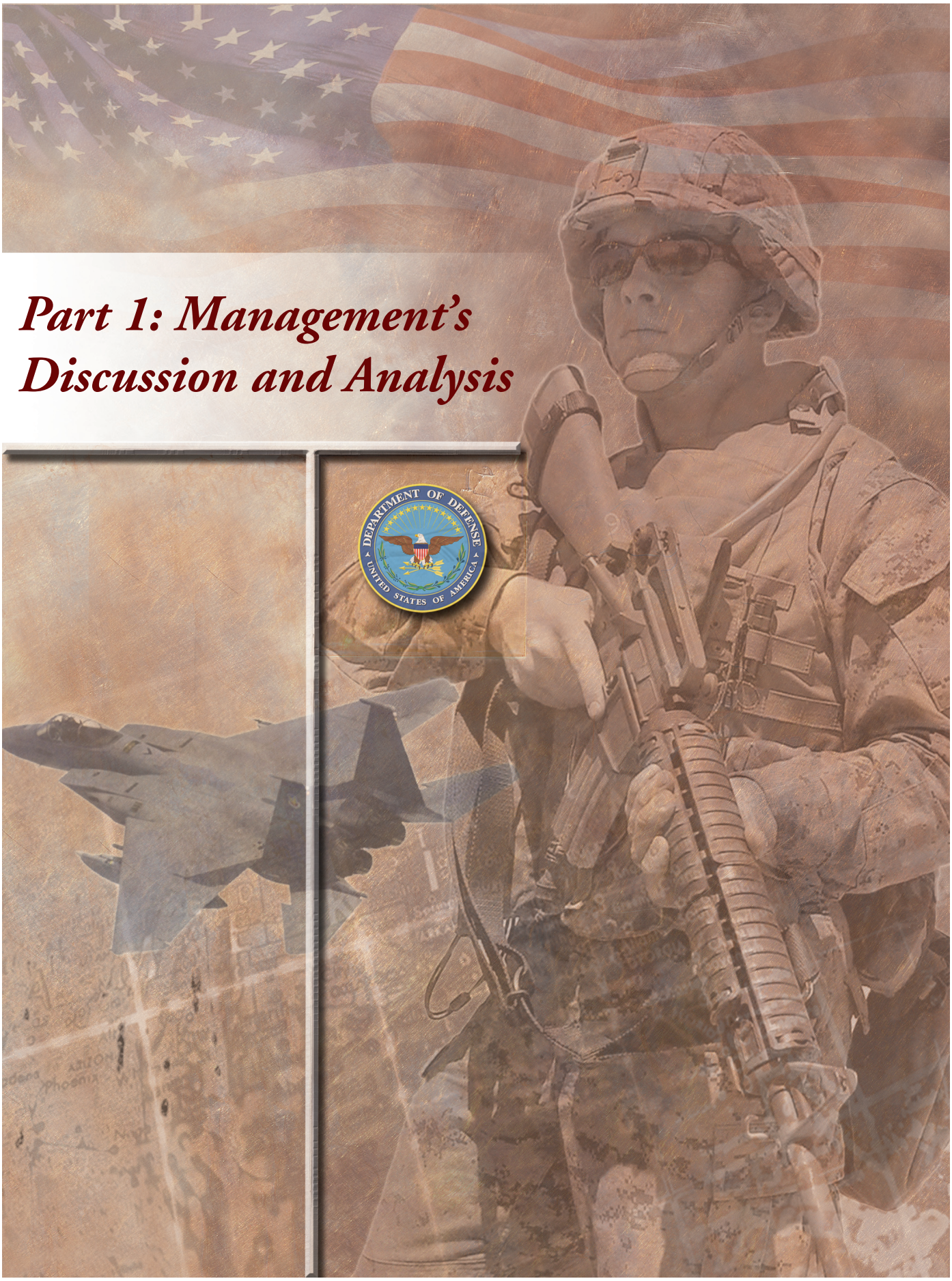
Part 1: Management's Discussion and Analysis



How the Department Evolved

1775 - The Army, Navy, and Marine Corps were established in concurrence with the American Revolution.

1789 - The War Department was established and was the precursor to what is now the Department of Defense.

1798 - The Department of the Navy, and the U.S. Coast Guard, were founded.

1947 – Congress established a civilian, Cabinet-level Secretary of Defense. The Department of the Air Force was created, the War Department was converted to the Department of the Army, and the three military departments of the Army, Navy and Air Force were placed under the direct control of the first Secretary of Defense.

1949 - the national defense structure was consolidated further, creating what we now know as the Department of Defense, and withdrawing cabinet-level status for the three Military Department Secretaries.

Management's Discussion and Analysis

This part of the report provides an overview of the Department of Defense's financial and performance results for fiscal year (FY) 2005. Detailed performance information is presented in Part 2; detailed financial information is presented in Part 3.

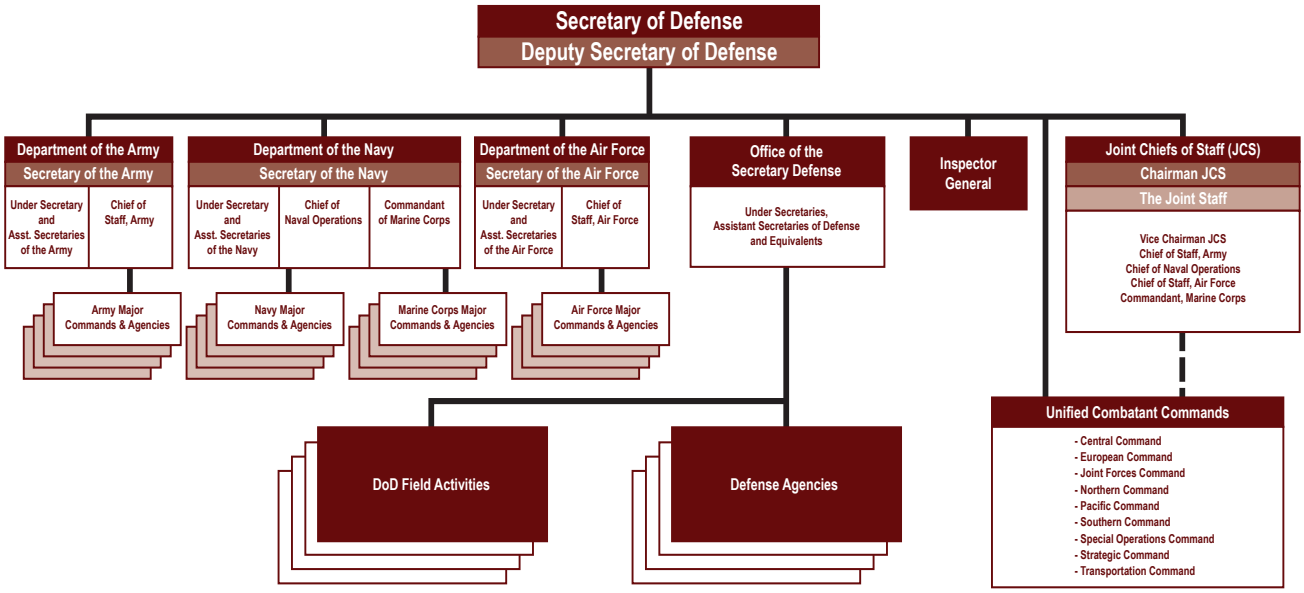
Mission, Organization, and Resources

Mission

The mission of the United States Armed Forces is to defend the United States; deter aggression and coercion forward in critical regions; swiftly defeat aggression in overlapping major conflicts while preserving for the President the option to call for a decisive victory in one of those conflicts, including the possibility of regime change or occupation; and conduct a limited number of smaller-scale contingency operations.

Organization

The Department of Defense (DoD) is America's oldest, largest, busiest, and most successful organization. Since the creation of America's first army in 1775, the DoD has evolved to become a global presence of 3 million individuals stationed in more than 146 countries dedicated to defending the United States by deterring and defeating aggression and coercion in critical regions. The DoD works for America's Chief Executive Officer, the President; the Board of Directors, the Congress; and the Nation's stockholders, the American people. As do all successful organizations, the DoD embraces the core values of leadership, professionalism, and technical knowledge. Its employees are dedicated to duty, integrity, ethics, honor, courage, and loyalty.
The chart below shows how the DoD is structured.



The Secretary and the Office of the Secretary

The Secretary of Defense and the Office of the Secretary of Defense are responsible for the formulation and oversight of defense strategy and policy. The Office of the Secretary of Defense supports the Secretary in policy development, planning, resource management, and fiscal and program evaluation.

Military Departments

The Military Departments consist of the Army, Navy (of which the Marine Corps is a component), and the Air Force. In wartime, the U.S. Coast Guard becomes a special component of the Navy; otherwise, it is a bureau of the Department of Homeland Security. The Military Departments staff, organize, train, equip, and sustain America's military forces. When the President and Secretary of Defense determine that military action is required, these trained and ready forces are assigned to a Combatant Command responsible for conducting the military operations.

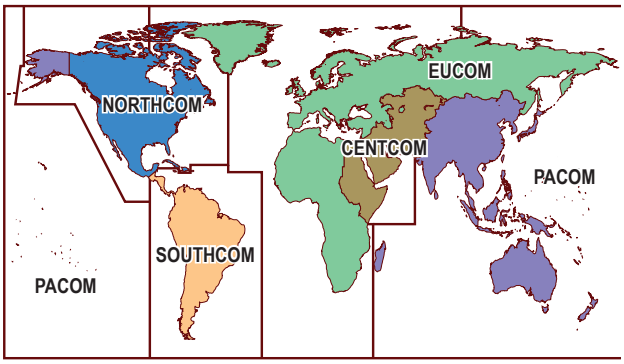
The Military Departments include Active duty, Reserve, and National Guard forces. Active duty forces are full-time duty military service members. The Reserves, when ordered to active duty by the Congress, support the active forces. They are an extension of the active duty personnel and perform similarly when called into service. The Reserves are also relied upon to conduct counter-drug operations, provide disaster aid, and perform other peace-keeping missions. The National Guard has a unique dual mission with both federal and state responsibilities. In peacetime, the Guard is commanded by the governor of each respective state or territory who can call the Guard into action during local or statewide emergencies, such as storms, drought, or civil disturbances. When ordered to active duty for mobilization or called into federal service for emergencies, units of the Guard are under the control of the appropriate DoD Military Department. The Guard and Reserve are recognized as an indispensable and integral part of the Nation's defense from the earliest days of a conflict.

Chairman of the Joint Chiefs of Staff

The Chairman of the Joint Chiefs of Staff is the principal military advisor to the President, the National Security Council, and the Secretary of Defense. The Chairman assists the President and the Secretary in providing for the strategic direction of the armed forces, including operations conducted by the Commanders of the Combatant Commands. As part of this responsibility, the Chairman also assists in the preparation of strategic plans and helps to ensure that plans conform to available resource levels projected by the Secretary of Defense.

Combatant Commands

The nine Combatant Commands are responsible for conducting the DoD missions around the world. The Army, Navy, Air Force, and Marine Corps supply forces to these Commands.



Five of these Commands have specific mission objectives for their geographic area of responsibility, as shown in the map above:

- U.S. European Command (EUCOM) is responsible for activities in Europe, Greenland, Russia, and most of Africa.
- U.S. Central Command (CENTCOM) is

responsible for the Middle East, eastern Africa, and several of the former Soviet republics. This Command is primarily responsible for conducting Operation Enduring Freedom in Afghanistan and Operation Iraqi Freedom.

- U.S. Pacific Command (PACOM) is responsible for China, Southeast Asia, Australia, and the Pacific Ocean.
- U.S. Southern Command (SOUTHCOM) is responsible for South America and the southern Caribbean.
- U.S. Northern Command (NORTHCOM) is responsible for North America and the northern Caribbean.

Four Commands have worldwide mission responsibilities, each focused on a particular function:

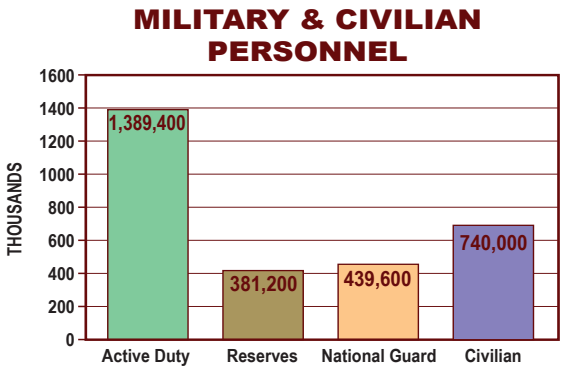
- U.S. Strategic Command is responsible for providing global deterrence capabilities and synchronizing the DoD efforts to combat weapons of mass destruction worldwide.
- U.S. Special Operations Command is responsible for leading, planning, synchronizing and, as directed, executing global operations against terrorist networks.
- U.S. Transportation Command is responsible for moving military equipment, supplies, and personnel around the world in support of operations.
- U.S. Joint Forces Command is responsible for developing future concepts for joint warfighting.

Defense Agencies and the DoD Field Activities

Defense Agencies and the DoD Field Activities provide support services commonly used throughout the Department. For instance, the Defense Finance and Accounting Service provides accounting services, contractor and vendor payments, and payroll services; and the Defense Logistics Agency provides logistics support and supplies to all the DoD activities.

Resources

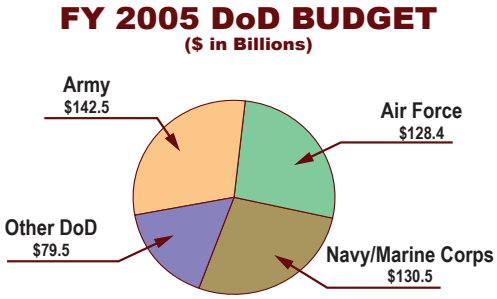
To provide Americans with the highest level of national security, the DoD employs nearly 1.4 million men and women in Active duty, more than 820,000 in the Reserve and National Guard, and approximately 740,000 civilians. Together, these men and women work daily to protect U.S. interests around the world.



Source: FY 2006 President's Budget and FY 2005 Emergency Supplemental Request

The DoD's worldwide infrastructure includes nearly 600,000 buildings and structures in more than 6,000 locations on more than 30 million acres of land in 146 countries. To protect the security of the United States, the Department uses approximately 250,000 vehicles, 15,000 aircraft, 1,000 oceangoing vessels, and 550 public utility systems.

The Department's budget for FY 2005 was $480.9 billion[1]. The chart below shows how the budget was divided among the three Military Departments and the DoD Department-wide functions.



[1] *Does not include Trust Fund or U.S. Army Corps of Engineers Civil Works appropriations.*

The DoD, the federal government's single largest agency, receives more than half the discretionary budget of the United States. Looking to a future in which budgets likely will remain tight and subject to greater scrutiny, and the tempo of day-to-day military operations will remain high, the cost-effectiveness of America's forces takes on increased importance.

The Department uses a variety of metrics to demonstrate accountability for the resources provided by the American people. This report highlights those metrics in the next two sections of Management's Discussion and Analysis, "Performance Objectives, Goals, and Results" and "Analysis of Financial Statements and Stewardship Information."

Performance Objectives, Goals, and Results

Key Performance information is summarized in this section; details are provided in Part 2 of this report.

How the DoD Assesses Performance

The DoD is committed to effective resource stewardship and has implemented numerous performance and financial measures to help meet that commitment. To demonstrate tangible benefits to the American public and to carefully monitor its own performance, the Department uses the performance management model depicted in the diagram below. Each component of the model is described below.

Mission. Explains why the DoD exists, tells what it does, and describes how it does it.

Strategic Objectives. High-level, broad actions through which the Department carries out the military, national security, and defense strategies.

Strategic Goals. The Department's strategic goals center on balancing risk in four key risk management framework areas.

Performance Goals. The desired outcomes the Department plans to achieve to attain its strategic goals. The Department has 16 performance goals, four for each strategic goal.

Performance Measures. A series of indicators, expressed in qualitative, quantitative, or other tangible terms that the Department uses to indicate whether current performance achieves the performance goals.

Performance Targets. Expressions of desired performance levels or specific desired results targeted for a given fiscal year. Achievement of targets defines success. Where possible, targets are expressed in quantifiable terms.

The fiscal year (FY) 2005 Performance and Accountability Report chronicles the Department's achievements toward meeting its FY 2005 performance goals and targets.

Defense Strategy and Strategic Planning

As directed in the 2002 National Security Strategy, the Department is implementing the President's

commitment "to build a safer, better world that favors human freedom, democracy, and free enterprise." The 2005 National Defense Strategy outlines DoD's approach to dealing with challenges it will likely confront, not just those it is currently best prepared to meet. The intent is to create favorable security conditions around the world and to continue transforming how the Department thinks about security, formulates strategic objectives, and adapts to achieve success. The 2005 National Defense Strategy emphasizes the importance of influencing events before challenges become more dangerous and less manageable.

To guide the Department's activities in support of the broader effort to create conditions conducive to a secure international system—as the President's National Security Strategy states, a balance of power that favors freedom—the Department established four strategic objectives. These strategic objectives serve as links between defense activities and those of other government agencies in pursuit of national security goals.

Secure the United States from direct attack. The Department will give top priority to dissuading, deterring, and defeating those who seek to harm the U.S. directly, especially violent extremists with weapons of mass destruction.
Secure strategic access and retain global freedom of action. The Department will promote the security, prosperity, and freedom of action of the U.S. and its partners by securing access to key regions, lines of communication, and the global commons.

Strengthen alliances and partnerships. The Department will assist in expanding the community of nations that share principles and interests with the U.S. and help these partners increase their capacity to defend themselves and collectively meet challenges in the Nation's interest.

Establish favorable security conditions. The Department will create conditions conducive to a favorable international system by honoring the security commitments and working with others to bring about a common appreciation of threats; a broad, secure and lasting peace; and the steps required to protect against these threats.

The Department is focusing efforts on four key actions that enable accomplishment of these strategic objectives.

One action is to assure allies and friends. Throughout the Cold War, U.S. military presence and activities abroad upheld America's commitment to its international partners. The U.S. shared risks by contributing to their physical defense. Now, given new challenges, the DoD aims to assure a growing and more diverse community of partners of that same commitment. Another action is to dissuade potential adversaries. Would-be opponents will seek to offset U.S. military advantages. In response, the Department will work to limit their strategic options and dissuade them from adopting threatening capabilities, methods, and ambitions, particularly by sustaining and developing key U.S. advantages. A third action to accomplish the Department's strategic objectives is to deter aggression and counter coercion. During the Cold War, deterrence was based necessarily on the threat of a major response after suffering an attack. Today, there are many scenarios where the U.S. is not willing to accept the huge consequences of an attack before responding. Therefore, current deterrence policy places increasing emphasis on preventing and protecting against attacks. This requires maintaining rapidly deployable military forces and, when necessary, demonstrating the will to resolve conflicts decisively on favorable terms. Lastly, when deterrence fails or efforts short of military action do not forestall gathering threats, the U.S will employ military power, together with other instruments of national power, as necessary, to defeat adversaries. At the direction of the President, the Department will defeat adversaries in a manner that establishes conditions conducive to a secure peace.

The strategic circumstances of the 21st century are far different today from those of the Cold War. However, as described in the 2005 National Defense Strategy, America remains vulnerable to security challenges in this age of uncertainty. America has learned that an unrivaled capacity to respond to traditional challenges is no longer sufficient. The consequences of even a single catastrophic attack, for example, are unthinkable. Therefore, the U.S. must confront challenges earlier and more comprehensively, before they are allowed to mature. The Department must plan with surprise in mind.

