Department of Defense

Performance and Accountability Report

Fiscal Year 2004

November 15, 2004

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Message from the Deputy Secretary of Defense

November 15, 2004

I am pleased to present the Department of Defense fiscal year 2004 Performance and Accountability Report.

The Department has made significant progress in transforming America's defense posture to enable decisive plans to address future security challenges. We have demonstrated our superior warfighting capabilities in Iraq and Afghanistan. The price of democracy is not cheap. We see continual pressures on the Department's resources in the years ahead. We will focus relentlessly on efficient and careful use of these resources as we continue fighting the global war on terror.

The Department has made improvements in its personnel management practices and we will continue to drive towards a performance-based rating of our workforce. The quality of life of our military members, who risk their lives for all of us to enjoy the freedoms of democracy, has been enhanced by upgrading facilities and advancing private-public partnerships in military housing. We have also seen efficiencies due to practicing performance-based budgeting, increasing our focus on core support functions, and reforming our annual review of programs and funding.

Although the Department received a disclaimer of opinion on its financial statements, there have been advancements throughout the past year in the Department's efforts to improve financial reporting and management processes. Specifically, through the Department's Business Management Modernization Program, the financial management processes and controls are being integrated into the business processes to ensure accountability and auditability of the Department's business transactions.

The Department now has a report card that identifies how well we did in achieving the strategic plan, objectives, and goals. This is an effective management tool that is allowing us to fine-tune our implementation of the strategic plan. Looking at our report card results this year, the Department met several of its performance goals, but still has work to do in other areas. The report displays all of the Department's performance results this year and provides a clear picture of our progress in meeting our objectives.

The Department is committed to effective internal controls, full compliance with established guidelines and standards, and proper stewardship of the resources entrusted to it. During fiscal year 2004, we corrected 11 management control weaknesses, and except for the unresolved weaknesses noted in the Management Discussion and Analysis section of this report, the Department has reasonable assurance that its management controls are effective. The Department will continue its efforts to resolve the remaining issues and I am confident that the Department will continue to fulfill its mission responsibilities.

Looking ahead, the Department continues the transformation of its support structure and management practices. While the Department has made progress in many areas, we must continue to upgrade performance and accountability, streamline and strengthen management, and ensure that every defense dollar is expended as wisely as possible.

Paul Wolfowitz

Report Overview

The Department of Defense fiscal year 2004 Performance and Accountability Report is designed to provide useful information for American citizens, the President, Congress, other federal organizations, and Department of Defense military members, civilians and contractors.

Our report encompasses the Department's operations for fiscal year 2004, which occurred from October 1, 2003, through September 30, 2004. It contains five parts. Combined, they provide a thorough description of the Department's services to the American people and stewardship of our critical resources.

The pressures on the Department's resources have never been greater and will continue to grow in the years ahead. Our response must be to focus relentlessly on efficient and careful use and management of these resources. Only by effectively measuring the results we achieve, as documented in this report, can we adjust the tactics and strategies we use to meet our goal of mission excellence and deliver the best possible performance for the American people.

Part 1: Management Discussion and Analysis is a high-level overview of the Department's performance and financial information for fiscal year 2004. Part 1 starts with a discussion of the Department of Defense (DoD) mission, organization and resources. It highlights the Department's performance—covered in more detail in Part 2—by summarizing the strategic plan and goals and the fiscal year 2004 annual performance goals and results. Next, it provides financial highlights—covered in more detail in Part 3—for fiscal year 2004. The Department's compliance with legal and regulatory requirements is also discussed in this section. Part 1 concludes with a summary of the Department's status on meeting the President's Management Agenda objectives.

Part 2: Performance Information presents the Department's strategic plan, strategic objectives, annual performance goals, and annual performance results for fiscal year 2004 in accordance with the Government Performance and Results Act. It describes key performance indicators—and their fiscal year 2004 goals and results—that the Department uses to manage risks to the accomplishment of its strategic objectives.

Part 3: Financial Information is composed of the Department's principal financial statements, notes to these statements, consolidating and combining statements, and other required information for fiscal year 2004. This section includes the Inspector General, Department of Defense, Auditors' Report on the fiscal year 2004 financial statements. The Auditors' Report provides the Inspector General's assessment of whether the Department's financial statements are fairly presented in all material respects and conform to generally accepted accounting principles.

Part 4: Inspector General Summary of Management Challenges presents a summary of the most serious management challenges facing the Department. This assessment was prepared by the Inspector General, Department of Defense.

Part 5: Appendixes present detailed information about the Department's compliance with the Improper Payments Information Act of 2002, a glossary of acronyms, and a list of internet links for further information referred to in this report.

We are interested in your feedback regarding the content of this report. Please feel free to email your comments, or requests for copies of this report, to DoDPAR@osd.mil or write to:

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Washington, DC 20301-1100

You may also view this document at www.dod.mil/comptroller/par.

Year in Review

The Department of Defense is leading the global war on terror. The courageous men and women in uniform and the Department civilians who support them have accomplished tremendous feats since our country was attacked 3 years ago. They have:

- Overthrown two terrorist regimes, rescued two nations, and liberated some 50 million people;
- Hunted down thousands of terrorists and regime remnants in Iraq and Afghanistan;
- Ensured a safe environment for the first election in Afghanistan's 5,000 year history;
- Disrupted terrorist cells on several continents; and
- Likely prevented a number of planned terrorist attacks.

To continue these great accomplishments, the Department is providing these brave men and women the tools they need to win the global war on terror, transforming for the 21st century, and ensuring the Department manages the force properly. DoD's commitment to our men and women in uniform means they will have the training and tools necessary to prevail in wars our nation may have to fight—wars which could be notably different from today's challenges. This commitment extends to attracting and retaining the best and the brightest, thereby sustaining the quality of the all-volunteer force.

When this Administration took office, the President charged the Department of Defense with a mission—to challenge the status quo, and prepare the Department to meet the new threats our nation will face as the 21st century unfolds.

Marines of the 24th Marine Expeditionary Unit meet and greet Iraqi citizens. Marines patrolled the Iraqi neighborhoods, delivered water to residents who needed it and helped out the community as much as they could.

The Marines, escorted by a Light Armored Vehicle from Alpha Company, 1st Light Armored Reconnaissance Battalion, drove throughout their area of responsibility, stopping to offer residents water and to talk to them about their living conditions and how the Marines could help them. The day's activities are an important part of the Marines' security and stabilization mission in Iraq.

We have done a good deal to meet that charge, but our challenge is to build on these successes, and continue the transformation efforts that are now underway. In 2004, we:

- Continued to successfully prosecute the global war on terror;
- Further strengthened our combined and joint war fighting capabilities;
- Continued transforming the joint force, making it lighter, more agile and more easily deployable, and instilling a culture that rewards innovation and intelligent risk-taking;
- Strengthened our intelligence capabilities, and refocused our intelligence efforts to support the new defense strategy and our contingency plans;
- Began deploying the technologies necessary to protect our people from the deadly threat of ballistic missiles;
- Improved our management of the force;
- Taken critical steps to attract and retain talent in our Armed Forces—including targeted pay raises and quality of life improvements for the troops and their families;
- Refocused our overseas presence, further strengthening key alliances, and improving our security cooperation with nations that are likely partners in future contingencies;
- Worked with the North Atlantic Treaty Organization (NATO) in an effort to make the Alliance more relevant and credible in this post-Cold War era;
- Continued to improve and refine DoD's role in homeland security and homeland defense; and
- Further streamlined DoD processes by continuing financial management reform and shortening acquisition cycle times.

