



PERSONNEL AND  
READINESS

**UNDER SECRETARY OF DEFENSE**  
4000 DEFENSE PENTAGON  
WASHINGTON, D.C. 20301-4000

**JUL 22 2020**

The Honorable Nita M. Lowey  
Chairwoman  
Committee on Appropriations  
U.S. House of Representatives  
Washington, DC 20515

Dear Madam Chairwoman:

The Department's response to 10 U.S.C. § 240h(b) is enclosed. The statute requires that the Secretary of Defense annually submit to the congressional defense committees a report that includes a ranking of all of the Military Departments and Defense Agencies, in order of how much progress each such Department and Agency has made toward achieving auditable financial statements. The Fiscal Year 2019 annual report was provided to the congressional defense committees in January 2020.

The law further requires that the head of each Military Department and Defense Agency that is ranked in the bottom quartile of the annual report also submit to the congressional defense committees a separate report that addresses specific information, as itemized within the statute. The Defense Health Program ranked in the bottom quartile of the annual report. The enclosed report reflects the required information.

I am sending an identical letter to the other congressional defense committees. Thank you for your continued support for the health and well-being of our Service members, veterans, and their families.

Sincerely,

//SIGNED//

Matthew P. Donovan

USD for Personnel & Readiness

Enclosure:  
As stated



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**JUL 22 2020**

The Honorable Kay Granger  
Ranking Member  
Committee on Appropriations  
U.S. House of Representatives  
Washington, DC 20515

Dear Representative Granger:

The Department's response to 10 U.S.C. § 240h(b) is enclosed. The statute requires that the Secretary of Defense annually submit to the congressional defense committees a report that includes a ranking of all of the Military Departments and Defense Agencies, in order of how much progress each such Department and Agency has made toward achieving auditable financial statements. The Fiscal Year 2019 annual report was provided to the congressional defense committees in January 2020.

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The Honorable James M. Inhofe  
Chairman  
Committee on Armed Services  
United States Senate  
Washington, DC 20510

**JUL 22 2020**

Dear Mr. Chairman:

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The Honorable Jack Reed  
Ranking Member  
Committee on Armed Services  
United States Senate  
Washington, DC 20510

**JUL 22 2020**

Dear Senator Reed:

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WASHINGTON, D.C. 20301-4000

The Honorable Richard C. Shelby  
Chairman  
Committee on Appropriations  
United States Senate  
Washington, DC 20510

JUL 22 2020

Dear Mr. Chairman:

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**JUL 22 2020**

The Honorable Patrick J. Leahy  
Vice Chairman  
Committee on Appropriations  
United States Senate  
Washington, DC 20510

Dear Senator Leahy:

The Department's response to 10 U.S.C. § 240h(b) is enclosed. The statute requires that the Secretary of Defense annually submit to the congressional defense committees a report that includes a ranking of all of the Military Departments and Defense Agencies, in order of how much progress each such Department and Agency has made toward achieving auditable financial statements. The Fiscal Year 2019 annual report was provided to the congressional defense committees in January 2020.

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**JUL 22 2020**

The Honorable Adam Smith  
Chairman  
Committee on Armed Services  
U.S. House of Representatives  
Washington, DC 20515

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**JUL 22 2020**

The Honorable William M. "Mac" Thornberry  
Ranking Member  
Committee on Armed Services  
U.S. House of Representatives  
Washington, DC 20515

Dear Representative Thornberry:

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# Report to Congressional Defense Committees



**July 2020**

**10, U.S.C. § 240h(b)**

**Bottom Quartile Ranking Report  
for the Defense Health Program**

The estimated cost of this report or study for the Department of Defense (DoD) is approximately \$6,900 for the 2020 Fiscal Year. This includes \$3,100 in expenses and \$3,800 in DoD labor.  
Generated on 30 Jun 2020 RefID: 8-3E9254D

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**1.0 Purpose**

This report is provided to the congressional defense committees pursuant to 10 U.S.C. § 240h. The statute requires that the Secretary of Defense annually submit to the congressional defense committees a report that includes a ranking of all of the Military Departments and Defense Agencies, in order of how advanced each such Department and Agency is in achieving auditable financial statements. The Fiscal Year (FY) 2019 annual report was provided to the congressional defense committees in January 2020.