To contend with a world of uncertainty and surprise, the Department shifted its strategic planning from the "threat-based" model that guided DoD thinking in the past to a "capabilities-based" model for the future. Capabilities-based planning focuses more on how adversaries may challenge the U.S. rather than on who those adversaries might be or where conflict may occur. Under the threat-based model, planners looked at a threat posed, for example, by the former Soviet Union, and fashioned a force to fit it. Under a capabilities-based model, planners examine the capabilities that exist to threaten the U.S., such as chemical, biological, nuclear, or cyber-space capabilities, and fashion a response to contend with those capabilities regardless of where they might originate. This new approach focuses the Department on the growing range of capabilities and methods it must possess to contend with an uncertain future. Operating within fiscal constraints, this new approach enables the Secretary of Defense and Combatant Commanders to balance risk across traditional, irregular, disruptive, and catastrophic challenges.

As such, Cold War programs and weapons systems have been canceled or significantly modified, and lighter, faster systems have been added, as well as new technological advancements such as unmanned vehicles, laser communications, and new satellites for advanced command and control. All are tied together by the concept of net-centric warfare and truly joint/combined operations – absolute necessities for contending with the diverse and ever changing set of security challenges facing the U.S.

Experience in the war on terrorism has also underscored the need for a changed defense establishment—one postured both for extended conflict and continuous transformation. The U.S. is in a long-term struggle against persistent, adaptive adversaries, and must transform to prevail. Transformation is not only about technology. It is also about changing perspective in thinking about challenges and opportunities facing the Nation, adapting the defense establishment to that new perspective, and refocusing capabilities to meet future challenges. Therefore, the Department will continually adapt how it approaches and confronts challenges, conducts business, and works with others.

This demands an adaptive strategy, predicated on creating and seizing opportunities and contending with challenges through an active, layered defense of the Nation and its interests. The U.S. will seize the strategic initiative in all areas of defense activity—assuring, dissuading, deterring, and defeating. The U.S. must also defeat the most dangerous challenges early and at a safe distance, before they are allowed to mature. Such preventive actions include security cooperation, forward deterrence, humanitarian assistance, peace operations, and non-proliferation initiatives. The concept of active, layered defense includes international partners. Thus, among the key goals of the National Security Strategy is to work with other nations to resolve regional crises and conflicts.

Managing risk is a central element of the defense strategy. It involves balancing the demands of the present against preparations for the future consistent with the Department's strategic objectives and forms the basis for the strategic goals. The Quadrennial Defense Review is the Department's vehicle for risk assessment. The Quadrennial Defense Review is a comprehensive examination of the national defense strategy, force structure, force modernization,

infrastructure, budget plan, and other elements of the defense program and policies of the U.S. It allows the Secretary to consider the full range of risks associated with resources and operations and manage explicit tradeoffs across the Department.

The risk framework comprises force management risk, operational risk, institutional risk, and future challenges risk:

1) Force management risks are those associated with managing military forces fulfilling the missions described in the 2005 National Defense Strategy. The primary concern is the ability to recruit, retain, train, and equip a ready force and sustain that readiness.

2) Operational risks are those associated with the current force executing the strategy successfully within acceptable human, material, financial, and strategic costs.

3) Institutional risks are those associated with the capacity of new command, management, and business practices.

4) Future challenges risks are those associated with the Department's capacity to execute future missions successfully against an array of prospective future challengers.

These four dimensions of risk cannot be assessed and managed independently. Choices in one area affect choices in others. The Secretary makes deliberate choices that balance across and within the four risk areas.

The 2005 National Defense Strategy builds upon the Department's last Quadrennial Defense Review and culminating Report in 2001. Since the 2001 Quadrennial Defense Review Report was released, events have confirmed the importance of assuring our allies and friends, dissuading potential adversaries, deterring aggression and coercion, and defeating adversaries. America is a Nation at war, and the war on terrorism has exposed new challenges, but also unprecedented strategic opportunities to work at home and with our international partners to create conditions favorable to a secure international order. The Department's 2005 Quadrennial Defense Review is now underway, is incorporating these new challenges and is discussed in the last section of Part 1, titled "Looking Forward: Challenges for 2006 and Beyond."

Annual Performance Plan

The Secretary's Annual Defense Report serves as the Department's annual performance plan. The Annual Defense Report incorporates the strategic objectives and goals of Quadrennial Defense Review Report, as refined by the National Security, Defense, and Military Strategies.

The annual performance plan identifies four performance goals for each strategic goal, which are then further defined and measured by 71 corresponding metrics (measures and targets). These performance goals or dimensions of risk cannot be assessed and managed independently because choices in one area affect choices in others. The Department's guiding principle for managing risk is to deliberate choices that balance across and within the four risk areas.

Strategic Goal 1: Balancing Force Management Risk. Specific performance goals include:

- 1.1 Ensure Sustainable Military Tempo and Maintain Workforce Satisfaction.
- 1.2 Maintain a Quality Workforce.
- 1.3 Maintain Reasonable Force Costs.
- 1.4 Shape the Force of the Future.

Strategic Goal 2: Balancing Operational Risk. Specific performance goals include:

- 2.1 Maintain Force Readiness (Are Our Forces Currently Ready?).

2.2 Ensure Superior Capabilities Exist to Succeed (Are Our Forces Postured to Succeed?).
2.3 Align Forces Consistent with Strategic Priorities (Are Our Forces Employed Consistently With Our Strategic Priorities?).
2.4 Transition Forces Rapidly to Meet New Threats (Do We Have the Right Forces Available?).

Strategic Goal 3: Balancing Institutional Risk. Specific performance goals include:

3.1 Improve the Readiness and Quality of Key Facilities.
3.2 Manage Overhead and Indirect Costs.
3.3 Realign Support to the Warfighter.
3.4 Streamline the Decision Process, Improve Financial Management, and Drive Acquisition Excellence.

Strategic Goal 4: Balancing Future Challenges Risk. Specific performance goals include:

4.1 Define and Develop Transformational Capabilities.
4.2 Define Skills and Competencies for the Future.
4.3 Develop More Effective Organizations.
4.4 Drive Innovative Joint Operations.

The Annual Defense Report and more information on each of the strategic and performance goals and the corresponding 71 metrics can be found at http://www.defenselink.mil/execsec/adr2004/index.html.

Performance Assessment for FY 2005

During FY 2005, the DoD effectively accomplished its mission. On the international front, the Department faced challenges with the fierceness of the insurgencies in Afghanistan and Iraq, the deterioration of the relationship with Iran, and the mobilization of relief efforts following the tsunami in Asia. Closer to home, the DoD led efforts to provide relief for Hurricane Katrina and Hurricane Rita victims, and completed its Base Closure and Realignment recommendations to further transform the Department and optimize resources to support the warfighter.

The following paragraphs summarize the Department's performance results for the past fiscal year, and describe progress in achieving the results needed to meet the goals in each of the risk areas identified by the Annual Performance Plan.

Strategic Goal 1: Balancing Force Management Risk – recruit, retain, train, and equip a ready force and sustain readiness.

The Department continued its efforts to maintain a quality workforce satisfied with its quality of life, while making the best use of every dollar invested in the workforce and shaping the DoD workforce for the future. Thirty-seven metrics measure progress toward the four performance goals under Balancing Force Management Risk. Some of these metrics still are under development or just beginning to collect information, so meaningful, quantitative data is not yet available. In general, the preliminary steps required to establish these metrics were completed according to schedule in FY 2005.

Success stories in Force Management include two metrics where performance exceeded the goals by a wide margin. First, Active Component Enlisted Recruiting Quality (Metric 1.2.7) measures recruits' educational levels and scores on standardized aptitude tests taken by all military applicants. Working with the National Academy of Sciences, the DoD established benchmarks to support this metric that are highly accurate indicators of a recruit's success in the military. As an example, the DoD aimed to fill, at a minimum, 90 percent of its available recruitment slots with individuals that have earned a high school diploma; as of the end of third quarter FY 2005, 94 percent of recruits had earned a high school diploma.

Second, Military Personnel Costs—Enlisted Pay Gap (Metric 1.3.7) tracks the percentage of the pay gap between military and civilian pay that has been closed. Experience shows that when military is significantly less than the 70th percentile, as compared to civilian pay, recruiting and retention problems may arise. The DoD has established annual targets to close the gap at a rate of 25 percent annually until the gap is eliminated. The DoD exceeded its annual target for FY 2005 by closing the gap 54 percent over the previous year through an average pay increase, an average basic allowance increase for housing, and an increase in the basic allowance for subsistence. Overall, 88 percent of the enlisted pay gap has been closed.

The Department came close to meeting its performance goals for some of the metrics. "Came close" is defined as estimated to be within a few percentage points of the target, yet still within range to be considered acceptable performance. For example, Satisfaction with Access to Medical Care (Metric 1.1.5) measures individuals' satisfaction with access to appointments in TRICARE Prime, which is the Military Health Care System's equivalent of a health maintenance organization. Health care is a quality of life issue that affects recruitment, retention, and ultimately job satisfaction in any profession. The DoD's target was a satisfaction rate of 84 percent or higher; as of third quarter, the rate was 81.2 percent. The Department came up short on this goal due to a larger percentage of medical appointments for Active duty personnel, who tend to be younger and have higher expectations. Steps taken to improve the score in the future include using more contract physicians to improve appointment availability.

Some metrics showed mixed results; i.e., some Military Departments met or exceeded targets while others fell short. For example, Reserve Component Enlisted Recruiting Quantity (Metric 1.2.10) tracks the number of new Reserve recruits against targets designed to maintain required strengths after factoring in normal attrition, promotions, etc. Overall, as of the end of the third quarter, the DoD fell short and reached only 77,375 or 83 percent of its goal of recruiting slightly more than 93,000 reservists. The Marine Corps and the Air Force Reserves, however, met their targets. The Army National Guard and Army Reserve fell short of their targets and are not expected to achieve their goals for the year. Enhanced recruiting and retention incentives are helping to attract new Reservists.

Finally, some goals were not met due to a variety of factors. For instance, Critical Skill Recruit Needs (Metric 1.2.4) tracks the ability of the Services to recruit for Active duty individuals that fit one or more criteria, e.g., possess skills crucial to combat readiness or meet high entrance standards. The FY 2005 target was to fill all critical skills at 95 percent or more. The results, as of the third quarter, showed that one-third (22 of 67) of the designated critical skills did not meet that threshold. In particular, the Army reported notable declines in a significant majority of critical skills. These shortcomings are attributed to a more challenging recruiting environment, which the Department is addressing through various recruiting and retention incentives and bonuses.

Strategic Goal 2: Balancing Operational Risk – achieve and maintain operational superiority.

Prior to 2001, the DoD measured operational risk almost exclusively in terms of the ability of the Armed Forces to wage two major wars simultaneously in Northeast Asia and Southwest Asia. In 2001, the Department adopted a capabilities-based approach that reflects the fact that the DoD cannot be certain which nation, combination of nations, or non-state actor will pose threats to vital U.S. interests decades from now. This new approach more realistically captures the demands facing the armed forces by focusing more on how an adversary might fight rather than on the

identity of the adversary or where a war might occur. It requires identifying capabilities that U.S. military forces will need to deter and defeat adversaries who will rely on surprise, deception, and non-traditional styles of warfare to achieve their objectives.

Nine metrics measure the progress toward the four Balancing Operational Risk performance goals. These metrics are under development and progress is measured by adherence to specific milestones. Quantitative data will not be available until after FY 2005. Metric examples include:

- Adaptive Planning (Metric 2.1.1). This metric will ensure the capability to produce plans that are more timely, adaptive, and responsive to the current security environment, providing relevant options to the President and the Secretary of Defense. In FY 2005, the DoD began applying adaptive planning concepts into contingency planning guidance and several warplans.

- Global Force Management (Metric 2.2.1). This metric develops an integrated force assignment, apportionment, and allocation methodology. It provides comprehensive insight into U.S. forces available worldwide, and accounts for ongoing operations and constantly changing unit availability. The Secretary approved the guidance for the program in May 2005. The DoD also chartered five Global Force Management Boards led by Joint Staff study teams.

- Joint Concepts (Metric 2.3.1). This metric guides the transformation of the joint force so that it is prepared to operate successfully 8-20 years in the future. In simple terms, the joint force will eliminate military "stovepipes" by seamlessly combining the armed forces' capabilities necessary to address a situation or event. In FY 2005, the Joint Staff developed and the Secretary approved four joint operation concepts.

- Operational Availability (Metric 2.4.1). This metric ensures integrated data and management systems to assess the percentage of forces ready for specific joint tasks to address diverse requirements. These systems will enable DoD to develop the ability to rapidly transition forces to post-hostility operations, and identify and deter threats to the U.S., while standing ready to assist civil authorities in mitigating the consequences of a terrorist attack or other catastrophic event. In FY 2005, the DoD updated and used analytic baselines, a set of common scenarios and data, to assess mobility and air refueling capabilities.

Strategic Goal 3: Balancing Institutional Risk – align the organization and its resources to support the warfighter.

As the Department transforms its military capabilities to meet changing threats, it also must transform its institutions to ensure that its people can focus their immense talents on defending America, and that they have the resources, information, and freedom to perform. This means changing the way the Department conducts its daily business, because the current organizational arrangements, processes, and systems are draining scarce resources from training, infrastructure, operations, and housing.

This area has four performance goals to improve institutional management that focus on improving readiness and quality of facilities, timeliness of support, and financial management; streamlining processes; and reducing administrative costs. Fourteen metrics track achievements in this area. For example, Reduce Percentage of DoD Budget Spent on Infrastructure (Metric 3.2.1), is used to measure the trend in resources toward less infrastructure and more mission programs. The DoD's target, set in FY 2004, is 41 percent; for FY 2005, the projected percentage is 42 percent – slightly higher than the annual performance target.

The DoD also measures Customer Wait Time (Metric 3.3.1). The purpose of this metric is to

measure customer wait time in filling orders for military equipment materials, and spare and repair parts. The targeted turnaround time in filling customer orders was 15 days; the DoD average wait time as of the third quarter was 21 days due to heavy demands of Operation Iraqi Freedom.

Strategic Goal 4: Balancing Future Challenges Risk – execute future missions successfully against an array of prospective challengers.

While many elements of America's existing military force will continue to contribute to the DoD's capabilities, the DoD needs to develop new, leading-edge capabilities to meet the challenges of tomorrow. The Department needs to rapidly convert innovative warfighting concepts from prototypes into fielded capabilities. It needs to define the skills required for the future and plan to recruit, train, and retain talented individuals who have those special abilities. Finally, the DoD must continue to experiment with new warfare concepts, enhance its intelligence-gathering capabilities, and maintain its science and technology strengths.

This strategic goal has four performance goals, which include 11 metrics. Most of these metrics are under development and progress is measured by adherence to specific milestones. Quantitative data will not be available until after FY 2005. Examples of these metrics include:

- Deny Enemy Advantages and Exploit Weaknesses (Metric 4.1.1). This metric focuses on specific steps necessary to establish strategic outcomes and efficiency measures to gauge the effectiveness of America's intelligence activities and the DoD's training and associated program structures. Many domestic, international, and organizational variables contribute to the success of the overall program. The task of developing enduring outcome goals and measures involves a significant amount of developmental research and analysis. In FY 2005, the DoD initiated a polygraph program and began conducting polygraph examinations on translators and other personnel prior to their arrival at Guantanamo Bay.

- Attract, Recruit, Retain, and Reward High Quality People from Government, Industry, and Academia (Metric 4.2.1). This metric measures the DoD's success in bringing to its intelligence community people with broad and varied experiences who are agile problem solvers and can operate in an environment that changes as the threat changes. A key first step in FY 2005 was to establish a common human resources system for the DoD intelligence community.

- Enhance Homeland Defense and Consequence Management (Metric 4.3.1). This metric required the development of a comprehensive, Defense-wide Strategy for Homeland Defense and Civil Support, which was issued in June 2005. This strategy incorporates an integrated threat assessment and addresses force structure, technology, and resource implications. It includes implementation actions that will be reported in the FY 2006 Performance and Accountability Report.

- Maintain Balanced and Focused Science and Technology (Metric 4.4.2). This metric is designed to ensure a balanced and focused investment by funding basic research, applied research, and advanced technology development. The DoD established percentage goals for each category; as of the end of FY 2005, the balance between the funding levels was close enough to be viewed as meeting the goal.

Analysis of Financial Statements and Stewardship Information

This section summarizes key financial information; Part 3, Financial Information, provides more details.

Supporting the Department's warfighting mission is critical to defending the Nation's security. Among other things, success hinges on sound and reliable financial management. "Clean" or unqualified audits are one element of success. Overall success will be achieved when the DoD has accounted for all monies expended past and present, eliminated redundancies, revealed and corrected errors, and directed the savings from this effort toward improving the mission-readiness of those who serve this country.

The DoD continues to improve financial management by overhauling the Department's business and financial management processes and systems. This represents a major management challenge that goes far beyond financial accounting. The Secretary and his senior leaders are committed to changing the Department's business culture, thus improving the Department's combat support infrastructure. The DoD has three primary mechanisms in place to achieve these goals: the Business Management Modernization Program (BMMP), the Financial Improvement and Audit Readiness (FIAR) Plan, and the Under Secretary of Defense (Comptroller) Strategic Plan (FY 2005 - 2009).

Business Management Modernization Program

In 2001, the Department established this program as the foundation to transform the DoD business operations. Its approach targets essential business capabilities and functions, and creates integrated and executable plans to achieve business and financial transformation. One of its early achievements was the establishment of a Business Enterprise Architecture, a guide for investments in the DoD organization, operations, and systems as they relate to or affect business operations. The architecture plays a critical role in transformation by establishing clear links among systems/initiatives, business capabilities, Business Enterprise Priorities, and core business missions. Business systems development consists of setting priorities based on warfighting needs and financial accountability, assigning programs to provide the capabilities of those priorities, refining the architecture and transition plans to support those particular decisions, funding the approved programs, and then implementing the transformation. The architecture evolves and matures as the Department defines its priorities, identifies emerging viable programs, and institutes Department-wide standards.

In 2005, the Department developed an Enterprise Transition Plan, which provides an iterative, modular, and tiered approach to enable a manageable transformation. The plan highlights the business capabilities that the DoD needs to support warfighter requirements, identifies the known systems and non-systems solution to achieve business transformation, and identifies the resources for implementing those solutions. The Enterprise Transition Plan provides key milestones to mark the path to transformation and measure progress along that path.

Additionally, the Department implemented the concept of tiered accountability whereby systems or initiatives that affect Department-wide capabilities, or meet specific investment thresholds, are managed and reviewed as part of the DoD-wide portfolio. Business systems and initiatives not meeting those criteria are delegated to the DoD components for management and review.

The Defense Business Systems Management Committee chaired by the Acting Deputy Secretary of Defense defines the Business Enterprise Priorities based on desired outcomes—those areas where

transformed business operations will improve warfighter support, reduce costs, and improve regulatory compliance. In FY 2005, the Committee approved six Business Enterprise Priorities and 43 initiatives to achieve them. One of those priorities, the Financial Visibility Priority, focuses on achieving enhanced end-to-end financial information flow and visibility that will benefit the warfighter while continuously improving financial transparency and reducing systems complexity. The Department defined six core financial capabilities in support of the Financial Visibility Priority, including:

- Forecast, plan, program, and budget;
- Manage financial assets and liabilities;
- Funds allocation, collection, disbursement, and control;
- Manage General Ledger;
- Managerial accounting; and
- Financial reporting.

The DoD established performance measures to monitor and guide activities that will lead to the full development and maintenance of those financial capabilities. The FY 2005 accomplishments include developing a Standard Financial Information Structure (SFIS) and initiating a Program/Budget Framework.

