

December 7, 2005



Financial Management

Accuracy of the Contributions to the Medicare-Eligible Retiree Health Care Fund (D-2006-034)

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Acronyms

IG	Inspector General
OIG	Office of Inspector General
DFAS	Defense Finance and Accounting Service



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

December 7, 2005

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE
(COMPTROLLER)/CHIEF FINANCIAL OFFICER
ASSISTANT SECRETARY OF DEFENSE
(HEALTH AFFAIRS)
ASSISTANT SECRETARY OF THE ARMY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Report on Accuracy of the Contributions to the Medicare-Eligible Retiree
Health Care Fund (Report No.D-2006-034)

We are providing this report for review and comment. The Assistant Secretary of the Army (Financial Management and Comptroller) did not respond to a draft of the report; however, we considered comments from Under Secretary of Defense Deputy Comptroller/ Program/Budget, the Assistant Secretary of Defense (Health Affairs), the Assistant Secretary of Navy (Financial Management and Comptroller), and the Principal Deputy Assistant Secretary of the Air Force (Financial Management) when preparing the final report.

The comments received from the Under Secretary of Defense Deputy Comptroller/Program/Budget, the Assistant Secretary of Defense (Health Affairs), the Assistant Secretary of Navy (Financial Management and Comptroller) and the Principal Deputy Assistant Secretary of the Air Force (Financial Management) were responsive. Based on the comments from the Assistant Secretary of Defense (Health Affairs) we deleted recommendation 2.C., revised recommendation 4.B., and added recommendation 6. We added recommendation 5. to the Assistant Secretary of the Army (Financial Management and Comptroller) because the Army improperly withdrew a recommended supplemental payment to the Fund. We request comments from the Assistant Secretary of Navy (Financial Management and Comptroller) on recommendation 6. We request comments from the Assistant Secretary of the Army (Financial Management and Comptroller), Assistant Secretary of Navy (Financial Management and Comptroller), and the Assistant Secretary of the Air Force (Financial Management and Comptroller) by January 6, 2005.

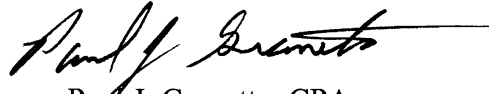
If possible, please send management comments in electronic format (Adobe Acrobat file only) to Audcolu@dodig.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

Management comments should indicate concurrence or nonconcurrence with the finding, each applicable recommendation, and the potential monetary benefits.

Comments should describe actions taken or planned in response to agreed-upon recommendations and provide the completion dates of the actions. State specific reasons for any nonconcurrency and propose alternative actions, if appropriate. If management nonconcurs with the potential monetary benefits, the comments should specify the amount at issue. Management should also comment on the material management control weaknesses discussed in Appendix A.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. James L. Kornides at (614) 751-1400 ext. 211 or Mr. Mark Starinsky at (614) 751-1400 ext. 231. For the report distribution, see Appendix B. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

A handwritten signature in black ink, appearing to read "Paul J. Granetto", with a long horizontal flourish extending to the right.

Paul J. Granetto, CPA
Assistant Inspector General
Defense Financial Auditing
Service

Department of Defense Office of Inspector General

Report No. D-2006-034

December 7, 2005

Project No. D2005-D000FJ-0081.000

Accuracy of the Contributions to the Medicare-Eligible Retiree Health Care Fund

Executive Summary

Who Should Read This Report and Why? The Military Department managers responsible for calculating contributions to the Medicare-Eligible Retiree Health Care Fund should read this report because it discusses the accuracy of each Military Department's contributions.

Background. The Medicare-Eligible Retiree Health Care Fund Audit Committee requested the audit. The Medicare-Eligible Retiree Health Care Fund (the Fund) was established to pay for health benefits for Medicare-eligible DoD military retirees, other non-DoD uniformed Service retirees (Coast Guard, Public Health Service, and National Oceanic and Atmospheric Administration), retiree family members, and survivors of retirees who are Medicare eligible). The Military Departments and the non-DoD uniformed Services make contributions to the Fund throughout the year to provide a reserve from which payments for medical expenses are made. A Board of Actuaries determines the normal contribution rates paid by the Military Departments. The Military Departments contributed \$3.9 billion to the Fund during the period of our audit, the last quarter of FY 2004 through the first quarter of FY 2005.

Results. The Military Departments did not provide accurate contributions to the Fund in the two quarters we reviewed. In the fourth quarter of FY 2004, the Navy overpaid the Fund by \$602,175 and the Air Force underpaid the Fund by \$393,235. In the first quarter of FY 2005, the Military Departments underpaid the Fund by \$218.8 million. The Military Departments need to improve controls to ensure their contributions are accurate. Additionally, the contribution process will be affected by a legislative change that requires annual contributions instead of monthly contributions starting in FY 2006, but implementing guidance was not developed.

Management Comments and Audit Response. The Under Secretary of Defense (Deputy Comptroller)/ Program/Budget concurred with the audit findings and recommendations and planned to issue new guidance for managing the annual contribution beginning in FY 2006. The Assistant Secretary of Defense (Health Affairs) concurred with the audit findings and planned to issue guidance on making corrective payments. He also planned to disclose all contribution errors in the financial statements. He nonconcurred with a recommendation to credit a Navy appropriation for the Marine Corps Reserve FY 2004 contribution error. We agreed with his comments and adjusted our recommendations. The Assistant Secretary of the Navy (Financial Management and Comptroller) concurred with the audit finding and recommendation and agreed to credit a future Navy contribution to the Fund for the amount of the overpayment that the Navy had made. The Principal Deputy Assistant Secretary of the Air Force (Financial Management) concurred with the audit finding and recommendations and agreed to take

corrective action. He planned to issue new guidance on disbursing and processing Fund contributions. He also indicated the Air Force would prepare its contributions to the Fund instead of DFAS, and it would provide an additional contribution to the Fund.

