



*Inspector General Act of 1978
Twenty-fifth Anniversary*

Inspector General

United States
Department of Defense

Semiannual
Report *to the*
Congress



April 1, 2003 - September 30, 2003

Required by Public Law 95-452

INSPECTOR GENERAL ACT REPORTING REQUIREMENTS

The table below cross-references the specific pages in this semiannual report to the reporting requirements prescribed by the Inspector General Act of 1978 (Public Law 95-452), as amended. I

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Section 4(a)(2)	“review existing and proposed legislation and regulation...make recommendations...”	27-29
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Section 5(a)(4)	“a summary of matters referred to prosecutive authorities and the prosecution and convictions which have resulted...”	1-10
Section 5(a)(5)	“a summary of each report made to the [Secretary of Defense] under section 6(b)(2)...” (instances where information requested was refused or not provided)	N/A
Section 5(a)(6)	“a listing, subdivided according to subject matter, of each audit report issued...” showing dollar value of questioned costs and recommendations that funds be put to better use.	32-43, 44
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Section 5(a)(10)	“a summary of each audit report issued before the commencement of the reporting period for which no management decision has been made by the end of reporting period...”	45
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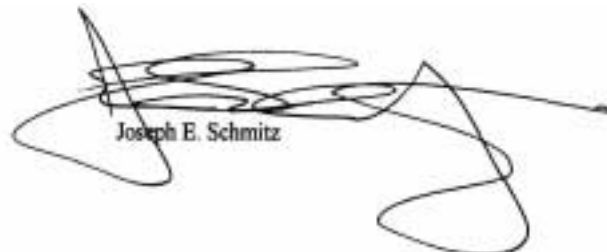
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FOREWORD

On October 14, 2003, President George W. Bush met in the White House with federal Inspectors General, the undersigned included, on the occasion of commemorating the 25th anniversary of the Inspector General Act of 1978. The Inspector General Act of 1978 was signed into law on October 12, 1978. This Act and subsequent amendments established offices of Inspector General throughout the federal government. The President observed that Inspectors General serve the vital role of promoting trust by the American people in the institutions of *their* government. The Inspector General Act charges each Inspector General to “provide leadership and recommend policies designed (A) to promote economy, efficiency and effectiveness in the administration of, and (B) to prevent and detect fraud and abuse” in the programs and operations of their agencies. The trust of the American public in *their* government requires confidence that the institutions of their government are acting in *their* interest by using funds effectively and efficiently. For 25 years, Inspectors General have sought to promote integrity, efficiency, and effectiveness in the programs and operations of government.

Recent efforts by this office to fulfill the Inspector General mission include:

- *Public Confidence in Integrity of DoD Programs and Operations:* The Inspector General of Housing and Urban Development issued a final “unqualified opinion” on the audit function of the Office of the Inspector General. The achievement of the unqualified “per review” opinion is the culmination of a great deal of effort to move from a previous “qualified opinion.”
- *Strategic Management of Human Capital:* Completed Phase I of the OIG transformation by: (a) hiring Mr. Francis “Gene” Reardon, formerly the Auditor General of the Army, to be the Deputy Inspector General for Auditing; and (b) standing up a new Deputy Inspector General for Inspections and Policy which established the Inspections and Evaluations Directorate under the leadership of Deputy Inspector General L. “Jerry” Hansen. Initially, this new Directorate is focusing on the sexual climate at the Military Academies, human trafficking, support to Combatant Commands and Joint IG doctrine and training.
- *Improved Support to Combatant Commanders:* The first rotation of OIG personnel has returned from service in Iraq, including RADM Larry Poe, USNR, the Deputy Inspector General for Intelligence, who completed a tour as the first Inspector General to Ambassador Bremer. A joint OIG team developed a “Quick Look” report to assess force protection risks associated with non-fissile radiological contamination in Iraq. The Inspector General and his four Deputies met with the Joint Forces Command Deputy Commander and staff to review possibilities for partnering.



Joseph E. Schmitz

SIGNIFICANT ACTIVITIES

INTRODUCTION

This report summarizes the significant activities of the Office of the Inspector General of the Department of Defense (OIG DoD) components and their work with other members of the DoD oversight and federal law enforcement communities.

CRIMINAL INVESTIGATIONS

The four Defense Criminal Investigative Organizations (DCIOs) continue to combat crimes affecting the Department of Defense (DoD). The Defense Criminal Investigative Service (DCIS) has focused its investigative priorities on terrorism, technology protection, product substitution, computer crime, financial crime, public corruption, and major thefts. The U.S. Army Criminal Investigation Command (USACIDC), the Naval Criminal Investigative Service (NCIS), and the Air Force Office of Special Investigations (AFOSI) also investigate procurement fraud, but their primary mission focus concentrates on terrorism, force protection, general crimes cognizant under the Uniformed Code of Military Justice, and crimes affecting major weapons systems within their respective Military Departments. The AFOSI and NCIS also conduct counterintelligence investigations and operations. The DCIOs continue to work together to support anti-terrorism investigations and participate as members of Joint Terrorism Task Forces (JTTFs). The DCIOs work cooperatively to resolve cases that impact more than one Military Service.

Monetary recoveries and fines related to all criminal investigations conducted by the DCIOs totaled more than \$615.6 million. Figure 1 (page 2) displays other statistical results achieved by the investigative organizations during the semiannual reporting period. The following are examples of significant cases.

Terrorism

After the tragic events of September 11, 2001, the OIG DoD moved to enhance law enforcement efforts in the prevention of terrorist attacks. The DCIS special agents are working at multiple JTTF locations around the country and in Iraq, in addition to doing their traditional work of ensuring our warfighters have the best and safest equipment to accomplish their missions.

- As a result of a DCIS investigation, the director of an international charity organization was convicted of violating the racketeering provision of the Organized Crime Control Act. Our investigation produced evidence to establish that the director

Judicial and Administrative Actions				
	Convictions	Indictments	Debarments	Suspensions
Terrorism	18	10		
Procurement/ Health Care Fraud	47	54	78	45
Other	188	155		
Total	253	219		

Figure 1

conspired to conduct the international charity organization as a criminal enterprise, through multiple schemes to defraud donors, while concealing the fact that donated funds were being used to support groups engaged in violent activities overseas. The director was sentenced to 136 months confinement, 36 months supervised release, and ordered to pay restitution of \$315,624.

- An individual in Ohio was convicted and sentenced to 3 years probation, 6 months home confinement, ordered to pay a \$2,000 fine, ordered to perform 50 hours of community service, and ordered to undergo mental health counseling for mailing two letters that contained a white powdery substance and threatened to kill a DoD employee.
- An Israeli firm and its director were found guilty of illegally smuggling Hawk and AIM-9 missile parts into the United States by falsely representing the value and contents of the packages. The director was sentenced to 3 years probation and ordered to pay restitution of \$43,475 and a \$5,000 fine. The company was sentenced to 5 years probation and ordered to pay restitution of \$43,475 and a \$25,000 fine. Both were debarred from doing business with the U.S. Government for 3 years.

Technology Protection

**Product Substitution
and Contract
Noncompliance**

- A Florida freight forwarder was convicted of conspiring with two other individuals and their foreign companies to cause illegal exports of U.S. Munitions List items in violation of the Arms Export Control Act. The Florida company was sentenced to 5 years probation and ordered to pay a \$50,000 fine. The owner was sentenced to 24 months incarceration and 3 years probation. The owners of the foreign companies were sentenced to a total of 30 months confinement, 6 years probation, and ordered to pay a \$50,000 fine.
- A German national was sentenced to 30 months incarceration and 36 months probation after pleading guilty to attempting to export military aircraft engines to Libya, an embargoed country, without a license from the U.S Department of State, Office of Defense Trade Controls, and without authorization from the U.S. Department of Treasury, Office of Foreign Asset Control.
- A major Defense contractor in the aviation industry agreed to pay \$3.2 million to the Government as part of a civil settlement to resolve allegations of defective pricing and delivery of a defective product. It was alleged that the aviation contractor was providing DoD with defective electrical components for the AH-64, Apache Attack Helicopter, and engaging in defective pricing.
- A major Defense contractor in Pennsylvania paid \$651,663 in a civil settlement to resolve a claim that the contractor historically failed to meet contract specifications by failing to ensure welding personnel were certified or qualified for the work required and consequently supplying non-conforming aircraft parts.
- Based on a qui tam complaint, a major Defense contractor reached a \$3.3 million civil settlement agreement with the government resolving allegations of false claims, common law fraud, payment by mistake, unjust enrichment, and breach of contract. This joint investigation revealed that a defectively connected chip detector caused a warning light to illuminate on board certain aircraft, which forced pilots to make unnecessary precautionary landings. No accidents were attributed to the problem. The investigation showed the contractor knew about the problem since the mid-1980s but made no efforts to repair it until 1991. Of the settlement, \$1.85 million was split among eight helicopter program contracts, \$75,000 to the Department of Justice, and \$1.4 million to the qui tam relator.

- In California, a Defense contractor, a subcontractor, and several of their senior executives were levied fines totaling \$29,000, paid \$42,873 in restitution, and were sentenced to various prison terms for submitting false statements and conspiracy. Working on an allegation received from the Suspected Unapproved Parts Task Force, a joint federal investigation centered on two variations of suspected counterfeit electrical contacts and their related conformance certifications. The investigation revealed that 100 suspect counterfeit contacts were sold to a Defense aircraft contractor and some were used in a fire control wire harness assembly, which was installed on a military aircraft.
- A Texas Defense contractor and its owner pled guilty to mail fraud and conspiracy for selling substandard plate assembly adapters to the military. The adapters could cause oil leaks and presented a flight safety concern. The contractor was ordered to pay \$155,359 in restitution and a \$400 special assessment. The owner was sentenced to 5 years probation.
- A major airline company, which provides maintenance work on C-17 engines for the DoD, agreed to a \$3.2 million civil settlement to resolve allegations of improper repair and testing of the engines. During the investigation, interviews with former and current employees revealed that the company did not properly repair or test the engines as contractually required.