The SFIS standardizes Department-wide financial information supported by the U.S. Standard General Ledger and marks a major step in achieving the financial management capabilities listed above. The DoD incorporated SFIS, a DoD-wide data structure that supports the Department's budget, cost/performance management, and external reporting requirements, into its Business Enterprise Architecture. As a common business language, SFIS provides the means to track and audit transaction-level financial information, thus enabling financial statement auditability consistent with the Federal Financial Management Improvement Act.

The Program/Budget Framework initiative provides a foundation for a new Program/Budget data structure using a common language, enabling senior-level DoD decision makers to weigh options and resource constraints across a spectrum of challenges. The Framework will help link the Department's strategic plans, programs, and budgets to accounting and performance data.

Financial Improvement and Audit Readiness Plan

Recognizing the need for a comprehensive, integrated financial improvement plan to orchestrate the financial improvement efforts of the DoD components, ensure integration and leverage of BMMP solutions, and provide the roadmap to verification of improvements through audit, the Department initiated an effort to develop, manage and execute a FIAR Plan. This plan complements the BMMP's Enterprise Transition Plan by integrating the Financial Visibility Priority discussed above with component-level FIAR Plans. The FIAR Plan is focused on, but not limited to, the Department's near-term objectives in four major areas: Military Equipment, Medicare Eligible Retiree Health Care Fund, Real Property, and Environmental Liabilities. These areas comprise some of the most significant balance sheet categories; improving these areas will greatly enhance the Department's financial auditability.

Major DoD components have prepared a FIAR Plan that delineates specific steps to meet a prescribed set of business rules for achieving financial improvement that is verified by audit. Issued by the DoD Chief Financial Officer in FY 2004, these business rules, or phases as they are sometimes called, are Discovery and Correction, Validation, Assertion, Assessment, and Audit. These business rules force the components to consider all pertinent factors when determining tasks and solutions, yet provide the flexibility to account for unique circumstances and environments. Although the estimated end dates for corrective action and completion of all phases vary,

the process, business philosophy, and critical factors are uniform across the Department. Over time, the FIAR Plan will enable the DoD to cost-effectively generate reliable financial data and forecast accurate budget expenditures and needs.

Under Secretary of Defense (Comptroller) Strategic Plan (FY 2005 - 2009)

The mission of the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer is to ensure that the Department's budget and financial expenditures support the national security objectives of the United States. This mission highlights proper stewardship and business management of taxpayer dollars in support of the Department. The strategic plan establishes executive-level performance goals and tracks results; designates key performance outcomes, measures, and indicators; and assigns responsibility for metrics to individual component levels within the Department. Budget and financial indicators monitor and guide financial management reform and target resources to areas where the DoD needs better stewardship of financial resources.

Financial Improvement Progress and Results

To date, the Department-wide financial statements have received a disclaimer of opinion from the auditors, which means that the financial information displayed in the statements is in such poor condition that the auditors are unable to express an opinion. The auditors have noted 11 specific financial statement weaknesses, which the Department has been working to resolve through various initiatives. These weaknesses and the Department's mechanisms in place to address them, as well as the Department's progress are discussed below. Overall, the DoD's inability to obtain an unqualified or "clean" opinion on its financial statements is due to inadequate systems and business processes.

Financial Statement Weakness	Description	Primary Corrective Action Mechanism	Status	Target Completion Date
Financial Management Systems	The DoD systemic deficiencies in financial management systems and business processes result in the inability to collect and report financial and performance information that is accurate, reliable, and timely.	BMMP	Implementation of the DoD BMMP Enterprise Transition Plan and the BMMP Business Enterprise Architecture containing financial management elements, including the SFIS, will resolve this material weakness.	FY 2015
Intra-governmental Eliminations	The inability to reconcile most intragovernmental transactions results in adjustments that cannot be fully supported.	BMMP	Under the BMMP Financial Visibility initiative "Intragovernmental Transactions," DoD will develop standardized, consolidated and integrated processes and system components.	FY 2015
Accounting Entries	The DoD continues to enter material amounts of unsupported accounting entries.	BMMP	Resolving this material weakness requires the implementation of the BMMP Enterprise Transition Plan and the BMMP Business Enterprise Architecture solutions, including the SFIS, Business Enterprise Information Services, and Intragovernmental Transactions initiatives. Additionally, deployment of modern accounting systems capable of using the SFIS is required. Resolution of this material weakness will be achieved incrementally as the BMMP solutions and systems are implemented.	FY 2015

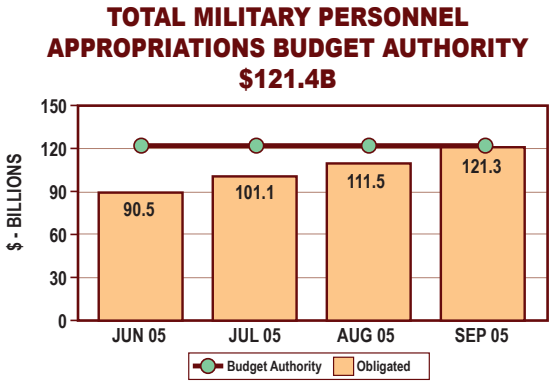
Financial Statement Weakness	Description	Primary Corrective Action Mechanism	Status	Target Completion Date
Fund Balance with Treasury	The Department has been unable to fully reconcile its records to those of the U.S. Treasury.	FIAR Plan	The Department strengthened internal controls for disbursements through reconciliation training and metric tracking to more accurately record disbursements. The Department obtained the necessary legislation to clear, and did clear, old unreconcilable suspense accounts and check issue differences totaling $609 million through FY 2005. The Department has a multi-phase program underway to enhance system functionality for improving expenditure reconciliation and reporting.	FY 2009 (Army and Air Force plan to have ready for audit in FY2006)
Environmental Liabilities	Guidance and audit trails are insufficient. The inventory of ranges and operational activities (landfills, open burning pits, etc.) is incomplete.	FIAR Plan	The Department issued guidance for closed sites in October 2002. The Department plans to issue financial guidance for ongoing operational activities by December 2005. Inventories of operational and non-operational ranges are complete. Additional review and validation are needed to ensure audit trails are sufficient.	FY 2010
General Property, Plant, and Equipment (PP&E)	The cost and depreciation of the DoD General PP&E is not reliably reported due to: (1) a new accounting requirement that went into effect in FY 2003 that classifies military equipment as General PP&E (such costs were previously expensed), (2) a lack of supporting documentation for General PP&E which were purchased many years ago, and (3) most legacy property and logistics systems are not integrated with acquisition and financial systems and were not designed to capture the acquisition cost, cost of modifications and upgrades, or calculate depreciation.	FIAR Plan	The Department implemented guidance and training to improve property accountability and provide better financial reporting. The Department has completed 95 percent of Army and Navy initial military equipment valuations and 100 percent of Air Force valuations. The Department plans to complete valuations of all known military equipment programs by December 2005. The military equipment baseline will be updated to a single base year in FY 2006. The Department began development of a system that will facilitate the update and maintenance of baseline values. The system will be deployed as a pilot by December 2005 and will be fully operational by the end of September 2006. At that time, the DoD will have established its military equipment baseline.	FY 2011
Government Property and Material in the Possession of Contractors	The cost of DoD property and material in the possession of contractors is not reliably reported due to a lack of an integrated reporting methodology.	FIAR Plan	The Department is developing policy and processes to help correct this weakness. The Office of Management and Budget will soon release new policy that will bring property in the possession of contractors up to leading industry standards and help the Department correct this weakness. To improve accountability, accuracy, and reliability, the DoD is creating an on-line government property system to be used jointly by government and industry for recording property in the possession of contractors. Initial data loads will take place in 2006.	FY 2011
Inventory	The existing inventory valuation at most activities is not reported in accordance with generally accepted accounting principles.	FIAR Plan	The Department issued a change in policy in FY 2001 to begin valuing inventory at moving-average-cost to comply with historical cost valuation requirements. In FY 2004, a DoD workgroup began to assess major logistics and financial systems—current and future—to determine the adequacy for producing historically-based valuations. Based on these efforts, the Department will issue a baselining requirements policy in FY 2006.	DoD components will complete plans by 12/31/05
Operating Materials and Supplies	The Department's systems were designed to expense materials when purchased rather than when consumed.	FIAR Plan	The DoD workgroup addressed issues pertaining to the capitalization of Operating Materials and Supplies versus expensing. The Department currently is reviewing its policies for potential update.	DoD components will complete plans by 12/31/05

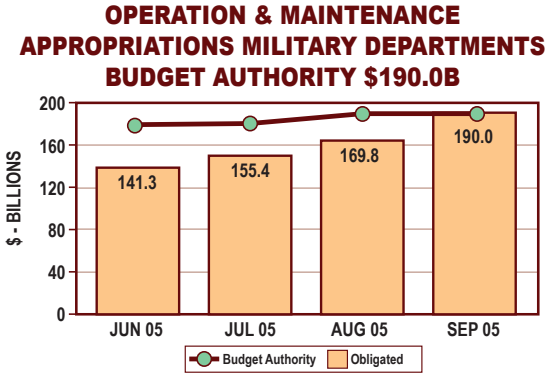
Financial Statement Weakness	Description	Primary Corrective Action Mechanism	Status	Target Completion Date
Statement of Net Cost	The Statement of Net Cost is not presented by programs that align with major goals and outputs described in the DoD's strategic and performance plans required by the Government Performance and Results Act. Revenues and expenses are reported by appropriation categories because financial processes and systems do not collect costs in line with performance measures.	BMMP	Resolving this material weakness requires the implementation of the BMMP Enterprise Transition Plan and the BMMP Business Enterprise Architecture solutions including the SFIS, Business Enterprise Information Services, and Intragovernmental Transactions initiatives. Additionally, deployment of modern accounting systems capable of using the SFIS is required. Resolution of this material weakness will be achieved incrementally as the BMMP solutions and systems are implemented.	FY 2015
Statement of Financing	The DoD cannot reconcile budgetary obligations to net cost without making unsupported adjustments.	BMMP	Resolving this material weakness requires the implementation of the BMMP Enterprise Transition Plan and the BMMP Business Enterprise Architecture solutions including the SFIS, Business Enterprise Information Services, and Intragovernmental Transactions initiatives. Additionally, deployment of modern accounting systems capable of using the SFIS is required. Resolution of this material weakness will be achieved incrementally as the BMMP solutions and systems are implemented.	FY 2015

The following are several of the budget and financial indicators that we monitor to help us guide financial management reform and target resources to areas where we need to drive better stewardship of financial resources.

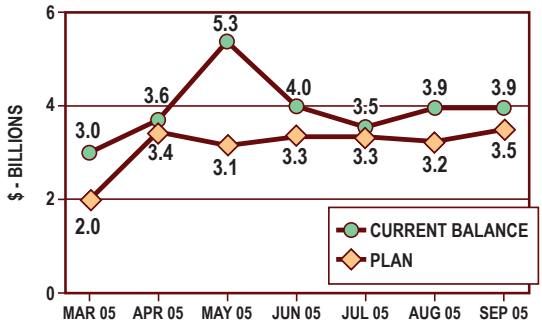
Execution of Military Personnel and Operation and Maintenance Appropriations

The Department executed 99.9 percent of its Military Personnel Appropriations by the end of September 2005 and 100 percent of its Operation and Maintenance Appropriations for the Military Departments. The Department uses the metric below to compare each appropriation's annual budget authority with the Service projected annual obligations to fund the full requirement. The Department's goal is to ensure projected obligations remain between 98 and 100 percent of budget authority for the fiscal yearend.



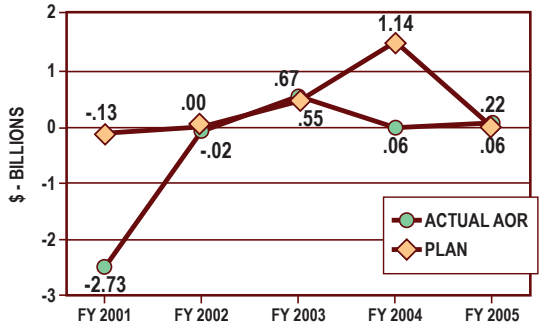


Defense Working Capital Fund Cash Management with U.S. Treasury



The management of cash within the Defense Working Capital Fund is defined as the ability to maintain sufficient liquidity to meet current obligations and accurately forecast cash requirements. The Department transferred $2.1 billion to the Operation and Maintenance appropriation this fiscal year. Transfers give the Fund the ability to maintain sufficient liquidity to service current obligations and accurately forecast cash requirements. Higher fuel costs and inventory replacement have severely reduced cash in FY 2005 and will severely reduce cash in FYs 2006 and 2007. Additional supplemental funding of $1.4 billion was required to offset the fuel loss in FY 2005.

Defense Working Capital Fund Accumulated Operating Results



The Accumulated Operating Results (AOR) reflects the cumulative operating gain or loss since inception for each industrial type business area. This indicator displays the variance between the phased plan for AOR provided in the budget and the actual AOR reported in the monthly financial statement. The Department anticipates completing FY 2005 ahead of plan due to increased revenue from workload related to contingency operations. Improved performance at the Depot Maintenance activities, Defense Information Systems Agency, and Defense Logistics Agency Distribution Depots are the primary drivers for AOR growth over plan. Rate adjustments in the budget years ahead will bring AOR closer to zero. Improved AOR from FY 2001 to FY 2002 was the result of corrections of prior year accounting data.

Late Payments of Commercial Invoices

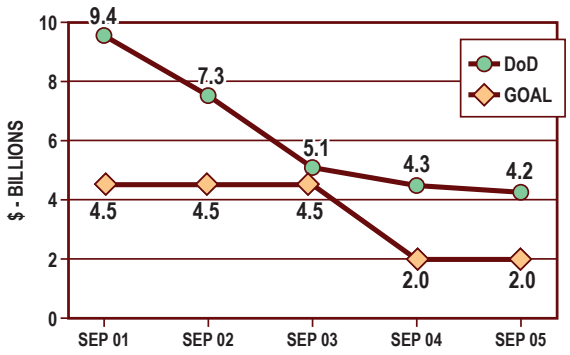
The Prompt Pay Act requires that invoices be paid on time. This indicator highlights the degree to which the DoD is able to reduce its untimely commercial payments. The Department met its FY 2005 goal to reduce late payments to a level not to exceed 2 percent of total commercial invoices. Improving this indicator reduces cost to the Department and improves its relationship with suppliers. The Department reduced late payments by 46 percent from FY 2004. Attention to this indicator has driven overdue payments to contractors down by 66 percent since FY 2001.

Delinquent Accounts Receivable

This Accounts Receivable indicator highlights the amount owed to the Government by an individual, organization, public entity, foreign entity, or any other entity (including Federal entities), to satisfy a debt or claim. Delinquent receivables are broken down into two types: public and intragovernmental. For FY 2005, the Department did not meet its goal to reduce these receivables by 75 percent from the FY 2003 baseline of $4.7 billion. The majority of public delinquencies are not under the Department's control. For September 2005, $3.7 billion of the

$4.6 billion of total public delinquencies were at Treasury or in litigation at the Department of Justice. For September 2005, the amount of receivables owed to the Department from other federal agencies was $261 million.

The DoD Travel Card Program Individually Billed Accounts Delinquency Rates



The indicator measures the percent of the DoD employee travel card balances outstanding for more than 61 days. Reducing outstanding balances helps increase rebates to the Department. The delinquency rate for individual travel accounts declined 55 percent since FY 2001.

Overview of Financial Statement Results

The DoD's financial management environment is complex and diverse. Its FY 2005 financial statements included $1.3 trillion in assets, $1.9 trillion in liabilities, and $635 billion in Net Cost of Operations. In FY 2005, DoD prepared and obtained an audit opinion on the Department-wide financial statements and nine major reporting components that comprise the Department-wide financial statements. The major reporting components include the Military Retirement Fund, the Medicare Eligible Retiree Health Care Fund, the U.S. Army Corps of Engineers, and the general funds and working capital funds for the Army, Air Force, and Navy.

Of those, only the Military Retirement Fund received an unqualified audit opinion, meaning that the financial statements are presented fairly, in all material respects. The liabilities of the Military Retirement Fund account for 47 percent of the Department-wide liabilities.

The Medicare Eligible Retiree Health Care Fund, which accounts for 5 percent of the DoD's assets and 28 percent of its liabilities, received a qualified opinion, which means that except for certain conditions, the financial statements meet the standards for an unqualified opinion as described above.

The DoD also prepares statements for many of the smaller entities within the Department that are then rolled up into the overall consolidated financial statement and identified as "Other Defense Organizations." Some of these smaller entities are subject to audit each year. Four organizations within this group achieved unqualified audit opinions again in FY 2005: the Defense Finance and Accounting Service, the Defense Contract Audit Agency, the Defense Commissary Agency, and the Defense Threat Reduction Agency. In addition, at the DoD-wide level, the Department received favorable audit results on three financial statement items in FY 2005: (1) Investments, (2) Federal Employees' Compensation Act Liabilities, and (3) Appropriations Received.

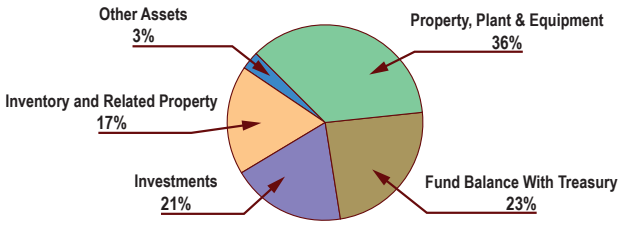
As a result of these financial improvements and audit successes, 21 percent of DoD's assets and 47 percent of its liabilities received favorable audit results in FY 2005. DoD's financial statements for FY 2005 are presented in their entirety in Part 3, Financial Information. A summary of results is provided below.

Assets

Assets are resources owned or managed by DoD that are available to provide future economic benefits.

The Consolidated Balance Sheet shows that DoD assets as of September 30, 2005, were $1.3 trillion, an increase of $58.4 billion from FY 2004. A summary analysis is provided below.

TYPES OF ASSETS



The DoD's Fund Balance with Treasury at September 30, 2005 of $290.7 billion is essentially unchanged from FY 2005. The Fund Balance with Treasury is the equivalent of DoD's "checkbook" balance or aggregate amount of funds deposited in Treasury available to make authorized expenditures or pay liabilities.

Investments increased by $32.5 billion primarily due to contributions and interest exceeding benefits paid by the Military Retirement Fund and the Medicare Eligible Retiree Health Care Fund for retired military members and their dependents.

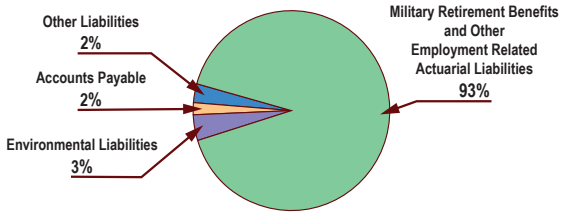
Plant, Property, and Equipment increased by $19.8 billion due primarily to DoD's ongoing efforts to identify and capitalize military equipment.

Asset Type	FY 05	FY 04	Change
Property, Plant, & Equipment	$460.7B	$440.9B	+$19.8B
Fund Balance w/Treasury	$290.7B	$289.6B	+$1.1B
Investments	$264.0B	$231.5B	+$32.5B
Inventory & Related Property	$222.6B	$220.5B	+$2.1B
Remaining Assets	$36.2B	$33.3B	+$2.9B
Total	**$1,274.2B**	**$1,215.8B**	**+$58.4B**

Liabilities

Liabilities are amounts owed by the DoD that will require payments from current or future assets. The Consolidated Balance Sheet shows that DoD liabilities as of September 30, 2005, were $1.9 trillion, an increase of $163.2 billion (10 percent) from FY 2004.

