Part 3: Management Discussion and Analysis

Agency Mission, Strategic Goals, and Organizational Structure

OPM's *Strategic Plan 2002–2007* describes OPM's mission and establishes the strategic goals and management strategy the agency is following to fulfill this mission. For each strategic goal, OPM has also established specific objectives to provide clarity to its strategic vision (see Table 1). For each strategic goal OPM describes the strategies for how it will achieve the goals and objectives. Finally, OPM describes the performance measures by which it and others may assess its success. The Strategic Plan is available on the OPM website at www.opm.gov/gpra/opmgpra/sp2002.

OPM's Mission

It is OPM's job to build a high-quality and diverse Federal workforce, based on Merit System Principles, which America needs to guarantee freedom, promote prosperity, and ensure the security of this great Nation.

OPM's strategic goals are extrapolated from its mission and aligned with its major business lines of developing and deploying human resource policy (Strategic Goal I); leading the human capital initiative across the Federal Government and ensuring merit system protections and accountability for all Federal employees (Strategic Goal II); and developing and delivering human resource products and services to Federal agencies, employees, annuitants, and their families (Strategic Goal III). In addition, OPM's management strategy establishes a standard of excellence for the agency's internal operations and programs. Included in its management strategy, OPM manages five e-Government initiatives that are transforming human resource processes and providing world-class, secure, modern, cross-agency, human resource solutions. These five interrelated initiatives support a Federal worker's life cycle; they are e-Clearance, e-Training, e-Payroll, Enterprise Human Resource Integration, and Recruitment One-Stop.

These goals and objectives recognize OPM's responsibilities as described in statute, and the expectations of the President, the Congress, other Federal agencies, and Federal employees and annuitants, as developed in consultations with these key stakeholders. The Strategic Plan holds OPM accountable for the transformation of human capital in all Federal agencies, based on the merit principles and other standards. This human capital transformation has an immediate impact on the security of the Nation while ensuring that the civil service remains a strong and vital component of a Federal Government that will continue to protect America and win the war on terrorism.

OPM's organizational structure reflects the goals articulated in the Strategic Plan and specific offices responsible for policy and coordination. Team OPM positions the agency to respond to and meet the unprecedented new responsibilities and higher profile it has been given. Team OPM comprises the following organizational components:

Specific officials on the Director's core management team;

- The *Chief of Staff* is responsible for advising the Director on issues affecting the agency and the Federal workforce, and coordinating the implementation of the Director's decisions throughout the agency.

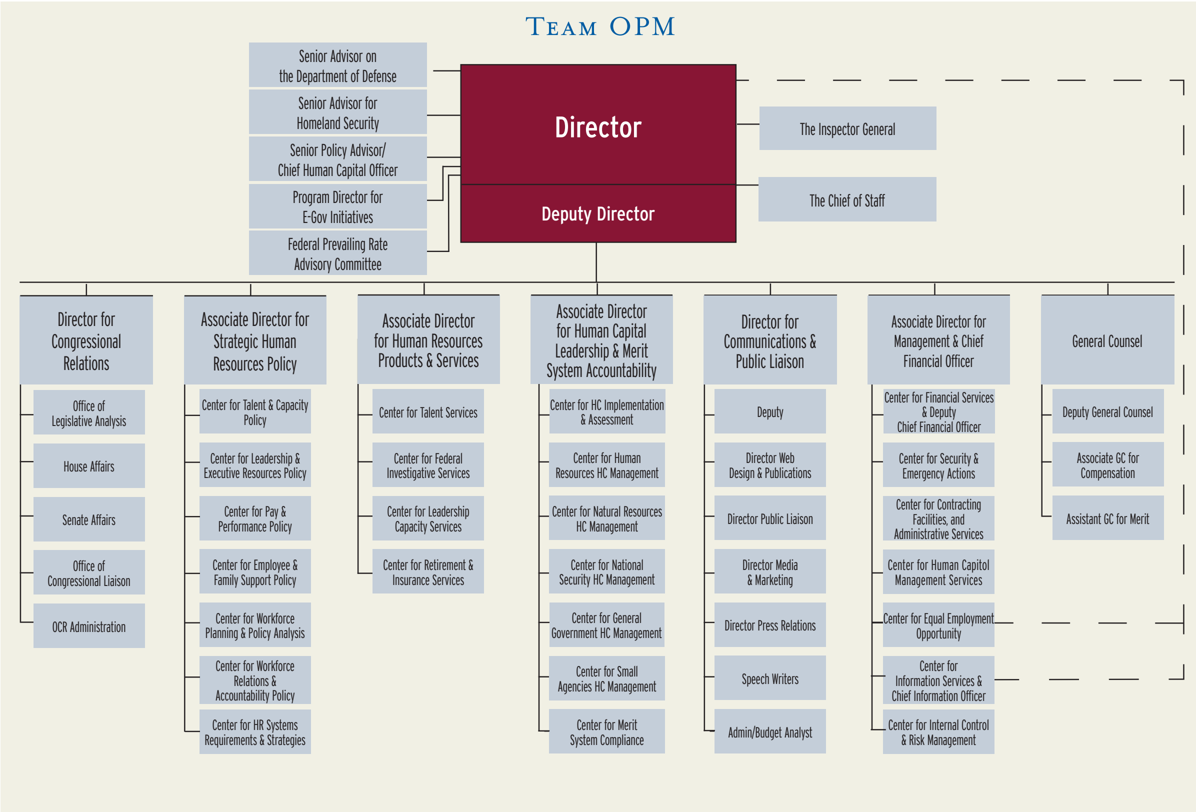
Table 1 — OPM Strategic Goals and Objectives

Strategic Goal I	**Federal agencies adopt human resources management systems that improve their ability to build successful, high-performance organizations.**
Objective 1	Agencies use OPM policy and guidance to develop and maintain the capacity of their workforce to continue to meet and improve their strategic performance targets.
Objective 2	Provide expert advice and assistance in establishing the Department of Homeland Security and ensure that human capital needs for the homeland security community are met.
Objective 3	Provide the Federal Government with a modern compensation system that is performance-oriented, market-sensitive, and used to assist Federal agencies in meeting their strategic goals.
Objective 4	Increase the effectiveness and efficiency of the Federal hiring process and make Federal employment attractive to high-quality applicants of diverse backgrounds.
Strategic Goal II	**Federal agencies use effective merit-based human capital strategies to create a rewarding work environment that accomplishes the mission.**
Objective 1	Provide advice to agencies and promote best practices on solutions, actions, and strategies to meet their human capital management needs.
Objective 2	Monitor and assess agencies' effectiveness in implementing merit-based strategies that support their mission.
Strategic Goal III	**Meet the needs of Federal agencies, employees, and annuitants through the delivery of efficient and effective products and services.**
Objective 1	Provide direct human capital products and services that are cost effective, relevant, and useful to agencies.
Objective 2	Facilitate retirement income security for Federal employees by making the transition from active employment to retirement seamless and expeditious.
Objective 3	Federal employees, annuitants, and their families can choose from among quality and fiscally responsible carriers to address their specific insurance needs.
Management Strategy	**OPM creates an environment that fosters the delivery of services to our customers and employees through effective communication and management of human capital, technology, financial resources, and business processes.**

- The *Senior Advisor on the Department of Defense,* the *Senior Advisor for Homeland Security,* the *Senior Policy Advisor and Chief Human Capital Officer*, and the *Chair of the Federal Prevailing Rate Advisory Committee*, report to the Director on matters concerning their specific initiatives or programs.

Executive offices.

- The *Office of the Inspector General* (OIG) conducts comprehensive and independent audits, investigations, and evaluations relating to OPM programs and operations. It is responsible for administrative actions against health care providers who commit sanctionable offenses with respect to the Federal Employees' Health Benefits Program or other Federal programs. The Office keeps the Director and Congress fully informed about problems and deficiencies in the administration of agency programs and operations, and the necessity for corrective action.
- The *Office of e-Government Initiatives* is responsible for the development of world-class, secure, modern, cross-agency, human resource solutions that transform the management of Federal human capital. The OPM e-Gov vision is for Federal agencies to use OPM e-Gov human resource solutions to improve their ability to build successful, high-performance organizations. To accomplish this, OPM e-Gov is providing a consolidated, portable, and secure on-demand human capital and talent management system for many of the essential functions of a Government human resources system including payroll, training, security clearance, recruitment, and an enterprise human resources data warehouse.



- The *Office of Congressional Relations* oversees and coordinates all of OPM's congressional relations, provides strategic advice and legislative analysis to OPM's Director and program offices, and responds to congressional initiatives that affect Federal human resources management issues.
- The *Office of Communications and Public Liaison* advances and defends the heritage and principles of America's civil service. The office aggressively promotes the policies and directives of the President and of the OPM Director and ensures they are fully supported as they relate to the Strategic Management of Human Capital initiative. The office provides the American citizenry, Federal employees, agency customers, and pertinent stakeholders with accurate information to aid in their planning and decision-making.
- The *Office of the General Counsel* provides legal services to OPM's Director, Deputy Director, and divisions. It also advises Government agencies in understanding and carrying out their civil service responsibilities and meeting the Merit System Principles. The office provides civil service-related legal assistance to members of the public, as needed, to serve the American people fairly and professionally.

Program divisions.

- The *Division for Strategic Human Resources Policy* (SHRP) is responsible for Strategic Goal I and its four supporting objectives. SHRP designs, develops, and leads the implementation of innovative, flexible, merit-based human resources policies and strategies that enable Federal agencies to meet their missions and achieve their goals.
- The *Division for Human Capital Leadership and Merit System Accountability* (HCLMSA) leads the transformation of human capital management across Government by proactively engaging agencies in the implementation of the Human Capital Standards of Success; providing them with technical advice and assistance; and assessing and reporting their results and adherence to Merit System Principles, veterans' preference, and other Governmentwide standards. These responsibilities are covered by Strategic Goal II and its two objectives.

Table 2 — OPM Goals and Responsible Organizations

	Strategic Goal I	Strategic Goal II	Strategic Goal III	Management Strategy
Responsible Organization	SHRP	HCLMSA	HRPS	Executive offices; MCFO
Objectives & Annual Performance Goals	**Objective 1** SHRP Annual Performance Goal 1 **Objective 2** SHRP Annual Performance Goal 2 **Objective 3** SHRP Annual Performance Goal 3 **Objective 4** SHRP Annual Performance Goal 4	**Objective 1** HCLMSA Annual Performance Goal 1 **Objective 2** HCLMSA Annual Performance Goal 2	**Objective 1** HRPS Annual Performance Goal 1 HRPS Annual Performance Goal 2 HRPS Annual Performance Goal 3 **Objective 2** HRPS Annual Performance Goal 4 **Objective 3** HRPS Annual Performance Goal 5	Executive Services Goal 1 MCFO Annual Objective 1 MCFO Annual Objective 2 MCFO Annual Objective 3 MCFO Annual Objective 4 MCFO Annual Objective 5 (e-Gov Goal) MCFO Annual Objective 6 OIG Annual Performance Goal 1 OIG Annual Performance Goal 2
FY 2004 Net Cost	$9 Million	$14 million	$62,111 million	$38 million

- The *Division for Human Resources Products and Services* (HRPS) has responsibility for Strategic Goal III and its three underlying objectives. HRPS provides high-quality, cost-effective products and services that help OPM customers recruit and retain the best talent; develop and maintain a results-oriented leadership capacity; and support Federal employees, annuitants, and their families.
- The *Division for Management and Chief Financial Officer* (MCFO) is responsible for implementing OPM's management strategy and the PMA within the agency. The division provides OPM offices with the full range of administrative services, including financial management, human capital and equal employment opportunity, contracting and administrative management, information technology, and security and emergency services. These services enable OPM to build mission capacity and maintain a high-quality and diverse workforce.

Analysis of Program Performance

Relationship of the Strategic Plan, Annual Performance Budgets, and Performance and Accountability Reports

OPM's Strategic Plan sets the framework for virtually all of its other performance planning and reporting documents, including the annual Performance Budget (Congressional Budget Justification), Human Capital Plan, Five-Year Financial Management Plan, and Capital Asset Plans that OPM prepares.