The draft report was issued July 12, 2005, and we requested that the Assistant Secretary of the Army (Financial Management and Comptroller) comment on the draft report by September 12, 2005. No comments were received from the Army. DoD Directive 7650.3 requires that all recommendations be resolved promptly. See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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Background

The Medicare-Eligible Retiree Health Care Fund (the Fund) was established in FY 2002 under section 1111, title 10, United States Code. In FY 2003, DoD began using accrual budgeting to pay for health care for DoD beneficiaries who are eligible for Medicare. In accrual budgeting, costs for pensions and medical benefits for retirees are recognized during the years in which the employees are working in lieu of when the benefits are actually paid. DoD needed to use accrual budgeting so that it could build a reserve of funds that would be available at the time the medical treatments were rendered and the funding to pay for the treatments was needed. The fund is administered by the Assistant Secretary of Defense for Health Affairs.

During the audit, the Military Departments made contributions on behalf of approximately 2.2 million full-time and part-time personnel. The three non-DoD uniformed Services (Coast Guard, Public Health Service, and National Oceanic and Atmospheric Administration) made contributions to the Fund on behalf of another 61,200 people.

The contributions were provided to the Defense Finance and Accounting Service (DFAS). DFAS was responsible for managing the fiscal operations of the Fund. DFAS invests the Military Departments' contributions and makes payments from the Fund.

The Fund's Board of Actuaries determined the monthly normal cost contribution rates each Military Department and the other agencies needed to use to calculate the amount owed. The Board of Actuaries provided two rates: a full-time and a part-time rate. The FY 2004 full-time rate was \$381 and the part-time rate was \$155. In FY 2005, the rates increased to \$447 and \$261 for each full-time and part-time person.

The Military Departments used the normal contribution rates in the calculation of the monthly contributions. As such, the Military Departments' contributions were a product of the applicable rate times the end strength for the most recently reported month.

Objectives

Our audit objective was to review the accuracy of the calculation of the Military Departments' monthly contributions to the Fund. We also reviewed the management control program as it related to the overall objective and assessed compliance with applicable laws and regulations. The audit supports the DoD Office of Inspector General (DoD OIG) audit of the FY 2005 Medicare-Eligible Retiree Health Care Fund Financial Statements. See Appendix A for a discussion of the scope and methodology and our review of the management control program. See Appendix A for prior coverage related to the objectives.

Contributions to the Medicare-Eligible Retiree Health Care Fund

The Military Departments did not always contribute the correct amounts to the Fund in the two quarters we reviewed. In the fourth quarter of FY 2004, the Navy overpaid the Fund by \$602,175 and the Air Force underpaid the Fund by \$393,235. Additionally, the Military Departments underpaid the Fund by \$218.8 million in the first quarter of FY 2005. Inaccurate amounts were paid because the Military Departments did not adhere to control procedures and management in the Departments did not provide adequate oversight. The Military Departments need to improve controls to ensure the contributions are accurate. The process will be affected by a legislative change that requires annual contributions instead of monthly contributions starting in FY 2006, but more effective controls are still necessary.

Contribution Requirements

The Military Departments were required by section 1116, title 10, United States Code to pay into the Fund at the end of each month. The amount paid was to be the product of the actuarial contribution rate times the total end strength for that month. The monthly end strengths were calculated using the number of members of the Military Departments on active duty (other than active duty for training) and full-time National Guard duty (other than full-time National Guard duty for training only) and members of the Ready Reserve of the Military Departments.

Contribution Due Dates. DoD Instruction 6070.2 “Department of Defense Medicare Eligible Retiree Health Care Fund Operations,” July 19, 2002, required the payment of the contributions to the Fund through the use of the Intra-Governmental Payment and Collection system. The Military Departments were to transfer the calculated amount by 10:00 a.m. “. . . Eastern time on the last working day prior to the fifth business day from the end of each month.”

Amount of Contributions

We began the audit in December 2004 and examined 6 months (July 2004 through December 2004) of data and contributions to the Fund. The Military Departments contributed \$3.9 billion to the Fund for the 6-month period from July through December 2004. The monthly contributions were generally paid on time. During the 6-month period there were 60 contribution payments from the Military Departments.* Of those 60 contributions, 51 were paid on time and the remaining 9 were late by no more than 1 business day. In all cases, the late contributions were in process at the time the payments were due. Each Military

* We counted the single Air Force contribution voucher as three vouchers; one for active-duty Air Force, one for the Air Force Reserve, and one for the Air National Guard.

Department, except for the Air Force, computed the monthly contribution amounts, prepared contribution requests, and forwarded the contribution requests to DFAS. DFAS itself prepared and computed the Air Force contribution.

The following table shows the contributions by the Military Departments in the fourth quarter of FY 2004 and first quarter of FY 2005.

Contributions to the Medicare-Eligible Retiree Health Care Fund (in millions)			
Military Departments ¹	4th Quarter FY 2004	1st Quarter FY 2005	Total
Army ²	\$213.5	\$1,017.6	\$1,231.1
Navy (including the Marine Corps)	698.2	842.1	1,540.3
Air Force	531.2	565.0	1,096.2
Totals	\$1,442.9	\$2,424.7	\$3,867.6
¹ Includes active and reserve Components.			
² Net of \$636.1 million because of Army overpayments for prior periods.			