TYPES OF LIABILITIES



Military Retirement Benefits and Other Employment Related Actuarial Liabilities increased $166.4 billion (11 percent), due in part to a significant increase in death benefits and life insurance for service members killed in combat. Also contributing to the increase is the significant number of military retirees and their family members who are taking greater advantage of military health facilities in recent years, and relying less on private sector health insurance. With civilian benefits eroding due to the high cost of health care, more and more veterans and their families are finding their TRICARE health benefit a better value. This phenomenon has required the adjustment of actuarial factors used to calculate the expected long-term costs of the TRICARE benefit.

Environmental Liabilities increased by $660.5 million primarily due to improving the Department's inventory of environmental sites and the accuracy of environmental liability estimates.

Liability Type	FY 05	FY 04	Change
Military Retirement Benefits and Other Employment Related Actuarial Liabilities	$1,736.1B	$1,569.7B	+$166.4B
Environmental Liabilities	$65.0B	$64.4B	+$0.6B
Accounts Payable	$30.6B	$30.2B	+$0.4B
Other Liabilities	$41.7B	$45.8B	-$4.1B
Total	**$1,873.4B**	**$1,710.1B**	**+163.3B**

Costs

The Consolidated Statement of Net Cost shows that the net cost of operations for the Department of Defense for FY 2005 was $634.9 billion, an increase of $29.5 billion (5 percent) from FY 2004. The principal reason for this increase continues to be military operations in Iraq and Afghanistan, as indicated by the table below, which reflects that costs to pay, operate, maintain, supply, and transport forces increased by $87.2 billion. Though liabilities associated with military retiree benefits increased significantly as discussed above, the table below reflects that total military retirement costs decreased from FY 2004 by $31.6 billion. This is due to the recognition of concurrent receipt benefits in FY 2004, which resulted in significant additional costs in FY 2004, and far exceeded the additional benefits recognized in FY 2005. The Consolidating Statement of Net Cost in Part 3, Financial Information, provides a more detailed breakout of the Department's costs.

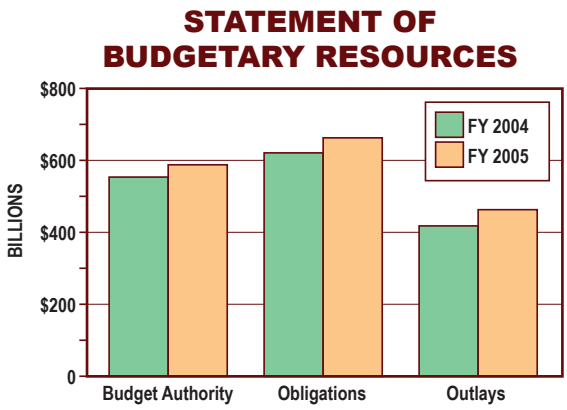
Program Type	FY 05	FY 04	Change
Military Personnel	$122.5B	$112.3B	+$10.2B
Operation & Maintenance	$264.1B	$187.1B	+$77.0B
Procurement	$62.0B	$79.2B	-$17.2B
Research, Development, Test & Evaluation	$61.9B	$56.8B	+$5.1B
Military Retirement	$121.8B	$153.5B	-$31.7B
Other Programs	$2.6B	$16.5B	-$14.1B
Total	**$634.9B**	**$605.4B**	**+$29.5B**

Budget Authority

Budget Authority is the authority provided by law to incur financial obligations that will result in outlays—payment for the amounts of orders placed, contracts and grants awarded, services received and similar transactions during a given period. Specific forms of budget authority requested by the Department include:

- Appropriations Received from Congress provide authority to incur obligations and to make payments from Treasury for specified purposes.
- Borrowing Authority from Congress to authorize the DoD to incur obligations and make payments to liquidate the obligations of funds borrowed from Treasury or directly from the public.
- Contract Authority from Congress permits obligations to be incurred in advance of appropriations or receipts with payments made only when a subsequent appropriation or offsetting collection is received.
- Appropriation Transfers from other funded agencies permit the DoD to incur obligations and make payments.

The Combined Statement of Budgetary Resources shows that the amount of budget authority the Department had for FY 2005 was $661.5 billion. This is a $45.2 billion (7 percent) increase from FY 2004. Increased funding to fight the global war on terror precipitated this increase and the corresponding increases to both obligations and outlays, which are discussed below.



Obligations

An obligation is a binding agreement that will result in outlays, immediately or in the future. Budgetary resources must be available before obligations can be incurred legally. The Combined Statement of Budgetary Resources shows that obligations made during FY 2005 were $777.5 billion, an increase of $56.8 billion (8 percent) from FY 2004.

Outlays

An outlay is a payment to liquidate an obligation (other than the repayment of debt principal). Outlays generally are equal to cash disbursements, but also are recorded for cash-equivalent transactions, such as the subsidy cost of direct loans and loan guarantees, and interest accrued on issues of public debt. Outlays are the measure of government spending. The Combined Statement of Budgetary Resources shows that outlays made during FY 2005 were $563.9 billion, an increase of $42.8 billion (8 percent) from FY 2004.

President's Management Agenda

The President's Management Agenda, announced in the summer of 2001, is an aggressive strategy for improving the management of the federal government. The Department has made significant progress toward achieving the goals of the President's Management Agenda. Each quarter, federal departments and agencies receive "stoplight" grades of green, yellow, or red from the Office of Management and Budget on both their current status and progress toward meeting the standards for success established for each area. A green score indicates success, yellow denotes mixed results, and red represents failure. The results for all agencies are reported on the Executive Branch Management Scorecard, which is available at http://www.results.gov. This website includes detailed information about the President's Management Agenda.

The Agenda currently focuses on five key federal government-wide management areas and two program initiatives:

- Electronic Government (e-Gov),
- Strategic Management of Human Capital,
- Improved Financial Performance,
- Budget and Performance Integration,
- Competitive Sourcing,
- Real Property Management Initiative, and
- Eliminating Improper Payments Initiative.

In addition, the President's Management Agenda includes several agency-specific initiatives, two of which apply to DoD:

- Coordination of Department of Veterans Affairs (VA) and DoD and
- Privatization of Military Housing.

As of September 30, 2005, the Department's grades were mixed:

Executive Branch Management Scorecard Results for DoD (September 30, 2005)

Government-Wide Program Initiatives	Status Score	Progress Score
Electronic Government (e-Gov)	Red	Red
Strategic Management of Human Capital	Yellow	Green
Improved Financial Performance	Red	Yellow
Budget & Performance Integration	Yellow	Green
Competitive Sourcing	Red	Red
Real Property Management Initiative	Red	Green
Eliminating Improper Payments Initiative	Yellow	Green
DoD-Specific Initiatives		
Coordination of VA and DoD Programs and Systems	Yellow*	Yellow*
Privatization of Military Housing	Green	Green

** Scores as of June 30, 2005*

Following is a brief description of each initiative and efforts the Department has undertaken thus far toward successful implementation of the President's Management Agenda.

Electronic Government

Goal: *To ensure that the DoD's multi-billion dollar annual investment in information technology (IT) is well spent.*

The DoD is working to ensure that all major IT investments are justified with strong business cases; all projects are completed within 10 percent of cost, schedule, and performance goals; and IT systems are secured properly and data is protected appropriately. The Department is taking an active role in several initiatives, including the government-wide SmartBUY, Integrated Acquisition Environment, and Grants.gov, as well as the DoD initiatives involving the Defense Travel System and education and training.

SmartBUY

The DoD participated actively in the government-wide SmartBUY team, which negotiated three "co-branded" software products on behalf of the entire federal government. These agreements enable federal agencies to obtain discounts and improved terms and conditions, and even better discount terms and conditions on large orders and enterprise licenses.

Integrated Acquisition Environment

The DoD leads government-wide implementation of the Integrated Acquisition Environment, which is a portfolio of systems and initiatives that support procurement and procurement-related processes. This ongoing implementation supports both federal and the DoD goals of strategic and cost-effective acquisition and delivery of the best possible goods and services to the warfighter, as well as unification and simplification of the acquisition business environment to support delivery. A key accomplishment includes adapting existing the DoD programs for government-wide use as a part of the portfolio. The federal versions of the DoD's Central Contractor Registry, the DoD Technical Data Solution, and Past Performance Information Retrieval System are all federal award-winning programs under the Integrated Acquisition Environment mantel. This simplifies the way the government does business, as well as the way industry interacts with government.

Grants.gov

The Department has been influential in shaping the policy related to the electronic processing of government grants. Earlier this year, the DoD

succeeded in adding language to the electronic grant application to better reflect the legal effect of individuals or organizations submitting a grant application electronically through Grants.gov. The DoD components are posting solicitations that may result in assistance agreements at Grants.gov. Use of Grants.gov and the standard solicitation announcement provide greater insight into the DoD's programs and funding and have the potential to expand the Department's research base by making program information more widely available.

Defense Travel System

The DoD Defense Travel System was developed separately from the General Services Administration's eTravel Service. It is more expansive in scale, scope, and functionality than the eTravel Service, which is being implemented in non-Defense agencies. The DoD and the General Services Administration collaborate closely on a wide range of federal travel issues, seeking common solutions where appropriate. The Defense Travel System represents a whole new way of doing business for government and the DoD must ensure that promises and goals envisioned are achievable. Specifically, the Department will assess whether it is delivering increased efficiencies, improved services, and achieving cost savings as promised. In doing so, the DoD will study carefully the several reports and evaluations of the system before taking any action.

Education and Training Initiatives

The DoD established a new Organizational Transformation Certificate program at the Information Resources Management College in June 2005. The program focuses on developing leaders who can anticipate and implement the transformational changes required to establish a net-centric environment that serves the citizen, warfighter, and the business mission equally well. Students may specialize in Electronic Government, National Security, Domestic Preparedness, or the Business of Government. This program replaces the current eGovernment Leadership Certificate program.

The College also inaugurated a new Enterprise Architecture Certificate program in January 2005. This program is organized around the seven core competencies for enterprise architecture established by the federal Chief Information Officers' Council, and builds on architectures & infrastructures, one of the 11 Chief Information Officer core competencies. The program includes a choice of classes concentrating on either the DoD or federal architectures as well as a final practicum course where students will apply their learning to solve real-world enterprise architecture challenges.

The DoD continues to expand the information technology and information assurance education opportunities available through the DoD's Information Assurance Scholarship program. One hundred and fifty students have participated in this program, with 65 graduated to date. The Department continues to enhance the flexibility of the program to meet emerging needs by adding part-time master's degree programs, authorizing enlisted participation at the Naval Postgraduate School, and increasing the number of partnership arrangements with civilian Centers of Academic Excellence.

Strategic Management of Human Capital

Goal: *To ensure that the Department's civilian workforce is high-performing, capable, agile, and well trained. This includes moving toward a mission-focused, performance-based human resources management system that provides flexibility while taking care of the DoD's civilian employees.*

The Department has several initiatives underway to meet this goal:

National Security Personnel System

The Department, with assistance from the Office of Personnel Management, designed the National Security Personnel System (NSPS), a modernized, performance-based civilian personnel system. This system, an essential element of the Department's overall transformation, will provide a more flexible means of managing the DoD's civilian workforce while preserving employee rights and protections. Civilians are critical to accomplishing the Department's mission. The NSPS not only will benefit the Department; it will provide the DoD employees with opportunities for greater control of their careers and advancement.

The DoD published a proposed regulation that outlined the fundamental features of the system in the February 14, 2005 Federal Register. More than 58,000 comments were received from employees, employee representatives, interest groups, elected officials, and the public. The Department reviewed and analyzed these comments and plans to issue the final regulations for Congressional notification and publication in the Federal Register by the end of 2005. After the regulations are published, the DoD will begin training its workforce and implementing the flexibilities afforded by NSPS.

Senior Executive Service Appraisal System

In addition to NSPS, the DoD is institutionalizing a performance-based culture at all levels. The Department developed a pay-for-performance strategy for Senior Executive Service members and equivalent senior executives. The design of the system grew out of the Department's experience with performance-based pay strategies at its personnel demonstration projects. The Office of Personnel Management approved the DoD Executive and Senior Professional Pay and Performance System in April 2005. Under this system, individual performance will be a basis for pay decisions and recognition of individual performance and contribution to the DoD's mission. The Department sent a request for provisional certification to the Office of Personnel Management in June 2005 and received a response in late August 2005. While DoD did very well overall, the Office of Personnel Management recommended improvement in translating and cascading performance requirements into more refined expectations, particularly in terms of achieving results. With only a few weeks remaining in the FY 2005 performance cycle, the DoD elected not to revise senior employees' performance plans. The Department will seek provisional certification by the end of 2005 for the FY 2006 performance cycle.

Critical Skills and Competencies

The correct mix of skills and competencies is critical to mission completion. Monitoring the fill rate of core and critical support occupations is one aspect of assessing skill gaps that the Department undertakes quarterly. Assessing competency gaps is another important element. The Department is approaching this from two directions: (1) convening study groups to focus on specific competencies required in core, critical occupations across the Department and (2) by recurring reviews of metrics that identify competency gaps in the workforce. The DoD recently initiated a project to identify the fundamental competencies and expertise needed by general/flag officers, senior executives, and senior noncommissioned officers serving in joint positions to identify gaps between required and available competencies and to develop proposals to close the gaps.

The Department also chartered a working group to examine the core DoD competencies associated with the development and progression in career fields. Competency identification will create a foundation for applications and investment in such areas as recruitment, selection, performance management, training and development, and strategic workforce shaping. The alignment of core competencies with

mission requirements will result in a more flexible, agile, and mission-focused civilian workforce.

The Department continues to perform thorough reviews of historical and projected loss and turnover rates for these mission-critical occupations quarterly. In light of findings from these reviews, the Department received approval for direct-hire authority for severe shortages in forensic biologist positions at the U.S. Army Criminal Investigation Laboratory and certain accountant positions, and successfully sought special pay rates for law enforcement occupations.

Workforce Restructuring

The Department of Defense Workforce Restructuring Plan and Human Resources Strategic Plan performance measures are valuable tools that enable effective monitoring of the Department's ability to meet current and future human capital needs and accomplish the Administration's objectives. All components continue to support the plan's initiatives in the following areas:

- Major Headquarters Reductions,
- Planned Reorganizations,
- Reduction in the Number of Managers and Supervisors,
- Projected Outsourcing Efforts, and
- Reengineered or Streamlined Processes Resulting in Efficiencies or Savings.

The DoD issued policy regarding the use of Voluntary Separation Incentive Pay (buyout) allocations to the components for FY 2005. Quarterly monitoring of usage indicates clearly that the DoD is applying buyout and early retirement authorities judiciously to shape the force as necessary.

The Department's Priority Placement Program is the primary vehicle for placing employees who have been affected adversely by workforce reductions, transfer of functions, and the Base Realignment and Closure process. The Department established the Base Realignment and Closure 2005 Working Group (consisting of members from the DoD components and Defense Agencies) to assess private sector transition assistance programs, evaluate the best practices/lessons learned from previous Base Realignment and Closure rounds, and recommend applicable Departmental guidance, publications, and services in advance of the 2005 process. The Department developed an on-line "tool kit" to help employees understand the process and become familiar with the programs and benefits available to them. The website provides information on various placement programs, separation incentives, transition benefits, frequently asked questions concerning a wide range of pertinent issues, links to the DoD component Base Realignment and Closure websites, and offers up-to-date information on Base Realignment and Closure developments. Additionally, Internet-based distance learning modules were developed to provide cost-effective training to reach all human resources specialists involved with reduction-in-force and placement activities.

Accountability

The Human Capital Accountability and Evaluation initiative launched during the fourth quarter will design, develop, and implement a Human Capital Accountability System to provide centralized management and oversight of human capital assessment and accountability efforts across the DoD. The effort will result in a common framework for identifying issues and comprehensive strategies to improve performance. This program is being developed in close cooperation with the Office of Personnel Management and will align with its framework. Implementation of the program is planned for FY 2006.

Improved Financial Performance

Goal: *To ensure transparency over the DoD's finances by having timely and reliable financial information available on a regular, recurring basis and using that information to make informed decisions about the DoD or program management. Transparency means knowing the costs and results of government programs and operations and being able to judge the best return on investment for the American people. Demonstrating fiscal accountability and achieving unqualified financial statements are good first steps. Ultimately, agency leadership will use this more accurate, precise, and timely financial information in day-to-day management.*

The Department has several initiatives underway to improve its financial performance: the Business Management Modernization Program, the Financial Improvement and Audit Readiness Plan, and the Under Secretary of Defense (Comptroller) Strategic Plan. These initiatives are discussed earlier in this report.

Budget and Performance Integration

Goal: *To improve program results and to ensure that performance is routinely considered in funding and management decisions.*

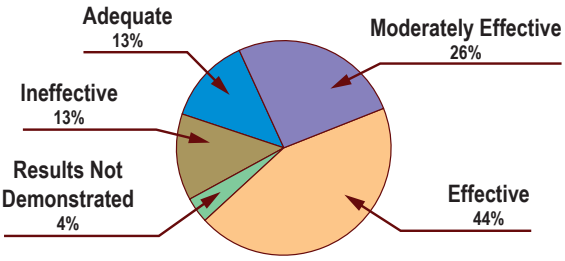
During FY 2005, the Department developed and defended its FY 2006 budget, which requested $419.3 billion in the DoD discretionary budget authority for FY 2006. The budget supports priorities established by Secretary Rumsfeld to fulfill the President's pledges to defeat global terrorism, restructure America's armed forces and global defense posture, develop and field advanced warfighting capabilities, and take good care of the DoD's people. To develop the FY 2006 budget, the Department continued to implement a new Planning, Programming, Budgeting, and Execution process and developed the DoD's first full 2-year budget. This process increases the effectiveness of the Department's resource allocation process by linking performance results to programming and budgeting decisions and placing additional emphasis on program execution. The Department addressed the marginal costs of achieving goals during the development of its FY 2006 President's Budget by considering alternatives that made performance trade-off decisions more focused and useful.

The Department developed and submitted the FY 2005 Emergency Wartime Supplemental Request for funds to finance continuing military operations in Iraq and Afghanistan. The request was formulated, in large part, by calculating the costs—based on current cost and performance data—for specific performance elements (e.g., the deployment of specific units to specific locations) and estimating the associated operational tempo.

The Department also met the goal of using the Program Assessment Rating Tool (PART) to assess programs representing 60 percent of its resources in the FY 2006 President's Budget. The PART provides a systematic and consistent approach to rating programs across the federal government. The PART process analyzes whether a program has a clear definition of success, uses strong management practices, and produces results.

The Office of Management and Budget provided favorable ratings to most DoD PART programs. Of the 23 DoD programs assessed using the PART through the FY 2006 President's Budget, the Office of Management and Budget rated 19 (83 percent) as Adequate or better. Examples of programs include Air Force Aircraft Depot Maintenance, Communications Infrastructure, and Navy Ship Operations. The Missile Defense Program improved the previous year's Results Not Demonstrated rating to a Moderately Effective rating. The following chart provides a breakout of the overall ratings for the DoD PART programs.

DoD PROGRAMS BY PART RATING CATEGORY



Competitive Sourcing

Goal: *To help agencies become more results-oriented and effective through public-private competition in accordance with Office of Management and Budget Circular A-76, "Performance of Commercial Activities," and efficiency alternatives to the A-76 process.*

The Department uses the A-76 process only when it makes military and economic sense to do so. Competition is a driving force enabling organizations to improve quality, reduce cost, and provide rapid delivery of better products and services. The DoD continues to use the process of public-private competition to obtain services clearly identified as commercial, thereby improving support to the warfighter and increasing readiness.