Because Performance and Accountability Reports (PARs), by definition, contain results for OPM's Performance Budgets, the Strategic Plan also defines much of the structure of OPM's PARs. For example, OPM's FY 2004 Performance Budget described 20 annual performance goals. Each annual goal relates to a specific strategic goal and objective, including the management strategy. As shown in Table 2, each of these groups of goals and objectives is the responsibility of one of OPM's program divisions, and specific executives who report

Table 3 — Status of Annual Performance Goals by Strategic Goal and Objective

Strategic Goal and Objective	Number of Annual Performance Goals	Goals Fully Met	Goals Partially Met	Goals Not Met
Strategic Goal I: Federal agencies adopt human resources management systems that improve their ability to build successful, high-performance organizations.				
1. Agencies use OPM policy and guidance to develop and maintain the capacity of their workforce to continue to meet and improve their strategic performance targets.	1	0	1	0
2. Provide expert advice and assistance in establishing the Department of Homeland Security and ensure that human capital needs for the homeland security community are met.	1	0	1	0
3. Provide the Federal Government with a modern compensation system that is performance-oriented and market sensitive, and assists Federal agencies in meeting their strategic goals.	1	1	0	0
4. Increase the effectiveness and efficiency of the Federal hiring process and make Federal employment attractive to high-quality applicants of diverse backgrounds.	1	0	1	0
Strategic Goal II: Federal agencies use effective merit-based human capital strategies to create a rewarding work environment that accomplishes the mission.				
1. Provide advice to agencies and promote best practices on solutions, actions, and strategies to meet their human capital management needs.	1	0	1	0
2. Monitor and assess agencies' effectiveness in implementing merit-based strategies that support their mission.	1	0	1	0
Strategic Goal III: Meet the needs of Federal agencies employees, and annuitants through the delivery of efficient and effective products and services.				
1. Provide direct human capital products and services that are cost effective, relevant, and useful to agencies.	3	2	1	0
2. Facilitate retirement income security for Federal employees by making the transition from active employment to retirement seamless and expeditious.	1	0	1	0
3. Federal employees, annuitants, and their families can choose from among quality and fiscally responsible carriers to address their specific insurance needs.	1	1	0	0
Management Strategy: Create an environment that fosters the delivery of services to our customers and employees through effective communication and management of human capital, technology, financial resources, and business processes.				
Executive services	1	1	0	0
Office of e-Government Initiatives	1	1	0	0
MCFO	5	4	1	0
Office of the Inspector General	2	1	1	0
FY 2004 Total	**20**	**11**	**9**	**0**

directly to the OPM Director. This structure supports accountability, and ensures OPM executives, managers, and staff are fully aware of their specific organizational and strategic priorities. It also enables OPM to track resources to goals. For instance, OPM is able to track its costs and revenues to its strategic goals and compute the net cost of each (see Table 2). It should be noted that the net cost for strategic Goal III is due to the very large actuarial expenses related to the retirement, health benefits, and life insurance programs. Additional information regarding the net cost per strategic goal can be found in Part 5: Financial Information; Note 17.

Performance Highlights

During FY 2004, OPM achieved at least partial success in all of its 20 annual performance goals, fully meeting 11 and partially meeting the remaining nine. As shown in Table 3, five of the annual goals under Strategic Goals I and II were partially met and one was met. Three of the five annual goals for Strategic Goal III were met, and the remaining two partially met; while seven of the nine goals under the agency's management strategy were fully met, and two partially met. Table 3 — Status of Annual Performance Goals by Strategic Goal and Objective provides a summary of this information. Details regarding all of these goals and OPM's specific accomplishments for each can be found in Part 4: FY 2004 Performance Information.

Strategic Goal I.
Federal agencies adopt human resources management systems that improve their ability to build successful, high-performance organizations.

To fulfill Strategic Goal I, OPM's Division for Strategic Human Resources Policy develops and promulgates the full gamut of human resources policy. During FY 2004, OPM produced new policy proposals and regulations, and provided ongoing support under Objective 1, *Agencies use OPM policy and guidance to develop and maintain the capacity of their workforce to continue to meet and improve their strategic performance targets*. Objective 1 covers several policy areas that include the employee and family support programs (retirement, health benefits, life and long term care insurance, teleworking), executive resources programs, and workforce planning and information programs.

In the benefits policy area, OPM developed a policy structure to offer high-deductible health plans and health savings accounts (HSAs) under the FEHBP.

OPM continued to promote teleworking across Government, developing two interactive electronic training courses, distributing promotional kits to agencies, and hosting three Internet conferences for agency telework coordinators. Although the number of Federal employees who telework increased from about 90,000 to nearly 103,000, the overall percentage of eligible employees teleworking remained unchanged from last year (see Table 4).

Table 4 — Key Performance Indicators: Strategic Goal I, Objective 1 (SHRP)

Indicator	FY 2001 Results	FY 2002 Results	FY 2003 Results	FY 2004 Targets	FY 2004 Results
Percent of teleworkers among eligible employees	–	14	14	16	14
Agency spending on student loan repayments ($)	–	6,000	3.1 million	None set	9.1 million
Percent of customers satisfied with workforce information products and services	–	91	88	88	89
Pay tables updated in a timely manner	Pay tables issued January 2001	Pay tables issued January 2002	Pay tables issued January 2003	Milestones Met	Pay tables issued December 2003

– not available

The use of the Student Loan Repayment Program grew substantially, to the point where 24 agencies used it to cover payments of $9.1 million (see Table 4) for 2,077 employees. This is an increase from 16 agencies that provided $3.1 million for 690 employees the previous year.

In support of the long-term development of the civil service, OPM issued guidance and/or regulations on such topics as SES post-employment restrictions, the Student Loan Repayment Program, and overtime maximum hourly rates.

Finally, OPM provided accurate and timely recordkeeping, data standards, and personnel action processing guidance to more than 1,600 Federal personnel offices. The majority of agency customers (89 percent, as shown in Table 4) expressed appreciation for receiving Central Personnel Data File information and personnel guidance.

Even though the DHS is now firmly established, its human resource management system is still being designed. Therefore, OPM's work continues toward Objective 2, *Provide expert advice and assistance in establishing the Department of Homeland Security and ensure that the human capital needs for the homeland security community are met.* During the year, DHS and OPM jointly issued proposed regulations to establish a new human resources management system within DHS. The proposed system governs basic pay, classification, performance management, labor relations, adverse actions, and employee appeals. These changes are designed to ensure that DHS's human resources management system aligns with its critical mission requirements while protecting the civil service rights of its employees. OPM and DHS expect that the new system will be established officially in FY 2005.

Similar to its work with DHS, OPM is partnering with DOD to implement provisions of the National Defense Authorizations Act of 2004. This landmark legislation charges the Secretary of Defense and the Director of OPM to jointly develop DOD's new National Security Personnel System under which 700,000 Federal employees will operate. To ensure that this partnership is successful, OPM established a new executive position within the agency, the Senior Advisor on the Department of Defense. High level staff from both agencies began working with unions representing the various DOD employee groups and other stakeholders in the developmental stage of the new personnel system.

OPM moved the Federal Government closer to performance-based pay during FY 2004, starting with the Government's top executives, as it continued to work toward Objective 3 under Strategic Goal I, *Provide the Federal Government with a modern compensation system that is performance-oriented and market-sensitive, and assists Federal agencies in meeting their strategic goals.* Specifically, the agency issued interim regulations to establish the new SES pay-for-performance system under which senior executives' rates of pay are set and adjusted within a wide range of pay rates. The regulations clarify that all pay adjustments must be based on a determination that performance warrants such adjustment. OPM later issued interim regulations specifying the criteria that performance management systems covering senior executives or senior professionals must meet to be certified by OPM, with OMB concurrence, that the systems make meaningful distinctions among relative performance of senior employees. That certification, conferred either provisionally or fully, is necessary before an agency can use a higher limitation on aggregate compensation or set senior executive pay at rates up to Level II of the Executive Schedule. OPM issued proposed pay administration regulations covering this new pay-for-performance system and prepared final regulations on the basis of comments received. As soon as those final regulations are in effect, certified agencies will be able to implement SES pay-for-performance more completely. OPM continued to support current pay systems by updating Governmentwide pay tables in a timely manner.

Objective 4 of Strategic Goal I is to *Increase the effectiveness and efficiency of the Federal hiring process and make Federal employment attractive to high-quality applicants of diverse backgrounds.* OPM provided agencies with new or revamped tools to solve staffing problems, simplify hiring, and reduce the time required to recruit and hire a diverse, high-quality workforce. OPM provided extensive training about the new tools in settings ranging from the Chief Human Capital Officers Academy to workshops delivered nationwide at field installations. Policy staff also prepared job aids and provided other assistance to support OPM's extensive job recruitment fairs. OPM also monitored agencies' use of new hiring flexibilities made available last year and opened a dialogue with agencies to understand why these options are not being more widely used and to determine what OPM can do to help. OPM also developed policies to support agencies' leadership succession planning efforts, specifically for a Governmentwide SES Federal Candidate Development Program (Fed CDP) and the PMF Program. In FY 2004, in response to changes that have occurred in Federal work and the workforce over time and especially since 9/11 and the establishment of DHS, OPM issued a revised classification standard for firefighters that recognizes the additional emergency work they perform and established a new occupational series for customs and border protection work.

Strategic Goal II. Federal agencies use effective merit-based human capital strategies to create a rewarding work environment that accomplishes the mission.

Strategic Goal II encompasses the Governmentwide Strategic Management of Human Capital initiative (the Human Capital Leadership Program) and OPM's work to ensure that Federal agencies adhere to the Merit System Principles and veterans' preference (the Compliance Program). The focus of Objective 1, *Provide advice to agencies and promote best practices on solutions, actions, and strategies to meet their human capital management needs,* is the Human Capital Leadership Program, which includes OPM on-going outreach to agencies to implement best practices in human capital management. Toward this objective, OPM engaged agencies that are members of the President's Management Council (PMC) to implement the Standards for Success in the Strategic Management of Human Capital and increased the number of agencies that are achieving these standards. For instance, by the end of FY 2004, 8 of 26 PMC agencies have achieved status scores of green on their human capital scorecards, meaning they are meeting the Governmentwide criteria for this initiative. At the beginning of the fiscal year, no agencies were meeting all of these criteria. More specifically, the number of agencies with reduced skill gaps and leadership succession plans (see Table 5) has increased significantly during FY 2004.

Objective 2 under Strategic Goal II is *Monitor and assess agencies' effectiveness in implementing merit-based strategies that support their mission.* To achieve this objective, OPM has revamped and broadened its historic oversight of the Merit System and veterans' preference through its Compliance Program to also include:

- Overseeing the impact of agency human capital strategies and human resources programs;
- Conducting targeted audits on human resources functions, including outsourcing human resource processes;
- Reviewing workforce security practices and site plans, including background investigations; and
- Ensuring that agencies have accountability systems for human capital results.

Table 5 — Key Performance Indicators: Strategic Goal II (HCLMSA)

Indicator	FY 2001 Results	FY 2002 Results	FY 2003 Results	FY 2004 Targets	FY 2004 Results
Human Capital Leadership Program					
Number of PMC agencies with significantly reduced skill gaps in mission-critical occupations	n/a	n/a	2	12	10
Number of PMC agencies with quality leadership succession plans	n/a	n/a	5	12	24
Compliance Programs					
Percent of PMC agencies with workforce safety plan	n/a	n/a	n/a	75	84
Percent of PMC agencies under Merit System Compliance audit	n/a	0*	0*	30	31

n/a not applicable; new indicators, data does not exist for these fiscal years
*In FY 2002 and FY 2003, audits focused on small agencies that are not members of the President's Management Council (PMC).

OPM has grouped its Compliance Program activities into two basic areas of activity: emergency preparedness and accountability.

In the area of emergency preparedness, OPM actively worked to improve emergency preparedness in Federal agencies by surveying agencies' emergency preparedness plans and establishing this as a measure of success. When agencies have adequate safety plans, they are more likely to be able to continue operations in times of emergency. When agencies are able to continue operations they continue to serve and protect the American people and provide security for the Nation. Eighty-four percent of PMC agencies had workforce safety plans in FY 2004.

To ensure that agencies are accountable for executing their human capital management transformation plans while adhering to Merit System Principles, OPM conducts reviews, audits, and appeals. As a measure of its effectiveness in assuring accountability, OPM measures the percentage of the PMC agencies under audit and the percentage of agencies that take appropriate action on significant audit recommendations. OPM had a successful year in its Compliance Program activities, meeting an accelerated audit schedule and completing audit work in eight PMC agencies; it is targeting 100 percent of those agencies taking appropriate action on significant audit recommendations.

Strategic Goal III. Meet the needs of Federal agencies, employees, and annuitants through the delivery of efficient and effective products and services.

OPM administers a variety of programs to deliver human resources products and services to Federal agencies, employees, and annuitants (retirees and survivor annuitants). Services to agencies include the Investigative Services Program (comprising personnel investigations and suitability determinations), the Talent Services Program (support for recruitment, examining, training, and organizational assessment), and the Leadership Capacity Services Program (management and executive development training). Generally, these programs are delivered on a revolving fund basis, whereby OPM charges agencies for services, and — in some instances — must compete in the marketplace to maintain its agency customer base. The significance of these services is highlighted in OPM's Strategic Plan by the Objective 1 under Strategic Goal III, which is: *Provide direct human capital products and services that are cost effective, relevant, and useful to agencies.* During FY 2004, OPM had mixed results for the Revolving Fund Programs — and for this objective — as workload surges caused declines in some performance indicators for the Investigations Program. However, the Talent Services and Leadership Capacity Services Programs continued to maintain or improve service levels, as shown in the Key Performance Indicators table (Table 6).