Army Overpayments in Periods Prior to the Audit. The active Army's contributions for the fourth quarter of FY 2004 were offset by a \$636.1 million adjustment for funds due from the Fund to the Army. On April 15, 2004, the Army notified the Fund Audit Committee of possible Army overpayments to the Fund because of revised end-strength reports. The revision to end strength was the result of inappropriate inclusion of the activated reservists in both the active Army and Reserve end strength for Fund contribution purposes. The Army should not have included the activated reservists in the active Army end-strength reports. Subsequently, the Army completed its analysis of the overpayments and calculated it had overpaid the Fund by \$394.6 million and \$241.4 million in FY 2003 and FY 2004 respectively. The Army appropriately offset the fourth quarter FY 2004 contributions by the amount of the overpayment. In addition, the third quarter FY 2004 and year-end FY 2004 Fund Financial Statements and footnotes disclosed the overpayment and the corrective action taken. As a result, the public accounting firm auditing the financial statements of the Fund, Deloitte and Touche LLP, recommended in its Management Letter on Internal Controls that the Military Departments' end-strength reports be provided to DFAS for reconciliation to contributions.

Fourth Quarter FY 2004 Contributions

Navy. The Marine Corps Reserve, a Component of the Department of the Navy, made a duplicate contribution for 3,885 enlistees because of a coding error on the August 2004 contribution voucher provided to DFAS for payment. The error went undetected because the Marine Corps Reserve did not establish adequate policies and procedures for preparing Fund contributions. Specifically, the

Marine Corps had not established procedures requiring the reconciliation of monthly contributions to data in the Marine Corps accounting systems. DFAS was unaware of the coding error and paid the full Marine Corps Reserve contribution for August 2004 because DFAS relied on the contribution voucher totals instead of individual categories listed. Subsequent to the DFAS payment, the Marine Corps Standard Accounting, Budgeting, and Reporting System rejected \$602,175 of the \$6,718,065 contribution amount because of the coding error for the 3,885 enlistees. After the Marine Corps system rejected the \$602,175, the Marine Corps mistakenly believed that a contribution underpayment occurred and requested the duplicate contribution of \$602,175 in September 2004. To correct this overpayment, the Assistant Secretary of Defense for Health Affairs should approve a credit against future Marine Corps contributions to the Fund for the amount of \$602,175.

Air Force. The Air National Guard, a Component of the Department of the Air Force, underpaid the Fund by \$393,235 for enlistees participating in two different training categories in FY 2004. It made a retroactive adjustment in its September 2004 contribution for the enlistees. The adjustment was retroactive for the period from October 2003 through July 2004. However, the Air National Guard did not include contributions for the enlistees for August 2004. It overlooked the August 2004 data because it had not established formal procedures for processing contributions to the Fund. As a result, the Air National Guard underpaid the Fund by \$393,235. The Air Force, on behalf of the Air National Guard, should pay an additional \$393,235 to the Fund in FY 2005 to cover the underpayment.

Internal Controls. The errors that resulted in the overpayments and underpayments to the Fund occurred because of internal control weaknesses. To improve the accuracy of the Military Department contributions to the Fund, we are recommending that the controls be strengthened by documenting and publishing appropriate contribution procedures.

First Quarter FY 2005 Contributions

The Army, Navy, and Air Force used FY 2004 rates instead of the proper FY 2005 rates to calculate some first quarter FY 2005 contributions. As a result, the Army, Navy, and Air Force underpaid the Fund by \$218.8 million in the first quarter FY 2005. Also, the Army made two unnecessary adjustments to the Fund totaling \$6,858 which were not material. The Military Departments' underpayments to the Fund are discussed below.

Army. The active-duty Army underpaid the Fund by \$131 million for the first quarter of FY 2005. The Army contribution for active-duty personnel incorrectly used the \$381 FY 2004 full-time rate instead of the \$447 FY 2005 full-time rate in the calculation of the Army's October, November, and December 2004 contributions to the Fund. The Army Reserve and Army National Guard used the correct rates in their separate contributions.

Beginning in FY 2005, the Army did not show the rate amount on its contribution vouchers. Previous vouchers had shown this information. The omission of the

rate may have contributed to the error since no Army or DFAS personnel could readily determine what rate the Army used in the contribution calculations. Army officials stated that the error occurred because of turnover of personnel responsible for the payment. We attributed the Army's incorrect contribution to the lack of formal guidance on how the contributions should be calculated. In lieu of formal procedures, the Army maintained informal procedures that were not dated, were not official, did not require a comparison of budgeted contribution amounts to actual contribution amounts, and did not address correction of prior errors.

During the audit, the Army made a supplemental payment to the Fund to address \$98 million of underpayments. It prepared and submitted a supplemental payment on February 3, 2005, for \$98 million to correct the underpayment. We reviewed the documentation and determined that the Army owed an additional \$33 million because it used the FY 2004 contribution rate to calculate the October 2004 contribution amount. After our discussions with Army officials, they prepared a \$33 million supplemental payment voucher on March 23, 2005. However, in October 2005, we found that the Army's supplemental payment had not been processed. DFAS officials told us that evidently the Army withdrew the voucher. Army officials withdrew the voucher believing that the \$33 million supplemental payment was already included in the \$98 million supplemental payment that was made.

The Army also made two unnecessary adjustments to the Fund for immaterial amounts. Specifically, the Army processed an adjustment on November 29, 2004, for \$1,143 because it increased the October end-strength numbers by three officers. In another case, the Army processed an adjustment on October 28, 2004, for \$5,715 because it increased the end-strength numbers by 2 officers and 13 enlisted personnel and cadets. The Army processed the adjustments because contributions to the Fund were based on initial reports that were subsequently revised. DoD Instruction 6070.2, "Department of Defense Medicare Eligible Retiree Health Care Fund Operations," July 19, 2002, does not specifically require adjustments to contributions based on revisions to the end-strength data. The DoD Instruction requires the use of the initial manpower reports and does not provide guidance on adjustments. If all the Military Departments made this type of monthly adjustments, a significant and unnecessary increase in the DFAS workload would occur. The Army and the DoD policies need to be modified to provide expanded guidance on how to determine whether a supplemental payment is needed. The two Army adjustments totaling \$6,858 are negligible when compared to the \$220 million average monthly Army contribution to the fund.