The alternatives to A-76 also produce significant efficiencies and are focused primarily on military to civilian conversions, high performing organizations in accordance with section 337 of the National Defense Authorization Act of 2004 (Public Law 108-136), and privatization initiatives.

A-76 competitions have produced significant savings for the DoD. From FY 2000 to the present, the Department expects to produce savings of nearly $10 billion through the periods of performance regardless of who ultimately wins the competition.

The DoD is committed to providing all responsible officials with the training required to meet their new and expanded duties required to successfully execute the Department's A-76 competitive sourcing program. Courses are being developed by the Defense Acquisition University to ensure the training is timely, effective, and consistent across the Department. Prior to competing a function, the government defines its requirements with both the in-house and contractor workforces independently determining how they will perform the function. When the decision favors contract performance, the contractor normally hires much of the existing workforce, thus reinforcing the competitive process and ensuring that the DoD has the right person for the job.

The DoD's web-based data information system provides the Department with real time daily updates on the status of A-76 initiatives with a special module to track the status of military to civilian conversions. The Department maintains oversight of the relatively small number of other types of competitive sourcing initiatives by tracking status periodically.

Ultimately, the success of competitive sourcing and achievement of true savings will be realized by addressing the cultural hurdles and embracing the reengineered work processes, funding and integrating the new technology tools with the existing systems, and ensuring a complete and seamless integration.

Real Property Management Initiative

Goal: *To help the DoD efficiently manage the nearly $100 billion in real property it owns. The Federal Real Property Council developed standards for how federal agencies should initiate improvements to property management, to include timely and accurate inventory data and performance measures in evaluating property acquisition, maintenance, and disposal decisions.*

The Department has developed and implemented a comprehensive plan to improve real property management to ensure that the right assets are available when and where needed with the capabilities necessary to support the warfighter. Accurately capturing the real property inventory, and continuing to refine performance measures that monitor how well the DoD sustains, restores, and modernizes its facilities are integral steps in accomplishing that goal. The Department's plan to monitor progress, identify and correct deficiencies, and address overall management of its real property includes:

- Increased visibility of the assets under management through improved real property inventories.
- Application of requirements models based on accurate and auditable commercial benchmarks and tied directly to the existing and forecasted assets.
- Standardization of performance targets across the Department through improved planning guidance.
- Implementation of mechanisms for continuous tracking of performance through the programming and budgeting cycle.
- Controlling the size of the Defense footprint through incentives and robust demolition and disposal programs, including Base Realignment and Closure 2005.
- An up-to-date asset management plan including goals and timelines, linked to and consistent with higher order plans and priorities.
- Achieving full sustainment funding levels to prevent waste through deterioration and loss of service life.
- Reaching a recapitalization rate that matches the expected service life of the assets under management to prevent loss of effectiveness through obsolescence.

To improve asset accountability, the Department developed a real property unique identification concept. All assets have a DoD-wide unique identifier, allowing management and financial systems to better track environmental, operational, and financial data to real property. This concept is being reviewed by industry and other federal agencies for use outside of the DoD.

Eliminating Improper Payments Initiative

Goal: *To strengthen financial management controls to better detect and prevent improper payments, thus enabling the DoD to better ensure the taxpayer dollar is put to the use the Congress intended.*

The Department makes more than $500 billion in payments to individuals and a variety of other entities each year. An improper payment occurs when the funds go to the wrong recipient, the recipient receives the incorrect amount of funds, or the recipient receives payment for an ineligible service. Improper payments also include duplicate payments and payments for products and services not received. The Department maintains a vigorous review process to identify and prevent duplicate vendor payments and make sure program dollars are spent as intended. This review process includes pre and post payment reviews, continual enhancements to commercial payment systems to detect potential erroneous payments prior to disbursement, post-payment reviews of commercial payments within 180 days of disbursement, and continual review by Office of Inspector General of purchase and travel card payments. The DoD's efforts to eliminate improper payments are described in the Analysis of Systems, Legal Compliance, and Controls section of this report and in greater detail in Part 3, Financial Information.

Coordination of Department of Veterans Affairs and DoD Programs and Systems

Goal: *This initiative seeks to ensure a seamless transition from active duty to veteran status, continuity of care,*

greater accuracy in forecasting patient population, and increased sharing of services to reduce costs and improve the quality of care.

Both the DoD and the Department of Veterans Affairs (VA) operate comprehensive medical care systems programs for Active duty military members and veterans. The DoD and VA continue to work together in a wide variety of areas to find efficiencies and improve health care to their beneficiaries. The Joint Executive Council and its subordinate Health Executive Council and Benefits Executive Council are pursuing opportunities to share health care resources between the two Departments and updating the Joint Strategic Plan for FY 2006. The plan includes goals, objectives, and performance metrics in the following areas:

- Leadership, commitment, and accountability,
- High quality health care,
- Seamless coordination of benefits,
- Integrated information sharing,
- Efficiency of operations, and
- Joint contingency/readiness capabilities.

As part of the integrated information sharing goal, the Departments have created the Federal Health Information Exchange to support the transfer of electronic health information from the DoD to VA at the point of a Service member's separation. VA clinicians and claims adjudicators use this information, which includes patient demographics, lab results, radiology reports, outpatient pharmacy data, allergy information, discharge summaries, consultation reports, and the DoD's standard ambulatory data records for specific health encounters. As of June 2005, the DoD had transferred medical records for more than 3 million unique patients to the exchange repository. More than 1.4 million of these patients—nearly half—have approached VA for care or claim determination. VA queries the exchange repository more than 2,500 times per week.

Privatization of Military Housing

Goal: This initiative seeks to eliminate inadequate family housing and increase the quality of life for Service members and their families.

DoD received "green" scores for both status and progress on this initiative. Leveraging the DoD's resources with private sector capital revitalizes inadequate housing faster and at a lower lifecycle cost to the taxpayer than traditional construction. Since the end of 2000, the DoD has privatized almost 111,600 housing units, and plans to privatize a cumulative total of more than 185,000 units by the end of 2007. The DoD tracks its progress in four categories: (1) elimination of inadequate housing units, (2) privatization of housing inventory, (3) average housing costs covered for Service members living in non-governmental housing, and (4) satisfaction of Service members who choose to live in revitalized private housing.

Analysis of Systems, Legal Compliance, and Controls

Systems

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 requires federal agencies to conform to the U.S. Government Standard General Ledger, comply with all applicable federal accounting standards, establish financial management systems that meet government-wide standards and requirements, and support full disclosure of federal financial data, including the costs of federal programs and activities.

The Department's Inspector General and the audit agencies in the Military Services have provided comprehensive reporting on the Department's failure to comply with the Act's requirements. The DoD's inability to comply materially with the Act primarily is the result of structural problems related to legacy accounting systems that do not accurately account for both budgetary and proprietary activities. Quite simply, the Department does not have the systems and accounting structures in place to achieve compliance.

To remedy these challenges, the Department of Defense is placing an unprecedented emphasis on reforming the Department's financial management systems and accounting structures. Primarily through the Business Management Modernization Program, the Department is identifying the business capabilities, standards, and solutions at the DoD-wide enterprise-level that support compliance. However, substantial compliance cannot be achieved completely until improved accounting systems and underlying accounting structures are in place to support proper accounting for both proprietary and budgetary activities.

As previously discussed, a major step toward achieving compliance is the development of a Department-wide Standard Financial Information Structure supported by a U.S. Government Standard General Ledger. This structure was incorporated in the DoD Business Enterprise Architecture and serves as a common business language that facilitates tracking and traceability of financial information at the transaction level. Improving visibility of financial information at the transaction level enhances financial statement auditability consistent with the Act.

Legal Compliance

In addition to establishing and maintaining effective controls throughout the Department, each year the DoD works aggressively to ensure that its programs and operations comply with laws to ensure that the federal government provides the best possible service to the American people.

Chief Financial Officers Act

The Chief Financial Officers Act of 1990 requires federal agencies to prepare auditable annual financial statements. An overview of the DoD's financial statement activity is included in the prior section on Analysis of Financial Statements and Stewardship Information; a detailed presentation of the statements and the auditor's report appear in Part 3, Financial Information.

As noted earlier, the DoD received a disclaimer of opinion from its auditors. The Department developed the Financial Improvement and Audit Readiness Plan to serve as a roadmap for financial improvement and plots the Department's course for accurate and reliable financial data that results in a clean financial audit. The plan's comprehensive strategy supports continual and integrated improvements, while its agility allows each DoD component to realistically identify goals, progress, and necessary actions. The Financial Improvement and Audit Readiness Plan's framework and boundaries ensure that the DoD's financial improvement efforts are consistent operationally.

To minimize the funds spent on audits until the financial statements are ready for audit, the Department implemented a rigorous five-phase process in FY 2004. Phase one requires entities to identify and correct deficiencies in financial reporting. In phase two, management validates that the deficiencies were corrected. After validation, in phase three, management asserts to the auditors that the information is reliable, and documents the basis for that assertion. In phase four, the auditors perform an assessment to determine audit readiness. If the information is ready, the auditors will perform a full audit in phase five.

Government Performance and Results Act

The DoD's activities under the Government Performance and Results Act of 1993 are highlighted in the prior section on Performance Objectives, Goals, and Results; detailed performance information is provided in Part 2, Performance Information.

Inspector General Act Amendments

The Inspector General Act of 1978, as amended, requires an explanation for all audit reports with recommendations open for more than 1 year. As of September 30, 2005, the Department had 214 audit reports open for more than 1 year, with potential monetary benefits of $7.1 billion. The Department closed out and implemented recommendations from 94 audit reports in FY 2005 with claimed monetary benefits of $444 million.

Improper Payments Information Act

The Improper Payments Information Act of 2002, as implemented by the Office of Management and Budget, requires federal agencies to review annually all programs and activities and identify those that may be susceptible to significant erroneous payments.

The DoD's FY 2005 survey did not identify any programs or activities where payments met the Office of Management and Budget's criteria for "significant" erroneous payments. During this survey, however, the DoD found military pay susceptible to significant risk for erroneous payments. In accordance with Office of Management and Budget guidance, the DoD calculated a statistically valid estimate of military pay erroneous payments and implemented a plan to reduce the amount of erroneous payments. The DoD reports to both the President and the Congress its progress in reducing erroneous payments. The Department also reports again this fiscal year on military health benefits and military retirement, two programs previously identified by the Office of Management and Budget as susceptible to significant erroneous payments. Reviews of these programs produced the following results.

Military Health Benefits. Numerous prepayment and postpayment controls are built into the military health benefits' claims processing system to minimize improper payments. One control, the claims edit system, "rebundles" services that the provider should have billed under a single code. Procedure "unbundling" occurs when the provider uses two or more procedure codes to describe a service for which a single comprehensive code exists that accurately describes all services performed. This is an inflationary practice and contributes to excessive health care costs.

An example of this practice is "unbundling" charges that should be included in a global surgical package. Some surgical codes represent an all-inclusive charge to include certain types of anesthesia, pre-op visits, post-op care in the recovery room, and typical follow-up visits after discharge for a 90-day period. Physicians who perform the entire global package should bill for their services with the single comprehensive surgical code. "Unbundling" occurs when a physician bills separately for services included in this global package. For example:

Code	Procedure	Cost
Unbundle Billing:		
30520	Repair of nasal septum	$547.60
00160	Anesthesia, nose/sinus	246.60
99214	Preop visit	64.25
99231	Subsequent hospital visit	37.03
	Final Unbundle Billing Cost	**$895.48**
vs.		
Bundle Billing:		
30520	Global surgical package	$547.60
	Final Unbundle Billing Cost	**$547.60**
OVERCHARGE		**$347.88**

In FY 2004, the DoD realized a cost avoidance of $110.7 million because of these rebundling edits. Anticipating that this trend will continue, the Department projects approximately a 10 percent increase in the cost avoidance for FY 2005.

Another control that helps to ensure the accurate payment of claims and appropriate expenditure of taxpayer dollars is the prepayment review required under the contracts. Contractors use this strategy to prevent payment for questionable billing practices. Prepayment review allows for a closer examination of the services rendered and may require the provider to submit medical documentation to support the services billed. In calendar year 2004, prepayment review resulted in a cost savings of $7.3 million.

The Department also requires each contractor to have a fraudulent claims investigation or anti-fraud unit to identify and investigate any pattern of suspicious or potential fraudulent billings. Artificial intelligence software is a contract requirement to facilitate data mining to identify questionable billing practices. In calendar year 2004, the Department received $6 million in fraud judgments and identified another $2.29 million for administrative recovery.

For FY 2005, the Department projected $150.0 million of improper payments (underpayments and overpayments) for the military health benefits purchased care program. This represents an error rate of approximately 2 percent of the $7.5 billion in military health benefits program payments made during FY 2005.

For many years prior to passage of the Improper Payments Information Act in 2002, the Department had in place performance standards for claims processing. Under the existing managed care support contracts, the DoD has a zero tolerance for unallowable costs. If the contractor pays a claim that is not allowable, the Department will not reimburse the contractor. In addition, contractors face a financial disincentive. In addition to placing the contractors at risk for unallowable costs, this contractual design provides a built-in incentive for the contractors to continually perfect their claims processing system, up to the point where financial costs outweigh the benefits.

Military Retirement. The Department conducts various types of prepayment and postpayment reviews for military retirement payments. Payments to deceased retirees pose the highest risk for improper payments. A review of confirmed payments to deceased retirees in FY 2005 indicated that the DoD had recovered 96 percent of the amount overpaid within 60 days.

For FY 2005, the Department projected $49.3 million of improper payments for this program, with most of that amount ($46.7 million) going to deceased retirees. This represents an error rate of 0.1381 percent of the $35.6 billion in military retirement payments.

Military Pay. Several sources identify improper payments for military pay. The Department performs monthly random reviews by Military Service, identifies pay system discrepancies, and conducts special audits or reviews. Monthly reviews are stratified by military pay account, which include the Active and Reserve components of the Military Departments and Army National Guard and the Air National Guard. The sampling plan produces estimates with a 95 percent probability and sample estimate precision of plus or minus 2.5 percent. For the first 10 months of FY 2005, the DoD reviewed 8,530 military pay accounts using the sampling plan criteria. Based on the sample results and discrepancies identified, the Department estimated $432 million in improper payments for military pay in FY 2005. This represents 0.63 percent of the total net pay of more than $66.8 billion.

For further reporting details about the Improper Payments Information Act, see Part 3, Financial Information.

Controls (Management Assurances)

The Federal Managers' Financial Integrity Act of 1982 requires federal agencies to assess the effectiveness of internal controls for program, operational, and administrative areas as well as accounting and financial management. Internal controls are the organization, policies, and procedures that are considered the tools that help program and financial managers achieve results and safeguard the integrity of their programs.

Using self-assessments as the basis, this Act requires agency heads to provide an annual statement of assurance on the effectiveness of the internal controls and to include material weaknesses found in internal controls that warrant reporting to a higher level. The Department's FY 2005 Annual Statement of Assurance is provided in the Acting Deputy Secretary's Message at the front of this report. The Department is also asserting that all DoD components have reported to the Secretary of Defense their individual statements of assurance over internal controls, except for the National Reconnaissance Office, which is reporting to the Director of National Intelligence beginning this fiscal year. Material weaknesses previously reported to the Secretary of Defense by the National Reconnaissance Office are being transferred to the Director of National Intelligence.

Maintaining integrity and accountability in programs and operations:

(1) Is critical for good government,
(2) Demonstrates responsible stewardship over assets and resources,
(3) Promotes high-quality, responsible leadership,
(4) Enhances the sound delivery of services to customers, and
(5) Maximizes desired program outcomes.

In FY 2005, the Department took numerous steps to improve the Department-wide training, awareness, communication, and emphasis for forthright reporting and prompt resolution of weaknesses. Early in the calendar year, the Department conducted a Department-wide conference attended by more than 120 representatives from the Department's 33 components. The main topic introduced was the broad strategy for implementing the Office of Management and Budget Circular A-123, "Management's Responsibility for Internal Control" Appendix A, which prescribes a statement of assurance on the effectiveness of internal controls over financial reporting. Also discussed at the conference was the DoD scorecard which is used to measure important elements of the Defense component feeder statements. These feeder statements help build the DoD Annual Statement of Assurance. The categories scored are the timeliness of the feeder statements, accuracy and completeness, evidence of effective program execution and training to ensure robust assessments of the internal controls, and prompt resolution of previously reported weaknesses. The scorecard (as shown in Table VI) has already improved the timeliness of component feeder statements. Since instituted, the timeliness has improved from 48 percent on time in FY 2003 to 97 percent on time in FY 2005.

The Department classifies management control weaknesses into three categories:

1. Section 2 Systemic Weaknesses: Weaknesses materially affecting management controls across organizational and program lines and usually affecting multiple DoD components.

2. Section 2 Material Weaknesses: Weaknesses materially affecting management controls that warrant reporting to a higher level and usually affect a single DoD component.

3. Section 4 System Nonconformance Weaknesses: System nonconformance with the principles, standards, or related requirements prescribed by the Comptroller General.

The prompt resolution of weaknesses became a leadership focus area in FY 2004 and, as a result of the scorecard and the quarterly tracking on the progress of corrective actions, the Department has dramatically reduced the number of Federal Managers' Financial Integrity Act (FMFIA) weaknesses in FY 2005.

Recognizing that training is essential for understanding how to establish and continuously assess the effectiveness of internal controls, the Department presented training briefings to 8 of the 33 Defense components in FY 2005. In addition, the Department conducted training at the American Society of Military Comptrollers national training session, introducing the Department of Defense overall strategy for implementing the Office of Management and Budget Circular No. A-123, Appendix A. This training was audio-taped and is now available on-line as course instruction for the Certified Defense Financial Manager certification.

The Department uses periodic management-conducted assessments as the basis for the Annual Statement of Assurance and reports internal control weaknesses relating to Sections 2 and 4 of the Federal Managers' Financial Integrity Act. Section 2 requires "internal accounting and administrative controls that reasonably ensure costs comply with applicable laws, assets are safeguarded, and revenue and expenses are recorded and accounted for properly." Section 4 requires that "accounting systems conform to principles, standards or related requirements prescribed by the Comptroller General."

In FYs 2002 through 2005, the Department reported one Section 4 system nonconformance weakness that encompasses the entire DoD financial system noncompliance with control requirements. The Department also considers the DoD financial systems' noncompliance as a Section 2 systemic weakness which affects multiple DoD components. In addition, the auditors have identified the DoD financial systems as a material weakness under the requirement of the Chief Financial Officers Act.

The following six tables list the weaknesses grouped differently as Section 2 (corrected, transferred, or ongoing, financial, and non-financial) and Section 4 (ongoing only).

Tables Ia and Ib

Section 2 Corrected Financial and Non-Financial Material Weaknesses list 22 corrected during this fiscal year.

Table II

Section 2 Material Weaknesses Transferred to Non-Defense Agency lists one material weakness that was transferred to the Director of National Intelligence.

FMFIA Weaknesses		Beginning FY05	New FY05	Resolved FY05	Transferred FY05	Ending FY05
Section 2 -Systemic	Financial	5	0	0	0	5
	Non-Financial	4	2	0	0	6
Subtotal		9	2	0	0	11
Section 2 - Material	Financial	12	4	8	0	8
	Non-Financial	25	4	14	1	14
Subtotal		37	8	22	0	22
Section 2 Total		**46**	**10**	**22**	**1**	**33**
Section 4 - System Nonconformance		1	0	0	0	1
TOTAL FMFIA WEAKNESSES		**47**	**10**	**22**	**1**	**34**

Table III

Section 2 Systemic Weaknesses – Ongoing lists the nine systemic weaknesses that remained open at the end of FY 2004, plus two additional weaknesses that were identified in FY 2005.

