



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

Washington, DC 20415

Office of the
Inspector General

November 6, 2014

MEMORANDUM FOR KATHERINE ARCHULETA

Director

FROM: PATRICK E. McFARLAND
Inspector General

A handwritten signature in black ink that reads "Patrick E. McFarland".

SUBJECT: Fiscal Year 2014 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 - strategic human capital, federal health insurance initiative, and background investigations - 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 must face.

The six internal challenges included in this letter are OPM's development of new information systems, the need to strengthen controls over its information security governance, security assessment and authorization, stopping the flow of improper payments, the retirement claims process, and the procurement process for benefit programs.

Inclusion as a top challenge does not mean we consider these items to be material weaknesses. In fact, the area of security assessment and authorization is the only challenge related to a current material weakness.

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;
- Security Assessment and Authorization;
- Stopping the Flow of Improper Payments;
- Retirement Claims Processing; and,
- Procurement Process for Benefit Programs.

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 are presented. I would also like to point out that we have removed the following challenges from last year's discussion:

- Hiring Reform has been removed from the Strategic Human Capital challenge. Previous hiring reform efforts yielded significant improvements in the hiring process, especially in the "speed" of hiring. Since that time, most agencies have made significant progress and have since reached a point of diminishing returns in attempting to further reduce hiring times. While speed of hiring is important, efforts are now shifting to a focus on "quality" of hiring.

- Claims processing backlog as a specific Retirement Claims Processing challenge has been removed from that summary based on OPM's efforts to reduce the number of retirement cases to a manageable level.

We have added the following challenges, or components of challenges:

- Phased retirement was added as a component under the Strategic Human Capital challenge. Phased retirement is a human resources tool that will allow full-time employees to work a part-time schedule and draw partial retirement benefits during employment.
- Security Assessment and Authorization, which is a comprehensive assessment that attests that an information system's security controls are meeting the security requirements of that system, was added as a new challenge.

I believe that the support of the agency's management is critical to meeting these challenges and will result in a better OPM for our customer agencies. I also want to assure you that my staff is committed to providing audit or investigative support as appropriate, and that they strive to maintain an excellent working relationship with your managers.

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

Attachment

**FISCAL YEAR 2014 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

Strategic human capital management remains on the U.S. Government Accountability Office's high-risk list of Government-wide challenges requiring focused attention. OPM leads efforts to address key human capital challenges including veterans' employment and skills gap closure. OPM is also taking the lead in implementing phased retirement.

A. Improving the Federal Recruitment and Hiring Process

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 and has made significant progress in addressing its human capital efforts in the areas of the Veterans Employment Initiative and closing skill gaps; however, challenges remain to meet the President's reform goals.

1) Veterans Employment Initiative

Since the signing of Executive Order 13518 and the creation of the Council on Veterans Employment, in fiscal year (FY) 2013, the Executive Branch of Government hired the highest percentage of veterans since the mid-1970s, surpassing previous highs set in FY 2011 and FY 2012. The success of the initiative can be attributed to OPM's continued leadership through its Veterans Services Group, which continues to provide strategic direction to an Executive Order-directed Federal infrastructure that was created to improve the opportunities for veterans and transitioning military service members seeking Federal employment.

The implementation of a revised Government-wide Veterans Recruitment and Employment Strategic Plan will continue to guide agency efforts in eliminating barriers affecting veteran employment in the Federal Government. In conjunction with the strategic plan, the Feds Hire Vets (www.fedshirevets.gov) website is the 'one-stop-location' to provide easy access to accurate and consistent Federal employment-related information for veterans and transitioning military service members. The veteran's employment initiative also required the establishment of Veteran Employment Program Offices in the 24 Chief Human Capital Officers

(CHCO) agencies, as well as a Government-wide marketing program on the value of America's veterans. The challenge for OPM is to ensure that Federal agencies continue to value the skills and talent that veterans bring to the workplace while leveraging the tools established by the Veterans Employment Initiative.

2) Closing Skill Gaps

OPM has partnered with the CHCO Council to identify and close skills gaps across the Federal Government. The group has designed an agreed-upon method for analyzing data to forecast and identify Government-wide and agency-specific occupations and competencies that pose current or projected skills gaps. The group identified as Government-wide skills gaps five occupations (IT-Cybersecurity, Acquisitions, Economist, Human Resources and Auditor) and the multiple occupations within the Science, Technology, Engineering and Mathematics (STEM) functional area. Seven competencies (strategic thinking, problem solving, data analysis, influencing/negotiating, grants management, grants financial management, grants compliance) were also identified and each agency applied the method to identify occupations and competencies requiring gap closure.