Computer Crime

- An individual in Alabama pled guilty to breaking into federal computer systems, stealing credit card information, and defacing approximately 37 web sites, to include DoD sites. This individual was sentenced to 2 years probation and was ordered to pay restitution of \$7,275 and a \$1,800 special assessment.
- A DoD employee in Virginia pled guilty to coercion and enticement of a minor for illegal sexual activity. He was sentenced to 46 months confinement and 3 years supervised release. This individual used his government computer in the commission of these offenses.
- A DoD employee in Richmond, Virginia, pled guilty to receiving child pornography. He used his government computer in the commission of this crime. The employee was sentenced to 30 months confinement and 3 years supervised release.

Financial Crime

- Three divisions of a major Defense contractor were suspended from government contracting as a result of the filing of criminal charges of theft of trade secrets against two managers of this contractor in California. Allegedly, proprietary data was stolen from another DoD contractor, who was competing for the same DoD contract, regarding the Evolved Expendable Launch Vehicle Program.
- A Florida Defense contractor and two affiliated companies were each sentenced for providing false invoices for cable television contracts at DoD installations in the United States and Japan, during Base Realignment and Closure termination settlement proposals. The three companies were ordered to pay fines totaling \$8 million, a forfeiture of \$8,075,445, restitution of \$5,454,720, special assessments totaling \$1,600, and each company was sentenced to 5 years probation.
- A major Defense contractor in Virginia paid \$60 million in a civil settlement with the government to resolve allegations that it falsely and fraudulently claimed improper costs against government contracts with the U.S. Navy for shipbuilding and ship repairs. The contractor allegedly charged a significant amount of commercial labor costs to research and development, resulting in greatly inflated costs being improperly allocated to its government contracts.
- A major Defense contractor in the telecommunications industry in California agreed in an administrative settlement to allocate \$4.1 million in payments to government contracts. It was alleged that over a period of 7 years, the contractor improperly allocated indirect expenses to business areas resulting in over-allocation to government contracts. The contractor also allegedly obstructed a Defense Contract Audit Agency (DCAA) audit by denying the existence of and failing to provide requested information.
- Based on a qui tam filed by a former financial control director, a major Defense contractor agreed to a civil settlement of \$111.2 million as part of a civil settlement resolving allegations that it overcharged the government on contracts in violation of the False Claims Act. A joint investigation found that company employees engaged in five separate schemes that increased costs for medium launch vehicle contracts with the military and the National Aeronautics and Space Administration from 1990 and 1997.

Under provisions of the agreement, the former employee received \$27.2 million.

- In Florida, a joint investigation based on allegations that a major government contractor defectively priced a Foreign Military Sales contract resulted in a \$37.9 million civil settlement. The company allegedly defectively priced the contract to create a budget reserve, to purchase obsolete parts for future contracts, to pay fines for defective pricing on other contracts, and to pay illegal foreign commissions.
- A former contractor employee, who was working as a technical specialist for a high profile Navy program, pled guilty to conspiracy and was sentenced to 24 months confinement, 3 years probation, and was ordered to pay \$290,291 in restitution. An investigation found that he diverted labor hours and paid his wife's company \$310,032 to scan logistics documents into a database at their residence. Ninety percent of the jobs were charged to his government-issued credit card. The civilian employee's wife also pled guilty to conspiracy and was sentenced to 150 consecutive days of in-home detention, 5 years probation, and was ordered to pay restitution.
- During a Defense contractor's bankruptcy proceedings, it was learned that numerous employee pension plans, funded by a military service as part of a missile test range contract, were over-funded. When another Defense contractor purchased the bankrupt company in late 1991, it terminated all pre-existing pension plans, paid out entitlements, and retained the remaining monies. Contractually, the new contractor was required to return any excess to the service upon termination of the plan. Based on a joint investigation, the Department of Justice accepted a civil settlement agreement for violations of cost accounting standards and the Federal Acquisition Regulation and a settlement of \$41 million from the new contractor.
- As a result of plea agreements on charges of wrongful use of others' credit card information, three civilian employees of a military exchange and a civilian received prison sentences and monetary fines. A joint investigation disclosed that two employees, during the course of their normal duties, obtained patrons' credit card and personal information. Those employees and the others later used the information to place orders on the

exchange's catalog website and then altered billing addresses to ensure billings were not received before shipment delivery. One employee received 27 months confinement and 3 years supervised release; the second employee received a 10-month sentence and 3 years of supervised release; and the third employee received 2 years probation and 3 years supervised release. The civilian received a 10-month sentence and 3 years supervised release. All three were ordered to pay \$100 special assessments and are jointly responsible for restitution of \$143,521.

Bribery and Kickbacks

- A DoD member of the senior executive service and his executive assistant were found guilty of conspiracy to commit money laundering, conspiracy to obstruct justice to include extortion, and for making false statements, and were ordered to forfeit \$2,053,226 and one BMW automobile valued at \$46,000 for abusing their official positions for private enrichment. They had previously been suspended from government contracting.
- A former five-term mayor of Bridgeport, Connecticut, and ten associates were found guilty of various charges including racketeering, interference with commerce by threats or violence, extortion, mail fraud, bribery, conspiracy, and filing a false income tax return. The mayor was sentenced to 108 months confinement, 3 years probation, and ordered to pay a \$150,000 criminal fine and a \$1,600 special assessment. Additionally, the mayor was ordered to make \$148,617 in restitution to the government. The mayor accepted bribes from contractors working on contracts for the city of Bridgeport, Connecticut, which included contracts funded by Base Realignment and Closure projects. The ten associates were sentenced to a total of 71 months confinement, 33 years probation, ordered to pay fines totaling \$1,102,700, special assessments totaling \$1,700, and ordered to perform a total of 2,250 hours of community service.
- A Navy civilian employee at Red Hill Fuel Storage Facility in Pearl Harbor, Hawaii, pled guilty to conflict of interest and kickback violations and was sentenced to 3 years probation, 6 months of home detention, 100 hours of community service, and was ordered to pay a \$10,000 fine and a \$200 assessment fee. The Navy employee improperly worked as a subcontractor for a company he inspected in his position as a government employee.

- An Army colonel was sentenced to 54 months of federal custody, 36 months of supervised release, ordered to pay a \$10,000 fine and \$300 special assessment, and was caused to forfeit \$729,329 as a result of a plea agreement concerning his involvement in accepting bribes from government contractors in return for providing procurement sensitive information. Charges filed against the colonel and 34 other government employees stationed with military forces in Korea included: aiding and abetting; blackmail; bribery; confidential information disclosure; conspiracy; interception of communications; money laundering; obstruction of justice, and Procurement Integrity Act violations. The colonel's wife was sentenced to 24 months supervised release, fined \$5,000 plus a \$100 assessment, and ordered to undergo psychiatric treatment. One civilian employee was sentenced to 24 months federal custody, 36 months supervised release, and fined \$5,000 plus a special \$200 assessment. Another was sentenced to 18 months federal custody, 36 months supervised release, and fined \$4,000 plus a \$200 assessment. A fourth accomplice was sentenced to 6 months home detention, 30 months supervised release, and fined \$5,000 plus a \$200 assessment. Action remains to be taken on the additional subjects of the joint investigation.

Government Purchase Card Fraud

- The brother of a former Pentagon employee was convicted and sentenced to 48 months confinement, 3 years supervised release, and ordered to pay restitution of \$1.63 million and a \$100 special assessment for his involvement with two Pentagon employees in the theft of \$1.7 million. The brother and the two employees devised a scheme to defraud the government through the Government Purchase Card Program by submitting invoices for audio-visual and printing services, which were never provided, from the brother's fictitious company. The two employees were previously sentenced and their employment terminated.
- A Defense Commissary Agency employee in Marysville, Washington, pled guilty to possession of child pornography and theft of government property and was sentenced to 30 months confinement, 3 years probation, and ordered to pay restitution of \$613. The employee used his assigned government purchase card to purchase personal items, including the child pornography, which was kept at the government facility where the employee worked.

- A U.S. Army Corps of Engineers employee, his girlfriend, and a vendor located in southern California, pled guilty to bribery and wire fraud charges for their collusive relationship in a scheme to defraud the government through false Government Purchase Card billings. The vendor was sentenced to 1 year and 1 day confinement and ordered to pay restitution of \$267,000. The Army employee's girlfriend was sentenced to 3 years probation and ordered to pay restitution of \$16,205. The Army employee is awaiting sentencing. The Army, through its employee, had contracted with the vendor to provide video services documenting construction projects. In carrying out the scheme, the vendor was paid for more than 100 fraudulent invoices, totaling in excess of \$267,000, the proceeds of which were split with the Army employee.