While successfully leading the global war on terror, the Department has also served the public around the world through various disaster relief and humanitarian missions, and other support to civil authorities.

Airmen with the 437th Airlift Squadron, Charleston Air Force Base, S.C., load relief supplies for victims of Hurricane Charley in Florida aboard a C-17 Globemaster III at Dobbins Air Reserve Base, Ga., on Aug. 14, 2004. The 437th was deployed in support of relief operations being conducted by the Federal Emergency Management Agency. *(DoD photo by Staff Sgt. Aaron D. Allmon II, U.S. Air Force.)*

We can continue to live as free people because the industriousness and ingenuity of the American people have provided the resources to build the most powerful and capable Armed Forces in human history, and because we have been blessed with the finest young men and women in uniform—volunteers all—that the world has known.

They are courageous, they are selfless, and they are determined. We are grateful to them and proud of them.

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Part 1: Management Discussion and Analysis

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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.[1]

Photos courtesy of Military Department webmasters

[1] Quadrennial Defense Review Report, Sep 30, 2001

Organization

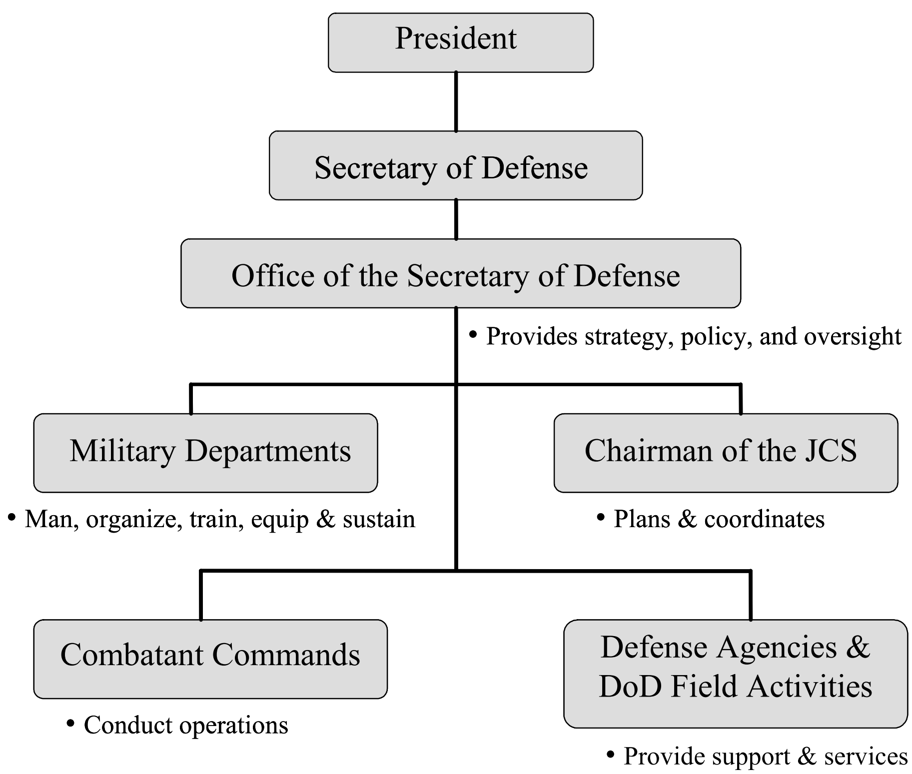
The Department of Defense (DoD) is a Cabinet-level organization that receives orders directly from the President of the United States. The Secretary of Defense is appointed by the President and is responsible for the formulation and execution of defense policy.

The Office of the Secretary of Defense carries out the Secretary's policies by tasking the Military Departments, the Chairman of the Joint Chiefs of Staff (JCS), the Combatant Commands, and the Defense Agencies and DoD Field Activities.

Military Departments. The Military Departments consist of the Army, Navy—of which the Marine Corps is a component—and the Air Force. The U.S. Coast Guard is also a special component of the Navy in wartime, but is otherwise a bureau of the Department of Homeland Security.

These Departments man, organize, train, equip, and sustain 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 that is responsible for conducting the military operations.

The Military Departments are composed of Active Duty, Reserve, and National Guard forces. The Reserve and National Guard represent approximately half of America's total uniformed force. These forces provide additional support during military operations. They also perform critical humanitarian, peacekeeping, law enforcement, and disaster assistance missions for the Department of Defense, all of which are important to protecting the national security of the United States.



Chairman of the Joint Chiefs of Staff. The Chairman of the JCS—who is the principal military advisor to the President, the National Security Council, and the Secretary of Defense—assists the President and 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 plans conform to resource levels the Secretary of Defense projects will be available.

Combatant Commands. The nine Combatant Commands have responsibility for conducting DoD missions around the world. For example, U.S. Central Command is primarily responsible for conducting Operation Enduring Freedom in Afghanistan and Operation Iraqi Freedom. 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:

- U.S. European Command (USEUCOM)
- U.S. Central Command (USCENTCOM)
- U.S. Pacific Command (USPACOM)
- U.S. Southern Command (USSOUTHCOM)
- U.S. Northern Command (USNORTHCOM)

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

- U.S. Strategic Command
- U.S. Special Operations Command
- U.S. Transportation Command
- U.S. Joint Forces Command

For example, the U.S. Transportation Command is responsible for moving military equipment, supplies and personnel around the world in support of operations.

Defense Agencies and DoD Field Activities. Defense Agencies and DoD Field Activities provide support services that are 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 DoD activities.

For additional information on the Department's organization structure and functions, visit www.defenselink.mil/odam/omp/pubs/GuideBook/ToC.htm and www.dtic.mil/doctrine/jel/new_pubs/jp0_2.pdf.

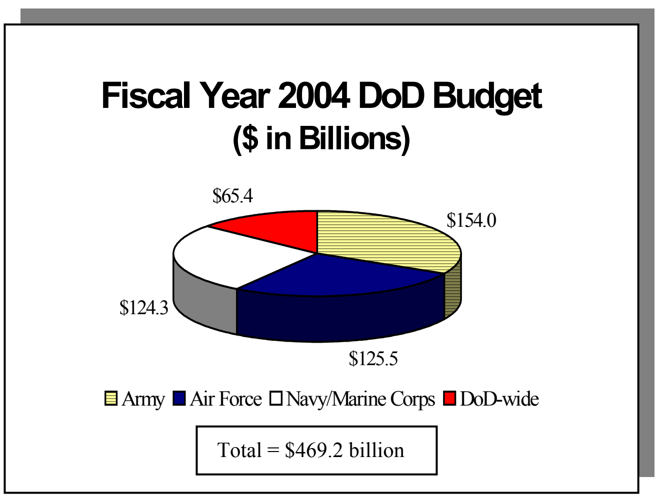
The World with Combatant Command Geographic Areas of Responsibility

Resources

People. To provide the citizens of the United States with the highest level of national security, the Department of Defense employs 1.4 million men and women in the Active Duty, another 1.2 million in the Reserve and National Guard, and approximately 740,000 civilians. Together, these men and women work daily to protect American interests in numerous countries.