Navy. The active-duty Navy underpaid the Fund by \$811,866 for the first quarter of FY 2005. It incorrectly used the FY 2004 full-time rate instead of the FY 2005 full-time rate to calculate the October 2004 contribution for its full-time enlisted Naval Reservists. The Navy had not established formal policies for contributions to the Fund that could have minimized the likelihood of errors. The Navy contributes for active-duty sailors and full-time Naval Reservists and the Naval Reserve contributes for part-time Naval Reservists. The Naval Reserve did use the correct rate in its separate contributions. The active-duty Navy repaid the Fund in its April 2005 contribution.

Air Force. The Air Force (active-duty and reserves) underpaid the Fund a total of \$86 million for the first quarter of FY 2005. DFAS Denver computed the combined Air Force (active-duty Air Force, Air Force Reserve, and Air National Guard) monthly contribution to the Fund and correctly computed the October 2004 contribution, using the FY 2005 rate. However, when DFAS Denver computed the Air Force's contributions for November and December 2004, it incorrectly used FY 2004 rates. DFAS Denver submitted an adjusting voucher on behalf of the Air Force and its Reserve Components on January 3, 2005, for an additional \$86 million to correct its underpayment for November and December. The Air Force underpayment included the active-duty Air Force, Air Force Reserve, and Air National Guard.

This miscalculation resulted from errors by DFAS Denver. The Air Force had not established the internal controls necessary to ensure the accuracy of the contribution payments to the Fund. Specifically, the Air Force did not prepare payment vouchers for the Fund. Instead, the Air Force delegated the responsibility to DFAS in Denver. Neither the Air Force nor DFAS Denver had established procedures for the preparation, review, and approval of the Air Force monthly contributions to the Fund. Instead, DFAS Denver prepared the monthly consolidated Air Force payment voucher (SF 1049) for the Air Force, Air Force Reserve, and Air National Guard based on information e-mailed from those Components. The e-mails contained only the strength numbers and did not include either the rate or the total contribution amount for that month. While DFAS Denver prepares the payment voucher on behalf of the Air Force, the Air Force is ultimately responsible for ensuring the contributions to the Fund are accurate.

Legislative Changes for FY 2006 Contributions

The processes the Military Departments used to prepare contributions to the Fund need improvement. Upcoming legislative changes make this imperative. Section 1541 of Public Law 108-375, "National Defense Authorization Act for Fiscal Year 2005," October 28, 2004, amends section 1116, title 10, United States Code and replaces the required monthly contributions with a single annual contribution to the fund starting on October 1, 2005 (the first quarter of FY 2006). The Treasury Department will make an annual contribution based on the certified amounts provided by the Secretary of Defense rather than the Military Departments providing monthly payments into the Fund. Based on the results of our audit, there is a significant risk of contribution overpayments or underpayments for FY 2006 unless improvements are made. A risk of inaccurate future contribution payments also exists because DoD has not issued guidance to implement the change in public law that requires annual contributions.

Recommendations, Management Comments, and Audit Response

Deleted, revised, and added recommendations. We deleted draft recommendation 2.C. based on comments from the Assistant Secretary of Defense (Health Affairs) that indicate issuing a credit in FY 2005 may violate fiscal law and added recommendation 6. for the Assistant Secretary of the Navy (Financial Management and Comptroller) because the credit had been taken in September 2005. We also revised recommendation 4.B. to specify that an additional Air Force contribution should be made from the proper appropriation. We also added recommendation 5. for the Assistant Secretary of the Army (Financial Management and Comptroller) because the Army inappropriately withdrew a supplemental payment in the amount of \$33 million.

1. We recommend that the Assistant Secretary of Defense (Comptroller)/Chief Financial Officer issue written guidance for implementing the legislative change requiring annual contributions to the Medicare-Eligible Retiree Health Care Fund.

Comptroller comments. The Deputy Comptroller (Program/Budget) concurred with the recommendation and stated that implementing guidance addressing management of annual contributions will be issued by May 31, 2006.

Navy comments. Although not required to comment, the Assistant Secretary of the Navy (Financial Management and Comptroller) expressed concern that the revised funding methodology could result in inaccurate contributions that impact the Military Departments disproportionately.

Audit response. We understand the Navy's concern over the revised funding methodology; however, the change was directed by law. Our primary concern relates to the lack of implementing procedures.

2. We recommend that the Assistant Secretary of Defense (Health Affairs):

A. Issue written guidance to the Military Departments outlining the criteria and schedule for making corrective payments or requesting corrective collections.

B. Disclose the Military Departments' contribution errors in the footnotes section of the FY 2005 Medicare-Eligible Retiree Health Care Fund Financial Statements.

Health Affairs comments. The Assistant Secretary of Defense (Health Affairs) concurred with recommendations 2.A. and 2.B. and stated he will issue written guidance in 2005 and disclose the contribution errors in the FY 2005 Medicare-Eligible Retiree Health Care Fund Financial Statements.

3. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller), Assistant Secretary of the Navy (Financial Management and Comptroller), and the Assistant Secretary of the Air Force

(Financial Management and Comptroller) establish written procedures for their respective contribution processes.

Navy comments. The Assistant Secretary of the Navy (Financial Management and Comptroller) concurred with the recommendations and is willing to prepare guidance pending promulgation of guidance from Assistant Secretary of Defense (Comptroller)/Chief Financial Officer.

