UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

Office of the
Inspector General

October 31, 2012

MEMORANDUM FOR JOHN BERRY
Director

FROM: PATRICK E. McFARLAND
Inspector General

SUBJECT: Fiscal Year 2012 Top Management Challenges

The Reports Consolidation Act of 2000 requires the Inspector General to identify and report annually the top management challenges facing the agency. We have divided the challenges into two key types of issues facing the U.S. Office of Personnel Management (OPM) – environmental challenges, which result mainly from factors external to OPM and may be long-term or even permanent; and internal challenges, which OPM has more control over and once fully addressed, will likely be removed as a management challenge.

The three listed environmental challenges facing OPM are due to such things as increased globalization, rapid technological advances, shifting demographics, national security threats, and various quality of life considerations that are prompting fundamental changes in the way the Federal Government operates. Some of these challenges involve core functions of OPM that are affected by constantly changing ways of doing business or new ideas, while in other cases they are global challenges every agency has to deal with.

The five internal challenges included in this letter represent OPM's development of new information systems, the need to strengthen controls over its information security governance, internal controls over the financial management reporting for the Revolving Fund and Salaries and Expenses Accounts, stopping the flow of improper payments, and the retirement claims process.

Inclusion as a top challenge does not mean we consider these items to be material weaknesses. In fact, the areas of Background Investigations (as part of the Revolving Fund material weakness reported in the Office of the Inspector General's Federal Managers' Financial Integrity Act Management Assurance letter) and Information Security Governance are the only challenges related to the reported material weaknesses.

The remaining challenges, while not currently considered material weaknesses, are issues which demand significant attention, effort, and skill from OPM in order to be successfully addressed. There is always the possibility that they could become material weaknesses and have a negative impact on OPM's performance if they are not handled appropriately by OPM management. We have categorized the items included on our list this year as follows:

**Environmental Challenges**

- Strategic Human Capital;
- Federal Health Insurance Initiatives; and,
- Background Investigations.

**Internal Challenges**

- Information System Development;
- Information Security Governance;
- Financial Management System and Internal Controls: Revolving Fund and Salaries and Expenses Accounts;
- Stopping the Flow of Improper Payments; and,
- Retirement Claims Processing.

We have identified these issues as top challenges because they meet one or more of the following criteria:

1) The issue involves an operation that is critical to an OPM core mission;
2) There is a significant risk of fraud, waste, or abuse of OPM or other Government assets;
3) The issue involves significant strategic alliances with other agencies, the Office of Management and Budget, the Administration, Congress, or the public;
4) The issue is related to key initiatives of the President; or,
5) The issue involves a legal or regulatory requirement not being met.

The attachment to this memorandum includes written summaries of each of the challenges that we have noted on our list. These summaries recognize OPM management's efforts to resolve each challenge. This information was obtained through our analysis and updates from senior agency managers so that the most current, complete and accurate characterization of the challenges is presented. I would also like to point out that we have removed the challenges shown below that were on this list last year:

- Tribal Healthcare – In May 2012, OPM began accepting Federal Employees Health Benefits Program (FEHBP) enrollment applications from eligible Tribes, Tribal organizations, and urban Indian organizations. As of August 2012, enrollment reached 3,000 individuals representing 33 tribes. While OPM's commitment to expanding Tribal healthcare enrollment continues, we believe OPM has successfully implemented this important feature of the Affordable Care Act. This was accomplished by building a strong (and continuing) partnership between the Tribes, Tribal organizations, urban Indian organizations, the Department of Health and Human Services, the Indian Health Service, and the Bureau of Indian Affairs. OPM has also entered into a successful agreement with the U.S. Department of Agriculture's National Finance Center to process applications and premium payments from Tribes and Tribal Organizations. Therefore, we no longer believe that the Tribal healthcare initiative meets the management challenge criteria.

- Pre-Existing Condition Insurance Plan – Since its inception in August 2010, OPM has demonstrated that it has and continues to successfully administer this program. Due to this and the fact that the program will be replaced by provisions of the Affordable Care Act on January 1, 2014, we no longer believe that the Pre-Existing Condition Insurance Plan represents a management challenge for OPM.

- Improving Internal Controls over OPM's Human Resources Solutions (HRS) Vendor Management Branch Operations – This has been removed based on HRS's efforts that have significantly improved the internal controls over the interagency agreement process.

This year, we have added two additional discussions under the Federal Health Insurance Initiatives challenge. These address OPM's challenges in the implementation and oversight of the Medical Loss Ratio (MLR) premium rate setting methodology and the FEHBP Carrier's Fraud and Abuse Programs.