Physical Assets. The Department maintains a robust infrastructure, operating approximately 600,000 individual buildings and structures located at more than 6,000 different locations, and using approximately 30 million acres. 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.

Budget. The Department's budget for fiscal year 2004 was $469.2 billion.[2]



Because the American people have entrusted these resources to the Department of Defense, the Department is committed to effective resource stewardship and has implemented numerous performance and financial measures to help meet that commitment. The Department continues to research and develop new methods and measures to enhance management and stewardship of these resources.

Today, the Department has more than 70 performance metrics in use or under development. The report highlights them in the next two sections, "Performance Highlights" and "Financial Highlights," and they are detailed in Part 2, "Performance Information" and Part 3, "Financial Information."

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

Performance Highlights

Strategic Plan

America is a nation at war. We face a diverse set of security challenges. Yet, we still live in an era of advantage and opportunity. The defense strategy outlines an active, layered approach to the defense of the nation and its interests. It seeks to create conditions conducive to a secure international order favorable to freedom, democracy, and economic opportunity. This strategy promotes close cooperation with others around the world that are committed to these goals. It addresses mature and emerging challenges.

The Quadrennial Defense Review Report serves as the Department of Defense's strategic plan. The last review was completed in 2001.

The Quadrennial Defense Review Report describes America's security in the 21st Century, U.S. interests and objectives, the changed security environment, and the status of the U.S. military. It outlines U.S. Defense Strategy and includes strategic objectives and defense policy goals.

The strategy also describes the need for sustained transformation of the U.S. military and Defense establishment over time; including a paradigm shift in force planning that describes what the force must be capable of and where it should be positioned to best meet the challenges of the new security environment. *Transformation is at the heart of the Defense Strategy.*

The Department will conduct its next review in 2005 and publish its next report in 2006.

Part of the U.S. Army's transforming brigade combat teams, these soldiers patrol in Stryker armored wheeled vehicles during a search for criminals and weapons in Mosul, Iraq, on Oct. 4, 2004. The soldiers are with the Stryker Brigade Combat Team, 2nd Infantry Division, from Fort Lewis, Wash. *DoD photo by Specialist John S. Gurtler, U.S. Army.*

Strategic Objectives

Four strategic objectives guide the development of U.S. forces and capabilities, their deployment, and use:

Secure the United States from direct attack. The Department will give top priority to those who seek to harm the U.S. directly.

Secure strategic access and retain global freedom of action. The Department will promote the security, prosperity, and freedom of action of the United States and its partners by securing access to key regions, lines of communication, and the global commons.

Strengthen alliances and partnerships. The Department will seek to expand the community of like-minded nations and help partners increase their capacity to defend themselves and collectively meet challenges to our common interests.

Establish favorable security conditions. The Department will create conditions conducive to a favorable international system by honoring our 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.

Policy Goals

The Department accomplishes its objectives along four broad avenues of effort described below.

Assure allies and friends. The Department will provide assurance by demonstrating our resolve to fulfill our defense commitments and help protect common interests. The presence of American forces overseas is one of the most profound symbols of the U.S. commitment to allies and friends. Through its willingness to use force in its own defense and that of others and to advance common goals, the U.S. demonstrates its resolve and the credibility of the U.S. military. The Department helps allies and friends create favorable balances of military power in critical areas of the world to deter aggression or coercion. The Department's strategic direction is inevitably linked with that of U.S. allies and friends.

Dissuade potential adversaries. The Department will work to dissuade potential adversaries from adopting threatening capabilities, methods, and ambitions, particularly by developing our own key military advantages. U.S. strategy and actions influence the nature of future military threats, guide threats in certain directions, and complicate military planning for potential adversaries. The United States also exerts influence by conducting research, development, test, and demonstration programs, and by maintaining or enhancing advantages in key areas of military capability. Well targeted strategy and policy can dissuade other countries from initiating future military competitions.

Deter aggression and counter coercion. The Department will deter by maintaining capable and rapidly deployable military forces and, when necessary, demonstrating the will to decisively resolve conflicts on favorable terms.

Defeat adversaries. At the direction of the President, the Department will defeat adversaries at the time, place and in the manner of our choosing – setting conditions for future security. U.S. forces must maintain the capability to decisively defeat any adversary of the United States and its allies and friends.

Four guidelines structure our strategic planning and decision-making. They serve to guide the Department in the accomplishment of its objectives.

Active, layered defense. The Department will focus military planning, posture, operations, and capabilities on the active, forward, layered defense of our nation, our interests, and our partners.

Continuous transformation. The Department will continually adapt how it approaches and confronts challenges, conducts business, and works with others.

Capabilities-based approach. The Department will strengthen its opportunity-oriented approach for addressing mature and emerging challenges—setting priorities among competing capabilities.

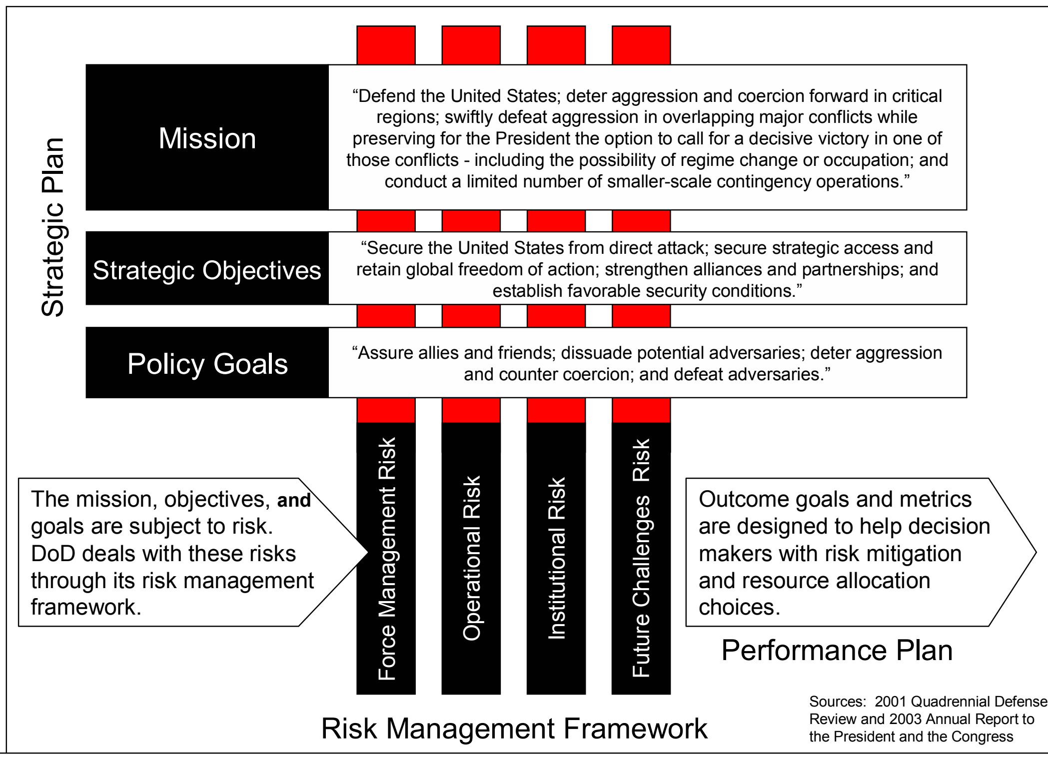
Managing risks. The Department will consider the full range of risks associated with resources and operations and manage explicit tradeoffs across the Department.