Air Force comments. The Principal Deputy Assistant Secretary of the Air Force (Financial Management) concurred with the recommendation and agreed to issue new guidance on disbursing and processing Fund contributions

4. We recommend that the Assistant Secretary of the Air Force (Financial Management and Comptroller):

A. Direct Air Force personnel to prepare the contributions to the Fund instead of delegating the responsibility to DFAS.

B. Contribute \$393,235 to the Fund because of the FY 2004 Air National Guard underpayment, provided it is paid from the proper appropriation.

Air Force comments. The Principle Deputy Assistant Secretary of the Air Force (Financial Management) concurred with the recommendations and stated that the Air Force will prepare the contributions to the Fund instead of DFAS. The Assistant Secretary indicated that the Air Force would make an additional contribution to the Fund.

5. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller) process the \$33 million supplemental payment related to the FY 2005 underpayment.

6. We recommend that the Assistant Secretary of the Navy (Financial Management and Comptroller) properly prepare an adjusting accounting entry to record the \$602,175 as an adjustment to the FY 2004 appropriation in accordance with fiscal law.

Management Comments Required

We request additional comments from the Assistant Secretary of Navy (Financial Management and Comptroller) on recommendation 6. In addition, we request comments from the Assistant Secretary of the Air Force (Financial Management and Comptroller) on revised recommendation 4.B.

The Assistant Secretary of the Army (Financial Management and Comptroller) did not comment on a draft of this report. DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Assistant Secretary Army (Financial Management and Comptroller), the Assistant Secretary of Navy (Financial Management and Comptroller) and the Assistant Secretary of the Air

Force (Financial Management and Comptroller) provide comments on the final report by January 6, 2005.

Appendix A. Scope and Methodology

The objective of the audit was to review the accuracy of the calculation of the Military Departments' monthly contributions to the Medicare-Eligible Retiree Health Care Fund as requested by the Fund's Audit Committee. This audit is in support of the Deloitte and Touche LLP, audit of the FY 2005 Fund Financial Statements. We contracted with Deloitte and Touche LLP, to audit the FY 2005 Medicare Eligible-Retiree Health Care Fund Financial Statements and are providing oversight of that effort.

The Fund includes the Army, Navy, and Air Force and three non-DoD uniformed Services (Coast Guard, Public Health Departments, and National Oceanic and Atmospheric Administration). The non-DoD uniformed Services signed an interagency agreement in February 2003 with DoD to participate in the Fund as required by section 1111(c), title 10 United States Code. DoD Directive 6070.1 and DoD Instruction 6070.2 apply to the non-DoD uniformed Services.

We visited the Army, Navy, Air Force, Marine Corps, Coast Guard, Public Health Service, and National Oceanic and Atmospheric Administration. Our audit announcement did not include the non-DoD uniformed Services; however, we requested and obtained cooperation from the non-DoD uniformed Services and we will provide our results to their respective Inspectors General.

We limited our review to the Military Department's normal contributions for the last 6 months of calendar year 2004 (the fourth quarter of FY 2004 and the first quarter of FY 2005). We obtained copies of contribution vouchers from DFAS Arlington and obtained supporting documentation from the Military Departments. We reviewed contributions to determine if the Military Departments used the correct rate, and we recalculated the vouchers using the end-strength information given in the vouchers. Also, we determined whether the Military Departments used the most recent end-strength figures, we compared the end-strength information given in the vouchers to either active-duty end strengths from a Washington Headquarter Service Web site or from reserve-duty end-strength reports requested from Defense Data Manpower Center. We noted that the Navy and the Naval Reserve use budgeted end strengths in their contributions and adjust their vouchers at the end of the fiscal year to reflect actual end strengths to budgeted end strengths.

We reviewed documentation to determine whether the Military Departments' contributions were timely. We compared the Intra-Governmental Payment and Collection system "accomplished date" for each of the contributions to the due date. We calculated the due date for each of the 6 months (July through December 2004) in accordance with paragraph 5.2.2.2 of DoD Instruction 6070.2, "Department of Defense Medicare Eligible Retiree Health Care Fund Operations," July 19, 2002.

We performed this audit from December 2004 through May 2005 in accordance with generally accepted government auditing standards.

Use of Computer-Processed Data. We did not review the computer systems used to process contributions to the Fund. We reviewed the hard copy documentation produced by those systems and performed an analytical review on the data. We did not review either the computer systems or processes that were used to develop the Military Department's end-strength numbers. We identified the source computer systems or processes for which the end-strength data were developed. We did not complete a formal assessment of the computer systems or processes used to determine the end-strength numbers used in the calculation of the contribution amounts. However, we did compare the Military Departments' end-strength numbers to other data sources in order to assess the reasonableness of the end-strength data.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of DoD financial management which has been identified as a high-risk area.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the management controls over the contributions to the Fund. We also reviewed the adequacy of management's self-evaluation of those controls.

Adequacy of Management Controls. We found material weaknesses in the Military Department's internal controls over the monthly contributions to the Medicare-Eligible Retiree Health Care Fund. Specifically, proper normal cost contribution amounts were not used, contributions (adjustments) for insignificant amounts were processed, and contributions were not properly approved by the Air Force. We identified material management control weaknesses for Army, Navy, and Air Force as defined by DoD Instruction 5010.40. Specifically, management controls over contributions to the Medicare-Eligible Retiree Health Care Fund were not adequate to ensure that the amounts paid were accurate. Recommendations 1, 2, and 3, if implemented, will correct the identified weaknesses and could result in accurate contributions to the Medicare-Eligible Retiree Health Care Fund. A copy of the report will be provided to the senior officials responsible for management controls in the Army, Navy, and Air Force. The recommendations in this report, if implemented, should reduce the possibility of contribution errors and should result in sound internal controls.

Adequacy of Management's Self-Evaluation. The Assistant Secretary of Defense (Health Affairs), DFAS, and Military Departments did not identify contributions to the Medicare-Eligible Retiree Health Care Fund as a distinct

assessable unit and, therefore, did not identify or report the material management control weaknesses identified by the audit.

