Mission Statement

The Department of Defense Inspector General promotes national security and integrity and reliability in Government by conducting objective and independent audits, investigations, examinations and other activities to prevent, detect, and help correct problems in DoD programs, and to identify opportunities for improving efficiency and effectiveness.
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FOREWORD

It is my pleasure to report on the accomplishments of the Office of the Inspector General, Department of Defense, for the period April 1, 1999 through September 30, 1999. This Semi-annual Report summarizes significant Department-wide audit and investigative efforts. Oversight projects relating to the intelligence community are discussed in a separate classified annex.

The *Highlights* section provides an overview of the most significant issues discussed in the report. Chapter One contains brief updates on what we consider to be the Department’s principal high-risk areas. We have also included more detailed discussions of two special emphasis areas: *Year 2000 (Y2K) Conversion* and *Contract Management*. Chapter Two contains discussions of other important audit and investigative efforts that took place during the period, again resulting in significant criminal prosecutions and the identification of large dollar savings and recoveries.

This has been an extremely busy reporting period, with Y2K conversion matters receiving our fullest attention. Auditing Y2K conversion has required significant reprioritization of our resources and coverage throughout 1998 and 1999, with nearly 180 audits performed. The very positive responses we have received to our efforts in this critical area from the Department, the Office of Management and Budget, the General Accounting Office and the Congress indicate that our extensive work was warranted and useful. As this report illustrates, our efforts with the Department in the area of contract management and our ongoing work with the Defense Contract Audit Agency also have been productive and beneficial.

In our last report, I indicated that we were successful in gaining support within the Department relative to our resource shortages and, absent unplanned reductions, we would be able to meet our statutory mission for audit and investigation of high-risk programs. Although the Department budgeted for additional resources that were sorely needed, the Congress reduced our appropriation request by $3.3 million. We will make every effort to provide the fullest coverage and support possible, however, this reduction in resources will cause us to delay or forego a number of critical projects in high-risk areas, such as acquisition, computer security, financial reporting, disbursing and property disposal. I urge that our requirement for adequate resources be supported in the fiscal year 2001 budget review, so that we may continue to be responsive to an ever-increasing workload.

The men and women of the Office of the Inspector General are proud of accomplishing our unique mission, and remain committed to helping make the Department of Defense a stronger, safer and more efficient organization.

Donald Mancuso
Acting Inspector General
HIGHLIGHTS

INTRODUCTION
During the 6-month period ending September 30, 1999, the Office of the Inspector General, Department of Defense (OIG, DoD), continued to place emphasis on reducing vulnerabilities and improving controls in the principal high risk areas in the Department: Acquisition, Financial Management, Infrastructure and Information Technology Management. In addition, the OIG, DoD, focused on two special emphasis areas: Year 2000 (Y2K) Conversion and Contract Management.

Acquisition
In fiscal year 1999, the DoD purchased about $135 billion in goods and services, using more than 250,000 contracts, grants, cooperative agreements and other transactions. The DoD internal audit agencies issued 25 reports on acquisition management with recommended opportunities for improvement in such areas as verifying the models used to calculate munition requirements, performing lease versus purchase cost analysis, avoiding excessive prices for spare parts and ensuring that multiple award task order contracts are not used to avoid competition.

Financial Management
The DoD continued efforts to field the new generation of automated systems that are needed to correct chronic financial management problems. During this reporting period, the DoD audit agencies issued 73 reports related to these problems, e.g., an inability to produce auditable financial statements for nearly all major funds and poor internal controls in finance and accounting processes. The risk of Antideficiency Act violations and duplicate payments remains unacceptably high because of the continued inability to match disbursements with valid obligations in DoD accounting records. As of August 1999, the DoD had at least $6.3 billion in problem disbursements that were not properly recorded.

Infrastructure
The Department has put a high priority on reducing support costs while attempting not to degrade logistics support or the quality of life for military and civilian personnel. The DoD audit community issued 82 reports on support programs and participated in numerous logistics reform task forces. There are about 300 reform initiatives in the logistics area, which is an unprecedented level of emphasis on management improvement. Many of these reform efforts include adopting commercial practices and increasing use of web-based information technology.
Information Technology Management

The challenges faced by the DoD in managing its enormous inventory of systems and networks directly affect all other support areas, as well as warfighting. During the reporting period, the DoD audit agencies issued 16 reports on information technology issues other than Y2K. This clearly represents a minimal level of coverage for a Department with over 2,000 mission-critical systems, nearly 7,000 other essential systems, several hundred ongoing projects, a severe information assurance problem and increasing reliance on electronic commerce.

YEAR 2000 (Y2K) CONVERSION

The Department’s Y2K effort exceeds that of any other public or private sector organization in magnitude and complexity with a current estimated cost of conversion at $3.6 billion. As of September 1999, the DoD was in the final phases of its higher level testing program, which includes 31 end-to-end tests by function, such as vendor pay or procurement; 35 operational evaluations of warfighting systems by the Combatant Commands; and 56 organizationally unique efforts, such as Navy battle group systems integration tests. The DoD Y2K conversion appears at this point to be a success story, largely because of the emphasis applied by the Secretary and Deputy Secretary of Defense. The DoD audit community will continue its quick reaction reporting on Y2K readiness through the end of 1999 and will assist in determining the cause of any significant unforeseen problems that emerge to help identify the lessons learned from the Y2K experience.

CONTRACT MANAGEMENT

Although the DoD budget declined between fiscal years 1990 and 1998, the number of procurement actions has actually risen. The DoD procurement arena remains highly vulnerable to corruption. During this period of acquisition workforce downsizing, process changes, new automated procurement management systems and transition to electronic commerce, it is vital that the Department continue to maintain strong controls against fraud. The DoD audit community is working closely with the Department to decrease vulnerabilities in such areas as medical service contracts and other vendor pay.

OTHER ACTIVITIES

During this reporting period, the DoD Hotline received 7,099 telephone calls and letters reporting fraud, waste and mismanagement in DoD operations. The Hotline initiated 936 cases resulting from the information provided. Since 1982, over $418 million have been recovered as a direct result of Hotline inquiries.
CHAPTER ONE – REDUCE HIGH RISK VULNERABILITIES

INTRODUCTION

The DoD audit, inspection and investigative communities provide essential support to policy makers, managers and commanders across the spectrum of activities where controlling risk, fighting fraud and reducing costs are significant concerns. There is a close correlation between the Department's strategic management goals, improvement plans and known high risk areas. To the extent allowed by resource constraints, our oversight coverage is geared toward reducing vulnerabilities and improving controls in those high risk areas, which we have discussed in the past several semiannual reports. In this report, we provide updates on challenges and oversight activity in Acquisition, Financial Management, Infrastructure and Information Technology Management. We also discuss two focus areas—Year 2000 Conversion and Contract Management.

ACQUISITION

In fiscal year 1999, the DoD purchased about $135 billion in goods and services, using more than 250,000 contracts, grants, cooperative agreements and other transactions. Due to its huge scale and impact on U.S. military capability, the DoD acquisition program always has been controversial, and there have been nearly continuous reform efforts over the past 20 years to reduce costs and acquisition lead time.

The OIG, DoD, and the Defense Contract Audit Agency (DCAA) continued to be heavily involved in the reform initiatives, participating in numerous steering groups and task forces, and furnishing advice to the DoD and the Congress on proposed legislation and regulations.

The Defense criminal investigative organizations aggressively pursued cases involving bribery, kickbacks, mischarging, product substitution, false claims and other procurement matters, as discussed in Chapter Two and the Contract Management focus area.

During this semiannual period, the DoD internal audit agencies issued 25 reports on acquisition management issues. The audits recommended opportunities for improvement in such areas as verifying the models used to calculate munition requirements, performing lease versus purchase cost analysis, reducing weapon system life-cycle costs through design decisions, avoiding excessive prices for spare parts and ensuring that multiple award task order contracts are not used to avoid competition. We are especially pleased that the Congress, Office of Management and
Budget (OMB) and DoD took immediate legislative or regulatory actions to address the misuse of task order contracts that we reported.

The Department and Congress also have responded to the need to increase funding for equipment replacement and modernization. Nevertheless, the lack of stability in procurement planning remains a significant problem. Likewise, the Department continues to lack reliable information on the results of many acquisition initiatives taken over the past several years, partially because they are still being implemented. Recognizing the impossibility of fine tuning these initiatives without good performance data, the Department recently took measures to map the flow of acquisition management information related to its acquisition goals. Much more needs to be done, however, to develop useful metrics, and it is vital that reported data be validated. Internal audits would be especially useful in this regard; however, the DoD internal audit agencies lack the resources for a concerted effort in the acquisition area. Many of the audits being performed address specific DoD management or Congressional concerns, such as questions on whether the Navy fully disclosed F/A-18 E/F Hornet test data to the Office of the Secretary of Defense; we found no impropriety. Very little comprehensive audit of acquisition programs is being done, however, by either the OIG, DoD, or Military Department auditors. The lack of audit coverage of many hundred DoD acquisition programs results in many missed opportunities for early detection of impending program failures, such as on the Army Ground Based Common Sensor.