An F-15E Strike Eagle receives fuel from a 908th Expeditionary Aerial Refueling Squadron KC-10 Extender during a mission over Iraq. *U.S. Air Force photo by Senior Master Sgt. Mark Moss*

Annual Performance Goals and Results

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 strategy's priorities. To do this in a consistent, analytic manner, the Department introduced in 2001 a new risk management framework to help the Secretary and his advisors evaluate tradeoffs among key performance objectives and fundamental resource constraints.

The risk categories are described and illustrated below. Each category has associated outcome goals and metrics designed to gauge performance. This creates a continuous thread to ensure the Department's performance supports the strategy.



The **Risk Management Framework** ties the **Performance Plan** to the **Strategic Plan** with outcome goals and metrics designed to measure how well the Performance Plan mitigates risks.

1. Force management risk addresses our ability to recruit, retain, train, and equip sufficient numbers of quality personnel and sustain the readiness of the force while accomplishing our many operational tasks.

2. Operational risk focuses on achieving military objectives in a near-term conflict or other contingency.

3. Institutional risk covers the management practices and controls that affect the efficiency with which resources are used and that shape the effectiveness of the Defense establishment.

4. Future challenges risk addresses new capabilities and new operational concepts needed to dissuade or defeat mid-term to long-term military challenges. This risk management framework reflects DoD's experiences over the last decade in attempting to balance strategy, force structure, and resources.

Each of these quadrants is further defined by specific outcome goals. By assessing the Defense establishment in these four areas against those goals, the Department can directly assess how well it is developing and transforming the operational force, realizing key enabling capabilities, and providing the deployment and support infrastructure needed to achieve the strategic goals of the defense strategy.

Even as we accept some increased near-term risk so we can prepare for the future, our performance goals for fiscal year 2004 recognized that new and unexpected dangers will likely be waiting just over the horizon—and that we must be flexible to face them.

The challenge during the past year was to do three difficult things at once:

- Win the global war on terror,
- Prepare for the threats we will face later this decade, and
- Continue transforming for the threats we will face in 2010 and beyond.

The following paragraphs summarize the Department's performance results for the past fiscal year, and describe our progress in achieving the results needed to ensure risk remains balanced across the Department's many activities and investments. These results are measured against the Department's performance goals as outlined in the 2003 Annual Report to the President and Congress (www.defenselink.mil/execsec/adr2003).

Balancing Force Management Risk. Force management risks steadily mounted during the 1990's. The Department's investments left compensation and quality of life programs, like housing, short of their desired goals. At the same time, the increase in military deployments led to unusual stresses on units and personnel brought on by frequent or extended periods away from home. Together, these trends took a toll on military families, reduced morale, and contributed to the reduced ability to retain military personnel with key skills and leadership abilities. This negative cycle illustrates the kind of force management risk that the Department must monitor and control.

Just as the Department invests resources to maintain the operational readiness of its forces, it is now also consciously investing resources to mitigate force management risks. These actions are indispensable in terms of sustaining the nation's commitment to an all-volunteer force, and to keeping faith with the men and women who serve in uniform. The Department met its fiscal year 2004 performance goals related to the force management risk area with some notable exceptions.

While the Nation continues to operate in a state of National Emergency, the Army and Air Force end strengths exceeded the goal to remain within 2% of the end strength authorized in the National Defense Authorization Act.

The Reserve Components are facing significant recruiting challenges in 2004. Active component recruiting met its quality and quantity goals, however, there are fewer applicants than desired in the pool of those awaiting basic training (known as the Delayed Entry Program), suggesting 2005 will be a challenge.

All Services are on track to meet retention goals and Reserve component enlisted attrition is well within acceptable limits. Nevertheless, the Department is watchful for indications of a downturn.

The Department continues to work to improve the working and living conditions for its people, including the quality of military health care and other force management related goals. Obtaining these goals is critical for ensuring effective recruitment, training, and retention.

Sergeant Major of the Army Kenneth O. Preston, left, speaks to first-week recruits during basic training at Fort Leonard Wood, Mo. As the Army's senior enlisted Soldier, Preston serves as the Army Chief of Staff's personal adviser on all enlisted-related matters, particularly in areas affecting Soldier training and quality of life.

Balancing Operational Risk. During the 1990's, near-term operational risks were the dominant concern of the Department, distracting attention from other sources of risk. Under the previous construct, operational risk was measured 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 new approach—known as a "capabilities-based approach"—to manage operational risk, moving away from the two war construct.

The capabilities-based approach reflects the fact that the United States cannot know with confidence what nation, combination of nations, or non-state actor will pose threats to vital U.S. interests decades from now. The new construct more realistically captures the demands facing the Armed Forces by focusing more on how an adversary might fight rather than on whom the adversary might be 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 asymmetric warfare to achieve their objectives. These new capabilities manifest themselves in the shape of transforming U.S. military forces.

In support of, and complementing, a capabilities-based approach, the Secretary of Defense directed the Chairman of the Joint Chiefs of Staff to develop improved methods for allocating forces to the Geographic Combatant Commanders. With these new force allocation methods, each Combatant Commander is responsible for developing and maintaining operations plans which are developed to meet potential contingencies. In the past, the allocation of forces did not account for on-going operations or for the current state of readiness of individual units. To overcome these issues, the Secretary also directed the U.S. Joint Forces Command to develop a means for monitoring joint force operational availability; in other words, knowing how ready a unit is and how soon it can be deployed for operations. In response to a capabilities-based approach and new force allocation methods, the Department initiated the Global Force Management process, designed to continuously manage the process that provides forces to conduct operational missions. Global Force Management provides comprehensive insight into U.S. force postures worldwide, and accounts for ongoing operations and constantly changing unit availability. Throughout 2004, the Department made steady progress establishing Global Force Management. Complementing the effort was a major decision making USJFCOM responsible for developing timely, global, joint sourcing solutions that provide Combatant Commanders the right units with the right capabilities.

In addition to employing a capabilities-based approach to mitigating operational risk, the Department is focusing effort on security cooperation, adaptive planning, and better ways to learn from current operations.