Medical Fraud

- A major health care corporation agreed to a civil settlement of \$54 million to resolve allegations of unnecessary cardiac procedures and surgeries. The settlement agreement was based on allegations that physicians at one of the health care corporation's hospitals performed numerous unnecessary cardiac procedures, to include interventional cardiology procedures and cardiac surgery that were not medically necessary. In addition to the medical risks to the patients, the medically unnecessary procedures resulted in the submission of alleged fraudulent claims to the Medicare, Medicaid, and TRICARE programs. The settlement represents the largest recovery in the history of the Department of Justice in a case alleging lack of medical necessity.
- A major pharmaceutical manufacturer agreed to pay \$354.9 million to resolve criminal charges and civil liabilities for violating the Prescription Drug Marketing Act. The settlement is the result of a qui tam lawsuit alleging fraudulent drug pricing and marketing practices with regard to an advanced prostate cancer drug. Specifically, the pharmaceutical manufacturer provided illegal incentives and/or kickbacks to physicians in return for their exclusive use of the prostate cancer drug. In addition, many physicians allegedly sold the pharmaceutical samples of the drug to patients and then fraudulently billed a variety of federal health care programs, including the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS), the predecessor of TRICARE. In addition to the pharmaceutical manufacturer, one doctor was sentenced to 1 year probation and ordered to pay a fine, restitution, and special

assessment of \$66,065, and another doctor was sentenced to 1 year probation and ordered to pay a fine, restitution, and special assessment of \$73,000. Both doctors were sentenced for fraudulently billing federal health programs including Medicare and TRICARE for the prostate cancer drug.

Environmental Crimes

- A Defense contractor pled guilty to making a false statement involving hazardous waste manifests. The contractor was sentenced to pay a fine, restitution, and special assessment totaling \$265,400, and was placed on probation for a period of 3 years. The investigation disclosed that the contractor improperly disposed of more than 200,000 gallons of hazardous waste products obtained from Fort Irwin, California. Further, the Defense Logistics Agency suspended the corporation and its officers from future government contracting, for their involvement in the scheme.
- A Defense contractor and its president were sentenced for violating the Resource Conservation and Recovery Act. The contractor was ordered to serve 1 year of supervised probation and pay a fine and special assessment of \$100,400. The president was sentenced to 12 months and 1 day incarceration and 2 years of supervised release. The contractor, a manufacturer of high explosives and pyrotechnics for the DoD, violated the Resource Conservation and Recovery Act by transporting, storing, and disposing of substances known to contain hazardous waste without having proper permits.

DIRECTORATE FOR REPRISAL INVESTIGATIONS

The Directorate for Reprisal Investigations conducts investigations and performs oversight reviews of investigations conducted by the Military Departments pertaining to:

- Allegations that unfavorable actions were taken against members of the Armed Forces, DoD nonappropriated fund employees and Defense contractor employees in reprisal for making protected communications.
- Allegations that members of the Armed Forces were referred for mental health evaluations without being afforded the procedural rights prescribed in the DoD Directive 6490.1 and DoD Instruction 6490.4.

**Whistleblower
Reprisal Activity**

During the reporting period, the OIG DoD and the Military Department Inspectors General received 290 new complaints of whistleblower reprisal. Of the 146 cases closed during this period, 106 cases were closed after preliminary analysis determined further investigation was not warranted. A full investigation was conducted for 40 cases, in which 20 cases (50 percent) contained one or more substantiated allegations of whistleblower reprisal. These investigative results were referred to commanders and supervisors for corrective action.

**Examples of
Substantiated
Whistleblower
Reprisal Cases**

- An Air Force squadron commander reprised against a subordinate officer who had complained of unfair treatment to the Equal Opportunity officer, IG, and her chain of command. The unfavorable actions that the squadron commander took against the officer included referring her for a mental health evaluation; issuing her an unfavorable officer performance report and letter of reprimand; withholding a recommendation for pilot training; and denying an end of tour award. As a result of the substantiated findings, the squadron commander received a letter of admonishment that was placed in his official personnel record and his senior service school assignment was canceled.
- A Naval Reserve first class petty officer was removed from his supervisory position in reprisal for his protected communication to the Chief of Naval Personnel regarding safety issues and mismanagement and underutilization of Reserve personnel. Corrective action is pending.
- An Air Force commander forwarded derogatory information to a technical sergeant's new command in reprisal for the technical sergeant's prior IG complaints. As a result of the substantiated finding, the commander received a letter of counseling and was directed to review the Military Whistleblower Protection Act and its implementing DoD Directive and Air Force Instruction.
- An Army Reserve officer received a letter of reprimand and an unfavorable officer evaluation report in reprisal for reporting allegations of sexual harassment to the Equal Opportunity office. Corrective action is pending.
- An Army Nurse Corps officer was threatened with an unfavorable officer evaluation report and a position demotion because his supervisor believed he made a complaint to the installation Commanding General about the supervisor's unprofessional

comments at a “hail and farewell” luncheon. The supervisor retired from the Air Force before corrective action was initiated against her.

Referrals for Mental Health Evaluations

Thirty-nine OIG and Military Department cases closed during the reporting period contained allegations of violations of DoD Directive 6490.1, “Mental Health Evaluations of Members of the Armed Forces.” Investigations substantiated one allegation that a member was referred for a mental health evaluation in reprisal; and eight allegations that commanders failed to follow the procedural requirements of the Directive for referring Service members for mental health evaluations. We continue to coordinate with Military Department IGs to train commanders and mental health care providers regarding the procedural requirements of the Directive.

SENIOR OFFICIAL INQUIRIES

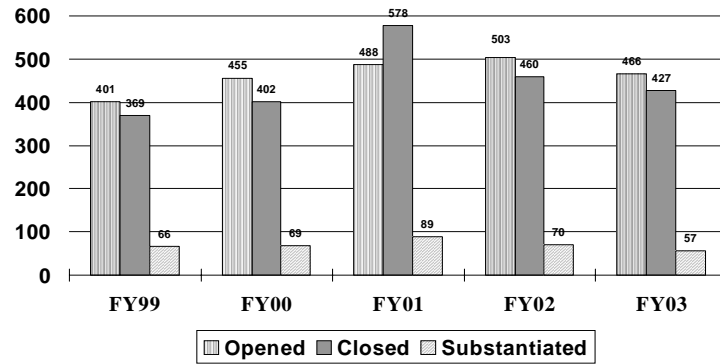
The Directorate for Investigations of Senior Officials conducts investigations into allegations against senior military and civilian officials and performs oversight of senior official investigations conducted by the Military Departments.

Figures 2 and 3 (page 13) show results of activity on senior official cases during the period. On September 30, 2003, there were 275 ongoing investigations into senior official misconduct throughout the Department, which represented an increase from April 1, 2003, when we reported 245 open investigations. Over the past 6 months, the Department closed 221 senior official cases, of which 32 (14 percent) contained substantiated allegations.

INSPECTIONS AND POLICY

The Office of the Deputy Inspector General for Inspections and Policy (ODIG-IP) has continued to develop during this reporting period, within existing resources, as part of the transformation of the OIG DoD to form the third arm of the team of investigators, inspectors, and auditors “inspiring by paradigm a culture of accountability and intelligent risk-taking throughout the Department of Defense.” The ODIG-IP includes the DoD Hotline, the offices of Investigative Policy and Oversight (IPO) and Audit Policy and Oversight (APO), and the recently established Inspections and Evaluations Directorate. The ODIG-IP has already undertaken several highly sensitive inspections, including the Air Force Academy sexual assault issues, the DoD program to prevent human trafficking, and a peer review requested by the Navy of its Office of Inspector General.

DoD Total Senior Official Cases FY 99 - FY 03



This chart shows the total number of senior official investigations conducted in the DoD over the past 5 fiscal years.

Figure 2

Nature of Substantiated Allegations Against Senior Officials During 2nd Half FY 03

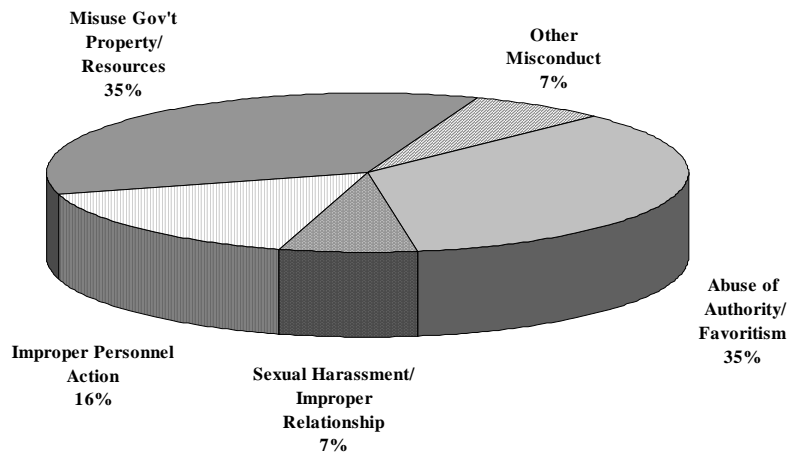


Figure 3

Hotline

The OIG Hotline continues to be a valuable intake activity for DoD employees and the public to report suspected instances of fraud, waste, mismanagement, and suspected threats to homeland security. During this reporting period, the OIG Hotline received 6,939 contacts from the public and members of the DoD community, initiated 1,419 investigations, and closed 1,262 cases. Investigations initiated by the OIG Hotline returned \$4.37 million to the government. Additionally, the OIG Hotline received 18 Congressional cases during this reporting period. The OIG Hotline continues to receive contacts on suspected threats to homeland security—a fairly new mission for the Defense Hotline.