I believe that the support of the agency's management is critical to meeting these challenges and will result in a better Government for the American people. I want to assure you that my staff is committed to providing any audit or investigative support needed and that they strive to maintain an excellent working relationship with your managers.

If there are any questions, please feel free to call me at 606-1200, or someone from your staff can contact Michael R. Esser, Assistant Inspector General for Audits, or Michelle B. Schmitz, Assistant Inspector General for Investigations, at 606-1200.

Attachment

Attachment

# FISCAL YEAR 2012 TOP MANAGEMENT CHALLENGES
# U.S. OFFICE OF PERSONNEL MANAGEMENT

## ENVIRONMENTAL CHALLENGES

The following challenges are issues that will in all likelihood permanently be on our list of top challenges for the U.S. Office of Personnel Management (OPM) because of their dynamic, ever-evolving nature, and because they are mission-critical programs.

## 1. STRATEGIC HUMAN CAPITAL

In May 2010, President Obama issued a Memorandum, *Improving the Federal Recruitment and Hiring Process*, resulting in the launch of the largest reform of the Federal hiring process in over 30 years. OPM continues to make strides in addressing its human capital challenges in the following areas: hiring reform, the Veterans Employment Initiative, and closing skill gaps.

### *Hiring Reform*

OPM continues to work collaboratively with Federal agencies represented on the Chief Human Capital Officers (CHCO) Council to ensure Job Opportunity Announcements (JOAs) are written in plain language, no longer require Knowledge, Skills & Abilities (KSA) narratives, and have been reduced to 2-3 pages in length. Ninety-four percent of JOAs now allow candidates to apply using a resumé.

OPM and the CHCO Council working group also further refined the performance metric to calculate the time to hire by establishing standardized guidelines to use a weighted average for the calculation. OPM believes that a weighted average is a superior calculation as it takes into account the volume of each agency's hiring. Using the new weighted average, the time to hire has been reduced to 93 days in 2011 from an un-weighted average of 105 days in 2010. OPM continues to monitor on a quarterly basis the time to hire Government-wide and for agency specific mission critical occupations as they work to reach the goal of hiring a Federal employee within 80 days.

### *Veterans Employment Initiative*

During fiscal year (FY) 2011 the highest percentage of veteran new hires was achieved by the Federal Government in the last 20 years. The success of the initiative can be attributed to OPM's leadership through its Veterans Services Group, which spearheaded the development of an Executive Order-directed Federal infrastructure that was created to improve the opportunities for veterans and transitioning military Service members seeking Federal employment. In addition, a first-ever Government-wide Veterans Recruitment and Employment Strategic Plan was crafted to better guide agency efforts in eliminating barriers affecting veterans employment in the Federal Government. In conjunction with the strategic plan, the Feds Hire Vets (www.fedshirevets.gov) website was created as the "one stop location" to provide easy access to Federal employment-related information for veterans and transitioning military Service members. The veterans employment initiative also required the establishment of Veteran Employment Program Offices in the 24 CHCO agencies as well as a Government-wide marketing program on the value of America's veteran. The challenge for OPM is to ensure that Federal agencies respect and apply veterans' preference laws, rules, and regulations while using the tools that have been made available.

*Closing Skill Gaps*

OPM co-chairs the CHCO Council Integrated Product Team (IPT) of action officers working group. The group has worked to define Government-wide competencies including the establishment of a clear, transparent, and replicable process for institutionalization in the future. OPM has actively engaged the Chief Management Officer Councils and the Office of Management & Budget to collaborate on the IPT findings and the proposed strategies to close skill gaps either by closing staffing gaps, or by closing competency gaps.

Additionally, OPM is conducting a survey in the fall of 2012 to determine existing competency gaps for the six mission critical competencies. This survey will be the first of its type in assessing competencies since the population is not limited to particular positions, but will assess employees that are at the GS 12-15 level. OPM has developed a comprehensive short-term and long-term strategy to close staffing gaps as well as to address priority competencies. OPM has worked closely with the Government Accountability Office in strategy development and implementation activities to increase agency performance through recruiting, hiring, developing and retaining a workforce with the needed competencies to meet mission objectives.

OPM continues its progress in meeting the challenges of helping agencies to recruit and retain the right people with the skills needed to achieve their goals. With the aging Federal workforce, OPM is charged with helping agencies to identify and close skills gaps, being responsive to changing applicant and workforce needs, and continuing to monitor organizational performance measures in efficiency, effectiveness, and progress.