The Department continues to focus on major defense policy themes that include combating terrorism, influencing key nations and improving relationships with them, and strengthening alliances for the future. This has improved the quality of the security cooperation program—the program the Department undertakes to build defense partnerships with friends and allies. Importantly, this program must ensure close cooperation with other agencies involved in foreign policy, like the Department of State.

The Department made significant progress advancing the adaptive planning concept. The adaptive planning concept will replace existing planning methods with an ability to produce plans that are more timely and responsive to the current security environment. The Secretary approved the concept and established a team to ensure successful implementation throughout the Department.

The Enhanced Joint Lessons Learned Program Study was completed; this initiative analyzes existing capabilities to capture lessons-learned and develop alternative courses of action. As part of this effort, the U.S. Joint Forces Command established the Joint Center for Operational Analysis–Lessons Learned; joint lessons-learned specialists were placed in the individual Services' lessons-learned centers to assist with the collection, analysis, and distribution of lessons-learned.

Paratroopers prepare to board a U.S. Air Force C-130 aircraft at Al Asad Air Base, Iraq, during Operation All-American Lightning. Two-hundred and forty 82nd Airborne Division Soldiers jumped during the airborne operation, which functioned as a show of force.

Balancing Institutional Risk. As the Department transforms its military capabilities to meet changing threats, it must also 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.

Mitigating institutional risk necessitates changing the way the Department conducts its daily business. It is a matter of urgency because left alone, the current organizational arrangements, processes, and systems will continue to drain scarce resources from training, infrastructure, operations, and housing. In addition, if left unattended, institutional risks over time will increase risks in other areas like force management, operational, and future challenges risks. The Department met several fiscal year 2004 goals related to the institutional risk area.

The Department made progress toward Acquisition Excellence, moving to level the playing field for all contractors—ensuring fairness in contracting and making it easier for new entrants to the acquisition contract process. Acquisition Excellence has the additional benefit of giving DoD greater exposure to new ideas. Further, the aim is to invigorate the fiscal well being of the defense industry by rewarding good performance and fostering strong competition vital to maintaining a healthy industrial base.

The Department is improving the transparency of component program and budget submissions. Older programming and budget tools did not produce easily verifiable data and this hindered management discussions and decisions. By streamlining the flow of data from the components to the Department, and taking measures to improve data accuracy and validity, the Department is better able to align its resource plans with the Secretary's strategic guidance. The result is better-informed leaders with the insight they need to make decisions.

Extraordinary logistics demands in the current wartime environment caused higher customer wait times—the elapsed time from when a customer (military unit or other DoD organization) orders an item of material until its receipt. Through the second quarter, the average customer wait time was 24 days. Current operations will continue to stress logistics pipelines. Nevertheless, satisfying the operational needs of the troops remains a top priority, and the measure of that satisfaction is the ability to achieve a customer wait time of 15 days or less.

Balancing Future Challenges Risk. In light of the dynamic changes in the security environment, a premium has been placed on the need to manage future challenges risk. While many elements of the existing force will continue to contribute to the United States Armed Forces capabilities, defense managers acknowledge the need to develop new, leading-edge capabilities. The Department met several fiscal year 2004 goals regarding future challenges risk.

The goal of the Department's experimentation program is to rapidly convert innovative warfighting concepts to prototypes and then turn those into fielded capabilities. Accordingly, the April 2003 Transformation Planning Guidance directed the development of the Joint Concept Development and Experimentation Campaign Plan to describe the role of joint experimentation as a major generator of transformational change. The Chairman of the Joint Chiefs of Staff approved the Plan and submitted it to the Secretary of Defense. As of the end of the third quarter of FY 2004, the U.S. Joint Forces Command co-sponsored four major exercises with each of the Services that included multi-national partners. These exercises served as "testing grounds" for new concepts.

In 2003, the Secretary of Defense directed the five Geographic Combatant Commands to establish Standing Joint Force Headquarters by FY 2005. This headquarters serves as a planning staff during day-to-day operations. In the event of a crisis, the in-place Headquarters is immediately prepared to execute command and control functions for the integrated employment of land, air, maritime, and information forces. These headquarters will be established by FY 2005 with the exception of U.S. Central Command's, where the ongoing contingency has delayed participation. The other Geographic Combatant Commands conducted initial training, procured appropriate facilities, and installed garrison equipment for their Standing Joint Force Headquarters. They have completed plans to conduct a full-scale joint training event in FY 2005 that will serve as the "graduation" event for their new joint command and control capability.

In the technology arena, an independent peer review panel rated the Department's Defense Technology Objectives, reviewing technologies such as radar, jet engines, nuclear weapons, night vision, and smart weapons. The review panel assesses whether a technology objective is on budget, on time, and performing as required. Favorable ratings in these criteria give an objective a satisfactory progress rating. For FY 2004, the Department exceeded its performance target of 70% of technology objectives progressing satisfactorily.

Financial Highlights

Key Financial information is summarized in this section with detailed financial information provided in Part 3 of this report.

Financial Overview

The Department of Defense 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.

Each year the Department spends billions of dollars designing, building, operating and maintaining business systems that support the troops. Many of these systems support one military service, a specific defense agency, or in some cases, an individual command. Consequently they are unable to operate as a single enterprise network of systems. The Armed Forces of the United States must have business systems that can interact with one another and facilitate the execution of end-to-end business processes; provide DoD decision makers with timely, accurate, and reliable information; comply with all financial management laws, standards, and requirements; and produce auditable financial statements.

Furthermore, the transformation of the business management systems and the business processes they support must be accomplished without interrupting the level of support provided to the warfighter and on-going military operations. This unprecedented, comprehensive, and visionary task remains one of the Department's top priorities.

The Department has already made progress in transforming its business and financial processes and systems.

Nearly 50 percent of the Department's total liabilities received an unqualified audit opinion again this year

As indicated by the table below, six of the Department's subordinate financial statement reporting entities received unqualified audit opinions, one received a qualified audit opinion, and three of the Department-wide financial statement items received favorable audit results. As a result of the Military Retirement Fund receiving an unqualified audit opinion, nearly 50 percent of the Department's total liabilities received unqualified audit opinion again this year.

DoD Component	Audit Opinion
Defense Commissary Agency	Unqualified
Defense Contract Audit Agency	Unqualified
Defense Finance and Accounting Service	Unqualified
Defense Threat Reduction Agency*	Unqualified
Military Retirement Fund	Unqualified
Medicare Eligible Retiree Health Care Fund	Qualified
Inspector General, DoD*	Unqualified
DoD-Wide Financial Statement Lines	**Audit Results**
Appropriations Received*	Favorable
Federal Employee Contribution Act Liabilities*	Favorable
Investments*	Favorable

* = New for fiscal year 2004

DoD is accomplishing the difficult task of business transformation and improved financial management through the business management modernization program, financial improvement initiative, and financial management balanced scorecard.

Business Management Modernization Program. During the three years since the Department of Defense began the business management modernization program, significant progress has been achieved in building a baseline architecture, governance structure, and re-engineering methodology to reach the ultimate goal of streamlining and integrating business processes and systems. In 2004, the Department achieved the following.

