

| <b>5. Health Care</b>          |  |                          |
|--------------------------------|--|--------------------------|
| A. IG Summary of the Challenge | B. IG Assessment of Progress   | C. Management's Response |
|                                | <p>embark on a change in governance. The Department completed various studies of a unified medical command. Using those studies and recommendations made by the Defense Business Board, the Department decided on an incremental approach to increasing joint governance. The Department is exploring the opportunities provided by the 2005 Base Realignment and Closure recommendations as well as establishing a joint medical education and training center. In addition, the Department also is looking into bringing support functions such as finance, logistics, information technology, facilities, human capital management, and medical research and development under joint governance in a combined headquarters. These functions would serve as corporate assets and the Military Health System could potentially enhance medical readiness while gaining efficiency and economy of scale.</p> |                          |

## Summary of Financial Statement Audit and Management Assurances

The Federal Managers' Financial Integrity Act (FMFIA) requires Federal agencies to assess the effectiveness of internal management controls for program, operational, and administrative areas as well as accounting and financial management. Internal management controls are the organization, policies, and procedures that are considered the tools that help program and financial managers achieve results and safeguard the integrity of their programs. The program strengthens integrity and accountability within programs and operations, and:

- Is critical for good government
- Demonstrates responsible stewardship over assets and resources
- Promotes high-quality, responsible leadership
- Enhances the sound delivery of services to customers
- Maximizes desired program outcomes.

The Department conducts its assessments of the internal management controls under a formalized program conducted throughout the Department to include forward-deployed units such as the Multi-National Forces - Iraq. Using assessments according to the Office of Management and Budget Circular A-123, "Management's Responsibility for Internal Control," as the basis, the Department prepared the FY 2007 Annual Statement of Assurance (presented in the Management's Discussion and Analysis section of this report). The Department asserts that all Components have reported to the Secretary their individual statements of assurance over internal control.

The Department's internal control program is divided into two main processes:

1. The overall statement of assurance that covers the effectiveness of internal management controls for all functions and processes except for the financial reporting.
2. The statement of assurance over financial reporting which covers the effectiveness of internal management controls as prescribed by Appendix A of Circular A-123.

The Department has 34 entities required to report including (3) Military Departments, (9) Combatant Commands, (1) Joint Staff, (1) Office of the Secretary of Defense, (1) Office of the Inspector General, (18) Defense Agencies, and (1) Department Financial Reporting Senior Assessment Team. Components are required to conduct a robust programmatic approach to establishing and assessing internal management controls for the overall operations with the Component heads annually providing assurance to the Secretary of Defense. Only specified Components are also required to include financial reporting assurance. The Department uses these feeder statements as the basis for the Department's Statement of Assurance. The Department has dramatically reduced the number of outstanding material weaknesses since fiscal year 2001, by 84 percent from 116 material weaknesses to 19 in fiscal year 2007. The percentage of material weaknesses resolved rose from 21% in fiscal year 2006 to 34 percent in fiscal year 2007.

The Department reports several types of weaknesses. Table 1 shows the material weaknesses in financial statement reporting as identified by the Department of Defense Inspector General, who audits the annual financial statements. Table 2 shows management self-identified material weaknesses. Table 2a identifies financial reporting weaknesses, Table 2b identifies overall material weaknesses, and Table 2c identifies system nonconformances identified by the Department through its internal control process.

Details about each weakness are presented in expanded tables available at <http://www.defenselink.mil/comptroller/afr/fy2007/fy07afrsection3fmfia.pdf>. Table 2d summarizes the Department's compliance with the Federal Financial Management Improvement Act of 1996.

The Department-identified weaknesses fall into three categories:

- Section 2 Financial Reporting Material Weaknesses:** Financial reporting material weaknesses are identified as materially affecting the Department's financial reporting identified under the oversight of the DoD Senior Assessment Team during the limited assessment of internal controls over financial reporting. The Department is using an incremental approach in complying with OMB Circular A-123, Appendix A. In fiscal year 2007, the assessments conducted include: fund balance with Treasury, investments, accounts receivable, inventory and operating materials and supplies, real property, military equipment, accounts payable, Federal Employees' Compensation Act Liabilities, environmental liabilities, Medicare-eligible Retiree Health Care Liabilities, and appropriations received.
- Section 2 Overall Operations Material Weaknesses:** Overall operations material weaknesses materially affect internal management controls usually affecting multiple Department Components for all functions except financial reporting weaknesses unless those financial weaknesses were identified through assessments which were not under the oversight of the

Department's Senior Assessment Team. At this time, only one material weakness, general personal property, is functionally part of the financial reporting, but it is included in the overall material weakness category because the assessment did not fall under the oversight of the Senior Assessment Team.