## 2. FEDERAL HEALTH INSURANCE INITIATIVES

OPM continues to face challenges it must address in order to ensure the Federal Employees Health Benefits Program (FEHBP) contracts with insurance carriers that offer comprehensive health care benefits at a fair price. In addition, with the passing of the Affordable Care Act (ACA), OPM's roles and responsibilities related to Federal health insurance have been expanded significantly. Under the ACA, OPM has been designated as the agency responsible for implementing and overseeing the multi-state program plan options which start in 2014. The following highlights these challenges and current initiatives in place to address them.

### A. Federal Employees Health Benefits Program

The ever-increasing cost of healthcare is a national challenge. For the upcoming year, 2013, the average FEHBP premium increase is 3.4 percent, which is slightly lower than last year's increase of 3.8 percent. However, it is a continuing challenge for OPM to keep premium rate increases in check. As the administrator of the FEHBP, OPM has responsibility for negotiating contracts with insurance carriers covering the benefits provided and premium rates charged to approximately eight million Federal employees, retirees, and their families. The FEHBP must utilize industry best practices and ensure quality healthcare for enrollees while controlling costs. This includes exploring creative ways to control costs and utilization of benefits, such as increased use of wellness initiatives and global purchasing of pharmacy benefits. They must also adjust to changes in the healthcare industry's premium rating practices. These challenges may require legislative, regulatory, procurement and contracting, and administrative changes. OPM believes that the following initiatives will help ensure that the FEHBP continues to offer enrollees quality healthcare services at fair and reasonable premium rates.

**1) Program-wide Claims Analysis/Health Claims Data Warehouse**

The challenge for OPM is that, while the FEHBP directly bears the cost of health services, it is in a difficult position to analyze those costs and actively manage the program to ensure the best value for both Federal employees and taxpayers, because OPM has not routinely collected or analyzed program-wide claims data. The Health Claims Data Warehouse (HCDW) project is an initiative to collect, maintain, and analyze data on an ongoing basis. The data will be derived from health and prescription drug claims under the FEHBP. The HCDW will allow OPM to understand the drivers of cost increases and model the potential effects of health system reform or environmental changes on Federal employees. This warehouse will also strengthen OPM's ability to strategically shape future benefits design by better positioning the agency to negotiate effectively with the FEHBP carriers to keep premium increases below industry-wide levels.

During FY 2012, OPM has continued its collaboration with the Office of the Inspector General (OIG) to implement and operate a HCDW. In October 2011, OPM entered into an agreement with a vendor to obtain a contractor capable of configuring and building a comprehensive health care claims analytical package to run within the HCDW. Development efforts of both the HCDW and claims analytics package have continued throughout FY 2012. The HCDW is expected to be operational in FY 2013, at which time OPM can begin analyzing FEHBP claims data.

It is important to note that developing and maintaining a health claims data warehouse of this magnitude presents its own complex challenges [including managing multiple data formats and feeds; large size; security; data validation and verification; flexibility (healthcare is a dynamic industry); etc.]

## 2) Prescription Drug Benefits and Costs

Increases in drug costs have been a major contributor to the rapid growth in healthcare costs over the last few years. Of continuing concern to our office are the pharmacy benefit managers (PBMs), who administer drug benefits for the FEHBP carriers. The FEHBP carriers, not OPM, negotiate the pricing of these pharmacy benefits. Consequently, prior to contract year 2011, these contracts lacked transparency, which limited our ability to audit and provide adequate oversight of this high cost benefit. This lack of transparency also made it impossible to ensure that FEHBP enrollees were receiving quality benefits at a fair price. However, effective January 1, 2011, any renewing PBM contract must meet the transparency standards outlined in FEHBP Carrier Letter #2010-04. Specifically, these standards require:

- Pass-through transparent pricing in carrier contracts with PBMs;
- PBM's profit under the contract must be tied to clearly identifiable sources;
- PBM's administrative fees must be clearly identified to retail claims, mail claims, and clinical programs, if applicable; and,
- Contracts and other documentation supporting charges to the carrier must be fully disclosed to and auditable by the carrier or its agent and the OPM OIG.

To encourage cost savings, OPM's FEHBP benefit and rate call letters, over the last two years, outlined expectations for all carriers to expand their programs to provide benefits for appropriate substitutions for higher-cost drugs, such as lower or no copayments for generic drugs and clinically appropriate therapeutic alternatives. As part of this initiative, OPM expressed its objective of having a generic dispensing rate of at least 75 percent for the FEHBP program as a whole in CY 2013. To accomplish this, carriers were asked to include in their 2013 benefit and rate proposals their current (historic) generic dispensing rate and their projected dispensing rate. Carriers were also encouraged to develop programs aimed at managing the cost and use of specialty drugs, which account for approximately 10 percent of total prescription costs. To assess carriers' progress in this area, OPM is requesting that carriers provide information on their current growth of specialty drugs, cost trends, and proposals for managing this benefit. The objective is to keep the growth of specialty drugs and their cost below industry averages. Overall, OPM has a continued interest in benefit and rate proposals that demonstrate effective prescription drug management without cost shifting or burdening patients.