Investigative Policy and Oversight

The Office of Investigative Policy and Oversight (IPO) assists the OIG DoD in fulfilling its statutory responsibilities to prevent fraud, waste, and abuse by developing investigative policy for and monitoring and evaluating the performance of over 3,600 special agents and 48,000 law enforcement personnel in the Department. The IPO reviews individual investigations; issues Department-wide policies affecting the investigative and law enforcement community; coordinates on legislative interests and other special projects with particular importance to those communities; and oversees the OIG DoD subpoena and Voluntary Disclosure programs. The IPO also provides oversight of the operations, policies, and products of the four DCIOs, which investigate crimes affecting the DoD. Information on some of the IPO’s actions and products follow.

Following reports concerning the Air Force’s response to allegations of sexual assaults at the Air Force Academy, IPO initiated an oversight evaluation focusing on several key areas. In May 2003, IPO administered a survey, concentrating on sexual assaults on female cadets at the Air Force Academy. Figure 4 summarizes the preliminary results of that survey. The IPO’s oversight activities and analysis continue.

Breakdown of Sexual Assaults at the Air Force Academy by Class Year of Graduation					
Class Year	Total Usable Responses	Total Sexual Assault Victims	Percent of Respondents	Rape or Attempted Rape Victims	Percent of Respondents
2003	128	31	24.2%	15	11.7%
2004	117	32	27.4%	10	8.5%
2005	154	27	17.5%	11	7.1%
2006	180	19	10.6%	7	3.9%
Total	579	109	18.8%	43	7.4%

Figure 4

Misuse of Government Purchase Cards (GPC) continues to receive attention from Congressional and DoD leadership. On January 1, 2003, the OIG DoD began collecting statistical information regarding DCIOs' investigations of the misuse/fraudulent use of the GPCs. From January 1 to September 30, 2003, the DCIOs initiated 42 investigations, which identified fraud schemes ranging from small personal purchases to large-scale operations. One case totaled \$2.6 million and involved 6 DoD civilian employees, 24 non-DoD employees, and 25 companies. Investigations continue on 34 of the 42 investigations. Seven are at various stages of legal action. Action to date on four of the cases has resulted in non-judicial punishment with a monetary forfeiture, resignation from service, and pending separation from the military.

During this period, the IPO streamlined the process whereby DoD criminal investigators request Inspector General subpoenas. The narrative request format was replaced by question and answer format that addresses all matters necessary to help ensure subpoenas are legally sufficient. The change has resulted in an estimated 90 percent reduction in follow-up questions to requesting agents and a corresponding 1.8-day average decrease in subpoena processing time.

On July 29, 2003, the Inspector General revised DoD Instruction 5100.86, "DoD Forensic Science Committee." The revised Instruction assigns committee responsibilities for the review and resolution of forensic science issues of concern to the DoD forensic science community and its customers.

**Voluntary
Disclosure
Program**

The Voluntary Disclosure Program encourages contractors to disclose potential criminal or civil fraud that may affect their contractual relationship with the DoD or the contractor's responsibility under the Federal Acquisition Regulation. During this reporting period, the government recovered \$634,604 in settlement of disclosures and received four requests for admission to the Program. The Program has recovered more than \$423 million since its inception in 1986.

Examples of cases received include a company that reported it failed to comply with certain test procedures during construction of destructor bombs intended to detonate underwater mines. Another company reported that it failed to perform certain dimensional tests on equipment installed on fighter aircraft sold to the Navy. Both of these disclosures were accepted into the Voluntary Disclosure Program and resulted in civil recoveries totaling \$625,000.

Audit Policy and Oversight

In accordance with the Inspector General Act of 1978, as amended, the Office of Audit Policy and Oversight (APO), provides policy direction for and monitors and evaluates adherence to policies, practices, and principles of over 6,500 DoD auditors, ensures appropriate use of non-federal auditors and their compliance with auditing standards, and ensures that contracting officials comply with statutory and regulatory requirements when processing contract audit reports. During the reporting period, APO completed or participated in the following activities.

With the Office of the Deputy Inspector General for Auditing, the APO conducted an assessment of DoD processes and congressional interaction related to leasing actions (D-2003-129) requested by the Under Secretary of Defense for Acquisition, Technology, and Logistics.

The APO reviewed a Hotline allegation concerning DCAA management actions taken in response to inappropriate actions taken by certain DCAA auditors regarding a quality control review.

In accordance with its responsibilities under OMB Circular A-133, §400(a)(5), the APO referred an employee to the Professional Ethics Division, American Institute of Certified Public Accountants, because the audit for the Center for Naval Analyses did not meet OMB Circular A-133 audit requirements and Government Auditing Standards.

Inspections and Evaluations

On September 8, 2003, the Inspector General established an Inspections and Evaluations Directorate within the ODIG-IP. This completed another phase in the OIG DoD transformation plan. The Directorate will identify opportunities to improve performance and efficiency in DoD programs and operations, and promote positive change through a focus on outcomes. In addition to monitoring compliance with law and DoD policy, evaluators will assess whether DoD programs can perform their duties effectively and are making changes today to be relevant in 5 years. To do this, evaluators will be experts both in evaluation methodologies and a subject area, such as occupational health or joint operations.

At the end of fiscal year 2003, the Directorate had 14 people in three divisions. By the end of fiscal year 2005, the Directorate is scheduled to have 50 military and civilian personnel divided among six divisions:

- Joint Operations, Military Departments, and Service Inspectors General

- Homeland Defense
- Safety and Operational Health
- Engineering and Environment
- Utilization and Integration of Reserve Forces
- Special Projects and Technical Assistance

The groups are designed to provide broad subject area expertise to address the President's Management Agenda, DoD identified top priorities, and OIG performance and management challenges for the Department of Defense.

AUDITING

On September 9, 2003, the Honorable Kenneth M. Donohue, Inspector General of the Department of Housing and Urban Development, provided his office's "unqualified opinion" on the OIG audit office system of quality control. This "unqualified opinion" marks a major milestone in ongoing efforts to transform the OIG. Further, the opinion provides assurance of material compliance with professional audit standards in the conduct of OIG audits.

The central audit offices of the DoD are the OIG DoD, the Army Audit Agency, the Naval Audit Service, and the Air Force Audit Agency. The organizations all together issued 301 reports, identifying the opportunity for \$8.8 billion in monetary benefits. Appendix A lists internal audit reports by management challenge area. Appendices B and C, respectively, list OIG DoD reports with potential monetary benefits and statistically summarize audit followup activity.

The DCAA provided financial advice to contracting officers in 1,550 reports issued during the period. Contract auditing resulted in approximately \$5.4 million in questioned costs and funds that could be put to better use. Further details are at Appendix D. Contracting officers disallowed \$390,464 as a result of significant DCAA post-award contract audit reports closed during the period. Additional details on the status of actions taken on significant post-award contract audits are in Appendix E.

Acquisition Audits

The Department is the largest purchaser in the world. In fiscal year 2002, the Department spent \$200 billion on acquisition. On an average working day, the Department issues more than 20,000 contract actions

valued at \$692 million and makes more than 5,000 purchase card transactions valued at \$26 million. The Department's challenge is to obtain the best value of quality and cost for a myriad of goods and services. During the reporting period, the DoD audit community issued 79 reports on acquisition issues. Any acquisition dollar that is not effectively managed is a dollar that is not available to fund the top 10 priorities of the Secretary of Defense, such as the global war on terrorism and joint warfighting capabilities.

The DoD auditing and investigative communities continue to be heavily engaged in helping the Department reduce its vulnerability to credit card misuse. The Services and the Defense agencies performed an in-depth review of purchase card transactions for 1,357 purchase card holders and determined that 182 card holders potentially used their purchase cards inappropriately or fraudulently. As a result, the 182 card holders expended about \$5 million in scarce resources on potentially inappropriate and fraudulent transactions. The DoD Purchase Card Program Office, along with the Navy, initiated actions that will strengthen internal controls by increasing the tools available to DoD managers. Those actions include data mining techniques designed to detect potentially inappropriate and fraudulent transactions. With the use of data mining and other management actions, the integrity of the Purchase Card Program is improved along with confidence in DoD to spend money prudently.

An OIG DoD assessment showed that the Air Force plan to lease Boeing 767 tanker aircraft could have been improved. Although not required by statute, applying a best business practice of weighing the need to conduct a formal analysis of alternatives to achieve the best possible system could have improved the Air Force leasing process.

Another OIG DoD report found that DoD did not adequately administer contracts with approximately \$5.5 billion of performance-based payments. Specifically, 43 of 67 contracts reviewed had problems with performance-based payments. As a result of inadequate administration of these payments, \$4.1 billion (including a possible \$900 million in accelerated payments) of the \$5.5 billion lacked adequate documentation to ensure that the payments were for demonstrated performance.

The Army Audit Agency reported that the Program Manager of the Future Combat System's simulation support office aggressively managed requirements determination for models and simulations. Responding to a Program Management Office directive, the simulation

support office reduced a \$699 million funding requirement to \$282 million by eliminating \$344 million in requirements that would benefit multiple systems--not just the Future Combat Systems--and eliminating \$73 million through budget cuts and the reallocation of funds within specific requirements. And, based on its recommendations, the office reallocated another \$47 million from requirements the office no longer intended to fund.