- Developed specific business transformation metrics that are tied directly to goals, objectives and targets. These metrics represent the program's first set of integrated business transformation metrics.

- Implemented an incremental approach to transformation, which allows DoD to prioritize and focus on the most pressing business transformation initiatives. Although the Department previously had defined Increment 1 (obtaining better financial traceability, total asset accountability, and total personnel visibility), it had not done so for the increments subsequent to it. Increment 2 will focus on reengineering the Department's method of contracting for and acquiring goods and services, accounting for physical assets, and improving military health care delivery. Increment 3 will focus on improving the Programming, Planning, Budgeting and Execution process and achieving an integrated total force picture.

- Established portfolio management policies and broadly outlined duties and responsibilities for managing information technology investments across the department.

- Released version 2.2 of the business enterprise architecture, which includes an enterprise business process model, describing the end-to-end business processes for DoD; it also incorporates statutory, regulatory, and administrative requirements and procedures. Visibility of these requirements in the context of DoD business operations is necessary to correct deficiencies, assure uniform interpretation and implementation, and provide timely, accurate and reliable business information.

The Department will incorporate the remaining statutory, regulatory, and administrative requirements in future versions of the business enterprise architecture. The timetable for these improvements is outlined in the table below.

Release Dates for Future Versions of the Business Enterprise Architecture:

Description	Release Date
Release of Business Enterprise Architecture Version 2.3 *Updates all business enterprise architecture work activities, information, system functions and interchanges needed to support the defined enterprise business process model.*	November 2004
Release of Business Enterprise Architecture Version 2.4 *Continue to detail enterprise business process model. Addresses remaining statutory, regulatory, and administrative requirements and map those deemed financially relevant to the enterprise business process model for increment 1.*	January 2005

Through the above accomplishments, DoD has laid the groundwork for significant progress during the coming year. The work is proceeding steadily. The scope and complexity of DoD business processes and systems are too large and unwieldy to change all at once and the transformation will take time. Long term efforts will focus on the following integrated activities.

- Incrementally build and extend a business enterprise architecture,

- Establish and enforce an agency-wide governance process that ensures efficient execution, guidance, and oversight for DoD business transformation and compliance activities,

- Reduce or eliminate redundant, outdated, and stove-piped systems using a systems review and portfolio management process, and

- Reengineer the Department's business processes a piece at a time using an incremental approach.

For detailed information on the Department's Business Management Modernization Program, visit www.dod.mil/comptroller/bmmp/pages/index.html/

Financial Improvement Initiative. Although strategic change through the business management modernization program will take time, the department is taking steps to correct weaknesses and deficiencies using the discipline and methodology of financial audits.

To help meet this objective, the Department launched the financial improvement initiative in 2003. The goal of the financial improvement initiative is to ensure proper transfer of good data and processes into the broader reengineered business processes. By cleansing data and reengineering processes based on the rules documented in the business enterprise architecture, the Department will mitigate the risk of importing poor data and poor controls into the new architecture.

To accomplish the goal of receiving an unqualified audit opinion, the DoD components developed and submitted financial improvement plans listing deficiencies and necessary corrective actions. The financial improvement initiative has allowed the Department to:

- Better define and align financial statement deficiencies to financial statement lines,
- Begin linking deficiencies to enterprise business process model processes, and
- Provide Department-wide oversight and visibility to improving financial statements.

The improvement plans identify deficiencies that must be corrected through policy revisions, process improvements, or systems changes. This information is being linked to the Business Management Modernization Program so that the Department can clearly distinguish between problems that can be solved in the near term through policy and process actions and problems that must be solved through systems changes.

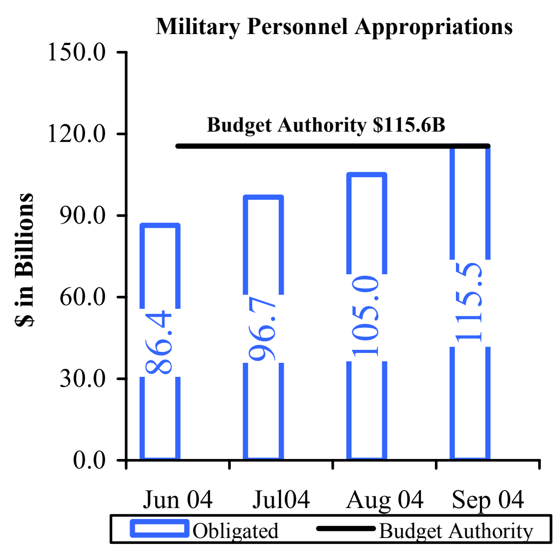
Financial Management Balanced Scorecard. The Department's Financial Management Balanced Scorecard is aligned with the risk management framework established in the Department's strategic plan. The Scorecard provides the framework for establishing executive-level performance goals and tracking results; designates key performance outcomes, measures, and indicators; and assigns responsibility for cascading performance metrics to the individual component levels within the Department.

Budget and financial indicators are used to monitor and guide financial management reform and target resources to areas where DoD needs to drive better stewardship of financial resources.

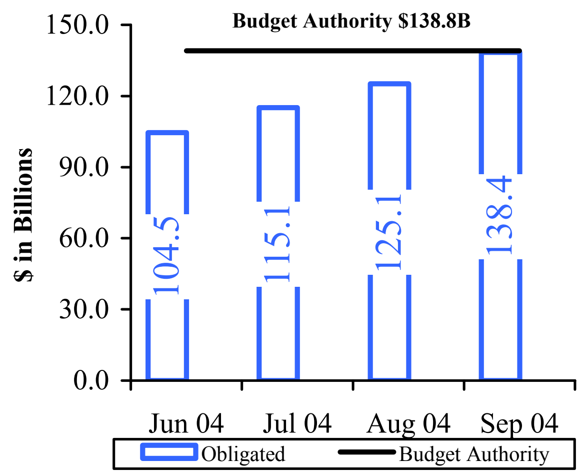
Execution of Appropriations

Military Personnel and Operation and Maintenance Appropriations

The Department obligated 99.9 percent of its Military Personnel Appropriations and 99.7 percent of its Operation and Maintenance Appropriations. The Department developed the following Military Personnel Appropriations and Operation and Maintenance Appropriations indicators to monitor the execution of DoD's budget and project the rate and amount of funds the Military Services obligate. The Department compares each appropriation's annual budget authority with each Service's projected obligations to ensure funds are available to finance the requirement.

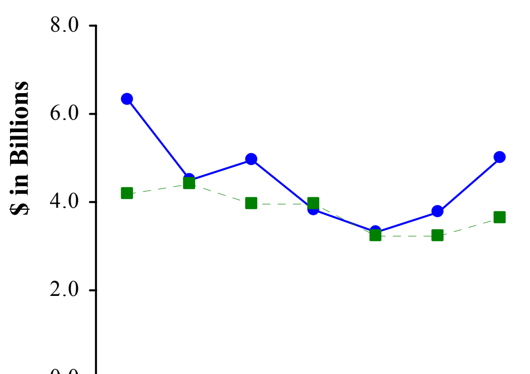


Operation and Maintenance Appropriations



Defense Working Capital Fund Cash Management

Cash Management 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 $3.8 billion in fiscal year 2004 to Operation and Maintenance appropriations. Cash is inflated in fiscal year 2004. Higher than normal inventory sales in fiscal year 2004, due to the global war on terror and pricing of transportation services, has generated substantial cash. However, when this inventory is replaced and with lower transportation pricing, cash will decrease significantly to pay for the restocking of inventory in fiscal year 2005. The fiscal year 2004 ending cash balance is $4.99 billion.

