, as defined in GAO's Green Book. The DHP identified 94 ELCs, of which 12 were determined to be ineffectively designed. Of the remaining 82 controls, 72 were determined to be operating ineffectively. The DHP did not achieve any of the 17 GAO Green Book principles across the five components of internal control.

**Cause:** The DHP has not formally established a MICP to support the effective design and operation of ELCs. The DHP has not fully transitioned from component-based internal control programs to an Enterprise-wide program with formalized policies, templates, metrics, and procedures for components' adherence. Components do not fully participate in the DHP MICP; rather, they align with their respective Military Department.

When component data and documentation is received, they are not formally reviewed and analyzed to support the consolidated DHP annual Statement of Assurance (SOA) required under FMFIA.

**Effect:** Without an effective entity-level control program in place, DHP is susceptible to inefficient and ineffective operations, unreliable financial reporting, and noncompliance with laws and regulations.

**Recommendations:** Kearney recommends that the DHP establish a policy for the MICP that requires, at a minimum, the development of ELCs at the DHP and component levels that align with the DHP MICP. The policy should require both the DHP and individual components to:

1. Review Green Book standards and accompanying implementation guidance to design Enterprise-wide ELCs to be implemented at the DHP and component levels.
2. Perform a data call with each of the components to establish an understanding of the following:
  - a. Component points of contact (POC).
  - b. Key supporting documents, policies, and references identified within the components' current ELCs.
  - c. Current programs, functions, and responsibilities to support the agency's compliance with the Green Book.
3. Update assessment criteria based on OMB Circular A-123, best practices, and knowledge of agency operations.





4. Review FY 2017 and FY 2018 results and final test plans; update control activity inventory through annual risk assessment process, hold understanding meetings with DHP ELC POCs, and review existing agency documentation; and crosswalk the documented controls to the respective principle in DHP-approved templates.
5. Design standard templates that are updated to support the assessment strategy and document results at the principle and component levels to provide sufficient evidence to support the effective operation of internal controls.
6. Document identified instances of control gaps based on design assessment; evaluate the magnitude of impact, likelihood of occurrence, and nature of each deficiency; and develop recommendations for compliance and/or improvement.
7. Develop a risk assessment model for ELCs, considering work performed under the agency's Enterprise Risk Management (ERM) effort and the Green Book's principles.

## II. Financial Reporting (*New Condition*)

Deficiencies in two related areas define this material weakness:

- A. Definition of a Reporting Entity
- B. DHP Consolidated Financial Statements.

**Background:** As part of the financial reporting process, the DHP is required to assess related entities and compile consolidated financial statements based on the results. FASAB issued SFFAS No. 47, *Reporting Entity*, effective for periods beginning after September 30, 2017. The standard guides preparers of Government-wide general purpose Federal financial reports (GPFFR) in identifying organizations to report as “consolidation entities” and “disclosure entities.” Consolidated financial statements are prepared based upon these determinations.

To prepare its financial statements, the DHP utilizes a service organization. The service organization performs financial statement compilation and reporting using information provided by each of the DHP components within the Defense Departmental Reporting System (DDRS) – Budgetary (B) and DDRS – Audited Financial Statements (AFS).

### A. Definition of DHP Reporting Entity

**Condition:** The DHP did not complete an assessment to define its financial reporting entity in accordance with SFFAS No. 47. While component reporting entities have been identified, the DHP has not completed a formal assessment of potential consolidation entities and disclosure entities for which the DHP and its components are accountable. For example, the DHP did not complete an assessment of its relationship and business activities with the Henry Jackson Foundation (HJF), across component reporting entities, to determine the impact over financial reporting and/or required disclosures.

The DHP has not implemented sufficient monitoring controls to verify that the financial statements have been completely and accurately prepared by its service organization in accordance with the DHP-defined reporting entity. The DHP has not established a formal





process to periodically redefine and verify its financial reporting entity completeness and compliance with generally accepted accounting principles (GAAP).

The DHP has not adequately assessed its risk of financial statement material misstatements, nor established its monitoring of internal controls over financial reporting to prevent, detect, and correct material misstatements at the DHP level.

**Cause:** The DHP does not have a formal and effective process to accurately define its financial reporting entity to ensure the production of complete and accurate financial statements and related disclosures in accordance with GAAP.

**Effect:** The DHP is unable to assert to the completeness of its financial statements and related disclosures. The DHP's financial statements may be materially misstated by the omission of consolidation entities and/or disclosure entities for which the DHP or component reporting entities may be accountable.

**Recommendations:** Kearney recommends that the DHP:

1. Establish a formal process to annually assess and revalidate its GPFFR financial reporting entity for completeness in accordance with the provisions of SFFAS No. 47. The assessment should be formalized with appropriate review and approval from DHP senior leaders, as well as each component's reporting entity. The approved DHP reporting entity definition should be communicated to applicable stakeholders, including the DHP's service organization for financial reporting.
2. Maintain documentation to evidence the completion of the assessment, including the analysis performed, sources referenced, and conclusions reached. The DHP should establish a Standard Operating Procedure (SOP) to ensure this process is performed consistently at the DHP level and by each component reporting entity.
3. Review the compiled financial statements from its service organization for completeness and accuracy to verify the statements have been prepared in accordance with the DHP-defined reporting entity.

#### **B. DHP Financial Statement Consolidation**

**Condition:** The DHP, with its service organization, did not have an adequate control environment in place to produce complete and accurate DHP consolidated financial statements and related footnotes. For the Quarter (Q) 2 FY 2018 financial statements submission, the DHP provided a final DHP Balance Sheet that was out of balance between Total Assets and Total Liabilities and Net Position. For Q3, the DHP was unable to timely prepare a complete Q3 DHP financial statement package. The DHP, in conjunction with its service organization, manually prepared the DHP financial statements outside of DDRS-AFS. The Q3 DHP financial statement package was provided on October 1, 2018, more than 68 days after the financial statement preparation timeline. In Q4, the DHP's financial statements were still unable to be produced from DDRS-AFS, requiring manual preparation of the consolidated trial balance, financial



statements, and footnotes, outside of the service provider's normal control environment for financial reporting compilation.

**Cause:** The DHP, with its service organization, did not implement processes or internal controls to effectively and timely review the DHP's financial statements to prevent and detect misstatements. Additionally, effective manual compensating controls were not in place to mitigate financial reporting risk of misstatement resulting from system limitations in compiling the DHP's financial statements.

**Effect:** The DHP, with its service organization, was unable to timely produce complete and accurate DHP financial statements, footnotes, and a supporting trial balance as of Q3 FY 2018 and Q4 FY 2018. The manual production of the Q4 DHP trial balance did not establish a reconcilable (i.e., auditable) link between the DHP component underlying general ledger (GL) details and adjusted trial balances to the DHP trial balance. Therefore, the DHP could not perform the complete reconciliation of the DHP financial statements back to supporting component GL systems.

**Recommendations:** Kearney recommends that the DHP, in coordination with its service organization:

1. Ensure DDRS-AFS is properly configured to produce the DHP consolidated financial reports.
2. Ensure that the DHP is provided an opportunity to review System Change Requests (SCR) affecting the DHP and component financial reports.
3. Ensure the DHP consolidated financial reports are produced within the official DDRS-AFS reporting structure and are, therefore, subjected to the applicable reconciliation and edit checks.
4. Implement formal processes and procedures within the DHP to fully review, and approve as final, the DHP consolidated financial reports.

### III. Universe of Transaction Reconciliations (*New Condition*)

**Background:** The DHP operates in a non-integrated systems environment with financial information from many systems feeding into various DHP component GL systems. DHP financial data are captured within component GL systems from several feeder systems. Monthly, the DHP's service organization transfers feeder files from the component GL systems to DDRS-B. The transmitted data from each GL system undergo a series of translations (e.g., pre-processing) and transfers (i.e., from DDRS-B to DDRS-AFS) and are updated by a variety of supported and unsupported financial statement adjustments to produce the DHP's financial statements.

The DHP developed the Universe of Transactions (UoT) containing transaction-level details to support the consolidated financial statement balances. To reconcile the UoT to each component's trial balances and the consolidated financial statements, the DHP established a reconciliation process using the Auditable Universe of Data – Intelligence Tool (AUD-IT) in FY





2017. With the exception of DHA-CRM, all of the DHP's components have been included in the UoT reconciliation process. DHA-CRM receives a standalone audit and, therefore, is not included in the UoT reconciliation process. The UoT reconciliation process was developed to provide transaction-level details to support the DHP's financial statements.

The six DHP components included in the AUD-IT utilize seven GL systems. The overall reconciliation process includes reconciliation points to attempt to support the overall compilation of the DHP's financial statements from component GL systems to DDRS-B and to DDRS-AFS. The UoT reconciliation process consisted of three separate reconciliations for each component at the start of FY 2018 and was expanded to four separate reconciliations for each component, as well as two additional reconciliations at the DHP level, during FY 2018.

**Condition:** The DHP, in coordination with its service organizations, was unable to completely reconcile its UoT from the GL system trial balance through to the final DHP financial statements. The DHP could not sufficiently explain material variances between GL transaction details and GL system trial balances, as well as GL system trial balances and the final DDRS-AFS trial balance used for compiling the DHP's financial statements. Additionally, transactional records of financial feeder systems which bypass the DHP component GL systems have not been reconciled to journal voucher (JV) data recorded in DDRS.

The DHP cannot timely support the current reconciliation process for the financial statement balances. The DHP was unable to produce the UoT reconciliations over FY 2017 Q4, FY 2018 Q1, and FY 2018 Q2 to coincide with the delivery of final financial statements. Delivery of completed reconciliations ranged from six weeks after quarter-close to 10 weeks after quarter-close.

The DHP did not fully document the review and approval of reconciliations or complete checklists designed to support full completion of reconciliation steps.

**Cause:** The DHP did not maintain effective controls to ensure the UoT reconciliation process was complete and that all identified variances were supported. In addition, the DHP did not maintain service-level agreements (SLA) or Memorandums of Understanding (MOU) with its service organizations to establish official submission deadlines for key components of the reconciliation process performed each quarter.

Material variances were noted as a result of the lack of a formalized, repeatable, and auditable processes for the transformation of data from GL system GLACs which are not United States Standard General Ledger (USSGL)/Standard Financial Information Structure (SFIS)-compliant, to USSGL GLACs. The DHP and its service organization have not completed reconciliations of the DDRS feeder file transactional details to the summarized data recorded in DDRS.

The DHP's use of seven GL systems adds complexity, risk, and time to the overall reconciliation process. GL transaction-level data must be obtained, normalized, and reconciled before it is useable across each of the GL systems. Subsequently, the DHP is performing review and approval procedures for each reconciliation package of the seven GL systems. The end-to-end



process cannot currently be performed in the compressed financial reporting timeline following quarter-end.

**Effect:** The DHP is unable to prepare financial statements reconciled to the supporting transaction-level data in a timely manner. The DHP management is unable to assert to the completeness and accuracy of the financial statements in accordance with GAAP and USSGL Department of the Treasury (Treasury) reporting requirements.

**Recommendations:** Kearney recommends that the DHP:

1. Complete formalized end-to-end reconciliation process policy or SOPs documenting the roles and responsibilities of each stakeholder with established timelines. The SOP should include documented steps for preparers and reviewers.
2. Develop formal SLAs and/or MOUs to establish a formal delivery timeline of the GL detail, trial balance detail, JV detail, and applicable reconciliation packages to the DHP subsequent to each quarter-end.
3. Monitor service organization progress in generating key components of the reconciliation process to allow for alternative procedures if extended delays are anticipated.
4. Develop an analysis of the financial statement impact of not having GL transaction data to fully reconcile to GL system trial balances. Additionally, the DHP should work with the AUD-IT service organization to obtain GL transaction data for no-year appropriation funds.
5. Coordinate with the service organization AUD-IT Team to develop oversight or review procedures to ensure all GL data is complete and includes all necessary records.
6. Coordinate with its service organization and applicable the DHP components to implement procedures to complete and document crosswalk reconciliations from GL system trial balances to DDRS trial balances to ensure completeness and accuracy from native GLAC to USSGL. The crosswalk reconciliations should be formalized to allow an external auditor to re-perform the crosswalking exercise from GL system trial balances to DDRS-B.
7. Continue the development and implementation of reconciliations for DDRS feeder file transaction details to summarized data within DDRS or ensure compensating controls are in place to ensure the completeness and accuracy of the data used in feeder file adjustments.

#### **IV. Internal Controls over Defense Departmental Reporting System Journal Vouchers (New Condition)**

**Background:** As part of the process of compiling the DHP's financial statements, the DHP's service organization for financial reporting posts monthly JV adjustments in the DDRS-B and quarterly JV adjustments and trial balance input adjustments (TBIA) in DDRS-AFS on behalf of the DHP components. The financial reporting service organization self-classifies each DDRS-AFS and DDRS-B JV as either "supported" or "unsupported."





Included in the monthly and quarterly financial reporting processes are the posting of trading partner adjustments and elimination entries. There are two types of eliminations: 1) intra-DHP eliminations, which are those within the DHP and its components, and 2) inter-DHP eliminations, which are those outside of the DHP. Prior to execution of the elimination entries, trading partner seller-side adjustments are made. According to the DoD Financial Management Regulation (FMR), DoD's accounting and feeder systems do not capture trading partner information at the level required to facilitate intra-departmental trading partner reconciliations and subsequent eliminations. Therefore, the buyer-side balances are aligned with seller-side balances, as it is presumed that the amounts reported by the seller are more accurate than corresponding amounts reported by the buyer.

**Condition:** The DHP's financial statements contain material unsupported JV adjustments. Included in the financial statements are unsupported adjustments, as self-classified by the DHP's service organization. Of approximately 6,300 JVs recorded as of September 30, 2017 affecting the opening balances of FY 2018, 90% were classified as unsupported. This amounted to an excess of 5,500 unsupported DDRS-B JVs and six unsupported DDRS-AFS JVs and TBIA's.

During FY 2018, unsupported adjustments, as self-classified by the DHP's service organization, were posted on behalf of the DHP components in Q1 and Q2. Of approximately 2,000 JVs recorded as of March 31, 2018, 71% were classified as unsupported. This amounted to an excess of 1,400 unsupported DDRS-B JVs and thirteen unsupported DDRS-AFS and TBIA's.

The DHP, in coordination with its service organization, has not performed an assessment of the known unsupported JVs recorded to determine the impact of unsupported amounts reflected in the DHP financial statements.

The following service organization adjustments, self-classified as "supported," impacting the FY 2018 Q2 financial statement balances did not contain sufficient supporting documentation:

- Eight seller-side adjustments were not supported by underlying transaction-level details
- Twenty-one AR data call adjustments were not supported by underlying transaction-level details.

Trading partner seller-side adjustment JVs, recorded in DDRS-AFS to adjust the buyer-side intra-governmental transactions to the seller-side intra-governmental transactions, are unsupported as no underlying reconciliation of trading partner activity is performed to support the adjustments. DDRS elimination JVs (intra-DHP eliminations and inter-DHP eliminations) and reports at the DHP financial statement level lack evidence of review and approval.

**Cause:** The DHP financial reporting environment is complex, necessitating an inordinate volume of JVs to prepare financial statements. The DHP components do not share a common GL system, and each component utilizes a multitude of contributing feeder information systems. Many of these feeder systems and adjustments do not interface with DHP GL systems; rather, underlying activity is recorded directly into DDRS-B and DDRS-AFS via adjustment entries.



The DHP does not exercise oversight of its components and its service organization to enforce the generation and retention of supporting documentation to maintain an audit trail. The DHP components have not developed business processes to ensure accounting events are fully supported by adequate underlying documentation.

The DHP has not established policies or procedures to reconcile intra-departmental transactions and balances with its trading partners. The DHP has not implemented appropriate or effective oversight of its service organization and has not adequately designed or implemented controls for appropriate review and approval over intra-DHP and inter-DHP trading partner eliminations for the DHP's financial statements.

**Effect:** As a result of the magnitude of unsupported JVs recorded during financial statement preparation, the DHP could not attest to the accuracy and completeness of its FY 2018 opening balances and the financial statement balances impacted by such adjustments recorded during FY 2018.

**Recommendations:** Kearney recommends that the DHP, in coordination with its service organization:

1. Analyze the unsupported DDRS-AFS JVs, DDRS-AFS TBIA's, and DDRS-B JVs to determine the nature of the adjustments. Results of this analysis should be used to identify the nature of the missing underlying support related to the unsupported adjustments. Upon completion of the analysis, a corrective action plan should be developed by JV category to set a path forward to resolve the underlying reason for the JV.
2. Coordinate with the DHP components and GL system owners to migrate monthly and quarterly adjustments, such as collections and disbursements, budget, and accountable property system of record (APSR) adjustments, to the DHP component GL systems which can accommodate USSGL reporting and transaction-level details.
3. Update or implement appropriate policies and procedures to facilitate coordination and communication between the DHP components and its service organization to obtain, maintain, and reconcile the underlying transaction-level data necessary to determine and support the monthly and quarterly adjustments for each DHP component and GL system to be entered at the DDRS-B and DDRS-AFS level.
4. Assess the unsupported JVs to determine the financial reporting impact to the DHP financial statements. The assessment should include appropriate detail to provide the percentage of significant financial statement line items which cannot be asserted for completeness and accuracy as a result of unsupported JVs included in the line item balance.
5. Implement policies and procedures for reconciling trading partner data at the transaction level based on the transactions and source documentation provided by trading partners. Once reconciliations are complete, the DHP should coordinate with its trading partners to adjust balances, as necessary, to reflect the actual amounts incurred and owed to trading partners based on the provision of goods and/or the receipt of services.





6. Update relevant intra-DHP elimination policies and procedures to require its service organization to submit the intra-DHP eliminations with all appropriate and necessary JV support to allow for proper review to be performed by the DHP and to require the coordination directly with trading partners to develop processes for obtaining transaction details for intra-DHP eliminations.
7. Establish an SLA to ensure the trading partner elimination notifications occur within business hours, ensuring the DHP's availability for review and approval during the agreed-upon response window within the SLA.
8. Implement formal policies and procedures to perform and document the review of the intra-DHP and inter-DHP trading partner eliminations made on behalf of the DHP. This should include the development of an SOP to ensure that the review and approval process is consistently applied at the Enterprise level.

#### V. Fund Balance with Treasury (*New Condition*)

**Background:** The FBWT account represents the aggregate amount of funds available at the Treasury for which DHP components are authorized to make outlays. FBWT is increased by receiving appropriations, continuing resolutions, transfers-in, and offsetting collections, and it is decreased through rescissions and cancellations of budget authority, transfers-out, and disbursements.

All Treasury Index (TI) 97 Other Defense Organizations (ODO), including DHP components, are assigned specific limits which designate the amount or use of funds for a certain purpose or identify sub-elements within the account for management purposes. Federal agencies are required to reconcile FBWT at the limit level. Reconciling FBWT accounts with Treasury's Central Accounting Reporting System (CARS) records at least monthly helps ensure that balances are accurate and complete, differences are resolved in a timely manner, and financial statements are presented fairly. The DHP utilizes a service provider to perform monthly reconciliations between recorded amounts and those reported at Treasury.

In addition to supporting FBWT reconciliations, the service provider processes collections and disbursements and reports the DHP's total expenditure activity to Treasury on behalf of the Enterprise. Statements of Differences (SOD) arise when amounts reported to Treasury differ from actual disbursements and collections processed by financial institutions and the Treasury Regional Financial Centers. When reported transactions cannot be linked to a specific appropriation or reporting entity, they are placed into a DoD budget clearing (suspense) account for research and resolution.

**Condition:** The DHP experienced the following issues regarding the accuracy and completeness of collections and disbursements and related changes to FBWT:

- The DHP, in coordination with its service provider, does not have a complete, documented, end-to-end reconciliation process over FBWT



- The DHP does not have controls over the monitoring of its service provider FBWT processes, including the review, approval, and monitoring of monthly FBWT reconciliations and variance resolution to ensure FBWT is accurate and complete
- The DHP's financial statements include an unsupported/unreconciled opening FBWT balance of \$1.8 billion, or 9% of the DHP's opening FBWT balance
- FBWT reporting and reconciliation controls were not operating effectively and the DHP does not monitor or review its service provider processes to ensure FBWT is accurate and complete
- Cash Management Report (CMR) reconciliations, used to reconcile CARS to TI-97 ODO limits balances, are not properly designed and contain a \$227.2 million unreconciled difference between CARS and the CMR related to Treasury Account Symbol (TAS) 97130130
- A monthly reconciliation is not performed between the CMR and DHP components' trial balances at the limit level after all adjustments are recorded
- The CMR has unreconciled collection and disbursement differences that could increase or decrease DHP components' limit balances.

The DHP, in conjunction with its service provider, has not implemented internal control activities to help ensure completeness of the DHP's financial statements with respect to identifying and properly recording actual or estimated suspense and SOD balances.

**Cause:** The DHP, in coordination with its service provider, has not designed all necessary internal control activities or documented its end-to-end FBWT reporting and reconciliation process and associated risks. To further complicate the process, Treasury does not report FBWT at the limit level below the TAS, inhibiting the DHP components' abilities to reconcile directly with Treasury.

FBWT reporting and reconciliation controls performed on behalf of the DHP are ineffective due to incomplete policies and procedures, ineffective management review and approval, failure to adhere to defined policies for timeliness, and a lack of consistent policy requirements across service provider locations. The DHP and its components have not formally developed and implemented oversight procedures or mitigating controls to compensate for the risk of ineffective controls over the FBWT reconciliation process.

**Effect:** The DHP may not be able to assess the potential risks to the accuracy and completeness of FBWT without a complete end-to-end reconciliation process, and the DHP may be unable to determine the total unsupported differences between its recorded FBWT and the balance reported in CARS. Without aggregating and reconciling component-level FBWT reconciliations, DHP management may also be unaware of a potential risk of a financial statement misstatement.





**Recommendations:** Kearney recommends that the DHP, in coordination with its service provider:

1. Develop an accounting policy for FBWT which specifically addresses the requirements for a complete end-to-end FBWT reconciliation process to be performed at the component and DHP levels.
2. Identify impediments to the TI-97 FBWT reconciliation process (e.g., excluded activity from the CMR, TI-97 suspense accounts) and develop compensating controls at the DHP and component levels to reconcile any excluded FBWT activity or, through documented materiality analysis, indicate that management accepts the risk of potential misstatement.
3. Establish DHP and component oversight procedures over FBWT processes performed, including identifying and documenting roles and responsibilities for FBWT reconciliations, reviewing and approving reconciliations performed, and performing causative research, for reconciling items identified on a monthly basis.
4. Work with Treasury to determine the feasibility of adding subaccounts to basic symbols (e.g., 0130, 0500) to allow the DHP and its components to reconcile directly with Treasury.
5. Work with applicable parties to transition away from using monthly Non-Treasury Disbursing Office reporting to daily Treasury Disbursing Office.
6. Develop and implement a methodology to identify the actual or estimated impact of SOD and budget clearing accounts for recording and reporting into the GLs and financial statements.
7. Develop, implement, and document an effective reconciliation process for identifying any unmatched disbursements and collections and ensure that all resulting adjustments are fully supported at the DHP component level.
8. Review unidentified CMR differences and provide supporting information to clear differences.
9. Research and resolve suspense transactions by correcting the transactions in source systems and assist with necessary supporting documentation for corrections, if needed.

## **VI. Medical Revenue and Associated Receivables (*New Condition*)**

**Background:** The DHP and its SMA components provide health support for military operations. The DHP and its SMAs process both billable and non-billable medical encounters that arise from performing medical services. Billable encounters are processed for patient care provided to non-TRICARE beneficiaries or for patient care provided to TRICARE beneficiaries who are either uncovered or covered by other insurance. Billing consists of the MTF sending invoices to patients or agencies for medical services provided. The SMAs utilize a billing and collection system as a subsidiary ledger to track and process collections on medical billings.

SMA MTFs also provide medical services for beneficiaries that are dual-eligible under Medicare, as well as Federal beneficiaries of the United States Coast Guard (USCG), Public Health Service (PHS), National Oceanic and Atmospheric Administration (NOAA), and Department of Veterans Affairs (VA). Payment for services provided to such beneficiaries varies based on established agreements with each entity.



**Condition:** The DHP SMA components do not account for revenue or AR resulting from medical services provided in a consistent manner in accordance with GAAP. Not all SMA components record revenue earned from medical services provided on an accrual basis; rather, revenue is recorded on a cash basis. Monthly JVs recorded by the DHP's service organization to correct the cash basis of accounting for public services provided was not performed for all SMA components or contained posting logic errors, or complete transaction-level detail supporting the JV was not provided in response to the audit request. No process is in place to completely correct the cash basis of accounting for Federal services provided for the DHP.

The DHP SMA components receive quarterly prospective payments in advance of care provided from two Federal trading partners. The accounting for prospective payments is not consistent across the SMAs. The SMAs either recognize revenue upon receipt of payment prior to performing services, which is not in accordance with GAAP, or recognize the prospective payments as unearned revenue with periodic recognition over time based on actual care provided or historical data. The DHP did not perform an assessment to validate that the periodic recognition of revenue based on historical data was appropriate, rather than actual care provided in the current FY.

The DHP was unable to provide sufficient audit evidence to support the validity of AR balances within the billing and collection subsidiary ledger. AR transactions were noted as invalid because they were previously collected and never closed in the system, or the DHP could not provide sufficient documentation to support amounts billed for services provided.

**Cause:** The DHP has not formulated Enterprise-wide accounting policies or guidance for its components to ensure consistent and accurate accounting of medical services provided in accordance with GAAP.

SMAs have not established effective business processes with associated internal controls to properly recognize medical service revenue and associated AR using the accrual basis of accounting. In addition, specific to Federal prospective payments received for care to be provided, the SMAs have not established an effective business process with associated internal controls to properly recognize revenue based on care provided from actual activity occurring in the current FY.

The DHP has not established effective business processes to properly perform billing, collecting, and recording of medical AR with the public in its subsidiary system. The DHP did not develop, maintain, or provide sufficient documentation to adequately support the reported medical AR with the public.

**Effect:** The DHP's financial statements may contain misstatements associated with AR and Other Liabilities on the Balance Sheet, as well as Revenue and Expenses on the Statement of Net Cost. In addition, any unrecorded Federal AR would result in the understatement of Spending Authority from offsetting collections presented on the Statement of Budgetary Resources.





The lack of Enterprise-wide policies and guidance for the accounting treatment of medical services resulted in inconsistent accounting treatment across the SMAs, as well as noncompliance with Federal accounting standards and, accordingly, the FFMIA.

**Recommendations:** Kearney recommends that the DHP develop an accounting policy for medical services revenue and associated AR, which specifically addresses the appropriate accounting treatment as prescribed within SFFAS No. 1 and SFFAS No. 7. The accounting policy should be developed through coordination with all SMAs. In addition, DHP SMAs should also perform the following:

1. Establish formalized business processes to record medical service revenue and associated AR in the GL system at the time of billing from the medical billing system.
2. Formalize revenue recognition procedures for Federal trading partners to be aligned with actual care provided in the current FY. Revenue recognized should be supported by transactional activity recorded in the GL system.
3. Design and implement a process to verify collected patient billings are appropriately closed in the subsidiary ledgers. Monitoring controls should be established, to include performing a reconciliation between aged AR balances in the subsidiary ledger and collections to ensure that invalid AR entries have been closed.
4. Supporting documentation and retention requirements should be strengthened to evidence the validity of patient billings.

## **VII. General Equipment Existence and Completeness (*New Condition*)**

**Background:** FASAB defines general equipment (GE) as all personal property that is functionally complete for its intended purpose, durable, and nonexpendable. Additionally, GE typically has an expected service life of two or more years, is not intended for sale, does not ordinarily lose its identity or become a component part of another article when put into use, and has been acquired (or constructed) with the intention of being used.

**Condition:** The DHP did not record GE in a consistent manner across component reporting entities. One DHP component is in possession of GE assets whose purchase price was greater than DoD's capitalization threshold in place for DoD PP&E. However, the component did not capitalize any GE within the opening balances reported for FY 2018, and no GE was recorded during FY 2018. The component does not have formal policies or procedures documenting its operational processes and controls to identify, track, record, and value its GE in accordance with GAAP, as promulgated by FASAB.

The remaining DHP components did not demonstrate sufficient existence and completeness for GE which was recorded as part of opening balances for FY 2018. The DHP could not locate or did not provide sufficient audit evidence to support the existence for 3% of 819 tested assets. The DHP did not record approximately 11% of 353 tested assets, which were selected while performing testwork at DHP MTF locations (i.e., completeness of DHP recorded assets).



**Cause:** The DHP has not implemented policies, procedures, or internal controls to identify, recognize, and report capitalizable GE for all component entities. The DHP is currently in the process of completing its assessment of capitalizable GE at various locations and, therefore, has not yet finalized its approach to valuing GE.

Existence and completeness exceptions over GE are due to the lack of effective inventory management controls, inaccurate reporting of assets within the APSR, and lack of effective retention of supporting documentation.