- Section 4 System Nonconformance Material Weaknesses:** System nonconformance material weaknesses are identified as systems that nonconform with Government-wide requirements such as the Federal Financial Management Improvement Act as prescribed by OMB Circular A-127, "Financial Management Systems." The Department is reporting one weakness that covers the entire pervasive problems identified with system nonconformance.

DoD Reportable Conditions are weaknesses identified as materially affecting only one Department Component unless the weakness is so pervasive that it is deemed material to the Department as a whole. Reportable conditions, as prescribed in the OMB Circular A-123, are not reported in the Statement of Assurance, but are tracked internally for correction. The Department is reporting five material weaknesses in overall operations as being reassessed to reportable conditions in fiscal year 2007.

The tables below summarize the results of the fiscal year 2007 financial statement audit and the results of management's assessments of the Department's internal control process. Links in tables 2b, 2c, and 2d will take you to specific details on each weakness.

**Table 1. Summary of Financial Statement Audit**

| Audit Opinion             |  | Disclaimer        |     |          |              |                |
|---------------------------|--|-------------------|-----|----------|--------------|----------------|
| Restatement               |  | Yes               |     |          |              |                |
| Material Weakness         |  | Beginning Balance | New | Resolved | Consolidated | Ending Balance |
| 1                         | Accounts Payable                                 | 1                 |     |          |              | 1              |
| 2                         | Accounting Entries                               | 1                 |     |          |              | 1              |
| 3                         | Environmental Liabilities                        | 1                 |     |          |              | 1              |
| 4                         | Government Property in Possession of Contractors | 1                 |     |          |              | 1              |
| 5                         | Intragovernmental Elimination                    | 1                 |     |          |              | 1              |
| 6                         | Operating Materials and Supplies                 | 1                 |     |          |              | 1              |
| 7                         | Statement of Financing                           | 1                 |     |          |              | 1              |
| 8                         | Statement of Net Cost                            | 1                 |     |          |              | 1              |
| 9                         | Financial Management Systems                     | 1                 |     |          |              | 1              |
| 10                        | Fund Balance with Treasury                       | 1                 |     |          |              | 1              |
| 11                        | General Property, Plant & Equipment              | 1                 |     |          |              | 1              |
| 12                        | Inventory  | 1                 |     |          |              | 1              |
| 13                        | Accounts Receivable                              |                   | 1   |          |              | 1              |
| Total Material Weaknesses |  | 12                | 1   | 0        | 0            | 13             |

<sup>1</sup> In accordance with OMB guidance, the Statement of Financing is a note to the financial statements, Reference Note 21.

Table 2. Summary of Management Assurances

| Table 2a. Summary of Management Assurances   |              |                   |          |          |              |            |                |
|--|--------------|-------------------|----------|----------|--------------|------------|----------------|
| Effectiveness of Internal Control over Financial Reporting (FMFIA Section 2)                   |              |                   |          |          |              |            |                |
| Statement of Assurance   | No Assurance |                   |          |          |              |            |                |
| Material Weaknesses (information deemed necessary for clarification)                           | Ref Table 1  | Beginning Balance | New      | Resolved | Consolidated | Reassessed | Ending Balance |
| 1) Valuation of Property Plant and Equipment -Military Equipment                               | 11           | 1                 |          |          |              |            | 1              |
| 2) Real Property Assets  | 11           | 1                 |          |          |              |            | 1              |
| 3) Environmental Liabilities   | 3            | 1                 |          |          |              |            | 1              |
| 4) Health Care   |              | 1                 |          |          |              |            | 1              |
| 5) Fund Balance with Treasury (includes reported problems with unsupported accounting entries) | 10 & 2       | 1                 |          |          |              |            | 1              |
| 6) Accounts Receivable   | 13           |                   | 1        |          |              |            | 1              |
| 7) Inventory Valuation   | 12           |                   | 1        |          |              |            | 1              |
| 8) Operating Materials and Supplies  | 6            |                   | 1        |          |              |            | 1              |
| 9) Accounts Payable (includes reported problems with eliminations)                             | 1 & 5        |                   | 1        |          |              |            | 1              |
| <b>Total Financial Reporting Material Weaknesses</b>   |              | <b>5</b>          | <b>4</b> | <b>0</b> | <b>0</b>     | <b>0</b>   | <b>9</b>       |

