INSPECTOR GENERAL’S STATEMENT OF MANAGEMENT AND PERFORMANCE CHALLENGES FOR FY 2014

Each year, the Inspector General, DoD (DoD IG) prepares a statement that summarizes what he considers to be the most serious management and performance challenges facing the Department and a brief assessment of the Department’s progress in addressing these challenges. The DoD IG cited challenges are in addition to those identified by the Government Accountability Office in its February 2013 biennial report, entitled High Risk Series, An Update.

For FY 2014, the DoD IG identified challenges in the following seven categories:

• Financial Management
• Acquisition Processes and Contract Management
• Joint Warfighting and Readiness
• Cyber Security
• Health Care
• Equipping and Training Afghan National Security Forces
• The Nuclear Enterprise

Detailed discussion of the DoD IG’s statement and the Department management’s response follows.
### SUMMARY OF IDENTIFIED CHALLENGES

#### 1. IG-Identified Challenge: Financial Management

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<tr>
<th>1-1A. Achieving Financial Statement Audit Readiness</th>
<th>IG Summary of Challenge</th>
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The Department’s financial management challenges impair its ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting, and policy decisions. Gaps in the financial framework harm the accuracy, reliability, and timeliness of budgetary and accounting data and financial reporting, reducing the effectiveness of decisions made by leaders at all levels. The key to solving the Department’s financial management problems is the production of auditable financial statements and receiving unmodified opinions on them.

Achieving auditable financial statements is a long-standing and daunting task. The success of the DoD financial improvement and audit readiness (FIAR) effort depends on the Department’s ability to accomplish the following:

- Resolve material internal control weaknesses to ensure internal controls are properly designed, properly implemented, and working effectively.
- Sustain improvement in internal controls and systems to provide consistent and repeatable financial data used in decision making and reporting.
- Effectively develop and implement the financial improvement effort by monitoring DoD progress in achieving milestones, developing comprehensive improvement initiatives across DoD functional areas, and holding managers accountable for the timely implementation of these efforts.

Congress requires the Department to validate its Statement of Budgetary Resources (SBR) and the other DoD financial statements as audit ready by September 30, 2014, and September 30, 2017, respectively. However, the Department continues to struggle with effective and timely development and implementation of their business transformation efforts. Furthermore:

- **Public Law 111-383, Section 881** requires the Department to establish interim milestones to achieve audit readiness of its financial statements earlier than September 30, 2017. These interim milestones for Military Departments and Defense Components call for the achievement of audit readiness for each major element of the SBR, such as “civilian pay, military pay, supply orders, contracts, and the funds balance with the Treasury.”

- **Public Law 112-81, Section 1003** requires the Department have a plan that includes interim objectives and a schedule of milestones for each Military Department and for the Defense agencies, to support the goal of validating the SBR as audit ready by September 30, 2014. The Department must aggressively pursue the development and implementation of comprehensive improvement initiatives and must monitor progress according to interim milestones. The Department may need to revise these initiatives and milestones as it identifies additional deficiencies and corrective actions as a result of DoD’s iterative FIAR process.

- **Public Law 112-239, Section 1005(b)(1)** requires that the plans to achieve audit readiness of the SBR “by September 30, 2014, include steps to minimize one-time fixes and manual work-arounds, be sustainable and affordable, and not delay the full auditability of financial statements.”
Public Law 113-66, Section 1003(a) requires that the Secretary of Defense ensure that a full audit of the DoD financial statements for FY 2018 is performed and the results of the audit submitted to Congress not later than March 31, 2019.

Although the Department did not meet the 2014 deadline for full SBR audit readiness, the Department continues to make progress. Because the Department recognized that it could not achieve SBR audit readiness by 2014, an incremental approach to achieving SBR audit readiness was implemented. The Department has chosen to address SBR audit readiness incrementally by focusing on the current year information contained in the SBRs of the General Funds.

Specifically, the limited scope FY 2015 SBR audits will be on current-year appropriation activity and transactions, which the Department calls the “Schedule of Budgetary Activity” (SBA). As a result, the Department’s initial audit efforts will focus on the SBA. The Department plans on achieving audit readiness for the SBR by the 2017 due date that was originally planned for all financial statements. Since the 2014 deadline for SBR audit readiness has been a challenge for the Department, meeting the 2017 deadline for all DoD financial statements to be audit ready remains an even more significant challenge as the Department must also focus on the audit readiness of the remaining portions of the SBR, implementation of the enterprise resource planning systems (ERPs), and achieving audit readiness of the full financial statements. Additionally, results of the FY 2015 SBA audits may identify additional internal control weaknesses that require corrective action, which may further delay the Department’s plans for achieving audit readiness.

The Department must continue to develop and implement a comprehensive plan that identifies the interim objectives and schedule of milestones to achieve audit readiness of the full SBR for both the General and Working Capital Funds. In addition, the interim milestones must address the existence and completeness of each major category of DoD assets, which includes general equipment, real property, inventory, and operating material and supplies, to achieve audit readiness of the full financial statements.

1-1B. Achieving Financial Statement Audit Readiness

Although the Department is far from reaching an unmodified opinion on its financial statements, it has made progress. The DoD senior leadership has placed an increased emphasis on achieving this goal. The DoD IG believes this increased senior leadership emphasis is essential to the Department’s ability to meet its internal milestones as well as to make progress in achieving full SBR audit readiness and meet the 2017 audit readiness mandates.

Despite pervasive and long-standing Department financial management problems, the U.S. Army Corps of Engineers – Civil Works, and various Defense agencies, such as the Defense Commissary Agency and Defense Contract Audit Agency, and the Military Retirement Fund, have received unmodified audit opinions. The Department must sustain its achievements as well as advance in the remaining significant areas.

The Department continues to make progress toward meeting the 2014 audit readiness goal of the SBR; however, the Department has modified its strategy based on the U.S. Marine Corps (USMC) audit experience. The Military Services now plan to assert audit readiness on the SBA. The USMC encountered many challenges during this first type of audit, which resulted in disclaimers of opinion in FY 2010 and FY 2011. However, progress was seen in the Corps’ ability to produce supporting documentation on transactions within the SBA, and the USMC achieved an unqualified opinion on its FY 2012 SBA. As a result, the USMC is undergoing subsequent SBA audits. The USMC, the Navy, and the Department are using USMC experience to correct weaknesses, as well as prepare the other Military Services for their eventual SBR audits.
The May 2014 FIAR Plan Status Report (FPSR) only addressed audit readiness for certain aspects of the SBR and stated that the Department did not expect every Component to achieve a clean audit opinion on its SBA in FY 2015. The Department reported in the November 2011 FPSR, and continued to report in the May 2014 FPSR, that it had significantly changed its audit goals to include achieving audit readiness of the General Fund SBR by the end of FY 2014, in addition to achieving audit readiness of all DoD financial statements by the end of FY 2017. However, in the November 2012 FPSR, the Department reported it would limit first-year SBR audits in FY 2015 to audits of schedules containing only current-year appropriation activity, that is, a Schedule of Budgetary Activity (SBA).

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

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<th>1-1C. Achieving Financial Statement Audit Readiness</th>
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<td>The Department generally agrees with the DoD IG’s assessment of the Department’s status and progress in achieving financial statement audit readiness. The Department’s goal of achieving audit readiness on the SBR remains the same. However, the strategy for achieving that goal has been modified to limit the scope of initial audits.</td>
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<td>The Department has focused consistently on achieving SBR audit readiness by September 30, 2014. Audit readiness means strengthening internal controls and improving financial practices, processes, and systems used to manage the Department’s budgetary resources so there is reasonable confidence the information can withstand an audit by an independent auditor. The Department modified the strategy to limit the scope of initial audits to focus on current year budgetary transactions reported on a Schedule of Budgetary Activity (SBA). The SBAs rely on the same internal controls and financial practices, processes, and systems as the SBR and contain a substantial subset of the financial information reported on the SBR.</td>
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<td>The change in strategy was based on lessons learned from the U.S. Marine Corps SBR audit. The Marine Corps was unable to produce documentation supporting historical transactions associated with SBR beginning balances quickly enough to meet the audit timelines. Historical documentation (for example, requisitions, receiving reports, and invoices) exists primarily in paper form and is dispersed across various commands and activities. The Marine Corps was, however, able to produce documentation for current-year transactions, and in December 2013, the Marine Corps became the first DoD Military Service to receive an unmodified (clean) audit opinion on its FY 2012 SBA.</td>
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<td>The Department’s modified strategy implements a sensible and cost effective approach to validating SBR audit readiness by way of SBA audits in FY 2015 through FY 2017. Beginning balances will be addressed during the SBA audits and will be audit ready by September 30, 2017, prior to full financial statement audits in FY 2018. This sensible approach has been favorably received by the Government Accountability Office (GAO) and the DoD IG.</td>
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### 1-2A. Modernizing Financial Systems (Enterprise Resource Planning)  
#### IG Summary of Challenge

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

The Department noted in the May 2014 FIAR update that the ERPs continue to be essential to the Department’s audit readiness efforts. However, not all ERPs will be fully deployed for the FY 2015 SBA audits or the 2017 readiness deadlines. This will require the Department to continue to rely on legacy systems.