The law further requires that the head of each Military Department and Defense Agency that is ranked in the bottom quartile of the annual report also submit to the congressional defense committees a report that includes responses to 10 questions which are itemized within the statute. The Defense Health Program (DHP) ranked in the bottom quartile of the annual report. Accordingly, responses to the 10 questions contained within the statute are provided herein.

**2.0 Responses to Questions**

**1. A description of the material weaknesses of the Military Department or Defense Agency.**

The independent public accountant (IPA) identified 13 material weaknesses in the FY 2019 Independent Auditor’s Report of the consolidated financial statements of the DHP. The DHP appropriation funds the mission of the Military Health System (MHS) to carry out the medical and health care programs of the Department of Defense (DoD) as exercised by its principal agent, the Defense Health Agency (DHA). In FY 2019, the DHP financial statements were comprised of seven separate, lower-level component financial statements. The auditor-identified material weaknesses listed below are consistent with the findings and concerns the components have identified through the required annual internal controls assessment and priority remediation areas. The material weaknesses identified in the auditor’s report for the DHP consolidated financial statements are:

Accounting Area	Material Weakness Description
Entity-Level Controls	I. Accounting and Financial Reporting Governance and Entity-Level Controls (ELCs)
Financial Reporting	II. Financial Reporting – Universe of Transactions (UoT) Reconciliations III. Financial Reporting – Defense Departmental Reporting System (DDRS) Adjustments
Fund Balance with Treasury (FBWT)	IV. FBWT
Accounts Receivable (AR)	V. Medical Revenue and Associated Receivables
Property, Plant, and Equipment (PP&E)	VI. General Equipment (GE) Existence and Completeness VII. Valuation of PP&E VIII. Real Property (RP)

	IX. Internal Use Software (IUS) and IUS In-Development
Inventory and Related Property	X. Operating Materials and Supplies (OM&S) and Stockpile Material
Accounts Payable (AP) and Related Liabilities	XI. Liabilities and Related Expenses
Budgetary Resources	XII. Monitoring and Reporting of Obligations
Information Technology (IT)	XIII. Information Systems

**2. The underlying causes of such weaknesses.**

The size, global presence, and complexity of the MHS contributed to the root causes of the material weaknesses in business processes and IT systems. Further, because the MHS' work is highly mission-oriented, its operational structure was established to principally support core functional capabilities, prioritizing above all the healthcare needs of our Service members, retirees, and their families. Transforming and standardizing business processes poses a significant challenge to the established culture and requires the full cooperation and involvement of all organizations, including our Service Providers where a heightened degree of dependency exists. In addition, with an annual budget of approximately \$35 billion (not including pay for military personnel) and uniformed, civilian, and contract personnel spread across the nation and outside the contiguous United States, a considerable amount of time will be needed for the workforce to learn and implement new policies, business operations, and internal control procedures. The DHP appropriation is currently executed in three major accounting general ledger systems. Efforts are underway to migrate to one Standard Financial Information Structure (SFIS) compliant system, adding necessary standardization and controls into our business processes. Rolling out MHS GENESIS (the new single electronic health record) across the MHS will add improved billing capabilities to the enterprise. In addition, reforms to business operations are ongoing as a consolidation of healthcare facilities under the DHA's authority, direction and control is implemented in accordance with statutory requirements.

The specific causes that led to the material weakness are:

Material Weakness	Cause
I. Accounting and Financial Reporting Governance and ELCs	<ul style="list-style-type: none"> <li>No formalized accounting and financial reporting governance across reporting entities</li> <li>ELCs are not designed and operating effectively, including sufficient monitoring of Service Providers</li> </ul>
II. Financial Reporting – UoT Reconciliations III. Financial Reporting – DDRS Adjustments	<ul style="list-style-type: none"> <li>Monetary variances identified in General Ledger (GL) to Trial Balance reconciliations lack supporting documentation</li> <li>The DDRS journal voucher (JV) review process is not effectively designed to ensure adjustments are fully supported</li> </ul>