| Table 2b. Summary of Management Assurances  |             |                   |     |          |              |            |                |
|---|-------------|-------------------|-----|----------|--------------|------------|----------------|
| Effectiveness of Internal Control over Overall Operations (FMFIA Section 2)   |             |                   |     |          |              |            |                |
| Statement of Assurance  | Qualified   |                   |     |          |              |            |                |
| Overall Material Weaknesses (information deemed necessary for clarification)  | Ref Table 1 | Beginning Balance | New | Resolved | Consolidated | Reassessed | Ending Balance |
| 1) Ending Balance Adjustments at Defense Finance and Accounting Service   |             | 1                 |     | 1        |              |            | 0              |
| 2) Accounts Receivable Noncompliance at Defense Finance and Accounting Service                                      |             | 1                 |     | 1        |              |            | 0              |
| 3) Foreign Military Sales Authority (consolidated into Overall Operations Material Weakness #19)                    |             | 1                 |     |          | 1            |            | 0              |
| 4) Unsupported Adjustments at Defense Logistics Agency (consolidated into Financial Reporting Material Weakness #9) |             | 1                 |     |          | 1            |            | 0              |
| 5) Joint Training Exercises   |             | 1                 |     | 1        |              |            | 0              |
| 6) Pharmaceuticals  |             | 1                 |     | 1        |              |            | 0              |
| 7) Engineering Plan   |             | 1                 |     | 1        |              |            | 0              |
| 8) Civilian Premium Payment   |             | 1                 |     | 1        |              |            | 0              |
| 9) Information Technology Capital Implementation  |             | 1                 |     | 1        |              |            | 0              |
| 10) Systems Acquisition Program (consolidated into Overall Operations Material Weakness #27)                        |             | 1                 |     |          | 1            |            | 0              |
| 11) Status of Funds (reassessed as a DoD Reportable Condition)  |             | 1                 |     |          |              | 1          | 0              |
| 12) Planning Program (reassessed as a DoD Reportable Condition)   |             | 1                 |     |          |              | 1          | 0              |
| 13) Force Readiness   |             | 1                 |     | 1        |              |            | 0              |
| 14) Program Inefficiencies  |             | 1                 |     | 1        |              |            | 0              |
| 15) Inaccurate Accountability of Equity (reassessed as a DoD Reportable Condition)                                  |             | 1                 |     |          |              | 1          | 0              |

| Table 2b. Summary of Management Assurances   |             |                   |          |           |              |            |                |
|--|-------------|-------------------|----------|-----------|--------------|------------|----------------|
| Effectiveness of Internal Control over Overall Operations (FMFIA Section 2)  |             |                   |          |           |              |            |                |
| Statement of Assurance   | Qualified   |                   |          |           |              |            |                |
| Overall Material Weaknesses (information deemed necessary for clarification)   | Ref Table 1 | Beginning Balance | New      | Resolved  | Consolidated | Reassessed | Ending Balance |
| 16) Lack of Policy (reassessed as a DoD Reportable Condition)  |             | 1                 |          |           |              | 1          | 0              |
| 17) Foreign Military Sales Export Controls   |             | 1                 |          | 1         |              |            | 0              |
| 18) Foreign Language Inadequacies (reassessed as a DoD Reportable Condition)   |             | 1                 |          |           |              | 1          | 0              |
| 19) Department of Defense Financial Management Systems and Processes (includes reported problems with unsupported accounting entries, reconciliation of net costs of operations to budget, and unauditible financial statements) | 2,7,8, & 9  | 1                 |          |           |              |            | 1              |
| 20) Management of Information Technology and Assurance   |             | 1                 |          |           |              |            | 1              |
| 21) Personal Property (General Personal Property which includes reported problems with the cost of DoD property and material in the possession of contractors)   | 11 & 4      | 1                 |          |           |              |            | 1              |
| 22) Personnel Security Investigations  |             | 1                 |          |           |              |            | 1              |
| 23) Real Property Infrastructure   |             | 1                 |          |           |              |            | 1              |
| 24) Government Card Program  |             | 1                 |          |           |              |            | 1              |
| 25) Inventory Valuation (reassessed and moved to DoD Financial Reporting Material Weakness # 7)  |             | 1                 |          |           |              | 1          | 0              |
| 26) Non-Department of Defense Contracts  |             | 1                 |          | 1         |              |            | 0              |
| 27) Contracting  |             | 1                 |          |           |              |            | 1              |
| 28) Procurement Reporting  |             | 1                 |          | 1         |              |            | 0              |
| 29) Accounts Payable (reassessed and moved to DoD Financial Reporting Material Weakness # 9)   |             | 1                 |          |           |              | 1          | 0              |
| 30) Procurement Data   |             |                   | 1        |           |              |            | 1              |
| 31) Interagency Acquisition and Potential Anti-Deficiency Act Violations   |             |                   | 1        |           |              |            | 1              |
| <b>Total Material Weaknesses for Overall Operations</b>  |             | <b>29</b>         | <b>2</b> | <b>12</b> | <b>3</b>     | <b>7</b>   | <b>9</b>       |