To address the Government-wide occupations, OPM partnered with occupational leaders to design and implement strategies to close skills gaps. Each occupational leader collaborated with OPM to identify human capital strategies to address root causes for the skills gap, and implemented initiatives for recruitment, retention, development, and/or knowledge management. Each occupational leader identified a measurable indicator that has been used to track progress, and all occupations have met or exceeded their performance targets. For competency gap closure, OPM solicited agencies interest in creating pilot projects to close competency gaps, and helped agencies develop project plans with performance metrics and targets. These pilot projects will continue to be tracked for the next several years to measure competency gap closure.

In FY 2015, OPM will partner with the CHCO Council to re-evaluate skills gaps using a range of workforce data and analytic tools. Based on this reevaluation, new occupations and/or competencies may be identified while current occupations may be revalidated for continued attention. By implementing a four-year cycle of analysis/planning, strategy/implementation, and evaluation, OPM seeks to institutionalize a repeatable management process that will position the Federal government to anticipate and close skills gaps in order to assure mission accomplishment.

OPM continues to make progress in closing critical skill gaps in the Federal workforce to help agencies recruit and retain the right people with the skills needed to achieve their goals. The current challenge will be to re-evaluate the selected Government-wide and agency specific Mission Critical Occupations (MCOs) and Mission Critical Competencies (MCCs) to determine which occupations and competencies should remain as Government-wide MCOs and MCCs. OPM must

also identify new occupations and competencies that warrant attention. With the aging Federal workforce, OPM must be able to help agencies identify and close skills gaps, be responsive to changing applicant and workforce needs and continue to monitor organizational performance measures in efficiency, effectiveness, and progress.

B. Phased Retirement

Phased retirement was signed into law on July 6, 2012, as part of the Moving Ahead for Progress in the 21st Century Act (MAP-21). Due to the government's aging workforce and the expectancy of a "retirement wave" as employees retire in coming years, MAP-21 requires OPM to publish regulations in the Federal Register implementing phased retirement under the Civil Service Retirement System and the Federal Employees' Retirement System. Section 100121 of MAP-21 amended Title 5, United States Code, by adding provisions to permit certain retirement-eligible employees to enter phased retirement. OPM published final regulations implementing phased retirement on August 8, 2014. Employees may start submitting applications for phased retirement no earlier than November 6, 2014.

Phased retirement is a human resources tool that will allow full-time employees to work a part-time schedule and draw partial retirement benefits during employment. The main purpose is to enhance the mentoring and training of the employees who will be filling the positions, or taking on the duties of more experienced retiring employees, but it may also be used for any learning activities that would allow for the transfer of knowledge and skills from one employee to others.

Federal agencies will be able to retain employees who would have fully retired, but who are willing to continue in Federal service for a period of time on a part-time schedule while engaging in mentoring. Phased retirement will not only assist agencies with knowledge management and continuity of operations in the short term, but also to prepare the next generation of experts for success.

The challenge for OPM is to determine how they will address administrative and procedural matters in the guidance that they provide to Federal agencies to execute phased retirement.

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 began 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, 2015, the average FEHBP premium increase is 3.2 percent, which is slightly lower than last year's increase of 3.7 percent. 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. OPM 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.

The HCDW project is managed by OPM's Planning and Policy Analysis (PPA) office. PPA has hired a contractor to perform the technical development of the HCDW, and has entered into a Mutual Agreement of Understanding with the Office of the Inspector General (OIG) to share existing Fee-For-Service carrier data currently received by the OIG. The system is scheduled to go live in early FY 2015, but must first complete OPM's System Accreditation and Authorization process to ensure that adequate IT security controls are in place. The OIG will also independently evaluate the security controls of the HCDW before transferring its data to PPA.

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.] This continues to be a complex project with a variety of operational and security issues that need to be addressed. Senior leadership will need to closely monitor this project.