**Effect:** The DHP components' lack of effectively designed and implemented controls resulted in the loss of accountability for asset custodianship and unsupportable financial reporting over PP&E, causing the DHP to misstate the balance of PP&E.

**Recommendations:** Kearney recommends that the DHP:

1. Establish an Enterprise-wide accounting policy to require annual inventory of GE, tracking GE, and proper cost classification in accordance with SFFAS No. 6, to include appropriate footnote disclosures.
2. Finalize SOPs surrounding annual inventory and accountability procedures in accordance with the DoD FMR and DoD Instructions (DoDI) 5000.64.
3. Complete ongoing efforts to verify the existence and completeness of GE for the purpose of bringing the GE portfolio to record for financial reporting. Obtain the latest inventory results and reconcile to GE recorded in the APSR. The DHP should also perform variance resolution and make adjustments to the APSR, as appropriate.
4. Perform a final assessment of available supporting documentation based on the known exceptions from testwork. Adjustments to the component APSRs should be recorded to remove known existence exceptions and add any remaining known completeness exceptions from the asset detail schedule.
5. Disseminate the GE existence and completeness audit testing results to all equipment custodians to promote awareness of the impact that effective inventory management controls have on property accountability.
6. Adhere to criteria and internal guidance related to the proper storing of documentation to support the acquisition, transfer, and disposal of GE.

#### **VIII. Valuation of Property, Plant, and Equipment (*New Condition*)**

**Background:** DHP components own, operate, and maintain stewardship of a diverse and significant portfolio of PP&E. The DHP has determined the asset classes for its PP&E as follows: GE; construction in-progress (CIP); IUS; IUS in-development; heritage assets; leases; and leasehold improvements. The DHP reported PP&E, net of accumulated depreciation and accumulated amortization, to be \$3.7 billion.

In August 2016, FASAB issued SFFAS No. 50, *Establishing Opening Balances for General Property, Plant, and Equipment*, amending existing PP&E accounting standards to allow a reporting entity, under specific conditions, to apply alternative valuation methods in establishing





opening balances for PP&E. The alternative valuation methods available under SFFAS No. 50 may be applied in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements are presented fairly in accordance with GAAP. As SFFAS No. 50 is applicable to the valuation of opening balances only, all changes to the DHP PP&E portfolio as a result of current-year transactions are subject to the valuation requirements set forth in SFFAS No. 6.

**Condition:** The DHP PP&E valuation as of September 30, 2018 is not in accordance with GAAP. The DHP disclosed that the opening balances of PP&E have not been valued at historical cost in accordance with valuation techniques promulgated by either SFFAS No. 6 or SFFAS No. 50.

**Cause:** The DHP has not established effective business processes, internal controls, or information systems necessary to accurately value PP&E in accordance with SFFAS No. 6. The accumulation of historical cost information with supporting documentation for PP&E acquisitions has not been appropriately maintained to support acquisition costs recorded in property systems. While the DHP intends to elect the alternative valuation techniques within SFFAS No. 50 to report property balances, they were not ready to make the election within FY 2018.

The DHP has not formulated accounting policy or accounting guidance from an Enterprise level to be issued to its components to appropriately value PP&E at historical cost in accordance with GAAP. As new accounting guidance was released by FASAB, no formal assessment of the DHP PP&E portfolio was performed from an Enterprise perspective or at the component level to determine if implementation of alternative valuation techniques afforded by SFFAS No. 50 was necessary across the components.

**Effect:** The DHP was unable to accurately and appropriately value its PP&E assets for FY 2018 in accordance with GAAP. The lack of accounting policy from an Enterprise perspective resulted in a lack of preparedness at the component level to re-value FY 2018 PP&E opening balances at historical cost in accordance with SFFAS No. 50.

The opening balances for FY 2018 did not reflect historical cost in accordance with GAAP, and the DHP did not have a remediation timeline to bring PP&E valuation GAAP-compliant by FY 2018 year-end. The DHP's recorded balance for PP&E of \$3.7 billion, net of accumulated depreciation and accumulated amortization, may be materially misstated as presented within the DHP's financial statements.

**Recommendations:** Kearney recommends that the DHP:

1. Develop an Enterprise-wide accounting policy for PP&E which specifically addresses historical cost valuation in accordance with SFFAS No. 6 and SFFAS No. 50. In its determination to implement historical cost valuation for opening balances under SFFAS No. 50, the DHP must maintain PP&E processes with supporting internal controls that



are both designed and operating effectively to value new PP&E acquisitions at historical cost in compliance with SFFAS No. 6.

2. Reference FASAB's Federal Financial Accounting Technical Release (TR) No. 18, *Implementation Guidance for Establishing Opening Balances*, dated October 2, 2017.
3. Retain appropriate key supporting documentation for underlying valuation methodology.
4. Document the valuation technique by asset class for all assets currently in the DHP PP&E portfolio.
5. Establish a timeline for the valuation and steps that each component is required to perform.
6. Detail requirements for valuation of new acquisitions that are compliant with SFFAS No. 6.

#### **IX. Real Property (*New Condition*)**

**Background:** DHP components own, operate, and maintain stewardship of a diverse and significant portfolio of PP&E Real Property (hereafter referred to as real property). Health care provided by the DHP is delivered in MTFs, which constitute more than 55 full-service hospitals and over 370 clinics located on military installations around the world.

**Condition:** The DHP did not record real property, in use by its components, on the DHP financial statements. The DHP did not record real property as part of the PP&E opening balance as of October 1, 2017, and real property was not subsequently added during interim reporting periods as of March 31, 2018 and June 30, 2018 or year-end reporting as of September 30, 2018.

**Cause:** The DHP did not record real property in its financial statements for FY 2018 in accordance with existing DoD-wide accounting policy. The decision to withhold real property from the DHP's financial statements was based on anticipated revisions to DoD-wide accounting policy related to the financial reporting responsibilities of real property for the DoD.

The DHP did not develop an accounting policy or standard guidance for component reporting entities to value and record real property.

**Effect:** The DHP did not comply with SFFAS No. 6 in the accounting treatment and financial reporting of real property. General PP&E, as presented on the Balance Sheet, was understated by the omission of the DHP's real property. In addition, any corresponding depreciation expense was understated on the Statement of Net Cost. The DHP cannot quantify the potential understatement to PP&E on its financial statements.

The lack of a formal policy to value and report real property could result in inconsistent reporting, as well as a material understatement of real property and depreciation on the DHP's financial statements when the DHP elects to record real property.





**Recommendations:** The DHP should evaluate GAAP and existing DoD-wide policy and record real property appropriately. Kearney further recommends that the DHP:

1. Conduct an existence and completeness review of all real property (e.g., facilities, linear structures) associated with the DHP's health support for all military operations. Working with the U.S. Navy, Army, and Air Force, the DHP should make a determination as to which reporting entity meets the FASAB requirements for ownership and recognition of real property.
2. Incorporate real property in the development of the DHP accounting policy for PP&E. As recommended above at Section VII, *Valuation of PP&E*, the accounting policy should specifically address historical cost valuation in accordance with SFFAS No. 6 and SFFAS No. 50.
3. Upon release of new accounting policy for the DoD-wide, assess the policy with GAAP and develop an implementation strategy for the DHP-identified real property assets, as appropriate.

#### **X. Internal Use Software and Internal Use Software In-Development (*New Condition*)**

**Background:** Internal use software (IUS) includes application and operating system programs, procedures, rules, and any associated documentation pertaining to the operation of a computer system or program that an entity uses in operations or for other internal use. IUS does not include software embedded in military equipment, nor does it include software used in Special Test Equipment. IUS may be acquired through commercial off-the-shelf (COTS) purchases, developed by entity employees, or developed by contractors to the entity.

IUS owned by the DHP includes the Armed Forces Billing and Collection Utilization Solution (ABACUS), Composite Health Care System (CHCS), and Defense Medical Logistics Standard Support (DMLSS). In addition, the DHP is currently implementing a new electronic health record (EHR), MHS GENESIS, for the MHS to manage inpatient and outpatient medical and dental information for more than 9.4 million DoD beneficiaries.

As previously detailed in Section VII *Valuation of PP&E*, DHP management did not make an unreserved assertion as it pertains to the implementation of SFFAS No. 50. Without an unreserved assertion for SFFAS No. 50, the governing FASAB standard for the DHP's IUS is SFFAS No. 10.

**Condition:** The DHP's opening balance valuation of IUS, including IUS in-development, is not in accordance with GAAP. The DHP did not record IUS as part of opening balances of PP&E for FY 2018. The DHP did not begin valuation efforts over IUS using alternative valuation techniques in accordance with SFFAS No. 50, and it is unable to value IUS at historical cost in accordance with SFFAS No. 10.

**Cause:** With the DHP's intent to implement SFFAS No. 50 for IUS valuation, there has been an historical lack of effective business processes, internal controls, and information systems in place to accurately account for IUS in accordance with SFFAS No. 10. The DHP has not implemented



policies, procedures, or internal controls to inventory IUS currently in use, track IUS projects in-development, or determine appropriate cost classification of expenditures for proper financial reporting.

The DHP has not finalized its approach to valuing IUS in accordance with SFFAS No. 50 for opening balances and SFFAS No. 10 after opening balances have been established.

The DHP has not performed a complete assessment of operational business processes to determine the financial reporting impact and proper accounting treatment of operations. Specific to the MHS GENESIS project, the DHP has not performed an assessment to determine the appropriate accounting classification as IUS or IUS in-development. The DHP was unable to obtain cost information to begin required analyses for classification and valuation efforts.

**Effect:** The DHP was unable to accurately account for the existence, completeness, or valuation of IUS in accordance with Federal accounting standards. The opening balance of PP&E on the Balance Sheet is understated by the omission of IUS and IUS in-development. The DHP was unable to quantify the misstatement on its financial statements.

**Recommendations:** Kearney recommends that the DHP:

1. Develop an accounting policy for IUS. The policy should provide for annual inventory of IUS, tracking IUS in-development, proper cost classification, and proper valuation in accordance with SFFAS No. 50 and SFFAS No. 10.
2. Continue pursuing expanded functionality in the IUS APSR to track and inventory IUS and IUS in-development to support the completeness and valuation of the IUS balance.
3. Develop annual inventory and accountability procedures in compliance with the DoD FMR and DoDI 5000.76, *Accountability and Management of Internal Use Software*.
4. Design and implement formalized internal controls for proper cost classification associated with IUS in-development to facilitate the identification and reporting of capitalizable costs.
5. Ensure, as part of the annual SOA, that IUS is incorporated as an assessable unit. Risk assessment procedures should be conducted to identify financial reporting risks associated with IUS and the extent of internal controls in place to address identified risks, as well as to identify internal control gaps which may exist.

#### **XI. Operating Material and Supplies and Stockpile Material (*New Condition*)**

Deficiencies in two related areas define this material weakness:

- A. Enterprise Assessment of Operating Material and Supplies (OM&S)
- B. Policies, Procedures, and Controls Surrounding Stockpile Materials Held by the DHP.

**Background:** SFFAS No. 3 defines OM&S as tangible personal property to be consumed in normal operations with the exclusion of: 1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity; 2) stockpile materials;





3) goods held under price stabilization programs; 4) foreclosed property; 5) seized and forfeited property; and 6) inventory. Per SFFAS No. 3, the consumption method of accounting must be applied unless it is: 1) not significant amounts; 2) in the hands of the end user; or 3) if not cost-beneficial to apply the consumption method, the purchases method may be applied. The DHP components' OM&S encompasses pharmaceuticals, pharmaceutical medical supplies, and non-pharmaceutical medical supplies needed for MTFs.

DHP components are also required to maintain various medications for the DoD in the event a medical epidemic reaches the United States. The DHA component maintains SLAs with Federal entities to purchase medications on behalf of DHA. DHA also maintains SLAs to store and distribute medication materials for medical preparedness. Medications purchased for DHA by other Federal entities remain at the manufacturing facility until such time that they need to be administered throughout the DoD.

#### **A. Enterprise Assessment of OM&S**

**Condition:** The DHP has not performed an annual assessment of OM&S for the purposes of determining appropriate accounting treatment under SFFAS No. 3. Currently, OM&S acquired has been directly expensed as allowable under SFFAS No. 3; however, the DHP has not conducted a formalized annual assessment of its OM&S portfolio to determine whether directly expensing acquisitions is appropriate. The DHP has not documented its determination of whether OM&S are significant amounts, in the hands of the end user for use in normal operations, or if it is cost-beneficial to capitalize OM&S.

**Cause:** The DHP has not developed and implemented policies and procedures to ensure that OM&S acquired by component reporting entities are appropriately and accurately accounted for and captured in the DHP's financial statements in accordance with Federal accounting standards.

**Effect:** The opening balance of Inventory and Related Property, as required to be reported on the DHP Balance Sheet and disclosed in the supporting footnotes, may be incomplete and the corresponding expenditures associated with the purchase and issuance of OM&S may be misstated on the Statement of Net Cost.

**Recommendations:** Kearney recommends that the DHP:

1. Develop and implement a strategy to perform an annual assessment to support the elected accounting treatment for OM&S under SFFAS No. 3.
2. Support the assessment with formalized documentation, evidencing the selected criteria and applicable analysis.

If the DHP is unable to support one of the three criteria required for directly expensing OM&S acquisitions, Kearney recommends that the DHP:

1. Develop and implement a strategy to verify the existence, rights and obligations, valuation, and completeness of OM&S at the DHP and component levels.





2. Evaluate flexibilities provided by SFFAS No. 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, to establish opening balances.
3. Develop a DHP strategy for valuing, recording, maintaining (accountability), and reporting OM&S to provide guidance to the components.
4. Develop an Enterprise-wide policy to define the appropriate accounting treatment, recording, and financial reporting of OM&S.

#### **B. Policies, Procedures, and Controls Surrounding Stockpile Materials Held by the DHP**

**Condition:** The DHP components did not account for stockpile material in accordance with requirements set forth in SFFAS No. 3. Throughout FY 2018, the DHP incorrectly expensed stockpile material upon purchase, rather than appropriately capitalizing the material on the Balance Sheet. In Q4 of FY 2018, the DHP recorded an adjustment of approximately \$32.5 million of stockpile materials as of September 30, 2018. The DHP was unable to support the balance recorded.

**Cause:** The DHP management has not developed and implemented DHP policies and procedures to ensure that stockpile materials are appropriately and accurately captured in the financial statements. In addition, the DHP has not performed a complete assessment of operational business processes to determine the financial reporting impact and proper accounting treatment of operations.

**Effect:** The opening balance of the Inventory and Related Property line item is understated by the stockpile materials held by the DHP. Additionally, period expenses may be overstated by any stockpile material acquisitions that have occurred to date in FY 2018 which were not appropriately captured in recording stockpile as of September 30, 2018.

Due to the lack of controls surrounding stockpile acquisitions and tracking, the DHP was unable to support the value of stockpile material recorded or determine the value of any misstatement.

**Recommendations:** Kearney recommends that the DHP:

1. Develop financial reporting policies and procedures to ensure that the DHP's operational business processes are reviewed to determine the appropriate accounting treatment, recording, and financial reporting impact.
2. Incorporate stockpile material as an assessable unit within the DHP MICP.
3. Implement policies, procedures, and controls for the end-to-end business process of stockpile materials. The policy, procedures, and controls should be developed to formally cover acquisition, receipt, issuance, transfers, inventory management, and disposal activities.
4. Complete ongoing efforts to verify the existence and completeness of DHP-owned stockpile material for the purpose of bringing the portfolio to record for financial reporting.



5. Complete ongoing efforts to value stockpile material in accordance with Federal accounting standards. The DHP should consider the valuation techniques within SFFAS No. 48 in establishing its opening balance of stockpile material.
6. Establish appropriate accounting policy to value new acquisitions and the consumption of existing stockpile material in accordance with SFFAS No. 3. New acquisitions should be recorded using the consumption method of accounting defined in SFFAS No. 3.

## **XII. Liabilities (*New Condition*)**

**Background:** During the normal course of operations, Federal agencies incur certain economic events that give rise to amounts owed to external entities. These liabilities can include, among others, AP for goods and services received from and progress in contract execution made by other entities excluding those services rendered by employees; unfunded leave representing unpaid leave that is earned and to which employees are entitled upon separation; Environmental and Disposal Liabilities (E&DL) for the cleanup costs associated with removing, containing, and/or disposing of hazardous waste or property that consists of hazardous waste; and loss contingencies for pending or threatened litigation and possible claims and assessments.

The Federal Employees Compensation Act (FECA) actuarial liability includes the expected liability for death, disability, medical, and other approved costs. The Department of Labor (DOL) administers FECA and sends Federal agencies the actuarial liability estimates for future workers' compensation benefits. In addition, DOL makes actual payments for workers' compensation benefits and then sends annual bills to the employing agencies in the chargeback process.

**Condition:** The DHP does not completely account for its liabilities and related expenses. Specifically, the DHP and its components have not completely recorded estimated AP for goods and services received but not yet billed in accordance with SFFAS No. 5. The DHP has not completely recorded other classes of liabilities and lacks internal control activities to help ensure the proper accounting of liabilities. The following transaction classes were either not considered by the DHP components or were not consistently recorded across components:

- Unfunded annual leave liability
- E&DL and the related expense
- Contingent or actual liabilities and related expense
- FECA liabilities, both actuarial and actual.

**Cause:** DHP components have not designed and implemented an effective internal control within respective procurement processes to ensure goods and services received but not yet paid for are appropriately accrued.

Specific to unfunded annual leave, one SMA component could not differentiate leave information between the SMA level and the respective Military Department level within the Defense Civilian Payroll System (DCPS).





For E&DL, settlements and judgments, and FECA, DHP components either lacked policies and procedures to gather appropriate information to determine whether liabilities exist which should be reported or an appropriate assessment had not been performed to determine the reporting responsibility between DHP components and each respective Military Department

**Effect:** The DHP is unable to determine whether its liabilities, net costs, and changes in net position were complete and fairly stated in accordance with GAAP.

In situations where Military Departments pay for amounts on behalf of respective SMAs, there is risk of a potential augmentation of the DHP appropriation and violation of the Antideficiency Act.

**Recommendations:** Kearney recommends that the DHP:

1. Conduct a comprehensive analysis of business processes that give rise to liabilities, including unrecorded AP at the end of an accounting period, to determine whether there are unrecorded liabilities and expenses.
2. Analyze, evaluate, and update, as appropriate, policies and procedures to require the execution of internal control activities for the complete and accurate recording of liabilities, including AP and any estimates needed for goods and services received but not recorded.
3. Document estimate methodology for any liability estimates developed by the DHP and its components. The DHP should also implement internal control activities for estimate development and monitoring of the accuracy of the estimate.
4. Coordinate with applicable system owners, as appropriate, to obtain transaction-level detail for the civilian payroll unfunded leave liability pertinent to its reporting entity.
5. Collaborate with the Office of General Counsel (OGC); determine and document the legislative basis by which the Military Departments pay for E&DL, settlements and judgments, and FECA on behalf of SMA components, as applicable; and evaluate whether amounts are being charged to the correct appropriation. If any amounts are being charged to an incorrect appropriation, the DHP should evaluate the purpose statute and related concepts regarding augmentation of an appropriation and report any Antideficiency Act violations in accordance with applicable reporting requirements.

### **XIII. Information Systems (*New Condition*)**

**Background:** The DHP operates in a complex information system environment to execute its mission and record transactions timely and accurately using several accounting systems and a mixture of health IT and non-medical systems. This includes third-party systems owned and operated by organizations outside of the DHP that affect the Enterprise's business processes and financial statements.



**Condition:** The DHP has control deficiencies in the design, implementation, and operating effectiveness of internal controls related to financially significant systems which could have a material effect on the financial statements. Internal control deficiencies exist in 21 financially-significant systems, including six GL and financial reporting systems, four health IT systems, and other key feeder systems and environments. The following is a summary of critical deficiencies:

- Security Management
  - Inconsistent IT policies, procedures, and practices across the DHP
  - Responsibilities for controls not clearly defined and communicated throughout all components and levels of the agency
  - Unavailable or outdated system security plans and authorizations to operate for key financial management systems and supporting applications
- Access controls
  - Incomplete, inconsistent, or not fully implemented policies and procedures for managing and monitoring access to key financial management applications and third-party systems
  - Incomplete and/or inconsistent implementation of user account recertifications to verify the continued propriety of access
  - Incomplete and/or inconsistent logging and monitoring of activity for key financial management systems
- Segregation of Duties
  - Incomplete or not fully implemented policies and procedures for the proper segregation of duties within applications, databases, and operating systems
- Configuration Management
  - Lack of clear, concise IT security requirements for in-house-developed and acquired systems
  - Inability to produce detailed user listings to support periodic recertification of privileged and non-privileged user accounts
  - Inability to produce application-level audit logs related to account management and configuration management
  - Incomplete and inaccurately documented baseline configuration inventory of hardware, software, and firmware
  - Incomplete, inconsistent, or unmaintained requirements and documentation of configuration changes
- Service Organization Management
  - Incomplete, inconsistent, or not fully implemented policies and procedures for monitoring service organizations

For two systems (i.e., one core GL system and one health IT system), the DHP, with its service organizations, could not support audit procedures over internal control design and operating effectiveness which we deemed necessary to form conclusions over the respective information system control environment.





**Cause:** The deficiencies result from a multitude of causal factors, with the most pervasive ones being inconsistent governance and oversight from DHP IT leadership over the component reporting entities and service organizations, lack of consistent IT policies and procedures, system limitations that prevent or hinder the implementation of effective controls, inconsistent or inadequate control design and/or implementation, and limited resources.

DHP service organizations for two systems declined to support audit procedures as a result of ongoing System and Organization Controls (SOC) examinations at the time of the financial statement audit.

**Effect:** Without sufficient controls throughout the information system environment, users may intentionally or unintentionally abuse computer resources, process unauthorized program changes or transactions, or perform other actions that jeopardize the confidentiality, integrity, or availability of systems and data.

For two systems, the DHP was unable to support audit procedures to obtain a complete understanding of information system controls, as well as the operating effectiveness of those controls, which would be necessary to plan and perform the audit in a timely manner. The limitation over our audit procedures over the GL system extended to the design, implementation, and operating effectiveness of key information system controls over financial reporting, including JV entry, GL posting logic, and feeder system interfaces. The limitation over our audit procedures over the health IT system extended to the design, implementation, and operating effectiveness of key information system controls, including enterprise-level access controls. These controls for both systems are essential to the DHP's controls over financial reporting and represent a significant risk if ineffective.

**Recommendations:** Kearney recommends that the DHP:

1. Strengthen overall IT governance by providing guidance and oversight to the components, MTFs, and service organizations on the assignment of responsibilities for the consistent implementation of internal controls.
2. Establish and communicate IT policies and procedures to the components, MTFs, and service organizations.
3. Focus on high-priority remediation activities to strengthen the maturity of the internal control environment.
4. Consider existing system limitations in the development and implementation of new and replacement systems to improve the overall control environment and keep existing limitations from being perpetuated going forward.





1701 Duke Street, Suite 500, Alexandria, VA 22314  
PIT: 703.931.5600, FX: 703.931.3655, www.kearneyco.com

## **INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS, REGULATIONS, CONTRACTS, AND GRANT AGREEMENTS**

To the Assistant Secretary of Defense for Health Affairs and Inspector General of the Department of Defense

We were engaged to audit, in accordance with the auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 19-01, *Audit Requirements for Federal Financial Statements*, the financial statements of the Defense Health Program (DHP) as of and for the year ended September 30, 2018, and we have issued our report thereon dated November 9, 2018. Our report disclaims an opinion on such financial statements because we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. The DHP also asserted to departures from generally accepted accounting principles.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the DHP's financial statements are free from material misstatement, we performed tests of its compliance with provisions of applicable laws, regulations, contracts, and grant agreements, noncompliance which could have a direct and material effect on the financial statements, and provisions referred to in Section 803(a) of the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions and did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the DHP. Providing an opinion on compliance with those provisions was not an objective of our audit; accordingly, we do not express such an opinion. The results of our tests, exclusive of those referred to in the FFMIA, disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-01 and are described in the accompanying Schedule of Findings.

The results of our tests of compliance with FFMIA disclosed that the DHP's financial management systems did not comply substantially with the Federal financial management system's requirements, applicable Federal accounting standards, or application of the United States Standard General Ledger (USSGL) at the transaction level, as described in the accompanying Schedule of Findings.

Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.



### **The DHP's Response to Findings**

The DHP's response to the findings identified in our engagement is described in a separate memorandum attached to this report in Section 2, *Financial Section*, of the Agency Financial Report. The DHP's response was not subjected to the auditing procedures applied in our engagement to audit the financial statements; accordingly, we do not express an opinion on it.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's compliance. This report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* and OMB Bulletin No. 19-01 in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in blue ink that reads "Kearney &amp; Company".

Alexandria, Virginia  
November 9, 2018



## Schedule of Findings

### Noncompliance and Other Matters

#### I. The Federal Managers' Financial Integrity Act of 1982 (FMFIA) (*New Condition*)

The Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, implements the requirements of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). FMFIA and OMB Circular A-123 require agencies to establish a process to document, assess, and assert to the effectiveness of internal control over financial reporting.

The Defense Health Program (DHP) has not established and implemented controls in accordance with standards prescribed by the Comptroller General of the United States, as codified in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* (the Green Book), as evidenced by the material weakness in our *Report on Internal Control over Financial Reporting*.

As discussed in Section I, *Governance Structure and Entity-Level Controls*, of our *Report on Internal Control over Financial Reporting*, the audit identified the following instances of noncompliance with FMFIA and OMB Circular A-123:

- The DHP has not fully implemented processes to support the effective design and operation or evaluation of its entity-level internal controls. Due to extensive design and effectiveness failures noted, the DHP did not achieve the GAO-prescribed principles for an effective internal control system
- The DHP lacks an established organizational structure to effectively implement, direct, and oversee the assessment process across components.

#### II. The Federal Information Security Modernization Act of 2014 (FISMA) (*New Condition*)

The Federal Information Security Modernization Act of 2014 (FISMA) requires agencies to provide information security controls commensurate with the risk and potential harm of not having those controls in place. The National Institute of Standards and Technology (NIST) publishes standards and guidelines for Federal entities to implement for non-national security systems. Deviations from NIST standards and guidelines represent departures from FISMA requirements. During our audit, we noted several deviations from NIST standards and guidelines that contributed to an overall material weakness related to information systems, as described in Section XIII, *Information Systems*, in our *Report on Internal Control over Financial Reporting*. These deviations represent the DHP's noncompliance with FISMA. By not complying with FISMA, the DHP's security controls may adversely affect the confidentiality, integrity, and availability of information and information systems.





### **III. The Federal Financial Management Improvement Act of 1996 (FFMIA) (*New Condition*)**

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires that an entity's overall financial management systems environment operate, process, and report data in a meaningful manner to support business decisions. Compliance with FFMIA is achieved through substantial compliance with the following three Section 803(a) requirements:

- Federal financial management system requirements
- Applicable Federal accounting standards
- United States Standard General Ledger (USSGL) at the transaction level.

The DHP's financial management systems do not substantially comply with the requirements within FFMIA, as asserted to by management, and as discussed below.

#### ***Federal Financial Management Systems Requirements***

FFMIA requires reliable financial reporting, including the availability of timely and accurate financial information, and maintaining internal control over financial reporting and financial system security. The matters described in the *Basis for Disclaimer of Opinion* section in the accompanying *Independent Auditor's Report*, as well as the material weaknesses reported in the accompanying *Report on Internal Control over Financial Reporting*, represent noncompliance with the requirement for reliable financial reporting.

FFMIA requires financial management systems owners to implement and monitor Federal information system security controls to minimize the impact to the confidentiality, integrity, and availability of the systems and data. The primary means for Federal entities to provide these controls is the implementation and monitoring of controls defined in NIST Special Publication (SP) 800-53, *Recommended Security Controls for Federal Information Systems*. The DHP deviated from recommended controls included in NIST SP 800-53, as discussed in Section XIII, *Information Systems*, in our *Report on Internal Control over Financial Reporting*. These deviations related to security management, access controls, segregation of duties, and configuration management, which represent instances of noncompliance with information security requirements.

#### ***Federal Accounting Standards***

FFMIA requires that agency management systems maintain data to support reporting in accordance with generally accepted accounting principles (GAAP). As identified through our audit procedures and as noted by the DHP in Note 1, *Summary of Significant Accounting Policies*, the DHP disclosed several instances where it departed from GAAP. The DHP asserted to the following departures from GAAP:





- Accrual accounting requirements per Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, and SFFAS No. 5, *Accounting for Liabilities of The Federal Government*
- Recognition and valuation requirements set forth in SFFAS No. 3, *Accounting for Inventory and Related Property*
- Liability requirements set forth in SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, and SFFAS No. 12, *Recognition of Contingent Liabilities Arising from Litigation*
- Recognition and valuation requirements set forth in SFFAS No. 6, *Accounting for Property, Plant, and Equipment*
- Revenue recognition requirements set forth in SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*
- Recognition and valuation requirements set forth in SFFAS No. 8, *Supplementary Stewardship Reporting*
- Recognition and valuation requirements set forth in SFFAS No. 10, *Accounting for Internal Use Software*
- Reporting and valuation requirements set forth in SFFAS No. 29, *Heritage Assets and Stewardship Land*
- The full cost provisions of SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, as amended by SFFAS No. 30, *Inter-Entity Cost Implementation* and SFFAS No. 55, *Amending Inter-entity Cost Provisions*
- Accounting and reporting requirements associated with restatements per SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, and OMB Circular A-136, *Financial Reporting Requirements*
- Reporting requirements set forth in SFFAS No. 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29, and 32*
- Recognition and reporting requirements set forth in SFFAS No. 47, *Reporting Entity*.