Prior Coverage

During the last 5 years, the DoD Inspector General (DoD IG) issued three reports discussing the Medicare-Eligible Retiree Health Care Fund. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>. In addition, the FY 2004 Medicare-Eligible Retiree Health Care Fund Financial Statements, including the independent auditor's report, are available at <http://www.dod.mil/comptroller/cfs/fy2004.html>.

DoD IG Report No. D-2005-031, "Endorsement of the Management Letter on Internal Controls Over Financial Reporting for the FY 2004 DoD Medicare-Eligible Retiree Health Care Fund," January 31, 2005

DoD IG Report No. D-2005-019, "Endorsement of the Qualified Opinion on the FY 2004 DoD Medicare-Eligible Retiree Health Care Fund Financial Statements," November 8, 2004. The report is For Official Use Only. For Official Use Only Reports can be requested by filing a Freedom of Information Act request.

DoD IG Report No. D-2003-119, "Controls Over DoD Medicare-Eligible Retiree Health Care Fund Investments," July 31, 2003

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense for Health Affairs

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Information Systems Agency

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Homeland Security and Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

Office of the Under Secretary of Defense Comments



COMPTROLLER
(Program/Budget)

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

OCT 3 2005

MEMORANDUM FOR PROGRAM DIRECTOR, DEFENSE FINANCIAL AUDITING
SERVICE, OFFICE OF THE INSPECTOR GENERAL,
DEPARTMENT OF DEFENSE

SUBJECT: Office of the Inspector General, Department of Defense (OIG, DoD) Draft
Report on Accuracy of the Contributions to the Medicare-Eligible Retiree
Health Care Fund (Project No. D2005-D2000FJ-0081.000)

This memorandum is in response to the July 12, 2005, subject draft report
provided to this office for review and comment. Our response to the audit report
recommendation directed to the Under Secretary of Defense (Comptroller)/Chief
Financial Officer is attached.

We appreciate the opportunity to respond to your draft audit report and look
forward to resolving the cited issue. My point of contact is Mr. Tom Summers. He may
be reached by telephone at 703-697-3193 or by e-mail at tom.summers@osd.mil.

A handwritten signature in black ink, appearing to read "John P. Roth".

John P. Roth
Deputy Comptroller

Attachment:
As stated

cc:
OASD(HA)
DFAS

DRAFT REPORT DATED JULY 12, 2005
PROJECT NO D2005-D2000FJ-0081.000

“Accuracy of the Contributions to the Medicare-Eligible
Retiree Health Care Fund”

OIG AUDIT RECOMMENDATION 1

The Office of the Inspector General (OIG), Department of Defense (DoD), recommends that the Under Secretary of Defense(Comptroller)/Chief Financial Officer (CFO) issue written guidance for implementing the legislative change requiring annual contributions to the Medicare-Eligible Retiree Health Care Fund.

USD(C) RESPONSE

The Department concurs. Specific procedures to ensure the timely funding of the MERHCF are outlined as follows:

1. The DoD Medicare-Eligible Health Care (MERHC) Board of Actuaries will issue a letter each year (generally in August) approving the required amortization payment and the required normal cost contributions for the Uniformed Services (DoD, United States Coast Guard, Public Health Service and the National Oceanic and Atmospheric Administration). The normal cost contributions will be determined in accordance with Title 10, United States Code, section 1115(b). The normal cost per capita rates determined by the DoD MERHC Board of Actuaries are multiplied by the expected average force strength during the fiscal year (this will be the levels included in the President's Budget submission unless final Congressional action has been made adjusting these levels).
2. The Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) will prepare a letter for Secretary of Defense signature to the Secretary of the Treasury certifying the total amortization payment and the Department's normal cost contribution amounts. In addition, the letter will request that the Treasury issue warrants at the start of the fiscal year to the DoD MERHCF account (ref: 97_0850) for the amortization payment and to the ten new MERHCF contribution accounts set up by the Office of Management and Budget (OMB) for the DoD contributions. Each of these contribution accounts corresponds to one of the ten Military personnel accounts (Active, Reserve and National Guard).

Attachment
Page 1 of 2

3. The OUSD(C) will submit an apportionment request to OMB for the ten MERHCF contribution accounts.

4. Subsequent to the issuance of the warrants by the Treasury at the start of the fiscal year, the Military Services will, on the same day, transfer all of the funding to the MERHCF (with respect to the non-DoD Uniformed Services, it is assumed that the Secretaries of Commerce, Health and Human Services, and Homeland Security will separately certify and request warrants from the Treasury for their normal cost contributions).

The new procedures for funding the unfunded liability and normal cost outlined above will be incorporated into the Department of Defense Financial Management Regulation (DoD 7000.14-R) ("DoDFMR").

Estimated Completion Date: May 31, 2006 ("DoDFMR" change)

Attachment
Page 2 of 2

Assistant Secretary of Defense Comments

Final Report
Reference



HEALTH AFFAIRS

THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D. C. 20301-1200

OCT 07 2005

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL
DEPUTY INSPECTOR GENERAL FOR AUDITING
DIRECTOR, DEFENSE FINANCIAL AUDITING SERVICE

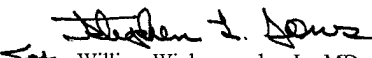
SUBJECT: Draft Report on Accuracy of the Contributions to the Medicare-Eligible
Retiree Health Care Fund (Project No. D2005-2000FJ-0081.000)

Thank you for the opportunity to review and provide comments on the subject draft report.

I concur with recommendations 2a and 2b of the DoD IG findings. However, I non-concur with recommendation 2c concerning the fourth Quarter Fiscal Year (FY) 2004 Marine Corps Reserve overstated contribution due to accounting problems. Approving a credit against future Marine Corps contributions to the Fund for the amount of \$602,175 is inconsistent with Federal appropriations and fiscal law requirements. A more detailed discussion on this recommendation is provided in the attached comments.