Tables IVa and IVb

Section 2 Financial and Non-Financial Material Weaknesses – Ongoing list the 22 ongoing material weaknesses. Eight are financial issues of which four are being newly reported. Fourteen are related to non-financial issues of which four were newly identified this fiscal year. For these material weaknesses, a sample of the corrective actions was selected for reporting. The status dates for FYs 2004 and 2005 are listed to show progress in completing the weakness as planned.

Table V

Section 4 System Nonconformance Weaknesses – Ongoing lists the one ongoing Section 4 system nonconformance material weakness.

Since FY 2003, the Department has scored the annual statements of assurance provided by the DoD components. The results for each of the components for FY 2005 scoring have been included in **Table VI, Scorecard Results for FY 2005.**

TABLE 1a. Section 2 Corrected Financial Material Weaknesses

Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
1. Estimation of accrued liabilities, when goods and services are provided, is not always properly monitored due to inadequate controls recording undelivered orders. (Defense Finance and Accounting Service)	- Revised and published the estimation policy in the DoD financial management guide.	1st QTR 2005	Completed
	- Developed adequate procedures and controls for the DoD Business Enterprise Architecture.	1st QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 2003	***Correction Target Date: 4th Qtr, FY 2005 Completed***		
2. Suspense account balances with Treasury trial balances are not fully resolved and reconciled. (Defense Finance and Accounting Service)	- Legislation passed to allow DoD to write-off aged suspense accounts to help reduce the balances to zero.	Completed	Completed
	- Began write-offs.	Completed	Completed
	- Implemented courses of action to reduce account activity to an acceptable level, thus improving the reconciliation process.	4th QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 1997	***Correction Target Date: 4th Qtr, FY 2005 Completed***		
3. Appropriation balances in the accounting records do not always balance with the Treasury's balances and transaction level reconciliations are not always performed. (Defense Finance and Accounting Service)	- Updated procedures on how to reconcile the DoD balances with Treasury Balances.	Completed	Completed
	- Conducted the first Department-wide conference highlighting business rules.	Completed	Completed
	- Expanded systems solutions for Treasury reporting.	4th QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 1999	***Correction Target Date: 4th Qtr, FY 2005 Completed***		

TABLE 1a. Section 2 Corrected Financial Material Weaknesses			
Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
4.Telecommunication invoices are not always certified and obligations are not pre-validated prior to payment. (Defense Finance and Accounting Service)	- Began summary certification process for the Defense Information Telcommunications.	Completed	Completed
	- Received from the Defense Information Telecommunications leadership a formal decision on how to account for the receipt of telecommunication services.	1st QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 2001	***Correction Target Date: 4th Qtr, FY 2005 Completed***		
5. Inadequate controls have caused payments to be made to deceased retirees which were not reclaimed in an effective or timely manner. (Defense Finance and Accounting Service)	- Standardized the procedures for suspending retirement payments when Department suspects the retiree has died.	Completed	Completed
	- Improved documentation of procedures.	Completed	Completed
	- Trained customer service representatives to differentiate between accounts suspended due to death rather than for other reasons.	1st QTR 2005	Completed
	- Automated processes for using existing records to determine if payment should be made.	3rd QTR 2005	Completed
	- Validated that the weakness was corrected.	3rd QTR 2005	Completed
First Reported: FY 2004	***Correction Target Date: 3rd Qtr, FY 2005 Completed***		
6. Inadequate data being provided to the Services for budget planning results in the appearance of over-obligation on the financial statements. (Defense Finance and Accounting Service)	- A team was established from all the Services to work in concert with finance for a viable solution to the varied problems.	Completed	Completed
	- Began implementing forward compatible pay.	2nd QTR 2005	Completed
	- Validated that the weakness was corrected.	3rd QTR 2005	Completed
First Reported: FY 2004	***Correction Target Date: 3rd Qtr, FY 2005 Completed***		
7. Adequate controls are not in place to ensure that "fast payment purchases" are received in Department of the Navy vendor pay offices. (Defense Finance and Accounting Service)	- Established control mechanisms to confirm receipt of payment data.	Completed	Completed
	- Developed and distributed standard operating procedures.	Completed	Completed
	- Initiated system change requirements to automatically compare receipt data in the supply system to payment data.	Completed	Completed
	- Weakness has been downgraded from a material weakness to significant deficiency.	3rd QTR 2005	Completed
First Reported: FY 2004	***Correction Target Date: 3rd Qtr, FY 2005 Completed***		
8. Contract pay services are non-compliant with Certifying Officer's Legislation because some invoices are not individually reviewed and certified prior to payment. (Defense Finance and Accounting Service)	- Implemented a daily validation process that compares invoice data to payment data.	Completed	Completed
	- Modified the contract pay certification process.	2nd QTR 2005	Completed
	- Pursued data mining techniques to enhance and automate the comparison of invoices to payments.	2nd QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 2004	***Correction Target Date: 4th Qtr, FY 2005 Completed***		

TABLE 1b. Section 2 Corrected Non-Financial Material Weaknesses

Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
9. Procedures are not always adequate to ensure that the prices paid for contracts are reasonable. (Defense Logistics Agency)	- Conducted reviews to ensure proper documentation of "price-reasonableness."	Completed	Completed
	- Conducted a management review to assess performance.	1st QTR 2005	Completed
	- Validated that the weakness was corrected.	2nd QTR 2005	Completed
First Reported: FY 2001	***Correction Target Date: 2nd Qtr, FY 2005 Completed***		
10. Payments for fuel charges incurred as part of the DoD Fleet Card have been delinquent. (Defense Logistics Agency)	- Established an integrated process team for oversight of program management.	Completed	Completed
	- Established periodic audit procedures. Developed a plan to ensure oversight responsibilities are adequate.	1st QTR 2005	Completed
	- Established and implemented a formal training program for program coordinators and end-users.	1st QTR 2005	Completed
	- Validated that the weakness was corrected.	1st QTR 2005	Completed
First Reported: FY 2002	***Correction Target Date: 1st Qtr, FY 2005 Completed***		
11. Controls for assessing which employees can receive mass transit benefits are not always adequate. (Defense Logistics Agency)	- Obtained Union agreement on mass transit benefits.	Completed	Completed
	- Validated parking decals. Certified employee participation against the Department of Transportation database.	1st QTR 2005	Completed
	- Validated that the weakness was corrected.	1st QTR 2005	Completed
First Reported: FY 2003	***Correction Target Date: 1st Qtr, FY 2005 Completed***		
12. Existing controls did not ensure that incidents of sexual assault among the cadet population were prevented or reported. (Department of the Air Force)	- Completed 138 of 165 corrective actions. Incorporated training to improve the gender climate.	Completed	Completed
	- Implemented remaining action items.	1st QTR 2005	Completed
	- Conducted unit compliance inspections to review institutional response to sexual assault and compliance within the instructions.	2nd QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 2003	***Correction Target Date: 4th Qtr, FY 2005 Completed***		
13. Controls over management of spare parts were not always adequate to meet the war fighter mission. (Department of the Air Force)	- Sponsored an integrated process team and performed an analysis to determine the correct number of stock level days that should be used in spares' computation. Revised the Department of Air Force guidance.	Completed	Completed
	- Initiated a management plan to enhance spare parts support and identify systematic supply shortfalls.	Completed	Completed
	- Determined the total spares parts requirement for FY 2004 Program Objective Memorandum.	Completed	Completed
	- Revised the requirements computation systems to provide more accurate consumption patterns.	Completed	Completed
	- Included the total spare parts requirement in the FY 2004 Program Objective Memorandum submission.	Completed	Completed
	- Compared the projected spare part requirements to actual and determined effectiveness of forecasting tools and other corrective actions.	4th QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 1999	***Correction Target Date: 4th Qtr, FY 2005 Completed***		

TABLE 1b. Section 2 Corrected Non-Financial Material Weaknesses			
Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
14. Better controls over efforts to provide safe areas surrounding air installations are needed to minimize public exposure from the hazards of aircraft operations. (Department of the Air Force) ***First Reported: FY 2000***	- Raised awareness of air hazards around aircraft operations. Developed the Department of Air Force multi-Service training.	Completed	Completed
	- Re-evaluated the Air Installation Compatible Use Zone Program.	2nd QTR 2006	Completed
	- Validated that the weakness was corrected. ***Correction Target Date: 4th Qtr, FY 2006 Completed***	4th QTR 2006	Completed
15. Processes for reporting the readiness for going to war are not always accurate and consistent. (Department of the Navy) ***First Reported: FY 2002***	- Discontinued the use of estimates to compile data, using only actual enrollees or graduates.	Completed	Completed
	- Revised training and readiness reporting procedures to ensure accuracy and consistency.	Completed	Completed
	- Developed an installation readiness assessment system to support and sustain forces.	3rd QTR 2005	Completed
	- Weakness has been downgraded from a material weakness to a significant deficiency. ***Correction Target Date: 4th Qtr, FY 2005 Completed***	4th QTR 2005	Completed
16. Some procedures for projecting training requirements have not been adequate, causing inefficient use of training resources and lost operational work years. (Department of the Navy) ***First Reported: FY 1999***	- Automated the instructor requirements.	Completed	Completed
	- Used computer software to develop more effective and efficient delivery techniques to provide instruction.	Completed	Completed
	- Transitioned to a curriculum module within the Training Information Management System, which will enable quantitative tracking and analysis.	4th QTR 2006	Completed
	- Weakness has been downgraded from a material weakness to a significant deficiency. ***Correction Target Date: 1st Qtr, FY 2007 Completed***	1st QTR 2007	Completed
17. Better management of Active and Reserve recruiting functions is needed to maintain a ready force. (Department of the Navy) ***First Reported: FY 2001***	- Ensured that the recruiter and classifier errors are corrected or waived in a timely and efficient manner.	Completed	Completed
	- Validated the corrective measures using an on-site verification.	1st QTR 2005	Completed
	- Validated that the weakness was corrected. ***Correction Target Date: 1st Qtr, FY 2005 Completed***	1st QTR 2005	Completed
18. Policies and procedures were not always adequate for processing other non-recurring requirement transactions. (Defense Logistics Agency) ***First Reported: FY 2004***	- Reviewed current policies and procedures.	Completed	Completed
	- Published policy and procedures guidance.	Completed	Completed
	- Completed validation of policy and procedures and published final policy.	2nd QTR 2005	Completed
	- Validated that the weakness was corrected. ***Correction Target Date: 2nd Qtr, FY 2005 Completed***	2nd QTR 2005	Completed

TABLE 1b. Section 2 Corrected Non-Financial Material Weaknesses			
Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
19. Inadequate training has caused inconsistent, uncoordinated, and sometimes inadequate approaches to satisfying the United States' commitment to provide foreign countries adequate assistance with Cooperative Threat Reduction. (Defense Threat Reduction Agency)	- Developed a program management training course.	Completed	Completed
	- Held two pilot training sessions for module 1, which addressed planning and documentation for milestone decision authority review and approval.	Completed	Completed
	- Held module 1 training session.	1st QTR 2005	Completed
	- Held pilot training session for module 2, which addressed contract and project execution, control and close-out.	2nd QTR 2005	Completed
	- Held module 2 training session.	2nd QTR 2005	Completed
	- Validated that the weakness was corrected.	3rd QTR 2005	Completed
First Reported: FY 2004	***Correction Target Date: 3rd Qtr, FY 2005 Completed***		
20. Inadequate controls to ensure that secondary item repair costs were properly budgeted. (Department of the Air Force)	- Developed instructions addressing responsibilities for validating sources of repair used in preparing budgets.	Completed	Completed
	- Published revised secondary item repair costs instructions.	2nd QTR 2005	Completed
	- Incorporated new procedures in automated budget processes to support budget development.	3rd QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 2004	***Correction Target Date: 4th Qtr, FY 2005 Completed***		
21. Controls were not always adequate to ensure accountability of automated data processing equipment. (United States Pacific Command)	- Disciplinary actions initiated to correct personnel performance issues.	Completed	Completed
	- Appointed custodians to assist in managing and tracking equipment.	Completed	Completed
	- Performed 100% wall-to-wall inventory.	4th QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 2004	***Correction Target Date: 4th Qtr, FY 2005 Completed***		
22. Manpower challenges impact the mission accomplishment of military intelligence operations. (Under Secretary of Defense (Intelligence))	- Identified manpower requirements.	Completed	Completed
	- Developed documentation for manpower requirements.	Completed	Completed
	- Validated manpower data to correct weakness.	2nd QTR 2005	Completed
	- Validated that the weakness was corrected.	2nd QTR 2005	Completed
First Reported: FY 2004	***Correction Target Date: 2nd Qtr, FY 2005 Completed***		

Table II. Section 2 Material Weaknesses Transferred to Non-Defense Agency
Lack of sufficient controls to ensure regulation compliance, information management, and records management. (National Reconnaissance Office)

Table III. Section 2 Systemic Weaknesses – Ongoing	
Title	**1. Department of Defense Financial Management Systems and Processes**
Description of Issue	The Department of Defense financial and business management systems and processes are costly to maintain and operate, not fully integrated, and do not provide information that is reliable, timely, and accurate.
Progress to Date	**A. Completed Milestones**: • Created a portfolio management approach to review information technology investments. • Incorporated the enterprise business process model into the Business Enterprise Architecture release 2.1. • Established integrated goals, objectives, measures, and targets. • Initiated a single Department-wide information technology registry to track all business systems. • Established five core business mission areas: financial management, human resources management, weapon system lifecycle management, real property and installation lifecycle management, and materiel supply and service management. These were business areas which worked together to unify the Department's business transformation efforts. • Established six initial business enterprise priorities: financial visibility; acquisition program visibility; materiel transaction visibility; personnel visibility; real property accountability; and common supplier engagement to guide the initial direction of transformation activities. • Defined six core financial capabilities in support of the financial visibility priorities, and established performance measures to monitor and guide activities that lead to the full development and maintenance of those capabilities. The six capabilities are: forecast, plan, program and budget; manage financial assets and liabilities; managerial accounting; funds allocation, funds collection, funds control, and funds disbursement; manage general ledger; and financial reporting. • Identified five initiatives to support the financial visibility priorities: Standard Financial Information Structure; business enterprise information services; defense cash accountability system; intragovernmental transaction system; and the program budget framework. • Chartered the Defense Business System Management Committee to oversee transformation in the five core business mission areas. • Established the Defense Financial Management Investment Review Board as the authoritative body to review and approve all investment priorities for all Defense business systems under the Under Secretary of Defense (Comptroller) purview. The Financial Management Investment Review Board will enhance the Department's ability to comply with the National Defense Authorization Act of FY 2005 to ensure the review all business system investments annually and certify the compliance of business system modernizations over $1,000,000.
	B. Planned Milestones for FY 2006 and beyond: • Publish version 3.0 of the Business Enterprise Architecture, which will include the elements of Phase 1 of the Standard Financial Information Structure. • Publish the Department of Defense Enterprise Transition Plan which will reflect the Department's goals, objectives, and implementation strategies and create an integrated picture of the Department's business transformation. • Update the Enterprise Transition Plan and Financial Improvement and Audit Readiness Plan every 6 months to ensure the Department of Defense components have the most up to date guidance available. • Update and publish versions 3.1 and 4.0 of the business enterprise architecture and integrate it with the Enterprise Transition Plan. • Integrate Phase 1 of the Standard Financial Information Structure into the business enterprise information services to create a shared business intelligence environment. The business enterprise information services will include a corporate general ledger where legacy accounting systems transactions (that have been cross-walked to the Standard Financial Information Structure) can be recorded. The financial management transformation team will work closely with the targeted accounting systems to ensure a common understanding and implementation of the Phase 1 elements of the Standard Financial Information Structure. • Implement Phase 2 of the Standard Financial Information Structure into the framework for a Statement of Net Cost. Phase 2 will define segments of responsibility and links to support the consolidation of financial statements, and provide a corporate level view of major operations segments of responsibility. • Align and integrate the program budget framework initiative with Phases I and II of the Standard Financial Information Structure to create a direct link between the Department's plans, programs, and budgets with execution and performance data. • Align the financial visibility performance measures to the Office of the Under Secretary of Defense (Comptroller) strategic plan goals and measures. ***Correction Target Date: 4th Quarter, FY 2015***
Title	**2. Management of Information Technology and Assurance**
Description of Issue	The Department of Defense information systems are potentially vulnerable to an information warfare attack. In addition, this issue has also been reported as a "significant deficiency" under the reporting requirements of the Federal Information Security Management Act.
Progress to Date	**A. Completed Milestones:** • Expanded the authority of the United States Strategic Command to include network operations and information assurance. • Completed and updated the Department of Defense policies addressing public key infrastructure and enterprise-wide certification requirements for information assurance / technology professionals.

Table III. Section 2 Systemic Weaknesses – Ongoing	
Progress to Date (continued)	**A. Completed Milestones (continued):** • Developed an automated security certification and accreditation process for information systems. Began the expansion to more robust web-based design using shared information and services that deliver improved functionality by interconnecting data transactions into a common database. • Awarded the Department of Defense-wide enterprise license for an information assurance vulnerability scanning tool. • Coordinated for comments the revised Department of Defense security certification and accreditation policy and process to improve compliance and to provide an enterprise management capability. • Incorporated a revised security certification and accreditation process, including vulnerability management into the enterprise mission assurance support system and began piloting this process in selected Defense components. • Developed and coordinated for comments the information assurance training, certification, and workforce management manual. The manual provides essential details necessary to track information assurance personnel through the personnel management systems. • Awarded the Department of Defense-wide enterprise license for an automated information assurance vulnerability "patching" tool and completed evaluating the "wrapper" capability that helps prevent malicious modification of operating systems by viruses. • Developed an on-line knowledge service that provides detailed guidelines, standards and collaboration tools for security certification and accreditation. • In the Federal Information Security Management Act report, dated March 2005, reported 84 percent of Department of Defense systems certified and accredited. • Approved Increment 1.0 of the information assurance element of the Global Information Grid architecture, which for the first time provides a comprehensive architectural basis for developing and providing information assurance within the Department.
	B. Planned Milestones for FY 2006: • Issue policy establishing a comprehensive process to develop and implement plans and milestones to manage and correct identified security performance weaknesses, and direct Department of Defense components to appropriately report all security weaknesses identified in annual reviews or audits. • Issue guidance on information assurance training and certification standards. • Award Department of Defense-wide enterprise license for operating system "wrapper" capability. • Continue modular development and deployment of additional services to support core information assurance processes, e.g., investment, resource management, workforce management, and information assurance management tools. • Expand the information assurance element of the Global Information Grid architecture. • Provide information assurance management tools as a core enterprise service. • Achieve 100 percent security certification and accreditation for the Department of Defense systems. • Complete the Defense Civilian Personnel Data System detailed information assurance workforce database updates. Incorporate changes to the military personnel databases to support the information assurance workforce management program.
	C. Planned Milestones for Beyond FY 2006: • Continue developing the information assurance element of the Global Information Grid architecture and deploy the information assurance capabilities. • Continue to identify and track information assurance personnel in the civilian and military personnel systems. • Provide the United States Strategic Command a real time situational awareness of the Department of Defense information assurance posture. ***Correction Target Date: 3rd Quarter, FY 2007***
Title	**3. Environmental Liabilities**
Description of Issue	The Department of Defense has not developed the policies, procedures, and methodologies needed to ensure that cleanup costs for all of its ongoing and inactive or closed operations are identified, consistently estimated, and appropriately reported. Site inventories and cost methodologies to identify budget requirements and financial liabilities continue to need improvement.
Progress to Date	**A. Completed Milestones:** • Provided guidance to accomplish an initial operational range inventory. • Reported the operational range inventory to Congress in February of FY 2004. • Completed a real property inventory business process reengineering and presented the concept for Department of Defense-wide review. • Revised the Financial Management Regulation for liability recognition and reporting for operational ranges and munitions response areas. • Published the directive entitled "Sustainment of Ranges and Operating Areas," that requires reporting of environmental remediation liabilities.