IV. FBWT	<ul style="list-style-type: none"> <li>Effective processes and controls are not designed and implemented to reconcile variances between FBWT GL balances and Treasury</li> </ul>
V. Medical Revenue and Associated Receivables	<ul style="list-style-type: none"> <li>Insufficient enterprise-wide accounting policies to ensure consistent and accurate accounting of medical services provided to the Public and Federal trading partners in accordance with Generally Accepted Accounting Principles (GAAP)</li> </ul>
VI. GE Existence and Completeness VII. Valuation of PP&E VIII. RP IX. IUS and IUS In-Development	<ul style="list-style-type: none"> <li>Procedures have not been designed to ensure GE is accurately reported</li> <li>Procedures have not been designed to appropriately value PP&amp;E at historical cost in accordance with GAAP</li> <li>Process has not been implemented to identify and classify pertinent cost information required for IUS reporting</li> </ul>
X. OM&S and Stockpile Material	<ul style="list-style-type: none"> <li>O&amp;MS processes are not fully documented</li> <li>Stockpile Material assets are not 100 percent recorded</li> </ul>
XI. Liabilities and Related Expenses	<ul style="list-style-type: none"> <li>Accounting-compliant processes for recording known liabilities on the balance sheet are not established for AP, Contingent Liabilities, and Federal Employees' Compensation Act (FECA)</li> </ul>
XII. Monitoring and Reporting of Obligations	<ul style="list-style-type: none"> <li>Reporting capability for unliquidated obligations or status of funds has not been sufficiently designed</li> <li>Dormant account review is not effective</li> </ul>
XIII. Information Systems	<ul style="list-style-type: none"> <li>Insufficient procedures on user access and logging of user activities</li> </ul>

### 3. A plan for remediating such weaknesses.

The Office of the Deputy Chief Financial Officer (ODCFO) FY 2020 strategy is to track material weakness closures, not simply the number of Notices of Findings and Recommendations (NFRs) closed. In addition, ODCFO and the MHS established FY 2019 financial statement remediation priorities that allow MHS components to better prioritize corrective actions and focus on challenges that are most significant and widespread. The ODCFO issued priority areas – Financial Reporting Internal Controls and FBWT. The DHA was asked to provide three additional priority areas. These areas are: Accounting and Financial Reporting Governance and ELCs; OM&S and Stockpile Material; and Liabilities and Related Expenses. In addition to

focusing on these key material weaknesses, the MHS continues to address the other material weaknesses noted above.

In addition to our prioritization efforts, DHA has an internal process for monitoring remediation efforts on corrective actions. Regular updates are provided to ODCFO and MHS senior leadership on remediation progress. This continued leadership attention and commitment to audit success sets a tone of accountability that reverberates throughout the agency. Lastly, performance ratings for key personnel include attributes that promote progress and accountability as it relates to auditability.

Remediation in the ODCFO and MHS priority areas and other financial statement priority areas are foundational to the MHS' long-term audit success. These remediation efforts are further described below:

Material Weakness	Remediation
I. Accounting and Financial Reporting Governance and ELCs	<ul style="list-style-type: none"> <li>• Develop financial and accounting governance, policies, and procedures</li> <li>• Redesign the DHA's ELCs in accordance with the Government Accountability Office Green Book principles, which will serve as the ELC framework throughout the MHS</li> <li>• Conduct Test of Design on DHA's redesigned ELCs and Component deviations, and correct any identified control failures</li> </ul>
II. Financial Reporting – UoT Reconciliations III. Financial Reporting – DDRS Adjustments	<ul style="list-style-type: none"> <li>• Develop a standard operating procedure documenting the UoT reconciliation process</li> <li>• Continue support and refinement of the data and usage of the ODCFO ADVANA tool</li> <li>• Stratify data populations across all GL systems in support of auditor sampling efforts</li> <li>• Develop reconciliations for additional DDRS-B feeder systems in support of financial system balances</li> <li>• Implement appropriate procedures to reduce unsupported manual JVs to produce the DHP financial statements and associated notes</li> <li>• Implement procedures on trading partner elimination process</li> </ul>
IV. FBWT	<ul style="list-style-type: none"> <li>• Work with Defense Finance and Accounting Service (DFAS) to support undistributed, Suspense and Deposit amounts</li> <li>• Coordinate with ODCFO and DFAS to move the current DHP 999* limit from the ODO Consolidated Statement to DHP's financial</li> </ul>