OPM is also requiring carriers to submit information on their current pharmacy costs and current drug benefits. This information will be used to compare pharmacy costs per enrollee, across plans, and for the program as a whole with the intent of ensuring the FEHBP remains competitive.

While these short-term measures should have a positive impact on the program, OPM, through its PBM working group, continues to assess potential long-term initiatives to further reduce prescription drug costs, as well as strengthen the controls and oversight of the FEHBP pharmacy benefits. The importance of this effort was highlighted in "The President's Plan for Economic Growth and Deficit Reduction," dated September 2011. The President's plan calls for the streamlining of the FEHBP pharmacy benefit contracting and would allow OPM to contract directly for pharmacy benefit management services on behalf of all FEHBP enrollees and their dependents, versus the current process where each carrier negotiates its own PBM contract. This change will allow the FEHBP to more efficiently leverage its purchasing power to obtain a better deal for enrollees and taxpayers. According to the President's plan, this proposal would save $1.6 billion over 10 years. A continued stumbling block to achieving this objective is the current legislation, which prohibits OPM from contracting directly with PBMs. OPM has proposed statutory authority language changes, which seek to amend the current FEHBP law to permit OPM to contract directly with PBMs. However, this language has yet to receive the approvals required to allow for a change to the law. That being said, OPM should still consider ways to position itself and gain the needed expertise to implement this contractual change should the proposed statutory language become law.

Ultimately, any changes implemented to the FEHBP's pharmacy benefits will need to meet the challenge of ensuring that the changes do not adversely impact FEHBP enrollees' health and safety while realizing true program savings.

### 3) Medical Loss Ratio Implementation and Oversight

Beginning in 2013, OPM will implement a new requirement for all Community-Rated carriers participating in the FEHBP, except those using a traditional rating methodology. Each Community-Rated carrier will be held to a specific medical loss ratio (MLR), as determined by OPM. Simply put, Community-Rated carriers participating in the FEHBP must spend at least 85 percent of their FEHBP premiums on medical claims and approved quality health initiatives. If a carrier does not meet or exceed the MLR, it risks returning the excess premiums in the form of a rebate to the FEHBP. As with any change, this new premium rate-setting methodology will have its share of challenges.

As the implementation of this new requirement continues, OPM must be prepared to:

- Provide guidance on complex rate-setting issues and set consistent limits;
- Address new issues and provide clear, consistent guidance to all carriers;
- Update data tracking systems to account for all of the intricacies within the MLR process;
- Process additional rate submissions as this new requirement is expected to attract new carriers to the FEHBP;
- Ensure that carriers do not sacrifice quality for quantity; and,
- Administer the new policy consistently with the highest quality while preventing fraud, waste, and abuse.

Fundamentally, MLR will be an added responsibility that OPM will need to focus resources on so that the change is properly implemented with minimal disruption to the community rating process and the program, as a whole.

**4) Carriers' Fraud & Abuse Programs**

Under the FEHBP, participating health benefit carriers are required to operate a program designed to detect and eliminate fraud and abuse by employees, subcontractors, healthcare providers, and individual FEHB members. This fraud and abuse (F&A) program must have the following components:

- an anti-fraud policy statement;
- written action plan and procedures;
- formal training;
- fraud hotlines;
- educational programs;
- technology;
- security; and,
- patient safety.

By failing to have a comprehensive and effective F&A program, fraud and abuse may go undetected, resulting in increased healthcare costs, as well as potentially impacting the safety of FEHBP members.

Recent OIG audits have identified systemic weaknesses in health benefit carrier F&A programs. The carriers were not in compliance with the applicable FEHBP contract clauses and FEHBP Carrier Letters relating to the F&A programs. Specifically, these carriers have not referred and/or reported all potential fraud and abuse cases and patient safety issues to OPM and the OPM OIG. Also, these carriers have not implemented procedures to refer and/or report fraud and abuse issues within their contracted pharmacy benefits managers. Furthermore, the audited carriers could not accurately report the actual recoveries, savings, and cost avoidance achieved as a result of their F&A programs. As a result, the OIG could not determine whether the F&A programs administered by these carriers are a benefit to the FEHBP with respect to the costs and overall savings. The pervasiveness of these weaknesses is significant enough to believe that this could be a program-wide concern.