Table III. Section 2 Systemic Weaknesses – Ongoing	
Progress to Date (continued)	**A. Completed Milestones (continued):** • Issued planning guidance that requires the assessment of environmental condition of the operational ranges. • Completed the final inventory of munitions sites (other than operational ranges) and made this information available to the public in accordance with Congressional direction. This inventory is updated and reported annually to Congress. • Developed and issued an interim change to the regulations that requires the reconciliation of real property and environmental site records. • Developed and coordinated guidance to enable Department of Defense components to recognize, document, and report environmental liabilities other than those included in the Defense Environmental Restoration Program. • Developed and coordinated the guidance on how to conduct operational range assessments. • Developed and coordinated the guidance on how to report and forecast real property inventory.
	B. Planned Milestones for FY 2006: • Complete the policy changes. • Closure of final recommendations in the Government Accountability Office report. ***Correction Target Date: 1st Quarter, FY 2006*** ***(Management within the Office of the Secretary of Defense for Acquisition, Technology and Logistics responsible for reporting this systemic weakness provided this information. However, the DoD components reporting similar weaknesses show corrective actions extending past the correction target date to FY 2007. Therefore, the corrective actions and correction target date will be reviewed and the impact assessed.)***
Title	**4. Personnel Security Investigations Program**
Description of Issue	The Department of Defense hiring is adversely affected because personnel security investigations are backlogged.
Progress to Date	**A. Completed Milestones:** • Signed an interagency agreement with the Office of Personnel Management to allow the Defense Security Service to use the Office of Personnel Management computer system for tracking and controlling the Department of Defense personnel security investigations and case processing. • Realigned 200 overhead positions in the Defense Security Service to investigator positions, redesigned the organizational structure, closed offices that lacked sufficient work, and deployed "tiger teams" to conduct overseas investigations. Reduced the number of pending cases in the case control management system from over 400,000 to less than 57,000. • Reinforced quality reviews of contractor work. Issued to the contractors cure letters for failing to meet agreed upon timelines. Took back a number of investigations from the contractors. • Transferred the security investigations function to the Office of Personnel Management in February 2005. The Department made final payments to contractors and terminated all contracts associated with this function. • Notified that the Office of Personnel Management has contracted with five investigative service providers to address the need for more investigators in order to improve the processing time of investigations. • Implemented the Joint Personnel Adjudication System for submitting and tracking all investigative requests. The verification and validation module achieved initial operating capability in May 2005. Beginning in July 2005, investigations for Defense contract personnel were submitted to the Office of Personnel Management through the Joint Personnel Adjudication System.
	B. Planned Milestones for FY 2006: • The Office of Personnel Management indicates that 90 percent of investigations submitted in FY 2006 will be completed within the timelines established by the Intelligence Reform and Terrorism Prevention Act of 2004 and that there will be no open investigations over a year old. ***Correction Target Date: 4th Quarter, FY 2006***
Title	**5. Real Property Infrastructure**
Description of Issue	The Department has not adequately managed the real property infrastructure to halt the deterioration or obsolescence of facilities on military installations.
Progress to Date	**A. Completed Milestones**: • Conducted a comprehensive review of planned facilities sustainment programs, resulting in an increase of $85 million in funding for FY 2005..

Table III. Section 2 Systemic Weaknesses – Ongoing	
Progress to Date (continued)	**A. Completed Milestones (continued)**: • Preserved the previously approved corporate facilities sustainment rate at 95 percent of benchmarks in FY 2005 • Improved funding to support an overall facilities recapitalization rate of 136 years, down from a funded rate of 149 years in FY 2003. • Issued updated strategic planning guidance to the Defense components addressing sustainment and recapitalization goals. • Initiated new efforts to model the operation costs for facilities and forecast requirements. • Published an updated Defense Installations Strategic Plan, expanding the focus to include environment and installation services, and directed the Defense components to prepare implementation plans. • Initiated a second survey of demolition and disposal requirements for obsolete and excess assets. • Completed a study of facility restoration requirements, which updated the target date for restoring adequate readiness conditions. • Accepted a reduction in funding for facilities recapitalization, which resulted in a slight increase in the overall recapitalization rate to 110 years in FY 2006, up slightly from 104 years in FY 2005. This risk is taken in view of upcoming restationing and Base Realignment and Closure actions that will decrease the size of the Department's inventory and increase the investment in recapitalization. • Refined and updated the unit costs for sustainment and construction of facilities, with emphasis on utility systems. • Completed a model that predicts the average annual cost required to modernize and refurbish facilities on an ongoing basis. • Corrected a deficiency in the methodology used to score facilities sustainment funding that had produced inaccuracies due to contingency-related costs. • Completed a model to improve the accuracy of forecasting costs associated with operating facilities. • Completed an assessment of demolition and disposal requirements for obsolete and excess assets. • Initiated actions to improve the accuracy of the facilities recapitalization metric. • Initiated efforts to report the condition of facilities in the Defense Readiness Reporting System. • Expanded metrics to include family housing and industrial facilities.
	B. Planned Milestones for FY 2006 and beyond: • Complete a standard reporting procedure for facility conditions in the real property inventory. • Deploy a model that predicts the requirements for facility-related services, utilities, and leasing. • Deploy a model that predicts the average annual cost required to modernize and refurbish facilities on an ongoing basis. • Implement new corporate procedures for demolition and disposal of facilities that will more accurately capture the net effect of eliminating excess and obsolete facilities. • Begin reporting installation and facility data in order to fully capture the impact of facility capabilities on mission readiness. • Integrate military family housing and industrial facilities into the facility's metrics. ***Correction Target Date: 1st Quarter, FY 2008***
Title	**6. Government Card Program Management**
Description of Issue	Instances of misuse, abuse, and fraud in respect to purchase and travel card use, and centrally billed accounts have been attributed to inadequate Department of Defense emphasis on proper use of the cards, poorly enforced controls, and lax oversight.
Progress to Date	**<u>Purchase Card Program:</u>** **A. Completed Milestones:** • Cancelled unnecessary cards and tailored spending limits to historical buying patterns. • Established methods to ensure cards are collected from departing civilians and service members. • Developed and issued a comprehensive purchase card concept of operations. • Completed the initial field tests of a centralized data mining tool to detect fraudulent, wasteful, and abusive card transactions. • Implemented new disciplinary guidelines specifically targeted to card misuse. Aggressively pursued prosecution of known fraud cases. • Increased awareness concerning the usage of purchase cards through training forums. Developed and enhanced training materials. • Issued omnibus charge card guidebook, including governing laws, regulations, and more salient business rules for purchase, travel, fleet, and air cards. • Implemented use of on-line statement review, approval, and certification. • Issued directive on purchase card roles and responsibilities.
	B. Planned Milestones for FY 2006: • Implement initial operating capability of authorization and data mining capabilities.

Table III. Section 2 Systemic Weaknesses – Ongoing	
Progress to Date	**Travel Card Program** **A. Completed Milestones** • Updated Joint Federal Travel Regulation and Joint Travel Regulation specifically prohibiting commercial travel offices from issuing premium class tickets without proper approval. • Issued guidance directing Defense components to modify contracts with commercial travel offices so that performance standards direct them not to issue airline tickets for premium class travel unless the traveler's orders identify that premium class travel is authorized. • Issued policy for all travelers to return unused paper and electronic tickets to their travel offices. • Issued policy to commercial travel offices to cancel unused tickets 30 days after the date of the last leg of the itinerary and to initiate refund actions. • Issued policy directing a contract modification with commercial travel offices that automatically cancels unused tickets 30 days after the date of the last leg of the itinerary and provides reports of unused airline tickets. • Issued policy to develop processes and procedures that minimize the potential for commercial travel offices to issue airline tickets under fraudulent circumstances. • Instituted a monthly review of travel card metrics. • Implemented mandatory split disbursement for military personnel and initiated bargaining for civilian employees. • Published disciplinary guidelines for both military and civilian personnel and modified systems to record and report instances of disciplinary actions taken. • Closed 161,000 unused accounts in FY 2004, and approximately 600,000 in FY 2002 and FY 2003. • Closed 3,900 accounts after reviewing the separation or retirement lists. • Collected approximately $48 million through salary offset. • Issued exemptions from mandatory use of the government travel charge card for travel related to deployments. • Instituted a monthly review of charges made on merchant codes that are supposed to be blocked from authorization. • Implemented a management initiative decision to require higher approval authorities for premium travel and to strengthen management controls. • Implemented a data mining pilot program with the Bank of America and Visa Corporation to flag and review high-risk transactions. • Published a standard training program. • Developed and issued additional guidelines for management of centrally-billed accounts. • Implemented the premium class travel task force recommendations regarding policies for the Department. • Developed a method for preventing or identifying centrally-billed travel tickets claimed for reimbursement on an individual's travel voucher.
	B. Planned Milestones for FY 2006: • Depending on the results of the Defense Travel System assessment, Office of the Under Secretary of Defense for Personnel and Readiness will determine whether to complete the deployment in FY 2006. • Continue to enhance the Defense Travel System to provide visibility of charges and establish additional controls. • Perform audits of travel claims to ensure compliance with new regulatory and policy guidelines on unused tickets and improper payments. • Continue to monitor travel card performance through monthly metric reviews. ***Correction Target Date: 4th Quarter, FY 2006***
Title	**7. Valuation of Plant, Property, and Equipment on Financial Reports**
Description of Issue	The Department of Defense is unable to accurately report the value of property, plant, and equipment on its financial statements.
Progress to Date	**A. Completed Milestones:** • Established offices and groups of personnel to develop baseline valuations for property, plant, and equipment. • Received financial improvement and executing plans from components. • Established recurring reviews of Department of Defense components' progress against plans. • Issued new guidance for internal use software financial management policy. The Military Departments have established working groups to address the valuation and accountability of internal use software and have begun formulating a universe of programs to be valued. • Initiated discussions with the Marine Corps to develop and implement a pilot program to value personal property items meeting capitalization criteria. • Directed the Defense Commissary Agency and the Military Departments to reconcile property under the Department's "preponderance of use" policy. The Department has begun a similar initiative with the Defense Agencies. • Reviewed and developed procedures in accounting for real property inventory assets. • Reviewed the capitalization threshold methodology for real property.

Table III. Section 2 Systemic Weaknesses – Ongoing	
Progress to Date (continued)	**A. Completed Milestones (continued):** • Established metrics that report on the status of the reconciliation of the "preponderance of use" policy, documentation of inventory, and construction in process. • Developed and issued the military equipment valuation business rules (reviewed by the Government Accountability Office and approved by the Deputy Chief Financial Officer) and updated the regulations. • Established initial valuations based on actual data; 95 percent of identified military equipment will be valued. • Developed a functional requirement for the first increment of a transaction based valuation system for military equipment. • Reconciled 40 percent of property for other Defense Agencies under "the preponderance of use" policy.
	B. Planned Milestones for FY 2006: • Provide the Military Departments with baseline valuations for military equipment, a process and corresponding business rules for valuation, and a tool to maintain these baseline valuations. This will allow them to begin the assertion process for general property, plant, and equipment. • Publish the Federal Acquisition Regulation rule on property in the hands of contractors. • Reconciling the remaining 60 percent of property for other Defense Agencies under the "preponderance of use" policy. • Complete the baseline valuation for military equipment. • Implement Increment 1, full operational capability of the Capital Asset Management System-Military Equipment.
	C. Follow on Actions (after completion of Increment 1): • Reconcile construction in progress, inventory and associated documentation. • Implement Increment 2, initial operational capability of the Capital Asset Management System-Military Equipment. ***Correction Target Date: 4th Quarter, FY 2006*** ***(Management within the Office of the Secretary of Defense for Acquisition, Technology and Logistics responsible for reporting this systemic weakness provided this information. However, the DoD components reporting similar weaknesses show corrective actions extending past the correction target date to FY 2008. Therefore, the corrective actions and correction target date will be reviewed and the impact assessed.)***
Title	**8. Valuation of Inventory on Financial Reports**
Description of Issue	The valuation of inventory is not always correctly reported.
Progress to Date	**A. Completed Milestones:** • Convened an inventory working group charged with developing a baseline for inventory valuation, establishing methodologies for valuing inventory, and testing the existence and completeness assertions. • Updated the policy on unique identification of assets. • Established an operating materials and supplies group, which is developing a methodology for baseline valuation. • Developed methodologies for valuing inventory; identified systems that are compliant with and could sustain moving average cost inventory valuations; and developed timelines and approaches to completing baselines for all systems to include testing existence and completeness assertions. • Worked with the Federal Accounting Standards Advisory Board to interpret and apply standards to the Department's processes. • Issued a final "unique identification and valuation" rule. • Published policy governing the application of passive radio frequency identification in the Federal Register for public comments. • Completed a methodology for baseline valuation based on the working group findings and recommendations. • Issued new and revised policies as a result of the working group findings and recommendations.
	B. Planned Milestones for FY 2006 • Extend "unique identification and valuation" rule to legacy items. • Publish policy governing application of identification tags to remaining commodities and locations. • Institute baseline inventory systems and implement processes to sustain them. ***Correction Target Date: 3rd Quarter, FY 2006*** ***(Management within the Office of the Secretary of Defense for Acquisition, Technology and Logistics responsible for reporting this systemic weakness provided this information. However, DoD components reporting similar weaknesses show corrective actions extending past the corrective target date to FY 2011. Therefore, the correction actions and correction target date will be reviewed and the impact assessed.)***

Table III. Section 2 Systemic Weaknesses – Ongoing	
Title	**9. Improper Use of Non-Department of Defense Contracting Vehicles**
Description of Issue	Non-Department of Defense contracting vehicles have been used improperly to procure services or supplies.
Progress to Date	**A. Completed Milestones** • Commenced collaboration with the General Services Administration on the "Get It Right" Campaign. • Created a new policy which establishes internal review procedures for any procurement of services or supplies greater than the simplified acquisition threshold when using non-Department of Defense contract vehicles. • Conducted site visits to multiple assisting agencies. • Issued Department of Defense guidance. • Tasked the Office of the Secretary of Defense, Military Departments, and Defense Agencies to perform compliance reviews and report results. • Developed training programs with the Defense Acquisition University and General Services Administration. • Issued policy memorandum. • Issued interim rules in the Defense Federal Acquisition Regulation. • Conducted outreach programs with assisting civilian agencies. • Commenced workforce training.
	B. Planned Milestones for FY 2006: • Commence reporting on the use of non-Department of Defense contracts from assisting civilian agencies. • Complete compliance review conducted by the Office of the Secretary of Defense, Military Departments, and Defense Agencies regarding proper implementation of policy in using non Department of Defense contracts. ***Correction Target Date: 2nd Quarter, FY 2006***
Title	**10. Department of Defense Contracting for Services**
Description of Issue	The Office of Inspector General, Department of Defense, and the Government Accountability Office have identified deficiencies in the policy for, and the execution of, procurement for services. (Newly reported: FY 2005)
Progress to Date	**A. Planned Milestones for FY 2006:** • Ensure Army reviews all logistic civil augmentation program contract orders to ensure that they are within scope and that they are being completed in a timely manner. • Ensure the Military Departments and Defense Agencies have adequate policies dealing with the appointment and training of contracting office representatives. • Provide guidance to the Military Departments and Defense Agencies regarding procedures for and use of waivers to competitive requirements. • Revise the policy on the proper use of other agencies' contracts to include guidance on conducting surveillance of services procured from other agencies' contracts. • Ensure the Military Departments' and Defense Agencies' service contract review processes and associated data collection procedures provide adequate visibility over contract surveillance.
	B. Planned Milestones for Beyond FY 2006: • Ensure that all personnel who develop statements of work receive performance-based service acquisition training. ***Correction Target Date: 2nd Quarter, FY 2007***

Table III. Section 2 Systemic Weaknesses – Ongoing	
Title	**11. Federal Procurement Data Reporting**
Description of Issue	The new Federal Procurement Data System is not fully functional causing inaccurate procurement reporting data and increased costs required for continued maintenance of legacy systems. (Newly reported: FY 2005)
Progress to Date	**A. Completed Milestones:** • Established a joint Federal Procurement Data System–Next Generation migration team in 2003. • Identified outstanding requirements to the General Services Administration, necessary to transition to the new system. • Held regular weekly meetings with the General Services Administration throughout FYs 2004 and 2005 to provide detailed explanation of the outstanding requirements and to answer questions. • Provided on-site support with subject matter experts to the General Services Administration throughout FYs 2004 and 2005. • Certified contract-writing systems that directly report to the new system.
	B. Planned Milestones for FY 2006: • Certify that all FY 2005 data has been appropriately submitted to the new Federal Procurement Data System–Next Generation. • Complete testing to ensure that data from FYs 1997-2004 has been correctly migrated to the new system, which will be done by the General Services Administration in conjunction with the Defense Management Data Center. • Receive certification from the General Services Administration that the Federal Procurement Data System–Next Generation has attained full operating capability. • Complete migration from the current reporting environment to the Federal Procurement Data System–Next Generation.
	C. Follow on actions: • Certify that all FY 2006 data has been submitted to Federal Procurement Data System–Next Generation. • Decommission feeder systems. ***Correction Target Date: 2nd Quarter, FY 2006***

Table IVa. Section 2 Financial Material Weaknesses - Ongoing			
Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
1. Adequate documentation does not always exist to support adjustments used to reconcile general ledger data to budgetary data. (Defense Finance & Accounting Service)	- Built crosswalks from the legacy line of accounting to the standard fiscal code to the Defense Departmental Reporting System-Budgetary.	Completed	Completed
	- Implemented and validated a crosswalk process to map transactions to the appropriate general ledger accounts.	Completed	Completed
	- Activated the Defense Departmental Reporting System-Budgetary.	2nd QTR 05	Completed
First Reported: FY 2003	- Validate that the weakness is corrected. ***Revised Correction Target Date: 2nd Qtr, FY 2006***	2nd QTR 05	2nd QTR 06
2. Policy for recording, reporting, collecting and reconciling accounts receivable from public and government sources is not always followed. (Defense Finance & Accounting Service)	- Monitored monthly and performed quarterly reconciliation.	Completed	Completed
	- Conduct random review of compliance to policy and procedures.	4th QTR 05	2nd QTR 06
	- Publish standard accounts receivable operating procedures for Department.	2nd QTR 05	4th QTR 06
First Reported: FY 2003	- Provide assertion that accounts receivables are ready for audit and validate that the weakness is corrected. ***Revised Correction Target Date: 2nd Qtr, FY 2007***	3rd QTR 06	2nd QTR 07