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

The Department plans to spend about $15 billion to develop and implement ERPs. These systems have experienced cost increases and schedule delays. The Department noted that some ERPs will not be fully deployed by the 2014 and 2017 audit readiness dates, and therefore, it must continue to rely on legacy systems. This will increase the risk that the audits of the FY 2015 SBR, or a schedule of current year budget activity, will not be successful and may not result in unmodified opinions, and that the Department will not meet the goal of full financial statement audit readiness by September 30, 2017. Reliance on legacy systems, along with schedule delays and poorly developed and implemented ERPs, will diminish the savings expected from transforming operations through business system modernization.

Furthermore, without fully deployed ERPs, the Department will be challenged to produce reliable financial data and auditable financial statements without resorting to extreme efforts, such as data calls or manual work-arounds, to provide financial data on a recurring basis. For example, the Department reported in the May 2014 FIAR Plan Status Report that the Air Force ERPs will not be fully deployed by 2014. As a result, the Department may need to rely on a combination of ERPs and legacy business and financial systems to conduct the SBA and SBR audits.

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

Without the effective and timely development and implementation of ERP systems, and without senior-level governance, the Department will continue to struggle to improve its financial management processes, achieve long-term sustainability of those improvements, and timely, and meaningful financial management information for internal and external users. Recent audits continue to find that system program managers have not configured systems to
Additionally, other audits have found that the Department has not sufficiently reengineered its business enterprise architecture processes nor incorporated the functionality in ERP systems. The Department has established certification requirements, and the Deputy Chief Management Officer and Deputy Chief Financial Officer have established validation and certification procedures for implementing SFIS requirements and ensuring business process reengineering has taken place; however, these procedures were not stringent enough to ensure compliance. The Department needs to continue to improve its validation and certification procedures.

1-2C. Modernizing Financial Systems (Enterprise Resource Planning)  
Department Response

The Department is committed to improving financial processes through the implementation of ERPs. In support of these efforts, the Department has been working diligently to improve business processes and oversee the development of the ERPs in support of auditability.

While it is true that legacy systems will continue to be used, the ERPs that have been implemented resulted in phasing out dozens of legacy systems. Several of the Department’s ERPs support the 2017 auditability goal. Where the Department is dependent on legacy systems, the Components’ Financial Improvement Plans incorporate those actions necessary to ensure that accurate, reliable financial information is reported.

Modernizing DoD business systems is a key aspect of our overall effort to achieve and sustain auditability. The Department plans to achieve the audit goals with a combination of both target and legacy systems. While taking proactive steps to align individual ERP programs with auditability outcomes, we also are focused on delivering audit-ready processes and controls that will remain outside the ERP systems. This will allow us to develop a sustainable business environment that can be cost-effectively audited.

The ERP programs, by their very nature, are designed to:

- Handle detail transactions in a defined, end-to-end process;
- Enforce process and execution standardization among implementing organizations;
- Manage consolidated business data in a single repository that allows centralized access control, and
- Facilitate the flow of information both within an organization and with external stakeholders.

These design principles within the ERPs directly enable the capabilities that are essential to auditability, such as the ability to trace all transactions from source to statement and to recreate a transaction; documented, repeatable processes and procedures; demonstrable compliance with laws, regulations and standards; and a control environment sufficient to reduce risk to an acceptable level.

Essentially, ERPs are acquired with industry best practices/“to-be” processes embedded within them. Each of the ERPs’ programs went through significant, up-front blueprinting and gap analysis to determine which configuration or customization would be necessary for the system to work within its particular business environment. The Department has focused on properly enforcing compliance with the target financial management environment, built on a backbone of the core ERP systems and aligned with the Business Enterprise Architecture’s end-to-end processes.
The Department’s investment management process ensures:

- Investments are aligned to functional strategies;
- The Department makes more informed investment decisions;
- Legacy systems that are no longer required are eliminated;
- Enhanced interoperability, and
- The Department transforms to an environment where business applications can be rapidly deployed on a common computing infrastructure.

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

To implement this investment management process, the Deputy Chief Management Officer issued guidance to ensure the Department continues to treat its business system investments with the purpose and discipline that will enable cost savings to be redirected to critical operational needs of the warfighter. The guidance, updated annually, includes an integrated business framework to align broad, DoD strategy with functional and organizational strategy to guide system implementations. The integrated business framework uses Functional Strategies and Organizational Execution Plans (OEP) to help achieve the Department’s target business environment.

The Financial Management (FM) Functional Strategy describes the Department’s financial management business mission area’s strategic vision, goals, target environment, and expected outcomes over the next five years. Key components of the FM functional strategy include FM data standards, process/system improvements, and how to leverage technology to assist the Department improve efficiency and effectiveness of FM processes.

In response to OSD Principal Staff Assistants’ (PSA) functional strategies, the Military Departments and Defense Agencies develop OEPs that describe how their business system portfolios will achieve the PSA’s directions and initiatives. The OEPs also provide more detailed information on how information technology investments align to the functional strategy initiatives.
### 1-3A. Improper Payments

**IG Summary of Challenge**

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

The Department faces difficulties in the completeness and accuracy of its improper payment reviews and the information reported. Additionally, the lack of an auditable Statement of Budgetary Resources (SBR) leaves the Department unable to reconcile outlays to the quarterly or annual gross outlays reported in the SBR to ensure all required payments for reporting purposes have been captured. These areas require improvement before the Department will be able to provide complete and accurate information on its estimated amount of improper payments.

### 1-3B. Improper Payments

**IG Assessment of Progress**

Although the Department made strides to improve the identification and reporting of improper payments and took many corrective actions to implement recommendations made by the DoD IG, more work is needed to improve controls over payments processed throughout the Department.

The Department complied with five of the six improper payment reporting requirements for FY 2013. Although improper payment rates for the reported payment programs were below the Office of Management and Budget established threshold, the Department did not achieve its improper payment reduction targets for five of eight payment programs with established targets. Further, for the second consecutive year, one of the payment programs did not meet its target rate. Not attaining reduction targets indicates that additional corrective actions are needed to reduce improper payments. In addition, the Department had deficiencies in the methodologies for five of the nine payment program areas that could affect the reliability of DoD’s improper payments estimates.

We commend the Department on aggressively pursuing recovery of identified improper payments, but unless it continues to improve its methodology for reviewing all its disbursements, it will likely not identify and accurately estimate the amount of improper payments. As a result, the Department will likely miss opportunities to identify causes of improper payments and implement effective corrective actions to prevent future improper payments.

### 1-3C. Improper Payments

**Department Response**

The Department appreciates DoD IG’s recognition of our efforts to minimize improper payments and our aggressive pursuit to recover identified improper payments. The Department has addressed the sampling methodology deficiencies to improve the integrity of the post-payment review results, and we continue to take ownership and corrective actions to address the recommendations in the latest DoD IG and GAO reports.

While the Department continually strives to reduce improper payments, it should be noted that the payment error rates experienced in most of DoD’s programs already are very low, many lower than half of one percentage point (detailed reporting on the DoD improper payment program is addressed in the “Other Information” section of this report).
The Department is collaborating with OMB to consider establishing more reasonable tolerance levels around the target reduction goals that consider the cost effectiveness of required remediation plans when the goals are not met or when actual payment error rates are very low. All of these actions, coupled with the Department’s progress toward achieving audit readiness, will increase public confidence in the Department’s stewardship of taxpayer dollars as well as strengthen the fundamentally sound DoD improper payments program.
## 2. IG-Identified Challenge: Acquisition Processes and Contract Management

### 2-1A. Enhancing the Acquisition Workforce

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<th>IG Summary of Challenge</th>
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<td>The Department’s senior leadership remains dedicated to continuously improving the size and the capabilities of its acquisition workforce. While the Department has made progress in growing its workforce to meet the demands placed on it by the volume and complexities of its programs and contracts, the Department needs to shift its focus to sustain the number of resources needed to execute the acquisition mission and increase opportunities for training and development.</td>
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In addition to improving the professionalism of the acquisition workforce, which is an initiative of Better Buying Power 2.0 (explained in Section 2-1B, below), Department leaders remain concerned over the effects of budget uncertainty and cuts. The budget instability decreases morale and negatively impacts the ability to recruit, train, and retain skilled acquisition professionals. The Department also faces significant challenges in the acquisition community resulting from an aging workforce. Over the next decade, over 50 percent of the acquisition workforce will be eligible for retirement. Accordingly, it will be critical that the Department plan for and invest in targeted training, education, and certification of the acquisition workforce left to succeed those leaving.