The Department has about 1,500 weapon systems acquisition programs valued at \$1.8 trillion over the collective life of the programs. The OIG DoD audits of the Chemical Demilitarization Program and Suite of Integrated Radio Frequency Countermeasures showed the need to update the acquisition program baseline, life cycle cost estimates, and test and evaluation plans to effectively manage the program and facilitate investment decisions. A Naval Audit Service review of the Digital Modular Radio showed significant engineering issues emerge during its development that proved the ineffectiveness of the Commercial Off-The-Shelf/Non-Developmental Initiative acquisition approach. The Naval Audit Service recommended that the Digital Modular Radio program be restructured to eliminate most of the Fleet Modernization Program legacy equipment replacement requirements and put approximately \$282 million of program funding to better use. For the Joint Air-to-Surface Standoff Missile, the Air Force Audit Agency determined that improvements were needed in test asset management, warranty administration, product quality assurance, and earned value management.

Human Capital Audits

The challenge in the area of human capital is to ensure that the DoD civilian and military workforces are appropriately sized, well trained and motivated, held to high standards of integrity, encouraged to engage in intelligent risk taking, and thus capable of handling the emerging technologies and threats of the 21st century. The Department has 2.6 million active duty and Reserve men and women under arms and a civilian workforce of nearly 654,000. The size of DoD and the wide variety of skills needed to meet this challenge are complicating factors, as are the constraints posed by personnel management rules.

Identifying and maintaining a balanced basic level of skills are needed to maintain in-house capabilities and meet the challenges of the 21st century. The aging workforce in the Department is highlighted by the fact that 66 percent of the workforce will be eligible to retire by 2006. The continuing increase in the number of retirement-age employees makes it difficult for DoD to maintain an institutional memory and to

develop the skilled civilian workers, managers, and leaders it will need to meet future requirements.

The DoD has undertaken a number of initiatives to transform its forces including adopting a capabilities-based approach to planning based on clear goals and to improve the linkage between strategy and investments. The Department recognized the need for a strategic plan for the civilian workforce by publishing the first civilian human resources strategic plan. The strategic plan imparts the Department's direction, with its vision, values, principles, critical success goals, and objectives.

The Department is developing and implementing a common DoD-wide military personnel system. The DoD audit community issued 13 reports on Human Capital issues. The OIG DoD reported that DoD achieved standardization of basic civilian personnel processing and reduced its personnel staffing levels by implementing regionalization and modernizing its systems. However, the Military Departments, the National Guard Bureau, and Defense organizations did not fully use the capabilities of the system and most added or planned to add nonstandard applications to the system to support their business practices. System users also had to perform numerous workarounds and received frequent software patches to make the system work. The Naval Audit Service reported that the Navy was using production recruiters in support positions (clerical and administrative jobs) as opposed to recruiting. When the Navy increased the number of recruiters (5,000 in fiscal year 2002), it did not increase the number of support billets. Recruiting districts were then forced to fill these positions from "out of hide" resources. The auditors calculated that recruiters spent a total of 901 enlisted recruiter workyears and \$58.4 million doing non-recruiter related work and identified a total of \$13.9 million to \$19.8 million that could be put to better use over the remaining Five Year Defense Plan.

An Army Audit Agency report found the combination of administrative requirements, high operational tempo, and force protection negatively affected the ability of the unit to train and execute its primary mission. Units weren't able to train the way they would fight because key personnel were withdrawn from the unit or tasked within the unit for force protection duties, borrowed military manpower and details, and court-martial and chapter processes. Burdens also were placed on units to maintain primary administrative systems. In addition, units had to perform secondary administrative requirements so they weren't as proficient in meeting their primary mission requirements.

**Financial
Management
Audits**

The Air Force Audit Agency reported 50 percent of the 168,000 men and women enlisting in the Air Force from fiscal years 1998 through 2002 took advantage of the Initial Enlistment Bonus Program and received between \$1,000 and \$17,000 upon completion of basic military and technical training. During the audit, Air Force officials modified the pay system to ensure that bonus payments are made on time.

The Department faces financial management problems that are complex, longstanding, pervasive, and deeply rooted in virtually all business operations throughout the Department. These problems have impeded the Department's ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting and policy decisions. The problems have also prevented the Department from receiving a clean opinion on its financial statements. During the reporting period the DoD audit community issued 84 reports on Financial Management.

The Office of Management and Budget anticipates that the Department will be the only agency covered under the Chief Financial Officer Act that will not receive a clean opinion in fiscal year 2003. To help resolve these problems, the Department established the Financial Management Modernization Program. Part of the program (renamed the business Management Modernization Program) includes the business enterprise architecture that will be used to construct and guide the Department's future business environment. The Department has delivered the initial version of the business enterprise architecture and transition plan; however, much work remains.

The Department's high-risk areas and material control weaknesses will prevent the Federal Government from achieving a clean opinion on their consolidated financial statements in fiscal year 2003. Of these high-risk areas and material control weaknesses, the most significant problem is the financial management systems. The Department currently relies on approximately 2,300 systems, including accounting, acquisition, logistics, and personnel systems, to perform its business operations. Many of these financial management systems do not comply substantially with Federal system requirements. In addition, there is little standardization across the Department, multiple systems performing the same task, identical data stored in multiple systems, manual data entry into multiple systems, and many workarounds and off-line records to translate data from one system to another.

The Army Audit Agency performed two reviews to ensure that automated feeder and financial systems meet requirements to provide accurate, timely, and valued information for managers and for preparation of financial statements. During these reviews the Army Audit Agency worked with the system developers during development to make sure the system has the necessary requirements built into the system and is working before deployment. These system reviews allowed the Army to take significant steps forward in financial management by deploying systems that will meet financial and functional requirements.

The OIG is working closely with the Department to address the administration's requirement for accelerated submission of audited financial statements. The OIG, at the request of the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, completed a study of the "size and scope" requirements to audit the Department's financial statements and establish a long-term audit strategy for auditing the Department's annual financial statements. If the recommendations from this study are implemented, the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer anticipate a clean opinion for the fiscal year 2007 financial statements. We support the high priority being given to providing accurate, timely, and reliable financial statements by the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer and the Defense Finance and Accounting Service (DFAS). Until the Department installs its new financial management architecture and integrated systems, it must rely on workarounds and manual compilations of financial data that are prone to errors. One OIG DoD audit reported that DoD did not have fundamental controls over the use of closed appropriations. During fiscal year 2001 and the first half of fiscal year 2002, the DFAS reported \$3.1 billion (absolute value) of adjustments to closed appropriations to the U.S. Treasury.

The OIG issued a report critical of how the DFAS was managing the investments for the Medicare Eligible Retiree Health Care fund. The lack of oversight and an investment strategy resulted in investments in short-term Treasury securities instead of long-term Treasury securities paying higher interest rates. The report estimated that \$6.9 billion in additional investment income could result from investing in long-term securities. In response to the report, the Under Secretary of Defense (Comptroller)/Chief Financial Officer initiated action to establish a DoD Investment Board with a charter, advisors from the private sector, and performance metrics.

The Air Force Audit Agency reported that Air Force government-furnished property managers did not adequately support, validate, and reconcile Miscellaneous Obligation Reimbursement Documents that resulted in \$54.5 million in unsupported reimbursement documents, unneeded obligations, and incorrect payments. By deobligating unneeded funds, managers could make available \$17.6 million for other uses.

The Naval Audit Service reported that the Naval Sea Systems Command had not established a recovery-auditing program consistent with Public Law 107-107. Consequently, the command had no means to identify and recover potential duplicate and erroneous contractor payments.

**Information
Security
Audits**

Information security is a cornerstone of Homeland Security. The information security threat to DoD systems and to other public and private sector systems, on which national security depends, is greater than ever. The DoD audit community issued 20 reports related to Information Security. Many of the reports are classified or For Official Use Only.

**Joint Warfighting
and Readiness
Audits**

For U.S. forces to operate jointly in conflict, they must also train and operate together in peacetime. Ensuring that U.S. forces are ready to carry out assigned missions is the preeminent responsibility and challenge of the DoD. A wide variety of Defense functions, particularly in personnel management, logistics, and acquisition areas, directly support and impact joint warfighting and military readiness. The DoD audit community issued eight reports related to joint warfighting and readiness.

The Naval Audit Service issued two reports on the Marine Corps using combat essential personnel to perform duties other than its billeted military occupational specialty and combat-related training.

**Information
Technology
Management
Audits**

The key to success on the modern battlefield and in internal business activities is the ability to produce, collect, process, and distribute information. Data must be accurate, timely, secure, and in usable form. The huge scale, unavoidable complexity, and dynamic nature of DoD activities make them heavily dependent on automated information technology. This dependence has proven to be a major challenge because DoD management techniques have not kept pace with the continual growth in information user requirements and the shortened life spans of technologies before obsolescence. The President's Management Agenda initiative on Expanded Electronic Government will assist the Department in meeting this management challenge.

The DoD audit community issued 15 reports related to information technology management. One OIG report on the Global Command and Control System - Joint Operation Planning and Execution System (JOPES) found the fielding of the most current version, JOPES 21, had fallen 46 months behind schedule because of insufficient project oversight. The Defense Information Systems Agency, the Program Manager for JOPES 21, agreed to provide greater attention to integrated logistics support planning and increase use of baseline management and performance-based service contracting.

There are also problems with information available on the Internet. A Naval Audit Service report determined that in one of four cases reviewed, classified weapon system information deemed “Secret and above” was present on websites in the public domain. An Air Force Audit Agency report determined that Air Force managers had not formulated and published a plan for migration of land mobile and other radio based devices.

In addition, auditors began reporting on progress in developing the DoD business enterprise architecture necessary to respond to Office of Management and Budget and congressional requirements, as well as to support its transforming initiatives. Auditors found that DoD has neither a single DoD-wide definition of a business management information technology system nor a systems inventory to support the business enterprise architecture initiative. This condition also makes the budgeting process for DoD information technology investment opaque to senior managers and impedes DoD responsiveness to Office of Management and Budget data calls and interdepartmental initiatives.