OPM's trust fund programs (Retirement, Health Benefits, Life, and Long Term Care Insurance) deliver important benefits to Federal employees, annuitants, and covered family members. OPM established two objectives under Strategic Goal III that describe its long term vision for these programs. For the Retirement Program, OPM seeks, under Objective 2, to *facilitate retirement income security for Federal employees by making the transition from active employment to retirement seamless and expeditious.* For the insurance programs, OPM's objective is that *Federal employees, annuitants, and their families can choose from among quality and fiscally responsible carriers to address their specific insurance needs.*

During FY 2004, the insurance programs made substantial progress toward this latter objective, with the percentage of customers enrolled in accredited health insurance plans increasing from 76 to 98 percent. This increase was driven by fee-for-service and consumer driven health plans receiving accreditation for various components of their delivery systems. As a result, significantly more enrollees should be receiving excellent health care services. Performance in the delivery of Retirement Program services — which comprise the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) — was mixed, as the timeliness of processing retirement claims dropped. This decrement was offset by improvements in timely processing of survivor claims and in the volume of customer telephone calls handled.

Table 6 — Key Performance Indicators: Strategic Goal III (HRPS)

Indicator	FY 2001 Results	FY 2002 Results	FY 2003 Results	FY 2004 Targets	FY 2004 Results
Revolving Fund Programs					
Percent of background investigations closed within contract delivery date	95	45	25	40	17
Percent of customers satisfied with Center for Talent Services products and services	–	–	96	>90	94
Evaluation ratings for Management Development Centers and Federal Executive Institute programs (scale of 1-5):					
- Level 2 Management Development Center and Center for Excellence in Leadership	4.2	4.2	4.0	4.0	4.3
- Level 2 Federal Executive Institute and Leadership for Democratic Society	3.9	4.0	4.0	4.0	4.2
Trust Fund Programs					
Percent of customers enrolled in FEHBP-accredited plans meets or exceeds prior year level	72	76	76	>76	98
Timeliness of claims paid under Life Insurance Program meets or beats 10-day industry standard (days)	5.7	6.0	5.2	10.0	6.4
Percent of Long-Term Care Insurance Program customers satisfied with customer service	n/a	n/a	90	95	95
Retirement claims processing timeliness (days):					
- CSRS annuity	54	55	59	56	73
- FERS annuity	101	70	83	80	97
- CSRS survivor	24	31	30	29	28
Retirement customer calls handled	1,324,591	1,425,452	1,476,853	1,500,000	1,648,834

n/a not applicable; program did not exist before FY 2003
– not available

Management Strategy.
OPM creates an environment that fosters the delivery of services to our customers and employees through effective communication and management of human capital, technology, financial resources, and business processes.

OPM's management strategy is carried out by the agency's executive offices (Office of the Director, Office of Communications and Public Liaison, Office of Congressional Relations, and Office of the General Counsel), the Office of e-Government Initiatives, MCFO, and OIG. Together, these entities provide leadership, guidance, oversight, and support to OPM's program offices, promote OPM's programs, and ensure that OPM has the resources needed to achieve its strategic goals and fulfill its mission.

During FY 2004, MCFO focused on improving OPM's internal security and emergency actions planning, reducing hiring cycle times, and generating savings from its Competitive Sourcing initiative and telecommunications enhancements. The agency was less successful in its financial management area, as delinquent accounts receivable remained unacceptably high during the year.

OPM's e-Gov projects continued their success in FY 2004 by enhancing services, increasing the use of these vital human resource tools by Federal agencies, and improving on nearly all performance indicators, as shown in the table on the previous page.

Table 7 — Key Performance Indicators: Management Strategy (MCFO)

Indicator	FY 2001 Results	FY 2002 Results	FY 2003 Results	FY 2004 Targets	FY 2004 Results
Hiring cycle time from receipt of manager's request to hire (workdays)	–	–	81	45	36
Estimated costs avoided resulting from job competitions ($)	–	–	2.1 million	4.0 million	4.2 million
Savings on telecommunications ($)	101,800	85,918	17,897	10,000	36,110
Percent of time mainframe available during agreed-upon service hours	–	–	99	99	99.9
Audit opinions	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
Percent of accounts receivable that are delinquent	26	48	37	15	40
Percent of payments meeting Prompt Payment Act requirements	97	99	95	95	99

– not available

Table 8 — Key Performance Indicators: E-Gov

Indicator	FY 2001 Results	FY 2002 Results	FY 2003 Results	FY 2004 Targets	FY 2004 Results
Number of agencies for which workforce planning tool is available	–	–	–	18	24
Improved e-HRIS Capital Asset Plan complete	n/a	n/a	n/a	Revise Plan	Completed
Project plan for technology replacement and merger strategy	n/a	n/a	n/a	Submit Plan	Completed
Percent of Federal agencies that have deployed e-QIP	–	–	2	10	32
The number of entities participating in GoLearn	–	–	31	58	70

n/a not applicable; program did not exist
– not available

Progress on the President's Management Agenda

OPM adopted the PMA as the framework for its management strategy and made the scoring for each of the five initiatives the yardstick for its progress. During FY 2004, OPM established itself as a leader among Federal agencies by advancing from yellow to green status scores on three of the five initiatives under the PMA — Human Capital, Competitive Sourcing, and E-Gov — and improving from red to yellow status on Budget and Performance Integration (BPI). In addition, the agency maintained progress scores at green throughout most of the fiscal year.

OPM believes its achievements on the PMA initiatives, as shown in Table 9, indicate its internal management functions are operating effectively and it is properly positioned to lead the transformation of human capital across Government, and provide Federal agencies with the human resources leadership, policy support, and services they need to ensure they have the workforces necessary to meet their missions and better serve the American people.

Quality of Performance Data

In accordance with the requirements of the Government Performance and Results Act (GPRA), OPM ensures information in its PAR accurately reflects the agency's performance in FY 2004 and is based on reasonably complete, accurate, and reliable data.

The performance information used in this report is more easily verifiable than that used in previous OPM PARs because more of it is based on quantitative measures of performance than in previous years. OPM's original FY 2004 Congressional Budget Justification was prepared during FY 2002 as the agency was undergoing a major restructuring. As the agency developed its FY 2005 Congressional Budget Justification, OPM used a program logic approach to develop better performance indicators that emphasized quantitative measures and implemented them for use in FY 2004.

In FY 2004, OPM improved controls over the collection and reporting of performance information. For instance, OPM updated its internal procedures to provide OPM offices with clearer guidance for documenting procedures and data collection processes, data quality standards, writing style, and project schedules. This allowed the agency to establish uniform procedures for measuring success in achieving targets and documenting this success for use in the PAR. The OPM Chief Financial Officer requires all OPM offices submitting performance information for this report certify the completeness, accuracy, and reliability of the information submitted.

In addition to these internal controls, OPM uses findings from traditional reviews and audits by the OIG, GAO, and independent certified public accountant to identify issues in performance measurement and reporting. These reviews have informed OPM about opportunities for improving polices and procedures for the preparation of performance budgets and reports and the collection and reporting of performance information, and have indicated where controls can be strengthened. They have also pointed out instances where reported results did not completely address pertinent performance indicators. OPM has accepted all of the recommendations made by these reviewers and auditors.

Addressing OPM's Top Management Challenges for FY 2004

OPM continued to address the management challenges identified by the OIG during FY 2004. The Reports Consolidation Act of 2000 requires agency Inspectors General to prepare a list of the top management challenges facing the agency for inclusion in the agency's Annual Performance and Accountability Report. Many of the nine management challenges identified by OIG for FY 2004 align with the five initiatives all Federal agencies have undertaken through the PMA (see Table 10). Because of this alignment, OPM addresses aspects of

Table 9 — OPM PMA Scorecard Results for FY 2004

Initiative		Begin year	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Human Capital	Status	Y	Y	Y	G	G
	Progress	G	G	G	G	G
Competitive Sourcing	Status	Y	Y	G	G	G
	Progress	G	G	G	G	Y
E-Gov	Status	Y	G	G	G	G
	Progress	G	G	G	G	G
Financial Performance	Status	Y	Y	Y	Y	Y
	Progress	G	G	G	G	G
Budget and Performance Integration	Status	R	Y	Y	Y	Y
	Progress	G	G	G	G	Y

Y Yellow R Red G Green

eight of the nine challenges as it achieves the criteria and progresses toward green status on the PMA initiatives.

Second, OPM aligns each management challenge with its related strategic goals, objectives, and annual performance goals. Since OPM's goals and objectives also align with its organizational structure, as discussed above in the Analysis of Program Performance section, the agency can focus resources to address and eventually resolve these issues.

1. Human Resources Management

This management challenge is actually about the Governmentwide initiative for the Strategic Management of Human Capital. The Inspector General correctly recognizes that as the Federal human resources management agency and leader of the Human Capital initiative, OPM must concentrate significant attention and resources toward directing, assisting, and reviewing agency human resources efforts. This includes fostering a more results-oriented approach to strategic human resources management across the Government and promoting broader application of best practices in human capital. OPM's leadership role also includes assessing human resources management in agencies and working with them to ensure more effective oversight of the Government's key human resources concerns.

OPM has responded to this challenge by focusing most of its budgetary resources from the Revolving Fund Programs and Salaries and Expenses on the Governmentwide Human Capital initiative. Salaries and Expenses represents all of the resources, activities and productivity of the Division for Strategic Human Resources Policy, and the Division for Human Capital Leadership and Merit System Accountability. It also

Table 10 — Aligning Management Challenges to the PMA and OPM's Strategic Goals

Management Challenge	Related PMA Initiative	Applicable Strategic Goal and Objective
1. Human Resources Management	Human Capital (Governmentwide)	Strategic Goal 1, Objectives 1, 3, and 4; SHRP FY 2004 Annual Performance Goals 1, 3, and 4 Strategic Goal 2, Objective 1; HCLMSA FY 2004 Annual Performance Goal 1 Strategic Goal 2, Objective 2; HCLMSA FY 2004 Annual Performance Goal 2 Strategic Goal 3, Objective 1; HRPS FY 2004 Annual Performance Goals 1, 2, and 3
2. Department of Homeland Security	Human Capital	Strategic Goal 1, Objective 2; SHRP FY 2004 Annual Performance Goal 2
3. Retirement Systems Modernization	e-Gov	Strategic Goal 3, Objective 2; HRPS FY 2004 Annual Performance Goal 4
4. Expanding e-Government	e-Gov	Management strategy; MCFO FY 2004 Annual Objective 5
5. Accelerated Deadline for the Performance and Accountability Report	Budget and Performance Integration; Financial Performance	Management strategy; MCFO FY 2004 Annual Objective 1
6. Revolving Fund and Salaries and Expenses s	Budget and Performance Integration; Financial Performance	Management strategy, MCFO FY 2004 Annual Objective 1
7. Maintaining and Improving Performance of the Federal Employees Health Benefits Program	Human Capital	Strategic Goal 1, Objective 1, SHRP FY 2004 Annual Performance Goal 1; Strategic Goal 3, Objective 3, HRPS FY 2004 Annual Performance Goal 5
8. Implementation of the Government Performance and Results Act	Budget and Performance Integration; Financial Performance	Management strategy, MCFO FY 2004 Annual Objective 1
9. OPM Restructuring	Human Capital (internal)	Management strategy

includes significant resources from OPM's executive offices. As shown in the table "Aligning Management Challenges to the PMA and OPM's Strategic Goals," no less than eight of OPM's annual performance goals for FY 2004 in some way address the management challenge for human resources management.

Thus, OPM believes it is appropriately responding to this challenge through its leadership of the Human Capital initiative, supported by new policy initiatives in the areas of recruitment, staffing, pay, and performance management, and Revolving Fund Programs services. During FY 2004, under HCLMSA Goal 1, OPM moved agencies forward in the transformation of human capital as 8 agencies progressed to green status, and 11 others improved to yellow status. Under SHRP Annual Performance Goals 1, 3, and 4, OPM provided agencies with human resources tools and strategies that support their human capital efforts; and under HRPS Annual Performance Goals 1, 2, and 3, OPM provided agencies with recruitment, hiring, and executive development services that essentially close the loop for human capital transformation.

OPM's residential training programs are successfully developing the competencies of executives, managers, supervisors, and team leaders toward effective human resources management. Agency-specific custom work emphasizes the critical skills senior agency staff must develop to significantly improve the way they approach human resources management at the strategic level. OPM also provides agencies with powerful succession planning tools such as the revitalized PMF Program with support for the retention strategies agencies need to ensure that they have the talent with the critical competencies to achieve their mission and program goals.