The DoD continued efforts to field the new generation of automated systems that are needed to correct chronic financial management problems. These problems include an inability to produce auditable financial statements for nearly all major funds and poor internal controls in finance and accounting processes. During the semiannual period, the DoD audit agencies issued 73 reports in this area. Most of these reports related to the DoD financial statements for fiscal year 1998.

The OIG, DoD, issued a detailed assessment of the Department’s Biennial Financial Management Improvement Plan in April 1999. We support the DoD effort to comply with a variety of statutory reporting requirements with a single document, the Biennial Plan. Annual updates will be needed, and the Department plans to submit an updated version in late 1999. In reviewing the Biennial Plan, we reported that the management oversight mechanisms and reporting concepts developed by DoD for the successful Y2K conversion effort would be easily adaptable for monitoring progress toward compliance with Federal accounting
standards by each of the over 200 critical DoD financial reporting systems. Most of those systems have principal functions, such as logistics, acquisition, and personnel or property management, and they do not belong to the Defense Finance and Accounting Service (DFAS). Without centralized monitoring, the individual system managers will have differing views on what constitutes compliance, will have limited realization of how their efforts compare to others and will report progress differently, if at all. The same problems existed, on a wider scale, when the Y2K initiative began. Although the Department agreed in May 1999 to apply these lessons in the financial reporting systems area, there has been little progress to date. This is disappointing and the OIG, DoD, will continue pressing the Department to adopt a more systematic, effective and visible management approach. Without it, there is considerable risk that compliant systems will continue to be deficient as far into the future as the middle of the next decade.

We also reported during the period that the risk of Antideficiency Act violations and duplicate payments remained unacceptably high because of the continued inability to match disbursements with valid obligations in DoD accounting records. Considerable progress was made in reducing certain categories of unmatched disbursements between 1996 and 1998, but some DoD organizations did not share in that downward trend and overall progress had slackened. As of August 1999, the DoD had at least $6.3 billion in problem disbursements that were not properly recorded.

In addition to improving the efficiency of DoD finance and accounting, the OIG, DoD, is working closely with the Department to combat fraud involving DoD finance activities, especially payments to contractors. As of September 30, 1999, the Defense Criminal Investigative Service (DCIS) had 85 open financial fraud cases. Further details are in Chapter Two.

**INFRASTRUCTURE**

Excessive costs in support areas such as supply, maintenance, transportation, facilities, environmental cleanup, property administration,
health care and miscellaneous administrative activities put additional pressure on DoD modernization and readiness accounts. The Department has put a high priority on reducing support costs while attempting not to degrade logistics support or the quality of life for military and civilian personnel. For example, there are about 300 reform initiatives in the logistics area alone, an unprecedented level of emphasis on management improvement. Many of the reform efforts throughout the support area entail adopting commercial practices, most of which are based on web-based information technology.

The DoD audit community issued 82 reports on support programs and participated in numerous logistics reform task forces during the reporting period. This is another area where much more needs to be done to develop reliable and useful performance reporting. Other significant issues identified by auditors included continued problems in attaining control over equipment and spare parts, so that shortages in operating units and war reserves are avoided, but excessive stocks in depots are minimized. Although DoD has cut the “wholesale” supply inventory nearly in half, saving some warehouse and carrying costs, the Air Force recently advised Congress that aircraft mission capable status had declined from 83 percent in 1991 to 73 percent, which is unacceptably low. Failure to provide spare parts to line units and repair depots is the principal problem. We believe that poor logistics management, cumbersome financial management, inadequate funding and paying excessive prices for spare parts are all causal factors. Audits also show poor visibility over material in-transit, failure to transfer usable items between Services instead of disposing of them and noncompliance by the Military Departments with DoD attempts to develop reliable depot capacity and utilization data. In the disposal area, the DCIS continued its aggressive efforts to pursue theft and fraud. There were 57 open investigations in September 1999 involving DoD property disposal.

In the health care area, auditors reported numerous ways to save money and improve service. For example, DoD spent about $45 million for in-patient treatment in military medical
facilities for dual-eligible beneficiaries on whose behalf another agency was making per capita payments to health maintenance organizations. Another evaluation showed that the 8.2 million potential beneficiaries of TRICARE, the DoD managed care health program, were not receiving adequate information on the program, a contributing factor to disappointingly high levels of user dissatisfaction with TRICARE. The DoD health care program is also a target for fraud, and the growing investigative caseload is difficult to manage under current resource constraints. In September 1999, the DCIS had 531 open health care fraud cases.

Although Information Technology Management is treated as a separate high risk area, the challenges faced by the DoD in managing its enormous population of systems and networks directly affected all other support areas, as well as warfighting. The most publicized of these challenges during the past 2 years has been the Y2K conversion task, which is discussed as a focus area below.

During the period, the DoD audit agencies issued 16 reports on information technology issues other than Y2K. This clearly represents a minimal level of coverage, given the fact that the Department has over 2,000 mission-critical systems, nearly 7,000 other essential systems, several hundred ongoing development and acquisition projects, a severe information assurance problem and rapidly expanding reliance on electronic commerce. In addition, there are longstanding problems in enforcing configuration management policies, frequency spectrum management, oversight of system acquisitions, interoperability, user acceptance, budget visibility and information technology infrastructure. We believe that the Department's senior managers and commanders are taking the information assurance threat very seriously, but audits continue to indicate a lack of emphasis at the installation and program office levels, partially because of the distraction created by the Y2K challenge.

Similarly, the DoD and Congress are clearly committed to improving management oversight of investment decisions, acquisition project status and the $16 billion annual DoD budget for information technology. Section 8121 of the Defense Appropriations Act for Fiscal Year 2000 mandates that no funds may be used for any mission-critical or essential system that is not registered with the DoD Chief Information Officer (CIO). This measure will eliminate the past uncertainty about the content of the DoD information technology portfolio. In addition, the Act
requires certification to Congress of compliance with Clinger-Cohen Act requirements for major automated systems passing designated acquisition milestones. The certifications must include data that previous audits have found missing for some new systems, such as funding baselines and an information assurance strategy. These requirements will lend impetus to the DoD effort to establish a more effective management control process. Past experience with weapon system acquisition oversight and the informal partnership between the DoD internal auditors and the CIO on Y2K indicate that audit validation of information reported to the CIO and Congress would be highly beneficial. Likewise, to the extent that resources permit, the audit community recognizes the need to plan much more extensive coverage of information assurance, controls in the electronic commerce area and other major information technology issues. Similarly, the DoD criminal investigative community is enhancing its direct support of DoD computer system intrusion defense.

A Navy member aboard the U.S.S. Carl Vinson stays in touch with family members through E-mail.
YEAR 2000 (Y2K) CONVERSION

PREVIOUS ASSESSMENTS

In previous semiannual reports, we described the magnitude of the challenge posed to the DoD by the Y2K computer code conversion problem. The Department has an estimated 10,000 vital networks, 1.5 million individual computers and tens of millions of embedded microprocessor chips in millions of equipment items. It also has 638 major installations, many thousand suppliers and extensive computer interfaces with Federal and state agencies, contractors, host nations, other allies and potential coalition partners. The DoD Y2K effort necessarily exceeded that of any other public or private sector organization in magnitude and complexity. The current estimated cost of the DoD Y2K conversion effort is $3.6 billion.

In the previous reports, we also discussed initial DoD problems in raising Y2K awareness among commanders and managers and in coping with the legacy of decades of very decentralized and often lax information technology management. However, in March 1999, testimony to the House Subcommittees on Technology and on Government Management, Information and Technology, as well as in our last semiannual report, we expressed confidence in the eventual success of the DoD effort. Specifically, we stated that, with continued intensive management attention through calendar year 1999, the DoD would not suffer system failures significant enough to impair critical mission performance. We noted, however, that while multi-system testing of unprecedented scope was scheduled, it had not yet taken place. Without the results of the integrated testing, it would have been premature to declare success. Likewise, much work remained to be done to convert several hundred still noncompliant mission-critical systems, ensure that viable contingency plans were in place, achieve compliance of all critical mainframe and mid-tier computers in data processing centers and ascertain the Y2K readiness status of suppliers and data exchange partners, especially overseas.

AUDIT VALIDATION

Over 200 DoD audits and inspections have been conducted to monitor, validate and facilitate implementation of the DoD Y2K Management Plan. For the OIG, DoD, auditing Y2K conversion has entailed significant reprioritization of resources and coverage throughout 1998 and 1999, with nearly 180 Y2K audits performed. The very positive responses to this body of work from the Department, OMB, the
President's Special Assistant on Year 2000 Conversion, industry, the General Accounting Office (GAO) and Congress indicate that the heavy emphasis was warranted and useful. The OIG, DoD, believes that the close cooperation between DoD auditors, inspectors and managers on Y2K constitutes an important precedent for future information technology initiatives and adds considerable credence to the confidence now being expressed by the DoD on Y2K readiness.