Table IVa. Section 2 Financial Material Weaknesses - Ongoing			
Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
3. Instances where an ineffective process prevents ensuring that disbursements and collections by service providers are properly recorded. (Defense Intelligence Agency)	- Established adequate staffing.	-	Completed
	- Establish a baseline for reconciliation.	-	4th QTR 06
	- Reconcile the Fund Balance with Treasury account.	-	1st QTR 07
	- Validate that the weakness is corrected.	-	4th QTR 07
First Reported: FY 2005	***Correction Target Date: 4th Qtr, FY 2007***		
4. Accounts Payable were not always accurately recorded in a timely manner. (Department of the Navy)	- Defined scope and created plan to correct problem.	-	Completed
	- Conduct training.	-	1st QTR 06
	- Collect requirements to modify the workflow process.	-	2nd QTR 06
	- Modify the workflow and systems to accurately record accounts payable.	-	1st QTR 07
	- Ensure that corrective actions are working.	-	3rd QTR 07
	- Assert that the account is ready to audit.	-	1st QTR 08
	- Conduct audit to validate that the weakness is corrected.	-	2nd QTR 08
First Reported: FY 2005	***Correction Target Date: 2nd Qtr, FY 2008***		
5. There are instances where unsupported adjustments are being made to the general ledger accounts. (Defense Logistics Agency)	Launched agency-wide effort to properly establish codes and correctly use them.	-	Completed
	Review procedures to maintain supporting documentation.	-	1st QTR 06
	Implement procedures to perform reconciliation.	-	1st QTR 06
	Validate that the weakness is corrected.	-	4th QTR 06
First Reported: FY 2005	***Correction Target Date: 4th Qtr, FY 2006***		
6. The Fund Balance with Treasury accounts for the Defense Agencies and Navy cannot always be accurately reconciled. (Defense Finance and Accounting Service)	- Develop a plan and milestones that address controls, reconciliation, and assertion that the accounts are ready to audit.	-	1st QTR 06
	- Implement full operational capability of financial system.	-	2nd QTR 06
	- Reconcile disbursements.	-	3rd QTR 06
	- Modify business procedures to eliminate incorrect subheads on transactions.	-	4th QTR 06
	- Perform validation of identified actions for selected Defense Agencies.	-	1st QTR 07
	- Validate that the weakness is corrected.	-	3rd QTR 07
First Reported: FY 2005	***Correction Target Date: 3rd Qtr, FY 2007***		
7. Accounts receivable and accounts payable need to be actively managed and reduced to acceptable levels. (Defense Logistics Agency)	- Issued standard guidance and procedures for managing accounts receivables and payables.	Completed	Completed
	- Collected, wrote-off, or closed-out supportable and valid account receivables over 2 years old except for certain categories.	Completed	Completed
	- Implemented a plan to liquidate valid over aged accounts payable and write-off invalid payables.	1st QTR 05	Completed
	- Validate that the weakness is corrected.	4th QTR 05	1st QTR 06
First Reported: FY 2002	***Revised Correction Target Date: 1st Qtr, FY 2006***		

Table IVa. Section 2 Financial Material Weaknesses - Ongoing

Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
8. The accounts payable do not always accurately reflect the liabilities associated with the actual receipt of goods and services in the appropriate time period. (Defense Finance & Accounting Service)	- Reviewed current business practices.	Completed	Completed
	- Established a plan of action.	1st QTR 05	Completed
	- Implement metrics to measure magnitude of problem and impact of corrective actions.	2nd QTR 05	2nd QTR 06
	- Validate that the weakness is corrected.	2nd QTR 06	1st QTR 07
First Reported: FY 2004	***Revised Correction Target Date: 1st Qtr, FY 2007***		

Table IVb. Section 2 Non-Financial Material Weaknesses - Ongoing

Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
9. Contractors are not always appropriately identifying themselves according to the Federal Acquisition Regulation. (National Defense University)	- Developed remedial training for contractors.	-	Completed
	- Standardized e-mail procedures for contractors.	-	Completed
	- Proper identification is established.	-	2nd QTR 06
	Validate that the weakness is corrected.	-	2nd QTR 06
First Reported: FY 2005	***Correction Target Date: 2nd Qtr, FY 2006***		
10. Inadequate controls to effectively manage pharmaceuticals. (Department of the Air Force)	- Issued policy.	-	Completed
	- Implemented system modifications to alert medical personnel of inappropriate procurement sources and to track backorder status.	-	2nd QTR 06
	- Publish procedures to manage procurement of pharmaceuticals.	-	3rd QTR 06
	- Validate that the weakness is corrected.	-	3rd QTR 07
First Reported: FY 2005	***Correction Target Date: 3rd Qtr, FY 2007***		
11. There are instances where planning for periods of crisis has not been fully developed. (Office of the Under Secretary of Defense (Counter-Intelligence Field Activity))	- Develop and implement a plan.	-	2nd QTR 06
	- Conduct training.	-	2nd QTR 06
	- Validate that the weakness is corrected.	-	2nd QTR 06
First Reported: FY 2005	***Correction Target Date: 2nd Qtr, FY 2006***		
12. The skill sets to support critical missions are currently inadequate. (Office of the Under Secretary of Defense (Intelligence))	- Identified the requirement for manpower.	-	Completed
	- Develop supporting documentation.	-	Completed
	- Obtain senior level approval.	-	3rd QTR 06
	- Validate that the weakness is corrected.	-	4th QTR 06
First Reported: FY 2005	***Correction Target Date: 4th Qtr, FY 2006***		

Table IVb. Section 2 Non-Financial Material Weaknesses - Ongoing

Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
13. DoD's capital investment process for information technology does not confirm that the best investments are selected, that they deliver expected benefits, or that the final product or service delivers what DoD expects. (Defense Information Systems Agency)	- Completed the inventory of the enterprise information technology hardware and established a mechanism to maintain it.	Completed	Completed
	- Publish a capital planning and investment guide that incorporates the portfolio management, enterprise architecture requirements, and information management.	2nd QTR 05	1st QTR 06
First Reported: FY 2002	- Validate that the weakness is corrected. ***Revised Correction Target Date: 1st Qtr, FY 2006***	3rd QTR 05	1st QTR 06
14. The Russian Federation failed to honor commitments associated with the Cooperative Threat Reduction Program. (Defense Threat Reduction Agency)	- The Russian Federation signed the amendments for storage security, weapons transportation security, and chemical weapon elimination.	Completed	Completed
	- Work with the Russian Federation to ensure plans are prepared for further reduction of nerve agents.	3rd QTR 05	1st QTR 06
First Reported: FY 2002	- Validate that the weakness is corrected. ***Revised Correction Target Date: 1st Qtr, FY 2006***	3rd QTR 05	1st QTR 06
15. DoD has not established guidance or effective controls for processing line of duty and incapacitation pay, which adversely affects reservists who attempt to receive benefits after their duty obligation is met. (Department of the Army)	- Developed policies and procedures.	Completed	Completed
	- Conducted legal review of the regulation changes.	1st QTR 05	Completed
	- Published the regulatory guidance.	2nd QTR 05	Completed
First Reported: FY 2002	- Conduct audit review to validate the effectiveness of corrective actions. ***Revised Corrected Target Date: 1st Qtr, FY 2006***	4th QTR 05	1st QTR 06
16. Current processes for managing workload, linking workload to dollars required, or predicting future manpower requirements have not been established. (Department of the Army)	- Validated the missions. Refined the linkage between operating and generating forces.	Completed	Completed
	- Analyzed workload for peacetime and wartime. Linked the workload to the operating force.	2nd QTR 05	Completed
	- Ensured that there is accurate documentation to validate the manpower requirements in the official record called the "Table of Distribution and Allowances."	4th QTR 05	Completed
	- Issued a change to the regulation on the approval authority for manpower requirement determinations.	4th QTR 05	Completed
First Reported: FY 1997	- Audit review to validate that the weakness is corrected. ***Revised Correction Target Date: 1st Qtr, FY 2006***	4th QTR 05	1st QTR 06
17. Automated management tools are needed to ensure accountability of Reserve component personnel from home station to duty station and back home. (Department of the Army)	- Modified the global command and control system to allow data entry at all the mobilization stations.	Completed	Completed
	- Corrected the mobilized unit identification codes.	1st QTR 05	Completed
	- Corrected any disconnects between mobilization orders and the data entry.	2nd QTR 05	Completed
	- Interfaced between the global command and control system and the mobilization deployment integration system to obtain the on-hand data.	2nd QTR 06	Completed
First Reported: FY 2003	- Validate that the weakness is corrected. ***Correction Target Date: 4th Qtr, FY 2006***	4th QTR 06	4th QTR 06

Table IVb. Section 2 Non-Financial Material Weaknesses - Ongoing			
Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
18. Lack of clearly defined strategies or implementation plans has caused program inefficiencies for both the Chemical Demilitarization and the Nuclear Weapons Physical Security Programs. (Office of the Under Secretary of Defense for Acquisition, Technology and Logistics) ***First Reported: FY 2004***	- Developed draft strategies and implement risk management plans.	1st QTR 05	Completed
	- Submitted draft strategies and plans for review and approval.	1st QTR 05	Completed
	- Completed actions required for a clearly defined strategies and implementation plans.	2nd QTR 05	Completed
	- Submit final transition plan to leadership.	2nd QTR 05	2nd QTR 06
	- Validate that the weakness is corrected. ***Revised Corrected Target Date: 2nd Qtr, FY 2006***	2nd QTR 05	2nd QTR 06
19. Inadequate controls have caused instances of inaccurate accountability for equipment sold to foreign countries. (Defense Security Cooperation Agency) ***First Reported: FY 2004***	- Set record keeping standards.	Completed	Completed
	- Developed checklists for validation.	Completed	Completed
	- Deployed automated application and conducted assessment visits.	4th QTR 05	Completed
	- Conduct final assessment visits and validate that the weakness is corrected. ***Correction Target Date: 4th Qtr, FY 2006***	4th QTR 06	4th QTR 06
20. Lack of policy and clear delineation of organizations and responsibilities puts the organization at risk for security violations, duplication of efforts, delays in program activities, and confusion over requirements. (Defense Security Cooperation Agency) ***First Reported: FY 2004***	- Reviewed and coordinated changes to regulations.	3rd QTR 05	Completed
	- Publish handbook.	2nd QTR 06	2nd QTR 06
	- Validate that the weakness is corrected. ***Correction Target Date: 2nd Qtr, FY 2006***	2nd QTR 06	2nd QTR 06
21. Controls were not always adequate over exported Defense articles from initial shipment point to receipt by foreign customers. (Defense Security Cooperation Agency) ***First Reported: FY 2004***	- Actively participated with interagency working groups.	Completed	Completed
	- Issue detailed documentation requirements and policy.	4th QTR 05	2nd QTR 06
	- Confirmation that the Bureau of Customs and Border Protection receives adequate information on shipments.	1st QTR 05	3rd QTR 06
	- Issue policy decision on freight tracking system.	4th QTR 05	4th QTR 06
	- Validate that the weakness is corrected. ***Correction Target Date: 4th Qtr, FY 2006***	4th QTR 06	4th QTR 06
22. Adequate policies to mandate the appropriate proficiency in foreign languages are necessary to more adequately support the global war on terror. (Office of the Under Secretary of Defense (Personnel and Readiness) ***First Reported: FY 2004***	- Obtained approval of a transformation roadmap.	1st QTR 05	Completed
	- Publish revised DoD Directive.	2nd QTR 05	Completed
	- Publish DoD Instruction.	3rd QTR 06	3rd QTR 06
	- Validate that the weakness is corrected. ***Corrected Target Date: 4th Qtr, FY 2006***	4th QTR 06	4th QTR 06

Table V. Section 4 System Nonconformance Weaknesses - Ongoing	
Description of Issue	The Department of Defense financial and business management systems and processes are costly to maintain and operate, not fully integrated, and do not provide information that is reliable, timely, and accurate.
Progress to Date	See Table III, number 1 above, for progress explanation.

Table VI. Scorecard Results for FY 2005

Agency	Rating Categories					Scoring		
	Timely	Format	Program Execution	Training	Material Weakness Reporting	FY05 Color Score	FY05 Over-all Score	Change from FY04 Overall Score
Defense Logistics Agency	Green	Blue	Blue	Blue	White	Blue	3.2	1.6
Department of Air Force	Green	Blue	Blue	Blue	White	Blue	3.2	0.4
Department of Navy	Green	Blue	Blue	Blue	White	Blue	3.2	1.4
Defense Finance and Accounting Service	Green	Blue	Blue	Green	White	Blue	3.0	1.6
Defense Commissary Agency	Blue	Blue	Blue	Blue	Green	Green	2.8	0.2
Defense Intelligence Agency	Blue	Blue	Blue	Blue	Green	Green	2.8	0.4
Pentagon Force Protection Agency	Blue	Blue	Blue	Blue	Green	Green	2.8	0.4
United States Special Operations Command	Blue	Blue	Blue	Blue	Green	Green	2.8	0.2
National Defense University	Blue	Green	Blue	Blue	Green	Green	2.6	0.8
National Security Agency	Green	Blue	Blue	Blue	Green	Green	2.6	0.0
Office of Secretary of Defense (OSD Principal Staff and DoD Field Activities)	Green	Blue	Blue	Blue	Green	Green	2.6	-0.2
United States Pacific Command	Blue	Green	Green	Green	Purple	Green	2.6	1.6
United States Strategic Command	Blue	Green	Blue	Blue	Green	Green	2.6	0.4
Defense Information Systems Agency	Green	Green	Blue	Blue	Green	Green	2.4	0.6
Defense Security Cooperation Agency	Blue	Amber	Green	Green	Purple	Green	2.4	1.0
Joint Staff	Green	Blue	Green	Blue	Green	Green	2.4	0.0
Missile Defense Agency	Green	Green	Blue	Blue	Green	Green	2.4	0.0
National Geo-Spatial Intelligence Agency	Blue	Green	Blue	Green	Green	Green	2.4	0.4
Office of the Secretary of Defense, Inspector General	Blue	Green	Blue	Green	Green	Green	2.4	1.0
United States Southern Command	Blue	Green	Green	Blue	Green	Green	2.4	0.2
United States Transportation Command	Green	Green	Blue	Blue	Green	Green	2.4	0.6
Defense Advanced Research Projects Agency	Blue	Blue	Green	Green	Amber	Green	2.2	0.0
Defense Contract Audit Agency	Blue	Green	Green	Green	Green	Green	2.2	0.4
Uniformed Service University of the Health Sci-ences	Blue	Green	Green	Green	Green	Green	2.2	0.4
Defense Contract Management Agency	Blue	Green	Green	Green	Amber	Green	2.0	0.8
Defense Threat Reduction Agency	Green	Green	Green	Green	Green	Green	2.0	0.6
United States Central Command	Green	Green	Green	Green	Green	Green	2.0	1.6
United States Joint Forces Command	Blue	Green	Green	Green	Amber	Green	2.0	1.0
United States Northern Command	Green	Green	Green	Green	Green	Green	2.0	0.6
Defense Security Service	Green	Amber	Green	Red	White	Amber	1.8	1.0
United States European Command	Green	Green	Green	Amber	Green	Amber	1.8	1.6
Department of Army	Red	Green	Amber	Blue	Red	Red	0.8	-0.4
Maximum Possible Scores	3 (Blue)	3 (Blue)	3 (Blue)	3 (Blue)	5 (White)	Blue	3.4	

Possible Scores per Category: White = 5, Purple = 4, Blue = 3, Green = 2, Amber = 1, and Red = -1

U.S. Government Accountability Office High-Risk Areas

Since 1990, the U.S. Government Accountability Office (GAO) has periodically reported on government operations that it has designated as high risk. GAO's high-risk status reports are provided at the start of each new Congress. GAO's audits and evaluations identify federal programs and operations that, in some cases, are high risk due to their greater vulnerabilities to fraud, waste, abuse, and mismanagement. Increasingly, GAO also is identifying high-risk areas to focus on the need for broad-based transformations to address major economy, efficiency, or effectiveness challenges.

In its latest report, GAO designated 26 high-risk areas. Eight cited DoD programs and operations specifically; five involved the DoD as well as other federal agencies. The DoD-related high-risk areas are listed below; the year that the area was first added to the list is noted in parentheses.

DoD-Specific:
- DoD Approach to Business Transformation (2005).*
- DoD Business Systems Modernization (1995).
- DoD Personnel Security Clearance Program (2005).
- DoD Support Infrastructure Management (1997).
- DoD Financial Management (1995).
- DoD Supply Chain Management (formerly Inventory Management) (1990).
- DoD Weapon Systems Acquisition (1990).
- DoD Contract Management (1992).

DoD Involved:
- Strategic Human Capital Management (2001).*
- Managing Federal Real Property (2003).*
- Protecting the Federal Government's Information Systems and the Nation's Critical Infrastructures (1997).
- Establishing Appropriate and Effective Information-Sharing Mechanisms to Improve Homeland Security (2005).
- Management of Interagency Contracting (2005).

(*) GAO noted that legislation is likely to be necessary, as a supplement to actions by the executive branch, to effectively address this high-risk area.

Emerging Areas

In addition to specific areas designated as high risk, GAO identified other important broad-based challenges facing the government that are serious and merit continuing close attention. GAO noted specifically that the DoD is in the process of transforming its force capabilities and business processes and commented that it had reported on limitations in the DoD's strategic planning and budgeting, including the use of overly optimistic assumptions in estimating funding needs, often resulting in a mismatch between programs and budgets.

The DoD's Efforts to Resolve GAO High-Risk Areas

In general, the DoD agrees with GAO's assessment of the high-risk areas facing the Department. These challenges are long-standing problems that defy quick fixes. The DoD has plans in place to resolve these problems areas, but recognizes that it will take time and resources to address the problems inherent in the Department. The DoD is pleased to note that GAO has acknowledged the Department's progress. The DoD Inspector General's list of management challenges, presented in Part 4 of this report, echoes most of the GAO high-risk designations. The President's Management Agenda also addresses many of the areas identified by

GAO and the Inspector General as opportunities for improvement. The DoD's response to the challenges it faces are presented throughout this report.

Looking Forward: Challenges for 2006 and Beyond

The "Defense Strategy and Strategic Planning" section mentioned the 2005 Quadrennial Defense Review process, which is now underway, and will incorporate the National Defense, National Military, and National Security Strategies. Past Quadrennial Defense Reviews focused on the proper "size" of the force; for 2005, the Department is first determining the right mix of capabilities for the 21st century and then considering the capabilities the Nation needs without prejudging to how these capabilities should be resourced, or even whether they belong in the DoD. The 2005 Quadrennial Defense Review will operationalize the new National Defense Strategy and shape the future force with a 20-year outlook by linking strategy to defense resources and encompassing four areas that drive capabilities development and force planning:

- Building partnerships to defeat terrorist extremist networks,
- Defending the homeland in depth,
- Shaping the choices of countries at strategic crossroads, and
- Preventing the acquisition or use of weapons of mass destruction by hostile state or non-state actors.

The 2005 Quadrennial Defense Review process is also looking at all aspects of the DoD, not just programs and force size: the right mix of capabilities; enablers like logistics, space, and ISR (intelligence, surveillance, and reconnaissance); roles, missions, and organizations; manning and balancing the force; business practices and processes; and DoD authorities.

The 2005 Quadrennial Defense Review recognizes that the United States is a Nation at war and is building upon lessons learned from recent and ongoing operations in Iraq and Afghanistan. Senior DoD leaders are guiding and participating in all aspects of the review to avoid "stovepiping" of issues and resource priorities. This Quadrennial Defense Review includes ideas from other government agencies, industry, allies, and partners. The DoD is consulting closely with Congress throughout the process. A theme crosscutting Quadrennial Defense Review issues is how America might help allies and partners develop their capacities to confront common security challenges. Experience in the war on terrorism has underscored the need for a changed defense establishment—one postured both for extended conflict and continuous transformation. This demands an adaptive strategy, predicated on creating and seizing opportunities and contending with challenges through an active, layered defense of the Nation and its interests.