#### ***USSGL at the Transaction Level***

FFMIA requires that agency management systems record financial events by applying the USSGL guidance in the Treasury Financial Manual (TFM) at the transaction level. The DHP's financial management systems do not always record financial events in accordance with the requirements of the USSGL at the transaction level. The DHP has not complied with USSGL requirements in the following instances:

- The DHP uses core accounting systems, which, for certain components, are not fully compliant with the USSGL. Specifically, such accounting systems do not:
  - Accumulate or transmit complete and accurate attribute data to support financial reporting requirements
  - Possess General Ledger Account Codes (GLAC) which match standard USSGL accounts correctly in all instances and require a crosswalk for reporting



- The DHP did not accumulate expenses for stockpile material in accordance with USSGL requirements. The DHP recorded stockpile material as operating expenses within the core accounting system. For additional details, see Section XI, *Operating Materials and Supplies (OM&S) and Stockpile Material*, in our *Report on Internal Control over Financial Reporting*
- Property, Plant, and Equipment (PP&E) capital expenditures were recorded as operating expenses within the core accounting system. The DHP was unable to separately identify capitalized expenses from non-capital expenses to appropriately record internal use software (IUS) expenditures in accordance with USSGL requirements. For additional details, see Section X, *IUS and IUS In-Development*, in our *Report on Internal Control over Financial Reporting*
- The DHP did not consistently track and accumulate revenue and accounts receivable data to post GL transactions consistent with USSGL requirements. The DHP had revenue and accounts receivable transactions recorded in subsidiary systems which were not recorded in the GL. For additional details, see Section VI, *Medical Revenue and Associated Receivables*, in our *Report on Internal Control over Financial Reporting*
- The DHP's financial statements included summarized amounts that could not be supported at the transaction level for:
  - Expenditure and obligation transactions for OM&S that were recorded in subsidiary systems but could not be reconciled to amounts recorded in the accounting system
  - Revenue transactions associated with patient care provided for which no underlying transactional activity is maintained.

#### **IV. The Debt Collection Improvement Act of 1996 (DCIA) (New Condition)**

The Debt Collection Improvement Act of 1996 (DCIA), as amended by the Digital Accountability and Transparency Act of 2014, requires that any non-tax debt or claim owed to the U.S. Government that is over 120 days delinquent, is required to be reported to the Department of the Treasury (Treasury) for purposes of administrative offset. The DHP did not transfer all outstanding eligible debt in accordance with DCIA requirements. The DHP had debts that were not referred to Treasury despite exceeding the delinquency threshold of 120 days. Outstanding debt not referred to Treasury exceeded 500 days delinquent on average.



# Response to Independent Auditor's Report



**DEFENSE HEALTH AGENCY**  
7700 ARLINGTON BOULEVARD, SUITE 5101  
FALLS CHURCH, VIRGINIA 22042-5101

## MEMORANDUM FOR KEARNEY AND COMPANY AUDITORS

SUBJECT: Management's Response to Independent Auditor's Report for Fiscal Year 2018

We appreciate the opportunity to comment on the Independent Auditor's Report on the Defense Health Programs Enterprise (DHP Enterprise) Fiscal Year (FY) 2018 consolidated financial statements, and the Reports on the Internal Control over Financial Reporting, and Compliance with Laws, Regulations, Contracts, and Grant Agreements. Although the FY 2018 audit resulted in a Disclaimer of Opinion, DHP Enterprise recognizes this was its first full scope audit and identified areas of opportunity for improvement throughout the organization.

We also acknowledge the material weaknesses identified in the Report on Internal Control over Financial Reporting and the findings identified in the Compliance with Laws, Regulations, Contracts, and Grant Agreements. We will continue to focus on efforts that implement risk management methodologies, modernize financial management systems, evaluate internal controls at the component level, and improve the accuracy of financial reporting. We will begin initiating root cause analyses and appropriate corrective action plans necessary to resolve financial reporting deficiencies. We will assess opportunities to enhance design and operating effectiveness of key controls as required. We are committed to timely implementation of enhancements and required change management processes.

DHP Enterprise has an obligation to the American taxpayer to be good stewards of its resources and to support sound business processes. DHP Enterprise understands providing reliable Information Technology systems and effective management internal controls are key to honoring these commitments. Thus, DHP Enterprise reiterates its continued focus on a strong internal control environment and highest standards of integrity and transparency in reporting its financial performance and looks forward to implementing recommendations to enhance existing controls and procedures related to DHP Enterprise's financial management processes.

If you have any question, please don't hesitate to call me. I can be reached at 703-681-7515 or [jeffrey.v.zottola.civ@mail.mil](mailto:jeffrey.v.zottola.civ@mail.mil).

  
Jeffrey V. Zottola  
Deputy Assistant Director (J-8)  
Chief Financial Officer



# Principal Financial Statements and Notes

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These financial statements have been prepared to report the financial position, results of operations, net position, and budgetary resources of DHP Enterprise, as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, other appropriate legislation, and in accordance with the form and content provided by OMB Circular A-136, *Financial Reporting Requirements*.

The responsibility for the integrity of the financial information contained within these statements rests with DHP Enterprise management. Kearney & Company, P.C. (Kearney) was the independent public accountant engaged to audit these financial statements. The Independent Auditor's Report accompanies the principal financial statements and notes.

A brief description of the nature of each required financial statement and the related notes are listed below.

## Consolidated Balance Sheet

The Balance Sheet presents amounts of current and future economic benefits owned or managed by DHP Enterprise (assets), amounts owed by DHP Enterprise (liabilities), and residual amounts which constitute the difference (net position).

## Consolidated Statement of Net Cost

The Statement of Net Cost presents the net cost of operations for the four program areas established in the DHP Enterprise's strategic plan. It also presents reimbursable costs related to services provided to other federal agencies and incurred costs that are not part of DHP Enterprise's core mission.

## Consolidated Statement of Changes in Net Position

The Statement of Changes in Net Position reports the change in net position during the period. Net position is affected by changes to its two components, unexpended appropriations and cumulative results of operations.

## Combined Statement of Budgetary Resources

The Statement of Budgetary Resources provides information about DHP Enterprise's budgetary resources, status of budgetary resources, and net outlays. The DHP Enterprise's budgetary resources consist of appropriations and spending authority from offsetting collections. Budgetary resources provide DHP Enterprise its authority to incur financial obligations that will ultimately result in outlays.

## Notes to Financial Statements

Notes to the financial statements communicate information essential for fair presentation of the financial statements that is not displayed on the face of the financial statement.

Department of Defense  
**Defense Health Program Enterprise**  
Consolidated Balance Sheet as of September 30, 2018  
(dollars in thousands)

		Unaudited FY 2018
<b>ASSETS (Note 2)</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$	20,533,206
Accounts Receivable (Note 4)		463,605
Total Intragovernmental Assets	\$	20,996,811
Accounts Receivable, Net (Note 4)	\$	701,933
Inventory and Related Property (Note 5)		32,461
General Property, Plant, and Equipment, Net (Note 6)		3,725,741
Other Assets (Note 7)		31,542
<b>TOTAL ASSETS</b>	<b>\$</b>	<b>25,488,488</b>
STEWARDSHIP PROPERTY, PLANT AND EQUIPMENT (Note 1)		
<b>LIABILITIES (Note 8)</b>		
Intragovernmental:		
Accounts Payable (Note 9)	\$	324,986
Other Liabilities (Note 10)		98,933
Total Intragovernmental Liabilities	\$	423,919
Accounts Payable (Note 9)	\$	676,201
Military Retirement and Other Federal Employment Benefits (Note 11)		251,338,190
Accrued Unfunded Annual Leave		335,237
Accrued Funded Payroll and Benefits		215,602
Environmental and Disposal Liabilities (Note 12)		15,566
Other Liabilities (Note 10)		34,118
<b>TOTAL LIABILITIES</b>	<b>\$</b>	<b>253,038,833</b>
COMMITMENTS AND CONTINGENCIES (Notes 13 and 14)		
<b>NET POSITION</b>		
Unexpended Appropriations	\$	19,243,749
Cumulative Results of Operations		(246,794,094)
<b>TOTAL NET POSITION</b>	<b>\$</b>	<b>(227,550,345)</b>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<b>\$</b>	<b>25,488,488</b>

The accompanying notes are an integral part of the statements.

Department of Defense

**Defense Health Program Enterprise**

Consolidated Statement of Net Cost for the year ended September 30, 2018

(dollars in thousands)

		Unaudited FY 2018
<b>Program Costs</b>		
<b>Operations, Readiness and Support</b>		
Gross Costs	\$	31,968,999
Less: Earned Revenue		(3,635,239)
Net Program Cost	\$	28,333,760
<b>Procurement</b>		
Gross Cost	\$	463,102
Less: Earned Revenue		(6,494)
Net Program Cost	\$	456,608
<b>Research, Development, Test and Evaluation</b>		
Gross Cost	\$	1,018,595
Less: Earned Revenue		(43,339)
Net Program Cost	\$	975,256
<b>Family Housing and Military Construction</b>		
Gross Cost	\$	(243,802)
Net Program Cost	\$	(243,802)
<b>Total Gross Costs</b>	<b>\$</b>	<b>33,206,894</b>
Less: Total Earned Revenue		(3,685,072)
<b>Net Program Cost</b>	<b>\$</b>	<b>29,521,822</b>
(Gain) from Actuarial Assumption Changes (Note 11)		(279,113)
<b>NET COST OF OPERATIONS</b>	<b>\$</b>	<b>29,242,709</b>

The accompanying notes are an integral part of the statements.



Department of Defense  
**Defense Health Program Enterprise**  
Consolidated Statement of Changes in Net Position for the year ended September 30, 2018  
(dollars in thousands)

		Unaudited FY 2018
<b>UNEXPENDED APPROPRIATIONS</b>		
Beginning Balances	\$	18,951,904
<b>Budgetary Financing Sources:</b>		
Appropriations received	\$	35,634,199
Appropriations transferred out		(1,191,372)
Other adjustments to Appropriations		(1,165,588)
Appropriations used		(32,985,394)
<b>Total Budgetary Financing Sources</b>	<b>\$</b>	<b>291,845</b>
<b>TOTAL UNEXPENDED APPROPRIATIONS</b>	<b>\$</b>	<b>19,243,749</b>
<b>CUMULATIVE RESULTS OF OPERATIONS</b>		
Beginning Balances	\$	(250,231,870)
<b>Budgetary Financing Sources:</b>		
Appropriations used	\$	32,985,394
Non-exchange revenue		7,771
Other Adjustments		(33,287)
<b>Other Financing Sources:</b>		
Transfers out without reimbursement		(572,060)
Imputed financing from costs absorbed by others		311,523
Other Adjustments		(18,856)
<b>Total Financing Sources</b>	<b>\$</b>	<b>32,680,485</b>
<b>Net Cost of Operations</b>	<b>\$</b>	<b>29,242,709</b>
Net Change	\$	3,437,776
<b>TOTAL CUMULATIVE RESULTS OF OPERATIONS</b>	<b>\$</b>	<b>(246,794,094)</b>
<b>TOTAL NET POSITION</b>	<b>\$</b>	<b>(227,550,345)</b>

The accompanying notes are an integral part of the statements.

Department of Defense  
**Defense Health Program Enterprise**  
Combined Statement of Budgetary Resources for the year ended September 30, 2018  
(dollars in thousands)

		Unaudited FY 2018
<b>BUDGETARY RESOURCES (Note 15)</b>		
Unobligated balance from prior year budget authority, net (discretionary and mandatory)	\$	5,752,610
Appropriations (discretionary and mandatory)		34,819,410
Spending Authority from offsetting collections (discretionary and mandatory)		3,529,955
<b>TOTAL BUDGETARY RESOURCES</b>	<b>\$</b>	<b>44,101,975</b>
<b>STATUS OF BUDGETARY RESOURCES</b>		
Total New obligations and upward adjustments	\$	38,799,770
Unobligated balance, end of year:		
Apportioned, unexpired accounts		3,357,330
Exempt from apportionment, unexpired accounts		122,809
Unapportioned, unexpired accounts		4,799
Unexpired unobligated balance, end of year	\$	3,484,938
Expired unobligated balance, end of year		1,817,267
Total Unobligated balance, end of year	\$	5,302,205
<b>TOTAL STATUS OF BUDGETARY RESOURCES</b>	<b>\$</b>	<b>44,101,975</b>
<b>OUTLAYS, NET</b>		
Outlays, net (discretionary and mandatory)	\$	32,929,101
Distributed offsetting receipts		(7,811)
<b>AGENCY OUTLAYS, NET</b>	<b>\$</b>	<b>32,921,290</b>

The accompanying notes are an integral part of the statements.

# Notes to the Financial Statements

## Note 1. Summary of Significant Accounting Policies

### 1. A. Reporting Entity Mission and Overall Structure

In 2011, the Deputy Secretary of Defense's Task Force on Reform of the Military Health System led to the creation of the Defense Health Agency (DHA), a Combat Support Agency (CSA) and a component of the Defense Health Program. In 2013, the DoD issued a directive in accordance with the Deputy Secretary of Defense memorandum formally establishing DHA as part of the DHP Enterprise, which achieved full operating capability by 2015. DHP Enterprise began preparing for the management and administration of MTFs in response to the FY 2017 NDAA. The DHP Enterprise receives its appropriation from Congress, apportioned by the Office of Management and Budget (OMB) to the Office of the Undersecretary of Defense (Comptroller), who allots these funds to the Assistant Secretary of Defense for Health Affairs (ASD(HA)). The ASD(HA) issues Funding Authorization Documents (FADs) to fund the 7 components that exist within DHP Enterprise. These 7 component entities collectively support DHP Enterprise's mission. With this appropriation, DHP Enterprise strives to promote a medically ready force by supporting a better, stronger, and more agile MHS, providing health care support for the full range of military operations, and sustaining the health of all those entrusted to its care. The DHP Enterprise's mission is to support the delivery of integrated, affordable, and high-quality health services to its beneficiaries and to drive greater global integration.

Based on DoD Directive 5136.01, the ASD(HA) exercises authority, direction, and control over DHP Enterprise and directs the use of its appropriations. For purposes of these consolidated and combined financial statements, the following 7 components comprise the DHP Enterprise financial statement reporting entity:

**U.S. Army Medical Command (Army MEDCOM):** Army MEDCOM provides sustained health services and research to enable readiness while caring for the soldiers and their families.

**The Navy Bureau of Medicine and Surgery (Navy BUMED):** Navy BUMED is a global health-care network that provides health-care support to the U.S. Navy, Marine Corps, their families, and veterans at medical treatment facilities, hospitals, clinics, hospital ships, and research units around the world.

**U.S. Air Force Medical Service (AFMS):** AFMS supports benefit execution and readiness to provide healthy/fit force, resilient families, and trained medics.

**Defense Health Agency (DHA) Financial Operations Division (FOD):** The DHA FOD distributes funding for DHA headquarters activities.

**Uniformed Services University of the Health Sciences (USUHS):** USUHS educates, trains, and prepares uniformed services health professionals, scientists, and leaders to support the Military and Public Health Systems, the National Security and National Defense Strategies of the United States, and the readiness of Uniformed Services.

**National Capital Region Medical Directorate (NCR MD):** The NCR MD supports the delivery of integrated, affordable, and high-quality health services and is responsible for driving greater integration of clinical and business processes across the National Capital Region.

**DHA Contract Resource Management Office (CRM):** The DHA CRM provides the following support: financial and reporting for TRICARE's centrally funded private-sector care; budget execution and component financial statements and notes preparation; and reimbursements for private-sector health-care providers for services rendered to TRICARE beneficiaries.



## 1. B. Basis of Accounting and Presentation

**Basis of Accounting and Presentation:** The DHP Enterprise's fiscal year ends September 30. These financial statements have been prepared to report the financial position, results of operations, net position, and budgetary resources of the DHP Enterprise, as required by the Chief Financial Officers (CFO) Act of 1990, expanded by the Government Management Reform Act (GMRA) of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the DHP Enterprise in accordance with, and to the extent possible, U.S. GAAP promulgated by the FASAB; OMB Circular A-136, *Financial Reporting Requirements*; and the DoD's *Financial Management Regulation (FMR)*.

The DHP Enterprise is presenting full financial statements for the first time in FY 2018. As a result, the DHP Enterprise financial statements only presents current year results of its operations, the financial position, the changes in the financial position, and the combined budgetary resources.

The accompanying financial statements account for all resources for which the DHP Enterprise is responsible unless otherwise noted. These financial statements, where possible, reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to the receipt or payment of cash. Budgetary accounting is designed to recognize the obligation of funds according to legal requirements, which in many cases is made prior to the occurrence of an accrual-based transaction. Budgetary accounting is essential for compliance with legal constraints and controls over the use of federal funds.

However, the DHP Enterprise is unable to fully implement all elements of U.S. GAAP as promulgated by FASAB and the form and content requirements for federal government entities specified by OMB in Circular A-136, *Financial Reporting Requirements*, due to limitations of financial and nonfinancial management processes and systems of certain component entities that support the financial statements. The DHP Enterprise derives reported values and information for major asset and liability categories largely from nonfinancial systems, such as logistical systems.

The DHP Enterprise's components' financial management systems used by DHP Enterprise are unable to meet all full accrual accounting requirements as many of their components' financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of U.S. GAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by U.S. GAAP. These systems were designed to support reporting requirements for maintaining accountability over assets, reporting the status of federal appropriations, and recording information on a budgetary basis, rather than preparing financial statements in accordance with U.S. GAAP. The DHP Enterprise continues to implement process and system improvements addressing these limitations.

**Elimination of Intra-Entity Transactions and Balances:** Accounting standards require an entity to eliminate intra-entity activity and balances from consolidated financial statements in order to prevent overstatement for business with itself. Transactions and balances within a reporting entity (intra-entity) have been eliminated from the *Consolidated Balance Sheet*, *Consolidated Statement of Net Cost*, and the *Consolidated Statement of Changes in Net Position*. The *Combined Statement of Budgetary Resources* is presented on a combined basis; therefore, intra-entity transactions and balances have not been eliminated from this statement.

**Entity and Non-Entity:** The DHP Enterprise reports both entity and non-entity assets. Entity assets are assets that the reporting entity has authority to use in its operations. Management may have authority to decide how funds are used or it may be legally obligated to use the funds a certain way. Non-entity assets are not available for use in DHP Enterprise's normal operations. The DHP Enterprise maintains stewardship accountability and reporting responsibilities for non-entity assets and will forward these non-entity assets to the Treasury or other federal agencies in the future. DHP Enterprise records a corresponding liability for these accounts receivable, net.

**Intragovernmental and Governmental Activities:** Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*, defines Intragovernmental and Governmental assets and liabilities. Intragovernmental assets and liabilities arise from transactions among federal entities. Intragovernmental assets are claims other federal entities owe to DHP Enterprise. Intragovernmental liabilities are claims DHP Enterprise owes to other federal entities.

Whereas governmental assets and liabilities arise from transactions of the federal government or an entity of the federal government with public entities, sometimes referred to as nonfederal entities. The term public entities encompasses domestic and foreign persons and organizations outside the U.S. Government. Governmental assets are claims of DHP Enterprise against public entities. Governmental liabilities are amounts that DHP Enterprise owes to public entities.

**Uses of Estimates:** The preparation of financial statements requires DHP Enterprise to make estimates and assumptions that affect these financial statements. Actual results may differ from these estimates.

**Discretionary and Mandatory Spending:** The DHP enterprise has both discretionary and mandatory spending. Discretionary spending is spending provided through an appropriations act(s). Mandatory spending is spending controlled by existing laws other than an appropriations act(s).

**Classified Activities:** SFFAS 56, *Classified Activities*, allows for certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information. As such, information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is not discernible.

## 1. C. Departures from U.S. GAAP

Financial management systems and operations continue to be refined as DHP Enterprise strives to record and report its financial activity in accordance with U.S. GAAP. The DHP Enterprise is determining the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with U.S. GAAP. One such action is the current revision of its accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). The DHP Enterprise has identified the following departures from U.S. GAAP, a number of which are pervasive problems within DoD that may not be remediated at the DHP Enterprise level.

**Definition of Reporting Entity:** The DHP Enterprise has not completed an appropriate assessment in accordance with SFFAS No. 47, *Reporting Entity*, in order to be able to properly define its financial reporting entity and ensure completeness of its financial statements and related disclosures, including beginning balances, at the Enterprise or component level. The DHP Enterprise has identified component reporting entities based on the reporting limits of the DHP appropriation, but a complete assessment of potential consolidation entities and disclosure entities for which the DHP Enterprise and its components are accountable has not been completed.

**Fund Balance with Treasury (Note 1.H. and Note 3):** The DHP Enterprise was not able to identify its undistributed collections and disbursements in a timely manner because the DHP Enterprise shares a Treasury Index (TI)-97 with Other Defense Organizations for Treasury reporting. In addition, the DHP Enterprise was not able to record and report transactions in suspense accounts since suspense balances are not included in FBWT balances. As a result, the DHP Enterprise is unable to explain discrepancies between its fund balance with treasury recorded in its general ledger accounts and the balance in the Treasury's accounts in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*.

**Accounts Receivable, Net and Revenue Recognition (Notes 1.E. and 1.J., and Note 4):** The DHP Enterprise did not have compliant processes in place to account for accounts receivable and the related revenue balances in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*, and SFFAS 7, *Accounting for Revenue and Other Financing Sources*.

The DHP Enterprise recorded accounts receivable and associated revenue upon the receipt of cash, instead of when earned. Additionally, the DHP Enterprise does not have an adequate process in place to accrue for pharmacy credits which it is owed but has not yet received.

The DHP Enterprise did not have a formal policy and procedures in place to estimate the allowance for uncollectible accounts receivable in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*.

**Inventory and Related Property, Net (Note 1.K. and Note 5):** The DHP Enterprise was not able to properly record and report inventory and other related property because its systems were not currently configured to support the management and valuation of all classes of inventory and related property in accordance with SFFAS 3, *Accounting for Inventory and Related Property*.

In addition, inventory and related property beginning balances have not been established using deemed cost as permitted by SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*.

**General Property, Plant, and Equipment, Net (Note 1.L. and Note 6):** Supportable general property, plant, and equipment, net beginning balances have not been established for facilities, equipment or internal use software using the alternative valuation methods permitted by SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment*.

The DHP Enterprise did not have compliant processes in place to account for general property, plant, and equipment, net, at historical cost, in accordance with SFFAS 6, *Accounting for Property, Plant and Equipment* and SFFAS 10, *Accounting for Internal Use Software*.

The DHP Enterprise has real property that meets both the reporting requirements of SFFAS and should be included on its balance sheet, however, portions of real property are excluded due to formal guidance from OUSD-C.

The DHP Enterprise did not have compliant processes in place to account for impairment of facilities and equipment in accordance with SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*.

**Leases (Note 1.L., Notes 6 and 13):** The DHP Enterprise did not have compliant processes in place to account for capital and operating leases in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government*, SFFAS 6, *Accounting for Property, Plant and Equipment*, and SFFAS 10, *Accounting for Internal Use Software*.

**Stewardship Property, Plant, and Equipment (Note 1.N.):** The DHP Enterprise did not have compliant processes for stewardship property, plant, and equipment which includes heritage assets in order to meet the disclosure requirements of SFFAS 29, *Heritage Assets and Stewardship Land*.

**Accounts Payable and Expenses (Note 1.O. and Note 9):** The DHP Enterprise did not have compliant processes in place to account for accounts payable, accruals, and the related expenses in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*, and SFFAS 5, *Accounting for Liabilities of the Federal Government*.

**Accrued Unfunded Annual Leave (Note 1.Q. and Note 8):** Due to system limitations, the DHP Enterprise was not able to fully recognize all of its accrued leave liability in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*.

**Federal Employee's Compensation Act (FECA) Liabilities (Note 1.O. and Note 11):** The DHP Enterprise did not report the FECA actuarial liabilities/expenses and chargeback billings in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government*.

**Environmental and Disposal Liabilities (Note 1.O. and Note 12):** The DHP Enterprise did not have compliant processes in place to account for cleanup cost associated with general property, plant, and equipment in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government*; SFFAS 6, *Accounting for Property, Plant and Equipment*; and *Federal Financial Accounting and Auditing Technical Release 2, Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*.



**Commitments and Contingencies (Note 1.R. and Note 14):** The DHP Enterprise did not have compliant processes in place to account for contingent legal liability arises from pending or threatened litigation and all contracts that contained clauses, such as price escalation, awarded fee payments, and/or dispute resolution due to the limited capabilities of the automated system processes to capture potential liabilities in accordance with SFFAS 5, *Accounting for Liabilities of The Federal Government* and SFFAS 12, *Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government*. Further, the DHP Enterprise does not have compliant processes in place to report an estimate of obligations related to canceled appropriations and amounts of contractual arrangements that may require future financial obligations.

Additionally, the DHP Enterprise did not have compliant processes in place to account for contingent liabilities arising from medical malpractice claims, claims brought under the Military Claims Act, and other settlements and judgments against the components of DHP Enterprise, in accordance with SFFAS 5, *as amended by SFFAS 12, Recognition of Contingent Liabilities Arising from Litigation*.

**Consolidated Statement of Net Cost (Note 1.U. and Note 16):** The DHP Enterprise did not have compliant processes in place to ensure its Consolidated Statement of Net Cost was presented in accordance with SFFAS 4, *Managerial Cost Accounting Concepts and Standards*, and SFFAS 55, *Amending Inter-Entity Cost Provisions*.

**Intra-Entity Activity:** The DHP Enterprise did not have compliant processes in place to account for intragovernmental transactions by customer in accordance with SFFAS 4, *Managerial Cost Accounting Concepts and Standards*, SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, and SFFAS 55, *Amending Inter-entity Cost Provisions*, which require that an entity eliminates intra-entity activity and balances from consolidated financial statements in order to prevent overstatement for business with itself.

## 1. D. Appropriations and Funds

**Appropriations:** The DHP Enterprise receives general fund appropriations. General funds are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and military construction. The DHP Enterprise uses these appropriations and funds to execute its missions and subsequently report on resource usage.

**Deposit Funds:** The DHP Enterprise maintains immaterial deposit funds. These funds are used to record amounts held temporarily until paid to the appropriate government or public entity. They are not the DHP Enterprise funds and as such, are not available for the DHP Enterprise operations. The DHP Enterprise is acting as an agent or a custodian for funds awaiting distribution.

## 1. E. Revenue and Other Financing Sources

**Exchange and Non-exchange Revenue:** The DHP Enterprise classifies revenue as either exchange revenue or non-exchange revenue. Exchange revenue is derived from transactions in which the DHP Enterprise provides goods and services to another party for a price; both the federal government and the other party receive value. Exchange revenue is presented on the *Consolidated Statement of Net Cost* and serves to offset the costs of goods and services. Non-exchange revenue is derived from the government's sovereign right to demand payment, such as specifically identifiable, legally enforceable claims. Non-exchange revenue is considered to reduce the cost of the DHP Enterprise operations and is therefore reported on the *Consolidated Statement of Changes in Net Position* as a financing source.

**Appropriations Used:** Most of the DHP Enterprise's operating funds are provided by congressional appropriations of budgetary authority. The DHP Enterprise receives appropriations on annual, multiple fiscal year, and no-year bases. Upon expiration of an annual or multiple fiscal year appropriation, the obligated and unobligated balances retain their fiscal

identity, and are maintained separately within an expired account. The unobligated balances can be used to make legitimate adjustments to prior year obligations, but are otherwise not available for new obligations. Annual and multiple fiscal year appropriations are canceled at the end of the fifth fiscal year after expiration. No-year appropriations do not expire. Appropriation of budget authority is recognized as used when costs are incurred, for example, when goods and services are received, or benefits and grants are provided.

**Imputed Financing Sources from Cost Absorbed by Others and Imputed Cost:** In certain cases, operating costs of the DHP Enterprise are paid in full or in part by funds appropriated to other federal entities. The DHP Enterprise includes applicable imputed costs in the *Consolidated Statement of Net Cost*. In addition, *Imputed Financing Sources from Cost Absorbed by Others* is recognized on the *Consolidated Statement of Changes in Net Position* as other financing source (non-exchange revenue).