TESTING

As of September 1999, the DoD was in the final phases of its multi-system ("higher level") testing program. The higher level tests included 31 end-to-end tests by function, such as vendor pay or procurement; 35 operational evaluations of warfighting systems by the combatant commands; and 56 organizationally unique efforts, such as Navy battle group systems integration tests. Given the number of tests and systems involved, operational considerations ranging from the air war in the Balkans to tensions on the Korean Peninsula, funding considerations and the compressed schedule necessitated by initially slow progress on system remediation, the testing program was reasonably successful. Managers were generally responsive to audit advice on test planning and the overall results were acceptable, although not as good as they could have been if there had been a less compressed schedule. There was inadequate cooperation among some DoD organizations in terms of sharing test results and enabling the Y2K Program Office to maintain an accurate accounting of what systems were tested and where they were tested. Also, the fact that code scanning tools uncovered numerous Y2K problems that were not found during either system level or higher level tests may indicate that more stressful tests would have been possible. Nevertheless, the testing effort provided beneficial Y2K assurance. In addition, some system problems were found that, while not Y2K related, could have had operational consequences.

Y2K READINESS OF SYSTEMS

The DoD was unable to comply fully with the timetable established by OMB for the phases of Y2K conversion—awareness, assessment, remediation, validation and implementation. Large numbers of systems missed the OMB deadlines for all five phases. Although all mission-critical systems were supposed to be converted by December 31, 1998, for example, only 72 percent of the DoD mission-critical systems had met that milestone by February 1999. Although significant progress was made to catch up, as shown in Figure 1, page 9, the Department continued to get poor grades from Congress on Y2K performance through the fall of 1999. We agree that any noncompliant mission-critical system is a potential cause for concern; however, the risk can be mitigated through sound contingency planning.
In addition to converting over 2,000 mission-critical systems and nearly 7,000 mission-essential systems, the DoD reacted promptly to audit advice that its processing center platforms needed special emphasis to ensure they will function properly after Y2K. Because those platforms run thousands of systems segmented into 351 domains, achieving Y2K compliance entailed tremendous cooperation between system managers, design activities and platform administrators. This difficult effort was successfully completed, as shown in Figure 2, page 10.

Regardless of the amount of effort put into Y2K system conversion and testing, OMB and GAO have appropriately stressed the need for sound contingency plans at both the individual system and organizational levels. Within the DoD, there was considerable initial difficulty in motivating managers and commanders to devote sufficient resources and time to this task. Through early September 1999, 173 audit and inspection reports indicated contingency plan deficiencies in virtually all DoD components. The frequent findings of missing, incomplete, uncoordinated or untested plans were brought to the attention of the Deputy Secretary’s Year 2000 Steering Committee, and considerably more management emphasis was evident as the last calendar year quarter began.

In addition to having sound contingency plans in place, managers need to consider measures to minimize risk. Such measures could include
temporarily discontinuing Internet access or rescheduling activities that depend on automated system support. These decisions are best made by line managers, not information technologists. It is important that DoD line managers use the remaining time in 1999 to fine tune continuity of operations plans and risk mitigation measures.

OUTREACH

Some of the most difficult Y2K challenges relate to the non-DoD organizations, firms and allies that interface with the Department. The DoD commanders and line managers, the key players in outreach to external organizations, were not fully cognizant of their vital role in Y2K conversion until the Secretary of Defense reemphasized the threat that Y2K disruptions would pose to overall military readiness in August 1998. Moreover, as slow as the DoD Y2K progress seemed during 1996 through mid-1998, many of the Department's data exchange partners and suppliers were even further behind, especially overseas.

It was early or mid-1999 before credible Y2K readiness information existed for many of the parties involved in supply chain or operational relationships with the DoD. Despite the belated initiation of Y2K dialogue, good progress has been made. This is particularly true regarding U.S. domestic infrastructure and most host nation support issues.
The DoD supplier outreach effort has been generally successful, although its scope was constrained by various factors, including problems in identifying critical supply items in a consistent, timely and accurate way. The Defense Contract Management Command did an excellent job in determining the readiness of the 100 critical suppliers that it reviewed.

There were very few instances of building up inventories of critical parts as a contingency measure, which was somewhat surprising. To a certain extent, this reflects high confidence that supply chains will not be disrupted, although in some cases concerns about funding or holding excess stock appeared to discourage more aggressive action and it is questionable whether all supply item managers took the problem seriously. Nevertheless, DoD confidence in the Y2K readiness of its supply chain is consistent with the assessment of other government agencies and most private sector experts regarding the U.S. business sector.

**SUMMARY**

In summary, the DoD has made a tremendous effort to prepare for Y2K. Although it frequently lagged behind OMB timelines for the effort, we believe the Department's high confidence is justified. Some systems are likely to have problems, hackers may be more active than usual and some suppliers and other governments may have more difficulty than currently anticipated. Nevertheless, the DoD Y2K conversion appears at this point to be a success story, largely because of emphasis applied by the Secretary and Deputy Secretary of Defense in late 1998, when progress was deemed unsatisfactory. The DoD audit community will continue its quick reaction reporting on Y2K readiness through the end of 1999. After the millenium date change and until the Y2K transition period ends in March 2000, we plan to assist in determining the cause of any significant unforeseen problems that emerge and to help identify the lessons learned from the Y2K experience.
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CONTRACT MANAGEMENT

DEFENSE PURCHASING

The huge size and complexity of the DoD acquisition program were discussed previously in the summary of high risk areas. After the Department determines its prioritized requirements for purchased materiel and services and obtains funding, it identifies an appropriate purchasing tool for each item, conducts a purchase transaction and takes measures to ensure contractor/vendor performance and to make payment. This focus area discusses purchasing strategies, prices paid and administrative functions related to ensuring that the Government gets what it pays for and complies with applicable laws and regulations. Despite the greatly increased use of credit cards and other transactions instead of traditional contracts, we use the term contract management in this report as a generic term encompassing the administrative aspects of all DoD purchases.

“Although the DoD budget declined between fiscal years 1990 and 1998, the number of procurement actions has actually risen....”

Although the DoD budget declined between fiscal years 1990 and 1998, the number of procurement actions has actually risen, as shown in Figure 3, page 14. The dollar value of procurement actions declined somewhat in real terms, but the overall totals remained fairly constant in then-year dollars, as indicated in Figure 4, page 15. The trend toward increased spending on services and less on equipment is shown in Figure 5, page 16.

Regardless of the purchasing vehicles used and the nature of the purchased items, each procurement transaction entails administrative responsibilities for DoD personnel and potential issues. These issues pertain to the efficiency of contract management and how well the Government’s interest is protected.

FRAUD

Vulnerability to procurement fraud, including product substitution and false billings, has been a concern in military acquisition programs since the Revolutionary War. In our last semiannual report, we discussed bribery, kickbacks and corruption as a focus area. We reported that the DoD procurement arena remains highly vulnerable to corruption because of the sheer volume of transactions and dollars expended. During this period of acquisition workforce downsizing, numerous procurement process changes, the introduction of new automated procurement management systems and transition to electronic business, it is imperative
that the Department maintain strong controls against fraud. We are working closely with the Department to decrease vulnerabilities in such areas as medical service contracts and other vendor pay. We are also making fraud control an important consideration when commenting on proposed acquisition legislation or regulation changes and when auditing contract management issues such as quality assurance and sole-source selections. Recent examples of procurement fraud cases, including product substitution investigations, and related statistics are included in Chapter Two of this report.

PROCUREMENT STRATEGY

Decisions made on the front end of the acquisition process related to new weapon system performance requirements and quantities, as well as subsequent design decisions, are the primary drivers of life-cycle costs. Once it is decided what to buy, however, considerations such as type of contract, competitive versus sole-source selection, economic order
quantities and contract terms come into play as cost drivers. Many contract management issues relate to how effectively the Department makes those decisions and how well the DoD uses its authorities and resources in the process.

**DCAA SUPPORT TO CONTRACTING OFFICERS**

Contracting officers have various sources of assistance as they perform market research or other analysis to determine price realism. One of the most essential sources of financial advice is the DCAA.

Recent legislation relieved contractors from the requirement to submit certified cost or pricing data for a broad range of procurements and expanded the definition of a commercial item. Consequently, the requests for DCAA audits of price proposals based on certified cost or pricing data have declined. However, there has been a corresponding increase in
requests for DCAA to provide other financial advisory services related to cost realism, commercial pricing and evaluation of requests for waivers of cost or pricing data.

These statutory changes have also presented challenges to DCAA customers at the buying offices. The DCAA is responding to its customers' needs by establishing Financial Advisory Service Centers at all principal DoD procurement activities.

In May 1995, the Secretary of Defense directed that integrated product teams (IPTs) be used throughout the Department. As a result, IPTs are often established at contractor sites to improve the contract price proposal preparation and review process. This initiative has significantly changed the way DCAA performs price proposal audits. When a price proposal IPT is established at a contractor location, the DCAA auditor serves as a member of the team providing real-time feedback on potential problems during the price proposal preparation process. The auditor also
begins the review process as parts of the proposal are completed and submitted to the team. An audit report is issued after submission of a completed proposal. Audit issues are identified and resolved in a more timely manner, and the procurement cycle time is reduced significantly.