	<p>statements to ensure completeness of the FBWT universe</p> <ul style="list-style-type: none"> <li>• Document the current end-to-end reconciliation and oversight processes</li> </ul>
V. Medical Revenue and Associated Receivables	<ul style="list-style-type: none"> <li>• Develop an enterprise accounting policy for Medical Services Revenue and associated AR, which specifically addresses the appropriate accounting treatment as prescribed within Statement of Federal Financial Accounting Standards (SFFAS) No. 1 and SFFAS No. 7</li> </ul>
VI. GE Existence and Completeness VII. Valuation of PP&E VIII. RP IX. IUS and IUS In-Development	<ul style="list-style-type: none"> <li>• Develop and implement GE processes</li> <li>• Develop accounting policy for PP&amp;E which specifically addresses historical cost valuation in accordance with SFFAS No. 6, SFFAS No. 10, and SFFAS No. 50</li> <li>• Incorporate Medical RP in the development of Enterprise accounting policy for PP&amp;E, aligning, as appropriate with the financial reporting responsibilities of RP prescribed at the DoD-wide level</li> <li>• Develop a valuation strategy and approach for IUS and record it on the financial statements in accordance with Federal accounting standards</li> </ul>
X. OM&S and Stockpile Material	<ul style="list-style-type: none"> <li>• Develop financial reporting procedures to document O&amp;MS accounting methodology and Stockpile reporting process</li> <li>• Complete an auditable Stockpile baseline inventory and maintain documentation for transactions recorded in the Accountable Property System of Record</li> <li>• Develop and implement policies and procedures to ensure Stockpile materials are accurately captured in the financial statements</li> </ul>
XI. Liabilities and Related Expenses	<ul style="list-style-type: none"> <li>• Develop a GAAP compliant AP accrual methodology to record estimated AP for goods and/or services received but not yet invoiced nor currently captured in other accrual processes</li> <li>• Develop and execute procedures for recording contingent liabilities</li> <li>• Document the FECA liability, payment and chargeback processes and enter amount onto the appropriate financial statement</li> </ul>

XII. Monitoring and Reporting of Obligations	<ul style="list-style-type: none"> <li>• Implement Dormant Account Review – Quarterly process to ensure dormant balances are reviewed and removed, as appropriate</li> </ul>
XIII. Information Systems	<ul style="list-style-type: none"> <li>• Update policy and documentation for access control monitoring for the four DHA-owned systems (the systems are used at the military treatment facility-level)</li> </ul>

**4. The total number of open audit notices of findings and recommendations (hereinafter referred to as “NFRs”) for the most recently concluded fiscal year and the preceding two fiscal years, where applicable.**

In FY 2018, the first DHP full financial statement audit year, 124 NFRs were issued by the IPA. Fifteen FY 2018 NFRs were closed in FY 2019. In FY 2019 there were 190 total NFRs issued. The 53 percent increase in the total number of NFRs was partially due to several NFRs from the previous audit (FY 2018) being reissued as multiple NFRs in the FY 2019 audit. This action provided a greater level of detail surrounding the issues and concerns previously identified by the auditors; it also allowed the necessary corrective actions to be aligned more appropriately. Another factor contributing to the increase was the expanded scope of the FY 2019 audit, which resulted in NFRs across areas not previously subjected to audit procedures. Though the numbers increased, the MHS welcomed the findings as they assisted the MHS organizations in targeting and prioritizing necessary improvements to our processes.

**5. The number of repeat or reissued NFRs from the most recently concluded fiscal year.**

There were 24 repeat and 100 modified repeat NFRs from the most recently concluded audit. Please note, FY 2018 NFRs could have been consolidated or disaggregated in FY 2019 in order to provide a deeper level of detail. Many of these repeat findings resulted from complex long-standing business processes that will require time and cross-MHS component solutions. Another contributing factor was business processes supported by legacy systems and system interfaces that are not compliant with audit requirements.