OPM's challenge is to continue to evaluate this issue and implement controls which will hold all FEHBP carriers accountable for operating an effective fraud and abuse program. This may require contract changes, as well as an updated FEHBP Carrier Letter covering the specific requirements for a comprehensive F&A program. Effective F&A programs will result in significant FEHBP savings and, more importantly, protect FEHBP members.

## B. Affordable Care Act (ACA)

Under the ACA, OPM is designated as the agency responsible for implementing and overseeing the multi-state plan options. In accordance with the ACA, at least two multi-state plans will be offered on each state health insurance exchange beginning in 2014. Multi-state plans (MSP) will be one of several health insurance options for small employers and uninsured individuals to choose. In total, state exchanges are expected to provide health insurance coverage for as many as 31 million Americans.

While implementing any new program represents a host of complex challenges, one of the greatest challenges will be securing sufficient resources for OPM's new MSP function, as well as the expanded FEHBP-eligible population. Currently, the ACA does not specifically fund OPM for its new healthcare responsibilities. In addition, ACA mandates that resources essential to the management of the FEHBP cannot be used to start up the new program.

OPM received limited FY 2011 and FY 2012 funding through an arrangement with HHS, which received ACA funding from Congress. With these funds, OPM established policy and operational teams to review program and policy issues related to implementing the MSP Program, as well as provided analytical support for the MSP Program. However, full funding beyond FY 2012 is a significant challenge for the agency, as well as for the OIG, which is charged with program oversight responsibilities. Without appropriate resources, OPM will not be able to support these new activities.

Even with adequate resources, implementation of the ACA presents a unique set of challenges for OPM. Since this is a totally new and complex program, OPM must:

- Develop a thorough understanding of complex laws and regulations governing the ACA, as well as State healthcare.
- Develop and implement regulations, policies, and contracts supporting the Multi-State Plan Program (MSPP).
- Work cooperatively with Administration Officials, Congress, and other Federal agencies/departments responsible for implementing the ACA.
- Initiate an outreach program with all stakeholders.
- Develop a short-term and long-term organizational structure to support the MSPP.
- Design and implement an internal control structure and management information system to ensure that MSPP goals and objectives are met, as well as to ensure compliance with all laws, regulations, and guidance.
- Create a comprehensive oversight program.

FY 2012 accomplishments included:

- Participated fully in inter-agency efforts to implement the Affordable Care Act.

- Reviewed and commented on several HHS, Treasury, and Labor regulations to determine their impact on MSPs. Negotiated provisions in these regulations to facilitate successful implementation of the MSPP.
- Completed complex analyses of State and Federal laws in a wide range of issue areas, in order to make policy decisions for inclusion in the proposed regulation.
- Published MSPP Notice of Proposed Rulemaking for public comment.
- Developed and obtained approval of MSPP acquisition strategy.
- Published draft issuer application for public comment.
- Began development of standard MSPP contract.
- Began development of systems needed to accept issuer applications.
- Conducted extensive outreach to States, potential issuer applicants, and other stakeholders.
- Conducted briefings for Congress, Administration officials, and internal OPM components.
- Coordinated MSPP implementation efforts with HHS.

Implementing and administering this new program represents an ongoing management challenge for OPM.

## 3. BACKGROUND INVESTIGATIONS

OPM's Federal Investigative Services (FIS), headquartered in Boyers, Pennsylvania, conducts background investigations on Federal applicants, employees, military members, and contractor personnel for suitability and security purposes. FIS conducts approximately 90 percent of all personnel background investigations for the Federal Government and processes approximately 2 million investigations per year. Agencies use the reports of investigations conducted by OPM to determine individuals' suitability for Federal civilian, military, and Federal contract employment, as well as their eligibility for access to national security classified information.

FIS has an effective system of integrity assurance and internal controls and works cooperatively with the OIG to bring offenders to justice. However, any fraud in background investigation reports is unacceptable from a national security perspective, so this issue requires continued close attention and monitoring by OPM management.

The OIG is concerned that the lack of an agency-wide debarment program puts OPM at risk. Using administrative sanctions and debarment proceedings on background investigators who have engaged in substantiated acts of serious misconduct, to include falsification, is highly recommended. This is important because there have been background investigators who falsified but were not prosecuted (due to age of the case or low dollar threshold) and were able to obtain employment with other background investigation firms. At the time of this memorandum, an OPM (employee) background investigator who pled guilty and is currently awaiting sentencing, applied for employment with a FIS contractor. If a suspension/debarment program was in effect, the individual may have been automatically excluded from such employment.

Additionally, FIS needs to maintain a dialog with the various contracting firms. Several contractors have suggested reducing the number of quality assurance re-contact letters as a cost-cutting measure. In light of the current high volume of open FIS falsification cases, any cut in quality assurance would be ill-advised.