The DHP Enterprise has elected to begin early implementation of SFFAS 55, *Amending Inter-Entity Cost Provisions*. SFFAS 55 permits entities to no longer recognize imputed costs and corresponding imputed financing from any non-business type activities, except for personnel benefit costs and Treasury Judgement Fund settlement costs.

The U.S. has cost-sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port (U.S. allies). However, the DHP Enterprise does not report the consolidated support provided by U.S. allies for common defense and mutual security on the *Consolidated Statement of Net Cost* and in Note 16, *Reconciliation of Net Cost of Operations to Budget*.

**Transfer In/(Out):** Intragovernmental transfers may include budgetary resources or assets without reimbursement, are recorded at book value, and reported in the *Consolidated Statement of Changes in Net Position*.

**Other Financing Sources:** The DHP Enterprises receives congressional appropriations as financing sources that expire annually, on a multi-year basis, or do not expire.

## 1. F. Recognition of Expenses

The DHP Enterprise estimates expenses for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. In the case of Operating Materiel & Supplies (OM&S), operating expenses are generally recognized when OM&S items are purchased.

OM&S is considered tangible personal property to be consumed in normal operations. The DHP Enterprise OM&S encompasses pharmaceuticals, pharmaceutical medical supplies, and non-pharmaceutical medical supplies.

## 1. G. Transactions with Foreign Governments and International Organizations

The DHP Enterprise sells services to foreign governments and international organizations under the provision of the Arms Export Control Act of 1976. Under the provisions of the Act, DoD has the authority to sell defense articles and services to foreign governments and international organizations, generally at no profit or loss to the federal government.

## 1. H. Fund Balance with Treasury

The U.S. Treasury Department performs cash management activities for all Federal Government agencies. The Fund Balance with Treasury (FBwT) represents the DHP Enterprise's right to draw funds from the Treasury for allowable expenditures. FBwT is increased by the receipt of appropriations and collections and decreased by outlays and fund transfers.

The U.S. Treasury maintains and reports fund balances at the Treasury Index appropriation level. Defense agencies, to include the DHP Enterprise, are included at the Treasury Index 97 appropriation level, an aggregate level that does not

provide identification of the separate defense agencies. As a result, the U.S. Treasury does not separately report on an amount for the DHP Enterprise.

FBwT is classified as unobligated available, unobligated unavailable, or obligated. Unobligated funds, depending on budget authority, are generally available for new obligations in current operations. The unavailable balance represents funds that were appropriated in prior years which are unavailable to fund new and future obligations. The obligated-not-yet-disbursed balance represents amounts designated for payment of goods and services ordered but not yet received, or goods and services received but for which payments have not been made.

The DHP Enterprise conducts a portion of operations overseas. Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations: (1) operations and maintenance; (2) military personnel; (3) military construction; (4) family housing operation and maintenance; and (5) family housing construction. The gains and losses are calculated as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year by OUSD-C. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation at the time of payment. The DHP Enterprise does not separately identify currency fluctuation transactions on its financial statements.

## 1. I. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury. Supported disbursements and collections have corroborating documentation for the summary-level adjustments made to accounts payable and receivable. Unsupported disbursements and collections do not have supporting documentation for the transaction. However, both supported and unsupported adjustments may have been made to the DoD or component entity in line with DoD accounts payable and receivable trial balances prior to validating underlying transactions.

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Supported undistributed disbursements and collections are then applied to reduce accounts payable and receivable accordingly. Unsupported undistributed disbursements are recorded as disbursements in transit and reduce nonfederal accounts payable. Unsupported undistributed collections are recorded in other liabilities due to the public.

### 1. J. Accounts Receivable, Net

Accounts receivable are amounts due to the DHP Enterprise from other federal entities or the public. All intragovernmental amounts are considered fully collectible because claims with other federal agencies are resolved in accordance with the intragovernmental business rules; therefore, no allowance for loss provision is recognized.

An allowance for loss on public receivables must be recorded, which will provide for reducing gross receivables by the amount of the estimated loss to their net realizable value. The CRM only recognizes an allowance for uncollectible amounts from the public. The method used to calculate the percentage for bad debt allowance on the accounts receivable balances is determined by taking a 12 month average of the accounts receivable balance against the 12 month average on the write off balance per each accounts receivable category. The data from the prior 12 months is used to calculate the percentages for the allowance. The CRM has one specific accounts receivable category that follows a different percentage calculation rule, the "Suspended Pharmacy" category. Per a DHA Program Integrity directive that prevents CRM's Pharmacy contractor from pursuing collection action against Suspended Pharmacies while under investigation, CRM uses a 100% allowance methodology for calculating the debt against the accounts receivable balance. Claims with other federal agencies are resolved in accordance with the intragovernmental business rules.



The DHP Enterprise is required to transfer the collection of accounts receivable at 120 days to the U.S. Treasury Department for additional collection efforts. Accounts receivable that are transferred to the U.S. Treasury Department for collection should remain on the DHP Enterprise's books until the U.S. Treasury Department acknowledges that the debt is uncollectible. Once the U.S. Treasury acknowledges that the debt is uncollectible, the DHP Enterprise will close out the bad debt and take it off their books.

## 1. K. Inventory and Related Property

The DHP Enterprise inventory and related property includes stockpile materials. Stockpile materials are strategic and critical materials held due to statutory requirements for use in national defense, conservation, or national emergencies. Stockpile materials are not held with the intent of selling in the ordinary course of business. The DHP Enterprise is required to maintain various medications for the DoD in the event a medical epidemic reaches the United States.

## 1. L. General Property, Plant, and Equipment, Net

**Capitalization Threshold:** The DHP Enterprise capitalizes acquisitions of fixed assets when the acquisition costs equal or exceed \$250 thousand and the fixed assets has a useful life greater than two years.

### **Depreciation Method:**

Asset Classes	Depreciation/Amortization Method	Service Life
Buildings, Structures, and Facilities	S/L*	20, 40 or 45
Software, Internal Use Software	S/L	2-5 or 10
Equipment	S/L	5

\*Straight line (S/L)

**Buildings, structures, and facilities:** Real property in the federal government generally includes land, land improvements, buildings, facilities, and structures. The DHP Enterprise does not own land or land improvements. However, for buildings, facilities, and structures, OUSD-C directed the DHP Enterprise to stop reporting these types of real property assets. As of September 30, 2018, the real property balance on the *Consolidated Balance Sheet* included certain facilities and structures.

**Equipment:** Equipment includes equipment, software purchased, and internal use software meeting the capitalization threshold and expected to be used in the DHP Enterprise's operations.

**Software:** The DHP Enterprise has not fully developed and executed its accounting policy and related reporting for software and internal use software.

**Construction-In-Progress (CIP):** In accordance with Technical Bulletin 2017-2, *Assigning Assets to Component Reporting Entities*, a policy change issued by the OUSD-C requires the DHP Enterprise components that are allocated construction funds to record CIP projects on that component's books. Completed CIP projects are then transferred to the respective Military Department property holder. The DHP Enterprise allocates and provides oversight for all its military construction. The U.S. Army Corps of Engineers, and Naval Facilities and Engineering Command, and the Air Force Civil Engineering Center are the execution agents for all DHP Enterprise CIP and related funds received.

**Leases:** The DHP Enterprise has not fully developed and executed its accounting policy and related reporting requirements for its lease activity. The DHP Enterprise is in the process of performing an analysis of its lease contracts, but that process has not yet been completed as of September 30, 2018.

## 1. M. Other Assets

**Advances and Prepayments:** When advances are permitted by law, legislative action, or presidential authorization, the DHP Enterprise's policy is to record advances or prepayments. As such, payments made in advance of the receipt of goods and services are reported as assets on the *Consolidated Balance Sheet*. The DHP Enterprise's policy is to expense and/or properly classify assets when the related goods and services are received.

## 1. N. Stewardship Property, Plant, and Equipment

Disclosures for stewardship property, plant, and equipment are required under SFFAS 29, *Heritage Assets and Stewardship Land*. DHP Enterprise has heritage assets. Heritage assets are unique for one or more of the following reasons: (1) historical or natural significance, (2) cultural, educational, or artistic importance, or (3) significant architectural characteristics. Heritage assets are generally expected to be preserved indefinitely. The DHP Enterprise operates the National Museum of Health and Medicine.

## 1. O. Liabilities

Liabilities represent probable and measurable amounts to be paid by the DHP Enterprise as a result of past transactions and are recognized when incurred, regardless of whether there are budgetary resources available to pay them. However, the liquidation of these liabilities will consume budgetary resources and cannot be made until available budgetary resources have been obligated. Thus, for financial reporting purposes, the liabilities are classified as liabilities covered or not covered by budgetary resources.

**Covered and Uncovered Liabilities:** Liabilities incurred that are covered by available budgetary resources as of the *Consolidated Balance Sheet* date are referred to as funded liabilities. Liabilities are covered by budgetary resources if they are funded by appropriations, provided that the resources are apportioned by OMB without further action by the Congress and without a contingency having to be met first. Budgetary resources include: (1) new budget authority, (2) unobligated balances of budgetary resources at the beginning of the year or net transfers of prior-year balances during the year, (3) spending authority from offsetting collections (credited to an appropriation or fund account), and (4) recoveries of unexpired budget authority through downward adjustments of prior-year obligations.

Liabilities that are not covered by available budgetary resources as of the *Consolidated Balance Sheet* date are referred to as unfunded liabilities.

**Current and Noncurrent Liabilities:** The DHP Enterprise segregates its other liabilities between current and noncurrent liabilities. The current liabilities represent liabilities that the DHP Enterprise expects to settle within the 12 months of the Balance Sheet date. Noncurrent liabilities represent liabilities that DHP Enterprise does not expect to be settled within the 12 months of the Balance Sheet date.

**Accounts Payable:** Accounts payable are amounts primarily owed for goods, services, or capitalized assets received, progress on contract performance by others, and other expenses due.

**FECA Liabilities:** FECA liabilities provide income and medical cost protection to covered federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (DOL), which pays valid claims against the DHP Enterprise and subsequently seeks reimbursement from DHP Enterprise for these paid claims. Therefore, the accrued FECA liability, included in Intragovernmental Other Liabilities, represents amounts due to DOL for claims paid on behalf of the DHP Enterprise. These liabilities are not covered by budgetary resources because funding has not been made available.

In addition, the DHP Enterprise recognizes an actuarial FECA liability. The actuarial FECA liability represents the liability for future workers' compensation (FWC) benefits, which includes the expected liability for death, disability, medical, and miscellaneous costs for approved cases. The liability is determined by DOL annually, as of September 30, using a method that utilizes historical benefits payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Projected annual payments were discounted to present value based on OMB's interest rate assumptions, which were interpolated to reflect the average duration in years for income payments and medical payments.

To provide more specifically for the effects of inflation on the liability for FWC benefits, wage inflation factors (cost-of-living adjustment) and medical inflation factors (consumer price index – medical) are applied to the calculation of projected future benefits. The actual rates for these factors are also used to adjust the historical payments to current-year constant dollars. These liabilities are not covered by budgetary resources because funding has not been made available.

**Environmental and Disposal Liabilities:** The DHP Enterprise has not fully developed and executed its accounting policy and related reporting for environmental and disposal liabilities. These liabilities are not covered by budgetary resources because funding has not been made available.

## 1. P. Military Retirement and Other Federal Employment Benefits

Military Retirement and Other Federal Employment Benefits provide income and medical benefits to covered military personnel and Federal civilian employees. These actuarial liabilities are not covered by budgetary resources because funding has not yet been made available.

The DHP Enterprise implemented requirements of SFFAS No. 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, which directs that the discount rate, underlying inflation rate, and other economic assumptions be consistent with one another. A change in the discount rate may cause other assumptions to change as well. For the September 30, 2018, financial statement valuation, the application of SFFAS No. 33 required DoD OACT to set the long-term inflation, the Consumer Price Index (CPI), the DHP actuarial liability is adjusted at the end of each fiscal year. The 4th Quarter, FY 2018 balance represents the September 30, 2018 amount that will be effective through 3rd quarter of FY 2019.

## 1. Q. Accrued Unfunded Annual Leave

Accrued leave includes salaries, wages, and other compensation earned by employees, but not disbursed as of September 30, 2018. Annually, as of September 30, the balances of accrued unfunded annual leave are adjusted to reflect current pay rates. Sick leave and other types of non-vested leave are expensed as taken. These liabilities are not covered by budgetary resources because funding has not yet been made available.

## 1. R. Commitments and Contingencies

A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. SFFAS 5, *Accounting for Liabilities of the Federal Government*, as amended by SFFAS 12, *Recognition of Contingent Liabilities Arising from Litigation*, requires contingent liabilities and related expenses to be recognized when a past event has occurred, and a future outflow or other sacrifice of resources is measurable and probable. Further, SFFAS 5, as amended, requires (1) report a contingent liability on the balance sheet when an unfavorable outcome is 'probable,' and (2) disclose a contingent liability in the notes to the financial statements when an unfavorable outcome is 'reasonably possible.' No disclosure is required if the loss from a contingent liability is considered 'remote.'

A contingent legal liability arises from pending or threatened litigation, possible claims, and assessments which could result in monetary loss to an entity. The actual monetary liability in contingent legal cases can be considered case-by-case or as an aggregate of multiple cases.

The DHP Enterprise's risk of loss and resultant contingent liabilities arising from pending or threatened litigation or claims and assessments are due to events such as medical malpractice, property or environmental damages, and contract disputes.

## 1. S. Net Position

Net position is the residual difference between assets and liabilities, and is comprised of Unexpended Appropriations and Cumulative Results of Operations.

**Unexpended Appropriations:** Unexpended appropriations represent the amounts of budgetary resources that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments that have not been incurred.

**Cumulative Results of Operations:** Cumulative Results of Operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. The cumulative results of operations also include transfers in and out of assets that were not reimbursed.

## 1. T. Treaties for Use of Foreign Bases

The DHP Enterprise has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. Generally, the treaty terms allow the DHP Enterprise continued use of these properties until the treaties expire. The DHP Enterprise purchases capital assets overseas with appropriated funds; however, the host country retains title to the land and capital improvements. In the event treaties or other agreements are terminated, use of the foreign bases is prohibited and losses are recorded for the value of any non-retrievable capital assets. The settlement due to the U.S. or host nation is negotiated and takes into account the value of capital investments and may be offset by the cost of the environmental cleanup.

## 1. U. Consolidated Statement of Net Cost

The *Consolidated Statement of Net Cost* represents the net cost of programs that are supported by appropriations or other means. The intent of the *Consolidated Statement of Net Cost* is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The DHP Enterprise current processes and systems capture costs based on appropriations groups. The lower level costs for major programs are presented on the statement as required by the Government Performance and Results Modernization Act of 2010.

Effective FY 2018, the Department elected early implementation of SFFAS No. 55, *Amending Inter-entity Cost Provisions*, which rescinds SFFAS No. 30, *Inter-Entity Cost Implementation: Amending SFFAS No. 4, Managerial Cost Accounting Standards and Concepts and Interpretation 6, Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4.* The DoD is in the process of reviewing available data and developing a cost reporting methodology as required by the SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, as amended.

## 1. V. Tax Status

The DHP Enterprise is not subject to federal, state, or local income taxes. Accordingly, no provision for income taxes is recorded.



## Note 2. Non-Entity Assets

Non-entity assets consisted of the following as of September 30, 2018 (*dollars in thousands*):

		Unaudited
<b>Non-Entity Assets with the Public</b>		
Accounts Receivable, Net	\$	3,225
<b>Total Non-Entity Assets with the Public</b>	\$	<b>3,225</b>
<b>Total Entity Assets</b>	\$	<b>25,485,263</b>
<b>Total Assets</b>	\$	<b>25,488,488</b>

The non-entity accounts receivable due from the public, restricted by nature, consists of refund receivables, interest receivables, penalties and fines, and the related allowance for loss on interest receivables. As debts are repaid, they are deposited to Treasury.

The DHP Enterprise acknowledges various departures from U.S. GAAP as discussed in Note 1.C, *Departures from U.S. GAAP*.

## Note 3. Fund Balance with Treasury

Fund balance with Treasury consisted of the following as of September 30, 2018 (*dollars in thousands*):

		Unaudited
<b>Status of Fund Balance with Treasury</b>		
Unobligated Balance		
Available	\$	3,480,139
Unavailable		1,822,066
Obligated Balance not yet Disbursed		15,842,634
<b>Total Status of Fund Balance with Treasury</b>	\$	<b>21,144,839</b>
Non-Fund Balance with Treasury Budgetary Accounts	\$	(611,633)
<b>Total Fund Balance with Treasury</b>	\$	<b>20,533,206</b>

Unobligated and obligated balances presented in this note may not equal related amounts reported on the *Combined Statement of Budgetary Resources* because unobligated and obligated balances reported on the *Combined Statement of Budgetary Resources* are supported by fund balance with Treasury and as other budgetary resources that do not affect fund balance with Treasury.

Non-Fund Balance with Treasury Budgetary Accounts reduce the Status of Fund Balance with Treasury. This amount is comprised of unfilled customer orders without advance and reimbursements and other income earned and not collected.

The DHP Enterprise acknowledges departures from U.S. GAAP related to fund balance with Treasury as discussed in Note 1.C, *Departures from U.S. GAAP*.

#### Note 4. Accounts Receivable, Net

Accounts receivable, net consisted of the following as of September 30, 2018 (*dollars in thousands*):

	<i>Unaudited</i>		
	Gross Amount Due	Allowance For Estimated Uncollectible	Accounts Receivable, Net
<b>Accounts Receivable</b>			
Intragovernmental Receivables	\$ 463,605	N/A	\$ 463,605
Receivables due from the Public	\$ 844,918	\$ (142,985)	\$ 701,933
<b>Total Accounts Receivable, Net</b>	<b>\$ 1,308,523</b>	<b>\$ (142,985)</b>	<b>\$ 1,165,538</b>

Intragovernmental receivables represent amounts due from other federal agencies. As of September 30, 2018, CRM had recorded \$188,600 thousand related to the Standard Discount Program (SDP) and the Additional Discount Program (ADP). The SDP resulted from the implementation of the Federal Ceiling Program for the TRICARE Retail Pharmacy Refunds Program as required by the FY 2008 National Defense Authorization Act, Section 703. The ADP resulted from voluntary agreements between TRICARE and the pharmaceutical manufacturers providing additional discounts above the SDP.

The DHP Enterprise acknowledges departures from U.S. GAAP related to accounts receivable, net as discussed in Note 1.C, *Departures from U.S. GAAP*.

#### Note 5. Inventory and Related Property

Inventory and related property as of September 30, 2018 (*dollars in thousands*):

	<i>Unaudited</i>
<b>Inventory and Related Property</b>	
Stockpile Materials Held in Reserve for Future Use	\$ 32,461
<b>Total Inventory and Related Property</b>	<b>\$ 32,461</b>

The DHP Enterprise utilizes both the actual cost and lower of cost or market valuation methods for determining its stockpile materials. Stockpile materials are restricted for use, to be used only in the event of a nationwide pandemic.

The DHP Enterprise acknowledges departures from U.S. GAAP related to inventory and related property as discussed in Note 1.C, *Departures from U.S. GAAP*.

## Note 6. General Property, Plant, and Equipment, Net

General property, plant, and equipment, net consisted of the following as of September 30, 2018 (*dollars in thousands*):

	Unaudited		
	Acquisition Value	(Accumulated Depreciation / Amortization)	Net Book Value
<b>Major Fixed Asset Classes</b>			
Buildings, Structures, and Facilities	\$ 1,556	\$ -	\$ 1,556
Software	393,919	(315)	393,604
General Equipment	1,667,477	(1,329,544)	337,933
Construction-in-Progress (CIP)	2,986,507	N/A	2,986,507
Other	19,322	(13,181)	6,141
<b>Total General Property, Plant, and Equipment</b>	<b>\$ 5,068,781</b>	<b>\$ (1,343,040)</b>	<b>\$ 3,725,741</b>

The majority of general property, plant, and equipment, net owned or leased by DHP Enterprise is primarily used to provide high quality, cost effective health care services to active forces and other eligible beneficiaries. The DHP Enterprise facilities range from sophisticated tertiary care medical centers to outpatient and dental clinics and physiological training units. Dental, surgical, radiographic, and pathologic equipment is essential to providing high quality health care services that meet accepted standards of practice. The required safety standards, related laws and regulatory requirements from credentialing and health care standard setting organizations influence and affect the requirement for, cost of, and replacement and modernization of medical equipment. The DHP Enterprise also acquires and leases capital equipment for MTFs and participates in other selected health care activities such as acquiring equipment for the initial outfitting of a newly constructed, expanded, or modernized health care facility; equipment for modernization and replacement of uneconomically repairable items; equipment supporting programs such as pollution control, clinical investigation, and occupational/environmental health; and MHS information technology (IT) requirements.

MHS GENESIS is the new electronic health record system that manages military patient health information. MHS GENESIS integrates inpatient and outpatient solutions that will connect medical and dental information across the continuum of care, from point of injury to the MTF. When fully deployed, MHS GENESIS will provide a single health record for service members, veterans, and their families. The DHP Enterprise acknowledges that MHS GENESIS is not presented in the balances above based on ongoing assessment of system for accounting and valuation purpose.

The DHP Enterprise has the use of overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. Generally, treaty terms allow DHP Enterprise continued use of these properties until the treaties expire. There are no other know restrictions on general property, plant, and equipment.

Depreciation and amortization expense totaled \$72,150 thousand for the year ended, September 30, 2018. Loss on disposition of assets totaled \$3,309 thousand for the year ended, September 30, 2018.

The DHP Enterprise acknowledges departures from U.S GAAP related to general property, plant, and equipment, net as discussed in Note 1.C, *Departures from U.S. GAAP*.

## Note 7. Other Assets

Other assets consisted of the following as of September 30, 2018 (*dollars in thousands*):

		Unaudited
<b>Other Assets</b>		
Advances and Prepayments	\$	31,542
<b>Total Other Assets</b>	\$	<b>31,542</b>

## Note 8. Liabilities

Liabilities include both covered and not covered by budgetary resources and consisted of the following as of September 30, 2018 (*dollars in thousands*):

		Unaudited
<b>Liabilities</b>		
<b>Intragovernmental</b>		
Other	\$	47,132
<b>Total Intragovernmental</b>	\$	<b>47,132</b>
<b>Liabilities Due to the Public</b>		
Accounts Payable	\$	30,895
Military Retirement and Other Federal Employment Benefits		251,338,190
Accrued Unfunded Annual Leave		335,237
Environmental and Disposal Liabilities		15,566
<b>Total Liabilities Due to the Public</b>	\$	<b>251,719,888</b>
<b>Total Liabilities Not Covered by Budgetary Resources</b>	\$	<b>251,767,020</b>
<b>Total Liabilities Covered by Budgetary Resources</b>	\$	<b>1,271,813</b>
<b>Total Liabilities</b>	\$	<b>253,038,833</b>

The DHP Enterprise acknowledges departures from U.S. GAAP related to various liabilities as discussed in Note 1.C, *Departures from U.S. GAAP*.



## Note 9. Accounts Payable

Accounts payable consisted of the following as of September 30, 2018 (*dollars in thousands*):

	Unaudited		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
<b>Accounts Payable</b>			
Intragovernmental Payables	\$ 324,986	\$ -	\$ 324,986
Payables due to the Public	\$ 676,184	\$ 17	\$ 676,201
<b>Total Accounts Payable</b>	<b>\$ 1,001,170</b>	<b>\$ 17</b>	<b>\$ 1,001,187</b>

Accounts payable include amounts owed to federal and public entities for goods and services received.

The DHP Enterprise acknowledges departures from U.S. GAAP related to accounts payable as discussed in Note 1.C, *Departures from U.S. GAAP*.

## Note 10. Other Liabilities

Other liabilities consisted of the following as of September 30, 2018 (*dollars in thousands*):

	Unaudited		
	Current Liability	Noncurrent Liability	Total
<b>Other Liabilities</b>			
<b>Intragovernmental Other Liabilities</b>			
Advances from Others	\$ 13,967	\$ -	\$ 13,967
FECA Reimbursements due to DOL	19,761	26,250	46,011
Employer Contributions and Payroll Taxes Payable	34,345	-	34,345
Other Liabilities	4,514	96	4,610
<b>Total Intragovernmental Other Liabilities</b>	<b>\$ 72,587</b>	<b>\$ 26,346</b>	<b>\$ 98,933</b>
<b>Due to the Public Other Liabilities</b>			
Advances from Others	\$ 3,663	\$ 3,434	\$ 7,097
Employer Contributions and Payroll Taxes Payable	20,274	-	20,274
Other Liabilities	6,747	0	6,747
<b>Total Due to the Public Other Liabilities</b>	<b>\$ 30,684</b>	<b>\$ 3,434</b>	<b>\$ 34,118</b>
<b>Total Other Liabilities</b>	<b>\$ 103,271</b>	<b>\$ 29,780</b>	<b>\$ 133,051</b>

**Advances from Others** represent liabilities for collections received to cover future expenses or acquisition of assets.

**FECA Reimbursements due to DOL** provides benefit coverage for death, disability, medical, and miscellaneous costs for approved cases of on the job incidents. FECA claims are submitted to and approved by the DOL.

**Employer Contributions and Payroll Taxes Payable** represents the employer portion of payroll taxes and benefit contributions for health benefits, retirement, life insurance and voluntary separation incentive payments.

The DHP Enterprise acknowledges departures from U.S. GAAP related to various liabilities as discussed in Note 1.C, *Departures from U.S. GAAP*.

### Note 11. Military Retirement and Other Federal Employment Benefits

Military retirement and other federal employment benefits consisted of the following as of September 30, 2018 (*dollars in thousands*):

	Unaudited Unfunded Liabilities
<b>Military Retirement and Other Federal Employment Benefits</b>	
<b>Pension and Health Benefits</b>	
Military Pre Medicare-Eligible Retiree Health Benefits	\$ 249,693,998
<b>Total Pension and Health Benefits</b>	<b>\$ 249,693,998</b>
<b>Other Benefits</b>	
FECA	\$ 213,964
Other	1,430,228
<b>Total Other Benefits</b>	<b>\$ 1,644,192</b>
<b>Total Military Retirement and Other Federal Employment Benefits</b>	<b>\$ 251,338,190</b>

The actuarial liability consists of the following as of September 30, 2018 (*dollars in thousands*):

	Unaudited Military Pre Medicare-Eligible Retiree Health Benefits
<b>Actuarial Liability</b>	
Beginning Actuarial Liability	\$ 252,512,861
<b>Expenses</b>	
Normal Cost	\$ 10,135,672
Interest Cost	9,772,839
Plan Amendments	(2,678,284)
Actuarial Experiences Gains	(8,729,912)
Other factors	(1)
<b>Total Expenses before Gains from Actuarial Assumption Changes</b>	<b>\$ 8,500,314</b>
<b>Actuarial Assumption Changes</b>	
Changes in trend assumptions	\$ (3,804,999)
Changes in assumptions other than trend	3,525,886
<b>Total (Gains) from Actuarial Assumption Changes</b>	<b>\$ (279,113)</b>
<b>Total Expenses</b>	<b>\$ 8,221,201</b>
Less: Benefit Outlays	11,040,064
<b>Total Changes in Actuarial Liability</b>	<b>\$ (2,818,863)</b>
<b>Ending Actuarial Liability (Total Pension and Health Benefits)</b>	<b>\$ 249,693,998</b>

Military Retirement and Other Federal Employment Benefits provide income and medical benefits to covered military personnel and Federal civilian employees. These actuarial liabilities are not covered by budgetary resources because funding has not yet been made available. The DoD Office of the Actuary (DoD OACT) calculates this actuarial liability at the end of each fiscal year using the current active and retired population plus assumptions about future demographic and economic conditions.

The DHP Enterprise implemented requirements of SFFAS No. 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, which directs that the discount rate, underlying inflation rate, and other economic assumptions be consistent with one another. A change in the discount rate may cause other assumptions to change as well. For the September 30, 2018, financial statement valuation, the application of SFFAS No. 33 required DoD OACT to set the long-term inflation, the Consumer Price Index (CPI), the DHP actuarial liability is adjusted at the end of each fiscal year. The 4th Quarter, FY 2018 balance represents the September 30, 2018 amount that will be effective through 3rd quarter of FY 2019.

**Actuarial Cost Method:** As prescribed by SFFAS No. 5, the valuation of the Military Retirement Health Benefits is performed using the Aggregate Entry Age Normal (AEAN) cost method. AEAN is a method whereby projected retiree medical plan costs are spread over the projected service of a new entrant cohort.

**Assumptions:** For the FY 2018 financial-statement valuation, the long-term assumptions include a 3.6% discount rate and medical trend rates that were developed using a 1.5% inflation assumption. Note that the term 'discount rate' refers to the interest rate used to discount cash flows. The terms 'interest rate' and 'discount rate' are often used interchangeably in this context.