**6. The number of NFRs that were previously forecasted to be closed during the most recently concluded fiscal year that remain open.**

Although the DHP financial statement audit received a disclaimer of opinion, the MHS components are making significant enhancements in the FY 2020 audit. The direction and audit emphasis communicated by the MHS senior leadership resulted in tangible improvements reflected via higher response rates to auditor documentation and information requests. Although issues with processes and systems remain, the number of NFRs that were previously forecasted to be closed during the most recently concluded audit was 4 NFRs; MHS ended up closing 15 NFRs in FY 2019.



**7. The number of closed NFRs during the most current fiscal year and prior years.**

The number of NFRs closed during the most current and prior fiscal year was 15. These corrections and improvements addressed several critical focus areas, such as:

- IT
- UoT
- Financial Reporting
- AP

We are diligently working towards closing the remaining findings. Qualitative changes are happening every day that will, over time, result in real change in how the DHA does business. The tone-at-the-top is being echoed by leaders at every level. The workforce's understanding of audit requirements continues to grow, and, as efficiencies are gained, value is being realized. As stated above, many of these repeat findings resulted from long standing business processes that will require time and cross-MHS component solutions. However, personnel across the agency are working hard to remediate and it is expected, over time, the findings will be closed.

**8. The number of material weaknesses that were validated by external auditors as fully resolved or downgraded in the current fiscal year over prior fiscal years.**

The auditor's report on the DHP consolidated financial statements for FY 2018 reported 13 material weaknesses, the same number was reported in FY 2019. The auditor removed one of the FY 2018 material weaknesses/scope limitations in FY 2019 related to defining the DHP financial reporting entity. However, the auditor added a new material weakness related to budgetary resources for FY 2019; hence, there was no change in the total number of material weaknesses from FY 2018 to FY 2019. It is too early in the FY 2020 audit to determine if any material weakness areas will be downgraded or resolved this FY.

**9. A breakdown by FYs in which open NFRs are forecasted to be closed.**

A breakdown by FY in which open FY 2019 NFRs are forecasted to be closed based on the ODCFO NFR Database:

- NFRs Currently Projected Closed = 4
- NFRs Projected to Close 2020 = 9
- NFRs Projected to Close 2021 = 67
- NFRs Projected to Close 2022+ = 56

**10. Explanations for unfavorable trends in the information under paragraphs (1) through (9).**

The DHP component financial management organizations continue to evolve during the FY 2020 audit as administrative functions are transferred from the Military Departments to a market-based

structure to manage hospitals and clinics under the DHA. The individual management of the MHS components, which are responsible for the execution of DHP funding across the Army, Navy, Air Force, DHA, and the Uniformed Services University of the Health Sciences on behalf of Health Affairs, operate independently and have not effectively merged into a cohesive, formalized accounting and financial reporting governance structure. These governance and reform challenges extend to our Service Providers who need to adjust to the evolving structure of the MHS. Multiple financial systems have compounded the issues. While the transition continues to impact organizations' ability to meet all audit requirements, efforts are being balanced to focus on remediation priorities and to put the much needed governance structure in place. The movement of all components utilizing the DHP appropriation onto a single SFIS compliant financial system, the General Fund Enterprise Business System, and onto MHS GENESIS will accelerate the standardization and remediation efforts.

### 3.0 Glossary

AP	Accounts Payable
AR	Accounts Receivable
DDRS	Defense Departmental Reporting System
DFAS	Defense Finance and Accounting Service
DHA	Defense Health Agency
DHP	Defense Health Program
DoD	Department of Defense
ELC	Entity-Level Control
FBWT	Fund Balance with Treasury
FECA	Federal Employees' Compensation Act
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GE	General Equipment
GL	General Ledger
IPA	independent public accountant
IT	Information Technology
IUS	Internal Use Software
JV	journal voucher
MHS	Military Health System
NFR	Notice of Findings and Recommendations
ODCFO	Office of the Deputy Chief Financial Officer
OM&S	Operating Materials and Supplies
PP&E	Property, Plant, and Equipment
RP	Real Property
SFFAS	Statement of Federal Financial Accounting Standards
SFIS	Standard Financial Information Structure
UoT	Universe of Transactions