In December 1995, the Single Process Initiative (SPI) was established to help eliminate costly redundant processes within contractor facilities. It established mechanisms for the contractor to reduce the number of processes used and to modify existing contracts on a facility-wide basis, rather than on a contract-by-contract basis. The auditor’s principal role in SPI has been to evaluate the contractor’s cost-benefit analysis to determine whether the monetary benefits of proposed changes exceed the implementation costs. The DCAA is also an active participant on management councils that evaluate contractor process improvement proposals. The participation by DCAA indicates the good working relationship with most contractors that has been forged over the past several years.

Like the OIG, DoD, the DCAA participates in numerous acquisition reform task forces and has revamped many of its own practices to streamline contract management. For example, the agency has improved its risk assessment procedures and sampling methodology for low dollar value incurred cost proposals. It also has helped implement a contractor direct billing initiative, conducted concurrent, instead of sequential, incurred cost audit segments to reduce cycle time and streamlined contract closeout audits. It is noteworthy that a customer satisfaction survey conducted as part of the 1997 Biennial Review of Defense Agencies and DoD Field Activities gave DCAA an overall DoD customer satisfaction rating of 97 percent. The report concluded that there is a very strong need for the services DCAA provides.

The DCAA and OIG, DoD, support the general acquisition reform goal of adopting proven commercial acquisition approaches when there is a healthy, competitive marketplace. The DCAA encourages its auditors to be proactive and advise the contracting officers to make optimum use of the latitude provided by acquisition reform legislation and updated regulations. However, the DoD buys many unique military systems that clearly are not subject to marketplace pricing. When this is the case, the DCAA and the OIG, DoD, believe the procurement should be based on the cost or pricing data requirement and subject to a DCAA audit. The cost or pricing data requirement ensures that DoD gets a reasonable price when there are no competitive market forces. A recent DCAA analysis shows that the benefits of the cost or pricing data requirement continue to
far outweigh the costs. In fiscal year 1997, audits of cost or pricing data generated nearly $1.4 billion of net savings to the Government.

Unfortunately, the DCAA has been under severe downsizing pressure throughout the 1990's. We urge the Department and Congress to consider the vital role of DCAA and its excellent record of return on investment when considering future budgets.

ENCOURAGING COMPETITION

Making effective use of tools like the Truth in Negotiations Act and contract audits will help ensure fair and reasonable prices in sole-source situations. The best way to reduce prices, however, is through competition. Measures to reduce the use of overly restrictive military specifications and standards and to oppose anticompetitive mergers or exclusive teaming arrangements are prudent and should be continued.

As shown in recent spare parts audits, the Department also needs to overcome longstanding tendencies to miss opportunities for component breakout for competition and not to acquire technical data to facilitate future source reconsideration. The growth in procurement of services makes it particularly important to take aggressive measures to maximize competition in this area, which is just beginning to receive as much acquisition reform attention as procurement of supplies and equipment. The increased use of performance-based contracting requirements should enhance competition and help introduce leading-edge commercial technology.

OTHER ISSUES

Although recent coverage has been limited, DoD and GAO auditors have raised questions concerning numerous contract management practices. These include the consistency and reasonableness of definitions of what is a commercial item; the ability of the DoD work force to cope with so many policy changes at one time; the adequacy of Government review of the disposition of its share of pension assets related to DoD contracts after contract mergers; contract term deviations and waivers; underutilization of uncertified cost data in situations where certified data are not obtainable; management of Government-furnished property in contractor plants; user acceptance of the new Standard Procurement System; and compliance with the Buy American Act and Berry Amendment. Currently, the OIG, DoD, is reviewing the impact of the 46 percent reduction in the DoD acquisition work force during the 1990's and will provide a report to the Department and Congress in early 2000.
SUMMARY

The GAO has appropriately termed Defense acquisition a high risk area, and contract management remains one of the most controversial aspects of DoD operations. The DoD audit and investigative communities apply more resources to this area than any other, which is indicative of its inherent challenges.
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CHAPTER TWO - SIGNIFICANT ACTIVITIES

INTRODUCTION

This chapter summarizes the significant activities of the OIG, DoD, components and their work with other members of the DoD oversight community.

CRIMINAL INVESTIGATIONS

The four Defense Criminal Investigative Organizations (DCIOs) continue to combat crime affecting the DoD and the Military Departments. The DCIS, the criminal investigative arm of the OIG, DoD, focuses the bulk of its 335 civilian criminal investigators on the investigation of procurement fraud by Defense contractors and health care fraud by health care providers. The three Military Department criminal investigative organizations, the Army Criminal Investigation Command (CIDC), the Naval Criminal Investigative Service (NCIS) and the Air Force Office of Special Investigations (AFOSI), also investigate procurement fraud, but focus the majority of their resources on other crimes against persons and property affecting their respective Military Departments. The AFOSI and NCIS also conduct counterintelligence investigations and operations. This section focuses on the procurement, health care and other major fraud investigations accomplished by the DCIOs.

Figure 6 (page 22) displays the investigative results achieved by the four organizations during this period. As in previous reports, the statistics shown in the table do not include general crime investigations (other than large-scale thefts) or counterintelligence activities.

Examples of Major Procurement Fraud

The following are examples of some of the more significant fraud cases investigated by the DCIOs during this semiannual period. It should be noted that in virtually all instances, the DCAA played a critical role in supplying needed audit support.

- David M. Mitchell, co-owner and president of Campbell M. Industries, Incorporated (CMI), Stockton, California, was sentenced to 42 months confinement, followed by 36 months probation, and ordered to pay $276,969 in restitution to the DoD and a $4,100 special assessment. An investigation disclosed Mitchell fraudulently provided surplus aircraft parts on 21 DoD small purchase contracts and portrayed the surplus parts as new. Mitchell
<table>
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<tr>
<th>LITIGATION RESULTS</th>
<th>Procurement Fraud and Major Health Care Fraud Investigative Case Results</th>
<th>Other Criminal Investigative Results</th>
<th>Total</th>
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<tr>
<td>Indictments - DoJ</td>
<td>93</td>
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<td>265</td>
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<td>234</td>
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<tr>
<td>Indictments - State/Local/Foreign</td>
<td>--</td>
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<tr>
<td>Convictions - State/Local/Foreign</td>
<td>--</td>
<td>40</td>
<td>40</td>
</tr>
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</table>

| MONETARY OUTCOMES | | |
|-------------------|-------------------|-------------------|-------|
| DoJ Only          | $171,625,529      | $78,521,580       | $250,147,109 |
| DoD Administrative Recoveries | 12,455,387       | 15,336,681        | 27,792,068   |
| Investigative Recoveries     | 3,964,975        | --                | 3,964,975    |
| State/Local/Foreign       | --                | 917,950           | 917,950      |
| Total Monetary Outcomes   | $188,045,881      | $94,776,211       | $282,822,092 |

<table>
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<tr>
<th>SUSPENSIONS AND DEBARMENTS RESULTING FROM INVESTIGATIONS</th>
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<td>Suspensions</td>
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<td>Individual</td>
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<td>Companies</td>
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Figure 6

received the contract awards based on his electronically submitted bids and false certifications that he provided factory-new, non-surplus parts. Mitchell's scheme included directing his employees to fill the purchase orders with surplus parts available on the Inventory Locator Service, having the parts repackaged, falsifying documentation about the origin of the parts and then shipping the parts via United Parcel Service to the required DoD delivery point.

- RGA Labs, Incorporated (RGA), Torrance, California, was sentenced to pay a criminal fine of $500,000, criminal restitution of $1.2 million, a $300 special assessment and was put on probation for a period of 5 years for allegedly making false claims to the DoD and to the National Aeronautics and Space Administration (NASA). RGA specializes in testing electronic components, to include semiconductors and integrated circuits used in high reliability applications, such as
military weapon and space systems. An investigation disclosed RGA falsely certified required performance testing when, in fact, testing was performed improperly or not at all. In many instances, RGA’s test equipment was broken or the equipment did not exist to perform the testing. In addition, RGA certified parts that had failed previous testing.

• Fadi Boutros of LaMesa, California, was sentenced to 37 months incarceration and fined $6,000 and an assessment for violation of the Arms Export Control Act and the International Emergency Powers Act. Boutros, an Iraqi national, arranged for the purchase and export of five pairs of Generation II night vision goggles used by helicopter pilots to the country of Jordan. During the investigation, it was learned that the final destination for the goggles was Iraq. Boutros arranged for a future purchase of 20 additional Generation III night vision goggles, also destined for Iraq. The Generation II and III goggles are state-of-the-art technology, a restricted commodity that requires licensing before export and are embargoed from export to Jordan and Iraq.

• Harsco Corporation, York, Pennsylvania, agreed to pay the Government $11 million to settle a civil action under the False Claims Act concerning its former BMY Division. In 1992, the Government entered into civil litigation regarding an Army contract with BMY to manufacture 305 M109-A2 self-propelled howitzers. The investigation disclosed BMY did not live up to the contractual requirements by failing to conduct the proper amount and frequency of testing to detect any structural flaws in its product. The BMY failure to properly test the howitzers caused the Army to conduct a recall to ensure the structural integrity of the howitzers. The resulting damages to the Army exceeded $5 million.