2. Department of Homeland Security

The legislation that established DHS requires OPM to partner with the new department to recommend the human resources system to be implemented as DHS becomes a single, unified agency. This involves developing a system uniting 170,000 Federal employees from 22 agencies, 17 separate unions, and 7 different payroll systems into a single department with a mission to protect America. OPM also contends with reaffirming title V protections and providing ongoing services to other Federal agencies.

Responding to this challenge, OPM established Objective 2 under Strategic Goal 1 which fully recognizes the agency's central role in this historic reorganization of the Executive Branch. Director Kay Coles James appointed a Senior Advisor for Homeland Security to lead OPM's work on what quickly became an intensive effort — and one of the largest acquisitions and mergers in the country. The DHS-OPM Human Resources Design Team was established, which brought together human resources policy experts in OPM and DHS, DHS managers, and representatives of the major DHS employee organizations.

During FY 2004, the design team developed 52 options dealing with pay, performance, classification, and labor and employee relations issues for a new human resources system at DHS. DHS and OPM

"The strategic management of human capital calls for a transformation in the employment, deployment, development and evaluation of the Federal workforce with results in mind."

—Kay Coles James, OPM Director

"OPM's e-Government initiatives are going to save a lot of money and make life a lot easier for the Federal workforce and the American people they serve. These e-Government programs provide a powerful way for Federal agencies to consolidate information into a single, trusted framework that will support government workers throughout their entire life cycle — from hire to retire."

—Kay Coles James, OPM Director

jointly issuing proposed regulations to establish a new human resources management system within DHS, as authorized by the Homeland Security Act of 2002. The proposed system governs basic pay, classification, performance management, labor relations, adverse actions, and employee appeals. These changes are designed to ensure that DHS's human resources management system aligns with its critical mission requirements while protecting the civil service rights of its employees.

OPM continues to focus considerable support toward the DHS human resources initiative, which will benefit OPM's overall strategic approach to human resources management for all Federal agencies. Under the National Defense Authorization Act of 2004, OPM has entered into a similar partnership with DOD to implement the National Security Personnel System.

3. Retirement Systems Modernization

Modernizing the systems and processes that support the Federal Government's two retirement systems continues to be OPM's central strategy for meeting its fiduciary, service delivery, and human capital outcomes for the Retirement Program. The Retirement Program comprises both the CSRS and the FERS. The present computerized systems that support processing of both CSRS and FERS retirement claims and provide other services and information to retirees, survivor annuitants, and Federal employees are insufficient in their processing and programming techniques. The Retirement Systems Modernization project is a long-term initiative to replace OPM's legacy systems with modern technology based on reengineered business processes. OPM agrees with the OIG that the project involves considerable risk and challenges, as do all such large projects.

In response, the project has been a key element of OPM's strategic and annual planning and has been featured prominently in its Annual Performance and Strategic Plans and Performance and Accountability Reports since FY 1999. OPM established a solid management team to oversee the project at its inception in 1997 and has secured the budgetary resources to move the project forward each fiscal year. To date, OPM has completed the design phase of this long-term project and in FY 2004, began its implementation phase. To achieve modernization, OPM must replace its existing technology and move from a paper to an electronic recordkeeping system. During FY 2004, OPM began developing an acquisition strategy to replace its current technology and began converting its millions of paper-based retirement records to electronic format.

4. Expanding e-Government

OPM's e-Gov projects are high-visibility endeavors to save millions of dollars. These projects are a part of the President's electronic Government initiative which seeks to enhance public access to and delivery of Government information and services through expanded use of technology. These projects will use Internet-related technologies to accelerate and streamline service delivery to citizens, reduce paperwork burdens on business, improve management and responsiveness of joint Federal-statelocal programs, and apply commercial best practices to improve Government operating efficiency. As a result of simplifying business processes and unifying Government operations around citizen needs, each e-Gov initiative will improve the efficiency and effectiveness with which the Government serves the American people.

OPM is responding to this challenge. The agency established the Office of e-Government Initiatives as an executive-level organization within the agency, reporting directly to the OPM Director. Further, the e-Gov projects are prominently featured in OPM's annual budgets and represented by an exclusive annual goal; moreover, they have received appropriate funding through the annual appropriations process. OPM's five e-Gov initiatives continued to progress on schedule during FY 2004, and these projects enhanced access and delivery of Government information and services through the expanded use of technology. The agency added new users and migrated additional agencies to its human resources technology solutions.

5. Accelerated Deadline for the Performance and Accountability Report

Beginning with FY 2004, the due date for agency PARs is November 15, just 45 days after the end of the fiscal year. OPM faces unique challenges in complying with this mandate, since much of the financial information it must report is dependent on outside sources whose financial time frames do not easily support the accelerated deadline. OPM began organizing to meet the new deadline as it prepared the PAR for FY 2003, publishing that year's report on December 31, 2003 — 30 days sooner than required — and intensified these efforts during FY 2004.

During FY 2004, OPM pursued a number of activities to ensure that it would meet the November 15 deadline for year-end financial reporting, working closely with outside organizations to streamline the capture, classification, analysis, and presentation of critical financial and performance information.

OPM's information technology support staff helped develop an automated process to estimate unpaid monies due the benefit trust funds as of September 30 from agencies and covered employees. Using prior year and prior quarter information, the agency tested these processes and found this estimation technique provides figures within 1 percent of the complete data.

OPM held a series of meetings with major health benefits carriers and the Federal life insurance carrier to arrange to receive fiscal year reporting of critical data by October 12 each year. Other key financial data will be derived from information already available regarding premium payments to community-rated carriers and "draw downs" from the letter-of-credit accounts used by experience-rated carriers.

OPM also coordinated an earlier calculation of administrative costs and transfer of monies from the benefit trust funds to the agency's Salaries and Expenses, and the trust fund actuaries have agreed to estimate actuarial liabilities by October 15.

6. Revolving Fund Programs and Salaries and Expenses

OPM needs to improve the financial management of its Revolving Fund Programs and Salaries and Expenses in order to reconcile its monthly cash balances with records maintained by the Department of the Treasury. Although the assets in these accounts represent less than one percent of OPM's total assets, it takes seriously the long-standing issues that the OIG has identified involving accounting procedures that need to be implemented and controls that continue to be inadequate.

During the past year, OPM has instituted various enhanced controls and procedures to help ensure the integrity and vitality of processes and operations. The following actions were taken to improve controls:

- Established monthly review of funding levels and obligations incurred to make sure OPM does not exceed the funds apportioned. In addition, OPM established quarterly reviews of status of funds for program offices and the agency overall.
- Devised a set of standard monthly financial reports that are disseminated to key offices and managers to help guide operations and provide timely feedback on status of funds.
- Implemented interim change control procedures and drafted formal procedures.

- Conducted extensive training of managers and staff to help ensure compliance with various financial management statutes and regulations.
- Compiled an inventory of automated system deficiencies that has been incorporated, in priority order, into a Financial Management Improvement Plan by which the system integrator is addressing the various deficiencies and issues within the system and its operations.
- Developed a plan for month-end close scheduled for the fourth workday of the following month.
- Enhanced controls over time and attendance, compliance with OPM personnel policies, and other requirements.

7. Maintaining and Improving the Performance of the Federal Employees Health Benefits Program

OPM's leadership and stewardship of the FEHBP continue to meet the challenges identified by the OIG for this critical employee benefit. OPM must moderate premium increases and contain overall program costs, while also ensuring that the program continues to meet enrollees' health benefit needs. Many variables affect program cost and performance, including an aging population, increased use of prescription drugs, medical services, costly but necessary new technology, and overall inflation in general health care services.

OPM has implemented significant changes to improve the performance of the FEHBP, such as offering new health maintenance organizations and other consumer-driven products that give enrollees additional choices in managing their own health care needs and health care dollars. Flexible spending accounts have been available to employees since July 2003. FY 2004 was the first time in five years that the number of health plan options increased, rising by 17 to 205. This trend will continue in FY 2005 as the number of options will increase to 249. Also as a result of OPM's tough negotiation stance with participating carriers during the summer of 2004, the average premium increase for 2005 will be the smallest in eight years at 7.9 percent.

8. Implementation of the Government Performance and Results Act

Since 1997, the OIG has assessed OPM's efforts to implement the GPRA. While acknowledging the progress OPM has made, the OIG continues to cite the need for stronger internal controls to ensure accurate reporting of performance data and improved explanations and disclosures of results.

During FY 2004, OPM focused additional resources toward GPRA implementation. The agency's GPRA agenda has been aligned with the PMA's Budget and Performance Integration (BPI) initiative, and OPM implemented many of the criteria for this initiative, achieving a yellow status score for BPI on the PMA Executive Scorecard administered by the OMB. As a part of its BPI activities, OPM has overhauled its performance measurement strategy to implement a solid base of performance metrics. As a result, OMB stated that while much remained to be done, the OPM FY 2005 Congressional Budget Justification is the best such document it had seen from OPM in years. OPM will continue to work hard to comply fully with all aspects of the BPI initiative and GPRA.

9. OPM Restructuring

The OIG added OPM's restructuring to its list of management challenges in FY 2004. OPM implemented its new organizational structure during the first half of FY 2003. The restructuring aligns OPM with the goals articulated in the *Strategic Plan 2002–2007* and is designed to meet the President's goal of forging a citizen-centered, results-oriented, and market-based organization. This new structure focuses on customer needs, emphasizes outcomes over process, and fosters integration of human resources management and accountability across Government.

OPM acknowledges the agency faces a diverse range of issues, such as staffing, transition management, finance, and logistics — all of which come with restructuring an organization. However, the new organization is firmly in place, and OPM produced significant program and organizational results in both FY 2003 and FY 2004. These achievements include leading the Government's Human Capital initiative, working with DHS to develop its new human resources management system, beginning work with DOD to implement the National Security Personnel System, proposing new performance-based pay regulations for the SES, positioning the agency for the possible transfer of the Defense Security Service and proposing new benefit offerings to maintain the competitiveness of the employee benefit programs. In addition, OPM achieved green status on its own Human Capital initiative.

Addressing Demands, Risks, and Uncertainties

The management challenges identified by OPM's Inspector General describe many of the demands, risks, uncertainties, and conditions that OPM must address to successfully fulfill its mission. Given its new role within the Government, and the uncertain and dangerous nature of the post–9/11 environment — not only for Federal agencies, but the Nation as a whole — OPM may have to address unforeseen events and demands on its resources, and elevated threats and risks regarding its assets, property, and resources. Anticipating the unexpected has become a part of OPM's modus operandi. Nonetheless, OPM has taken these factors in stride and set forward an aggressive agenda for next several years. Much of this agenda is outlined in OPM's *Strategic Plan 2002–2007* and forms the basis for its annual budget requests.

Major Human Resources Policy Initiatives

OPM is undertaking several significant initiatives in Governmentwide human resources policy that represent a major overhaul of human resources management for the Executive Branch agencies. These initiatives include implementing a new personnel system for the Department of Defense, implementing pay-for-performance — the anchor of Governmentwide pay reform, and coalescing lessons learned from the new personnel system for the Department of Homeland Security, and exporting them across all agencies.

OPM will supplement this already aggressive agenda by also developing and implementing new employee benefit options.

Human Capital Transformation

OPM must continue to provide leadership in the Strategic Human Capital initiative, the centerpiece of the PMA. However, OPM must now move agencies beyond scoring under the Human Capital Scorecard to active, comprehensive, and continuous human capital transformation. While agencies' progress on these scores is indicative of OPM's performance, OPM seeks to make best practices in human capital a part of the normal day-to-day process in all agencies.

Improving Financial Management Systems and Internal Controls

OPM must continue to make significant investments in the agency's core financial system to address not only the issues identified in the management challenges, but also to bring the system into full compliance with FFMIA and Federal accounting and financial management standards.

OPM must also strengthen internal controls over its business and financial processes, and information systems. To this end, Director James established the Center for Internal Control and Risk Management within the Division for Management and CFO. This new office will comprise an interdisciplinary team, consisting of financial experts, auditors, and procurement, information technology, and management analysts. The office's mission will be to create within the agency a culture of performance and accountability across all business lines.

Human Resources Line of Business

OPM will continue its leadership to expand electronic Government by transitioning its five e-Gov initiatives to the HR LOB. This transition will create a framework for Governmentwide, modern, cost effective, standardized, and interoperable HR solutions that provide common core functionality and maximize automation of processes to support the strategic management of human capital. The existing E-Gov initiatives, their systems, and their approach to delivering world-class services through cutting edge technologies will play a critical role in implementing the HR LOB. The HR LOB solution(s) will build upon the projected savings of the OPM-led e-government initiatives (Recruitment One-Stop, e-Clearance, e-Training, Enterprise Human Resources Integration, and e-Payroll). Other suitable legacy systems will be incorporated into the common solution(s) to ensure full coverage of HR functionality across all Federal agencies. The HR LOB will continue along and extend the projected savings path started by these e-government and other initiatives to deliver better HR services over the long-term.