2) Prescription Drug Benefits and Costs

Increases in drug costs continue to be a major contributor to the rapid growth in health care 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. In fiscal year 2014, our office began its first audit of a carrier that renewed its PBM contract under the pharmacy transparency standards that became effective on January 1, 2011. While the preliminary results show that the carrier's pharmacy claims are being priced in accordance with the terms of these standards, we still have concerns with the administrative fees that are also negotiated as part of the PBM contract. Since it is the FEHBP carriers, not OPM, that negotiated the contracts with the PBMs, and these carriers are reimbursed 100 percent for the costs they incur related to this benefit, we have concerns whether these negotiated fees are providing the best value to the FEHBP subscribers. We also continue to have concerns over the wide range of covered drugs and the use of large pharmacy networks, which contribute to the rising costs.

In its most recent FEHBP call letter (*Letter No. 2014-03, dated March 20, 2014*), OPM called on participating health plans to focus on ways to optimize pharmacy practices to ensure the safe and effective use of prescription medications while managing drug costs. To accomplish this objective, OPM called on participating health plans to consider the following in their 2015 (unless otherwise indicated) benefit proposals:

- Adding and expanding on drug management programs that control costs and improve quality and patient outcomes;
- Expanding efforts to use a common tiered benefit structure to improve members' understanding of their prescription drug benefits;
- Implementing a prescription drug cost calculator that will allow current and prospective enrollees to compare the cost of the prescription drugs they use. This calculator should be provided by all health plans by 2016;
- Implementing a managed formulary for contract year 2016. A cost calculator that allows current and prospective members to verify coverage of specific drugs, as well as an exception process, should accompany the implementation of the formulary;
- Optimizing the use of high value medication distribution channels by aligning member incentives with the most cost effective options;
- Utilizing more selective pharmacy network contracting based on cost and quality criteria; and,

- Examining the opportunity to reduce unnecessary payments where Medicare Part B provides primary coverage for Part B drugs and supplies, for plans not currently coordinating benefits with Medicare.

While we applaud the agency for these efforts and believe that they should have a positive impact on the program, we would encourage OPM to continue evaluating the relative costs and benefits of direct contracting for PBM services to ensure that the benefits and fees negotiated are in the best interest of the FEHBP members, as well as to strengthen the controls and oversight of the FEHBP pharmacy program. The importance of this effort was initially highlighted in “The President’s Plan for Economic Growth and Deficit Reduction,” dated September 2011. The President’s plan called for the streamlining of 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 would 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.

However, 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. While the language has been included in OPM’s FEHBP Modernization initiative, it has yet to receive the necessary approvals required to allow for a change to the law. That being said, OPM should position itself and gain the expertise it will need 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 (MLR) Implementation and Oversight

OPM’s FEHBP MLR methodology for community-rated carriers continues to present unique challenges. In its second year (third year for pilot program carriers), the MLR methodology requirements will need to be closely monitored and updated to adapt to a complex regulatory environment and ever-changing health insurance industry.

In order to ensure complete, accurate and current MLR carrier data, OPM must fully automate a system that stores, tracks and reports carrier MLR information (i.e., loss carry-over credits, MLR penalties paid, distributions to or from the MLR subsidization fund). The MLR carrier data will be used from one year to the next, and having an automated process will assure proper administration of the MLR methodology is maintained moving forward.

In addition, since future audit findings impact the MLR calculation and penalty, OPM must ensure that a system exists to properly account for necessary MLR penalty adjustments after MLR subsidization funds have been distributed.

OPM's efforts to monitor and update the MLR methodology requirements, streamline and automate carrier MLR data, and develop a system to account for future MLR penalty adjustments will increase the likelihood of program success and minimize disruptions to the FEHBP rating process.

4) Health Benefit Carriers' Fraud and 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, health care providers, and individual FEHBP members. This fraud and abuse (F&A) program must have the following components: (1) an anti-fraud policy statement; (2) written action plan and procedures; (3) formal training; (4) fraud hotlines; (5) educational programs; (6) technology; (7) security; and, (8) patient safety. If carriers do not have comprehensive and effective F&A programs, fraud and abuse may go undetected, resulting in increased health care 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, carriers have not reported or timely reported all potential fraud and abuse cases and patient safety issues to OPM and the OIG. Also, certain 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 recognizes the importance of FEHBP carriers having comprehensive, effective F&A programs and is benefiting from enhanced collaboration with the OIG and the carriers in light of recent audit findings in this area.

Currently, OPM is examining its practices and a broad range of industry procedures to strengthen its existing fraud and abuse program. Steps OPM is taking include:

- Establish and communicate to FEHBP carriers a set of minimum standards to protect Federal funds and detect instances of fraud and abuse through an update of carrier letters, ensuring that procedures and programs are aligned with current industry standards.