• A $331,411 civil settlement was reached between the Government and Domestic Industries of Virginia, Incorporated, and its
president, John C. Santoro, Jr., for allegedly submitting false claims in conjunction with supplying No. 5 burner oil to the Naval Weapons Station, Yorktown, Virginia. The investigation revealed that the defendants submitted false claims for products that failed to meet required specifications of the Defense Fuel Supply Center contracts. The defendants allegedly substituted used and waste oil obtained at a much lower price for the burner oil required by the contract. The investigation also disclosed that the defendants violated Environmental Protection Agency regulations by operating a storage tank as a hazardous waste storage facility without a permit.

- A $3 million civil settlement was reached between the Government and Baker & Taylor, Incorporated (B&T), Charlotte, North Carolina. B&T, a nationwide book wholesaler and distributor, allegedly devised a scheme to defraud its customers by deliberately overcharging for "trade books" and by manipulating discount levels in ways inconsistent with its contractual obligations. B&T negotiated master pricing contracts in which it agreed to sell certain categories of books at specified discounts from the publisher's suggested retail price. B&T knew at the time it entered into the contracts with the Government, State schools and public libraries that the representations and promises made about the level of discount the customers would receive were false. The scheme was carried out by systematically miscategorizing certain trade books as non-trade books, subject only to "short or net discounts."

- Litton Applied Technology Division and Litton Systems Canada, Limited, pled guilty to conspiracy to defraud the Government, false statements and mail fraud. Litton allegedly failed to disclose the use of foreign sales representatives who received prohibited commissions on the sale of Litton Defense articles. The prohibited commissions were later charged to Litton's Foreign
Military Sales and Foreign Military Financing contracts. As a result of a guilty plea, Litton agreed to pay the Government $18.5 million in fines.

Examples of Health Care Fraud

- Genentech, Incorporated, of San Francisco, California, was sentenced to pay the Government a total of $50 million to resolve issues relating to the introduction of misbranded drugs in interstate commerce. Genentech admitted that between 1985 and 1994, it aggressively marketed the synthetic hormone Protropin, one of its most lucrative prescription drugs, for various medical conditions for which the drug had not received Food and Drug Administration (FDA) approval. During this time period, the FDA had approved the drug only for use against a rare growth disorder found in a small percentage of children.

- As a result of an investigation in connection with a Qui Tam suit, a $7,742,564 settlement was reached between the Government and the Chapter 11 trustee for the National Recovery Institute Group (NRIG). The suit alleged that NRIG, a drug and alcohol abuse clinic, billed TRICARE, Medicare and Medicaid for services not rendered in accordance with program requirements and for services that were not medically necessary.

- A $1.2 million civil settlement was reached between the Government and VNA Plus, a durable medical equipment provider, to resolve allegations that included double billing, billing for services not rendered and altered billings.

- Investigation of a Qui Tam complaint resulted in a $51 million civil settlement by Kimberly Home Healthcare, Incorporated, of Miami, Florida (Kimberly), a subsidiary of Olsten Health Management Corporation. Kimberly pled guilty in U.S. District Courts in Atlanta, Miami and Tampa to one count informations charging Kimberly with mail fraud, conspiracy and receiving kickbacks. The information charged that Kimberly knowingly assisted the Columbia Healthcare Corporation in the preparation and filing of false cost reports with the Government with respect to home health care. In addition to the civil
settlement, the corporation was sentenced to pay fines totaling $10,080,000.

- As a result of an investigation in connection with a Qui Tam suit, an $863,711 civil settlement was reached between the Government and Sharp Memorial Hospital (Sharp). The suit alleged that Sharp knowingly violated the False Claims Act by using the wrong diagnostic codes and the wrong diagnosis related groups to receive higher reimbursement for tests performed to identify pneumonia causing bacteria.

- A $4,149,555 settlement agreement was reached between the Government and Nova Southeastern University, Incorporated (Nova), Fort Lauderdale, Florida. The settlement was a result of an investigation into allegations that Nova billed TRICARE, Medicare and Medicaid for psychological services purportedly provided by licensed therapists or physicians when, in fact, the services at issue were provided by unlicensed student interns.

> "[A]n orthopedic surgeon...was sentenced to 24 months incarceration, 24 months supervised probation and ordered to pay $739,694 in restitution...for submitting false statements to TRICARE."

- Dr. Mark Hoffman, an orthopedic surgeon from Conyers, Georgia, was sentenced to 24 months incarceration, 24 months supervised probation, and ordered to pay $739,694 in restitution and a $150,000 fine for submitting false statements to the TRICARE and other insurance programs. His spouse, Jayne Hoffman, a nurse and the office manager, was sentenced to 6 months home confinement, 24 months supervised probation, ordered to pay a $100,000 fine and serve 500 hours of community service. The Hoffmans operated the Rockdale Orthopedic Center from 1990 to 1998, and during that time they submitted claims that included double billing, billing for services not rendered and upcoded procedures.

- Dr. Samuel M. Green, owner of Green Medical Center (GMC), Vienna, Virginia, was sentenced to 27 months incarceration, 36 months supervised probation and ordered to pay $1,423,944 in restitution. Dr. Green’s clinic specialized in preventive medicine, specifically weight loss treatment, a treatment that is not covered by the insurance plans. Dr. Green submitted claims to insurance companies, including TRICARE, concealing the nature of his practice. During the investigation, it was also determined GMC billed for procedures or tests that were not
performed, or were performed less expensively than those charged, and billed for psychotherapy sessions performed by unlicensed members of the GMC staff.

- Aberdeen Ambulance Service, Incorporated, Aberdeen, South Dakota, and Carter B. Hall, its owner and president, were sentenced as follows: Hall, who previously pled guilty to four counts of engaging in money transactions in property derived from specified unlawful activity, was sentenced to 30 months confinement, 36 months of supervised release on each count, and ordered to pay $20,000 in fines and assessment. Hall and Aberdeen Ambulance, which had previously pled guilty to one count of wire fraud, were ordered to pay $702,500 in restitution. In addition, Hall agreed to a lifetime debarment from Government contracting. The investigation determined Hall submitted false and inflated billings for reimbursement of ambulance services to Medicare, TRICARE and the State of South Dakota Medicaid Program.

- Albert L. Asrouch, Jr., of Minneapolis, Minnesota, a former U.S. Air Force Reservist, was sentenced to 6 months confinement, 5 years probation and ordered to pay $59,816 in restitution for submitting false statements to obtain Federal employee compensation benefits as a result of reported back injuries. An investigation disclosed that for the period September 1993 through April 1997, Asrouch certified that he was not involved in any business enterprise when, in fact, he was actively involved in a family-owned snowplowing business.

Other Criminal Investigative Results

Examples of Other Criminal Investigations

Environment

- James M. Hong, a former president and owner of the Avion Environmental Group, Incorporated, Richmond, Virginia, was sentenced to 3 years imprisonment, 1 year supervised release and ordered to pay a $1.3 million fine and assessment for violation of the Federal Clean Water Act. The investigation
disclosed that Hong, a DoD contractor, negligently caused the discharge of untreated wastewater from Avion's facility into the Richmond wastewater treatment system, failed to provide adequate funding for Avion's filtration and treatment system and pressured his employees to process more wastewater with a nonfunctioning filtration system.

**Kickbacks**

- Carl William Kruse, Jr., a general partner in Eastern Electric Company (Eastern), Hampton, Virginia, was sentenced to 24 months incarceration, followed by 3 years supervised probation; ordered to pay $544,560 in restitution and a $25,000 fine and assessment for providing kickbacks and gratuities. An investigation disclosed that between 1992 and 1997, Kruse made monetary payments and non-interest bearing loans to an officer of Systems Engineering and Energy Management Associates, Incorporated (SEEMA), Hampton, Virginia, in return for favorable treatment in connection with subcontracts for Eastern. While acting as the project manager for SEEMA on the Simplified Acquisition of Base Engineering Requirements (SABER) contract at Langley Air Force Base, Kruse awarded all electrical subcontract work to Eastern, a company in which he was a partner. Kruse also provided gratuities to a Government official in charge of the SABER contracts. Larry Dennis, former president of SEEMA, was sentenced to 24 months incarceration, followed by 3 years supervised probation, ordered to pay a $10,000 fine and was debarred from Government contracting for a period of 3 years.