Logistics Audits

The DoD spent more than \$80 billion a year on logistics support operations for supplies, transportation, and maintenance costs. This includes \$40 billion, and nearly 700,000 military and civilian personnel and several thousand private sector firms, involved in the maintenance of more than 300 ships, 15,000 aircraft and helicopters, 1,000 strategic missiles, 350,000 ground combat and tactical vehicles, and hundreds of thousands of additional support assets. In addition, DoD maintains an inventory of items such as clothing, engines, and repair parts valued at an estimated \$63 billion to support the warfighter. The purpose of logistics is to reliably provide the warfighter with the right material at the right time to support the continuous combat effectiveness of the deployed force. The Department has strategic plans and numerous pilot programs to help improve logistics.

Control and accountability of material stored, used, and repaired at DoD depot maintenance facilities continues to be problematic. In fiscal year 2002, the DoD spent an estimated \$15.3 billion for depot maintenance. The proper management of this important function requires that adequate controls and procedures be in place and followed to ensure that assets remain viable to the materiel managers and that proper quantities be maintained. The DoD audit community issued 48 reports on logistics issues during the reporting period. The OIG DoD issued one report that identified \$20.4 million of parts that were either unaccounted for or excess to known requirements at one depot maintenance facility. Further, the error rate in the depot's inventory record was 11 percent. The OIG DoD also reported in a followup audit that the Army and the Navy had taken actions to improve procedures and controls to account for depot level repairable inventories; however, management needed to address several issues to further improve the inventory accountability.

The Army Audit Agency reported that, on a limited basis, the management and implementation of the Army Total Asset Visibility capability achieved its intended goals of providing operational and logistics managers with a means to obtain and act on information about the location, quantity, condition, and movement of Army assets. However, the full usefulness of this data was diminished because of a myriad of problems associated with the reliability and completeness of the data. For two of the four major automated systems that fed data to the capability, material variances existed between the asset balances recorded in the source systems and data reflected in the capability. In addition, source system owners needed to improve the reliability of data recorded in their systems and reported to the capability.

An Air Force Audit Agency report showed that the depot maintenance personnel could repair aircraft transparencies (canopies) using robotic polishing technology that base-level personnel traditionally condemned for disposal. The Naval Audit Service reported that the Marine Corps continues to store and maintain prepositioned inventory in Norway even though the strategic threat that rationalized the program ended with the demise of the Soviet Union. The Marine Corps plans to spend about \$45 million for operations and maintenance and about \$110 million to modernize through replacement of some of the prepositioned inventory during fiscal years 2003 through 2008.

**SIGNIFICANT OPEN
RECOMMENDATIONS**

Managers accepted or proposed acceptable alternatives for 324 (99 percent) of the 326 OIG DoD audit recommendations made in the last 6 months of fiscal year 2003. Many recommendations require

complex and time consuming actions, but managers are expected to make reasonable efforts to comply with agreed-upon implementation schedules. Although most of the 1,005 open actions being tracked in the OIG DoD follow up systems are on track for timely implementation, there were 224 reports more than 12 months old, dating back as far as 1990, for which management has not completed actions to implement the recommended improvements.¹

We are concerned that DoD was not benefiting from the recommended improvements and was not meeting the intent of the Inspector General Act to complete corrective actions promptly. To accelerate implementation of the corrective actions, the Inspector General wrote to each component head responsible for the delinquent recommendation and requested their assistance in completing the needed actions. This resulted in increased senior DoD leadership involvement in implementing the overdue corrective actions.

Significant open recommendations that have yet to be implemented include the following:

- Recommendations made in 1997 and 2000 to improve policy guidance on handling potentially dangerous munitions residue on training and test ranges. The applicable DoD instruction and implementing guidance are still being staffed.
- Recommendations made in 1998 to improve management of the electromagnetic frequency spectrum are partially accomplished, but final guidance has still not been issued.
- Recommendations made in 2000 to improve controls over the release of technical information ("deemed exports") to foreign governments and individuals.
- Recommendations made in 2000 to implement a process for prioritizing security clearance requests to improve the efficiency of the DoD personnel security clearance investigative efforts.

1. Section 6009 of the Federal Acquisition Streamlining Act, as amended, provides: "If the head of the agency fails to complete final action with regard to a management decision within the 12-month period, the inspector general concerned shall identify the matter in each of the inspector general's semiannual reports pursuant to section 5(a)(3) of the Inspector General Act of 1978 (5 U.S.C. App.) until final action on the management decision is completed." A list of OIG DoD reports on which management decisions have been made but final action has not been taken is continued in the Secretary of Defense Report issued pursuant to section 5(a) of the Inspector General Act.

- Recommendations made in 2001 addressing the effectiveness of the DoD Financial Management improvement plan. The recommendations will be implemented through the DoD financial management modernization program. The Department has developed a DoD-wide Business Enterprise Architecture and a transition plan to implement the architecture. However, implementation will be a long-term effort.

**COMMENTS ON
LEGISLATION/
TESTIMONY**

Section 4(a) of the Inspector General Act requires the Inspector General “to review existing and proposed legislation and regulations relating to the program and operations of [the Department of Defense]” and to make recommendations “concerning the impact of such legislation or regulations on the economy and efficiency in the administration of programs and operations administered or financed by [the Department] or the prevention and detection of fraud and abuse in such programs and operations.” The OIG routinely receives legislation for review that has been referred to the Department of Defense for comment.

During the current reporting period, the Inspector General commented on the following legislative items:

- National Defense Authorization Act for FY 2004, H.R. 1588, Title XI, Subtitle B, Department of Defense National Security Personnel System. The Inspector General supported this provision that provides increased flexibility to the DoD to manage civilian personnel.
- National Defense Authorization Act for FY 2004, H.R. 1588, section 1442, Authorization of Additional Commercial Contract Types. The Inspector General opposed this provision that would permit the use of time and material contracts or labor-hour contracts for the procurement of commercial services that are commonly sold to the public through such contracts.
- National Defense Authorization Act for FY 2004, H.R. 1588, section 1443, Clarification of Commercial Services Definition. The Inspector General opposed this provision that eliminates the word “catalog” from the definition of commercial services. The changes would allow a contractor to claim any service, including basic research and development, as commercial if the contractor claims it plans to sell the service to the public.

- National Defense Authorization Act for FY 2004, H.R. 1588, section 1444, Designation of Commercial Business Entities. The Inspector General opposed this provision that expands when a business can be designated a commercial business entity. Under the proposal, a business entity with at least 90 percent (in dollars) of the sales of the enterprise over the past three business years made to private sector entities could consider any item or services it offers or sells, including military unique items, to be a commercial item.
- National Defense Authorization Act for FY 2004, H.R. 1588, section 1454, Applicability of Certain Provision to Sole-Source Contracts for Goods and Services Treated as Commercial Items. The Inspector General opposed this provision. Section 1454 and section 1444 (discussed above) would allow contractors selling military unique items to be exempt from protections provided by the Cost Accounting Standards (CAS) and the Truth in Negotiations Act (TINA) and make DoD subject to higher prices for military unique items and services. The effect of the combined changes made by sections 1444 and 1454 is to raise the threshold for the application of the TINA from \$550,000 to \$15,000,000.
- National Defense Authorization Act for FY 2004, H.R. 1588, Section 903, Standards of Conduct. The Inspector General concurred with proposed comments by the Office of Government Ethics (OGE) objecting to Section 903 which would require the Secretary of Defense to promulgate standards of conduct for members of the Defense Policy Board and the Defense Science Board. The OGE noted that members of these boards are subject to standards of conduct applicable to all executive branch employees.
- H.R. 479, to authorize Army arsenals to undertake to fulfill orders or contracts for articles or services in advance of the receipt of payment under certain circumstances. The Inspector General supported this legislation which would help resolve a long-standing problem related to the Pilot Program on Sales of Manufactures Articles and Services of Army Industrial Facilities.

Additionally, the OIG DoD is given the opportunity to provide information to Congress pertinent to legislation under its consideration by participating in congressional hearings.

On June 25, 2003, Mr. Paul Granetto, Director, Defense Financial Auditing Service, testified before the Subcommittee on Government Efficiency and Financial Management, House Committee on Government Reform on Defense Financial Management. Mr. Granetto testified on the obstacles faced by the DoD in obtaining a clean audit opinion on its agency-wide financial statements. His testimony also described initiatives being taken by the Department to modernize its business management systems in order to enable the Department to comply with federal accounting and financial management reporting requirements. The OIG has also reorganized its financial auditing operations to focus additional resources on auditing the various Defense financial statements and assisting the Department in achieving favorable opinions.

The Honorable Joseph E. Schmitz, Inspector General of the Department of Defense, submitted a statement for the record for a hearing held July 29, 2003, by the House Budget Committee on Fraud, Waste, and Abuse in Mandatory Programs. The Inspector General's statement focused on fraud within the TRICARE and military retirement pay and survivor benefit programs. The OIG, through the DCIS, and in cooperation with other federal, state, and local law enforcement agencies, maintains a proactive program to investigate fraud in these programs. The Inspector General stated that, since fiscal year 2000, the DCIS has initiated 427 health care related investigations and 27 investigations involving fraudulent payments for military retirement and survivor benefits. Over this time period, the DCIS recovered over \$45 million as a result of health care fraud investigations and \$587,000 as a result of investigations of military retirement and survivor benefits.