- Clarify carriers' FEHBP F&A reporting requirements through an update of carrier letters.
- Join the Healthcare Fraud Prevention Partnership (HFPP). This collaborative arrangement allows public and private organizations to share information and best practices to improve fraud detection and prevent incorrect payments. OPM will become a communicative participant in the endeavor and will recommend that FEHBP carriers participate as well. This will allow OPM to stay abreast of changes in industry standards and work effectively with stakeholders.
- Work with the National Healthcare Anti-Fraud Association (NHCAA) to establish accreditation standards for the carriers' fraud investigators within the FEHBP. NHCAA is a public/private partnership similar to HFPP that provides data sharing services for private insurers and government entities, and education for individual fraud/abuse investigators.
- Collaborate with the OIG, share reports, questionnaires, and special projects, and engage in consistent oversight of all carrier fraud and abuse programs. OPM plans to seek OIG counsel on appropriate reporting, report analysis to maximize carrier accountability, and fluctuations in the industry to ensure their programs remain current and relevant.

Efforts thus far have confirmed inconsistencies, reporting discrepancies, and the need for clarification of some carrier requirements. OPM enhanced the review of carriers' annual reports and solicited corrective action plans to address deficiencies. OPM continues to draft updated guidance to carriers (factoring in input and suggestions from the Carriers and the OIG), seek to develop reasonable standards that might lead to a form of accreditation, and refine the measures by which carrier F&A programs can be shown to be a benefit to the FEHBP.

As is evident by the measures identified above, OPM appears committed to work collaboratively to address this important challenge facing the program. However, OPM must continue to implement controls (including contract changes, as appropriate) which will hold all FEHBP carriers accountable for operating an effective fraud and abuse 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 and manage the new program.

During fiscal years 2010 through 2012, OPM received limited funding through an arrangement with the Department of Health and Human Services (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 Multi-State Plan Program (MSPP), and provided analytical support for the MSPP. Direct funding was included in OPM's fiscal year 2013 budget; however, continued funding is a significant challenge for the agency, and 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 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, and to ensure compliance with all laws, regulations, and guidance.
- Create a comprehensive oversight program.

To meet the goal of making MSPP health insurance options available for enrollment, OPM has accomplished the following:

- Contracted with the Blue Cross Blue Shield Association (BCBSA) to offer MSPs in 31 marketplaces.
- Given presentations on MSP implementation to members of Congress, States, issuers, minority and small business groups, and public advocacy groups.
- Reviewed applications submitted by issuers to offer a plan on the MSP Marketplace.
- Conducted outreach efforts to insurance issuers and other groups to raise awareness and potential participation in the MSPP.
- Conducted contract negotiations with BCBSA to expand offerings into additional marketplaces as well as with other potential issuers to offer a plan(s) on the Marketplace.

- Compiled and transmitted information on each applicable state-level issuer to HHS for the Federally Facilitated Marketplace via the Health Insurance Oversight System; to states that intend to operate their own exchange but utilize the prescribed HHS templates via System Electronic Rate Filing Form; and directly to those states who will operate their own marketplace.
- Met routinely with OPM's OIG to (1) discuss internal control structures; (2) provide status reports; (3) get feedback on the proposed regulations and contract; (4) and discuss oversight concerns.

OPM has made MSPs available in 31 marketplaces and is steadily establishing necessary processes for working with the various stakeholders. However, the continued implementation, expansion, and administration of 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 95 percent of all personnel background investigations for the Federal Government and processes approximately 2 million background investigations per year. Agencies use the background reports of investigations conducted by OPM to determine individuals' suitability or fitness for Federal civilian, military, and Federal contract employment, as well as their eligibility for access to national security classified information and access to federal facilities and information systems.

FIS has an active Integrity Assurance group and works cooperatively with the OIG to bring those background investigators who defraud OPM by falsifying background investigation reports 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.

Prior to September 9, 2014, OPM held fieldwork contracts with US Investigations Services, LLC (USIS) and two other contractors. OPM also held a support contract with USIS. On September 9th, OPM informed USIS of its decision that it will not exercise additional contract options to extend the term of its contracts for background investigations and support services.

Capacity, or the number of resources available to perform the work, is a key factor in meeting timeliness expectations and managing costs. Each of OPM's other background investigations contractors have indicated that they are willing to expand to accommodate all of OPM's workload, and under their current contracts they are required to increase their caseload per OPM's distribution. Both contractors are now moving forward to increase their capacity. However, there will be impacts to timeliness until there is capacity available to manage the workload without backlogs.