Retirement Systems Modernization

OPM must also continue to modernize the processes and technology that support its administration of the Civil Service Retirement and Federal Employees Retirement systems. This project is at a critical juncture where budgetary resources will govern its future timeline, while maintaining its on-going capacity for processing new retirement and survivor annuity claims and providing other services to Federal retirees, survivor annuitants, and their families.

Analysis of OPM'S Financial Statements

In accordance with the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994, OPM prepares consolidated financial statements for the agency, which include agency operations as well as the Retirement, Health Benefits, and Life Insurance Programs. These statements are then audited by an independent certified public accountant, KPMG LLP. For the fifth consecutive year, OPM has received an unqualified audit report on its consolidated financial statements and on the individual financial statements of the Retirement, Health Benefits, and Life Insurance Programs.
OPM's principal financial statements are the:

- Balance Sheet
- Statement of Net Cost
- Statement of Changes in Net Position
- Statement of Budgetary Resources
- Statement of Financing

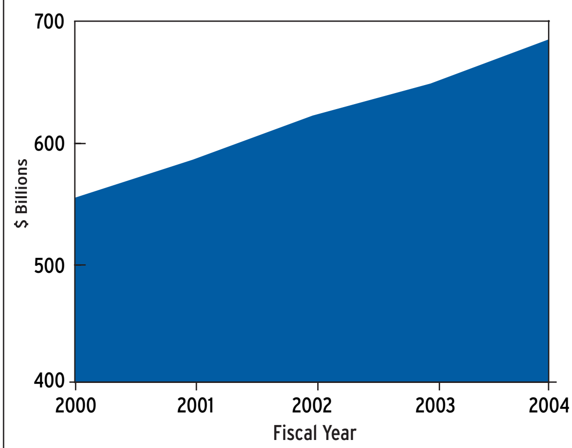
Balance Sheet

The Balance Sheet is a representation of OPM's financial condition at the end of the fiscal year. It shows the resources OPM holds to meet its statutory requirements *(Assets)*; the amounts that it owes that will require payment from these resources *(Liabilities)*; and the difference between them *(Net Position)*.

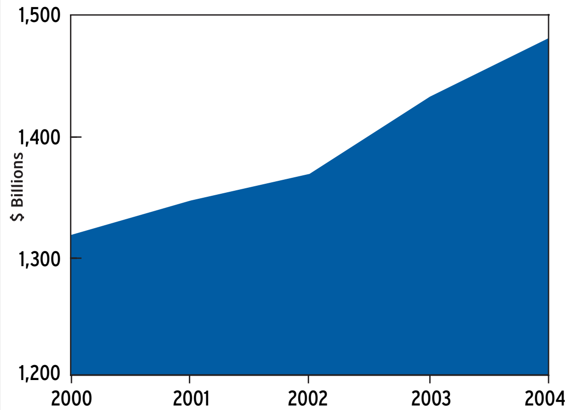
Assets. At the end of FY 2004, OPM held $683.7 billion in assets, an increase of 5.1 percent from $650.4 billion at the end of FY 2003. The majority of OPM's assets are intragovernmental, representing claims against other Federal entities. The Balance Sheet separately identifies intragovernmental assets from all other assets.

The largest category of assets is investments ($670.7 billion), which represented 98 percent of all OPM assets.

Growth of OPM Assets



Increase in OPM Liabilities



OPM invests all Retirement, Health Benefits, and Life Insurance Program collections not needed immediately for payment in special securities issued by the U.S. Treasury. As OPM routinely collects more money than it pays out, its investment portfolio (and consequently, its total assets) continues to grow. In FY 2004, the investment portfolio grew by 5.2 percent.

Liabilities. At the end of FY 2004, OPM's total liabilities were $1,476.5 billion, an increase of 4.4 percent from $1,414.4 billion at the end of FY 2003.

Three line items — the Pension, Postretirement Health Benefits, and the Actuarial Life Insurance Liabilities — account for more than 99 percent of OPM's liabilities. These liabilities reflect estimates by professional actuaries of the future cost, expressed in today's dollars, of providing benefits to participants in the future. To compute these liabilities, the actuaries make many assumptions about the future economy and about the demographics of the future Federal employee and annuitant (retirees and their survivors) populations.

The *Pension Liability*, which represents an estimate of the future cost to provide CSRS and FERS benefits to current employees and annuitants, is $1,174.5 billion at the end of FY 2004, an increase of approximately $39 billion, or 3 percent from the end of the previous year. [See discussion of the Net Cost to Provide CSRS and FERS Benefits below].

The *Postretirement Health Benefits Liability*, which represents the future cost to provide health benefits to active employees after they retire, is $261.6 billion at the end of FY 2004. This reflects an approximate $22 billion increase from the amount at the end of FY 2003, or 9 percent from the end of the previous year. [See discussion of the Net Cost to Provide Health Benefits below].

The *Actuarial Life Insurance Liability* is different from the Pension and Postretirement Health Benefits Liabilities. Whereas the other two are liabilities for "post-retirement" benefits only, the Actuarial Life Insurance Liability is an estimate of the future cost of life insurance benefits for both deceased annuitants and for employees who die in service. The Actuarial Life Insurance Liability increased by approximately $1.5 billion in FY 2004 to $30.8 billion, or 5 percent from the end of the previous year. [See discussion of the Net Cost to Provide Life Insurance Benefits below].

Net Position. OPM's total liabilities exceed its total assets in FY 2004 by $792.8 billion, primarily due to the large actuarial computed liabilities. It is important to note that the Retirement, Health Benefits, and Life Insurance Programs are funded in a manner that ensures that there will be sufficient assets available to pay benefits well into the future. Table 11 – Net Available for Benefits shows that OPM's net assets available to pay benefits have increased by over $33 billion in FY 2004 to over $674 billion.

Table 11 — Net Assets Available for Benefits

($ in Billions)	2004	2003	Change
Total Assets	$683.7	$650.4	$33.3
Less "Non-Actuarial" Liabilities	9.6	9.5	0.1
Net Assets Available to Pay Benefits	$674.1	$640.9	$33.2

Actuarial Gains and Losses

Due to actuarial gains and losses, OPM's Net Cost to Provide Retirement, Health Benefits and Life Insurance Benefits can vary widely from year to year. Actuarial gains decrease OPM's Net Cost, while actuarial losses increase it. What are actuarial gains and losses?

In computing the Pension, Postretirement Health Benefits and Actuarial Life Insurance Liabilities, OPM's actuaries must make assumptions about the future. When the actual experience of the Retirement, Health Benefits and Life Insurance Programs differs from these assumptions, as it always will, actuarial gains and/or losses will occur. For example, should the return on investments be better than the actuary assumed, there will be an actuarial gain.

Statement of Net Cost

The Statement of Net Cost is similar to a private-sector income statement. Unlike an income statement, which reports revenues less expenses incurred to arrive at net income, the Statement of Net Cost reverses this. It reports expenses first and then subtracts the revenues that financed those expenses.

OPM's Statement of Net Cost presents its cost of providing four major categories of benefits and services: CSRS, FERS, Health Benefits, and Life Insurance Benefits, as well as Human Resources Services. OPM derives its Net Cost by subtracting the revenues it earned from the gross costs it incurred in providing each of these benefits and services. OPM's total FY 2004 Net Cost of Operations was $62.2 billion, as compared with $86.0 billion in FY 2003.

Net Cost to Provide CSRS Benefits. As presented in Table 12 , OPM's Net Cost to Provide CSRS Benefits was $36.2 billion in FY 2004, $4.1 billion less than in FY 2003. There are three prime determinants of OPM's cost to provide CSRS benefits: one cost category (the actuarially-computed Pension Expense) and two categories of earned revenue (contributions by and for CSRS participants and earnings on CSRS investments).

The Pension Expense for the CSRS is the amount of future benefits earned by participants during the current fiscal year. For FY 2004, OPM incurred a Pension Expense for the CSRS of $68.6 billion, as compared with $73.1 billion in FY 2003. This decrease in the Pension Expense from FY 2003 is due primarily to the recognition of an actuarial gain in FY 2004 vis-à-vis an actuarial loss in FY 2003. When OPM's actuaries computed the Pension Expense for the CSRS in FY 2004, they recognized an actuarial gain of $2.1 billion, which served to decrease the Pension Expense. In FY 2003, an actuarial loss of $3.4 billion was recognized, increasing the FY 2003 Pension Expense.

Contributions by and for CSRS participants increased by $0.4 billion from FY 2003, as higher contributions by the U.S. Postal Service offset the declining number of CSRS participants. OPM's earnings on CSRS investments declined by $0.8 billion from FY 2003, as lower returns offset the effect of a larger CSRS investment portfolio.

Table 12 — Net Cost to Provide CSRS Benefits

($ in Billions)	2004	2003	Change
Gross Cost	$68.6	$73.1	($4.5)
Associated Revenues	32.4	32.8	(.4)
Net Cost	$36.2	$40.3	($4.1)

Although Federal accounting standards do not require disclosure of the entire amount OPM paid in CSRS benefits on the Statement of Net Cost, in FY 2004, OPM paid benefits of $50.0 billion, as compared to the $48.3 billion in FY 2003. The increase in benefits paid is due to the effect of the cost-of-living allowance paid to an increasing number of CSRS annuitants.

Net Cost to Provide FERS Benefits. As shown in Table 13, the Net Cost to Provide FERS Benefits in FY 2004 decreased by over $9.4 billion from FY 2003. As with the CSRS, there are three prime determinants of OPM's cost to provide FERS benefits: one cost category (the actuarially-computed Pension Expense) and two categories of earned revenue (contributions by and for participants and earnings on FERS investments).

The Pension Expense for the FERS is the amount of future benefits earned by participants during the current fiscal year. For FY 2004, OPM incurred a Pension Expense for the FERS of $21.9 billion, as compared with $29.5 billion in FY 2003. This decrease in the Pension Expense from FY 2003 is due primarily to the recognition of an actuarial gain in FY 2004 vis-à-vis an actuarial loss in FY 2003. When OPM's actuaries computed the Pension Expense for the FERS in FY 2004, they recognized an actuarial gain of $1.9 billion, which served to decrease the FERS Pension Expense. On the other hand, in FY 2003, a large actuarial loss of $8.64 billion was recognized in FY 2003, significantly increasing the FY 2003 FERS Pension Expense.

Contributions by and for FERS participants increased by $1.1 billion from FY 2003, or 10 percent from FY 2003, due to the increasing number of FERS participants (the CSRS is closed and all new employees participate in FERS). The number of FERS participants increased 2.4 percent from FY 2003. OPM's earnings on FERS investments increased by $0.7 billion from FY 2003, as a larger FERS investment portfolio offset the effect of lower returns.

Table 13 — Net Cost to Provide FERS Benefits

($ in Billions)	2004	2003	Change
Gross Cost	$21.9	$29.5	($7.6)
Associated Revenues	23.8	22.0	1.8
Net Cost	($1.9)	$7.5	($9.4)

As with the CSRS, the amount OPM paid in FERS benefits is not required to be disclosed on the Statement of Net Cost. In FY 2004, OPM paid benefits of $2.1 billion, compared with $1.8 billion in FY 2003, the 17 percent increase reflecting both a larger number of FERS retirees and the effect of the cost-of-living increase (2.0 percent for FY 2004). The number of FERS annuitants increased by 2.4 percent in FY 2004

Net Cost to Provide Health Benefits. The Net Cost to Provide Health Benefits in FY 2004 decreased by $10.1 billion from that in FY 2003. There are three prime determinants of OPM's cost to provide Health Benefits: two cost categories (the actuarially-computed Postretirement Health Benefits Expense and Current Benefits and Premiums) and one earned revenue category (contributions by and for participants).

The Postretirement Health Benefits Expense is the amount of future benefits earned by participants during the current fiscal year. For FY 2004, OPM incurred a Postretirement Health Benefits Expense of $31.5 billion, as compared with $41.0 billion in FY 2003, due primarily to the recognition of a smaller actuarial loss in FY 2004 than in FY 2003.

Current Benefits and Premiums increased $1.3 billion from FY 2003, due mainly to the increase in health insurance premium rates indicative of the economy as a whole. Contributions by and for participants increased by $2.0 billion from FY 2003, for much the same reason. OPM's earnings on Health Benefits investments increased minimally from FY 2003, as a larger Health Benefits investment portfolio offset the effect of lower returns.

Table 14 — Net Cost to Provide Health Benefits

($ In Billions)	2004	2003	Change
Gross Cost	$49.5	$57.6	($8.1)
Associated Revenues	21.9	19.9	2.0
Net Cost	$27.6	$37.7	($10.1)

Table 15 — Health Benefits Program Costs

($ In Billions)	Total 2004	Total 2003
Claims	$20.5	$18.8
Premiums	5.5	5.2
Administrative and other	1.4	1.4
Total	$27.4	$25.4

Net Cost to Provide Life Insurance Benefits. OPM's Net Cost to Provide Life Insurance Benefits decreased by $171 million in FY 2004. There are four prime determinants of OPM's cost to provide Life Insurance Benefits: two cost categories (the actuarially-computed Future Life Insurance Benefits Expense and Current Benefits and Premiums) and two earned revenue categories (contributions by and for participants and earnings on investments).