### 2-1B. Enhancing the Acquisition Workforce

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<td>Since reaching a maximum strength of 152,326 civilian and military personnel in 2012, the Department has since seen a decline of 1.3 percent in overall strength, to 150,247 personnel, in the third quarter of FY 2014. The issues related to the DoD acquisition workforce, however, do not relate only to the number of resources, but to the quality and the capability of the personnel the Department employs. For FY 2015, the Department plans to invest approximately $500 million using the Defense Acquisition Workforce Development Fund, of which the President requested $212.9 million in direct appropriations from Congress to support strategic objectives and continuous improvement of the defense acquisition workforce. Keeping in line with current initiatives, the funding will support both the remaining hiring of personnel to complete the rebuilding initiative and limited hiring for critical needs. It also will support training, development, and improvement of the acquisition workforce needed to increase buying power; modernize and reset our military force; improve acquisition outcomes; and ensure future technological superiority. As efforts in these areas continue, oversight and commitment remains imperative.</td>
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### 2-1C. Enhancing the Acquisition Workforce

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<td>The Department concurs with the DoD IG’s statements on the challenge and progress made in enhancing the acquisition workforce. Consistent with the President’s FYs 2014 and 2015 budget requests and the <em>Quadrennial Defense Review 2014</em> (QDR) objectives, strong leadership emphasis and initiatives will continue to move us toward objectives to improve acquisition productivity, increase buying power, and increased efficiencies. A necessary element of achieving these objectives requires continuous improvement and resources to sustain and strengthen the capability and professionalism of the acquisition workforce.</td>
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### 2-2A. Weapon System Acquisition

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<td>The Department remains challenged in its management of Major Defense Acquisition Programs (MDAPs), which declined from 85 in 2012 to 80 in 2013. While the number of programs within DoD’s portfolio decreased between FY 2012 and FY 2013, the overall cost of the programs increased by $14.1 billion. Furthermore, DoD programs cannot stay within the confines of cost and schedule estimates, as demonstrated by cost growth of over $14.1 billion and average schedule delays of over two months. With the expectation that defense budgets will continue to decline in the future, it will be more important than ever for the Department to identify opportunities to reduce costs and achieve efficiencies in its processes throughout the lifecycle.</td>
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### 2-2B. Weapon System Acquisition

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<td>Four years ago, DoD implemented the first iteration of the Better Buying Power and two years later, implemented the second set of initiatives known as Better Buying Power 2.0. While there is evidence that progress was made in areas such as program affordability, life-cycle costing and bottom-up estimating, competitive contracting, and program management, the cost and schedule growth attributable to the acquisition of major defense programs remained significant and demonstrated the need for additional work. The DoD IG audits continue to identify significant programmatic issues, such as poorly defined requirements, duplicate and redundant capabilities, incomplete system testing, improper fielding, and procurement quantities in excess of what is needed to successfully execute its mission. The enormity of the investment in weapon systems acquisition and the role it plays in making U.S. forces capable warrants continued oversight and a long-term commitment to process improvement. The need to continue support for the warfighter and the potential for savings argue against complacency.</td>
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### 2-2C. Weapon System Acquisition

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<td>Weapons Systems Acquisition has been and continues to be a high priority for DoD leadership. This commitment is reflected in the Department’s Better Buying Power (BBP) Initiatives and more recently in the interim revision of DoD Instruction 5000.02, which describes the policies applicable to the defense acquisition system. The DoDI 5000.02 revision, issued in November 2013, institutionalizes many of the BBP Initiatives. Key policy changes include affordability constraints for every program; a requirements decision point to ensure requirements are well understood, technically achievable, and affordable; enhanced emphasis on thoughtful business arrangements, to include better use of contract incentives and maintenance of a competitive environment; more effective developmental and operational testing – and much more. Department acquisition leadership aggressively monitors implementation of these policies via the Under Secretary of Defense for Acquisition, Technology, and Logistics (USD AT&amp;L) Business Senior Integration Group, program decision events, and careful review of periodic reports. Our objective is continuous, incremental improvement based on pragmatism and evidence.</td>
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2-3A. Contract Management

The Department continues to struggle to provide consistent effective oversight of its contracting efforts. The Department continues to face contracting deficiencies in these areas: obtaining adequate competition in contracts; defining contract requirements; overseeing contract performance; obtaining fair and reasonable prices; and maintaining contract documentation for contract payments.

Service contracts represent more than 50 percent of the Department’s contract spending. The Department faces several challenges in contract oversight and administration of services contracts. Without proper oversight, which DoD IG audits continue to identify, the Department cannot be certain that contractors are performing in accordance with contract requirements, may have overpaid for increases in contract costs, and cannot ensure that services are performed. This leaves the Department vulnerable to increased fraud, waste, and abuse.

The Department continues to face challenges in obtaining fair and reasonable prices for parts. Audits first started identifying problems with price-based acquisition and commercial pricing in the late 1990s, and it was not until 2008 that legislative changes allowed Contracting Officers to request information on labor costs, material costs, and overhead rates for commercial items.

More recently, the Department has moved to new performance-based logistics (PBL) arrangements, which have added a new challenge to obtaining fair and reasonable prices for parts since the Services now are procuring parts from the weapons systems contractors instead of other sources, such as the Defense Logistics Agency (DLA). These parts often are purchased unnecessarily and at higher prices rather than utilizing existing DLA inventory.

2-3B. Contract Management

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

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

Because service contracts make up the majority of the Department’s purchases, the BBP 2.0 area of improving tradecraft in the acquisition of services is very important. For the acquisition of services, the Department is focusing on assigning senior managers, improving requirements definitions, preventing requirements creep, and strengthening contract management outside the normal acquisition chain, among other initiatives.

As part of its goal of incentivizing productivity and innovation in industry and government, BBP 2.0 will increase effective use of Performance Based Logistics (PBL) arrangements, by which the Department has achieved improved readiness at significant savings, when PBL arrangements are properly structured and executed. However, PBL success depends on the workforce having the expertise and support to properly develop and implement the PBL concept.
Even with the implementation of BBP 2.0, the Department continues to struggle with implementing Federal Acquisition Regulation revisions on the use of cost-reimbursement contracts. Contracting activities are still challenged in documenting:

1) The approval for a cost-reimbursement contract was at least one level above the Contracting Officer;
2) Cost-reimbursement contracts were justified;
3) How the requirements under the contract could transition to firm-fixed price in the future;
4) That Government resources were available to monitor the cost-reimbursement contract; and
5) That contractors had an adequate accounting system in place at contract award.

### 2-3C. Contract Management

#### Department Response

The Department agrees with the DoD IG’s summary of challenges and assessment of progress and continues to work aggressively to resolve the long-standing material weaknesses in contract management. Key initiatives include:

**Efforts to Improve Competition**

The USD(AT&L) recently announced measures to boost competition in contracting at the field level for lower-dollar value services contracts, where there is more opportunity for improvement. The USD(AT&L) memorandum, entitled "Actions to Improve Department of Defense Competition," dated August 21, 2014, identifies actions to improve competition consistent with BBP 2.0 Initiatives to Promote Effective Competition. The memorandum encourages collaboration and sharing of best practices that have been successfully employed to increase competition, improve quality and performance, and lower cost for supplies and services. Specific actions include:

- Address competition on a quarterly basis at the Business Senior Integration Group meetings to track and manage progress in competition using expanded competition metrics to identify opportunities for improvement.
- Employ business intelligence tools to identify opportunities for improvement.
- Require contracting officers to obtain feedback on competitive solicitations in which more than one offer was expected based on market research, yet only one offer was received, and
- Require active market research using mandatory Request for Information notices on non-competitive acquisitions.

The August 21, 2014 memo announced publication of "Guidelines for Creating and Maintaining a Competitive Environment for Supplies and Services in the Department of Defense." The guidelines are intended to provoke thought about the various approaches that may be employed to competitively fulfill the Department's requirements.

**Improve Tradecraft in Acquisition of Services**

Services acquisition continues to play a critical role as the Department begins reducing the size of the force and appropriately balancing the mission requirements against the unique capabilities provided by the three types of labor in the Department’s total workforce: uniformed military, DoD civilians, and contractors.
As stated in the DoD IG progress assessment, the USD(AT&L) recognized the need to develop more guidance, metrics, and oversight for services acquisition and focused these efforts through the BBP Initiatives. The Principal Deputy USD(AT&L) has been appointed as the DoD Senior Services Manager leading the contracted services initiatives, with the Deputy Director, Defense Procurement and Acquisition Policy (DPAP), Services Acquisition (SA), focused on day-to-day leadership and oversight of the Department’s efforts, as detailed below.

The USD(AT&L) appointed DoD Functional Domain Experts (FDEs) to serve as the DoD-level lead for his or her respective Portfolio Group or Portfolio Category. The FDEs will actively oversee the life-cycle process for the contracted services within their portfolio, including forecasting and budgeting, requirements definition and validation, procurement, active management, and oversight of contracted services.