As mentioned previously, FIS is responsible for all background investigations in the federal government and conducts approximately 95 percent itself or through the use of contractors. The remaining five percent have been delegated to certain Federal agencies. FIS needs to continue to ensure these delegated agencies maintain a high level of quality assurance. In fulfilling government-wide oversight functions, FIS works closely with the Office of the Director of National Intelligence (ODNI) in pursuit of quality investigations. FIS's Agency Oversight office has established and collaborated with the ODNI to jointly conduct oversight audits of delegated agencies to evaluate the quality of the background investigations and to assess the effectiveness of the Quality Assurance Programs. FIS has increased the frequency of its audits of the delegated agencies to ensure they will be audited at least once every three years. If an audit finds that the background investigations do not meet quality standards, or if the agency does not maintain a high level of quality assurance regarding these investigations, FIS makes recommendations for corrective action.

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, for the most part they 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 information system development projects. In our opinion, the root causes of these issues have been related to the lack of centralized oversight of systems development. Many system development projects at OPM have been initiated and managed by program offices with limited 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.

At the end of FY 2013, the OCIO published a new system development lifecycle (SDLC) policy, which was a significant first step in implementing a centralized SDLC methodology at OPM. The new SDLC policy incorporated several prior OIG recommendations related to a centralized review process of system development projects. However, policy alone will not improve the historically weak SDLC management capabilities of OPM.

We also recommended that the OCIO develop a team with the proper project management and system development expertise to oversee new system development projects. Through this avenue, the OCIO should review SDLC projects at predefined checkpoints, and provide 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.

To date, the SDLC is only applicable to OPM's major investment projects, and is not actively enforced for all information technology (IT) projects in the agency. The OCIO acknowledges the need to enforce the SDLC policy to 100 percent of OPM's IT portfolio, and is currently implementing a reorganization that addresses this issue by assigning OCIO IT project managers as a direct point of contact for each of the agency's program offices. Although these positions have been planned and funded, the staff necessary to properly enforce and oversee the SDLC process for all OPM systems is not in place at this time. In the interim, the OCIO continues to provide training to existing project managers through a Project Management Community of Practice designed to provide guidance on best practices in systems development.

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 OPM's information security governance. OPM's lack of information security 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 our FY 2010 FISMA report, we suggested that OPM adopt a more centralized approach to IT security. We recommended that the agency recruit a staff of information security professionals to act as Information System Security Officers (ISSO) that report to the OCIO. However, throughout FY 2011 and 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.

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. The OCIO developed a plan to hire a team of ISSOs to centrally manage the agency's IT security program. The OCIO hired three ISSOs in FY 2013 and one additional ISSO in early FY 2014, but these four individuals were only able to manage the security for approximately one-third of OPM's major applications.

In FY 2014, OPM's Director approved a plan to restructure the OCIO that includes funding for 10 additional ISSO positions, bringing the total to 14. After these positions have been filled, the ISSO's security responsibility will cover 100 percent of OPM information systems.

Although limited tangible improvements have been made to the security management structure in FY 2014, the ISSO positions that have been planned, approved and funded represent significant progress over prior years. Therefore, we are reducing the material weakness to a significant deficiency in our FY 2014 FISMA audit due to the planned improvements. However, we may reinstate the material weakness in FY 2015 if the OCIO is not successful in adequately implementing the planned changes.

3. SECURITY ASSESSMENT AND AUTHORIZATION

Information system Security Assessment and Authorization (Authorization) is a comprehensive assessment that attests that a system's security controls are meeting the security requirements of that system.

Our FY 2010 FISMA audit report stated that weaknesses in OPM's Authorization process represented a material weakness in the agency's IT security program. These weaknesses related to incomplete, inconsistent, and poor quality Authorization packages. In FY 2011, the OCIO published updated policies, procedures, and templates designed to improve the overall Authorization process. The OCIO also dedicated resources to oversee OPM program office activity related to system Authorizations. These new controls resulted in a significant improvement in the agency's Authorization packages. The material weakness was lowered to a significant deficiency in FY 2011, and after continued improvement, completely removed as an audit concern in the FY 2012 FISMA report.