The change in the long-term assumptions is due to the application of SFFAS No. 33. This applicable financial statement standard is discussed further below. The standard is discussed further below. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on a blend of actual experience and future expectations. Because of reporting deadlines and as permitted by SFFAS No. 33, the current year actuarial liability is rolled forward from the prior year valuation results using accepted actuarial methods. This roll-forward process is applied annually. In calculating the FY 2018 "rolled-forward" actuarial liability, the following assumptions were used:

Discount Rate	3.6%	
Inflation	1.5%	
Medical Trend (Non-Medicare)	FY 2017 – FY 2018	Ultimate Rate FY 2042
Direct Care Inpatient	4.45%	4.00%
Direct Care Outpatient	6.00%	4.00%
Direct Care Prescription Drugs	6.00%	4.00%
Purchased Care Inpatient	1.95%	4.00%
Purchased Care Outpatient	3.30%	4.00%
Purchased Care Prescription Drugs	3.28%	4.00%
Purchased Care USFHP	3.95%	4.00%

After a 25 year select period, an ultimate trend rate is assumed for all future projection years.

The DHP Enterprise's actuarial liability decreased \$2.8 billion (1.1%). This resulted from the net effect of: an increase of \$8.9 billion due to expected increases (interest cost plus normal cost less benefit outlays), a decrease of \$0.3 billion due to changes in key assumptions; a decrease of \$2.7 billion due to plan changes; and a decrease of \$8.7 billion due to actual experience being different from what was assumed (demographic and claims data).

DoD complies with SFFAS No. 33. The standard requires the separate presentation of gains and losses from changes in long-term assumptions used to estimate liabilities associated with pensions, other retirement and other postemployment benefits. SFFAS No. 33 also provides a standard for selecting the discount rate and valuation date used in estimating these liabilities. SFFAS No. 33, as published on October 14, 2008, by the FASAB requires the use of a yield curve based on marketable U.S. Treasury Securities to determine the discount rates used to calculate actuarial liabilities for federal financial statements. Historical experience is the basis for expectations about future trends in marketable Treasury securities.

The statement is effective for periods beginning after September 30, 2009, and applies to information provided in general purpose federal financial statements. It does not affect statutory or other special-purpose reports, such as Pension or Other Retirement Benefit reports. SFFAS No. 33 requires a minimum of five periodic rates for the yield curve input and consistency in the number of historical rates used from period to period. It permits the use of a single average discount rate if the resulting present value is not materially different from what would be obtained using the yield curve.

For the September 30, 2018 financial-statement valuation, DoD OACT determined a single equivalent discount rate of 3.6% by using a 10-year average of quarterly zero coupon Treasury spot rates. These spot rates are based on the U.S. Department of the Treasury – Office of Economic Policy's 10-year Average Yield Curve for Treasury Nominal Coupon Issues (TNC yield curve), which represents average rates from April 1, 2008 through March 31, 2018.

**Other Benefits** This amount is calculated by the DoD OACT and provided to the DHP Enterprise for inclusion. The amounts captured are primarily for Incurred but not Reported (IBNR) Claim Estimates of (\$1,406,221) thousand plus administrative expenses of (\$4,532) thousand plus adverse experience margins (\$19,203) thousand, and Life Insurance Reserve amount of (\$242) thousand.

The DHP Enterprise acknowledges departures from U.S. GAAP related to FECA liabilities as discussed in Note 1.C, *Departures from U.S. GAAP*.



## Note 12. Environmental and Disposal Liabilities

Environmental and disposal liabilities consisted of the following as of September 30, 2018 (*dollars in thousands*):

	Unaudited	
Environmental and Disposal Liabilities due to the Public		
Environmental Disposal for Military Equipment / Weapons Programs		
Nuclear Powered Military Equipment / Spent Nuclear Fuel	\$	15,497
Other Accrued Environmental Liabilities - Non-BRAC		69
Total Environmental and Disposal Liabilities due to the Public	\$	15,566

Applicable laws and regulations for cleanup requirements:

- (a) Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)
- (b) Superfund Amendments and Reauthorization Act (SARA)
- (c) Clean Water Act
- (d) Safe Drinking Water Act
- (e) Clean Air Act
- (f) Resource Conservation and Recovery Act (RCRA)
- (g) Toxic Substances Control Act (TSCA)
- (h) Medical Waste Tracking Act
- (i) Atomic Energy Act
- (j) Nuclear Waste Policy Act
- (k) Low Level Radioactive Waste Policy Amendments Act

The DHP Enterprise is required to clean up contamination from past waste disposal practices, leaks, spills, and other activity resulting in public health or environmental risk. The DHP Enterprise accomplishes this effort in coordination with regulatory agencies and, if applicable, other responsible parties and current property owners. The DHP Enterprise is also required to recognize closure and post-closure costs for its general property, plant, and equipment, and environmental corrective action costs for current operations. Each of DHP Enterprise's major reporting entities is responsible for tracking and reporting all required environmental information related to environmental restoration costs, other accrued environmental costs, disposal costs of weapon systems, and environmental costs related to BRAC actions.

The DHP Enterprise follows the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA, Public Law 96-510), Superfund Amendments and Reauthorization Act of 1986 (SARA, Public Law 99-499), Resource Conservation and Recovery Act (RCRA, Public Law 94-580) or other applicable federal or state laws to clean up contamination. The CERCLA and RCRA require DHP Enterprise to clean up contamination in coordination with regulatory agencies, current owners of property damaged by DHP Enterprise and third parties with partial responsibility for environmental restoration. Failure to comply with agreements and legal mandates puts DHP Enterprise at risk of incurring fines and penalties.

The Nuclear Waste Policy Act of 1982 (Public Law 97-425) requires owners and generators of high-level nuclear waste and spent nuclear fuel to pay their share of the cost of the program. The Low-Level Radioactive Waste Policy Amendments Act of 1985 (Public Law 99-240) provides for the safe and efficient management of low-level radioactive waste.

For DHP Enterprise the types of environmental liabilities and disposal liabilities identified as nuclear or non-nuclear. Nuclear liabilities arise from a research reactor and irradiators. Non-nuclear liability arises from medical and chemical cleanup.

The DHP Enterprise is not aware of any pending changes but the liability can change in the future due to changes in laws and regulations, changes in agreements with regulatory agencies, and advances in technology.

Accounting estimates for environmental liabilities use reasonable judgments and assumptions based on available information. Actual results may materially vary if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. Liabilities can be further affected if investigation of the environmental sites reveals contamination levels differing from estimate parameters. The DHP Enterprise tangible property, plant, and equipment contains nonfriable asbestos. At this time, the DHP Enterprise is unable to reasonably estimate the clean-up costs.

The DHP Enterprise acknowledges departures from U.S GAAP related to environmental and disposal liabilities as discussed in Note 1.C, *Departures from U.S. GAAP*.

### Note 13. Operating Leases

Future payments due under operating leases consisted of the following as of September 30, 2018 (*dollars in thousands*):

ENTITY AS LESSEE-Operating Leases		Unaudited Asset Category Facilities
Future Payments Due		
Fiscal Year	Total	Future Leases Payments
2019	\$	20,829
2020		21,662
2021		22,529
2022		23,430
2023		24,367
After 5 Years		25,341
<b>Total Future Lease Payments Due</b>	<b>\$</b>	<b>138,158</b>

Future minimum rental payments presented above reflect lease arrangements that have been identified in fiscal year 2019 related to the Community-Based Homes Effort. As of September 30, DHP Enterprise was committed to non-cancellable operating leases covering the Community-Based Homes Effort, an initiative under the control of U.S. Army MEDCOM to allow soldiers to remain on active duty while undergoing medical treatment, and to live and perform those duties close to their homes.

The DHP Enterprise acknowledges departures from U.S. GAAP related to leases as discussed in Note 1.C., *Departures from U.S. GAAP*.

## Note 14. Commitments and Contingencies

The DHP Enterprise is a party to various administrative proceedings and legal actions related to healthcare claims payments, accidents, environmental damage, equal opportunity matters, and contractual bid protests which may ultimately result in settlements or decisions adverse to the federal government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown.

MEDCOM is a named party to Fair Labor and Standards Act (FLSA) claims against multiple Army MTFs. These cases are generally class actions brought by law firms on behalf of MTF employees. The potential liability stems from alleged misclassification of position descriptions which allegedly led to the underpayment of certain graded employees and, suffer and permit violations which allegedly involves employees working longer than their scheduled hours. Cases are pending at Fort Campbell, Fort Sill, White Sands, Fort Jackson, Fort Stewart, Fort Detrick, Fort Bragg, and Fort Irwin. The cases filed in the locations listed are either in preliminary or active arbitration. FLSA arbitration cases can take anywhere from 10-12 years from the date of the grievance to a decision. The Army has consolidated the defense of these cases at the Army level and major commands, along with installation legal offices, are actively participating in the defense of these cases. While some degree of this liability has been deemed reasonably possible by counsel at MEDCOM, the extent of the liability is difficult to define because in some cases lawsuits are against an entire installation rather than a single MTF and the entire settlement would not require DHP Enterprise funds. The estimated range of potential loss is estimated at \$80 million, however the defensive posture established by consolidation of these cases at the Army level is expected to reduce this exposure significantly.

Additionally, the DHP Enterprise is advised that there are situations where counsel was not able to express an opinion concerning the likely outcome of a case. As such, the DHP Enterprise did not make an estimate of any probable or reasonably possible loss contingencies through its respective legal counsel.

Furthermore, medical malpractice claims and settlements arising from the activities of the Navy Bureau of Medicine, Air Force Medical Service, and Army Medical Command are paid either by funds appropriated directly to the military service lines and/or the Department of Treasury's Judgement Fund.

The DHP Enterprise cannot estimate the amount of undelivered orders for open contracts citing cancelled appropriations.

The DHP Enterprise acknowledges departures from U.S GAAP related to the commitment and contingencies as discussed in Note 1.C, *Departures from U.S. GAAP*.

### Note 15. Disclosures Related to the Combined Statement of Budgetary Resources

Disclosures related to the *Statement of Budgetary Resources* consisted of the following for the year ended, September 30, 2018:

### Apportionment Categories of New Obligations and Upward Adjustments: Direct and Reimbursable Obligations

Apportionment categories of new obligations and upward adjustments consists of direct and reimbursable obligations. These obligations incurred against amounts apportioned under Category A, Category B, and Exempt from Apportionment. Category A apportionments distribute budgetary resources by fiscal quarters, whereas Category B apportionments typically distribute budgetary resources by activities, projects, objects, or a combination of these categories. The DHP Enterprise does not have any exempt apportionments. The amounts of direct obligations (derived from appropriations) and reimbursable obligations (derived from spending authority from offsetting collections) and upward adjustments by apportionment category for the year ended, September 30, 2018, consisted of (*dollars in thousands*):

	Unaudited
<b>Direct and Reimbursable Obligations</b>	
Direct Obligations	
Category A	\$ 33,447,530
Category B	3,336,172
<b>Total Direct Obligations</b>	<b>\$ 36,783,702</b>
Reimbursable Obligations	
Category A	\$ 1,900,216
Category B	115,852
<b>Total Reimbursable Obligations</b>	<b>\$ 2,016,068</b>
<b>Total Obligations</b>	<b>\$ 38,799,770</b>

### Undelivered Orders at End of the Year

Undelivered orders (UDOs) consist of goods and services obligated that have been ordered but not received. Unpaid UDOs represent obligations for goods and services that have not been received or paid. Whereas, paid UDOs represent obligations for goods and services that have been paid for in advance of receipt. The budgetary resources obligated for UDOs for the year ended, September 30, 2018, consisted of (*dollars in thousands*):

	Unaudited
<b>Undelivered Orders</b>	
Intragovernmental	
Undelivered orders – unpaid	\$ 4,815,357
<b>Total Intragovernmental Undelivered Orders</b>	<b>\$ 4,815,357</b>
With the Public	
Undelivered orders – unpaid	\$ 9,776,635
Undelivered orders – paid	29,304
<b>Total Undelivered Orders with the Public</b>	<b>\$ 9,805,939</b>
<b>Total Undelivered Orders</b>	<b>\$ 14,621,296</b>



## Legal Arrangements Affecting the Use of Unobligated Balances

Information about legal limitations and restrictions affecting the use of the unobligated balance of budget authority is specifically stated by program and fiscal year in the applicable appropriation language or in the alternative provisions section at the end of the appropriations act.

## Explanation of Differences between the *Consolidated Statement of Budgetary Resources* and the Budget of the U.S. Government

The reconciliation between the *Combined Statement of Budgetary Resources* and the Budget of the U.S. Government (Budget) is presented below. This reconciliation is as of September 30, 2017, because submission of the budget for FY 2019, which presents the execution of the FY 2017 budget, occurs after publication of these financial statements. The DHP Enterprise budget appendix can be found on the OMB website (<http://www.whitehouse.gov/omb/budget>) and will be available in early February 2019.

The amounts in the line 'Other Differences' in the table below cannot be further defined because appropriation-level detail is not provided in the Budget of the U.S. Government.

### **Budget of the U.S. Government (dollars in millions)**

Unaudited FY 2017	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
Combined Statement of Budgetary Resources	\$ 43,221	\$ 37,869	\$ (0)	\$ 32,466
Differences	(3,972)	(514)	(1,547)	(654)
<b>Budget of the U.S. Government</b>	<b>\$ 39,249</b>	<b>\$ 37,355</b>	<b>\$ (1,547)</b>	<b>\$ 31,812</b>

## Explanation of Differences between the *Consolidated Statement of Changes in Net Position* and the *Combined Statement of Budgetary Resources*

The 'Appropriations' line on the *Combined Statement of Budgetary Resources* does not agree with the 'Appropriations received' line on the *Consolidated Statement of Changes in Net Position* due to: 1) differences between proprietary and budgetary accounting concepts and reporting requirements; and 2) presentation of the *Consolidated Statement of Changes in Net Position* on a consolidated basis versus presentation of *Combined Statement of Budgetary Resources* on a combined basis.

## Note 16. Reconciliation of Net Cost of Operations to Budget

The reconciliation of net cost of operations to budget for the period ended September 30, 2018, is as follows (dollars in thousands):

	Unaudited
<b>Resources Used to Finance Activities</b>	
Budgetary Resources Obligated	
Obligations incurred	\$ 38,799,770
Less: Spending authority from offsetting collections and recoveries	(5,505,904)
Obligations net of offsetting collections and recoveries	\$ 33,293,866
Less: Offsetting receipts	(7,811)
Net obligations	\$ 33,286,055
Other Resources:	
Transfers out without reimbursement	(572,060)
Imputed financing from costs absorbed by others	311,523
Other	(18,856)
Net other resources used to finance activities	\$ (279,393)
<b>Total Resources Used to Finance Activities</b>	<b>\$ 33,006,662</b>
<b>Resources Used to Finance Items not Part of the Net Cost of Operations:</b>	
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:	
Undelivered Orders	\$ (167,242)
Unfilled Customer Orders	(26,802)
Resources that fund expenses recognized in prior periods	(7,389,447)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	7,811
Resources that finance the acquisition of assets	(162,974)
Other	590,917
<b>Total Resources Used to Finance Items not Part of the Net Cost of Operations</b>	<b>\$ (7,147,737)</b>
<b>Total Resources Used to Finance the Net Cost of Operations</b>	<b>\$ 25,858,925</b>
<b>Components of the Net Cost of Operations that will Not Require or Generate Resources in the current period:</b>	
Components Requiring or Generating Resources in Future Period:	
Increase in annual leave liability	\$ 2,273
Increase in exchange revenue receivable from the public	(4,081)
Other	4,534,829
<b>Total Components of Net Cost of Operations that will Require or Generate Resources in future periods</b>	<b>\$ 4,533,021</b>
Components Not Requiring or Generating Resources:	
Depreciation and amortization	\$ 72,150
Revaluation of assets or liabilities	(6,543)
Other	(1,214,844)
<b>Total Components of Net Cost of Operations that will Not Require or Generate Resources</b>	<b>\$ (1,149,237)</b>
<b>Total Components of Net Cost of Operations that will Not Require or Generate Resources in the current period.</b>	<b>\$ 3,383,784</b>
<b>Net Cost of Operations</b>	<b>\$ 29,242,709</b>

The *Reconciliation of Net Cost of Operations to Budget* explains how budgetary resources obligated during the period relate to the net cost of operations for DHP Enterprise.

Due to DHP Enterprise's financial system limitations, budgetary resources obligated during the period could not be reconciled to DHP Net Cost of Operations. This difference was a previously identified deficiency requiring adjustments for the schedule to reconcile.

***Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations, Other*** primarily consists of non-exchange gains and losses to revalue assets, as well as reconcile the proprietary and budgetary amounts. The absolute value of the adjustment that reconciles the balance with the *Consolidated Statement of Net Cost* for the period ended September 30, 2018, is \$29,242,709 thousands.

***Components Requiring or Generating Resources in Future Period, Other*** consist primarily of future funded expenses.

***Components Not Requiring or Generating Resources, Other*** primarily consist of cost capitalization offsets, applied overhead, and other expenses not requiring budgetary resources.

Recognition of liabilities not covered by budgetary resources on the *Consolidated Balance Sheet* were recognized as components of net cost that require or generate resources in future periods.

The following *Reconciliation of Net Cost of Operations to Budget* lines are presented as combined instead of consolidated, as intra-entity budgetary transactions are not eliminated:

Obligations Incurred

Less: Spending Authority from Offsetting Collections and Recoveries

Obligations Net of Offsetting Collections and Recoveries

Less: Offsetting Receipts

Net Obligations

Undelivered Orders

Unfilled Customer Orders

# Required Supplementary Stewardship Information

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## Non-Federal Physical Property

The DHP Enterprise operates MTFs overseas which require the use of land, buildings, and other overseas facilities. These items are obtained through various international treaties and agreements negotiated by the Department of State. In order to keep these facilities mission ready, DHP Enterprise also purchases capital assets with appropriated funds. When these treaties expire, ownership of these purchased assets and any related improvements to these MTFs revert to the host country. DHP Enterprise acknowledges that by definition this meets the definition of nonfederal physical property but does not currently track or have a process in place to report the required information. As such, DHP Enterprise acknowledges a departure from SFFAS 8, *Supplementary Stewardship Reporting*.

## Research and Development

Military combat is a joint service activity, and ensuring the best quality medical care of the warfighter must also be a cross-component effort. The medical mission of DoD is to enhance the DoD and our Nation's security by providing health support for the full range of military operations and sustaining the health of all those entrusted to our care. In order to be responsive to current needs and ready for the next fight, DoD invests significant resources into research and development of medical materiel products (e.g., equipment, tools, and devices) and knowledge products (e.g., clinical practice guidelines and protocols) for the warfighter.

The DHP Enterprise leads the MHS integrated system of readiness and health to deliver the Quadruple Aim (increased readiness, better health, better care, and lower cost). Within DHP Enterprise, the Research and Development Directorate (J-9) leads the discovery, development, and delivery of enhanced pathways to military health and readiness. The DHP Enterprise J-9 research and development activities are presented in the following three major categories:

- **Basic research:** systematic study to gain knowledge of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind;
- **Applied research:** systematic study to gain knowledge necessary for determining the means by which a recognized and specific need may be met;
- **Development:** systematic use of the knowledge gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.

The following are highlights of some of the research and development programs/projects and their accomplishments:



## Basic Research

### In-House Laboratory Independent Research (ILIR) Program

The ILIR Program at USUHS is designed to answer fundamental questions of importance to the military medical mission of DoD in areas such as military operational medicine and combat casualty care. The studies within the USUHS ILIR program support the essential military mission by enhancing and protecting the health, performance and fitness of service members throughout the deployment cycle. Their discoveries should lead to better strategies for enhancing and preserving memory and reasoning capabilities under battle conditions, help understand and ultimately prevent and treat neuropsychiatric illnesses such as depression and post-traumatic stress disorder (PTSD), and assist deployed troops and their families better prepare for and contend with common, significant stressors related to the deployment cycle.

*What this program will accomplish:*

#### Military Operational Medicine

- Refinement of a PTSD screening tool for use in the DoD Primary Care system
- Identification of the unique proteomic signature for the diagnosis and assessment of the neuro-immune response to traumatic brain injury (TBI)
- Identification of novel neural stem/progenitor cell pathways for therapeutic targeting in the development of neuro-regenerative therapies to treat brain injuries

#### Combat Casualty Care

- Bridging tissue gaps in the periphery following injury or surgery
- Guiding the regeneration of axons to neural-prosthetic interfaces following amputation and inhibiting axon extension following excision of neuromas
- Investigation of drug-induced arrhythmias to improve the safety profile of drugs used to treat pathological conditions such as cardiac hypertrophy or hypercholesterolemia

### Basic Operational Medical Research Sciences Program

The Basic Operational Medical Research Sciences Program provides support for basic medical research directed toward greater knowledge and understanding of the fundamental principles of science and medicine that are relevant to the improvement of force health protection. Research in this program is designed to address areas of interest to the Secretary of Defense regarding wounded warriors, capabilities identified through the Joint Capabilities Integration and Development System, and sustainment of DoD and multi-agency priority investments in science, technology, research, and development.

*What this program will accomplish:*

#### Military Operational Medicine

- Identification and characterization of the biomechanical responses of brain tissue in animal models due to the indirect mechanism of blast waves, i.e., through the vasculature, that will guide the development of interventions for mitigating blast-induced brain injuries
- Identification of candidate targets and neurological systems for treatment and diagnostic indicators of PTSD
- Identification of physical, physiological and psychosocial factors that may differentially impact the performance of female versus male service members and gender-based susceptibility to musculoskeletal injury

#### Combat Casualty Care

- Understanding of associated pathophysiologic mechanisms using advanced hemostatic and resuscitation approaches in prolonged field care scenarios
- Identification of molecular and cellular mechanisms involved in abnormal bleeding due to coagulopathy of trauma that occurs following severe trauma

## Applied Research

### Applied Biomedical Technology Program

The Applied Biomedical Technology Program provides applied research funding to refine concepts and ideas into potential solutions for military health and performance problems, with a view toward evaluating technical feasibility. Research in the Applied Biomedical Technology Program aims to develop medical countermeasures against operational stressors, prevent musculoskeletal, neurosensory, and psychological injuries during training and operations, and to maximize health, performance and fitness of service members. Additionally, the research is focused on optimizing survival and recovery from point of injury through en route and facility care including efforts to reconstruct, rehabilitate, and provide care for injured service members.

*What this program will accomplish:*

#### Military Operational Medicine

- Collection and analysis of experimental data to validate computational models of the direct and indirect mechanism of blast-induced brain injury and inner ear injury
- Delivery of an evidence-based approach to reduce stigma and a training program to increase provider skill in assessing and treating suicidality
- Identification and development of candidate biomarker panels indicative of treatment-related improvement, and animal/human PTSD disease model development

#### Combat Casualty Care

- Investigation of new diagnostic tools and the development of treatments for severe hemorrhage following injury including novel oxygen carriers for use in severe casualties where blood transfusions are not available
- Advancement of treatments for extremity trauma for wound stabilization in prolonged field care scenarios
- Evaluation of the effectiveness of acute lifesaving interventions and how to improve survival for those in critical care on the battlefield, in acute stages of injury, and for those in prolonged field care scenarios

#### Clinical and Rehabilitative Medicine

- Selection of products to transition to technology development in the areas of neuro-musculoskeletal injury, pain management, and regenerative medicine
- Identification of targets for therapies to alleviate acute, chronic, and battlefield pain and identification of strategies for addressing psychosocial aspects of pain management and pain-related substance abuse
- Development of candidate reconstructive and regenerative technologies and methodologies for replacement or regeneration of human cells, tissues, or organs for restoration or establishment of normal tissue form and function of bone, skin, muscle, nerve, vasculature and connective tissue

### Medical Technology Development Program

The Medical Technology Development Program provides funding for promising candidate solutions that are selected for initial safety and effectiveness testing in animal studies and/or small scale human clinical trials regulated by the US Food and Drug Administration prior to licensing for human use. Key focus areas of the research in the Medical Technology Development Program include care on the battlefield and in field hospitals prior to transporting patients out of theater to CONUS, and studies trauma resuscitation, hemorrhage control, and other life-saving interventions to keep critically wounded patients alive in the golden hour and to the next level of care. Additional goals of this research are to identify cutting edge techniques and technologies that can be employed by Air Force medics during contingency operations and develop medical technology solutions and components of early prototype systems for test and evaluation.

*What this program will accomplish:*

**Expeditionary Medicine Research & Development**

- Research and development of therapeutic interventions to sustain life through transfer to definitive care including blood sparing drugs for hemorrhagic shock resuscitation and treatment for neuroprotection, cryopreserved blood products, rhabdomyolysis and ischemia-reperfusion injury
- Evaluation of novel hemorrhage control products that utilize alternative technologies to active hemostatic coatings to provide a lower-cost, safer and more versatile solution to various hemorrhage control pathologies across the continuum of care

**Military Operational Medicine**

- Refinement and improvement of predictive auditory injury models in order to update acoustic injury standards for health hazard assessment
- Production of individualized treatment guidelines for PTSD as well as PTSD-related sleep disturbances

**Combat Casualty Care**

- Development of novel technologies to better assess, monitor and maintain the stability of more severely injured TBI casualties closer to point of injury and during prolonged field care
- Demonstration of photochemical cross-linking to strengthen veins for grafting to arteries in wounded warrior surgery and post-surgical benefits of photochemical bonding in reducing scarring and adhesions

## Development Research

**Medical Products Support and Advanced Concept Development Program**

The Medical Products Support and Advanced Concept Development Program provides funding to support advanced concept development of medical products, clinical and field validation studies supporting the transition of products and medical practice guidelines to the military operational user, prototyping, risk reduction and product transition efforts for medical IT applications, and medical simulation and training system technologies. Research in the Medical Products Support and Advanced Concept Development Program supports clinical assessments related to interventions for PTSD and real-time physiological status monitoring. Additionally, the research supports clinical trials such as those assessing biomarkers for TBI, pain management, regenerative medicine and advanced product development related to hemorrhage, extremity trauma, pre-hospital combat casualty care, and en-route care.

*What this program will accomplish:*

**Military Operational Medicine**

- Advanced development on a real-time physiological status monitor system
- Development of monitors detecting oxygen toxicity in combat and training environments
- Advance technologies supporting the integrated Soldier Sensor System to include sensor(s) quantifying the impact of energy expenditure and physical load, improved metabolic monitoring in training environments, and the assessment of cognitive status in operational settings

**Combat Casualty Care**

- Clinical studies on the Wound Stasis System, a product to control non-compressible hemorrhage within a body cavity
- Develop devices to enable first responders to more precisely triage, measure and monitor physiological parameters relevant to the progression of moderate and severe TBI in the battlefield
- Advanced development of technology that electronically captures, records, and transmits combat casualty clinical data during evacuation to higher echelons of care

#### Clinical and Rehabilitative Medicine

- Validation of regenerative medicine strategies to modulate the immune system in order to reduce the need for lifelong immunosuppression following transplantation
- Advanced clinical trials for oral trans-mucosal Ketamine, a fast acting, easily dispensed oral battlefield pain management product to assess its effectiveness in managing pain after surgery

#### Medical Products and Support Systems Development Program

The Medical Products and Support Systems Development Program provides funding for system development and demonstration of medical commodities that are directed at meeting validated requirements prior to full-rate initial production and fielding. Development and demonstration activities will be focused in areas such as medical modeling and simulation systems for training/education/treatment, rapid screening for fresh whole blood, spray-dried plasma, and TBI biomarker point of care devices.

*What this program will accomplish:*

#### Military Operational Medicine

- Validation, through end-user field testing, of a system-on-a-chip ultra-low power physiologic status monitoring system
- Real-time physiological status monitoring system that integrates algorithms and sensors into actionable real-time physiological status, health, and readiness information

#### Combat Casualty Care

- Clinical trials to confirm safety and effectiveness of the spray-dried plasma product in diverse populations
- Clinical studies to confirm safety and effectiveness of valproic acid, a drug to prolong survival following severe hemorrhage
- Validation of down-selected point of care device to assess and monitor TBI casualties in the far forward field environment.

## Research and Development Program Outlays and Expenses

Program: DHP RDT&E Program						
Program Expenses						
(dollars in thousands)						
Fiscal Year:	2018-2019	2017-2018	2016-2017	2015-2016	2014-2015	Total
Basic Research	\$ 658	\$ 9,706	\$ 25,621	\$ 43,752	\$ 118,051	\$ 197,788
Applied Research	\$ 10,274	\$ 75,195	\$ 1,424,441	\$ 1,336,362	\$ 1,047,900	\$ 3,894,172
Development	\$ 15,829	\$ 154,860	\$ 464,761	\$ 720,753	\$ 1,027,383	\$ 2,383,586
<b>Total</b>	<b>\$ 26,761</b>	<b>\$ 239,761</b>	<b>\$ 1,914,823</b>	<b>\$ 2,100,867</b>	<b>\$ 2,193,334</b>	<b>\$ 6,475,546</b>

*\*Note: Expenses derived from expenditures reported on the 1002 report.*

## Research and Development Program Outcomes and Outputs

Program: DHP RDT&E Program Outcomes and Outputs						
Fiscal Year:	FY2018	FY2017	FY2016	FY2015	FY2014	Total
Programs Transitioned to Advanced Development*	7	4	7	8	0	26
Patents/Patent Applications	179	186	226	144	48	783
Publications	2,874	2,183	1,726	1,178	630	8,591

*\*Material Development Decision, or beyond, has signed Technology Transition Agreement with developer, or delivered to a Program Manager.*



## Required Supplementary Information

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### Deferred Maintenance and Repairs

Although DHP Enterprise receives the economic benefit and is responsible for the sustainment of various general property, plant and equipment, the DHP Enterprise did not disclose deferred maintenance for FY 2018 in accordance with U.S. GAAP per SFFAS 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29, and 32*.