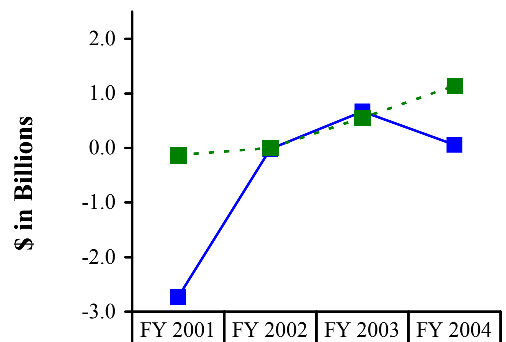


	Mar 04	Apr 04	May 04	Jun 04	Jul 04	Aug 04	Sep 04
Current Bal.	6.31	4.52	4.94	3.82	3.30	3.77	4.99
Plan	4.2	4.42	3.97	3.94	3.25	3.22	3.64

Defense Working Capital Fund Accumulated Operating Results

The Defense Working Capital Fund Accumulated Operating Results (AOR) indicator 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 reports.

Overall, the revenue is above plan by $3.2 billion and expenses are above plan by $1.7 billion, due to the global war on terror. However, Recoverable Operating Results were reduced by $0.8 billion to recognize the impact of cash transfers. As a result, the Department's fiscal year (FY) 2004 AOR of $0.06 billion was less than the planned $1.14 billion.



	FY 2001	FY 2002	FY 2003	FY 2004
Actual AOR	-2.73	-0.02	0.67	0.06
Plan	-0.13	0.00	0.55	1.14

Late Payments of Commercial Invoices

The Prompt Payment Act requires that invoices be paid on time—within 30 days of receipt. This indicator highlights the degree to which the Department is able to reduce untimely commercial payments. DoD's fiscal year 2004 goal was to reduce late payments to a level not to exceed 3 percent of total commercial invoices. The Department exceeded the goal by reducing late payments to 2.6 percent. Improving this indicator reduces cost and improves DoD's relationship with suppliers.

Delinquent Accounts Receivable

The Accounts Receivable indicator highlights the amount owed to the Government by an individual, organization, public entity, foreign entity, or any other entity to include federal entities, to satisfy a debt or claim.

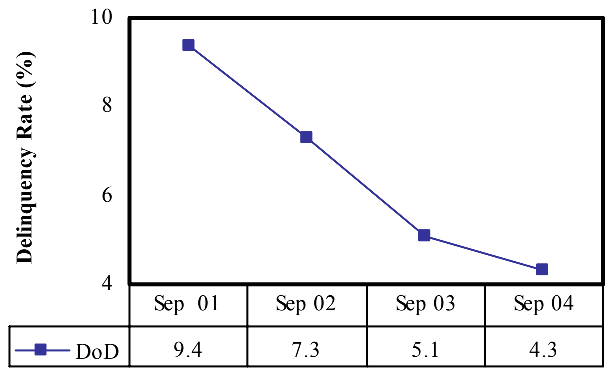
The Department's goal was to reduce delinquent receivables (more than 30 days old) by 25 percent in fiscal year 2004. The Department has two types of delinquent receivables: receivables with the public (i.e., individuals, contractors, local and foreign governments, etc.) and intragovernmental receivables with other federal government agencies.

Approximately $4.0 billion of the $4.9 billion delinquent public receivables were at Treasury for collection or in litigation. DoD is actively working to collect the remaining $0.9 billion in delinquent public receivables. The Department's delinquent public receivables, for which DoD controls collecting, decreased by 21 percent in fiscal year 2004.

Delinquent intragovernmental receivables owed to the Department by other federal agencies are currently $302 million. The Department reduced these receivables by 16 percent in fiscal year 2004.

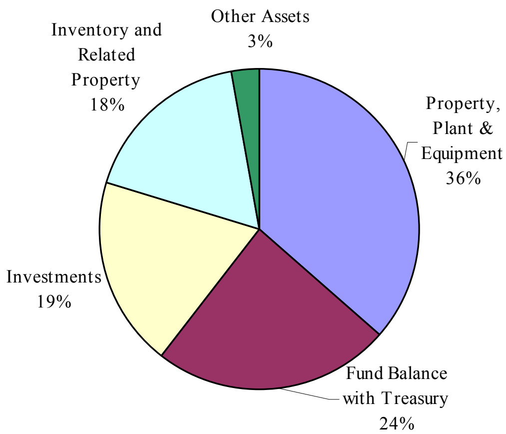
DoD Travel Card Program
Individually Billed Accounts Delinquency Rates

This indicator illustrates the Department employees' record for paying their travel card invoices in a timely manner—within 60 days. The Department measures the percent of delinquent payments relative to the total billed amounts. A low delinquency rate accrues cash benefits to the Department in the form of rebates and improves the credibility of the travel and purchase card programs with both the Congress and the general public. Since fiscal year 2001, delinquency rates for individual travel accounts declined 54 percent, from 9.4 percent delinquent to 4.3 percent delinquent.



Financial Statement Analysis

Types of Assets



Assets. The Consolidated Balance Sheet shows that DoD assets as of September 30, 2004, were $1.2 trillion, an increase of $67.2 billion (6%) from fiscal year 2003.

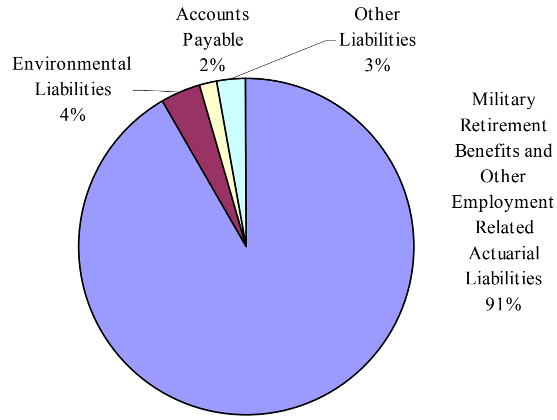
Increased funding to fight the global war on terror caused the Fund Balance with Treasury to increase $37.5 billion.

Investments increased by $25.9 billion primarily due to positive security cash flows for the Military Retirement Trust Fund and the Medicare Eligible Retiree Health Care Fund for retired military members and their dependents.

Assets

Asset Type	Fiscal Year 2004	Fiscal Year 2003	Change
	Billions		
Property, Plant, and Equipment	$440.9	$446.3	-$5.4
Fund Balance with Treasury	$289.6	$252.1	$37.5
Investments	$231.5	$205.6	$25.9
Inventory and Related Property	$213.2	$205.5	$7.7
Other Assets	$33.3	$31.8	$1.5
Total	**$1,208.5**	**$1,141.3**	**$67.2**

Types of Liabilities



Liabilities. The Consolidated Balance Sheet shows that DoD liabilities as of September 30, 2004, were $1.7 trillion, an increase of $150.5 billion (10%) from fiscal year 2003.