The Authorization packages reviewed as part of the FY 2014 audit generally maintained the same satisfactory level of quality that had been observed in recent years. However, 11 out of OPM's 47 major information systems were operating without a valid Authorization. The drastic increase in the number of systems operating without a valid Authorization is alarming, and represents a systemic issue of inadequate planning by OPM program offices to authorize the information systems that they own.

The OCIO's Information Technology Security and Privacy Group continuously provides OPM program offices with adequate guidance and support to facilitate a timely Authorization process. However, many program offices do not initiate the Authorization process early enough to meet their deadlines, do not adequately budget for the contractor

support that is needed to complete the process, and/or do not adhere to OPM policies and templates related to the artifacts required for Authorization. Each of these issues contributes to delays in finalizing system Authorizations.

We believe that the root cause of these frequent delays is the fact that there are no consequences for the program offices that operate OPM systems without a valid Authorization to operate. The Office of Management and Budget's (OMB) Circular A-130, Appendix III mandates that all Federal information systems have a valid Authorization. According to OMB, information systems should not be operating in a production environment without an Authorization, and OPM should consider shutting down systems that do not have a current and valid Authorization.

Not only is a large volume of OPM's systems operating without a valid Authorization, but several of these systems are amongst the most critical and sensitive applications owned by the agency. Two of the OCIO systems without an Authorization are general support systems that host a variety of other major applications. Over 65 percent of all systems operated by OPM (not including contractor operated systems) reside on one of these two support systems, and are therefore subject to any security risks that exist on the support systems. Furthermore, two additional systems without Authorizations are owned by OPM's Federal Investigative Services, which is responsible for facilitating background investigations for security clearance determination. Any weaknesses in the information systems supporting this program office could potentially have national security implications.

Maintaining active Authorizations for all information systems is a critical element of a Federal information security program, and failure to thoroughly assess and address a system's security weaknesses increases the risk of a security breach. We believe that the volume and sensitivity of OPM systems that are operating without an active Authorization represents a material weakness in the internal control structure of the agency's IT security program.

4. STOPPING THE FLOW OF IMPROPER PAYMENTS

Federal improper payments represent a significant loss to the government. Since 2009 the Federal Government has built a robust infrastructure of legislative and administrative requirements, most notably the OMB Circular A-123, Appendix C, with which agencies must comply to improve the detection and recovery of improper payments. OMB is set to issue updated guidance to agencies in the coming months that will apply to improper payments reporting for FY 2014 and beyond. Specifically, the updated guidance requires the following:

1. Agencies will report on improper payments in their Agency Financial Report (AFR) using 13 categories required for reporting in FY 2015 and beyond; they are encouraged to report in FY 2014 on the new categories where possible. There were previously only three categories for improper payments reporting.

2. Beginning in FY 2015, agencies will begin reporting on their internal controls over improper payments in the AFR. The primary purpose is to establish a thoughtful analysis linking agency efforts in establishing internal controls and reducing improper payment rates.
3. Beginning in FY 2014, agencies are required to conduct risk assessments to determine the risk for improper payments made to employees and charge cards.

OPM currently reports on improper payments made in the Retirement and Federal Employees Health Benefits Programs. OPM recently updated its Improper Payments Plan, highlighting activities put into place to reduce the improper payments made against these programs as well as improving collections. New developments for FY 2014 include:

1. Development of a new agreement with the Office of Workers Compensation Program. OPM has been working on renewing its agreement to conduct a match that will identify beneficiaries receiving both wage loss compensation for disability or death under the Federal Employees' Compensation Act and retirement or death benefits under the Civil Service Retirement System or Federal Employees Retirement System for the same period. The concurrent receipt of both benefits is prohibited.
2. OPM's Data Mining Working Group has developed a list of data mining activities and OPM is taking action to implement some of them.
3. OPM initiated a process to adopt the Department of the Treasury's (Treasury) Administrative Wage Garnishment regulations that will allow Treasury to garnish private sector wages for those who owe money to OPM. The rule was finalized in FY 2014.
4. OPM established a relationship with Treasury to recover improper payments made to deceased annuitants that have escheated to the states.
5. The Chief Financial Officer worked with the OIG to develop new case referral guidelines for referring improper payments to deceased annuitants to the OIG for investigation. The guidelines were effective August 2014.
6. OPM updated its work instruction for annual reporting on the improper payments program in the annual AFR based on a recommendation from the OIG in its April 2014 report. The improved controls in the revised instruction will further reduce the risk of errors in annual reporting.
7. OPM instituted processes to comply with Treasury's Do Not Pay (DNP) initiative in FY 2014. Retirement Services receives and reviews matches of OPM payments against DNP data bases. Thus far, the DNP matching process has not resulted in reduced improper payments due to the nature of OPM's programs and also due to

some technical issues with legacy payment files. OPM is working with Treasury to improve the DNP process.