Future Life Insurance Benefits Expense declined by $325 million from FY 2003, due primarily to the recognition of a smaller actuarial loss in FY 2004 than in FY 2003. Current benefits and premiums increased $151 million due to greater levels of insurance-in-force (due to a higher salary structure) and increased claims experience. Insurance-in-force is the total dollar amount of life insurance coverage for all program participants. Contributions by and for participants increased immaterially from FY 2003, while Earnings on Investments decreased by $101 million, as lower returns offset the effect of a larger investment portfolio.

Table 16 — Net Cost to Provide Life Insurance Benefits

($ in Millions)	2004	2003	Change
Gross Cost	$3,640	$3,813	($173)
Associated Revenues	3,451	3,453	(2)
Net Cost (Excess of Revenue)	$189	$360	($171)

Statement of Budgetary Resources

In accordance with Federal statutes and implementing regulations, OPM may incur obligations and make payments to the extent that it has budgetary resources to cover them. The Statement of Budgetary Resources presents the sources of OPM's budgetary resources, their status at the end of the year, and the relationship between its budgetary resources and the outlays it made against them.

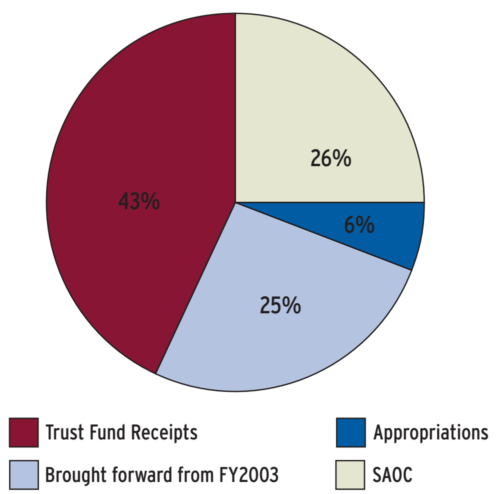
As presented in the Statement of Budgetary Resources, a total of $126.3 billion in budgetary resources was made available to OPM for FY 2004. OPM's budgetary resources in FY 2004 derive from those resources carried forward from FY 2003 ($32.8 billion) as well as the three major sources of new budgetary resources:

- Appropriations Received = $7.5 billion
- Trust Fund receipts = $52.5 billion
- Spending authority from offsetting collections (SAOC) = $33.5 billion.

Appropriations are funding sources resulting from specified Acts of Congress that authorize Federal agencies to incur obligations and to make payments for specified purposes. OPM's appropriations are intended to fund contributions for retirees and survivors who participate in the Health Benefits Program.

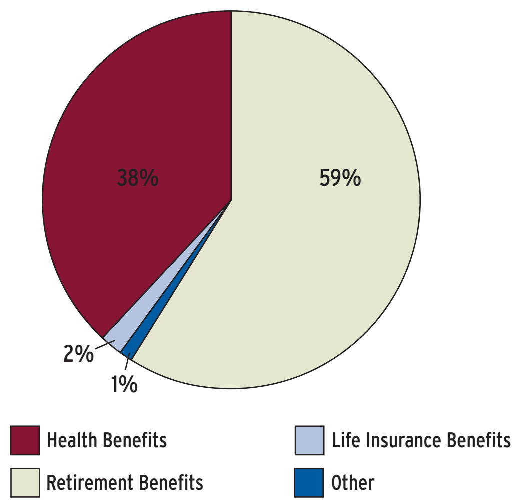
Both *Trust Fund Receipts* and *Spending Authority from Offsetting Collections* generally derive from collections. Collections by the Retirement Program, such as earnings on investments and contributions made by and for those participating, are classified as Trust Fund Receipts. Collections by the Health Benefits and Life Insurance and Revolving Fund Programs are classified as Spending Authority from Offsetting Collections.

Source of Budgetary Resources



From the $126.3 billion in budgetary resources OPM had available during FY 2004, it incurred obligations of $90.2 billion, mainly for benefits for participants in the Retirement, Health Benefits and Life Insurance Programs. Most of the excess of budgetary resources OPM had available in FY 2004 over the obligations it incurred against those resources is classified as being "unavailable" for obligation at year-end.

Obligations Incurred by Category



Compliance with Laws and Regulations

This section provides information on OPM's compliance with the following legislative mandates:

- Federal Managers' Financial Integrity Act
- Federal Financial Management Improvement Act
- Prompt Payment Act
- Debt Collection Improvement Act
- Improper Payments Information Act
- Inspector General Act, as amended
- Civil Monetary Penalty Act

Compliance with the Federal Managers' Financial Integrity Act

Evaluation of Management Controls. Management controls are the policies and procedures OPM uses to provide reasonable assurance that its:

- Obligations and costs comply with applicable laws;
- Assets are safeguarded against waste, loss, unauthorized use, or misappropriation;
- Revenues and expenditures applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial reports and to maintain accountability over assets; and
- Programs are efficiently and effectively carried out in accordance with applicable laws and management policy.

The Federal Managers' Financial Integrity Act (FMFIA) requires that Federal agencies conduct evaluations of their systems of management control and provide reasonable assurance annually to the President and Congress on their adequacy. Accordingly, OPM has evaluated the systems of management control it had in place during FY 2004. This evaluation included consideration of individual statements of assurance from program managers throughout the agency and the findings of KPMG LLP, the auditor of OPM's FY 2004 financial statements. Director James, in her "Letter from the Director" presented in this report, provided reasonable assurance that, with the exception of the material weakness identified below, OPM's systems of management control comply with the objectives of FMFIA.

OPM considers a weakness in management control to be material if it:

- Violates statutory or regulatory requirements;
- Significantly weakens safeguards against waste, loss, unauthorized use or misappropriation of funds, property or other assets;
- Significantly impairs the attainment of OPM's mission;
- Fosters a conflict of interest;
- Deprives the public of needed services; or
- Merits the attention of the Congress.

In its report on the audit of OPM's FY 2004 financial statements, KPMG LLP described its concerns about the financial management of the Revolving Fund Programs and Salaries and Expenses. KPMG has reported that, for FY 2004 the following conditions continue to affect the accuracy of financial information reported for the Revolving Fund Programs and Salaries and Expenses. More specifically, OPM does not consistently:

- Record financial transactions;
- Analyze its financial records in a timely manner; nor
- Reconcile its general ledger accounts to subsidiary ledgers, other supporting documentation, or with the Treasury.

The Director concurs with KPMG LLP's findings and has determined that the weaknesses in management control related to the Revolving Fund Programs and Salaries and Expenses, when considered collectively, rise to the level of a material weakness.

As a consequence of this determination, the Director has instructed that the CFO resolve the deficiencies that have resulted in the material weaknesses in management controls by the end of FY 2005. In fact, at September 30, 2004, the following actions had already been initiated and were in process:

- Development of reconciliation procedures for the Fund Balance with Treasury;
- Comprehensive financial management training regiment for financial managers, team leaders, and staff that covered the complete accounting cycle of financial events from appropriation of funds through expenditure and reporting as well as the U.S. Standard General Ledger;
- Modifications to the core financial management system, including revisions to proprietary and budgetary posting models;
- Development and implementation of standard month-end closing, analysis and reconciliation procedures for financial reporting purposes; and
- Implementation of management oversight controls, directly contributing to the identification of duplicate charges to the Revolving Fund Programs.

Evaluation of Compliance with Federal Systems Requirements. As part of its audit of the FY 2004 financial statements, KPMG LLP evaluated whether OPM substantially complies with Federal financial management systems requirements. Based upon her review, the Director has determined that OPM fully complies with, and meet the objectives of, the FMFIA for compliance with Federal systems requirements for FY 2004.

Table 17 — Number of Material Weaknesses in Management Controls

	Reported	Corrected	Pending
2004	1	0	1
2003	0	0	0
2002	0	0	0
2001	0	4	0
2000	0	5	4

Table 18 — Number of Material Nonconformances with Federal Systems Requirements

	Reported	Corrected	Pending
2004	0	0	0
2003	0	0	0
2002	0	2	0
2001	0	0	2
2000	0	0	2

Compliance with the Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 (FFMIA) is intended to ensure that financial management systems provide reliable, consistent disclosure of financial data, and that they do so on a uniform basis across the Federal Government from year to year, consistently using professionally-accepted accounting standards. To fulfill the requirements of the FFMIA, Federal financial management systems must comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and apply the U.S. Government Standard General Ledger (SGL) at the transaction level.

As part of the financial statement audit process, auditors must report on whether the agency substantially complies with the three FFMIA requirements. In accordance with the Act, KPMG LLP has, for FY 2004, reported that the financial management system OPM uses to administer the Revolving Fund Programs and Salaries and Expenses does not substantially comply with the requirements of the FFMIA because of deficiencies in its adherence to Federal accounting standards and its application of the SGL.

Based upon her review of KPMG LLP's report and other relevant and appropriate information, Director James has determined that for FY 2004:

- OPM complies substantially with all FFMIA requirements for the Retirement, Health Benefits and Life Insurance Programs.
- OPM does not comply substantially with the FFMIA requirements for adherence with applicable Federal accounting standards and the application of the SGL for the Revolving Fund Programs and Salaries and Expenses.

As a whole, the Director has determined that OPM complies substantially with the requirements of the FFMIA for FY 2004.

In accordance with the Act, the Director has instructed the CFO to establish a remediation plan, in consultation with OMB, to resolve the deficiencies that have resulted in the substantial noncompliance with regard to the Revolving Fund Programs and Salaries and Expenses. Although a remediation plan may allow three years for an agency to resolve such deficiencies, the Director has instructed that OPM's remediation plan provide for resolution by the end of FY 2005.

Compliance with the Prompt Pay Act

The Prompt Payment Act (Public Law 100-496), as amended, requires that Federal agencies pay companies transacting business with them in a timely manner. With certain exceptions, the Act requires that agencies make payment within 30 days of the later of the date of receipt of a properly prepared invoice or the receipt of goods or services purchased. For amounts not paid within the required period, agencies are obligated to pay interest at a rate established by the Treasury.

Performance is measured by the ratio of the number of payments paid to vendors without interest penalties over the total number of payments subject to the Act. At the end of FY 2003, the ratio was 95 percent. The FY 2004 performance objective was to maintain a ratio of 95 percent or better. As of September 30, 2004, OPM's performance was 99 percent.

Compliance with the Debt Collection Improvement Act

In response to a steady increase in the amount of delinquent debt owed to the United States, and concern that appropriate actions were not being taken to collect this delinquent debt, Congress passed the Debt Collection Improvement Act (DCIA) of 1996 (Public Law 104-134). The Act has had a major impact on the way OPM makes its payments and collects the monies owed to it. OPM complies with the DCIA in the following ways:

Cross-Servicing. Under the Act, all Federal agencies must refer past due, legally enforceable, non-tax debts that are more than 180 days delinquent to Treasury's Financial Management Service (FMS) for collection through the Treasury Offset Program (TOP). OPM has established an agreement with FMS to cross-service its debts, which allows FMS to refer automatically the debts to TOP as part of its collection effort. A debt is considered delinquent if it is 180 days past due and is legally enforceable. A debt is legally enforceable if there has been a final agency decision that the debt, in the amount stated, is due and there are no legal bars to collection action. Accordingly, OPM has referred 10,132 debts totaling more than $3.1 million to FMS for collection.

Data-Matching. OPM believes that it is important to prevent debts initially. Thus, OPM maintains an aggressive and active program integrity function to prevent waste, fraud, and abuse of Retirement Program benefit payments. One of the primary tools supporting this function is the use of database matching between Federal agencies. As such, OPM exchanges payment information with other benefit-paying agencies to identify individuals who have died or are otherwise no longer eligible for benefits. In FY 2004, OPM's data-matching activities identified more than $52.3 million in overpayments and prevented an additional $121.7 million from being overpaid. Table 19 summarizes OPM's debt management activity for FY 2004 and FY 2003.

Electronic Payments. As can be seen in Table 20, OPM excels in paying retirement benefits electronically. More than 94 percent of OPM's 2.4 million monthly Retirement Benefit Program payments are sent via electronic funds transfer, far exceeding that of any other Federal benefits-paying agency. To further increase the proportion of electronic payments, OPM now is focusing on its international recipients. As of September 30, 2004, 73 percent of OPM's recipients in Italy and 60 percent in Canada receive their monthly payments electronically. During FY 2004, OPM also expanded electronic payments to Panama through a joint venture with FMS and the Federal Reserve Banks of New York and Atlanta. This program has been well received, and it is anticipated that 75 percent of payees in Panama will enroll in electronic payments.