| Table 2c. Summary of Management Assurances  |              |                   |          |           |              |            |                |
|---|--------------|-------------------|----------|-----------|--------------|------------|----------------|
| Conformance with Financial Management System Requirements (FMFIA Section 4)   |              |                   |          |           |              |            |                |
| Statement of Assurance  | No Assurance |                   |          |           |              |            |                |
| Material Weaknesses (information deemed necessary for clarification)  | Ref Table 1  | Beginning Balance | New      | Resolved  | Consolidated | Reassessed | Ending Balance |
| 1) Department of Defense Financial Management Systems and Processes (includes reported problems with unsupported accounting entries, reconciliation of net costs of operations to budget, and unauditible financial statements) | 2,7,8, & 9   | 1                 |          |           |              |            | 1              |
| Total System Conformance Material Weaknesses  |              | 1                 | 0        | 0         | 0            | 0          | 1              |
| <b>Total FMFIA Weaknesses</b>   |              | <b>35</b>         | <b>6</b> | <b>12</b> | <b>3</b>     | <b>7</b>   | <b>19</b>      |

|  | Agency | Auditor |
|--|--------|---------|
| Overall Substantial Compliance                       | No     | No      |
| 1. System Requirements                               | No     | No      |
| 2. Accounting Standards                              | No     | No      |
| 3. U.S. Standard General Ledger at Transaction Level | No     | No      |

## ✓CHECK IT

The Department of Defense leadership is keenly aware and actively involved in helping its managers and employees understand that effective internal management controls are important to getting the job done right. The Department reminds its personnel that the Defense mission cannot be accomplished by the warfighters alone; everyone has a job to do, and every job is important. Internal management controls help ensure that what should happen does happen on a daily basis, but first internal management controls must be in place, effective and used. To help draw the attention of the approximately 2.9 million employees in more than 140 countries, the Deputy Secretary of Defense kicked off an awareness campaign known as, the Check It Campaign. The slogan states, "Check It. What gets checked, gets done."

Details about the campaign may be found at [http://www.defenselink.mil/comptroller/micp/03\\_check\\_it\\_campaign/index.html](http://www.defenselink.mil/comptroller/micp/03_check_it_campaign/index.html)

## Improper Payments Information Act Reporting

The Improper Payments Information Act (IPIA) of 2002, as implemented by the OMB Circular A-123, Appendix C, "Requirements for Effective Measurement and Remediation of Improper Payments," requires federal agencies to review all programs and activities annually and identify those that may be susceptible to significant erroneous payments. The Department's FY 2007 review did not identify any programs or activities at risk of significant erroneous payments in accordance with OMB criteria (programs with erroneous payments exceeding both \$10 million and 2.5% of program payments). However, based on the large volume of transactions or high dollar amounts, the following five programs are reportable in FY 2007: (1) Military Health Benefits, (2) Military Pay, (3) Civilian Pay, (4) Military Retirement, and (5) Travel Pay. Improper payment estimates for these programs are presented in the table below. Additionally, Commercial Pay information is included in Section V, Recovery Audit.

### FY 2007 Estimated Improper Payments (dollars in millions)

| Program                  | Estimated \$ | Estimated % |
|--------------------------|--------------|-------------|
| Military Health Benefits | \$ 156       | 2.00 %      |
| Military Pay             | \$ 370       | 0.51 %      |
| Civilian Pay             | \$ 75        | 0.26 %      |
| Military Retirement      | \$ 49        | 0.13 %      |
| Travel Pay               | \$ 44        | 1.00 %      |

### I. Risk Assessment

The Department's risk assessments for each of the programs identified above addressed the effectiveness of internal

controls in place to prevent improper payments (such as prepayment reviews) as well system weaknesses identified internally or by outside audit activities. While the Department's improper payment percentages are extremely low, numerous pre- and post-payment controls further minimize and eliminate improper payments. The following paragraphs summarize the processes in place and the results of survey assessment reviews.

### II. Statistical Sampling Process

The Department uses random sampling methods designed to meet or exceed the OMB requirement of annual estimates of improper payments with a 90% confidence interval (plus or minus 2.5%). Details on these sampling processes can be found at <http://www.defenselink.mil/comptroller/afr/fy2007/FY07AFRSection3IPIA.pdf>.

### III. Corrective Action Plans

(1) Military Health Benefits. The Department's contracts have had payment performance standards for military health benefit claims processing in place for many years. Overpayments found in the audit process are projected to the audit universe, and the managed care support contractor is liable for the total amount. This contractual design, combined with numerous prepayment and post-payment controls which effectively minimize improper payments, helps to ensure the Government is not at risk for improper payments in military health benefit payments. Additional discussion of these controls can be found at <http://www.defenselink.mil/comptroller/afr/fy2007/FY07AFRSection3IPIA.pdf>.