While these developments are a positive step, OPM has more to do. OPM must develop processes to identify the nature of its improper payments to match the reporting categories identified in the updated OMB Circular A-123, as well as linking its control activities to specifically reduce improper payments in the reporting categories. For example, OPM performs surveys and matches against the annuity roll to identify the beneficiaries who are not entitled to benefits, but doesn't capture whether the improper payment was the result of an error made by OPM versus an eligibility issue. OPM will have to develop a structure and process among its various systems to specifically identify the nature of its improper payments for reporting in the AFR.

In addition, while OPM has made a number of improvements in its efforts to reduce improper payments across all of its programs, improper payments to deceased individuals continues to be an area where OPM needs to improve, both in reducing these payments from occurring in the first place, and in recovering them once they are made. For FY 2014, through the end of the third quarter OPM paid out \$87 million to deceased annuitants. OPM needs to be more pro-active in identifying annuity payments made to deceased annuitants. Using the Social Security death data to identify deceased annuitants is a great internal control; however, there are some annuitant deaths that are never reported to Social Security or are not reported timely to Social Security and OPM, resulting in long-term improper payments.

We feel that three areas continue to hinder Retirement Services' ability to adequately address the problem of improper payments to deceased annuitants:

- OPM's Improper Payments Strategic Plan does not identify measurable goals/milestones for the Retirement Services' Retirement Inspections office, which is the primary office responsible for identification and prevention of improper payments to deceased annuitants through on-going matches, surveys, and fraud tips. The goals outlined in the Plan pertain to the overall improper payments from the retirement program as a percentage of program outlays. However, as of September 30, 2013, approximately 40 percent of the ending balance of reported retirement program improper payments pertains to improper payments made to deceased annuitants.
- A failure to adequately plan and complete special projects to identify improper payments - the best example of this is the Internal Revenue Service form 1099-R project. This project analyzed returned 1099-Rs mailed by OPM in an attempt to determine whether they were related to issues with the annuitants that need to be resolved - whether it is a change of address or the annuitant is deceased. OPM produced a report on its 1099-R project in April 2014 and referred hundreds of cases to our office of annuitants who had not responded to address verification letters from the Retirement Inspections office during the project. OPM had just placed the annuitants in "suspend status" when they made the referral to our office. However, these referrals were made prematurely because OPM had not completed

their normal process to determine the vital status of the annuitants. This project began in 2010, and four years later OPM was still determining eligibility status and improper payment amounts. The lack of a comprehensive, carefully designed plan with milestones and deadlines to complete the project is a direct cause of this inefficiency.

- The lack of consistent management attention to foster the importance of identifying, reducing, and recovering improper payments. OPM often points to the very low improper payment rate for its Retirement Program, and as such, has not made reducing it an agency priority. When the backlog of pending retirement claims reached unacceptable levels, OPM made it a priority to reduce the backlog in a timely manner and devoted resources to this effort. OPM's leadership and management needs to do the same with respect to improper payments, particularly to deceased annuitants. OPM's Data Mining Working Group (DMWG) is a prime example of the lack of OPM's management attention to make the issue of improper payments a top agency priority. In FY 2014, the DMWG came up with ideas to identify risk areas for improper payments. However, as we understand it, the DMWG has disbanded and its future is uncertain. The vision for this group was that it be permanent, meeting periodically to explore best practices and to continue data mining to uncover areas within the Retirement Program at risk for improper payments. OPM management should establish a control environment in which reducing improper payments is a top agency priority, and adequately staff the program offices responsible for program integrity work.

5. RETIREMENT CLAIMS PROCESSING

OPM is responsible for processing in excess of 100,000 retirement applications annually for Federal employees. The timely issuance of full annuity payments to annuitants has been a long-standing challenge for OPM. In January 2012, OPM released and began implementation of a strategic plan with the goal of reducing the backlog of claims from approximately 50,000 to a working inventory of 13,000, and of adjudicating 90 percent of retirement cases within 60 days starting in July 2013. While the backlog was successfully reduced to below 13,000 by December 2013, the timeliness goal has not yet been achieved. As of September 2014, only 78.8 percent of pending claims were processed in 60 days or less.