The USD(AT&L) also directed the development of a new DoD Instruction on Defense Acquisition of Services, which will:

- Establish policy, assign responsibilities, and provide procedures for identifying, assessing, reviewing, and validating requirements for the acquisition of services;
- Establish a simplified and flexible management framework for translating approved services requirements into stable, affordable, and well-managed programs;
- Authorize decision authorities, consistent with statutory and regulatory requirements for the acquisitions of services, to tailor the procedures to best achieve cost, schedule, and performance objectives; and
- Provide additional capability and oversight of services contracts.

The Department also is engaged in developing data capabilities to help stakeholders (including resource sponsors, Military Departments, and FDEs) understand and actively manage the services we are buying. The DPAP developed a Business Intelligence tool to provide visibility into our spending and allow greater management and oversight.

The Services Acquisition Functional Integrated Product Team (SA FIPT) is leading new and leveraging ongoing initiatives, to include development/deployment of formal Service Acquisition training for SA stakeholders, both Defense Acquisition Workforce Improvement Act (DAWIA) and non-DAWIA populations, in the lifecycle management of services contracts. The SA FIPT has identified competencies for services stakeholders and identified/endorsed five online modules (CLCs 011, 222, 007, 004, & 017), two classroom classes (ACQ101 and ACQ265), and one mission-assistance capability (Services Acquisition Workshop) related to improving services acquisitions for use within and outside of the DAWIA workforce. Work continues on completing both competency and full curriculum development.

Better Buying Power 2.0 Initiatives

The Better Buying Power (BBP) 2.0 Implementation Guidance of April 24, 2013, included specific direction to “Increase effective use of Performance-Based Logistics.” The following recent policies and guidance address use of Performance Based Logistics (PBL) and assist the defense acquisition workforce in developing effective PBL product support arrangements.

- On May 27, 2014, the ASD (L&MR) (Acting) issued the DoD PBL Guidebook. The Guidebook is designed to serve as both a reference manual for experienced PBL practitioners as well as a practical "how-to" guide for "new-to-PBL" logisticians. The guidebook provides PBL best practices and practical examples (tenets, analytics, metrics, and draft RFP information) for developing performance-based arrangements.
Additionally, the Defense Acquisition University (DAU) has incorporated PBL learning assets into the Life Cycle Logistics curriculum and is working to incorporate performance-based learning assets into Program Management, Contracting, Systems Engineering, and Business/Financial Management curriculum.

An initiative implemented in BBP 2.0 is "Continue to increase the cost consciousness of the Acquisition Workforce – change the culture" under the "Improve the Professionalism of the Total Acquisition Workforce" focus area. The Director, DPAP, continues to focus on improving the capability of the contracting workforce to include quality-focused initiatives to strengthen the capability and readiness. In FYs 2013 and 2014, DPAP prepared to reassess the proficiencies of the contracting workforce to determine if progress has been made to address competency gaps identified from the 2009 competency assessment and to determine if new training gaps exist. In the third quarter of FY 2014, the competency reassessment was deployed to the 30,000 member contracting workforce. The results of the competency assessment will be used for the basis of human capital actions/workforce planning; updated/initiating training, increasing/improving leadership developmental opportunities, and the results allow the Department to make informed and sustained investments in the workforce.

The DPAP continues to collaborate with DAU on the curriculum for the contracting, purchasing, and industrial property career fields. The new curriculum incorporates more pricing, competition, contract administration, services acquisition, small business, and the BBP initiatives. Efforts to improve acquisition workforce staffing and training continued in FYs 2013 and 2014. Courses CLC 106, COR With a Mission Focus, and CLC 222, Contracting Officer Representative, are ranked number one and number three amongst the “most taken” DAU online learning assets.

As recent as June 9-13, 2014, the Director of Defense Pricing and the Director of DPAP hosted a collaborative event for pricing subject matter experts from across the Department. Representatives from the Air Force, Army, Navy, Defense Logistics Agency (DLA), Missile Defense Agency (MDA), Defense Contract Audit Agency (DCAA), and Defense Contract Management Agency (DCMA) participated. The event included advanced training on topics such as contract incentives, subcontractor pricing, the Truth in Negotiations Act, and commercial pricing, and also included time devoted to each Component sharing best practices, examples of overcoming pricing challenges, and pricing success stories. Sessions on subcontract analysis/subcontracting issues, commercial item pricing, and effective incentive contracting, as well as vigorous discussions on these topics, enabled the participants to share experiences with strategies which have proven successful, and to brainstorm about possible further evolutions of these strategies. The Senior Leader Question and Answer session on competition/source selection allowed the participants to not only get the DPAP perspective on the process, but to engage in dialogue about some of the issues currently being experienced across the Department. Going forward, it is expected that the participants will avail themselves of these connections with other pricing experts across the Department to develop robust approaches to address the most complex pricing issues facing the DoD Components.

The Department developed the Contracting Officer Representative Tracking (CORT) tool to track and maintain COR assignment. The web-based tool, hosted on the Wide Area Workflow portal, enables Military Departments and Defense Agencies to manage nomination, training and tracking of their respective cadres of CORs and the contract(s) assigned to each COR. As of September 4, 2014, there were 50,288 registered CORs. Of the number registered, the Army has 31,578 users.

In addition to the BBP and BBP 2.0 initiatives, DCMA continued to both establish new and to refine existing capabilities to assist the Acquisition Workforce in making better business decisions. The DCMA stood up a commercial pricing cell to assist Procuring Contracting Officers in making commercial item determinations and to facilitate the cost reasonableness of commercial items. Calendar year 2014 marks the first full year DCMA had fully-staffed and operational Integrated Cost Analysis Teams (ICATs), comprised of dedicated business and technical pricing personnel located at 11 major contractor divisions. Expectations are for the
ICATs to more aggressively pursue opportunities to reduce costs in the supply chain in their proposal pricing efforts, including targeted engagements at second and third tier suppliers. The DCMA initiated a formalized process for coordinating and selecting locations for the conduct of overhead should-cost reviews to maximize benefit for the Department.
3. IG-Identified Challenge: Joint Warfighting and Readiness

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

The United States removed its combat troops from Iraq and is drawing down its presence in Afghanistan. The lead for security responsibility in Afghanistan has transitioned to the Afghan government. The drawdown of forces from Afghanistan will continue to challenge the Services as they deal with retrograde and reset equipment, with much of the equipment being returned after exceeding utilization rates in many of their design operating parameters. The Department will be challenged to maintain the readiness of the forces as equipment is repaired or replaced.

The Services are engaged in a strategic rebalance to the Asia-Pacific region while continuing to maintain the global presence needed to protect national interests. While undergoing this rebalance, the Department will need to address a wide spectrum of challenges, ranging from increased reliance on uncertain host nation infrastructure to vast areas of responsibility – both requiring pre-positioning and the need for enhanced knowledge of various languages and cultural, ethnic, and religious sensitivities. The Department also continues to address emerging terrorism and instability challenges in AFRICOM’s area of operation. Growth in AFRICOM’s operational partnering mission raises the issue of sufficiency of its resources to address the terrorist threat. The Department returned some facilities in Europe and continues to move toward the completion of the Strategic Alliance in Korea. Global conflict and crises will continue to impact the Department’s rebalancing and resetting. It is critical that the Department address these challenges to ensure our military is agile, flexible, and ready for the full range of contingencies during this time.

Meanwhile, the new budget reality is being sensed across the Department, especially in areas such as maintenance of existing equipment and systems, fielding and implementation of new systems, and the frequency and extent of training and exercises. The impact of sequestration was felt almost immediately as the Navy adjusted repair and overhaul schedules for ships and the Air Force began restricting flying hours for squadrons. The Services and the combatant commands need to ensure that the impact of the current sequestration, as well as future budget reductions, has minimal impact on the ability to respond to future threats. The Services will be challenged to review their existing force structures and make necessary changes or adjustments, especially when those changes or adjustments involve paradigm shifts in how we view future scenarios.

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

The Department must assess warfighter capabilities and readiness across the full range of strategic, operational, and tactical considerations. This assessment includes large questions, such as whether the joint force is capable of achieving the strategic objectives set forth in the National Security Strategy, to the tactical focus on individual unit readiness. The Department is making progress in addressing the many difficulties in the drawdown in Afghanistan, resetting equipment, and ensuring the long-term viability of the all-volunteer force. However, the Department must also be ready to address fiscal challenges; if not addressed, those fiscal challenges will overtake any improvements or enhancements the Department intends to make in the near term.

The National Security Strategy released in January 2012 placed increased emphasis on the Pacific theater. The realignment of forces from Okinawa, Japan, to Guam still faces formidable challenges, which have increased projected costs and schedules.
The Services will have to train to fight in conventional and unconventional scenarios, and they will be challenged to do so with diminishing resources while maintaining their readiness. The Department must also provide the necessary levels of oversight to ensure that forces returning from Afghanistan, and their families, continue to receive the medical and other support they need.