Table 19 — Debt Management Activity

Retirement Program ($ in Millions)		
	2004	2003
Total receivables at beginning of year	$164.4	$154.5
New receivables and accruals	$167.3	$177.5
Less collections, adjustments, and amounts written off	$163.1	$167.6
Total receivables at end of year	$168.6	$164.4
Total delinquent	$43.1	$47.1
Percent delinquent of total receivables	25.5%	28.6%
Health Benefits Program ($ in Millions)		
	2004	2003
Receivables at beginning of year	$35.5	$125.9
New receivables and accruals	$91.1	$28.2
Less collections and adjustments	$94.3	$118.6
Receivables at the end of year	$32.3	$35.5
Less management decisions in appeal	$2.6	$7.5
Currently available for collection	$29.7	$28.0

Table 20 — Electronic Payments

Payment Type	Percent
Retirement benefits	94.2
Salary	94.0
Carriers participating in Health Benefits and Life Insurance Programs	100.0
Other vendors	99.7

Compliance with the Improper Payments Information Act

The President has made the reduction of improper payments a major focus of his management agenda. The Congress has followed the President's lead by enacting the Improper Payments Information Act of 2002 (Public Law 107-300). The Act requires agency heads to review annually all programs and activities to identify those that may be susceptible to significant improper payments;

estimate the annual improper payments in the susceptible programs and activities; and report the results of their improper payment reduction plans and activities. In Memorandum 03-13, OMB defined a program as being susceptible to significant improper payments if the amount of improper payments exceeds both 2.5 percent *and* $10 million of program spending.

Although each of the following programs has historically had very low rates of improper payments, they have been reviewed in accordance with the requirements of Memorandum 03-13:

- Retirement Program
- Health Benefits Program
- Life Insurance Program

In Director James' vision, the administration of these programs is an essential public trust and OPM has a clear duty to ensure that payments are proper and accurate. This commitment is underscored by a statement given by the Honorable Linda M. Springer, Controller, Office of Federal Financial Management, Office of Management and Budget to the United States House of Representatives. On May 13, 2003, Ms. Springer testified:

> *"We should commend agencies like the Office of Personnel Management, which manages the Federal Employee Health Benefit Program and the Federal retirement benefit programs… for keeping their error rates low."*

Program Descriptions

Retirement Program. The program pays over $52 billion per year in defined benefits to retirees and their survivors and families. The program comprises the CSRS and the FERS.

Health Benefits Program. The program pays over $5 billion annually in premiums to community-rated carriers participating in the Program, and participating experience-rated carriers pay over $20 billion in benefits to participants. The program is administered through contracts with participating carriers, which provide hospitalization and major medical protection to Federal employees, retirees, former employees, family members, and former spouses.

Life Insurance Program. The program provides life insurance benefits of more than $2 billion per year to the survivors of Federal employees and annuitants. The program is administered through a contract with the Metropolitan Life Insurance Company.

Control Environment: Information Systems and Infrastructure

Retirement Program. Improper payment rates have historically been very low in the program due to OPM's strong internal control environment. This includes an active data-matching program with other large benefit-paying agencies and annual surveys of recipients to verify that they continue to meet all benefit eligibility requirements.

Health Benefits Program. Improper payments rates have been maintained at very low levels in the program due to OPM's strong oversight of the participating carriers. These oversight activities include:

- Periodic contract audits of participating carriers by OIG;
- A requirement that the largest carriers secure an annual audit by an independent public accountant (IPA) in accordance with Government Auditing Standards. These audits must include a statistical sampling of benefit payments and scrutiny of administrative charges;
- The inclusion of performance standards in OPM's contracts with the carriers that hold them accountable for providing accurate benefit payments; and
- A contractual requirement that the carriers aggressively identify and collect the improper payments made to their providers.

Life Insurance Program. OPM has a very strong internal control environment comprised of:

- Dual certification of benefits due from employing agency personnel and payroll systems;
- Oversight of principal carrier activities provided by OPM's OIG;
- A requirement that the principal Life Insurance Program carrier secure an annual audit by an IPA in accordance with Government Auditing Standards. These audits must include a statistical sampling of benefit payments and scrutiny of administrative charges; and
- A contractual requirement that the principal Life Insurance Program carrier aggressively identify and collect the improper payments made to beneficiaries.

Causes of Erroneous Payments and Actions to Reduce Them

Retirement Program. Seventy percent of the improper payments in the program occur because beneficiaries or family members delay reporting changes in their status (death, marriage, recovery from disability, etc.) that result in a different (or no) benefit payment. Nineteen percent result from inaccurate and incomplete information provided by former employing agencies. To a lesser extent, improper payments occur because individuals receive dual retirement benefit payments [10 percent]. Adjudication errors by OPM employees comprise only a miniscule percentage of the total improper payments in the program.

To reduce to any material extent the already low levels of improper payments in the Retirement Program, OPM must modernize its information systems and reengineer its business processes. The Retirement Systems Modernization (RSM) project is OPM's effort to reengineer the procedures used to administer the Retirement Program. OPM expects RSM to change fundamentally the way OPM does business — and to afford even more accurate payments. More specifically, RSM will allow OPM to reduce improper payments by establishing automated interfaces with:

- Federal personnel offices and payroll providers to collect the employment records and other documentation needed to adjudicate benefits;
- The Treasury for annuity payment delivery; and
- The Social Security Administration and the Defense Finance and Accounting Service and other private and public entities for coordination of benefits.

In the shorter-term, OPM will continue to pursue cost-effective methods to verify continued eligibility for benefits and to remind beneficiaries to inform OPM of events that could affect the amount of their benefits.

Health Benefits Program. Improper payments in the program stem from OIG audit findings and management's corresponding decisions to disallow charges to the program by the participating carriers. To reduce improper payments, the OIG is seeking additional resources that will allow it to conduct more frequent audits and has already begun audits targeted at specific categories of improper payments, such as those caused by coordination of benefits problems.

Life Insurance Program. The small incidence of improper payments in the program results from the incorrect certification of insurance coverage by retirement systems and employing agencies. Although it will be difficult to further reduce these already tiny improper payment rates, OPM intends to provide continued guidance to employing agency personnel and payroll officials.

Assessments of Risk/Sampling Process

Retirement Program. As is the usual practice, in FY 2004, an independent statistician analyzed OPM's adjudication and payment of Program benefits. Because there are two distinct retirement systems (CSRS and FERS), the statistician stratified the sample into two parts. OPM reviewed cases over a 36 year "cohort." Statistically valid samples were chosen disproportionately to the size of the population, because the statistician wanted to sample more of those cases that OPM believed contained a higher risk of being erroneously adjudicated and paid. Since CSRS cases were relatively free of error for the last four years, the statistician dropped the CSRS sample to 105 cases, which is a minimum for dual-purpose testing. The FERS sample was 275 cases. The results of this process confirm that the program was not at risk of significant improper payments.

Health Benefits Program. On an annual basis, the OIG performs audits that cover a very large proportion of the premiums paid to community-rated carriers and the benefits paid by experience-rated carriers. The coverage far exceeds the sample size required by OMB. Although this sample is judgmental and not random, it provides a reasonable estimate of improper payments in the program. In fact, it likely overstates improper payments in the program because those carriers chosen for audit tend to be those more prone to improper payments. The results of this process are that the program was not at risk of significant improper payments.

Life Insurance Program. Through an automated data-matching process, OPM compares the eligibility and coverage data of all covered Retirement Program annuitants who died during the year against the benefits paid to their beneficiaries by the principal carrier. OPM estimates that benefit payments paid to the beneficiaries of deceased annuitants in FY 2004 is approximately 67 percent of the total number and amount of payments. At this time OPM does not have, but is seeking to develop, a methodology to assess the risk inherent in the payment of benefits on behalf of deceased employees. The result of this process is that OPM can determine at this time that the program was not at risk of significant improper payments to the beneficiaries of deceased annuitants.

Summary of Improper Payments

Table 21 presents a summary of OPM's improper payments for FY 2004 and its target for improper payment reduction in FY 2005 through FY 2007. The improper payments for the Health Benefits Program are in actuality "net" overpayments; underpayments in the program are extremely small and are not separately captured. The improper payments for the Life Insurance Program are based only on payments made to the beneficiaries of deceased annuitants.

Recovery Auditing

OMB requires that agencies have a cost effective program of internal control to prevent, detect, and recover erroneous payments to contractors resulting from payment errors. For agencies with contracts that have a total value of more than $500 million in a fiscal year, OMB requires recovery audits as part of these internal controls. A recovery audit is a review of an agency's books and other information supporting its payments to identify overpayments to contractors that are due to erroneous payments.

OPM's OIG performs comprehensive audits of its contracts with the Health Benefits and Life Insurance Program carriers, which, if excluded, reduce the annual value of OPM's contracts to well below $500 million. The OIG's audits have proven to be highly effective in detecting and recovering erroneous payments. Since the terms and conditions of all OPM's contracts with Health Benefits and Life Insurance Program carriers provide for adjustments based on the OIG's audits, OPM has excluded them from the requirement for recovery audits.

Accountability for Reducing and Recovering Erroneous Payments

The Director has designated the Deputy CFO as the official responsible for establishing policies and procedures to assess agency and program risks of improper payments, taking actions to reduce those payments, and reporting the results of the actions to agency management.

As described earlier, OPM has already completed several key deliverables. It has inventoried its programs, assessed the risk in each of significant improper payments, and determined its improper payment rates. The Deputy CFO plans to work with Program officials to develop action plans with targets and dates for reducing further OPM's improper payment rates.

Barriers to Reducing Improper Payments

Retirement Program. Once OPM learns of the death of an annuitant, it requests that the Treasury reclaim all

Table 21 — Improper Payment Summary

Program ($ in Millions)		FY 2004 Outlays	FY 2004 Improper Payments	FY 2004 Improper Payments	FY 2005 Improper Payments (target)	FY 2006 Improper Payments (target)	FY 2007 Improper Payments (target)
		$	%	$	%	%	%
Retirement	Total	52,277	0.37	197.7	0.36	0.35	0.34
	Overpayments		0.32	167.3			
	Underpayments		0.05	30.4			
Health Benefits	Overpayments	27,183	0.32	86.1	0.31	0.30	0.29
Life Insurance	Total	959	0.22	2.1	0.21	0.21	0.21
	Overpayments		0.08	0.7			
	Underpayments		0.14	1.3			

posthumously-issued payments from the deceased's bank account. When there is insufficient money in the account, OPM seeks to collect from the individual who last withdrew money from the account. Based on current law and Treasury's regulations, financial institutions cannot provide OPM with the essential information necessary to recover these debts. The law and regulations have specifically exempted the Social Security Administration, Railroad Retirement Board and Department of Veterans' Affairs from this prohibition, but not OPM. This situation has a substantial impact on OPM's ability to prevent and recover improper payments. OPM will soon initiate discussions with the Treasury and OMB on remedies.

Health Benefits. In FY 2004, the OIG began its initiative to audit Pharmacy Benefit Managers (PBM) that participate in the program. It is estimated that pharmacy benefits represent approximately 25 percent of total benefit payments of many carriers. Carriers contract with PBMs to provide pharmacy benefits. In some cases only limited audit rights were given to the OIG through those contracts. To remedy this situation, OPM is in the process of revising the Federal Employees Health Benefits Acquisition Regulations to require carriers to provide the OIG audit rights in all contracts entered into with PBMs.

Travel and Purchase Card Usage

OPM measures its effectiveness in travel and purchase card usage by monitoring the percentage of the total outstanding balances for each that is 61 or more days old. Tables 22 and 23 compare OPM's percentages that are 61 or more days old to Governmentwide rates.

Table 22 — Travel Card Usage ($ in Thousands)

	FY 2004	FY 2003
Outstanding Balance	$351.9	$224.1
Outstanding more than 61 days	$7.6	$8.6
% outstanding more than 61 days (OPM)	2.00	3.84
% outstanding more than 61 days (Governmentwide)	3.33	4.27

Table 23 — Purchase Cards ($ in Thousands)

	FY 2004	FY 2003
Outstanding Balance	$516.8	$1,531.3
Outstanding more than 61 days	$0	$0
% outstanding more than 61 days (OPM)	0	0
% outstanding more than 61 days (Government wide)	0.85	1.18

As shown in the above charts, OPM's percentage of travel and purchase card outstanding balances that are 61 or more are less than the related Governmentwide averages.

Compliance with the Inspector General Act

The Inspector General Act, as amended, requires agencies to report on the final action taken with regard to audits by its Office of the Inspector General. OPM is reporting on audit follow-up activities for the period October 1, 2003 through September 30, 2004. Table 24 – Inspector General Audit Findings provides a summary of OIG's audit findings and actions taken in response by OPM management during this period.