OPM remains committed to providing accurate and timely processing of retirement claims. RS continues to take important steps to meet the challenge of improving its claims processing times by implementing its strategic plan, which includes four key areas: people, productivity and process improvements, partnering with agencies, and partial, progressive IT improvements.

Without proper resources, OPM's ability to meet its goal of processing 90 percent of retirement claims in 60 days is in jeopardy. In addition, if OPM does not receive funding for its IT initiatives, the ability to achieve sustained progress in meeting its processing goals will be severely impacted.

6. PROCUREMENT PROCESS FOR BENEFIT PROGRAMS

In last year's letter, we expressed concerns over OPM's procurement processes for the benefit programs it administers. These programs include the BENEFEDS benefits portal, the Federal Employees Dental and Vision Insurance Program (FEDVIP), the Federal Long Term Care Insurance Program (FLTCIP), and the Federal Flexible Spending Account Program (FSAFeds). Specifically, our concerns encompassed the following areas:

- Lengthy periods of performance awarded under the contract term and numerous options exercised to extend the performance periods;
- Contracting methods utilized under the procurements; and,
- Processes followed for contract modifications.

While we acknowledge recent strides OPM has made to ensure these programs are re-competed in a timelier manner, we still have concerns that OPM's perceived need for program continuity will continue to result in the use of contract modifications to address program changes and extend periods of performance when contract re-competitions would be in the Government's best interest. It is undisputed that the lapse of these contracts would have a severe impact upon the ability of Federal employees and annuitants to select benefits and could even adversely affect recruiting and retention of Federal employees. However, inadequate acquisition planning on behalf of the Agency is not a valid reason to extend periods of performance, especially when this rationale potentially ignores the savings that could have been achieved had the contract been re-competed in a timely manner.

Additionally, while we recognize that some program changes are best addressed through a contract modification, caution needs to be exercised when the recommended changes meet the definition of a **cardinal change**. Cardinal changes are so severe that they go beyond the contract's original scope of work and would require a new procurement to encompass these changes. In our audits of the FLTCIP and the FSAFeds contracts, we noted some instances where changes that were addressed through a contract modification did, in fact, meet the definition of a cardinal change and should have required a re-competition of those contracts. Therefore, we continue to believe it is crucial that OPM fully understands and takes into account the following:

- The need for timely re-competitions of these special benefit programs. For example, the FSAFeds contract has been extended numerous times to maintain program continuity while other programs were re-competed. The result of these extensions to the FSAFeds contract is that the program's period of performance has now exceeded an 11-year period, which we believe is disadvantageous to the Government because of the constant changes in the market for this type of benefit and a lack of built-in competition for enrollees that is inherent in other benefit programs administered by OPM (i.e., the FEHBP and the FEDVIP).

While we acknowledge that this program is currently undergoing a re-competition, we note that the re-competition has already been delayed, which resulted in the

issuance of a memo by our office to OPM's Chief of Staff on June 11, 2014. Subsequent to the issuance of that memo, we learned that the re-competition was delayed again per a July 29, 2014, email from OPM's Federal Employees Insurance Operations (FEIO) group.

- The importance of selecting the most appropriate contracting method for the benefit program being procured. For example, the contracting method selected for the FSAFeds program (which is a FAR contract) was fixed-price with prospective price redetermination. However, FAR 16.205-3 cites limitations for using this type of contracting method, and we believe that a firm fixed-price contracting method would have been more appropriate for these programs.

While OPM contends that the use of fixed-price with prospective price redetermination continues to be in the best interest of some Government programs due the frequently changing nature of external factors that impact these programs, we note that the recent procurement of the BENEFEDS contract utilized a firm fixed-price contracting method.

- The importance of following each program's contractual requirements for extensions and modifications. For example, our reviews of the special benefit programs found that OPM has a history of modifying contract terms and not documenting the justification for the modification, that the contract's price redetermination clause was not followed in cases where prices were re-determined, or that FAR 17.207(d)(2), the exercise of options clause, was not followed when exercising contract options.

To meet these challenges on future program procurements, we continue to encourage better coordination between OPM's Contracting Office and the FEIO group so that there is an understanding of the available procurement methods, selection of the most appropriate procurement method, and that the contractual requirements are followed from the development of the request for proposal until the contract is re-competed.