As mentioned above, FIS is responsible for all background investigations in the federal government and conducts approximately 90 percent. FIS has delegated the remaining 10 percent to certain federal agencies (FBI, CIA, DHS and the U.S. Agency for International Development to name a few). FIS also needs to continue to ensure these delegated agencies maintain a high level of quality assurance. Several of the agencies who have recently been audited by FIS were found to be lacking a true quality assurance program; therefore, the quality of the background investigations are at risk.

In addition to audits of the delegated agencies, in 2012, FIS and the OIG started a working group. Representatives from the delegated agencies meet several times a year with FIS and the OIG to network and conduct information sharing. At our most recent meeting, held on October 16, 2012, an Assistant United States Attorney was the featured speaker. The Federal prosecutor shared what she is looking for when indicting background investigators guilty of falsification. Many of these delegated agencies have never made a criminal case referral, however they are learning from the recent success by FIS and the OIG.

## INTERNAL CHALLENGES

The following challenges relate to current program activities that are critical to OPM's core mission, and that while impacted to some extent by outside stakeholders, guidance, or requirements, they for the most part are OPM challenges that have minimal external influence. They are areas that once fully addressed and functioning will in all likelihood be removed as management challenges. While OPM's management has already expended a great deal of resources to meet these challenges, they will need to continue their current efforts until full success is achieved.

### 1. INFORMATION SYSTEM DEVELOPMENT

OPM has a history of troubled system development projects. Past examples include the retirement modernization project, the Consolidated Business Information System financial management system, the Service Credit system, and the USAJOBS 3.0 website. While the problems that occurred during the implementation of these systems have been corrected, the fundamental control weaknesses remain. In our opinion, the control weaknesses relate to the lack of central oversight, policy, and institutional knowledge of proper system development and project management.

Our primary concern is that all of these systems were developed independent of agency-wide requirements or guidance – because no current guidance exists at OPM. Existing systems development lifecycle (SDLC) policy has not been updated in over 10 years, and it is not routinely used to manage current development projects. Most system development projects at OPM are initiated and managed by OPM program offices with little oversight or interaction with the Office of the Chief Information Officer (OCIO). These program office managers do not always have the appropriate background in project management or information technology systems development.

The OCIO is currently updating OPM's SDLC policy, which is a significant first step in implementing a centralized SDLC methodology at OPM; however, the policy will need additional updating in order to address the specific deficiencies we identified from audits conducted in FY 2012. In addition, policy alone will not improve the historically weak SDLC management capabilities of OPM – further action will be needed.

In a recently issued audit report, we recommended that the OCIO establish an SDLC review process in which the OCIO must review and formally approve SDLC work at various milestones for all OPM system implementation projects. While the OCIO does review major IT investments through the Tech-Stat process, smaller system development projects will probably not be subject to this level of review. The Service Credit system was an example of a system development project that did not meet the criteria of a major investment, but when it failed there were serious consequences for the agency – not financial, but impactful to stakeholders and embarrassing in terms of media exposure and political scrutiny.

We therefore also recommended that the OCIO develop a team with the proper project management and system development expertise fundamental to successful new system development projects. Through this avenue, the OCIO should provide oversight and strict guidance to ensure that program office management is following OPM's SDLC policy and is employing proper project management techniques to ensure a successful outcome for all new system development projects.

## 2. INFORMATION SECURITY GOVERNANCE

OPM relies on information technology to manage its core business operations and deliver products and services to many stakeholders. With increasing reliance on information systems, growing complexity, and constantly evolving risks and threats, information security has become a mission-critical function. Managing an information security program to reduce risk to agency operations is clearly an ongoing internal management challenge.

Information security governance is the overall framework and supporting management structure and processes that are the foundation of a successful information security program. Proper governance requires that agency management is proactively implementing cost-effective controls needed to protect the critical information systems that support the core mission, while managing the changing risk environment. This includes a variety of activities, challenges, and requirements, but is primarily focused on identifying key roles and responsibilities and managing information security policy development, oversight, and ongoing monitoring activities.

For many years, we have reported increasing concerns about the state of the agency's information security governance. In May 2009 we issued a Flash Audit Alert (FAA) to you and the Chief Information Officer (CIO) highlighting these concerns. The primary issues outlined in the FAA included outdated information security policies and procedures, and an understaffed IT security program, particularly the longstanding lack of a permanent senior agency information security official (SAISO).

The lack of policies and procedures was reported as a material weakness in the FY 2007 and FY 2008 Federal Information Security Management Act (FISMA) audit reports. In FY 2009, we expanded the material weakness to include the agency's overall information security governance program and incorporated our concerns about the agency's information security management structure. In the last two years, the OCIO has updated policy and created a viable information security group headed by a permanent SAISO.