Table 24 — Inspector General Audit Findings

	Number of Reports	Questioned Costs ($ in Millions)
Findings with no management decision on October 1, 2003	15	$28.3
New findings requiring management decisions	39	102.5
Management decisions made during the year:	40	98.5
Costs disallowed	–	85.6
Costs not disallowed	–	12.9
Findings with no management decision on September 30, 2004	14	$32.4

As of September 30, 2004, there were no reports with questioned costs outstanding that had not been resolved by management decision during the preceding six months.

Compliance with the Civil Monetary Penalty Act

A civil monetary penalty is any penalty, fine, or other sanction that is assessed or enforced by an agency pursuant to law, administrative proceeding or a civil action in the Federal courts. OPM neither assessed nor collected a civil monetary penalty during FY 2004.

Financial Management Performance

The PMA is an aggressive strategy for improving the management of the Federal Government. Director James has made implementing the PMA one of her primary goals. The PMA establishes the goals of creating a Government where citizen resources are well managed and wisely used; and holds Federal agencies accountable for allocating resources efficiently and effectively to the most critical programs to benefit citizens. It focuses on five Governmentwide goals, to improve Federal management and deliver results that matter to the American people, one of which being *Improved Financial Performance*.

OMB uses a PMA scorecard to track how well agencies are achieving the five PMA goals. On the scorecard, OMB assesses agencies against the following criteria for successful financial performance, as shown in Table 25.

Impediments to Improving Financial Management

Director James is committed to "getting to green" on the PMA Scorecard for improving financial performance. OPM has a rating from OMB of *yellow* for Status; and *green* for Progress on this initiative.

OPM has met with OMB staff regarding how OPM can integrate financial and performance information and use it for day-to-day management. There has been an emphasis on instilling management discipline to help ensure accurate, timely and effective formulation and execution of OPM budgets. OPM has supported the efforts of the CFO Council and the Joint Financial Management Improvement Program (JFMIP) for improving Governmentwide financial management and systems. A GFIS capital asset plan (i.e., OMB Circular A-11 Exhibit 300) is being developed that is consistent with OMB requirements and reflective of a viable system life-cycle management approach.

Goals and Strategies

OPM plans to achieve the goals of the PMA for improving financial management performance by executing the following strategy.

- Improve financial reporting while meeting all deadlines, receiving unqualified audit opinions, and avoiding material weaknesses and noncompliances;
- Enhance the core financial management system and implement a single integrated financial infrastructure for the agency;
- Strengthen stewardship, accountability, and internal controls over financial data;
- Attract and retain a highly qualified and effective financial management staff; and
- Reduce improper payments.

Improve Financial Reporting. OPM's goal is to improve its financial reporting process, while achieving and maintaining unqualified audit opinions, and avoiding material weaknesses and non-compliances. Improved financial reporting includes strengthening controls over the reporting process and ensuring that the financial data produced for management decision-making are reliable, verifiable, and consistent. OPM will seek, through better financial management system support, to reduce the time spent on financial statement preparation, so its financial management staff can be refocused on activities such as business performance and cost analysis.

Maintain Clean Audit Opinions. OPM has achieved unqualified audit opinions on its consolidated financial statements since FY 2000 and achieved its charge to publish its FY 2004 PAR by November 15 (45 days after the fiscal year end). To a major extent, OPM's unqualified opinions were achieved as a result of time-consuming, manual procedures, which have diverted resources from strategic decision making and overall agency performance.

OPM's success has resulted from the following factors:

- Revised estimating techniques for key accruals;
- Accelerated computation and audit of actuarial liabilities; and
- Close collaboration with the OIG and KPMG LLP to renovate completely the reporting and audit approach related to Health Benefits and Life Insurance Program carriers

Table 25 — Improved Financial Performance Scorecard Criteria

Green	Yellow	Red
• Meets all Yellow Standards for Success • Currently produces accurate and timely financial information that is used by management to inform decision-making and drive results in key areas of operations AND • Is implementing a plan to continuously expand the scope of its routine data use to inform management decision-making in additional areas of operations	• Receives an unqualified audit opinion on its annual financial statements • Meets financial statement reporting deadlines • Reports in its audited annual financial statements that its systems are in compliance with the Federal Financial Management Improvement Act • Has no chronic or significant Anti-Deficiency Act Violations • Has no material auditor-reported internal control weaknesses • Has no material non-compliance with laws or regulations AND • Has no material weaknesses or non-conformances reported under Section 2 and Section 4 of the Federal Managers' Financial Integrity Act that impact the agency's internal control over financial reporting or financial systems	• Receives an opinion other than unqualified on its annual financial statements • Does not meet financial reporting deadlines • Cannot report in its audited annual financial statements that its systems are in compliance with the Federal Financial Management Improvement Act • Commits chronic or significant Anti-Deficiency Act Violations • Has material auditor reported internal control weaknesses • Is in material non-compliance with laws or regulations OR • Has material weaknesses or non-conformances reported under Section 2 and Section 4 of the Federal Managers' Financial Integrity Act that impact the agency's internal control over financial reporting or financial systems

Eliminate Material Weakness and Substantial Noncompliance with FFMIA. OPM's compliance with the FMFIA is addressed earlier in this report. KPMG LLP reported that conditions continue to affect the accuracy of the Revolving Fund Programs' FY 2004 financial information and that OPM needs to improve controls over the timeliness of transaction entry and reconciliation. To resolve these deficiencies, OPM has begun to establish fundamental systemic and procedural controls over the Revolving Fund Programs and Salaries and Expenses. For instance, OPM has developed reconciliation procedures for the Fund Balance with Treasury (FBWT); standard month-end closing, analysis and reconciliation procedures for financial reporting purposes; a comprehensive annual close checklist, which includes reconciliation and validation tasks/activities; and, finally, identified erroneous charges to the Revolving Fund Programs. These activities are ongoing.

Enhance Financial Management Systems. OPM utilizes two core financial systems that are based upon commercial off-the-shelf packages supplied by CGI-AMS. The two systems are:

- The general ledger of the Employees Benefits System (EBS), which was implemented using Federal Financial System software and is used in administering the Retirement, Health Benefits and Life Insurance Programs.
- GFIS, which was implemented using Momentum software and which serves as OPM's core financial management system for its Revolving Fund Programs and Salaries and Expenses.

A major determinant of effective financial performance is sound financial management systems. Obviously, enhancing OPM's financial management systems will provide more reliable, consistent and timely information, thereby strengthening decision-making.

To strengthen internal controls over transaction entry into GFIS and related processes, OPM undertook a review of the system's transaction posting model and related systems logic. Modifications were made to correct incorrect transaction coding and to curtail the recording of improper transactions. In addition, a CGI-AMS "Tiger Team" was engaged to assess a wide-spectrum of GFIS issues, and to recommend potential solutions.

Additionally, OPM recently awarded a contract to Science Applications International Corporation (SAIC) to assist OPM in assessing and evaluating the GFIS implementation and its current capability in fulfilling OPM's acquisition, finance, and accounting functions. Under this contract, SAIC is to provide financial management system expertise and program integration and project management support to OPM to:

- assess the CGI-AMS "Tiger Team" recommendations;
- develop a GFIS Risk Mitigation Plan;

- assist in overseeing short-term GFIS fixes, including systems testing, and providing counsel to OPM;
- provide independent validation and verification support;
- recommend a long-term solution for satisfying OPM's financial management needs relative to Revolving Fund Programs and Salaries and Expenses financial functions;
- develop a strategic plan for supporting OPM's financial management responsibilities;
- assist with the development of a GFIS capital asset plan;
- assist OPM with overall project management, including support in implementing an earned value management system, and budget and financial management support; and
- identify "gaps" between GFIS functionality, as implemented, and pertinent OPM requirements.

Strengthen Stewardship, Accountability And Internal Controls Over Financial Data. The Director of OPM made a firm commitment and under her direction, senior management is executing the necessary actions to clean-up, maintain, and continue to improve the quality and integrity of financial information. The Director has established the FAC chaired by the OPM Chief of Staff and comprised of the CFO and other top agency executives. The FAC meets each week with the Director to discuss and address critical financial management issues.

Similarly, the Director has established a new Center for Internal Control and Risk Management, which will soon be operational, to perform high-level internal control review and quality assurance. The Director has appointed a senior level executive to lead the Center and has charged him to initiate an immediate overhaul of OPM's internal control systems.

Support Program Managers. OPM program managers do not receive timely, accurate, and useful financial information with which to make informed decisions. OPM's strategy is to focus on improving ongoing service to its internal customers. The strategy involves periodic monitoring of key metrics to ensure effective support for OPM administrative, mission, and program activities. There will be a further refining of monthly financial management reports to financial and program management communities.

Attract and Retain a Highly Qualified and Effective Financial Management Staff. To improve OPM's financial management, the Director created the proper financial management foundation by consolidating all financial management activities under the Chief Financial Officer. This has assured that all funds and financial management activities receive the high-level attention that they require. The Director then expedited the hiring of high-quality financial managers and professional staff: a new CFO, Deputy CFO, and several other high-level financial management officials. This team of talented and experienced professionals gathered from across the Government and with expert knowledge and extensive Federal financial management skills, has aggressively pursued opportunities to improve OPM financial management policies, processes, and procedures and controls.

A critical determinant of successful financial management is the ability to attract, retain and develop a highly skilled financial staff. To that end, the Director plans to build and increase the quality, availability, and diversity of entry-level personnel and to improve the recruitment of mid and senior level staff. This includes the establishment of an intern program to recruit and train entry-level individuals for professional careers in financial management. OPM also will focus on ensuring that OPM's financial management staff obtain and maintain the requisite expertise to meet current and future requirements.

In FY 2004, OPM defined and provided high-quality, on-going training to its managers and their staffs on the operation of OPM's financial management systems and the generation of viable information. Extensive in-house training was conducted, covering all phases of OPM's financial management operations and functions, as well as the complete accounting cycle of events, from appropriation of funds through expenditure, and financial statement reporting. This training included U.S. Standard General Ledger training conducted by the Department of the Treasury, Financial Management Service, on Basic and Intermediate U.S. Standard General Ledger.

Reduce Improper Payments. OPM is committed to reducing improper payments in accordance with the Improper Payments Information Act of 2002. For all programs where the risk of erroneous payments is significant, agencies must estimate the annual amount of erroneous payments, and report the estimates to the President and Congress with a progress report on actions to reduce erroneous payments.

None of OPM's payments were deemed to be susceptible to significant erroneous payments. Nonetheless, the agency recognizes the importance of maintaining adequate internal controls to ensure proper payments, and its commitment to continuous improvement in the disbursement management process remains very strong. OPM believe it can enhance our current process and will identify and implement additional procedures to prevent and detect erroneous payments.

Financial Management Systems

OPM currently operates two financial systems: GFIS, which is the primary administrative accounting system used for OPM's Revolving Fund Programs and Salaries and Expenses; and the EBS, which supports the Governmentwide employee earned benefits programs. These systems and applications support unique management and accounting functions of the agency or specific programs. OPM is continuing efforts towards finding technology that can support both GFIS and the EBS. OPM submitted an inventory and descriptions of its financial and mixed systems to OMB September 3, 2004.

Core Financial Management Systems. GFIS, OPM's core financial management system, provides the foundation for OPM's administrative financial management responsibilities. GFIS was designed and implemented based on the Momentum software package developed by CGI-AMS. The system includes a general ledger, budget/funds management, revenue/receipts management, procurement/payment management, and financial management reporting modules.

The EBS, which is based on CGI-AMS's Federal Financial Systems Software, complies with all Federal financial management systems requirements, Federal accounting standards, and the SGL at the transaction level. The EBS has various subsidiary feeder systems that reside on the mainframe which, with the exception of the Annuity Roll, are interfaced.

FFMIA Remediation Activities. OPM's FY 2004 assessment of GFIS disclosed that it does not comply substantially with requirements mandated by FFMIA. Specifically, the system does not comply with Federal accounting standards and does not support the requirement that transactions be posted in accordance with the SGL. OPM has devoted a great deal of time and resources to resolving this deficiency, including a complete renovation of transaction posting models for the Revolving Fund Programs and Salaries and Expenses. In consultation with OMB, OPM will develop a remediation plan that will contain the steps necessary to resolve this deficiency completely by the end of FY 2005.

Limitations of the Consolidated Financial Statements

- The principal financial statements have been prepared to report OPM's financial position and results of operations, pursuant to the requirements of 31 U.S.C. 3515(b).
- The statements have been prepared from OPM's books and records in accordance with generally accepted accounting principles for Federal entities and the formats prescribed by the OMB. They are in addition to the financial reports used to monitor and control OPM's budgetary resources, which are prepared from the same books and records.
- The statements should be read with the realization that they are for a component of the United States, a sovereign entity.

Click here for Part 4, "FY 2004 Performance Information"