- Gino Garilli, a purchasing agent for Kaman Aerospace Corporation, Bloomfield, Connecticut, was sentenced to 3 years probation, ordered to pay a $15,000 fine and assessment for receiving kickbacks and income tax evasion. An investigation disclosed that Garilli illegally received kickbacks from Royce Aerospace Material Corporation (Royce), a former DoD subcontractor and supplier of raw materials, such as aluminum and titanium. In return, Garilli provided Royce with bidding information. Garilli failed to report the additional income on his tax returns. The former president of Royce previously pled guilty and was sentenced to serve 38 months in prison.
Gratuity

- Gilbert P. Wilson, a former Government sales representative for Canon USA, Incorporated, was sentenced to pay a $1,000 fine and assessment for offering a gratuity to a public official. Wilson allegedly offered money to a DoD contracting specialist to influence the award of a DoD contract worth an estimated $800,000. The contract was to be awarded under a project to electronically scan paper documents accumulated by the Defense Electronics Supply Center, Dayton, Ohio, into an electronic storage media. The contracting specialist reported the bribe attempt to authorities, and the payment was never made.

Theft

- Jet Reclamation, Incorporated (Jet), John William Riddle, president of Jet, and Farrell Herbert Sutton, chief financial officer for Jet, were sentenced for conspiring to knowingly receive stolen Government property. Jet was sentenced to a $52,000 fine and assessment. Riddle and Sutton were each sentenced to 24 months incarceration (followed by 1 year of supervised probation) and ordered to pay $113,225 restitution to the Government. Between 1995 and 1998, Riddle and Sutton engaged in a scheme to steal aircraft parts from the Defense Reutilization and Marketing Office and the Defense Logistics Agency facilities located at Kelly Air Force Base, San Antonio, Texas. The aircraft parts most sought by Riddle and Sutton
were T-56 engine parts, which are used on the C-130 military aircraft.

- Six individuals were convicted in connection with an investigation into allegations of bribery at the McGuire Air Force Base Commissary. The investigation disclosed that the meat vendors bribed the managers at the meat department in exchange for favorable treatment while competing for commissary business. Two additional individuals are awaiting sentencing.

**HOTLINE**

Office of the Inspector General, Department of Defense Hotline

*for reporting Fraud, Waste, and Abuse (FWA)*

During this reporting period, the Hotline received 7,099 telephone calls and letters resulting in the initiation of 936 cases. During the same period, the Hotline closed 1,130 cases. The Hotline distributed 9,927 Hotline posters and other Hotline informational materials to various DoD activities and DoD contractors in its continuing effort to promote use of the DoD Hotline. Since 1982, over $418 million have been recovered as a direct result of inquiries initiated in response to information provided to the Hotline.

**Significant Hotline Complaints**

- Based on an anonymous complaint, a joint investigation was conducted by the FBI and DCIS, with audit assistance provided by the Office of the Assistant Inspector General for Auditing, OIG, DoD, into allegations of accounting abuses by a Defense contractor. The investigation identified altered labor reports to deliberately increase costs to the Government on follow-on contracts; double-billing the Government for engineering work;
charging improper labor rates and improper billing of commissions. As a result of settlement, the company controller pleaded guilty to submitting false claims and false statements to the Government, was fined a total of $40,000 and debarred from Government contracting for a period of 3 years. The contractor agreed to pay the Government $2.3 million.

- Based on a Hotline complaint, the NCIS substantiated allegations of faulty aerial refueling stores (wing fuel tanks) manufactured and sold to the Navy. The manufacturing contractor failed to advise the Government of test failures involving valves and cracks in the fuel/air fitting interface weld. Under the terms of the settlement, the company agreed to a contract modification to decrease the price of another Navy contract in the amount of $786,000 by offset.

**ADMINISTRATIVE INVESTIGATIONS**

The OIG, DoD, Departmental Inquiries Office conducts investigations and also performs oversight of investigations conducted by the Military Departments. These investigations pertain to:

- Allegations of whistleblower reprisal against military members, Defense contractor employees and nonappropriated fund employees.

- Allegations that military members were referred for mental health evaluations without being afforded the rights prescribed in the DoD Directive and Instruction pertaining to mental health evaluations of members of the Armed Forces.

- Noncriminal allegations against senior military and civilian officials within the DoD.

**Whistleblower Reprisal Activity**

During the reporting period, the Special Inquiries Directorate and the Military Department Inspectors General received 200 complaints of whistleblower reprisal. We closed 214 cases. Of the 214 cases closed, 136 were closed after preliminary analysis determined further investigation was not warranted; and 78 were closed after full investigation. Of the 78 cases closed after full investigation, 18 (or 23 percent) contained one or more substantiated allegations of whistleblower reprisal.

**Referrals for Mental Health Evaluations**

Nineteen cases closed during the reporting period contained allegations of improper referrals for mental health evaluation. We substantiated
violations of DoD Directive 6490.1, "Mental Health Evaluations of Members of the Armed Forces," in 6 of these cases.

Figures 7 and 8 (page 33) show the types and distribution of whistleblower reprisal cases as of September 30, 1999.

We previously reported our initial efforts to implement modifications to 10 U.S.C. 1034, enacted in the National Defense Authorization Act for Fiscal Year 1999. The modifications expanded the responsibilities of the IGs within the Military Departments for receiving, investigating and reporting allegations of military whistleblower reprisal. During this reporting period, we monitored the effectiveness of the interim procedural guidance we issued to the Military Department Inspectors General in February 1999.

Special Inquiries staff and the Military Department Inspectors General continue to work together to provide training, streamline processes and ensure the provisions of 10 U.S.C. 1034 are met. We are continuing our emphasis on conducting thorough preliminary analyses to determine whether a full investigation is warranted. As a result, we are resolving many allegations in a more timely manner.

- An Air Force airman first class received three letters of reprimand and three letters of counseling in reprisal for reporting sexual harassment and racial discrimination to a Social Actions Office.

- An Army National Guard staff sergeant received a lowered Noncommissioned Officer Evaluation Report in reprisal for reporting problems within the recruiting office to the Inspector General. Further, the responsible officials subjected the sergeant to a hostile work environment by issuing repeated verbal counselings, threats of Uniform Code of Military Justice action and threats to report the member as absent without leave.

- A Navy petty officer received an adverse performance evaluation, an adverse recommendation for instructor duty and an unfavorable duty assignment in reprisal for his support of a fellow military whistleblower.

- A technical sergeant was recommended for discharge from the Air National Guard for complaining to his chain of command, an Inspector General and the Social Actions Office.
Whistleblower Reprisal Inquiries/Investigations
By Category of Employee*
Open As Of September 30, 1999

*This graph provides a breakdown of reprisal cases according to the category of employee who filed the complaint (Military Member, non-appropriated fund (NAF) employee or employee of a Defense contractor).

Figure 7

Military Whistleblower Reprisal Inquiries
By Office Conducting Inquiry*
Open As of September 30, 1999

*This graph provides a breakdown of military whistleblower reprisal inquiries according to the organization conducting the inquiry. Military whistleblower inquiries completed by the Military Departments are submitted to the IG, DoD, Special Inquiries Directorate for review and approval.

Figure 8
• An Army major was reassigned and received a negative Officer Evaluation Report in reprisal for his participation in an IG investigation concerning his superior officer.

• A Defense contractor employee was discharged from his position as a quality control manager because he reported contract improprieties to Government contracting officials in Korea.

• A nonappropriated fund employee’s work hours were reduced and he was removed from the work schedule in reprisal for appealing to the commanding officer of the Naval installation to overturn his proposed separation. We recommended the employee receive back pay for the period in question and that he be returned to the work schedule.

Figures 9 and 10 (page 35) show results of activity on senior official cases during the period. On September 30, 1999, there were 229 ongoing investigations into senior official misconduct throughout the Department, down slightly since April 1, 1999 when we reported 250 open investigations. Over the past 6 months, we closed 198 senior official cases, of which 41 (21 percent) contained substantiated allegations.

• As directed by Section 1066 of the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999, we conducted a new investigation into matters concerning the 174th Fighter Wing (FW) of the New York Air National Guard. The law required that we examine circumstances that led to the December 1, 1995, grounding of the 174th FW and that we evaluate the administrative and disciplinary actions taken against members of that wing to determine whether those actions were appropriate.

As part of our work, we obtained sworn, taped testimony from over 50 witnesses, consulted with aviation safety experts and reviewed extensive documentation that was compiled during prior investigations. We found that the commander of the 174th FW grounded the unit in December 1995 as the ultimate step in dealing with perceived pilot attitude, morale and disciplinary problems that potentially compromised operational
Program Integrity
Nature of Substantiated Allegations Against Senior Officials
During 2nd Half FY99

- Sexual Harassment/Improper Relationship: 5%
- Abuse of Authority/Misuse of Position: 12%
- Misuse of Gov't Property/Resources: 38%
- Improper Personnel Action: 22%
- Other Misconduct: 23%

Total Cases: 198  Substantiated: 41

Figure 9

Program Integrity
Senior Official Inquiries
Open As of September 30, 1999

This graph provides a breakdown of senior official cases according to the organization which is conducting the inquiry. Inquiries completed by other organizations are submitted to the Program Integrity Directorate, OIG, DoD, for review.

Total Open Cases: 229

Figure 10
safety. We concluded that the grounding was justified for safety reasons and that its duration of 33 days was not unreasonable.

With the exception of nonjudicial punishment that was awarded to two of the 174th FW pilots, we concluded that the administrative and disciplinary actions taken against members of the wing were appropriate. We provided the report of our investigation to the Congress on September 1, 1999.