As the drawdown continues in Afghanistan, the Department must ensure that adequate oversight of equipment being returned and the equipment reset process is properly managed so that only unusable equipment is disposed and that which is new is fielded to intended users. The DoD IG recently reported on concerns with the security of equipment staged for retrograde in Afghanistan. We also identified concerns with the contract oversight of the multimodal contract used to facilitate the transporting of equipment to the United States for reset.

Efforts to redeploy military units around the globe will enable the Services to better shape and focus their force structure to provide greater flexibility in responding to threats.

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<tr>
<th>3-1C. Joint Warfighting and Readiness</th>
<th>Department Response</th>
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<td>Turmoil around the world continues, ranging from the threat presented by ISIL in Iraq to the potential of an Ebola pandemic. Despite our continued high operations tempo, the Department remains committed to ensuring deployed forces around the globe are trained, equipped, and ready to perform their assigned missions. Deploying capable and ready forces for current operations continues to impact the non-deployed forces’ ability to prepare for full spectrum operations. Non-deployed forces are focusing their available training time to prepare for their next mission in support of Operation Enduring Freedom, or training to full spectrum readiness hedging against the need to execute other potential contingencies.</td>
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<td>The ongoing reduction of forces from Afghanistan has reduced the stress on forces in the near term; however, fiscal constraints will result in tough decisions on materiel, manpower, and infrastructure that could negate the positive aspects expected from the reductions in operational stress. Additionally, even with the reduction of ground forces in the Central Command area of responsibility, it is anticipated the demand for Naval and Air Forces will continue unabated for the foreseeable future.</td>
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<td>The Department is continually developing and refining comprehensive plans for both resetting and rebalancing the total force, which includes all Reserve Component forces, in the most effective and efficient manner possible. We recognize the most important part of maintaining joint warfighting capability and readiness is caring for the all-volunteer force and their families. During these times of fiscal austerity, particularly the potential to return to Budget Control Act funding levels, finding the proper balance between maintaining readiness, force structure sizing, modernization, and future threats remains the highest priority of the Department’s leadership.</td>
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### 4. IG-Identified Challenge: Cyber Security

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<tr>
<th>4-1A. Cyber Security</th>
<th>IG Summary of Challenge</th>
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<td><strong>Although the Department has operated in the information and cyberspace environment for years, making “cyber” a new domain of warfare in the 2010 Quadrennial Defense Review (QDR) brought it into the forefront of warfighter planning. However, bringing the cyber domain into parity with the more easily distinguished and widely developed air, land, and sea domains will remain a challenging task for the near future.</strong>&lt;br&gt;&lt;br&gt;As described in the National Military Strategy for Cyberspace Operations, cyberspace threats generally fall within six categories: traditional, irregular, catastrophic, disruptive, natural, and accidental. Addressing the rapidly increasing threats in the cyber domain is a priority. As such, developing offensive as well as defensive operations within the domain takes specialized equipment along with uniquely trained personnel.&lt;br&gt;&lt;br&gt;In the relatively short life of the newly described cyber domain, the Department has developed strategies for both offensive and defensive operations. In a June 12, 2013, statement before the Senate Committee on Appropriations, the Commander, United States Cyber Command stated, “We are improving our tactics, techniques, and procedures, as well as our policies and organizations. This means building cyber capabilities into doctrine, plans, and training – and building them in a way that senior leaders can plan and integrate such capabilities as they would capabilities in the air, land, and sea domains.” As stated by the Department’s past Chief Information Officer, “There will never be a time that we can assume a comfort posture.” As such, the Department must be ever vigilant to continuously invent and reinvent how it operates in the cyber domain.</td>
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<th>4-1B. Cyber Security</th>
<th>IG Assessment of Progress</th>
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<td><strong>The Department has made strides in developing strategies for operating in the cyber domain, developing frameworks for evaluating risks, and building its cyber workforce strategy for the future. The Department is establishing cyber support elements at several geographic combatant commands to provide both technical capability and expertise for the combatant commander. The Department continues to develop, refine, and implement programs and processes for the five initiatives identified in the Department of Defense Strategy for Operating in Cyberspace. The Department continues to invest in cybersecurity capabilities by expanding the cyber forces that will defend the networks, degrade adversary cyber capabilities, and support defense of National infrastructure.</strong>&lt;br&gt;&lt;br&gt;In March 2014, the Department issued instructions for the Risk Management Framework (RMF) for DoD Information Technology (IT). The instructions describe how cybersecurity requirements for DoD information technologies will be managed through RMF, consistent with the principles established by the National Institute of Standards and Technology. Also in March 2014, a new instruction on cybersecurity was issued to establish a cybersecurity program to protect and defend DoD information and information technology. The Quadrennial Defense Review 2014 commits the Department to dedicate additional resources to cybersecurity. Lastly, the Department continues to increase the number of high-level positions with a cyber leadership role. However, unlike in the air, land, and sea domains, accomplishments can be quickly overcome by the stream of threats, and the Department must continue to challenge all military, civilian, and contractor employees to successfully implement cyber security while operating in the cyber domain.</td>
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4-1C. Cyber Security

The Department continues to make progress in ensuring the strategic goals of the cyber environment are met. To ensure cyber security for the nation, the Cyber Mission Force was created. The Cyber Mission Force continues to mature to respond to cyber security demands of the nation. Several programs have been put in place to ensure the Cyber Mission Force is properly manned, trained, and equipped.

The Assistant Secretary of Defense for Global Strategic Affairs has been assigned the role of Principal Cyber Advisor to inform the Secretary of Defense on policy related to the Cyber Mission Force. The Department is examining the role of the National Guard and Reserve Component for the Cyber Mission Force. The department is leveraging cyber National Guard forces to coordinate train, advise, and assist the Cyber Mission Force. Using the National Guard in this capacity allows the Department to take advantage of the knowledge and training of both the military and private sectors. In addition, the Department is ensuring a right sized, properly trained and equipped civilian cyber force by ensuring the proper hiring policy and authority is in place to recruit the talent needed. Lastly, the Department is taking action to create a persistent training environment is available to certify the Cyber Mission Force is properly trained.

Per the National Defense Authorization Act for FY 2014, the Department recently submitted a report to Congress which made recommendations across a range of issues in support of cyberspace, including the manpower, recruitment, retention, roles, mission requirements, training, infrastructure and structure for the Reserve Components (RC). This report also addressed how the Military Services supply personnel to the Cyber Mission Force.

4-2A. Cyber Workforce

IG Summary of Challenge

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

In the current environment of economic uncertainty and fiscal constraints, the Department faces a significant challenge in filling the multitude of cyber positions it needs to operate, defend, and protect its networks. The Center for Strategic and International Studies issued a report, “A Human Capital Crisis in Cybersecurity,” April 2010, identifying a national shortage of skilled cyberspace personnel that could potentially impact DoD’s operational readiness and put national security at risk. Additionally, the most recent Government Accountability Office report, High Risk Series, An Update, February 2013, includes strategic human capital management and identifies information technology management/cybersecurity as a Government-wide mission critical occupation. As of 2014, DoD is in the process of building its cyber mission force to provide effective defense of the nation, support combatant command military operations, and defense of DoD Information Networks. However, it is still imperative that the Department continue focused efforts to recruit, train, and retain a cyber workforce in the competitive national environment to meet the threat.

4-2B. Cyber Workforce

IG Assessment of Progress

Training and retaining a skilled cyber force is one of the biggest gaps in the cyberspace domain. The Department has taken steps recently to build its cyber workforce. On November 21, 2013, the Deputy Secretary of Defense issued the “Department of Defense
Cyberspace Workforce Strategy,” identifying six strategic focus areas for building and maintaining a competent and resilient cyber workforce. For example, the Army developed a new military occupational specialty and graduated its first class of cyber network defenders in November 2013 as a means to building a cyber workforce. Also, the Deputy Secretary of Defense included funding in FYs 2014 and 2015 to field the approximately 6,000 personnel cyber mission force. In addition, the Department will add additional military and civilians to perform other cyberspace functions for U.S. Cyber Command, the combatant commands, and the Services related to defending networks, degrading adversary cyber capabilities, and supporting defense of national infrastructure. In addition, the 2014 budget adds resources to increase the quality and throughput of DoD’s training pipeline. Although the Department has made progress in beginning to build a cyber workforce, it must maintain momentum through implementation to ensure the resourcing initiatives allow DoD to recruit, train, and retain a competent cyber workforce.

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<th>4-2C. Cyber Workforce</th>
<th>Department Response</th>
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The Department has set a goal of 6,000 personnel trained, equipped, and working as the Cyber Mission Force by the end of fiscal year 2016. To facilitate success, the Department is ensuring the proper policy and authorities are in place to hire the right personnel to meet this goal. While personnel with cyber security skills remain in high demand, the Department has put incentives in place to attract world class talent.

The Department also is conducting the Civilian Cyber Workforce Challenges study, which will examine the current human resources systems and practices in place at the National Security Agency and United States Cyber Command to ensure that human resources and funding systems are flexible for a dynamic community.