<i>Combining Statement of Budgetary Resources for the year ended September 30, 2018 (dollars in thousands)</i>	<i>Operations, Readiness and Support</i>	<i>Procurement</i>	<i>Research, Development, Test and Evaluation</i>	<i>Family Housing and Military Construction</i>	<i>Total Budgetary Accounts</i>
<b>BUDGETARY RESOURCES</b>					
Unobligated balance from prior year budget authority, net	\$ 3,161,945	\$ 365,031	\$ 1,319,109	\$ 906,525	\$ 5,752,610
Appropriations (discretionary and mandatory)	31,803,899	498,350	1,871,866	645,295	34,819,410
Spending Authority from offsetting collections (discretionary and mandatory)	3,510,602	(0)	19,353	-	3,529,955
<b>TOTAL BUDGETARY RESOURCES</b>	<b>\$ 38,476,446</b>	<b>\$ 863,381</b>	<b>\$ 3,210,328</b>	<b>\$ 1,551,820</b>	<b>\$ 44,101,975</b>
<b>STATUS OF BUDGETARY RESOURCES</b>					
Total New obligations and upward adjustments	\$ 35,821,242	\$ 572,738	\$ 1,757,424	\$ 648,366	\$ 38,799,770
Unobligated balance, end of year:					
Apportioned, unexpired accounts	885,408	242,386	1,389,117	840,419	3,357,330
Exempt from apportionment, unexpired accounts	122,809	-	-	-	122,809
Unapportioned, unexpired accounts	4,799	-	-	-	4,799
Unexpired unobligated balance	\$ 1,013,016	\$ 242,386	\$ 1,389,117	\$ 840,419	\$ 3,484,938
Expired unobligated balance	1,642,188	48,257	63,787	63,035	1,817,267
Total Unobligated balance, end of year	\$ 2,655,204	\$ 290,643	\$ 1,452,904	\$ 903,454	\$ 5,302,205
<b>TOTAL STATUS OF BUDGETARY RESOURCES</b>	<b>\$ 38,476,446</b>	<b>\$ 863,381</b>	<b>\$ 3,210,328</b>	<b>\$ 1,551,820</b>	<b>\$ 44,101,975</b>
<b>OUTLAYS, NET</b>					
Outlays, Net (discretionary and mandatory)	\$ 30,553,433	\$ 427,596	\$ 1,335,746	\$ 612,326	\$ 32,929,101
Distributed offsetting receipts	-	-	(7,811)	-	(7,811)
<b>AGENCY OUTLAYS, NET</b>	<b>\$ 30,553,433</b>	<b>\$ 427,596</b>	<b>\$ 1,327,935</b>	<b>\$ 612,326</b>	<b>\$ 32,921,290</b>



### III. Other Information

## Summary of Financial Statement Audit and Management Assurances

Table 1 below provides a summary of Financial Statement Audit.

**Table 1:** *Summary of Financial Statement Audit*<sup>12</sup>

Summary of Financial Statement Audit						
Audit Opinion	Disclaimer					
Restatement	No					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Governance Structure and Entity-Level Controls		1				1
Financial Reporting		1				1
Universe of Transaction Reconciliations		1				1
Internal Controls over Defense Departmental Reporting system Journal Vouchers		1				1
Fund Balance with Treasury		1				1
Medical Revenue and Associated Receivables		1				1
General Equipment Existence and Completeness		1				1
Valuation of Property, Plant, and Equipment		1				1
Real Property		1				1
Internal Use Software and IUS In-Development		1				1
Operating Materials and Supplies and Stockpile Material		1				1
Liabilities		1				1
Information Systems		1				1
<b>Total material weaknesses</b>	-	13	-	-	-	13

<sup>12</sup> The Summary of Financial Statement Audit of material weaknesses are from the Independent Auditor's DHP Report on Internal Controls over Financial Reporting.



Table 2 below provides a summary of management assurances

**Table 2: Summary of Management Assurances<sup>13</sup>**

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	Reasonable Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Accounts receivable	3					3
Acquire to retire	1					1
Budget to report	12		2			10
Civilian pay	1					1
Consumables	1					1
Contract/vendor pay	1					1
Financial management systems	1					1
Financial reporting	3					3
Fund balance with Treasury	1					1
General equipment	1					1
Health care liabilities	1					1
Internal use software	2					2
Operating materials and supplies	1					1
Order to cash	4					4
Plan to stock	1					1
Real property assets	1					1
<b>Total material weaknesses</b>	<b>35</b>	<b>-</b>	<b>2</b>	<b>-</b>	<b>-</b>	<b>33</b>

<sup>13</sup> The total number of material weaknesses and non-Compliances for ICOFR, ICO and internal controls over federal financial management system requirements include both material weaknesses and significant deficiencies.

Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	Reasonable Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Compliance	1		-			1
Financial management systems	1					1
Fund balance with Treasury	1					1
Health care liabilities	9					9
Operations	5		1			4
Operations and compliance	6					6
<b>Total material weaknesses</b>	<b>23</b>	<b>-</b>	<b>1</b>	<b>-</b>	<b>-</b>	<b>22</b>
Compliance with Federal Financial Management System Requirements (FMFIA § 4)						
Statement of Assurance	Reasonable Assurance					
Noncompliance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Financial management systems	1					1
<b>Total noncompliances</b>	<b>1</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1</b>
Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)						
	Agency		Auditor			
1. Federal financial management system requirements	No lack of compliance noted		Lack of compliance noted			
2. Applicable federal accounting standards	No lack of compliance noted		Lack of compliance noted			
3. USSGL at transaction level	No lack of compliance noted		Lack of compliance noted			

Management's assessment of FFMIA compliance was completed prior to the results of the FY 2018 financial statement audit. Our auditor has noted the DHP Enterprise financial management systems did not comply substantially with the Federal financial management system's requirements, applicable Federal accounting standards, or application of the United States Standard General Ledger (USSGL) at the transaction level, as a result of material weaknesses noted in the Independent Auditor's Report on Internal Control over Financial Reporting. The DHP Enterprise is in process of evaluating the FY 2018 audit findings contributing to noncompliance to begin the process of remediation plans necessary to bring the financial managements systems into substantial compliance.

# Management Challenges

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Per OMB Circular A-136 as it relates to form and content of an AFR, the DHP Enterprise's Inspector General (IG) must, "as required by the Reports Consolidation Act of 2000, include as OI, a statement summarizing what the IG considers to be the most serious management and performance challenges facing the agency and assessing the agency's progress in addressing those challenges." For the reporting purposes of the DHP Enterprise, the DoD IG on behalf of DHP Enterprise has reviewed DoD's Top Management Challenges for FY 2018, and determined Challenge 5 (DHP Challenge 1) *Improving Financial Management*, and Challenge 9 (DHP Challenge 2), *Providing Effective, Comprehensive, and Cost-Effective Health Care*, are applicable challenges to DHP Enterprise.

## Challenge 1: Improving Financial Management

The DoD is the only federal agency that has never undergone a full financial statement audit. Moreover, the lack of a favorable audit opinion on the DoD financial statements is the major impediment to a successful audit of the U.S. government. Long-standing financial management challenges continue to impair the DoD's ability to provide reliable, timely, and useful financial and managerial information to support reported financial statement balances. Additionally, the lack of reliable financial information prevents its full use in operating, budgeting, and policy decisions. The DoD's financial management challenges involve a complex array of issues. These include maintaining documentation that supports recorded transactions, recording timely and proper accounting entries, maintaining a valid universe of transactions, operating with many decentralized and noncompliant IT systems, accurately documenting business processes, implementing strong internal controls over accounting data and business operations, and eliminating the need for journal vouchers to force agreement of budgetary, financial, and accounting transactions and balances. The DoD is required by the Chief Financial Officers Act of 1990 to undergo a full financial statement audit covering its budget, assets, and liabilities. In addition, the NDAA for FY 2010 specifically requires the DoD to have audit-ready financial statements by September 30, 2017. In the past, DoD Office of Inspector General (OIG) and independent public accounting firm auditors have not conducted a full-scope, detailed audit of the DoD financial statements because the DoD's supporting records have not been suitable for audit. Since the DoD began preparing financial statements in the early 1990s, the DoD Under Secretary of Defense (Comptroller)/Chief Financial Officer and the Military Departments have consistently acknowledged that weaknesses exist with respect to financial reporting. In addition to process design weaknesses and insufficient accounting policies, the DoD could not previously assert that it was able to provide auditors with sufficient evidence to complete a timely financial statement audit.

### Importance of Strong Financial Management

For decades, auditors have reported weaknesses in DoD financial management, including financial statement reporting and financial management systems. These weaknesses affect not only the DoD's ability to attain an unmodified opinion on its financial statements but also its ability to make sound decisions related to its mission and operations. Having sound financial management practices and reliable, useful, and timely financial information is also important to ensure accountability over the DoD's budgets and assets and to allow DoD leadership to make informed decisions. Sound financial management is particularly important for the DoD because its expenditures constitute nearly half of the government's discretionary spending and its physical assets represent more than 70% of the government's physical assets. A key component of sound financial management is an agency's network of internal controls. Strong internal controls include the procedures, requirements, instructions, and checks designed to ensure that agency resources are used effectively and safeguarded properly. For example, within the DoD, key financial management internal controls include leadership commitment to auditability, automated system security, policies and procedures that ensure compliance with accounting standards, checks to ensure adherence to asset or fiscal accountability, documented data reconciliations, performance

measurement, and tracking corrective actions to audit findings. Internal controls are also vital to effective financial management. For example, sound internal controls over asset quantities, asset cost information, item movement, customer requirements, and product ordering help ensure that property location, movement, and costs are known and accurate. Internal controls help prevent waste and even fraud, minimize costs, and allow timely decision-making. For example, accurate quantity and cost information is essential to making informed procurement decisions. In addition, when managers can trust that financial data is accurate, buying and inventory decisions will improve. With respect to internal control over asset accountability, recent DoD OIG audits had determined that the DoD needs improvements in this area. Specifically, the DoD continues to struggle to provide auditors with detailed asset cost information and to maintain accurate asset quantity information when assets are tracked in multiple property systems. Better internal controls, such as detailed reconciliations and research of quantity discrepancies, would improve the accuracy of financial reports and could improve budgeting decisions because the financial system data would match actual quantities on hand. When internal controls are strong and on-hand quantities and costs of physical assets are known and accurate, the DoD can make the most cost-effective buying decisions. Internal controls over asset accountability, such as periodic inventories, also minimize the risk of buying more stock than needed. Unreliable financial information also makes it difficult to accurately develop and execute budgets and to determine the effectiveness and efficiency of military operations. DoD financial management challenges hinder the ability to see potential waste, mismanagement, and cost overruns when certain data is untimely, unavailable, or inaccurate. For example, auditors of the Military Department's budgetary financial statement have recently concluded that adequate supporting records were not available to complete the audit. The findings demonstrate the difficulty that the DoD has in maintaining accounting control of the hundreds of thousands of transactions that occur all over the world every day. Yet, internal control weaknesses and noncompliance continue to exist within the DoD's financial feeder systems. Feeder systems contain information that the DoD provides to its accounting agency (the Defense Finance and Accounting Service) to support dollar values reported in DoD financial statements. The feeder systems are decentralized and consist of over 200 significant systems that process millions of transactions reported in DoD financial statements. Independent public accountants have issued hundreds of findings to the DoD related to the lack of internal controls and noncompliant IT processes in these feeder systems. Improving financial feeder systems and controls by correcting weaknesses identified by auditors may be the most demanding challenge related to DoD financial management and audit readiness. For example, the DoD reported in its May 2017 Financial Improvement and Audit Readiness Plan Status Report that each Military Department will have uncorrected IT weaknesses when the FY 2018 financial statement audits begin. As part of improving financial management, the DoD must eliminate outdated systems and continue to develop and document adequate controls that comply with accounting standards and improve system security. The DoD also needs to expedite its plan to retire legacy systems while ensuring that remaining systems interface with each other without the need for manual processes to validate that data is transferred accurately. The remaining systems should record, maintain, and disseminate timely and accurate transaction data that decision-makers can rely on for financial reporting and for assurance that programs are working and funds are being used properly. Characteristics of strong financial management include routine and documented reconciliations without the need for thousands of journal vouchers and other adjustments. Sound process improvements would also significantly reduce the current effort being made to reconcile transactions between DoD business partners and limit the need for processing thousands of journal vouchers.

### **Financial Audibility**

Throughout FY 2017, DoD senior leadership has been clear regarding its commitment to undergoing full financial statement audits beginning in FY 2018, as required by statute. For example, in a May 2017 memorandum, Secretary of Defense Mattis stressed the challenge of achieving a clean audit opinion, as well as the importance of improving financial management. He stated that DoD leadership would be held accountable for achieving a positive audit opinion in the shortest time frame possible. He also indicated that undergoing a full financial statement audit is the best tool to improve controls and strengthen business processes and systems. On September 27, 2017, Secretary Mattis and DoD Comptroller Norquist



asserted to the DoD Acting Inspector General that the DoD is ready for a financial statement audit. They added that the DoD was not expecting an unmodified audit opinion on its agency-wide consolidated financial statements, and it was not a certification that the DoD financial statements or components' financial statements are reliable. Rather, they were asserting that the DoD has the capabilities to allow an auditor to scope and perform a full financial statement audit that results in actionable feedback on various financial processes, systems, and documentation. At the same time, Secretary Mattis notified Congress that the DoD will begin full financial statement audits in FY 2018. He wrote that it will take time for the DoD to go from being audited to passing an audit. He noted that "Direct feedback from auditors keeps audit remediation in the forefront of our day-to-day work and helps us to be accountable to DoD decision-makers as well as responsive to you and other stakeholders." In addition, Deputy Secretary of Defense Shanahan wrote a memorandum to all DoD employees stating the DoD's support for the FY 2018 financial statement audits. He wrote that he expected everyone to make it a priority to correct problems identified in these audits. He noted "This Department is the last federal agency to not have a clean agency-wide financial opinion. This must change. We must lead and not lag behind." He added that the audits will give DoD leaders and commanders the reliable information they need to exercise judgment and accomplish their mission. Other DoD leaders have also initiated actions to obtain buy-in from all personnel involved in the recording and reporting of financial data. For example, Army leaders have stressed the publication for functional components to support audit readiness. In addition, the DoD pursued initiatives to support audit readiness or improve overall financial management. For example, the Financial Improvement and Audit Readiness Directorate continues to work toward improving the quality of DoD financial information with a positive audit opinion as the desired outcome. The Financial Improvement and Audit Readiness Directorate also provides DoD reporting entities the key tasks and requirements that should be followed to become audit ready. And the DoD has created working groups to ensure that solutions to its financial management challenges comply with accounting standards and can pass auditor testing. The groups are working to address long-standing accounting weaknesses, including FBWT reconciliation, property valuation documentation, and a full account of billions of dollars in payments to DoD contractors. Further, the DoD continues to update the Financial Management Regulation and issue policy memorandums designed to improve accounting operations and establish standard and sustainable processes. The DoD's definition of "audit ready" and the DoD Comptroller's position that a clean audit opinion is not expected immediately demonstrates that, while progress has been made, the magnitude of what remains to be done to achieve a favorable opinion is significant. Even if the DoD does not obtain clean audit opinions immediately, the DoD OIG agrees that performing full financial statement audits can benefit the DoD. Financial statement audits can help DoD leadership ascertain where financial and other business processes are working as intended and where specific deficiencies need to be corrected.

### **Current Status of DoD Financial Statement Audits**

The DoD continues to award financial statement audit contracts for entities that have asserted audit readiness. In FY 2016, the DoD contracted for seven financial statement audits and three Military Department budgetary statement audits. The U.S. Army Corps of Engineers, the Military Retirement Fund, and DHP Enterprise CRM all passed FY 2016 audits with unmodified audit opinions. In addition, the results of the Defense Information Systems Agency financial statement audit were generally favorable in that one of its two business segments attained a clean opinion. Other FY 2016 audits were not as successful. Independent public accountants determined that the Military Department budgetary financial statements were not audit-ready and thus the auditors disclaimed opinions. In FY 2017, the Defense Logistics Agency (DLA) and the Marine Corps underwent a full financial statement audit. However, the independent public accountants determined that DLA and Marine Corps personnel were not able to provide sufficient documentation to the auditors to perform a full audit. In addition, independent public accountants continue to perform audits of FY 2017 Army and Air Force budgetary records. Recently, these independent public accountants notified Army and Air Force leadership that the auditors were not provided sufficient documentation to perform a full audit and that the auditors plan to issue disclaimers of opinion on the budgetary financial statement. Other audit contracts continue to be awarded, including those for the FY 2018 financial

statement audits of the U.S. Special Operations Command, the U.S. Transportation Command, and the DHP Enterprise. In addition, actions have been taken to award contracts or exercise options so that independent public accountants can perform FY 2018 financial statement audits of the Military Departments. The CFO Act requires that the DoD OIG either perform or contract for DoD financial statement audits. To fulfill this responsibility, the DoD OIG performs oversight of the contractors to ensure that the independent public accountants follow auditing standards, comply with DoD security policies, and meet contract requirements. DoD OIG audits have found a lack of supporting documentation for account balances and system data that are not reliable, accurate, or timely. In addition, asset information, such as certain inventory and equipment balances, continue to lack sufficient valuation documentation, and sometimes lack accurate location and quantity information. These deficiencies have consequences. For example, inaccurate inventory and equipment counts can result in DoD personnel placing orders for new parts or equipment even though there are sufficient supplies in stock. Likewise, inaccurate asset information limits the DoD's ability to ensure material and equipment are available for operational readiness if actual on-hand balances are lower than balances in the property system. Other DoD OIG financial management audits continue to identify the need for improved financial management controls and reporting. In FY 2017, the DoD OIG issued reports that highlighted problems with FBwT reconciliations, ineffective financial management system strategies, and inaccuracies in reported costs of programs. As of July 2017, 172 open DoD OIG recommendations related to DoD finance and accounting topics, such as management of DoD suspense accounts, transactions that support financial statements and budget submissions, and DoD financial management and accounting systems. Implementing the necessary actions to close these recommendations has proven challenging for the DoD because business processes and accounting policies need to be reviewed, improved, and monitored. For example, the DoD's implementation of new integrated logistics and accounting systems that include proper internal controls, such as compliant and timely accounting entries, has been slow and costly. When the property systems of record include accurate account balances, reliance on these balances, such as physical asset counts or cost information, can result in efficient buying decisions

### **What's Left To Do – DoD Auditor Perspective**

Although the DoD plans to conduct its full financial statement audits beginning October 1, 2017, as required by law, numerous key challenges continue to face the DoD when preparing for the FY 2018 and subsequent financial statement audits. According to the DoD, a key indicator of its FY 2018 audit readiness will be its ability to respond to auditors' requests for supporting documentation. This indicator is very different from the normal objective of a financial statement audit, which is to determine whether the agency's financial statements are fairly presented in all material respects in accordance with U.S. GAAP. For the FY 2018 financial statement audits, the DoD needs to clearly demonstrate the extent to which it has remediated the material weaknesses previously identified. Remediating these weaknesses requires improved internal controls, systems, and data reliability. Evidence that these weaknesses have been corrected will contribute to auditable financial statements that contain complete, reliable, timely, and consistent data for financial management decision making. The major impediments to auditability require the DoD to improve, and in some cases change, its way of doing business. Long-standing business processes that have supported DoD missions are not always sufficient for an audit. For example, audits conducted by independent public accounting firms of the Military Department's FY 2016 budgetary financial records cited more than 700 combined findings and recommendations that revealed individual and systemic issues that prevented the auditors from opining on the Military Department budgetary statements. These audit results demonstrate that current DoD business practices need to be redesigned to support Federal accounting policies and IT requirements. DoD OIG and independent auditors have consistently found that the DoD needs to develop sustainable and repeatable processes to better respond to audit requirements and provide timely and sufficient supporting documentation for transactions. To achieve and sustain reliable financial data, the DoD must also focus on other high-risk areas, such as the ability to eliminate the use of journal vouchers as a means of addressing unsupported or unreconciled accounting transactions. DoD accountants use journal vouchers for various reasons, such as to adjust errors identified during financial statement compilation; record accounting entries that, due to system limitations or timing differences, have not been

otherwise recorded; or for month and year-end closing purposes. For decades, DoD accountants have prepared journal vouchers as a means to complete financial reporting requirements and force balances to agree without detailed reconciliation processes to fully support and explain the accounting adjustment. Unsupported journal vouchers and unresolved differences between the DoD and the Department of the Treasury have contributed to unfavorable audit results on prior DoD financial statements. Another area of significant concern that delays an auditor's ability to opine on financial statement balances is the lack of a verifiable universe of transactions from the outset of the audit. The DoD recognizes the need for detailed transactions and continues to work internally with stakeholders to develop a complete universe of transactions that reconciles from feeder systems to its financial statements. Further, the DoD must be able to account for the assets reported on its balance sheet, including adequate support for how much assets cost, how much the DoD owns, and where the assets are located. These challenges must be addressed as the DoD pursues its plan to reduce the number of financial and feeder systems. With the heightened level of review and scrutiny of full financial statement audits, the DoD should anticipate additional independent public accountant audit findings and recommendations. The DoD needs to be prepared for this additional workload and have the capability to prioritize the current and new weaknesses and recommendations into an efficient plan for success. The need for corrective actions to address current and newly identified material weaknesses and deficiencies will compete for tight resources in the future. In summary, the DoD plans to have its largest agencies under financial statement audit in FY 2018, including the Military Departments and many Defense agencies. DoD leaders have acknowledged that there are still corrective actions to be implemented and remediation efforts to be completed before unmodified audit opinions can be achieved. Without these corrections, the DoD financial statements will continue to remain unreliable and affect the DoD's ability to make important financial, management, and resource decisions.

## Challenge 2: Providing Effective, Comprehensive, and Cost Effective Health Care

The DHP Enterprise is a global, comprehensive, integrated health care system that includes a health care delivery system, combat medical services, public health activities, medical education and training, and medical research and development. The DHP Enterprise provides medical care to service members, retirees, and their eligible family members. It includes direct and purchased care. Direct care is health care provided at MTFs, primarily by military, civilian, and contracted doctors. Purchased care is health care provided at commercial locations through the TRICARE program, which is the DoD's health care program. The DHP Enterprise manages the TRICARE program under the authority of the Assistant Secretary of Defense (Health Affairs). In total, the DHP Enterprise must provide health care, within fiscal constraints, for over 9 million beneficiaries, while facing increased user demand and inflation. As with any large health care system, the DHP Enterprise must also respond and adapt to changing demographics, shifting policies, evolving standards for access and quality, advances in science and medicine, complex payment and cost considerations, rapidly evolving communications and IT capabilities, and fluid patient expectations. As a result, providing health care at a reasonable cost without sacrificing quality remains a challenge for the DoD. Over the last 10 years, the DoD OIG has performed audits and evaluations and made multiple recommendations related to DoD health care, many of which are still awaiting full implementation. As of March 31, 2017, the DoD had 114 open recommendations related to health care and morale issues, including recommendations to improve tracking of suicides throughout the DoD and reducing health care costs. The DoD OIG believes that fully implementing those open recommendations will help the DoD effectively address these challenges.

### Quality, Safety and Access

In August 2014, the DHP Enterprise Review Group published a report to the Secretary of Defense, which concluded that the DHP Enterprise generally provided quality care that was safe, timely, and comparable in access, quality, and safety to that found in the civilian sector. However, as former Secretary of Defense Charles "Chuck" Hagel stated, "We cannot accept average when it comes to caring for our men and women in uniform and their families. We can do better; we all agree that we can do better." The DHP Enterprise Review report indicated some areas where the DHP Enterprise excelled and other

areas where some facilities underperformed. The report contained 78 recommendations to improve military health care. The report made recommendations in six major areas and recommended immediate action to improve underperformance and establish clear performance goals with standardized metrics. On October 1, 2014, the Secretary of Defense issued a memorandum, which directed the DoD to follow up on the August 2014 review results and to perform other specified tasks to improve transparency and transform the DHP Enterprise into a High Reliability Organization. In addition, the National Defense Authorization Act for FY 2016 added several requirements for the DoD that highlighted the importance of health care quality, safety, and access. For example, the Act included a provision requiring the Secretary of Defense to establish access standards for routine and specialty care and to ensure that TRICARE Prime beneficiaries seeking an appointment obtain appointments within those standards. The Act added requirements for the Secretary of Defense to publish on a DoD public website all measures he deemed appropriate to assess patient safety, quality of care, patient satisfaction, and health outcomes for health care provided under the TRICARE program. The Act also added requirements to detail the number of practitioners at MTFs that were reported to the National Practitioner Data Bank, and to assess the accreditation status of MTFs and other data related to health care quality, safety, and access. According to DHP Enterprise personnel, the DHP Enterprise has implemented all of the National Defense Authorization Act for FY 2016 requirements. In FY 2017, the DoD OIG initiated two evaluations, and plans to initiate another evaluation, to determine whether the DoD's response to the August 2014 DHP Enterprise Review Final Report improved access to care, quality of care, and patient safety. The DoD OIG also initiated an audit to review access to care at selected MTFs.

## **Behavioral Health**

Behavioral health treatment for the military continues to be a significant issue for the DoD. In recent years, the DoD has focused significant attention and resources on detecting, diagnosing, and treating mental disorders—especially those related to long and repeated deployments and combat stress. Between 2012 and 2016, mental disorders were among the leading cause for hospitalization of active duty service members, accounting for between 12 to 15 percent of hospitalizations during those years. In addition, mental disorders accounted for the second most common reason for outpatient clinic visits by active duty service members in FY 2016. In particular, proactively diagnosing and treating those with behavioral health conditions and those at risk for suicide remains a challenge for the DoD. A RAND report published in August 2017 highlighted the continuing challenges facing the DoD in providing both access and follow up to quality behavioral health care, which are key to the DoD's suicide prevention efforts. The RAND report concluded that the DHP Enterprise continues to be a leader in achieving high rates of follow up after psychiatric hospitalization, and that the DHP Enterprise excels at screening for suicide risk and substance use, but that follow up for service members who have already been identified as having elevated suicide risk needs improvement. The report also concluded that quality of care for post-traumatic stress disorder and depression varied by Service branch, TRICARE region, and service member characteristics, and suggested that opportunities for quality improvement may be achievable by systemic enhancements of processes across the DoD. A DoD spokesperson stated that the DoD is reviewing the report findings and recommendations and that they will be used to shape and improve the future direction of patient care.

## **Separation from Service of Personnel with Mental Health Conditions**

The Government Accountability Office (GAO) reported in May 2017 that from FY 2011 through FY 2015, 62 percent of service members separated for misconduct were diagnosed with post-traumatic stress disorder, traumatic brain injury, or other mental health conditions within 2 years of separation. Other mental health conditions for these separated service members included adjustment disorders, alcohol-related disorders, anxiety disorders, bipolar disorders, depressive disorders, personality disorders, and substance-related disorders. Of those with mental health conditions, 23 percent received other than honorable characterizations of service, making them potentially ineligible for health benefits from the Department of Veterans Affairs. The GAO concluded that, because of policy inconsistencies and limited monitoring, the DoD had minimal assurance that certain service members diagnosed with post-traumatic stress disorder or traumatic brain



injuries received the required screening and counseling before they were separated from the Service for misconduct. Additionally, the risk increased that service members may be inappropriately separated for misconduct without adequate consideration of these conditions' effects on behavior, separation characterization, or eligibility for the Department of Veterans Affairs benefits and services. The GAO recommended that the Secretary of Defense direct the Air Force and Navy to address inconsistencies in their policies with DoD policy related to screening service members and reviewing results prior to separation for misconduct, and training service members to identify mild traumatic brain injuries in a deployed setting. The GAO also recommended that the Secretary of Defense ensure that the military Services routinely monitor adherence to those policies and policies related to counseling on Department of Veterans Affairs benefits and services. The DoD agreed with the recommendations.