Comments on the DoD IG's Management Control Program review in which the draft report identifies perceived management control weaknesses regarding the accuracy of the MERHCF contributions are also attached.

My points of contact for this matter are Mr. Robert Moss (functional) and Mr. Gunther Zimmerman (Audit Liaison) at (703) 681-3492.


William Winkenwerder, Jr., MD

Attachments:
As stated

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DEPARTMENT OF DEFENSE INSPECTOR GENERAL
DRAFT OF A PROPOSED REPORT
D2005-2000FJ-0081.000

Agency Comments on Draft Report, "Accuracy of the Contributions to the Medicare-Eligible Retiree Health Care Fund"

TRICARE MANAGEMENT ACTIVITY (TMA) COMMENTS

Recommendation 2: We recommend that the Assistant Secretary of Defense (Health Affairs):

- a. Issue written guidance to the Military Departments outlining the criteria and schedule for making corrective payments or requesting corrective collections
- b. Disclose the Military Departments' contribution errors in the footnotes section of the FY 2005 Medicare-Eligible Retiree Health Care Fund Financial Statements
- c. Approve a credit to future Navy contributions for the amount of \$602,175 because of the FY 2004 Marine Corps Reserve overpayment.

DoD Response:

a. **Concur.** The DODI 6070.2, Department of Defense Medicare Eligible Retiree Health Care Fund Operations, will be revised later this calendar year. Included in the instruction will be a section on the criteria and schedule for making corrective payments or requesting corrective collections.

b. **Concur.** Included in the Management Discussion & Analysis (MD&A) and footnotes of the end of FY 2005 Medicare Eligible Retiree Health Care Fund financial statements will be a disclosure of the Military Departments' normal cost contribution errors.

c. **Non-Concur.** We cannot approve a credit to future Navy contributions as a result of the Marine Corps Reserve overpayment in FY 2004. Under Federal appropriations and fiscal law requirements, adjustments must relate to the appropriation available for obligations incurred during the year in question. Thus, the remedy for a FY 2004 overpayment is a refund to the appropriate FY 2004 appropriations account, rather than an offset against FY 2005 obligations, for which the FY 2004 appropriation is not available. Any other solution is a violation of fiscal law.

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**DEPARTMENT OF DEFENSE INSPECTOR GENERAL
DRAFT OF A PROPOSED REPORT
D2005-2000FJ-0081.000**

Agency Comments on Draft Report, "Accuracy of the Contributions to the Medicare-Eligible Retire Health Care Fund"

TRICARE MANAGEMENT ACTIVITY (TMA) COMMENTS

The "Management Control Program Review" section of the DoD IG Draft of A Proposed Report addresses the controls over the contributions to the Fund. The narrative addresses the adequacy of management's self-evaluation of those controls. The DoD IG addresses three (3) issues related to the MERHCF contributions: 1) the accuracy of the Military Department MERHCF normal cost contributions; 2) management control weaknesses over contributions to the MERHCF were not adequate to ensure the amounts paid were accurate; and 3) adequacy of management's self-evaluation.

Accuracy of the Military Department's MERHCF Contributions:

The DoD IG asserts in the draft report that they found material weaknesses in the Military Departments' internal controls over the monthly contributions to the MERHCF. The OIG specifies that the proper normal cost contribution amounts were not used, contributions (adjustments) for insignificant amounts were processed, and contributions were not properly approved by the Air Force.

Inadequacy of Management Controls Over Contributions:

The draft report identifies material management control weaknesses for the Army, Navy, and Air Force due to inadequate management controls over the contributions to the MERHCF were not adequate to ensure that the amounts paid were accurate. The report states that the implementation of Recommendations 1, 2 and 3 will correct the identified weaknesses and could result in the accurate contributions to the MERHCF.

As indicated earlier in this response, our efforts will address the actions directed in Recommendation #2. Towards that end, we concur with the direction to issue guidance to the Military Departments for issuing corrective payments or requesting collective collections guidance. We also concur with identifying Military Department contribution errors. We do not concur with making future corrective adjustments for overpayments that occurred in previous years. Recommendations 1 and 3 need to be addressed by the Under Secretary of Defense (Comptroller) and the Assistant Secretaries of the Military Departments (Financial Management and Comptroller).

Adequacy of Management's Self-Evaluation:

The draft report indicates that the Office of the Assistant Secretary of Defense (Health Affairs), DFAS, and the Military Departments did not identify contributions to the MERHCF as distinct assessable units and therefore, did not identify or report the material management control weaknesses identified by the audit.

Since the Military Departments' financial management and manpower organizations develop the contribution calculation, TMA does not believe an assessable unit should be established to oversee the MERHCF contribution accuracy. TMA does not have a method to estimate military end strength inasmuch as military end strength is only known to the Military Departments

The DoD IG should request the Under Secretary of Defense (Comptroller) direct the Military Departments to include an assessable unit in their management control programs for MERHCF contribution accuracy

Department of the Navy Comments

Final Report
Reference



THE ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON, DC 20350-1000

15 September 2005

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Review of Draft Report on the Accuracy of the Contributions to the
Medicare-Eligible Retiree Health Care Fund
(Project No D2005-D2000FJ-0081 000)

Thank you for the opportunity to comment on the DRAFT report on the Accuracy of the Contributions to the Medicare-Eligible Retiree Health Care Fund. My responses to each recommendation made in the draft audit are below.