Lastly, the Services are creating occupational series specifically for cyber missions. These new career fields will replace the existing model of taking personnel from disparate career fields to become part of the Cyber Mission Force. Instead, the new career fields will be used to supply personnel to the Cyber Mission Force.

To ensure the Cyber Mission Force is properly trained, the Department continues to mature the United States Cyber Command Training and Readiness Manual. This document details individual training requirements for the Cyber Mission Force. It has seen wide distribution and coordination throughout the Department throughout the creation process.

The Department continues to prioritize cyber workforce and has developed a strategy for providing a phased cyber workforce development that is large enough and strategically structured to secure, protect, and defend Department networks. Budget constraints, including indiscriminate cuts, put that strategy at risk.
5. IG-Identified Challenge: Health Care

5-1A. Health Care

The Military Health System (MHS) must provide quality care for 9.6 million beneficiaries within fiscal constraints while facing increased user demand, legislative imperatives, and inflation. These factors make cost control difficult in the public and private sectors. Over the last decade, health care costs continued to grow substantially, and MHS costs have been no exception. The DoD FY 2014 appropriations for health care were $32.7 billion, which is an increase of about 80 percent since FY 2005, and which has almost tripled since FY 2001 appropriations of $12.1 billion. However, the Department’s appropriations slightly decreased by $16 million from FY 2013. The Department reported that growing health care costs will limit its ability to fund medical readiness requirements.

Health care fraud is another challenge in containing health care costs. Health care fraud is among the top five categories of criminal investigations of the DoD IG’s Defense Criminal Investigative Service (DCIS). Specifically, as of March 31, 2014, DCIS had 322 health care cases representing 19.8 percent of the 1,725 open cases. The Defense Health Agency reported that during calendar year 2013, its program integrity unit managed 388 active investigations, opened 212 new cases, and responded to 931 leads or requests for assistance.

As the Military Health System continues to adapt to budgetary and force transformation constraints, the Department must maintain the medical readiness of the force. Challenges will include public health, suicide prevention, access to care, pre- and post-deployment health care, medication management, and Reserve Component health care. The Department continues to enable the recovery and transition of wounded, ill, and injured Service Members by using Wounded Warriors programs and the Integrated Disability Evaluation System. Due to the drawdown in Iraq and Afghanistan, the Military Services will be challenged with "right-sizing" their medical transition programs.

5-1B. Health Care

The Department’s efforts in controlling health care costs, while still ensuring our service men and women and their families receive the care they need and deserve, will continue to be a challenge. The MHS is focusing on many areas to manage health care costs per capita. Three managed-care support contracts are in effect; however, award protests resulted in staggered implementation of the new-generation TRICARE contracts. These contracts provide incentives for customer satisfaction and contractors for managed care support as partners in support of medical readiness. The Department continues to examine how the MHS purchases health care from the private sector.

The Department identified areas that assist in managing costs, including the use of the TRICARE Mail Order Pharmacy program. The DoD IG reported in July 2013 that the TRICARE Mail Order Pharmacy Program was more cost efficient than the retail program due to the difference in the cost of the pharmaceuticals. The Defense Health Agency Pharmacy Operations Directorate implemented an aggressive communication plan to encourage the increased use of receiving prescription drugs through the mail to reduce costs.

Also, through the authority provided in Section 703 of the FY 2008 National Defense Authorization Act, DoD obtains federal pricing discounts in the TRICARE retail network pharmacies in the form of refunds from pharmaceutical manufacturers. According to the Defense Health Agency, as of May 2014, DoD achieved savings to the Defense Health Plan of $493 million through the program. Finally, according to the Defense Health Agency, DoD achieved savings through DoD and VA joint pharmaceutical purchase contracts totaling $30 million in 2014, with further potential contracts pending totaling $129 million.
However, the Department continues to struggle with containing costs in the TRICARE Overseas Program. DoD IG reported in April 2014 that the Defense Health Agency and its overseas contractor officials did not negotiate rates in any of the 163 overseas locations, which represented $238 million in health care payments in FY 2012. TRICARE payments increased from $21.1 million in FY 2009 to $63.8 million in FY 2012, or about 203 percent, in six, high-dollar volume locations without negotiated rates or other cost containment measures. The Department did not agree to implement cost containment measures for these locations, but did agree to implement cost containment measures, similar to rates established by the Centers for Medicare and Medicaid Services, in the U.S. territories.

Since 2011, the IG has extensively assessed the efficiency and effectiveness of medical care and transition programs for wounded, ill, and injured Service Members. The Services have refined and improved these transition programs and have implemented plans to continually assess ongoing requirements.

The MHS Quadruple Aim Concept focuses on four factors in providing quality health care to DoD beneficiaries: readiness, population health, experience of care, and cost. Continuing to implement the MHS Quadruple Aim Concept should improve quality and reduce costs by focusing on improved care coordination and delivering care in the appropriate setting. Additionally, the MHS identified optimization of the pharmacy practices and implementation of the patient-centered medical home as strategic initiatives, both of which aim to increase the quality of health care while reducing its cost.

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<th>5-1C. Health Care</th>
<th>Department Response</th>
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<td>The Department acknowledges the summary of the DoD IG’s challenges and assessment of the Department’s progress regarding health care.</td>
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An Airman positions a Service Member for a CT scan at the Craig Joint Theater Hospital on Bagram Airfield, Afghanistan.

Photo by Staff Sgt. Evelyn Chavez
6. IG-Identified Challenge: Equipping and Training Afghan Security Forces

6-1A. Afghan National Security Forces

**IG Summary of Challenge**

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

- Developing ministerial capability to plan and manage resources and human capital;
- Ensuring enabling-force capabilities (combat support and combat service support elements) are fielded prior to withdrawal of Coalition capabilities;
- Measuring and reporting ANSF operational readiness and effectiveness;
- Professionalizing the ANSF;
- Ensuring the ANSF logistical system can support an independent and sustainable security force; and
- Preparing for post-2014 operations.

Coalition force drawdown and retrograde have added significant challenges as ANSF completes the transition to full Afghan government responsibility for security.

**Security Ministries.** The Department must continue its focus on advising and assisting the development of the resource management capabilities of the Ministry of Interior and Ministry of Defense. Budget planning and execution, training and development of human resources, increasing the ranks of civilian professionals, and leader emphasis on command and control of logistics are key areas for continued emphasis. Ensuring the capacity of the ANSF and U.S./NATO command to maintain accountability and control over direct funding and equipment provided via the U.S. Afghan Security Forces Fund remains a key challenge. Additionally, coordination between the Afghan National Army (ANA), Afghan National Police (ANP), Afghan Air Force (AAF), and Special Operations Forces will be important to ensuring a multi-layered, long-term defense against insurgents and criminals.

**Enabling Force Capabilities.** Completing the fielding of “enablers,” or military capabilities essential to building ANSF’s capacity to accomplish its missions, is increasingly important. Fielding and integration of combat and support capabilities in the ANA and ANP will remain a priority. As Coalition advisors and trainers are withdrawn, the Department must take steps to mitigate the impact of the withdrawal of coalition provided enabler capability. Additionally, the Department must continue to identify, assess, and address the training, advice, and assistance requirements for fielding enabling capabilities beyond 2014.

**Assessment of ANSF Progress.** Assessing capabilities and identifying capability gaps will become more difficult during Coalition force withdrawal. The Department’s visibility of the operational readiness and effectiveness of ANSF units is diminishing as the number of partner units and advisors continue to decrease. The challenge is to ensure sufficient skilled and qualified advisors are in key positions to continue assessing and developing ANSF leadership, command and control, and critical units.

**Professionalization.** The Department must continue to support ANSF’s current efforts to professionalize the force. Command reports show recruitment and management of initial training at the enlisted and officer levels are becoming ANSF strengths. Developing quality leadership, managing effective training at all army and police levels, providing career development opportunities, and maintaining accurate personnel records have all been identified as areas requiring a sustained effort to build a professional army and police force.
Post-2014 Operations. Although no decision has been made on when the transition of DoD’s security cooperation and assistance activities to the Department of State will occur, the Department should begin planning for an eventual transition. With the recent announcement by the President of a ceiling of 9,800 U.S. troops in 2015 in Afghanistan, reducing that presence to a Kabul-based presence, with a strong security assistance component by the end of 2016, careful deliberate planning is required to ensure timely progress in the development of a future DoD Office of Security Cooperation to provide ongoing security cooperation and support for the ANSF.

6-1B. Afghan National Security Forces

IG Assessment of Progress

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

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

Ministerial development is a primary emphasis, and the Coalition is increasing resource management training for security ministry personnel. Ministerial advisors are delivering assessments of the security ministry departments, reporting departmental setbacks as well as successes, and planning and revising training milestones and objectives as necessary. However, lack of sufficient experienced and trained advisors remains a challenge that the Command is trying to address.