The OIG also regularly reviews new and revised regulations proposed by the DoD. During this reporting period the OIG reviewed 96 draft issuances or re-issuances of DoD directives, instructions, manuals, and other policy guidance.

INTELLIGENCE

The Intelligence Community Inspectors and Auditors General continue to evaluate programs and operation of importance to DoD and the congressional oversight committees. Ninety-four reports were completed by the Office of the Inspector General of the DoD, the IGs of Defense Intelligence Agency, National Imagery and Mapping Agency, National Reconnaissance Office, National Security Agency the Naval Audit Service, the Air Force Audit Agency, the Army Audit Agency,

and the Defense Contract Audit Agency. The reports are categorized into the General Accounting Office High Risk Areas as shown in Figure 5.

IG and Audit Agency Evaluations				
GAO High Risk Areas	OIG DoD	Military Departments	Defense Agencies	Total
Human Capital Management	2	0	5	7
Information Security	2	2	7	11
Systems Modernization	1	1	1	3
Financial Management	4	7	8	19
Infrastructure Management	3	11	14	28
Inventory Management	0	0	1	1
Weapon Systems Acquisition	0	0	1	1
Contract Management	5	0	11	16
Other	0	0	8	8
TOTAL REPORTS ISSUED	17	21	56	94

Figure 5

See the Classified Annex to this report for a listing and summaries of the 94 reports.

The Intelligence Community Inspectors and Auditors General continued to share information and improve the effectiveness and efficiency of oversight of DoD intelligence activities. The Intelligence Communities Inspectors General Forumserves as a mechanism for sharing information among Inspectors General whose duties and responsibilities include audit, inspection, or investigation or programs and operations of Intelligence Community elements. The Information Assurance Working Group, established by the intelligence Community Inspectors General Forum in 1999, monitors and evaluates the status of management policies and oversight efforts to protect the Intelligence Community systems. See the Classified Annex to this report for information on meetings of these groups.

Within DoD, the Joint Intelligence Oversight Coordination Group works to improve the effectiveness and efficiency of DoD oversight intelligence activities by identifying areas needing more emphasis, and deconflicting various oversight programs. The group is comprised of senior representatives of the Office of the Secretary of Defense and

Military Department audit, evaluation, and inspection organizations. At the September 29, 2003 meeting, Mr. Steven Cantrell, Deputy Assistant Secretary of Defense for Intelligence Oversight briefed the group on Intelligence Operations matters. The group also discussed other matters of importance to the intelligence oversight, audit, and inspection community.

APPENDIX A*
REPORTS ISSUED BY DOD INTERNAL AUDIT ORGANIZATIONS

Excludes base level reports issued by the Air Force Audit Agency and memorandum reports and consulting reports issued by the Army Audit Agency. Includes evaluation reports issued by the OIG DoD.

Copies of reports may be obtained from the appropriate issuing office by calling:

OIG DoD
(703) 604-8937

Army Audit Agency
(703) 681-9863

Naval Audit Service
(202) 433-5525

Air Force Audit Agency
(703) 696-8027
(703) 697-8014

Summary of Number of Reports by Management Challenge Area
April 1, 2003 - September 30, 2003

	IG, DoD	Military Depts.	Total
Financial Management	15	69	84
Acquisition	23	56	79
Logistics	8	40	48
Readiness	1	7	8
Information Technology Management	4	11	15
Infrastructure and Environment	4	17	21
Homeland Security	5	15	20
Human Capital	0	13	13
Health Care	1	5	6
Other	2	5	7
Total	63	238	301
For information on intelligence-related reports, including those issued by other Defense agencies, refer to the classified annex to this report.			

* Partially fulfills requirements of the Inspector General Act of 1978, as amended, 5 U.S.C., Appendix 3, Section 5(a)(6) (See Appendix B).

**FINANCIAL
MANAGEMENT**

IG DoD

D-2003-073 Reliability of the FY 2002 National Imagery and Mapping Agency Financial Statements and Adequacy of Related Procedures and Controls (CLASSIFIED) (4/2/03)

D-2003-074 Report on Reliability of the FY 2002 Defense Intelligence Agency Financial Statements and Adequacy of Related Procedures and Controls (CLASSIFIED) (4/7/03)

D-2003-079 Promptness of FY 2003 Third Quarter DoD Payments to the Department of the Treasury for District of Columbia Water and Sewer Services (4/15/03)

D-2003-082 Joint Operation Planning and Execution System Funding (4/25/03)

D-2003-084 Ordnance Accountability at Fleet Combat Training Center Atlantic (4/29/03)

D-2003-091 Reliability of the FY 2002 National Security Agency Financial Statements and Related Procedures and Controls (CLASSIFIED) (5/14/03)

D-2003-094 Allegation Concerning Financial Management at the Civilian Personnel Management Service (5/23/03)

D-2003-095 Accounting for Reimbursable Work Orders at Defense Finance and Accounting Service Charleston (6/4/03)

D-2003-118 Promptness of FY 2003 Fourth Quarter DoD Payments to the Department of the Treasury for District of Columbia Water and Sewer Services (7/15/03)

D-2003-119 Controls Over DoD Medicare Eligible Retiree Health Care Fund Investments (7/31/03)

D-2003-122 Closing the Army's 1985 M1A1 Tank Contract (Contract Number DAAE07-85-C-A043) (8/13/03)

D-2003-123 Corps of Engineers Equipment Reporting on Financial Statements for FY 2002 (8/20/03)

D-2003-124 Certification of a DoD Payment for Telecommunications Services (8/22/03)

D-2003-127 Allegation of Improper Accounting for Direct Billable Hours by the Defense Finance and Accounting Service (8/28/03)

D-2003-133 Controls Over DoD Closed Appropriations (9/15/03)

Army Audit Agency

A-2003-0169-FFG Independent Auditor's Opinion--Secretary of Defense/Joint Staff Welfare and Recreation Association Fund--Financial Statements (4/1/03)

A-2003-0200-AMW Stock Funded Depot Level Repairable Credit Policy, Office of the Program Executive Officer, Tactical Missiles (4/3/03)

A-2003-0213-FFG Review of the Army Management Control Process (Fiscal Year 2002), U.S. Army Intelligence and Security Command, Fort Belvoir, Virginia (4/8/03)

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D-2003-076 Document Automation and Production Service Public/Private Competition (FOR OFFICIAL USE ONLY) (4/8/03)

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N2003-0051 Weapon Systems Information Available on the Internet (5/20/03)

N2003-0055 Department of the Navy Antiterrorism Risk Assessment Management Approach for Naval District Washington (6/25/03)

N2003-0071 Intrusion Vulnerability of the Corporate Enterprise Training Activity Resource System (8/8/03)

Air Force Audit Agency

F2003-0008-FB4000 United States Air Forces in Europe Information Security Program and Practices (FOR OFFICIAL USE ONLY) (4/16/03)

F2003-0009-FB4000 Controls Over Classified Web Pages (FOR OFFICIAL USE ONLY) (4/17/03)

F2003-0003-FD3000 Memorandum Report, Homeland Security Policy (6/11/03)

F2003-0010-FB4000 Air Force Space Command Information Security Program and Practices (FOR OFFICIAL USE ONLY) (6/30/03)

F2003-0012-FB4000 Air Combat Command Information Security Program and Practices (FOR OFFICIAL USE ONLY) (8/14/03)

F2003-0013-FB4000 Air Force Materiel Command Information Security Program and Practices (FOR OFFICIAL USE ONLY) (8/19/03)

F2003-0014-FB4000 Certification and Accreditation of Air Force Classified Systems (FOR OFFICIAL USE ONLY) (8/20/03)

F2003-0015-FB4000 Controls Over Web Applications (FOR OFFICIAL USE ONLY) (9/2/03)

HUMAN CAPITAL

Army Audit Agency

A-2003-0166-FFF Courseware Development for Distance Learning, U.S. Army Training And Doctrine Command (5/2/03)

A-2003-0306-FFP Workers' Compensation, U.S. Army Pacific, Fort Shafter, Hawaii (6/16/03)

A-2003-0329-FFB Workers' Compensation Program (6/26/03)

A-2003-0301-IMU Administrative Burden on Units, 1st Infantry Division, U.S. Army, Europe and Seventh Army (6/27/03)

A-2003-0312-AMA Projected Personnel Savings, U.S. Army Contracting Agency (6/30/03)

A-2003-0415-FFF Advanced Individual Training Courses, U.S. Army Air Defense Artillery School, Fort Bliss, Texas (8/27/03)

Naval Audit Service

N2003-0047 Use of Navy Recruiters to Perform Administrative and Support Jobs (5/6/03)

N2003-0063 Civilianizing the Marine Corps Nonappropriated Fund Audit Service (7/23/03)

N2003-0072 Justification of Military Billets (8/8/03)

N2003-0087 Marine Corps East Coast Bases' Utilization of Combat Essential Personnel (9/11/03)

Air Force Audit Agency

F2003-0001-FD2000 Quick Reaction Report, Controls Over the Army and Air Force Exchange Service - Cash Discounts (FOR OFFICIAL USE ONLY) (6/10/03)

F2003-0001-FD4000 Initial Enlistment Bonus Program (8/4/03)

F2003-0002-FD2000 Air Force Drug Testing Laboratory (8/21/03)

HEALTH CARE

IG DoD

D-2003-113 Franchise Business Activity Contracts for Medical Services (6/30/03)

Army Audit Agency

A-2003-0286-IMH Contracting for Medical Goods and Services, Contract DADA10-01-C-0010, U.S. Army Medical Command (6/5/03)