### **Suicide Prevention**

As noted above, suicide prevention continues to be a challenge for the DoD. As of the 4<sup>th</sup> Quarter, FY 2016, the total number of suicide deaths for DoD was 276 for the Active Component and 203 for the Reserve Component. In response to the number of suicides, the DoD developed and promoted prevention policies, practices, and programs to attempt to reduce military suicide. For example, the Defense Suicide Prevention Office was established in FY 2011 to provide advocacy, program oversight, and policy for DoD suicide prevention, intervention, and follow-up efforts to reduce suicidal behaviors in service members, civilians, and their families. It also leads working groups of representatives from the Services, the Office of the Assistant Secretary of Defense (Health Affairs), and other interested organizations, related to expanding access to behavioral health care for service members. In FY 2015, the Defense Suicide Prevention Office also implemented the DoD Strategy for Suicide Prevention, which is designed to guide and coordinate suicide prevention efforts across the DoD. As one part of that effort, the Defense Suicide Prevention Office published and distributed guides to military family members on suicide warning signs, risk factors, and actions to take in a crisis. The office also sponsors research initiatives and training that address gaps in suicide prevention and resilience policies and practices. The DoD collaborated with the Department of Veterans Affairs to develop suicide prevention and intervention policy. For example, in June 2013, the DoD and Department of Veterans Affairs jointly developed the Clinical Practice Guideline, "Assessment and Management of Patients at Risk for Suicide," which recommended best practices for assessing and managing the risk of suicide among active duty military and veterans. The DoD OIG has performed several evaluations to assess DoD suicide prevention efforts. For example, in September 2015, a DoD OIG evaluation found that the DoD lacked a clearly defined governance structure and alignment of responsibilities for the Defense Suicide Prevention Program. In addition, the DoD OIG identified the lack of clear processes for planning, directing, guiding, and resourcing to effectively develop and integrate the Suicide Prevention Program within the DoD. In response to the DoD OIG's recommendations, the Defense Suicide Prevention Office issued and implemented the 2015 Strategy for Suicide Prevention, noted above, to coordinate suicide prevention efforts across the DoD. In response to another DoD OIG evaluation report in November 2014, the Defense Suicide Prevention Office developed and is in the process of issuing guidance for data collection and reporting on suicide events. In November 2014, the DoD OIG recommended that the Under Secretary of Defense for Personnel and Readiness publish guidance requiring suicide event boards to establish a multidisciplinary approach for obtaining the data necessary to make comprehensive DoD Suicide Event Report submissions. The DoD OIG reported this as a key open recommendation in its July 2017 Compendium of Open Recommendations. Without a comprehensive and complete DoD Suicide Event Report submission, it will be difficult for the DoD to conduct the trend or causal analysis necessary to develop effective suicide prevention policy and programs to reduce suicide rates across the force. In summary, the DoD needs to continue to pursue programs to diagnose behavioral health issues and risk factors for military personnel and its other health care beneficiaries.

## Increasing Health Care Costs

The DoD faces a continuing challenge to contain costs and prevent health care fraud. Over the last decade, health care costs in the United States have grown dramatically, and DHP Enterprise costs have been no exception. For example, the DoD FY 2016 appropriations for health care were \$32.3 billion, almost triple the FY 2001 appropriation of \$12.1 billion. In its FY 2018 budget, the DoD requested \$33.7 billion for the DHP Enterprise. One of the leading contributors to health care cost is fraud. Health care fraud is one of the top investigative priorities for the Defense Criminal Investigative Service (DCIS). As of July 7, 2017, DCIS had 523 open health care investigations. In FY 2016 and FY 2017 combined, DCIS health care fraud investigations resulted in 100 criminal charges and 68 convictions, the seizure of \$53 million in assets, and \$117 million in recoveries for TRICARE and the DHP Enterprise. However, health care fraud schemes are constantly evolving. As one vulnerability is closed, corrupt individuals look for another vulnerability within the health care payment system to exploit. Therefore, the DoD needs to be constantly vigilant to detect health care fraud, and to establish strong internal controls to determine areas at risk for health care fraud.

## Pharmaceuticals

The DCIS continues to vigorously investigate fraud epidemic that exploited TRICARE in FY 2014 and 2015, mixing, or altering two or more ingredients to create a customized medication for an individual patient. In FY 2015, the DHP Enterprise experienced a dramatic increase in compounding pharmacy fraud, with \$1.6 billion spent on compound medications in that 1 year alone. Much of expenditures were fraudulent. For example, compound drug fraud schemes involved providers who prescribed compound drugs, including various pain and other creams, without examining or even meeting the patient; medication refills sent without the consent of the patient; kickbacks paid to providers, marketers, and patients; and grossly inflated bills for prescriptions. These schemes took advantage of a TRICARE reimbursement policy that allowed for full and immediate reimbursement of prescribed compound drugs. The DHP Enterprise changed its reimbursement policy for compound drugs in response to the significant losses it realized. As a specific example of this type of fraud, one compounding pharmacy in Florida sought reimbursement for compounding pharmaceutical prescriptions that were not medically necessary and were prescribed by physicians that had never actually examined or even seen the patients. Further, a military member involved in the scheme committed identity theft by stealing fellow military members' personally identifiable information in order to facilitate additional billings to TRICARE in exchange for kickbacks. In this case, 14 individuals have been convicted of various crimes, \$31 million has been court-ordered back to the DHP Enterprise as restitution, and approximately \$10 million in assets have been seized. In May 2015, the DHP Enterprise implemented new controls, which reduced payments for compound drugs from \$497 million in April 2015 to \$10 million in June 2015. In an audit report issued in July 2016, the DoD OIG found that, while the controls were effective in reducing costs for compound drugs, additional controls were necessary to prevent reimbursement for certain non-covered compound drug ingredients. The DHP Enterprise agreed with the recommendation and took actions to improve controls related to compound drugs. Fraud and escalating costs also occur in non-compound pharmaceuticals. The DoD OIG has two ongoing audits related to pharmaceuticals, including an audit reviewing the DHP Enterprise's process for implementing controls in response to escalating costs for non-compound pharmaceuticals, and an audit to determine whether the Defense Logistics Agency Troop Support managed its Pharmaceutical Prime Vendor Program to effectively control health care costs.

## Autism Treatment

One emerging fraud trend involves Applied Behavioral Analysis, which employs techniques and principles to encourage a meaningful and positive change in behavior. Applied Behavioral Analysis is a benefit offered by TRICARE for children with a diagnosis on the Autism Spectrum. In a March 2017 audit, the DoD OIG determined that the DHP Enterprise made improper payments for autism services to five companies in the TRICARE South Region. Specifically, the DHP Enterprise improperly paid for services where the beneficiary was not present; the beneficiary was napping; providers were not authorized by TRICARE; documentation to support services was lacking; and the provider billed for higher qualified health

care professionals than those who actually performed the services. As a result, the audit determined that the DHP Enterprise improperly paid \$1.9 million of the total \$3.1 million paid to the five companies in FY 2015. The DCIS also investigated an Applied Behavioral Analysis therapy clinic that allegedly provided therapy using personnel who were not properly trained per the DHP Enterprise guidelines, billed group therapy as one-on-one therapy, and billed for services never rendered. The investigation resulted in the indictment and conviction of the clinic owner and the reassignment of TRICARE beneficiaries from this clinic to others in the area.

### **Payment Collections**

Another aspect of controlling health care costs involves ensuring collections are made for services provided at MTFs. The DoD OIG issued six reports from August 2014 through January 2017 related to collections from non-DoD beneficiaries, which concluded that MTFs did not actively pursue collections from non-DoD beneficiaries for 129 accounts, valued at \$13.1 million, of the 145 accounts the DoD OIG reviewed. The MTFs also did not appropriately transfer funds to the U.S. Treasury for 114 delinquent accounts, valued at \$13.4 million, of the 145 accounts the DoD OIG reviewed for collection. In 2017, the DoD OIG plans to perform another audit to review billing and reimbursement for health care provided to Department of Veterans Affairs patients at selected Army MTFs. While the DHP Enterprise has made progress in controlling some costs, people committing fraud will continue to look for new vulnerabilities to exploit. As internal controls are tightened in one area, those intent on committing fraud seek other vulnerabilities to exploit. For example, emerging areas of concern for fraud within the DoD health care system involve genetic and DNA testing, durable medical equipment, and opioids. The DHP Enterprise needs to be vigilant in reviewing billing trends to look for the next fraud schemes and implement effective controls to help prevent payments for fraudulent claims.

### **Electronic Health Records**

In addition, the DoD faces challenges with the security of electronic health records and integration of those records with the Department of Veteran Affairs. According to a media report, more than 115 million patient records in the United States were compromised in FY 2015, and more than 25 million records were compromised from January to October 2016. The DoD has a responsibility to protect the patient health information for its 9 million beneficiaries and transfer records as needed to the Department of Veterans Affairs. The DoD OIG also found security weaknesses within the DoD's electronic health records. A July 2017 DoD OIG audit reported that DHP Enterprise and Army officials did not consistently implement effective security protocols to protect systems that stored, processed, and transmitted electronic health records and electronic patient health information. Specifically, DHP Enterprise and Army officials did not enforce the use of Common Access Cards to access five electronic health record systems and did not comply with DoD password complexity requirements for three systems. In addition, the DoD OIG reported that system and network administrators at three Army facilities did not consistently mitigate known vulnerabilities affecting Army networks, protect stored data for five systems, and grant user access to the seven systems based on the user's assigned duties. The DoD OIG began a similar audit in April 2017 of the Navy and Air Force electronic health records. In addition to the security of health records, according to congressional testimony by a GAO official in FY 2016, the DoD and the Department of Veterans Affairs have failed in several attempts to integrate their respective electronic health records since FY 1998. The testimony noted that the Department of Veterans Affairs has undertaken a patchwork of initiatives with the DoD to allow their health information systems to exchange information and increase interoperability. These have included initiatives to share viewable data in their existing (legacy) systems, link and share computable data between their updated health data repositories, and jointly develop a single integrated system that would be used by both departments. The National Defense Authorization Act for FY 2017 directed the DoD and the Department of Veterans Affairs to integrate their electronic health records and gave the Departments 5 years to meet this requirement. The Secretary of the Department of Veterans Affairs announced in FY 2017 that the Department of Veterans Affairs will acquire the same system as DoD. The DoD should monitor this acquisition and work closely with the Department of Veterans Affairs to ensure that the system will be interoperable with the DoD system.

The DoD should work closely with the Department of Veterans Affairs to ensure interoperability between the Departments' electronic health records and ensure that sensitive patient health information contained in electronic health records are adequately protected. In summary, providing quality, cost-effective health care to the DoD's 9 million beneficiaries will continue to be a significant challenge for the DoD. The DoD must continue to seek efficiencies to control costs without undermining timely access to quality health care. That is not an easy task. At the same time, the DoD needs to address behavioral disorders and aggressively seek to reduce the number of suicides within the military. In addition, the DoD must protect patient health information within its electronic health records and work closely with the Department of Veterans Affairs to integrate electronic health records between the Departments. The DoD OIG will continue to perform reviews of high-risk health care issues and monitor progress in these areas to identify additional ways to improve health care for DoD beneficiaries.



## Payment Integrity<sup>14</sup>

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The Federal Improper Payments Coordination Act of 2015 amended the Improper Payment Elimination and Recovery Improvement Act of 2012 (IPERIA) and earlier legislation affecting improper payment and requires extension of DoD reporting of its data analytics performance. The intent is to ensure federal and state entities maintain strong financial management controls to better detect, prevent, and report improper payments to the president and the Congress in the annual AFR.

OMB Circular No. A-123, Appendix C, defines an improper payment as any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Incorrect amounts are overpayments or underpayments that are made to eligible recipients (including inappropriate denials of payment or services, any payment that does not account for credit for applicable discounts, payments that are for an incorrect amount, and duplicate payments). An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received (except for such payments authorized by law). In addition, when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment.

The DHA reports its improper payments and payment recapture programs in accordance with applicable laws and regulations. The following subcategories are included in this section:

- I. Risk assessment
- II. Payment reporting
  - A. Root causes
  - B. Corrective actions
- III. Recapture of improper payments reporting
- IV. Agency improvement of payment accuracy with the Do Not Pay Initiative
- V. Barriers
- VI. Accountability
- VII. Agency information systems and other infrastructure
- VIII. Sampling and estimation
- IX. Significant accomplishments

The DHA reports improper payments for the MHS TRICARE purchased health care program for payments made by the DHA to private sector contractors for delivery of health care services to TRICARE eligible beneficiaries. For FY 2018 the Agency reports improper payments for the following private sector contracts, DHA administrative costs and other plans and programs:

- Managed care support contracts (MCSCs):
  - T-3 North Region, HealthNet Federal Services
  - T-3 South Region, Humana Government Business
  - T-3 West Region, UnitedHealthcare Military and Veterans
- TRICARE Dual Eligible Fiscal Intermediary Contract (TDEFIC)

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<sup>14</sup> 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)

- TRICARE Overseas Program (TOP)
- TRICARE Pharmacy Program (TPharm)
- Active Duty Dental Program (ADDP)
- DHA Administrative Contract Cost
- Other:
  - Uniformed Services Family Health Plan (USFHP)
  - Women, Infants, and Children (WIC)
  - TRICARE Dental Program
  - TRICARE Retiree Dental Program
  - Mail-Order Pharmacy

## I. Risk Assessment

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 purchased-care contractors. The EIC identifies improper payments resulting from the contractors' noncompliance with the military health care system (collectively referred to as TRICARE in this report) benefit and/or reimbursement policies, regulations, and contract requirements. The risk level of programs is evaluated based on results of these compliance reviews.

In FY 2018, the Agency applied statistical sampling estimation methods to produce and report statistically valid improper payment estimates for the military health benefits program. In accordance with OMB Circular A-123, Appendix C, agencies are not required to perform additional risk assessments on programs reporting improper payment estimates. However, any new programs identified must be assessed for improper payment risk prior to reporting an improper payment estimate. DHA had no new program(s) implemented in FY 2017, and therefore no additional risk assessment was required for FY 2018 reporting.

## II. Payment Reporting

Table 1 reports the estimated amounts that were improperly paid and the corresponding percent by program for FY 2018. It also reports the estimated amount of improper payments that resulted in overpayments or underpayments and the DHA contractual reduction targets by program for FY 2019.

**Table 1: Improper payment reduction outlook**

(dollars in thousands)												12-Month Sampling <sup>1</sup> Time Frame for FY 2018 Data	
Program Name	FY 2017 Outlays	FY 2017 IP Amount	FY 2017 IP Rate	FY 2018 Outlays	FY 2018 IP Amount	FY 2018 IP Rate	FY2018 Over- payment \$	FY2018 Under- payment \$	FY2019 Est. Outlays <sup>2</sup>	FY2019 Est. IP % <sup>3</sup>	FY2019 Est. IP \$	Month and Year Start Date for Data	Month- and Year- End Date for Data
T3 North Region	\$ 3,513,321.91	\$ 18,285.16	0.52%	\$ 3,548,471.18	\$ 12,902.22	0.36%	\$ 6,847.19	\$ 6,055.02	\$ 3,686,861.56	0.85%	\$ 31,338.32	10/1/2016	9/30/2017
T3 South Region	\$ 4,632,307.25	\$ 18,407.04	0.40%	\$ 4,451,158.26	\$ 29,708.84	0.67%	\$ 25,570.67	\$ 4,138.17	\$ 4,624,753.43	1.29%	\$ 59,659.32	10/1/2016	9/30/2017
T3 West Region	\$ 3,985,064.60	\$ 32,211.62	0.81%	\$ 3,668,395.99	\$ 23,715.69	0.65%	\$ 18,341.52	\$ 5,374.17	\$ 3,811,463.44	0.93%	\$ 35,446.61	10/1/2016	9/30/2017
TDEFIC	\$ 3,558,675.79	\$ 7,595.91	0.21%	\$ 3,531,990.60	\$ 8,480.08	0.24%	\$ 6,080.54	\$ 2,399.54	\$ 3,669,738.23	0.66%	\$ 24,220.27	10/1/2016	9/30/2017
TOP	\$ 238,372.49	\$ 2,707.85	1.14%	\$ 234,321.36	\$ 3,358.97	1.43%	\$ 2,802.41	\$ 556.56	\$ 243,459.90	1.28%	\$ 3,116.29	9/1/2016	8/31/2017
TPharm	\$ 3,161,134.46	\$ 70,213.07	2.22%	\$ 2,758,492.03	\$ 11,864.59	0.43%	\$ 11,745.51	\$ 119.07	\$ 2,866,073.22	1.35%	\$ 38,691.99	11/1/2016	10/31/2017
ADDP	\$ 81,260.69	\$ 746.88	0.92%	\$ 82,787.70	\$ 1,211.29	1.46%	\$ 995.52	\$ 215.77	\$ 86,016.42	1.62%	\$ 1,393.47	8/1/2016	7/31/2017
DHA Administrative <sup>4</sup>	\$ 1,225,766.16	\$ -	0.00%	\$ 751,728.53	\$ -	0.00%	\$ -	\$ -	\$ 781,045.95	0.00%	\$ -	10/1/2016	9/30/2017
Other <sup>5</sup>	\$ 3,487,396.60	\$ -	0.00%	\$ 4,269,209.00	\$ -	0.00%	\$ -	\$ -	\$ 4,435,708.15	0.00%	\$ -	10/1/2016	9/30/2017
TOTAL	\$ 23,883,299.95	\$ 150,167.53	0.63 <sup>6</sup> %	\$ 23,296,554.65	\$ 91,241.68	0.39%	\$ 72,383.36	\$ 18,858.30	\$ 24,205,120.30	0.80%	\$ 193,866.27		

**Footnotes:**

**1** – DHA reports data 12 months in arrears, thus this FY2018 AFR includes data from FY2017 reviews.

**2** – The FY2019 Est. Outlays were calculated using the OMB CPI-U Annual Averages and Percent Change Table. As DHA reports 12 months in arrears, the FY 2018 CPI-U medical percent change was used to calculate the FY 2019 outlay estimates.

**3** – DHA established its FY2019 Est. IP % based on a trend of actual improper payment data from prior years. These figures are estimated to be higher than the FY 2018 actuals as a result of DHA's implementation of medical record reviews (which have the potential to identify additional improper payments) and the implementation of NDAA 2017 legislative requirements, which established changes to the TRICARE program that could result in increased payment errors.

**4** – DHA Administrative data represents payments shared among multiple contractors to administer the TRICARE program. These costs include contractually defined claim rates for processing TRICARE claims, and non-claim rate administrative costs (i.e., contract change orders, per member per month charges, and contract incentive payments). Payments are validated via TED system program edits, COR review/validation procedures, and/or internal/external financial audits.

**5** – Other data represents contracts that are not included in DHA EIC independent audits but which have internal and external pre- and post-payment controls. The following contracts are included in the "other" category:

- a. Uniformed Services Family Health Plan ("USFHP")
- b. Women, Infants, and Children ("WIC")
- c. TRICARE Dental Program ("TDP")
- d. TRICARE Retiree Dental Program ("TRDP")
- e. Mail Order Pharmacy ("MOP")

**6** – The FY 2017 IP Rate of 0.63% does not represent a true statistical estimate for the agency because the 2015'10-2016'09 low dollar TPharm audit that was not conducted (due to the contractor opting out of participating in the audit, as approved by the Contracting Officer). This audit represented \$138,057,695 paid dollars.

Chart A below reports the estimated amount and percentage of payments made correctly under the DHA health benefits program in FY 2017.

**Chart A:** Amount and percentage of DHA improper vs. proper payments

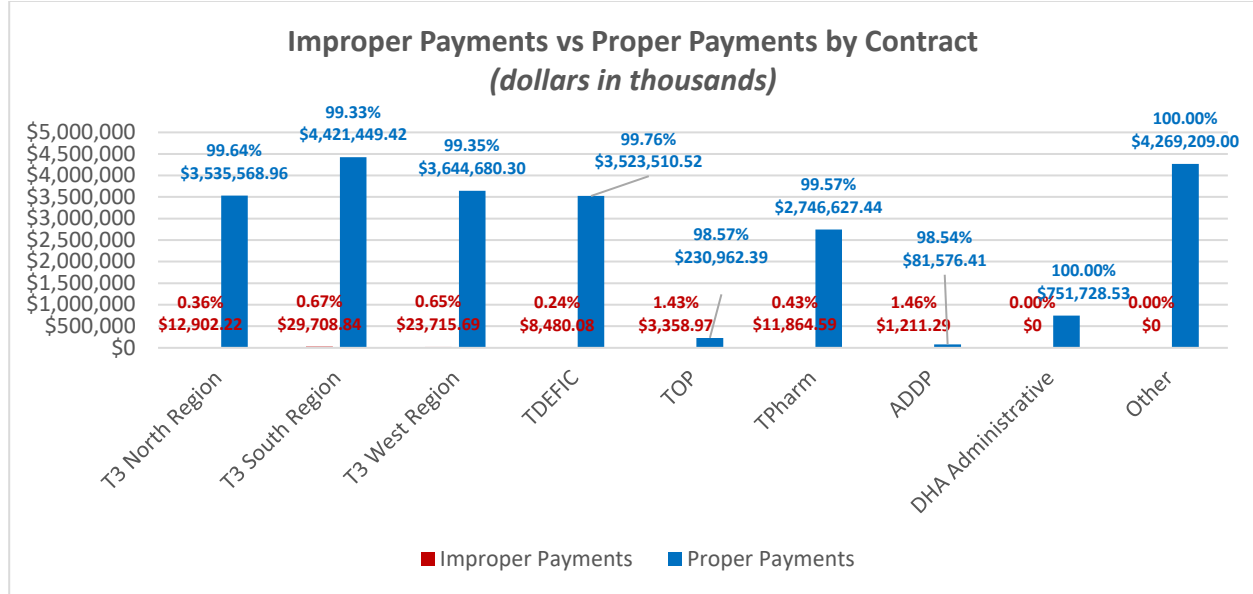


Table 2 below provides current year estimate statistical information.

**Table 2:** Current year estimate statistical information

Program Name	CY Confidence Level	CY Margin of Error
T3 North Region	90%	0.20%
T3 South Region	90%	0.25%
T3 West Region	90%	0.27%
TDEFIC	90%	0.29%
TOP	90%	0.33%
TPharm	90%	0.25%
ADDP	90%	0.56%
DHA Administrative	90%	0.00%
Other	90%	0.00%
<b>TOTAL</b>	<b>90%</b>	<b>0.09%<sup>1</sup></b>

**Footnotes:**

1 – The TOTAL CY Margin of Error (0.09%) is not a direct sum of CY Margin of Error values from this table, because the values must be weighted according to the outlays. The final value was derived as the square root of the variance of all contracts (not shown in this table) times the z-score, divided by the total outlays (from Table 1).



Table 3 reports the root cause for overpayments and underpayments by amount and by program for FY 2018.

**Table 3:** Improper payment root cause category matrix<sup>1</sup>

(dollars in thousands)

Program Name	Payment Type	Program Design or Structural Issue	Inability to Authenticate Eligibility: Inability to Access Data	Inability to Authenticate Eligibility: Data Needed Does Not Exist	Failure to Verify: Death Data	Failure to Verify: Financial Data	Failure to Verify: Excluded Party Data	Failure to Verify: Prisoner Data	Failure to Verify: Other Eligibility Data (explain)	Administrative or Process Errors Made by: Federal Agency	Administrative or Process Errors Made by: State or Local Agency	Administrative or Process Errors Made by: Other Party (e.g., participating lender, health care provider, or any other organization administering Federal dollars)	Medical Necessity	Insufficient Documentation to Determine	TOTAL
T3 North Region	OP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 6,847.19	\$ -	\$ -	\$ 6,847.19
T3 North Region	UP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 6,055.02	\$ -		\$ 6,055.02
T3 South Region	OP	\$ -	\$ 16.04	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 25,553.12	\$ -	\$ 1.52	\$ 25,570.68
T3 South Region	UP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 4,138.17	\$ -		\$ 4,138.17
T3 West Region	OP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 18,341.36	\$ -	\$ 0.16	\$ 18,341.52
T3 West Region	UP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 5,374.17	\$ -		\$ 5,374.17
TDEFIC	OP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 6,080.54	\$ -	\$ -	\$ 6,080.54
TDEFIC	UP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 2,399.54	\$ -		\$ 2,399.54
TOP	OP	\$ -	\$ 1.01	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 2,746.59	\$ -	\$ 54.81	\$ 2,802.41
TOP	UP	\$ -	\$ 0.89	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 555.67	\$ -		\$ 556.56
TPharm	OP	\$ -	\$ 0.22	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 11,650.11	\$ 85.59	\$ 9.59	\$ 11,745.51
TPharm	UP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 119.07	\$ -		\$ 119.07
ADDP	OP	\$ -	\$ 6.16	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 748.75	\$ 96.01	\$ 144.60	\$ 995.52
ADDP	UP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ 215.77	\$ -		\$ 215.77
DHA Enterprise Admin.	OP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
DHA Enterprise Admin.	UP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ -	\$ -		\$ -
Other	OP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other	UP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -	\$ -	\$ -		\$ -
<b>Total</b>		<b>\$ -</b>	<b>\$ 24.32</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>		<b>\$ -</b>	<b>\$ -</b>	<b>\$ 90,825.07</b>	<b>\$ 181.60</b>	<b>\$ 210.68</b>	<b>\$ 91,241.67</b>

**Footnotes:**

1 – Figures were derived by multiplying the proportion of sample error dollars for each error category by the extrapolated overpayment (OP) or underpayment (UP) dollars from Table 1. For example, for TPharm, Medical Necessity overpayments from samples totaled \$1,143.89. All sample overpayments from the TPharm samples totaled \$156,973.23. Therefore, this error category accounted for 0.7287% of total sample overpayment dollars (\$1,143.89 divided by \$156,973.23). 0.7287% of the TPharm FY2018 Overpayment \$ from Table 1 (\$11,745,514.25) yields \$85,591.51. Rounded to millions, this number becomes \$0.86 (which is shown in this table). This process was repeated for each cell in the table.

## A Root Causes

The following section provides additional information regarding the root causes of improper payments for each program reported in Table 3 above.

The DHA contracts with an external independent contractor (EIC) to conduct quarterly, semiannual, and annual compliance reviews of previously processed health care claims. EIC auditors review claims to identify improper payments and to validate the accuracy of the claims processing procedures used by TRICARE private sector contractors. Overpayment or underpayment errors can be assessed for (but not limited to) payments in the correct amount being sent to the wrong payee, incorrect denial of a payable claim, misapplication or calculation of a patient's deductible or co-payment/share liability, or payment of a non-covered service or supply. In FY 2017, EIC compliance reviews determined the root cause for over/underpayment errors was the result of the following:

- **Inability to Authenticate Eligibility:** DHA private sector contractors incorrectly paid or denied health care claim(s) as a result of an incorrect patient eligibility determination.
- **Administrative or Process Errors Made by Other Party:** DHA's EIC determined throughout the course of compliance reviews that DHA private sector contractors incorrectly processed health care claims by either:
  - Applying an incorrect reimbursement determination or methodology when processing a health care claim
  - Incorrectly calculating the government's liability after consideration of other health insurance (OHI) payment(s)
  - Based on a patient's health care claims history, incorrectly made duplicative payments for previously paid health care services or supplies
  - Miscalculated the patient's cost-share or benefit deductible liability
  - Made a payment for services or supplies which were not a TRICARE benefit or incorrectly denied payment for services or supplies that were a TRICARE benefit
  - Incorrectly calculated the government's reimbursement of health care based on a billed amount other than what was being reported on a health care claim form or itemized medical bill
  - Incorrectly based its reimbursement determination/methodology on an incorrect procedure code
  - Claims processor failing to follow TRICARE authorization or pre-authorization requirements prior to processing a payment
  - Claims required further development prior to payment (i.e. additional or correct information needed)
  - Other health insurance payments omitted when calculating government liability
  - Reimbursement rates miscalculated for institutions subject to Diagnosis Related Group (DRG) reimbursement system.
- **Medical Necessity:** The claims processor failed to follow TRICARE medical necessity review policy requirements prior to processing and paying a health care claim or failed to provide the medical necessity review documentation needed to support or substantiate the adjudication of the claim being reviewed during audit.
- **Insufficient Documentation to Determine:** The EIC determined during a compliance review that the claims documentation provided by private sector contractors was insufficient and/or did not support the adjudication of the health care. As a result the EIC determined the services or procedures rendered should not have been paid.

Table 4 below reports the amount of improper payments identified in samples by contract that resulted in actual monetary losses to the government. The purpose of this classification is to estimate the monetary loss to the Federal Government due to improper payments. Monetary loss to the Government would be an amount that must not have been paid and in theory should/could be recovered (e.g. improper overpayment errors). This table excludes improper underpayments.