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

Additionally, the shortage of qualified volunteers with sufficient education remains a challenge for ANSF; nevertheless, ANSF continues to support human capital development and training, particularly literacy training. The literacy program is on course to fully transition to ANSF ownership in January 2015. Literacy training is now mandatory for all ANA and ANP recruits.

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

Importantly, operational readiness and effectiveness of the ANA and ANP continues to show improvement. The Regional Command (RC) ANSF Status Report (RASR) in March 2014 assessed 62 of 85 key headquarters and units as either fully capable or capable, the two highest definition levels. With the decrease in advisor teams and advisor resources at the Corps and Police Headquarter level, Coalition forces are shifting to using Afghan reporting to understand ANSF capabilities. Challenges remain in getting reliable data with this newly developed ANSF self-assessment tool.

The ANSF assumed the lead for security nationwide on June 18, 2013 and remains on target to assume full responsibility for Afghanistan security by the end of 2014. Coalition forces have assumed a Train, Advise, and Assist role rather than a combat role, except for
force protection and certain counter-terrorism operations conducted with ANSF. As a consequence, Coalition casualties have been significantly reduced, but ANSF casualties have commensurately increased. The Coalition is providing equipment to mitigate this trend to the extent possible, especially with respect to Improvised Explosive Device (IED) attacks, which account for many of the ANSF wounded or killed.

The Coalition is monitoring the performance of ANSF in the current fighting season to determine its strengths and weaknesses. According to the “Report on Progress Toward Security and Stability in Afghanistan,” issued in April 2014 by the Secretary of Defense, the Ministry of Defense (MOD) and the Ministry of Interior (MOI) continued to make progress in both budget execution and accountability, and critical support functions, but still required coalition assistance and are expected to require support for the near future, particularly with logistics and facilities. There were ministerial developmental shortfalls in acquisition and financial management; strategic plans and policy; and human resource management. The ANSF capability development shortfalls were in command and control (C2), leadership, combined arms integration, training, and logistical sustainment. Developmental shortfalls consisted of counter-IED, medical, fire support coordination, special operations capabilities, including counterterrorism (CT), and air power. The Afghan Security Institutions and ANSF both continued to rely on support from ISAF to mitigate these shortfalls and gaps.

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<th>6-1C. Afghan National Security Forces</th>
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<td>The Department concurs with the DoD IG's assessment.</td>
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### 7. IG-Identified Challenge: The Nuclear Enterprise

#### 7-1A. Redefining the Importance of the Nuclear Enterprise and Overcoming Past Neglect

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<td>Following the Soviet Union’s collapse in 1991, the United States began to shift from a nuclear weapon-centric Cold War posture to a more dynamic and flexible force structure. Two Strategic Arms Reduction Treaties (START) and the 2010 Nuclear Posture Review (NPR) culminated in further steps to reduce the role of nuclear weapons in U.S. security strategy. Moreover, the NPR directs the Department to strengthen non-nuclear capabilities and reduce the role of nuclear weapons in deterring non-nuclear attacks. The shift in strategic priorities caused a cultural crisis throughout the nation’s nuclear forces, particularly in the Air Force. In June 2013, President Obama affirmed that the United States will maintain a credible deterrent, capable of convincing potential adversaries that the adverse consequences of attacking the United States, or its allies and partners, far outweigh any potential benefit they may seek to gain through an attack. The President reaffirmed that as long as nuclear weapons exist, the United States will maintain a safe, secure, and effective arsenal that guarantees the nation’s defense and that of U.S. allies and partners. The President has supported significant investments to modernize the nuclear enterprise and maintain a safe, secure, and effective arsenal. However, mishaps in the DoD nuclear enterprise, ranging from cheating scandals to fundamental errors in sustainment and acquisition, have tarnished the reputation of those providing the nation’s nuclear deterrent, while budgetary constraints have hampered modernization. Just as both the inadvertent transfer of nuclear warheads and the discovery of Intercontinental Ballistic Missile (ICBM) fuses accidentally shipped to Taiwan eroded the confidence in the bomber and logistics communities, several other high-profile incidents struck at the core of trust and reliability of the ICBM community in 2013 and 2014.</td>
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<th>IG Assessment of Progress</th>
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<td>This past year witnessed a setback in public perception of the integrity and professionalism of the nuclear force, primarily in the ICBM leg of the nuclear triad. A probe into cheating was launched in 2013 after a drug trafficking investigation involving missile launch officers revealed information on classified tests stored on cell phones. The investigation into the cheating resulted in the firing of nine commanders and the disciplining of 79 nuclear officers. This incident followed on the heels of failed inspections and disciplinary action for missile launch officers who had fallen asleep at their post. Finally, two Flag Officers were relieved of their nuclear duties due to off-duty incidents. The incidents throughout 2013 and 2014 resulted in both the Secretary of Defense and the Secretary of the Air Force acknowledging that systemic problems exist in the ICBM community. In January 2014, Secretary of Defense Hagel initiated an internal DoD review and an independent review of the entire nuclear enterprise in response to the cheating scandal and other failures in the ICBM community. The charter for the internal review directed an examination of the nuclear mission of both the Air Force and the Navy, to include personnel, training, testing, command oversight, mission performance, and investment. In addition, the Secretary of the Air Force, the Chief of Staff of the Air Force, and the Chief Master Sergeant of the Air Force visited all three ICBM wings in January 2014 to gather feedback</td>
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from the Force and to reinforce Air Force standards and expectations. The Secretary of the Air Force developed a seven-point action plan to address systemic problems in the nuclear community and delivered the action plan to Secretary Hagel in March 2014.

Air Force Global Strike Command developed the Force Improvement Program, which pulled input directly from airmen at the organizational level on the most pressing issues. The command is pressing forward with a series of initiatives under the Force Improvement Program to change and improve the culture of the airmen who perform the nuclear mission. Building on the success of the Force Improvement Program’s results from the ICBM wings, Air Force Global Strike Command initiated a similar effort for the B-52 wings at Minot Air Force Base (AFB) and Barksdale AFB, as well as the B-2 wing at Whiteman AFB.

Assessing the impact of these initiatives is premature, but this massive commitment of resources by senior leadership likely will improve morale and reinforce standards and expectations. As part of our FY 2015 project planning process, we are looking at potential projects that would follow up on these issues and corresponding Air Force actions.

### 7-1C. Redefining the Importance of the Nuclear Enterprise and Overcoming Past Neglect

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<td>The Department concurs with the DoD IG’s assessment.</td>
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An unarmed AGM-86B Air-Launched Cruise Missile is released from a B-52H Stratofortress over the Utah Test and Training Range during a Nuclear Weapons System Evaluation Program sortie. Conducted by Airmen from the 2nd Bomb Wing, Barksdale Air Force Base, La., the launch was part of an end-to-end operational evaluation of 8th Air Force and Task Force 204’s ability to pull an ALCM from storage, load it aboard an aircraft, execute a simulated combat mission tasking, and successfully deliver the weapon from the aircraft to its final target.

*Photo by Staff Sgt. Roidan Carlson*
### 7-2A. Modernizing the Nuclear Force in the Face of Declining Resources

**IG Summary of Challenge**

The U.S. nuclear triad of land-based Intercontinental Ballistic Missiles (ICBMs), submarine-launched ballistic missiles (SLBMs), and heavy bombers has served for decades in providing a survivable and capable deterrent force. In essence, the triad has only been modernized twice – once in the early 1960s and once in the 1980s. Every one of the systems, to include the Nuclear Command, Control, and Communications (NC3) system, will require significant modernization or replacement in the next two decades. Both the Senate and House Armed Service Committees are concerned with sustainment and replacement efforts in the DoD nuclear enterprise. Similarly, the Defense Science Board Standing Task Force on Nuclear Weapons Surety states that failures continue in fundamental areas, negatively affecting the fielded forces and the replacing or upgrading of old equipment.

### 7-2B. Modernizing the Nuclear Force in the Face of Declining Resources

**IG Assessment of Progress**

The Services have initiated several programs to transform the aging nuclear force into a modern, nuclear-deterrent arm capable of operating into the latter part of the 21st century. Renovating the nuclear enterprise entails sustaining nuclear assets and developing replacement systems that integrate the latest technologies. When completed in 2030, almost every component of the strategic nuclear force will be replaced or updated.

**Air Force**

**Long Range Strike Bomber (LRS-B):** The LRS-B is funded and in the acquisition cycle. The Air Force released a request for proposal and anticipates vendor selection in FY 2015. However, Air Force leaders have issued contradictory statements regarding whether the first bomber variant will be nuclear capable. This ambiguity raises questions about the Air Force’s strategic message that the nuclear mission is its number one priority, and is strikingly similar to the Air Force’s acquisition strategy to procure conventional F-35s first before producing a nuclear variant. Additionally, the Air Force has not announced a commitment to require the LRS-B to be hardened against Electro-Magnetic Pulse (EMP). Any plans for future nuclear weapon platforms must consider the existing threat environment.