- In another investigation, we substantiated allegations that a director of a DoD agency violated Government ethics regulations pertaining to conflict of interest by engaging in official matters affecting a contractor with whom he was seeking employment. However, we concluded that the matter did not involve a violation of criminal statute because the individual's employment search had not progressed to the point of negotiating for a position.

The Office of Criminal Investigative Policy and Oversight (CIPO) published the following significant reports during the reporting period.

- The Evaluation of the Defense Protective Service (DPS) provided an in-depth assessment of the police force that protects the Pentagon and its personnel. The report reviewed the roles, responsibilities and relationships of DPS; its organization and management; personnel issues; law enforcement operations; and operations support. The report provided 26 specific recommendations to improve DPS. The DPS management accepted these recommendations and is implementing them.

- The Evaluation of Military Criminal Investigative Organizations’ Investigative Effectiveness Regarding U.S. Forces Civilians Stationed Overseas examined the ability of the MCIOs to competently investigate crimes committed by this segment of the DoD community. The report concluded that despite the diversity and complexities posed by overseas environments, the MCIOs are able to conduct effective investigations of U.S. Forces civilians who commit serious offenses. It also found that relationships and communications between DoD investigators and host nation authorities were in place and were effective.
- The Evaluation of Military Criminal Investigative Organization and Law Enforcement Organization Crime Scene Management examined crime scene management policies and procedures, and their implementation by military law enforcement officers and criminal investigators. The evaluation determined that the policies and procedures compared favorably to a Best Practices Template that was developed from standards established by civilian police agencies, law enforcement accreditation organizations and police training institutions. Further, site visits during the evaluation amply validated that DoD police officers and investigators adhered to these policies and procedures.

**AUDITING**

The OIG, DoD, auditors and those of the Military Departments issued 286 reports during the reporting period, identifying $1.5 billion in potential monetary benefits and recommending improvements across a wide spectrum of management activities, including the high risk areas discussed in Chapter One.

See Appendix A for a list of audit reports, sorted by major subject area. Appendices B and C list OIG, DoD, audit reports with quantifiable monetary benefits and DoD internal audit followup activities, respectively. The DCAA also continued providing essential financial advice to DoD contracting officers, as summarized in Appendix D.

**Export Licensing**

At the request of Senator Fred Thompson, Chairman of the Senate Committee on Governmental Affairs, the Inspectors General of the Departments of Commerce, Defense, Energy, State and Treasury, as well as the Central Intelligence Agency, performed a joint review of the export licensing process for dual-use commodities and munitions. Dual-use commodities are goods or services with both military and commercial applications. The results were discussed in a joint report and separate, agency-specific reports.

The six Inspectors General reported that the dual-use licensing process would be best served if the Export Administration Act were reenacted. In addition, interagency coordination could be improved, export licensing requirements specifically related to items and information “deemed to be exports” needed clarification and the exporter appeals process should be formalized. The review by the OIG, DoD, indicated various administrative deficiencies in the Department’s process for reviewing export license cases and documenting the rationale for advice given to decision makers. Management generally agreed with the findings and the numerous recommendations. The National Defense Authorization Act
for Fiscal Year 2000 calls for additional annual joint reviews in this subject area. In addition, the Deputy Secretary of Defense has expressed dissatisfaction with the slowness of the license application review procedures and directed a special effort by the involved DoD components to develop a more efficient process. This increasing emphasis on technology transfer issues is likely to create considerable additional workload for OIG auditors and investigators.

Audit Oversight

The DoD internal audit community has successfully implemented a new audit quality control peer review process, which will supplement direct oversight by the OIG, DoD, of DoD internal audit effectiveness and compliance with applicable standards. Using the peer review guide issued by the President’s Council on Integrity and Efficiency, review teams completed assessments of the Army, Navy and Air Force audit organizations. In all three cases, the results of the review indicated that the audit quality control processes were effective. The OIG, DoD, and DCAA are working together to strengthen the DCAA quality control review process and enable the OIG, DoD, to focus on the most significant audit process issues.

OIG, DoD, Testimony

On April 14, 1999, the Inspector General testified before the Senate Subcommittee on Readiness and Management Support, regarding Defense Financial Management. The Acting Inspector General testified on the same subject before the House Subcommittee on Government Management, Information and Technology on May 4, 1999. The Assistant Inspector General for Auditing testified to the House Subcommittee on National Security, Veterans Affairs and International Relations on June 16, 1999, on the Prompt Payment Act and DoD disbursing processes. The testimonies recounted problems the Department has experienced in developing auditable financial statements, implementing new automated systems and addressing chronic difficulties such as unmatched disbursements and vulnerability to fraud in payment operations.

On June 23, 1999, the Acting Inspector General testified before the Senate Committee on Governmental Affairs on export licensing processes for dual-use commodities and munitions.

INTELLIGENCE REVIEW

For information regarding specific work performed, see the Classified Annex to this report.
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APPENDIX A*
REPORTS ISSUED BY CENTRAL DOD INTERNAL AUDIT ORGANIZATIONS

Excludes base level reports issued by the Air Force Audit Agency. Includes evaluation reports issued by the OIG, DoD.

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

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<th></th>
<th>OIG, DoD</th>
<th>Army Audit Agency</th>
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<tr>
<td></td>
<td>(703) 604-8937</td>
<td>(703) 681-9863</td>
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<tr>
<td>Naval Audit Service</td>
<td>(703) 681-9126</td>
<td>Air Force Audit Agency</td>
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The OIG, DoD, also issued 3 reports on audit oversight reviews (99-6-005, 99-6-007 and 99-6-008). In addition, the Naval Audit Service issued 2 oversight reports, the Army issued 1 and the Air Force issued 1.

*Fulfills requirements of 5 U.S.C., Appendix 3, Section 5(a)(6).
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99-203 Status of Implementation of the Pilot Program on Sales of Manufactured Articles and Services of Army Industrial Facilities (7/8/99)

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99-244 Independent Review of the Defense Finance and Accounting Service Competitive Sourcing Study of the Transportation Accounting Function (9/1/99)

99-260 Life-Cycle Management for Military Aircraft Landing Gear (9/29/99)

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AA 99-168 Using Credit Cards For Intra-governmental Purchases (4/6/99)


AA 99-372 Commentary on Network Managers for the Digitized Battlefield (8/19/99)

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061-99 Department of the Navy Competitive Sourcing Program (9/16/99)

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99-239 DoD Unaccompanied Enlisted Personnel Housing Requirements Determination (8/20/99)

99-250 Construction and Rehabilitation of Reserve Component Indoor Small-Arms Ranges (8/20/99)
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AA 99-184 Program Objective Memorandum 98-03 Efficiencies--Utilities Modernization Central Heating Plants, Fort Belvoir, Virginia and Fort Meade, Maryland (4/2/99)

AA 99-224 Program Objective Memorandum 98-03 Efficiencies--Utilities Modernization Central Heating Plants, Fort Leonard Wood (4/19/99)

AA 99-225 Program Objective Memorandum 98-03 Efficiencies--Utilities Modernization Central Heating Plants, Fort Riley (5/7/99)

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AA 99-370 Program Objective Memorandum 98-03 Efficiencies--Leases and Disposal of Non-Operation and Maintenance, Army Excess (8/31/99)

AA 99-396 Cost-Benefit Study for Libby Range, Fort Belvoir (9/8/99)

AA 99-399 Program Objective Memorandum 98-03 Efficiencies--Utilities Modernization Central Heating Plants, Fort Campbell (9/2/99)

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99052020 Followup Audit, Facility Condition Codes (6/15/99)

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99-127 Data Supporting the FY 1998 DoD Military Retirement Health Benefits Liability Estimate (4/7/99)
99-135  Trends and Progress in Reducing Problem Disbursements and In-Transit Disbursements (4/16/99)

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**IG, DoD**


99-186 Review of the DoD Export Licensing Processes for Dual-Use Commodities and Munitions (6/18/99)

**Army Audit Agency**

AA 99-297 DOD Support to the NATO Summit (8/16/99)

AA 99-342 Army's FY 98 Billings to the Multinational Force and Observers (6/30/99)

**Air Force Audit Agency**

97062009 Software Support for Foreign Military Sales of F-16 Aircraft (4/14/99)
AUDIT OVERSIGHT REVIEWS

IG, DoD

99-6-005 Army Audit Agency Process for Determining Audit Requirements and Requesting Resources (5/27/99)

99-6-007 Air Force Audit Agency Process for Determining Audit Requirements and Requesting Resources (8/20/99)

99-6-008 PriceWaterhouse Coopers L.L.P., and Stanford University, Fiscal Year Ended August 31, 1997 (9/8/99)

Army Audit Agency

AA99-323 Peer Review of Naval Audit Service (8/9/99)

Naval Audit Service

045-99 Quality Control Review of Supervision (7/26/99)

056-99 Peer Review of Air Force Audit Agency (8/18/99)