**Table 4: Improper payment classification**  
(dollars in thousands)

Program Name	Actual Monetary Loss to the Government Identified in Sample	Estimated Total Monetary Loss to the Government
T3 North Region	\$ 191.19	\$ 6,847.19
T3 South Region	\$ 1,961.11	\$ 25,570.68
T3 West Region	\$ 1,198.04	\$ 18,341.52
TDEFIC	\$ 131.49	\$ 6,080.54
TOP	\$ 480.72	\$ 2,802.41
TPharm	\$ 156.97	\$ 11,745.51
ADDP	\$ 20.95	\$ 995.52
DHA Administrative	\$ -	\$ -
Other	\$ -	\$ -
<b>TOTAL</b>	<b>\$ 4,140.47</b>	<b>\$ 72,383.37</b>

## B Corrective Actions

### Military Health Benefits (FY 2018 IP Amount = \$91.24m)

DHA private sector contractors are monetarily incentivized or dis-incentivized, through 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 reimbursements. Additionally, details of the EIC compliance reviews are shared with the private sector contractors, DHA program offices, private sector contract contracting officers, and contracting officer representatives (CORs) to coordinate appropriate corrective action plans with the respective private sector contractor. Moreover:

- Upon completion of an EIC compliance review, contractors review results, formulate an action plan to mitigate future findings, and derive a process to avoid future improper payments.
- If warranted, contractor claims processing systems are modified to meet the Department's health care policy, reimbursement, or benefit requirements.
- If review results show a potential error pattern for a certain type of claim, additional claims are pulled to conduct a focused study, and adjustment actions are taken as appropriate.

Each private sector contractor has its own business process for evaluating compliance review results, conducting root cause analyses to ensure the accuracy of future claims payment, and developing internal corrective action plans. If required, DHA contracting officers and contracting officer representatives issue contractor corrective action plans (CAPs) to resolve and track noncompliance with TRICARE health care policy/regulations and purchased-care contracts.

For each payment error/root cause category assessed as a result of ongoing compliance reviews, DHA will continue to instruct private sector contractors to follow Code of Federal Regulation (CFR) Chapter 199.11, *Overpayments recovery*, instructions and to investigate and make necessary adjustments to those claims identified as having payment errors. In addition, DHA will:

- Modify TRICARE purchased care contracts requiring contractors to develop procedures for reporting CAPs for each payment error category/root cause assessed against a claim during a quarterly or semi-annual compliance review cycle as well as developing procedures for government entities to validate proposed CAPs

- Develop Contract Data Requirements List (CDRL) requirements that require contractors to provide monthly status reports on CAPs established for each payment error category/root cause assessed for a specified compliance review cycle (reference TRICARE Operations Manual (TOM), Chapter 14, for additional information regarding DHA CDRL requirements)
- Include TRICARE private sector contractor CAP reports as part of DHA's AFR reporting to the DoD Comptroller annually
- Develop database or tracking tool to monitor TRICARE private sector contractor CAP reporting and contractor actions taken

### III. Recapture of Improper Payments Reporting

Table 5 below reports each program or activity that exceeds \$1 million or more annually that recapture payments outside of a payment recapture audit and the amounts recovered through sources other than recapture audits.

DHA utilizes a number of different mechanisms to prevent, identify, and collect improper payments. These include claims auditing by an EIC, contractor utilization of DHA's Duplicate Claims System, and periodic independent reviews of private sector payments. This process employs pre- and post-payment review techniques, performed internally and by external contractors, with overpayment recoveries returned to the military health benefits program.

Contract payments make up a large volume of transactions with high-dollar values; therefore, DHA is vigilant to ensure payment accuracy. In addition to the pre- and post-payment reviews, DHA also uses various internal manual and automated prepayment initiatives to prevent improper payments. During FY 2017, DHA recovered \$22.482 million in overpayments as a result of overpayment errors identified by the EIC, refunds occurring in the course of routine claims adjustments, and ongoing private sector contractor internal audits, resulting in a 543 percent overpayment recovery rate.

**Table 5: Overpayment Payment Recaptures with and without Recapture Audit Programs**

(dollars in thousands)

Does This Include Funds Recaptured From a High-Priority Program (Y/N)	Program or Activity	Overpayments Recaptured Through Payment Recapture Audits				Overpayments Recaptured Outside of Payment Recapture Audits	
		Amount Identified in FY 2018	Amount Recaptured in FY 2018	Recapture Rate in FY 2018	FY2019 Recapture Rate Target	Amount Identified in FY 2018 <sup>1</sup>	Amount Recaptured in FY 2018 <sup>2</sup>
N	T3 North Region	-	-	-	-	\$ 191.19	\$ 3,858.58
N	T3 South Region	-	-	-	-	\$ 1,961.11	\$ 5,609.41
N	T3 West Region	-	-	-	-	\$ 1,198.04	\$ 7,072.21
N	TDEFIC	-	-	-	-	\$ 131.49	\$ 1,916.41
N	TOP	-	-	-	-	\$ 480.72	\$ 952.62
N	TPharm	-	-	-	-	\$ 156.97	\$ 3,001.29
N	ADDP <sup>3</sup>	-	-	-	-	\$ 20.95	\$ 71.72 <sup>3</sup>
N	DHA Administrative	-	-	-	-	\$ -	\$ -
N	Other	-	-	-	-	\$ -	\$ -
	<b>TOTAL</b>	-	-	-	-	\$ 4,140.47	\$ 22,482.24

**Footnotes:**

1 – Amount Identified in FY 2018 represents the total overpayment dollars from sampled claims.

2 – These numbers include recoupments for overpayments identified in audits as well as refunds occurring in the course of routine claim adjustments (for claims initially paid in FY 2017 and other fiscal years). DHA has no way to distinguish overpayment recoupments from routine claim adjustments.



3 – The Active Duty Dental Program refunds were calculated differently. The amount recovered in FY 2018 figure for ADDP represents refunds shown on contractor invoices to DHA. ADDP data is not included in the TED system, so contractor invoices were used because TED transactions are not available.

## IV. Agency Improvement of Payment Accuracy with the Do Not Pay Initiative

**Individual Payments:** The DHA processes relatively few (5–20) case recoupment refunds each month for small dollar amounts (\$5–\$20,000). The Single Online Search service is utilized pre-payment for 100% of all case recoupment refunds to verify (1) a business or individual has not been placed on the List of Excluded Individuals/Entities (LEIE) and (2) an individual has not died. Any matches will be referred to the DHA Office of General Counsel.

**Vendor, Contract Payments:** The DHA processes approximately 226 routine payments per month for thirteen unique contractor payees. The Single Online Search service is utilized pre-payment once a month to verify a DHA contractor payee has not been placed on the Excluded Parties List System (EPLS) or the LEIE. Any matches are validated with the Treasury Offset Program (TOP) ensuring the contractor does not have the same Employer Identification Number (EIN) as a person’s Social Security Number (SSN). The contractor is responsible for resolving these matching issues due to proprietary reasons. If the contractor is on the list, the finding is referred to the assigned Contracting Officer. DHA processed approximately 312 payments totaling \$2,088,582,881.81 with no matches on the Do-Not-Pay system for Fiscal Year of 2018.

The risk for payments to a subcontractor or individual via the contractor, however, lies outside of DHA control. DHA contractors are not required to utilize the Do-Not-Pay database, and there is no current mechanism in place to require the contractors to use the Do-Not-Pay databases at the prepayment phase to comply with IPERA.

Table 6 below provides results of the Do Not Pay Initiative for DHA’s Military Health Benefits program.

**Table 6:** Results of the Do Not Pay Initiative in Preventing Improper Payments

<i>(dollars in thousands)</i>	Number (#) of Payments Reviewed for Possible Improper Payments	Dollars (\$) of Payments Reviewed for Possible Improper Payments	Number (#) of Payments Stopped	Dollars (\$) of Payments Stopped	Number (#) of Potential Improper Payments Reviewed and Determined Accurate	Dollars (\$) of Potential Improper Payments Reviewed and Determined Accurate
Reviews with the IPERIA-specified databases	312	\$ 2,088,582.88	0	\$ 0	312	\$ 2,088,582.88
Reviews with databases not listed in IPERIA	0	\$ 0	0	\$ 0	0	\$ 0

## V. Barriers

The Agency did not identify any statutory or regulatory barriers limiting its corrective actions in reducing improper payments in those programs determined in FY 2018 to be susceptible to significant improper payments.

## 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 \(DoDFMR\), 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 [DoDFMR, Volume 5, Chapter 28](#), “Management and Collection of Individual Debt,” and [DoDFMR, Volume 10, Chapter 18](#), “Contractor Debt”.

The DoD FMR contains other policies that specifically address Improper Payments ([DoDFMR Volume 4, Chapter 14](#)) and Recovery Auditing ([DoDFMR Volume 10, Chapter 22](#)). Beginning in Quarter 3, FY 2013, all reporting DoD Components were required to begin downloading their improper payment reports to the DFAS ePortal, as the Office of the Deputy Chief Financial Officer’s Accounting & Finance Policy Directorate was designated as the Executive Agent to manage this information and its associated reporting requirements. 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.

## VII. Agency Information Systems and Other Infrastructure

DHA has much of the information and infrastructure needed to reduce improper payments. DHA Purchased Care Program (managed by the Contract Resource Management Office) includes an immense volume of claims processed by TRICARE purchased care contractors. To track programs, CRM uses the following systems:

- **TRICARE Encounter Data Set (TEDS):** TEDS is a financial feeder system, through which all claims are processed to Oracle Federal Financials. TEDS is the entry point of claims information from DHA purchased care contractors. TEDS records provide detailed information for each treatment encounter and are submitted as either an institutional or non-institutional record. TEDS is primarily required by DHA to account for the expenditure of government funds, develop statistical information, and is a data source of records for EIC audits. Records submitted through the TEDS must pass numerous validation edits prior to being accepted into TEDS.
- **E-Commerce System (ECS):** ECS is an integrated, centralized major system that improves DHA’s core financial, contracting and business process by providing seamless integrated financial and contracting systems.
- **Oracle Federal Financials (OFF):** OFF is the financial subsystem of the DHA ECS. It supports budget and accounting/financial functions and health care (TEDS) claims processing and contains TRICARE Claims Management, Accounts Receivable, Accounts Payable, Purchase Orders and the General Ledger modules. CRM uses OFF to track commitments and obligations. These transactions are submitted to DFAS and become the primary source into financial statements.

In addition to internal DHA financial systems, DHA purchased care contractors claims processing systems are developed and designed in accordance with TRICARE System Manual <http://manuals.tricare.osd.mil/pages/v3/DisplayManual.aspx?SeriesId=TS15> requirements and contain numerous system edits. These edits include patient eligibility (verified via the Defense Enrollment Eligibility Reporting System (DEERS)), provider eligibility, and more. If a claim passes initial eligibility edits, benefit calculations occur based on programmed payment rules and reimbursement methods determined by TRICARE Reimbursement Policy. The claims processing systems are able to determine the appropriate reimbursement methodology based on information included in the healthcare claim such as type of service, claim form type, provider specialty, etc.

Further, DHA has developed the TRICARE Duplicate Claims System (DCS). This tool facilitates the identification of duplicate claim payments, the initiation and tracking of recoupments, required by purchased care contractors, and the ultimate cancellation of duplicate records from the TEDS database. DHA purchased care contractors are contractually required to use the DCS and resolve duplicate payments.

## VIII. Sampling and Estimation<sup>15</sup>

DHA followed OMB Circular A-123, Appendix C, dated October 20, 2014, when developing its sampling methodology to select FY 2017 claims for its EIC compliance review. This statistically valid sampling methodology met OMB's requirements of a 90 percent confidence level and a margin of error of  $\pm 2.5$  percent. By using this methodology, DHA is able to identify valid sample sizes and project improper payment percentages for the Agency's improper payment program. DHA performs 100 percent pre-payment reviews of its administrative and other program disbursements.

DHA defines samples (sets strata boundaries, calculates sample sizes, and randomly selects claims for review) and the EIC reviews the selected claims to identify improper payments. Payment accuracy compliance reviews include two sample types: a payment sample (to ensure payment accuracy by identifying underpayment and overpayments) and a denied sample (to ensure appropriate claim denial). Paid samples are conducted as a stratified random sample based on paid amounts and denied samples are conducted as a stratified random sample based on billed amounts. Samples are drawn on either a quarterly or semi-annual basis, respective of DHA purchased care contract requirements.

- **Payment Sample:** Paid samples are conducted to identify improper payments and measure payment accuracy. Depending on the private sector contract type (i.e., MCSC, TDEFIC, TOP, etc.), the universe for a paid sample may contain between several hundred thousand to 30 million claims. All claims with government payment amount above a high-dollar threshold (i.e., \$200,000) are reviewed by the EIC. Claims between the high-dollar threshold and a low-dollar threshold (i.e., \$100) are randomly sampled based on stratification of the government payment amount and reviewed by the EIC. Claims below the low-dollar threshold are not included in EIC audits (but are represented by DHA Low-Dollar Internal Reviews).
  - Samples for paid claims include between four and 12 strata, depending on the composition of the claims in the universe. Mathematical formulas are utilized to identify optimal strata boundary points, and sample sizes are calculated to meet (or exceed) an estimate with a minimum of 90 percent confidence plus or minus 2.5 percentage points (as stipulated in the OMB Circular A-123, Appendix C guidelines).
- **Low-Dollar Internal Review:** In addition to the ongoing EIC quarterly and semi-annual reviews, the EIC conducts an annual statistically valid review of low-dollar claims that fall below the low-dollar threshold for payment samples. Audits for these EIC reviews are stratified if appropriate, given the composition of the universe data.
- **Denied Sample.** The primary purpose of the denied payment samples is to ensure that health care/supplies are not being denied inappropriately (which may represent obstacles in TRICARE beneficiaries' access to care) by private sector contractors. Records that encompass the denied payment sample universe are limited to records with government payment amount equal to \$0. All denied claims with a billed amount above a high-dollar threshold are reviewed, and claims below this threshold are randomly sampled based on stratification of the billed amount. Depending on the contract type, a denied audit universe may contain between several thousand to over 1 million claims.
  - The denied payment sample is similar in design to the payment sample; the primary difference is that the denied sample is stratified based on billed amount since the paid amount for a denied claim is equal to \$0.
- **Combining the Samples:** Results from the payment sample, denied sample, and DHA's internal low-dollar review are all considered when DHA calculates the overall improper payment rate.

## IX. Significant Accomplishments

The DHA is committed to full compliance with the requirements of IPERIA. As part of the Agency's audit efforts, DHA Components diligently review and report all payments subject to IPERIA, as well as examining processes for identifying the complete universe of payments. Moreover, DHA continues to explore measures to improve its internal controls to prevent improper payments, and strengthen post payment reviews to identify and recover improper payments. To ensure the

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<sup>15</sup> FY 2018 Sampling Methodology for FY 2017 Purchased Health Care Costs

accurate and reliable reporting of improper payments, DHA modified the TRICARE pharmacy contract to require the contractor to participate in the annual low-dollar pharmacy claim reviews. As a result, DHA's reported improper payment estimates includes the complete universe of payments, as required by OMB guidance.



## Fraud Reduction Report

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OMB Circular No. A-136 requires that, “Under the Fraud Reduction and Data Analytics Act of 2015, each agency must include in its Agency Financial Report or Performance and Accountability Reports a report on its fraud reduction efforts undertaken in FY 2018.” The DHA OIG began working towards its goal of preventing fraud, waste, and abuse a little over two years ago. Prior to the Deputy IG’s arrival in April 2016, the DHP Enterprise did not have an IG – it relied on the services and the DoD IG to provide a hotline program and other IG services. The DHA OIG currently has five civilian government employees and three contract support personnel. As the DHA OIG becomes fully staffed, they will operationalize the four major IG functions of inspection, investigations, teach and train, and assistance. The office will also evolve from a reactive to proactive model where it spends concerted effort helping the DHP Enterprise identify and address problems through inspections before occurrence, promoting organizational health, and enabling DHP Enterprise readiness.

The DHA OIG derives its authority to inspect and investigate from the Director, DHP Enterprise. The DHA OIG control and reporting relationship may not be further delegated. Approval with written authority must be gained from the director to conduct inspections or full investigations. However, the DHA OIG can respond to requests for assistance and can conduct informal inquiries, generally to gather initial facts to determine if a formal investigation is warranted, without the director’s personal approval. The DHA OIG staff are impartial and independent whose loyalty rests with the Agency, not just with the director.

In accordance with the authority in DoD Directive 5106.01, the DHA OIG maintains the DHP Enterprise Hotline Program, ensuring that inquiries resulting from allegations are conducted in accordance with applicable laws, DoD regulations, and policies. Per DoD Instruction (DoDI) 7050.01, the DHP Enterprise Hotline Program provides a confidential, reliable means for individuals to report fraud, waste and abuse; violations of law, rule or regulation; mismanagement; and classified information leaks involving the DHP Enterprise. The detection and prevention of threats and danger to the public health and safety of the DoD and the United States are essential elements of the hotline mission. The DHP Enterprise Hotline Program maintains a public awareness campaign ensuring that the current DoD fraud, waste, and abuse hotline poster, prepared by the DoD Office of the Inspector General, is displayed in common work areas.

### Allegations of Fraud

Hotline personnel promptly report all allegations of fraud to the appropriate Defense Criminal Investigative Organization in accordance with DoDI 5505.02, *Criminal Investigations of Fraud Offenses*, August 29, 2013, as amended. Fraud is defined by DoD regulations as any intentional deception designed to deprive the United States unlawfully of something of value or to secure from the United States a benefit, privilege, allowance, or consideration to which a person or entity is not entitled. Such practices include, but are not limited to:

- Offering to make a payment or accepting bribes or gratuities
- Making false statements
- Submitting false claims
- Using false weights or measures
- Evading or corrupting inspectors or other officials
- Deceiving either by suppressing the truth or misrepresenting material fact
- Adulterating or substituting materials
- Falsifying records and books of accounts
- Arranging for secret profits, kickbacks, or commissions
- Conspiracy to do any of the above

## Performance Metrics and Trend Analysis

Hotline personnel collect and analyze data to:

- Identify opportunities to improve the management of hotline complaints from receipt to resolution
- Identify trends that will help DHP Enterprise decision-makers combat fraud, waste, abuse, and mismanagement in DHP Enterprise programs and operations more effectively

## Preventing and Deterring Fraud

Curbing fraud is vital to conserving scarce health care resources and protecting beneficiaries. Fraud schemes shift over time, but certain health care services have been consistent targets. They include services provided by durable medical equipment (DME) suppliers, pharmacy companies, and providers. To secure the future of health care for our beneficiaries, the DHP Enterprise must be vigilant in reducing wasteful spending and promoting better health outcomes at lower costs. As the DHA OIG evolves and coordinates with offices to include DHP Enterprise Program Integrity and the appropriate Defense Criminal Investigative Organization, cost savings will continue to be recognized.

DHA OIG will ensure the workforce and culture continue to serve as a reflection of core Department values – values that are rooted in the belief of doing the right thing.

## Grants Oversight and New Efficiency (GONE) Act Requirements

Army MEDCOM			
Category	2–3 Years	>3–5 Years	>5 Years
Number of grants/cooperative agreements with zero-dollar balances	0	0	0
Number of grants/cooperative agreements with undisbursed balances	0	0	0
Total amount of undisbursed balances	-	-	-
Navy BUMED			
Category	2–3 Years	>3–5 Years	>5 Years
Number of grants/cooperative agreements with zero-dollar balances	0	0	0
Number of grants/cooperative agreements with undisbursed balances	0	0	0
Total amount of undisbursed balances	-	-	-
Air Force SG			
Category	2–3 Years	>3–5 Years	>5 Years
Number of grants/cooperative agreements with zero-dollar balances	0	0	0
Number of grants/cooperative agreements with undisbursed balances	0	0	0
Total amount of undisbursed balances	-	-	-
DHA/FOD			
Category	2–3 Years	>3–5 Years	>5 Years
Number of grants/cooperative agreements with zero-dollar balances	0	0	0
Number of grants/cooperative agreements with undisbursed balances	0	0	0
Total amount of undisbursed balances	-	-	-

Uniformed Services University of the Health Sciences			
Category	2–3 Years	>3–5 Years	>5 Years
Number of grants/cooperative agreements with zero-dollar balances	0	0	0
Number of grants/cooperative agreements with undisbursed balances	0	0	0
Total amount of undisbursed balances	-	-	-
National Capital Region MD			
Category	2–3 Years	>3–5 Years	>5 Years
Number of grants/cooperative agreements with zero-dollar balances	8	0	0
Number of grants/cooperative agreements with undisbursed balances	1	0	0
Total amount of undisbursed balances	\$319.00*	-	-
*The \$319.00 balance represents expired FY 2016/17 funds. A DD 448-2 MIPER Addendum will be sent to the grantor in the amount of \$319.00 to close out this action.			
DHA Contract Resource Management			
Category	2–3 Years	>3–5 Years	>5 Years
Number of grants/cooperative agreements with zero-dollar balances	0	0	0
Number of grants/cooperative agreements with undisbursed balances	0	0	0
Total amount of undisbursed balances	-	-	-

**Table 7:** Total number of Federal grant and cooperative agreement awards and balances for which closeout has not yet occurred but the period of performance has elapsed by more than two years.



## IV. Appendices



## Appendix A: Abbreviations & Acronyms

ACGME	Accreditation Council for Graduate Medical Education	CRM	Contract Resource Management Office
ADA	Anti-deficiency Act	CSA	Combat Support Agency
ADDP	Active Duty Dental Program	CY	Calendar Year
ADP	Additional Discount Program	DATA	Digital Accountability and Transparency Act of 2014
ADSM	Active Duty Service Members	DCIA	Debt Collection Improvement Act of 1996
AEAN	Aggregate Entry Age Normal	DCIS	Defense Criminal Investigative Service
AFMS	U.S. Air Force Medical Service	DCPS	Defense Civilian Personnel System
AFR	Agency Financial Report	DCS	Duplicate Claims System
AHCC	Annual Health Care Cost	DEERS	Defense Enrollment Eligibility Reporting System
AIMS	Accounting and Inventory Management System	DFAS	Defense Finance and Accounting Service
AL	Actuarial Liability	DHA/FOD	Defense Health Agency, Financial Operations Division
ALC	Agency Location Code	DHA-C	DHA-Comptroller
Army MEDCOM	U.S. Army Medical Command	DHP	Defense Health Program
ARRA	American Recovery and Reinvestment Act	DISA-OKC	Defense Information Systems Agency-Oklahoma City
ASD (HA)	Assistant Secretary of Defense (Health Affairs)	DLA	Defense Logistics Agency
BS	Balance Sheet	DMDC	Defense Manpower Data Center
BUMED	Bureau of Medicine and Surgery	DME	Durable Medical Equipment
CAP	Corrective Action Plan	DMLSS	Defense Medical Logistics Standard Support
CAP	College of American Pathologists	DOD	Department of Defense
CCMD	Combatant Command	DODI	Department of Defense Instruction
CCS	Choctaw Contracting Services	DOL	Department of Labor
CDRL	Contract Data Requirements List	DON	Department of Navy
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act	DP	Designed Providers
CFO	Chief Financial Officer	DPP	Designated Providers Program
CFR	Code of Federal Regulations	DRRS	Defense Readiness Reporting System
CHAMPUS	Civilian Health and Medical Program of the Uniformed Services	DRG	Diagnosis Related Group
CHCBP	Continued Health Care Benefits Program	ECS	E-Commerce System
CIP	Construction in Process	EHR	Electronic Health Record
CLRS	CFO Load Reconciliation System	EIC	External Independent Contractors
CMAC	CHAMPUS Maximum Allowable Charge	EIN	Employer Identification Number
CMR	Combat Mission Requirement	EPLS	Excluded Parties List System
CONUS	Continental United States	ESA	Enterprise Support Activities
COR	Contracting Officer Representative	ESI	Express Scripts
COTS	Commercial Off-the-Shelf	ESRD	End-stage renal disease
CPI	Consumer Price Index	FAD	Funding Authorization Document
CPT-4	Current Procedural Terminology	FASAB	Federal Accounting Standards Advisory Board
		FBCH	Fort Belvoir Community Hospital
		FBWT	Fund Balance With Treasury

FCA	False Claims Act	LEIE	List of Excluded Individuals/Entities
FCP	Federal Ceiling Price	KSA	Knowledge, Skills and Abilities
FFATA	Federal Funding Accountability and Transparency Act of 2006	LES	Leave and Earnings Statement
FFMIA	Federal Financial Management Improvement Act	M2	MHS Mart
FFS	Federal Financial System	MCSCs	Managed Care Support Contractors
FGB	GFEBs Functional Governance Board	MDR	Military Health System (DHP Enterprise) Data Repository
FIAR	Financial Improvement and Audit Readiness	MERHCF	Medicare-Eligible Retiree Health Care Fund
FLSA	Fair Labor Standards Act	MHBs	Military Health Benefits
FMR	Financial Management Regulation	MHS	Military Health System
FSIO	Financial Systems Integration Office	MILCON	Military Construction
FSRE	Financial Statement Reporting Entity	MTF	Military Treatment Facilities
FY	Fiscal Year	NWCF	Navy Working Capital Fund
GAAP	Generally Accepted Accounting Principles	NAVY BUMED	Navy Bureau of Medicine Surgery
GAO	Government Accountability Office	NCR	National Capital Region
GFEBs	General Funds Enterprise Business System	NCR MD	National Capital Region Medical Directorate
GMRA	Government Management Reform Act	NDA	National Defense Authorization Act
GONE	Grants Oversight and New Efficiency	NGPL	No Government Pay List
GPRAMA	Government Performance and Results Modernization Act of 2010	NIPRNET	Internet/Non-secure Internet Protocol Router Network
HA	Health Affairs	NOAA	National Oceanic & Atmospheric Administration
HGB	Humana Government Business Inc.	O&M	Operation and Maintenance
HMO	Health Maintenance Organization	OACT	Office of the Actuary
HNFS	Health Net Federal Services	OASD(HA)	The Office of the Assistant Secretary of Defense for Health Affairs
HRO	High Reliability Organization	OCONUS	Outside of the Continental United States
HRQOL	Health Related Quality of Life	OFF	Oracle Federal Financials
IBNR	Incurred but not reported	OGC	Offices of General Counsel
ICO	Internal Controls Over Operations	OHI	Other Health Insurance
ICOFR	Internal Controls Over Financial Reporting	OI	Other Information
ICOFs	Internal Controls Over the Financial Systems	OMB	Office of Management and Budget
IG	Inspector General	OPM	Office of Personnel Management
ILIR	In-House Laboratory Independent Research	OP	Other Procurement
IP	Improper Payment	OP	Overpayment
IPERA	Improper Payments Elimination and Recovery Act of 2010	OSD	Office of the Secretary of Defense
IPERIA	Improper Payment Elimination and Recovery Improvement Act of 2012	OUSD-C	Office of the Under Secretary of Defense (Comptroller)
IPIA	Improper Payment Act of 2002	PCM	Primary Care Manager
iRAPT	Invoice Receipt, Acceptance and Property Transfer	PHS	Public Health Service
IT	Information Technology	PI	Program Integrity
JPC	Joint Pathology Center	PIMS	Participant Information Management System
JFMIP	Joint Financial Management Improvement Program	POG	Process Owner's Group

POS	Point-of-service	TEDS	TRICARE Encounter Data Set
PPA	Prompt Payment Act	TFL	TRICARE for life
PPO	Preferred Provider Organization	TFM	Treasury Financial Manual
PVFB	Present Value of Future Benefits	TMA	TRICARE Management Activity
PVFNC	Present Value of Future Normal Costs	TMOP	TRICARE Mail Order Pharmacy
PTSD	Post-Traumatic Stress Disorder	TNC	Treasury Nominal Coupon Issues
QA	Quality Assurance	TOM	TRICARE Operations Manual
RCRA	Resource Conservation and Recovery Act	TOP	TRICARE Overseas Program
RDT&E	Research Development Test & Evaluation	TOP	Treasury Offset Program
ROI	Return On Investment	TPharm	TRICARE Pharmacy Program
SARA	Superfund Amendments and Reauthorization Act	TPR	TRICARE Prime Remote
SBR	Statement of Budgetary Resources	TPRADFM	TRICARE Prime Remote for Active Duty Family Members
SDP	Savings Deposit Program	TRDP	TRICARE Retiree Dental Program
SDP	Standard Discount Program	TRO	TRICARE Regional Offices
SFFAS	Statement of Federal Financial Accounting Standards	TSCA	Toxic Substances Control Act
S/L	Straight Line	TSM	TRICARE Systems Manual
SMA	Service Medical Activity	TYA	TRICARE Young Adult Program
SME	Subject Matter Expert	UHM&VS	UnitedHealth Military and Veterans Services
SMS	Sustainment Management System	UP	Underpayment
SNC	Statement of Net Cost	USACE	United States Army Corps of Engineers
SNP	Statement of Changes in Net Position	U.S.C.	United States Code
SOFA	Status of Forces Agreement	USFHP	Uniformed Services Family Health Plan
SSN	Social Security Number	USSGL	U.S. Standard General Ledger
TAMP	Transitional Assistance Management Program	USUHS	Uniformed Services University of the Health Sciences
TBI	Traumatic Brain Injury	VA	Veterans Affairs
TCM	TRICARE Claims Management	WIC	Women, Infant, and Children
TDEFIC	TRICARE Dual Eligible Fiscal Intermediary Contract	WPS	Wisconsin Physicians Services
TDP	TRICARE Dental Program	WRNMMC	Walter Reed National Military Medical Center

**Defense Health Headquarters (DHHQ)**

7700 Arlington Blvd,  
Falls Church, VA 22042  
<https://health.mil/dha>