**Sustaining current bombers:** While the LRS-B is in development and production, the current fleet of bombers still needs sustainment, both for conventional and nuclear missions. Some of the systems and particular parts are showing aging issues that affect the fleet’s readiness and reliability. Similar to other nuclear platforms, as these systems age, more parts fail for the first time, many with old or obsolete technologies. The cost to create a manufacturing base for parts that are no longer available is prohibitively expensive.

**Air Launched Cruise Missile/Long Range Stand-Off (ALCM/LRSO):** The LRSO effort will develop a weapon system to replace the Air Force’s ALCM, operational since 1986. The LRSO weapon system will be capable of penetrating and surviving advanced Integrated Air Defense Systems from significant stand-off ranges to prosecute strategic targets. The ALCM is well past its expected operational lifetime, but the LRSO missile will not begin development in fiscal year 2015, as was scheduled; instead, development will slip by three years, deferring almost $1 billion in spending beyond FY 2018.

**B61-12:** The B61 family of nuclear gravity bombs, which include components dating to the 1960s, is going through a life extension process to preserve capabilities while consolidating the variants currently fielded. This process is a joint venture with the Department of Energy (DOE), which requires that the Air Force synchronize its schedules with DOE to field life extension programs without further delay. The weapon’s planned modernization is required for
integration with the anticipated nuclear variant of the F-35, when it is nuclear capable, and the LRS-B.

**Minuteman III/Ground Based Strategic Deterrent:** The National Defense Authorization Act of 2007 directed the Air Force to sustain the Minuteman III (MMIII) ICBM until 2030. The MMIII has received several generations of sustainment and modernization, most recently focusing on propulsion replacement, guidance replacement, and Mk21 fuse refurbishment. At the same time, the Air Force must balance investment between the legacy system and the new Ground Based Strategic Deterrent (GBSD). The GBSD refers to the yet-to-be-determined follow-on to the MMIII. The requirement for the new GBSD was expressed in the April 2010 Nuclear Posture Review (NPR), which stated the "...U.S. Nuclear Triad of ICBMs, SLBMs, and nuclear capable heavy bombers will be maintained..." Thus, DoD began an initial study of alternatives in fiscal years 2011 and 2012. The studies identified a range of possible deployment options, with the objective of defining a cost-effective approach that "supports continued reductions in U.S. nuclear weapons while promoting stable deterrence," and "Exploring new modes of ICBM basing that enhance survivability and further reduce any incentives for prompt launch." Federally-mandated budget cuts, coupled with parts obsolescence for the legacy MMIII, put both sustainment of the MMIII and acquisition of the new GBSD at risk.

**Security Helicopter:** Despite continued congressional urging and a decade of studies highlighting the inadequacy of the UH-1 helicopter as an ICBM missile field security platform, the Air Force is still using aircraft with combat time dating to the Vietnam war. The FY 2014 budget request did not include funds for replacing the previously terminated Common Vertical Lift Support Platform, raising concerns in the Senate Armed Services Committee that the Air Force's number one priority to sustain an effective nuclear deterrent is being insufficiently supported.

**National Airborne Operations Center (NAOC) E-4B:** Aircraft availability has not met mission needs over the last two and a half years. In FY 2013, the lack of aircraft negatively manifested itself through significantly reduced training sorties jeopardizing aircrew proficiency. Additionally, the E-4Bs existing Very Low Frequency/Low Frequency system is mechanically/electronically obsolete and unsustainable.

**Integrated Tactical Warning and Attack Assessment (ITW/AA):** The ITW/AA enterprise’s mission is to provide timely, accurate and unambiguous warning of air, missile, and space attacks against North America to the U.S. President, the Prime Minister of Canada, the Chairman of the Joint Chiefs of Staff, Combatant Commands, and other forward users. The ITW/AA is composed of Air and Space Missile Warning Missions, with sensors and forward users located worldwide, and at correlation centers at Peterson AFB, Cheyenne Mountain AFS, Offutt AFB, and Vandenberg AFB. Portions of this legacy system are unsustainable, and plans for replacement systems have been delayed.

**Navy**

**Ohio Class Submarine Replacement:** The current Ohio class of ballistic missile submarines (SSBN) were commissioned between 1984 and 1997, and their lifetime has been extended from 30 to 42 years – unprecedented for a nuclear submarine. Additional Ohio life extensions are unrealistic, and these SSBNs will begin to be retired at a rate of one per year in 2027. Ohio replacement construction must begin in 2021 to commence its first Strategic Patrol in 2031. The FY 2013 budget delayed delivery of the first new SSBN by two years, which produced manageable risk for the future transition. Additional delays are not manageable and would create a gap in at-sea strategic requirements.

**Fixed Submarine Broadcast System (FSBS):** The existing Low Frequency/Very Low Frequency stations were designed and built in different periods from 1953 to 1983. Consequently, each station is unique, and all are suffering from varying degrees of component obsolescence. System efficiencies are relatively low, which results in excessive energy consumption and complicated logistics support. This past year, the DoD IG examined the FSBS and concluded that while the transmitter equipment was well maintained, the supporting infrastructure at the geographically-isolated sites is on the verge of failing.
Nuclear Command, Control, and Communications (NC3)

The NC3 system is a large and complex system-of-systems comprised of numerous land, airborne, and space-based components used to assure connectivity between the President and nuclear forces. The NC3 system remains a primary concern for Congress. The National Defense Authorization Act of 2012 directed the then Assistant Secretary of Defense for Networks, Information and Infrastructure, in coordination with the service secretaries, to submit a report on the NC3 architecture and long-term strategy. More recently, the Senate Armed Services Committee report accompanying a bill for the National Defense Authorization Act for Fiscal Year 2013 mandated GAO to assess DoD’s efforts to sustain and improve the NC3 system. These concerns for NC3 stem from the multitude of aging and obsolete legacy systems that require modernization and replacement.

7-2C. Modernizing the Nuclear Force in the Face of Declining Resources

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<td>The Department concurs with the DoD IG’s assessment.</td>
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A convoy follows a payload transporter (PT) through the weapons storage area at Malmstrom Air Force Base, Montana. The PT returned after maintenance crews removed the last multiple independently targetable reentry vehicle in the Air Force intercontinental ballistic missile inventory from a Minuteman III, helping bring the Air Force towards compliance with the New Strategic Arms Reduction Treaty and comply with direction from the 2010 Nuclear Posture Review.

Photo by Senior Airman Katrina Heikkinen
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<tr>
<th>7-3A. Lack of an Integrated End-to-End Governance Process</th>
<th>IG Summary of Challenge</th>
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<td>No integrated, end-to-end governance process exists for the DoD nuclear weapon enterprise. Existing forums are generally effective, but are separate entities, either in substance or process, that are not viewed as part of an integrated, whole-DoD effort.</td>
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<th>7-3B. Lack of an Integrated End-to-End Governance Process</th>
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<td>With isolated exception, coordinated senior-level leadership attention dedicated to nuclear issues in the Department is insufficient. The Congressional Budget Office estimates that the nation is faced with $296 billion of nuclear weapon-related decisions to be made over the next 10 years. Without centralized and integrated management, these decisions will be made with an eroded capability to properly analyze these issues. No governance structure exists that empowers a single DoD organization to ensure that capabilities are planned, resourced, modernized, and sustained as an integrated program of record in all DoD Services and organizations. Multiple committees, including the Nuclear Weapons Council, the Senior Nuclear Oversight Council, and the National Leadership Command, Control, and Communication Executive Management Board, have overlapping memberships to address various issues in the nuclear enterprise. Most committees, however, are not full-time bodies and cannot be expected to delve deeply into the details of every programmatic decision. Additionally, many of these committees are merely advisory or coordination bodies, unable to commit resources. The absence of a DoD-wide nuclear enterprise governance structure has resulted in gaps, seams, and overlap among these committees. Not having clear delineations of responsibility is a trend throughout most of the DoD IG’s recent nuclear enterprise reports. This trend may be hard to overcome for NC3 systems with multiple organizations hosting portions of it, but in other instances we find examples where responsibility is shared or uncertain. Notable exceptions have recently occurred. The Deputy’s Management Action Group effectively provided some specific programmatic direction for the Services, and the DoD Chief Information Officer established organizations to oversee Nuclear Command, Control, and Communications.</td>
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<th>7-3C. Lack of an Integrated End-to-End Governance Process</th>
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<td>The Department concurs with the DoD IG’s assessment, but notes that the Department is leading a congressionally mandated council for NC3. The Council on Oversight of the National Leadership C3 System, which was established in the FY 2014 National Defense Authorization Act, comprises DoD stakeholders to address declining resources for NC3 modernization. The Council members include the USD(AT&amp;L), USD Policy, Vice Chairman of the Joint Chiefs of Staff, the Director of the National Security Agency, the DoD CIO, and the Commander of U.S. Strategic Command.</td>
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