Recommendation 1:

The DODIG recommended that the Under Secretary of Defense (Comptroller)/Chief Financial Officer issue written guidance for implementing the legislative change requiring annual contributions to the Medicare-Eligible Retiree Health Care Fund

Response:

Concur. However, I am concerned that the legislative change and the process for implementing it could result in significant inaccuracies in fund contributions. According to law, one payment is to be made at the beginning of the year. This could result in significant execution year variances between the estimated strength against which the contribution was calculated and the actual strength. Further, the current implementation plan does not allow for an update of strength from the estimates in the President's Budget, which is generally submitted 8 months prior to the beginning of the fiscal year. This could exacerbate the variance. These variances might lead to inadequate or excess funding in the Medicare-Eligible Retiree Health Care Fund, and adjustments to future year accruals that could disproportionately impact the services

Recommendation 2:

The DODIG recommended that the Assistant Secretary of Defense (Health Affairs)

A. Issue written guidance to the Military Departments outlining the criteria and schedule for making corrective payments or requesting corrective collections;

B. Disclose the Military Departments' contribution errors in the footnotes section of the FY 2005 Medicare-eligible Retiree Health Care Fund Financial Statements;

C. Approve a credit to future Navy contributions for the amount of \$602,175 because of the FY 2004 Marine Corps Reserve overpayment.

Response:

Concur. For part C, the credit is to be posted in September 2005

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Recom-
mendation 6

SUBJECT: Review of Draft Report on the Accuracy of the Contributions to the Medicare-Eligible Retiree Health Care Fund
(Project No. D2005-D2000FJ-0081 000)

Recommendation 3:

The DODIG recommended that the military department Assistant Secretaries (Financial Management and Comptroller) establish written procedures for their respective contribution processes

Response:

Concur. I am prepared to issue written procedures for the administration of transfers to the Medicare-Eligible Retiree Health Care Fund pending the promulgation of guidance from the Secretary of Defense (Comptroller)/Chief Financial Officer for implementing the legislative change requiring annual, vice monthly, contributions

Recommendation 4:

The DODIG recommended that the Assistant Secretary of the Air Force (Financial Management and Comptroller)

A. Direct Air Force personnel to prepare the contributions to the Fund instead of delegating the responsibility to DFAS; and

B. Contribute \$393,235 to the Fund because of the FY 2004 Air National Guard underpayment

Response:

Not applicable to the Department of the Navy.

My point of contact for this matter is Mr. James Moser, FMB-14, who can be reached at (703) 614-0066.



Richard Greco, Jr.

Revised

Department of the Air Force Comments



Office Of The Assistant Secretary

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC

NOV 01 2005

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDITING
OFFICE OF THE INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

FROM: SAF/FM

SUBJECT: DoDIG Draft Report of Audit, "Report on Accuracy of the Contributions to the Medicare-Eligible Retiree Health Care Fund", July 12, 2005 (Project No. D2005-D2000F1-0081.000)

This is in reply to your memorandum requesting we provide comments on subject report. We concur with the findings and recommendations specific to the Air Force pertaining to establishing internal controls necessary to ensure the accuracy of the contribution payments to the Fund. We also agree with the need for the Air Force to prepare the contribution payments to the Fund instead of delegating the responsibility to DFAS Denver.

Corrective action to the findings will be achieved via automation and updating written policy procedures by 30 November 2005. Specific management comments are attached.

If you have any questions, please contact Ms Rita Chico at 703-695-0036.

A handwritten signature in black ink, appearing to read "John G. VonGLIS".

JOHN G. VONGLIS
Principal Deputy Assistant Secretary
of the Air Force (Financial Management)

Attachment:
Management Comments

AIR FORCE RESPONSE TO DoDIG REPORT D2005FJ-0081 000
Report on Accuracy of the Contributions to the Medicare-Eligible Retiree Health Care Fund

SAF/FM Comments:

Finding 3 – The Air Force has not established internal controls necessary to ensure the accuracy of the contribution payments to the Fund. In addition, both the Air Force and DFAS Denver have not established procedures for the preparation, review and approval of the Air Force monthly contribution to the Fund.

Recommendation 3 – The Assistant Secretary of the Air Force for Financial Management and Comptroller (SAF/FM) should direct Air Force personnel to establish written procedures for the contribution process.

Comment 3 – Concur. SAF/FM will issue guidance for the disbursement and process of the fund contributions. SAF/FMBOP is drafting a checklist outlining the new contribution process for the annual transfer of funds from Air Force to the Department of the Treasury. The written procedures will be incorporated into the FMBOP Continuity Book. (Estimated Completion Date: 30 Nov 2005)

Finding 4 – Air Force Personnel did not prepare the contribution payments to the Fund; instead, it delegated the responsibility to DFAS Denver.

Recommendation 4a – The Assistant Secretary of the Air Force (Financial Management and Comptroller) should direct Air Force personnel to prepare the contributions to the Fund instead of delegating the responsibility to DFAS.

Comment 4a – Concur. SAF/FMBOP has taken action for FY 2006. In accordance with a memo issued by OSD addressing the new process, the Air Force worked closely with DFAS to transfer the annual contribution to the Department of the Treasury. The Treasury will make the monthly contributions to the Fund. (Completed: 5 Oct 2005)

Recommendation 4b – The Assistant Secretary of the Air Force (Financial Management and Comptroller) should contribute \$393,235 to the Fund because of the FY 2004 Air National Guard underpayment.

Comment 4b – Concur. The Air National Guard made the payment of \$393,235 into the fund for the Air National Guard underpayment. (Completed: Aug 2005)

Potential Monetary Benefit (PMB) (Recommendation): N/A

Revised

Team Members

The Office of the Deputy Inspector General for Auditing of the Department of Defense, Defense Financial Auditing Service Directorate, prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

Paul J. Granetto
Patricia A. Marsh
James L. Kornides
Mark Starinsky
Ted R. Paulson
Peter G. Bliley
Meredith Johnson