However, the decentralized nature of OPM's IT security program continues to be a root cause of many of the recurring instances of non-compliance with FISMA requirements. An IT security program can be designed with a centralized or decentralized model, although most agencies adopt a hybrid structure with characteristics of both approaches. OPM, however, has chosen to implement a highly decentralized structure with most of the responsibility for IT security in the program offices, while the OCIO is responsible for policy development and oversight.

While it is true that IT security should be a shared responsibility between the OCIO and the program offices, FISMA assigns ultimate responsibility to the CIO for developing and maintaining an effective IT security program. Our audits over an extended period of time have clearly shown that OPM's decentralized approach is not effective. Program offices, in general, have neither the expertise nor the interest in properly managing an IT security program for their systems. Program offices will naturally focus limited resources on operational issues, and IT security is normally a secondary concern.

In our FY 2010 FISMA report, we recommended that OPM adopt a more centralized approach to IT security. We suggested that the agency recruit a staff of information security professionals to act as designated security officers (DSO) that report to the SAISO. Throughout FY 2012, the OCIO continued to operate with a decentralized IT security structure that did not have the authority or resources available to adequately implement the new policies. However, in August 2012, the OPM Director issued a memorandum to Associate Directors and Office Heads notifying them that IT security responsibilities would be centralized under the OCIO effective October 1, 2012. Once this transition is completed, we expect to see an improvement in compliance with FISMA requirements. Nevertheless, the issue will continue to be a significant internal management challenge pending successful implementation of the centralized DSO plan.

## 3. FINANCIAL MANAGEMENT SYSTEM AND INTERNAL CONTROLS: REVOLVING FUND AND SALARIES AND EXPENSES ACCOUNTS

During FY 2012, the Office of the Chief Financial Officer (OCFO) has made progress in resolving the long-standing issue related to the Fund Balance with Treasury (FBWT) reconciliation. The following steps were taken:

- Monthly reconciliations have been performed every month since July 2011 to reconcile the Government-Wide Accounting (GWA) activities with those in the General Ledger (GL). The reconciliations identified discrepancies between the GL and the GWA at the transactional level.
- Efforts have been made to record all cash receipt and disbursement activities by month-end, including identification of potential improvements in work processes. For example, a naming convention change for cash receipts from both incoming and outgoing Intra-Governmental Payment and Collection (IPAC) activity has been proposed that will facilitate reconciliation between the GL and the GWA.

The plan includes new reconciliation reports and procedures that have been put into place. Daily reconciliations for payment schedules have been performed since August 2011. A cutoff schedule has been implemented for September 2012 as well as all subsequent accounting closes. Additionally, new and additional staff resources have been dedicated to the process.

While these steps have been taken to address this challenge, during the audit of OPM's FY 2012 financial statements the auditors noted that deficiencies continue to exist in the operation of the OCFO's internal controls over financial management and reporting, affecting the accuracy of the Revolving Fund and Salaries and Expenses Accounts.

## 4. STOPPING THE FLOW OF IMPROPER PAYMENTS

Improper payments by Federal agencies continue to receive attention from elected officials. During FY 2011, OPM paid out $236 million in improper payments from the *Civil Service Retirement and Disability Fund* (CSRDF), including $103 million in payments to deceased annuitants. The CSRDF is defined by the Office of Management and Budget (OMB) as being susceptible to significant improper payments.

We issued a report on improper payments to deceased annuitants from the CSRDF on September 14, 2011. Two Congressional hearings were held this year regarding the matter. Director John Berry directed a team of four senior OPM executives, consisting of the head of Retirement Services (RS), the Chief Operating Officer, the Chief Financial Officer, and the head of Internal Oversight and Compliance, to help oversee the resolution of the four remaining OPM recommendations from this report, and implement the changes needed to correct the improper payment issue. The group developed a draft strategic plan that addresses actions OPM will take in the next 18-24 months to close the open recommendations. Our review of the strategic plan identified concerns, particularly the lack of specific dates and milestones to reach closure of the open recommendations in the next 18-24 months. We received a revised draft of the Strategic Plan for Stopping

Improper Payments to Deceased Annuitants in October 2012, and are currently in the process of reviewing and providing comments to OPM staff. OPM must establish a strong commitment to taking the corrective actions necessary to close the four open recommendations and eliminating all preventable improper payments within the 18-24 month timeframe cited.