Air Force Audit Agency

99023012 Peer Review of Army Audit Agency (8/9/99)

Our report on the status of OIG, DoD, reports over 12 months old in which management decisions have been made but final action has not been taken has been provided to the Department and is available upon request.
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### APPENDIX B*
**INSPECTOR GENERAL, DoD, AUDIT REPORTS ISSUED CONTAINING QUANTIFIABLE POTENTIAL MONETARY BENEFITS**

<table>
<thead>
<tr>
<th>Audit Reports Issued</th>
<th>Potential Monetary Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>99-147 Followup Audit of the European Theater C-9A Aircraft Flying Hour Program (5/5/99)</td>
<td>N/A $8,600,000</td>
</tr>
<tr>
<td>99-152 Overlapping Inpatient Treatment Expenditures for DoD Beneficiaries Enrolled in Medicare Health Maintenance Organization Plans (5/13/99)</td>
<td>N/A 271,000,000</td>
</tr>
<tr>
<td>99-159 Interservice Availability of Multiservice Used Items (5/14/99)</td>
<td>N/A 10,800,000</td>
</tr>
<tr>
<td>99-208 Defense Finance and Accounting Service Commercial Activities Program (7/8/99)</td>
<td>N/A 287,000</td>
</tr>
<tr>
<td>99-218 Sole-Source Noncommercial Spare Parts Orders on a Basic Ordering Agreement (7/27/99)</td>
<td>N/A 53,700,000</td>
</tr>
<tr>
<td>99-223 Defense Base Realignment and Closure Budget Data for the Closure of Roslyn Air Guard Station and Realignments to Stewart International Airport Air Guard Station, New York (7/26/99)</td>
<td>N/A 6,000,000</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>0 $350,387,000</strong></td>
</tr>
</tbody>
</table>

*Fulfills the requirement of 5 U.S.C., Appendix 3, Section 5(a)(6).

1There were no OIG audit reports during the period involving disallowed costs.
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APPENDIX C*
FOLLOWUP ACTIVITIES

<table>
<thead>
<tr>
<th>Status</th>
<th>Number</th>
<th>Funds Put to Better Use</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. For which no management decision had been made by the beginning of the reporting period.</td>
<td>29</td>
<td>$2,307,900</td>
</tr>
<tr>
<td>B. Which were issued during the reporting period.</td>
<td>130</td>
<td>350,387</td>
</tr>
<tr>
<td>Subtotals (A+B)</td>
<td>159</td>
<td>2,658,287</td>
</tr>
<tr>
<td>C. For which a management decision was made during the reporting period.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) dollar value of recommendations that were agreed to by management</td>
<td>129</td>
<td></td>
</tr>
<tr>
<td>- based on proposed management action</td>
<td></td>
<td>287</td>
</tr>
<tr>
<td>- based on proposed legislative action</td>
<td></td>
<td>287</td>
</tr>
<tr>
<td>(ii) dollar value of recommendations that were not agreed to by management</td>
<td></td>
<td>2,624,700²</td>
</tr>
<tr>
<td>D. For which no management decision has been made by the end of the reporting period. Reports for which no management decision was made within 6 months of issue (as of September 30, 1999).³</td>
<td>30</td>
<td>33,300</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>7,900</td>
</tr>
</tbody>
</table>

¹There were no OIG audit reports during the period involving questioned costs.
²OIG Report No. 99-043, “Navy Quantitative Requirements for Munitions,” issued December 3, 1998, represents $2.3 billion of this total. The report recommended that the Navy limit munitions requirements to the war reserve requirement, and testing, training and current operational requirements. The Navy agreed to continue to work with OSD and the Joint Staff to develop requirements to support the Commanders in Chief and the needs of a forward deployed Navy and Marine Corps. An OIG summary report will address the broader issues covering the entire DoD munitions requirements determination process.

*Fulfills requirements of 5 U.S.C., Appendix 3, Section 5(a)(8)(9) and Section 5(b)(2)(3).
<table>
<thead>
<tr>
<th>Status of Action</th>
<th>Number of Reports</th>
<th>Funds Put to Better Use</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OIG, DoD</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Action in Progress - Beginning of Period</td>
<td>295</td>
<td>$147,794</td>
</tr>
<tr>
<td>Action Initiated - During Period</td>
<td>129</td>
<td>287</td>
</tr>
<tr>
<td>Action Completed - During Period</td>
<td>116</td>
<td>151,911</td>
</tr>
<tr>
<td>Action in Progress - End of Period</td>
<td>308</td>
<td>13,3792</td>
</tr>
<tr>
<td><strong>Military Departments</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Action in Progress - Beginning of Period</td>
<td>367</td>
<td>5,249,319</td>
</tr>
<tr>
<td>Action Initiated - During Period</td>
<td>145</td>
<td>314,554</td>
</tr>
<tr>
<td>Action Completed - During Period</td>
<td>152</td>
<td>464,658</td>
</tr>
<tr>
<td>Action in Progress - End of Period</td>
<td>360</td>
<td>4,740,789</td>
</tr>
</tbody>
</table>

1There were no audit reports during the period involving questioned costs.

2On certain reports (primarily from prior periods) with audit estimated monetary benefits of $587 million, it has been agreed that the resulting monetary benefits can only be estimated after completion of management action, which is ongoing.
### APPENDIX D

**CONTRACT AUDIT REPORTS ISSUED**  
($ in millions)

<table>
<thead>
<tr>
<th>Type of Audit</th>
<th>Reports Issued</th>
<th>Examined</th>
<th>Audit Exceptions</th>
<th>Funds Put to Better Use</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incurred Costs(^2)</td>
<td>17,303</td>
<td>$56,164.9</td>
<td>$1,989.9</td>
<td>$282.7</td>
</tr>
<tr>
<td>Forward Pricing Proposals</td>
<td>5,396</td>
<td>43,150.3</td>
<td>--</td>
<td>2,258.3</td>
</tr>
<tr>
<td>Cost Accounting Standards</td>
<td>2,152</td>
<td>152.1</td>
<td>95.6</td>
<td>--</td>
</tr>
<tr>
<td>Defective Pricing(^3)</td>
<td>835</td>
<td>--</td>
<td>115.7</td>
<td>--</td>
</tr>
<tr>
<td>Other(^4)</td>
<td>6</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>25,692</td>
<td>$99,467.3</td>
<td>$2,201.2</td>
<td>$2,540.0</td>
</tr>
</tbody>
</table>

1Because of limited time between availability of management information system data and legislative reporting requirements, there is minimal opportunity for the DCAA to verify the accuracy of reported data. Accordingly, submitted data is subject to change based on subsequent DCAA authentication.

2Incurred cost funds put to better use are from the cost avoidance recommended in economy and efficiency audits of contractor operations.

3Defective pricing dollars examined are not reported because they are considered a duplication of forward pricing dollars reported as examined.

4Relates to suspected irregular conduct cases.

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**Waivers of Advisory and Assistance Service Contracts**

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

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

The Joseph H. Sherick Award, named after the first DoD Inspector General, is presented annually. The award recognizes the actions and accomplishments of an individual that most strongly support and foster the mission and functions of the OIG. Mr. William H. Reed, Director, Defense Contract Audit Agency (DCAA), received the award from the Acting Inspector General on October 27, 1999. The citation for the award follows:

Mr. William H. Reed is awarded the Joseph H. Sherick Award in recognition of his outstanding leadership in the Federal audit community and his invaluable support to the OIG’s criminal investigations and audits. As the Director of DCAA, Mr. Reed has distinguished himself by skillfully leading the largest audit activity in the Federal Government through a period of particular turbulence and challenge. Despite severe budget reductions at his agency, Mr. Reed has achieved an impressive record of high productivity, good morale and utmost professionalism while providing vital financial advice to Government contracting officials. During his tenure as Director, audits have resulted in approximately $65 billion in recoveries and cost avoidance. In addition, Mr. Reed consistently provided timely and highly professional audit support to dozens of procurement fraud investigations by the Defense Criminal Investigative Service and other law enforcement agencies.

Mr. Reed is one of the foremost experts in the country on contract financial issues and contract auditing. As such, he has furnished sound advice to lawmakers and DoD decision makers on vital aspects of acquisition reform. His expertise, integrity, common sense approach to contentious matters and willingness to discuss those matters reasonably with even the most vociferous critics has won tremendous respect for him in both industry and Government circles. The OIG, DoD, relies heavily on him as a superbly reliable and effective ally in efforts to protect the best interest of the DoD in acquisition matters.

The Joseph H. Sherick Award is appropriate recognition for Mr. Reed’s strong commitment to excellence and his impressive achievements as the head of a dynamic and critically important component of the DoD.

From left: Don Mancuso, Acting IG; William Reed, Director, DCAA; Joseph Sherick, Former Inspector General, DoD; Robert Lieberman, Assistant Inspector General for Auditing
A. Report Title: Inspector General Department of Defense Semiannual Report to the Congress Apr 1, 1999 through Sept 30, 1999

B. DATE Report Downloaded From the Internet: 11/02/00

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions) Inspector General, Department of Defense 400 Army Navy Drive (Room 801) Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

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