A-2003-0336-FFP Third Party Claims, Tripler Army Medical Center, Honolulu, Hawaii (6/26/03)

A-2003-0352-IMH Unpaid Medical Claims for FYs 99-00 at Madigan Army Medical Center, U.S. Army Medical Command (7/17/03)

A-2003-0369-IMH Unpaid Medical Claims for FY 01 at Madigan Army Medical Center, U.S. Army Medical Command (7/22/03)

A-2003-0406-IMH Followup Issues-Administrative Controls Over Sensitive Drugs, Madigan Army Medical Center, Tacoma, Washington (8/21/03)

OTHER

IG DoD

D-2003-069 Interagency Review of Federal Export Enforcement Efforts (FOR OFFICIAL USE ONLY) (4/18/03)

D-2003-131 Cooperative Threat Reduction Program: Solid Rocket Motor Disposition (9/11/03)

Army Audit Agency

A-2003-0270-IMT Management Control Process, California Army National Guard (5/21/03)

A-2003-0292-FFP Federal Oversight of the Hawaii National Guard (6/12/03)

A-2003-0428-AMA The Unit Set Fielding Process (9/17/03)

Naval Audit Service

N2003-0046 Program C (CLASSIFIED) (5/2/03)

N2003-0058 Program D (CLASSIFIED) (7/14/03)

APPENDIX B*
OIG DOD AUDIT REPORTS ISSUED CONTAINING
QUANTIFIABLE POTENTIAL MONETARY BENEFITS

Audit Reports Issued	Potential Monetary Benefits	
	Disallowed Costs ¹	Funds Put to Better Use
D-2003-107 DoD Petroleum War Reserve Requirements (U) (6/26/03)	N/A	\$20,400,000
D-2003-119 Controls Over DoD Medicare Eligible Retiree Health Care Fund Investments (7/31/03)	N/A	6,900,000,000
D-2003-130 Accountability and Control of Materiel at the Ogden Air Logistics Center (9/5/03)	N/A	20,400,000
Totals		\$6,940,800,000
¹ There were no OIG audit reports during the period involving disallowed costs.		

* Partially fulfills the requirement of the Inspector General Act of 1978, as amended, 5 U.S.C., Appendix 3, Section 5(a)(6) (See Appendix A).

Waivers of Advisory and Assistance Service Contracts

A review is made of each waiver granted by the Department for advisory and assistance services contracts related to testing support. This review is required by Section 802, Defense Authorization Act for Fiscal Year 1990.

The Department made no waivers during the period and therefore, no reviews were made by the OIG.

APPENDIX C*
FOLLOWUP ACTIVITIES

DECISION STATUS OF INSPECTOR GENERAL ISSUED REPORTS WITH RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE (\$ in thousands)		
Status	Number	Funds Put to Better Use¹
A. For which no management decision had been made by the beginning of the reporting period.	22	\$123,400
B. Which were issued during the reporting period.	61	6,940,800
Subtotals (A+B)	83	7,064,200
C. For which a management decision was made during the reporting period.	57	90,000
(i) dollar value of recommendations that were agreed to by management		
- based on proposed management action		21,800
- based on proposed legislative action		
(ii) dollar value of recommendations that were not agreed to by management		68,200 ²
D. For which no management decision has been made by the end of the reporting period.	26	6,974,200
Reports for which no management decision was made within 6 months of issue (as of September 30, 2003).	3 ³	33,400
¹ There were no OIG DoD audit reports issued during the period involving "disallowed costs." ² Management has agreed to take the recommended actions, but the amount of agreed monetary benefits cannot be determined until those actions are completed. ³ OIG DoD Report No. D-2003-023, "The Reserve Retirement Repository System," issued November 15, 2002, and OIG DoD Report No. D-2003-061, "The Development of the Navy Standard Integrated Personnel System," issued March 12, 2003, had no management decision as of September 30, 2003. OIG DoD Report No. D-2003-021; "Export Controls Over Biological Agents," issued November 12, 2002, also had no management decision as of September 30, 2003, but was decided October 1, 2003.		

*Fulfills requirements of the Inspector General Act of 1978, as amended, 5 U.S.C., Appendix 3, Section 5(a)(8)(9)&(10).

APPENDIX D
CONTRACT AUDIT REPORTS ISSUED¹
(\$ in millions)

Type of Audit ²	Reports Issued*	Amounts Examined	Questioned Costs ³	Funds Put to Better Use
Incurring Costs, Ops Audits, Special Audits	15,997	\$53,336.9	\$675.1	\$90.3 ⁴
Forward Pricing Proposals	5,145	\$98,920.2	--	\$3,977.7 ⁵
Cost Accounting Standards	1,304	\$149.7	\$43.5	--
Defective Pricing	394	(Note 6)	\$37.9	--
Totals	22,840	\$152,406.8	\$756.5	\$4,068.0

¹This schedule represents Defense Contract Audit Agency (DCAA) contract audit reports issued during the 6 months ended September 30, 2003. Both "Questioned Costs" and "Funds Put to Better Use" represent potential cost savings. Because of limited time between availability of management information system data and legislative reporting requirements, there is minimal opportunity for the DCAA to verify the accuracy of reported data. Accordingly, submitted data is subject to change based on subsequent DCAA authentication.

²This schedule represents audits performed by DCAA summarized into four principal categories, which are defined as:

Incurring Costs - Audits of direct and indirect costs charged to Government contracts to determine that the costs are reasonable, allocable, and allowable as prescribed by the Federal Acquisition Regulation, Defense Federal Acquisition Regulation, and provisions of the contract. Also included under incurred cost audits are Operations Audits, which evaluate a contractor's operations and management practices to identify opportunities for increased efficiency and economy; and Special Audits, which include audits of terminations and claims.

Forward Pricing Proposals - Audits of estimated future costs of proposed contract prices, proposed contract change orders, costs for redeterminable fixed-price contracts, and costs incurred but not yet covered by definitized contracts.

Cost Accounting Standards - A review of a contractor's cost impact statement required due to changes to disclosed practices, failure to consistently follow a disclosed or established cost accounting practice, or noncompliance with a CAS regulation.

Defective Pricing - A review to determine whether contracts are based on current, complete, and accurate cost or pricing data (the Truth in Negotiations Act).

³Questioned costs represent costs that DCAA has questioned because they do not comply with rules, regulations, laws, and/or contractual terms.

⁴Represents recommendations associated with Operations Audits where DCAA has presented to a contractor that funds could be used more effectively if management took action to implement cost reduction recommendations.

⁵Represents potential cost reductions that may be realized during contract negotiations.

⁶Defective pricing dollars examined are not reported because the original value was included in the audits associated with the original forward pricing proposals.

*Applies to Army Corps of Engineers and DCAA only.

APPENDIX E
STATUS OF ACTION ON SIGNIFICANT POST-AWARD CONTRACT AUDITS¹
(\$ in thousands)

	Number of Reports	Costs Questioned	Disallowed Costs ⁶
Open Reports:			
Within Guidelines ²	431	\$421,744	N/A ⁷
Overage, greater than 6 months ³	269	\$613,133	N/A
Overage, greater than 12 months ⁴	252	\$875.613	N/A
In Litigation ⁵	173	\$2,547,892	N/A
Total Open Reports	1,125	\$4,458,382	N/A
Closed Reports	425	\$974,990	\$390,464 (40.05%)
All Reports	1,550	\$5,433,372	N/A

¹This schedule represents the status of Defense Contract Audit Agency reports on incurred costs, defective pricing, and noncompliance with the Cost Accounting Standards as reported by the Army, Navy, Air Force, Defense Contract Management Agency, and TRICARE. Contract audit followup is reported in accordance with DoD Directive 7640.2, "Policy for Followup on Contract Audit Reports." Because of limited time between availability of the data and reporting requirements, there is minimal opportunity to verify the accuracy of the reported data.

²These reports are being processed within the time frames established by OMB Circular A-50, Audit Followup, and DoD Directive 7640.2.

³OMB Circular A-50 requires that audit reports be resolved (the contracting officer decides on a course of action) within 6 months after report issuance.

⁴DoD Directive 7640.2 states that audit reports are overage if not dispositioned within 12 months from date of issuance. Disposition is achieved when the contractor implements audit recommendations, the contracting officer negotiates a settlement with contractor, or the report is superseded.

⁵Of the 173 reports in litigation, 25 are under criminal investigation.

⁶Disallowed costs are costs sustained by the contracting officer in negotiations with contractors.

⁷N/A (not applicable)



Friedrich Wilhelm Augustus von Steuben was the Inspector General of the Continental Army and served under General George Washington. He is recognized as the "Father of the Inspector General System" of the United States Military.



Inspector General Department of Defense



This report, as well as audit report and testimony text, are available on the Internet at: www.dodig.osd.mil
Additional information on or copies of this report may be obtained by writing or contacting:

Office of the Inspector General of the Department of Defense
Office of Communications and Congressional Liaison
400 Army Navy Drive, Arlington, VA 22202-4704

Mr. John R. Crane 703-804-8324; DSN 664-8324

NO MONEY SHALL BE DRAWN FROM THE TREASURY, BUT IN CONSEQUENCE OF APPROPRIATIONS MADE BY LAW;
AND A REGULAR STATEMENT AND ACCOUNT OF THE RECEIPTS AND EXPENDITURES OF ALL PUBLIC MONEY SHALL BE
PUBLISHED FROM TIME TO TIME. U.S. CONSTITUTION - ARTICLE I, SECTION 9