OPM reported its progress in reducing improper payments under the *Improper Payments Elimination and Recovery Act* (IPERA) in its FY 2011 Agency Financial Report. We performed an audit of OPM's compliance with the IPERA reporting requirements this year and found that OPM was not compliant in reporting on agency accountability for reducing improper payments and did not report on its specific efforts to recover improper payments. In addition, we found various internal control deficiencies in its reporting on improper payments, including proper identification of the causes of improper payments and identification of specific actions to address the causes, as well as the lack of a current agency improper payments plan. OPM established an Improper Payments Working Group early this year comprised of representatives across all OPM programs, including Retirement Services, the Chief Financial Officer, and Policy and Internal Control (PIC). The group meets regularly to discuss improper payments legislation and OPM policy and initiatives for complying with applicable OMB guidance for reducing improper payments. The group is currently working on a revised version of OPM's improper payments plan and has produced a framework or template to ensure compliance with the reporting requirements under IPERA.

Lastly, the Administration issued a memorandum in June 2010 concerning an initiative for reducing improper payments through a "Do Not Pay (DNP)" list. In April of this year, OMB issued a directive to agencies to establish a plan for using the DNP solution for pre-payment eligibility reviews. OPM concluded that some provisions of the DNP may not be applicable or relevant for all of OPM's pre-payment and pre-award processes, but believes such a list would improve its ability to serve Federal annuitants and the public by preventing errors, waste, fraud, and abuse after individuals are added to the annuity roll. OPM expressed concern that using the DNP in the pre-award process would delay its ability to provide interim payments, on which many retirees rely to make ends meet. Further, being on the DNP list does not necessarily disqualify someone from receiving their annuity. The only conditions under which an annuitant would surrender his or her payment are enumerated in Title 5 U.S. Code Section 8312.

## 5. RETIREMENT CLAIMS PROCESSING

The timely issuance of full annuity payments to annuitants has been a long-standing challenge for OPM. Processing the retirement claims of Federal employees is a mission-critical OPM program. OPM is challenged with reducing a backlog of retirement applications that was over 48,000 at the end of December 2011. OPM has taken important steps to meet this challenge by making improvements in both technology and program application processing over the last year. OPM has made the following technology and program improvements to help reduce the backlog in claims processing:

- Worked with the National Business Center to achieve technical compliance and become the first payroll provider to send electronic retirement data to the repository;
- Continued working with other data providers to begin the technical compliance process;
- Provided access to agencies of imaged records/data stored electronically within OPM to help improve the submission of their applications;
- They are close to completing the IT Strategy which will provide partial IT improvements throughout the program, within fiscal constraints; and,
- RS underwent an initial Six Sigma review to create a more streamlined process for adjudicating cases. From this Six Sigma review, RS established a Case Development Team to help develop incomplete retirement applications upon arrival at OPM. This process frees up Legal Administrative Specialists (LAS) to focus their time on adjudication, and uses less experienced, front-line employees in the time-intensive task of gathering missing information.

In January 2012, OPM developed a strategic plan to eliminate the claims backlog and improve the programs application process so that 90 percent of all claims will be adjudicated within 60 days. The plan consists of four pillars:

1. People

    - Bring "all hands on deck" to add claims production capacity immediately;
    - Hire new LAS; and,
    - Hire new Customer Service Specialists (CSS).

2. Productivity and Process Improvement

    - Review process enhancements with goal of increasing production;
    - Expand work hours and effective use of overtime;
    - Complete Lean/Six-Sigma review of the claims process; and,
    - Improve LAS production capabilities by providing complete cases and removing superfluous duties.

3. Partnering with Agencies

    - Improve accuracy and completeness of incoming claims;
    - Involve Chief Human Capital Officers; and,
    - Provide more frequent feedback to agencies on claims deficiencies.

4. Partial, Progressive Information Technology (IT) Improvements

    - Pursue long-term data flow strategy;
    - Explore short-term strategy to leverage work agencies do now; and,
    - Review and upgrade systems used by LAS.

To date, OPM has hired 66 additional LAS and 22 additional CSS. They have moved all Non-Disability pending cases to Boyers, PA. Non-disability cases involving court orders or special cases are still processed at the OPM headquarters in Washington, DC. To date, a number of changes have been made to the front end of the retirement adjudication process which has resulted in improved processing.

OPM has demonstrated that this four pillar strategy has increased monthly claims adjudication capacity to nearly 10,000 claims per month since January 2012. From January – September 2012, the inventory was decreased from 61,108 to 41,176, roughly 33 percent.

However, incoming retirement applications are running at a higher pace than projected, and if history repeats, OPM can expect to receive as many as 21,000 new claims in January 2013. On top of those cases, OPM could potentially receive an additional 20,000 early-retirement cases from USPS. Therefore it is critical that OPM meets the challenge of eliminating the backlog of claims, as well as implementing continued improvements in the claims adjudication process.