Military Retirement Benefits and Other Employment Related Actuarial Liabilities increased $140.1 billion primarily due to a new law which allows certain disabled military retirees to concurrently receive disability payments from the Veterans Administration and their DoD military retirement pay. Prior to this legislation, disability payments offset military retirement payments by an equal amount.

Environmental Liabilities increased by $2.9 billion primarily due to improved accuracy in the reporting of environmental liabilities.

Accounts Payable increased by $2.2 billion primarily due to the global war on terror.

Liabilities

Liability Type	Fiscal Year 2004	Fiscal Year 2003	Change
	Billions		
Military Retirement Benefits and other Employment Related Actuarial Liabilities	$1,569.7	$1,429.6	$140.1
Environmental Liabilities	$64.4	$61.5	$2.9
Accounts Payable	$30.2	$28.0	$2.2
Other Liabilities	$45.8	$40.5	$5.3
Total	**$1,710.1**	**$1,559.6**	**$150.5**

Costs. The Consolidated Statement of Net Cost shows that the net cost of operations for the Department of Defense for fiscal year 2004 was $605.4 billion, an increase of $93.1 billion (18%) from fiscal year 2003. The principal reasons for this increase were the military retirement program's new legislation just discussed and the global war on terror. As indicated by the table below, increases occurred in several major military programs to support this effort. Most notably, the Department's military retirement costs increased $52.2 billion due to increased actuarial liabilities. In addition, costs to operate, maintain, supply and transport forces increased by $14.6 billion. The *Consolidating Statement of Net Cost* provides a more detailed breakout of the Department's costs.

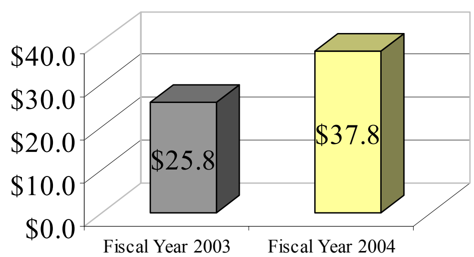
Costs

Program Type	Fiscal Year 2004	Fiscal Year 2003	Change
	Billions		
Military Personnel	$112.3	$108.9	$3.4
Operation & Maintenance	$187.1	$172.5	$14.6
Procurement	$79.2	$60.0	$19.2
Research, Development, Test & Evaluation	$56.8	$51.1	$5.7
Military Retirement	$153.5	$101.3	$52.2
Other Programs	$16.5	$18.5	-$2.0
Total	**$605.4**	**$512.3**	**$93.1**

Revenues. The Consolidated Statement of Net Cost shows that the total revenues received by the Department for fiscal year 2004 were $37.8 billion. This is a $12.0 billion (47%) increase in revenues from fiscal year 2003. The increase in revenues was mainly due to the U.S. Treasury directing that other gains on assets be treated as revenue, whereas previously other gains were netted against costs.

Revenues

($ in billions)



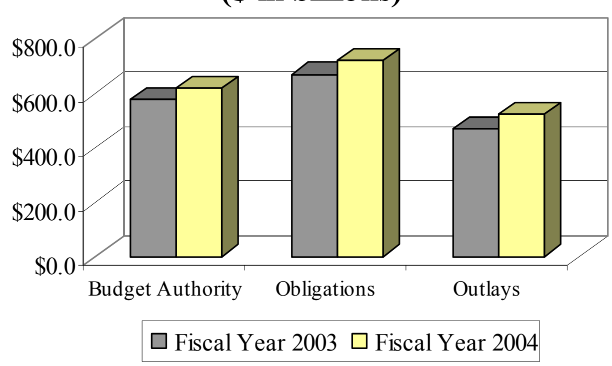
Budget Authority. This is the authority provided by law to incur financial obligations that will result in outlays. Specific forms of budget authority include appropriations, borrowing authority, contract authority, and appropriation transfers from other agencies. The Combined Statement of Budgetary Resources shows that the amount of budget authority the Department had for fiscal year 2004 was $616.5 billion. This is a $40.0 billion (7%) increase from fiscal year 2003. Increased funding to fight the global war on terror caused 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 fiscal year 2004 were $720.9 billion, an increase of $51.1 billion (8%) from fiscal year 2003.

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 fiscal year 2004 were $521.1 billion, an increase of $52.6 billion (11%) from fiscal year 2003.

Statement of Budgetary Resources

($ in billions)



Compliance with Legal and Regulatory Requirements

Each year the Department works aggressively to comply with laws made by Congress to ensure that the federal government provides the best possible service to the American people. Among these laws are the:

- Chief Financial Officers Act of 1990
- Federal Managers' Financial Integrity Act of 1982
- Federal Financial Management Improvement Act of 1996
- Inspector General Act Amendments of 1988
- Improper Payments Information Act of 2002

Chief Financial Officers Act

The Chief Financial Officers Act requires federal agencies to prepare auditable annual financial statements. Each year, the Department prepares financial statements.

As discussed earlier, several of the Department's subordinate agencies have received a favorable audit opinion on their financial statements. However, to date, the DoD-wide statements have received a disclaimer of opinion from the auditors, which means the statements are not able to be audited.

The Department created detailed financial improvement plans. These plans identify specific corrective actions, costs, and key milestones for improving the information reported in the Department's financial statements.

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 is required to validate that the deficiencies were corrected. After the validation, management is to assert to the auditors that the information is reliable in phase three. The assertion process contains detailed requirements for documenting the basis for asserting. 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.

The Department currently has 11 auditor identified financial statement material weaknesses. A summary of these weaknesses and their corrective status follows.

Financial Statement Weakness	Description	Status
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.	The Department developed the initial version of a new business enterprise architecture. The architecture helps describe how the Department's business processes and systems will integrate to ensure that accurate and timely financial information is readily available for decision makers.
Intragovernmental Eliminations	The inability to reconcile most intragovernmental transactions results in adjustments that cannot be fully supported.	The Department is taking action internally and with other federal agencies to help resolve this issue.
Accounting Entries	The DoD continues to enter material amounts of unsupported accounting entries.	The Department has implemented a training program to minimize unsupported accounting entries and is tracking progress through the financial metrics program. Total elimination of these entries is contingent upon full implementation of the Department's business enterprise architecture, new systems, and business processes.
Fund Balance with Treasury	The Department has been unable to fully reconcile its records to those of the U.S. Treasury.	The Department strengthened internal controls for disbursements through reconciliation training and metric tracking to more accurately record disbursements. The Department also obtained legislation to clear old unreconcilable suspense accounts and check issue differences. The Department has a multi-phase program underway to enhance system functionality for improving expenditure reconciliation and reporting.
Environmental Liabilities	Guidance and audit trails are insufficient. The inventory of ranges and operational activities (landfills, open burning pits, etc.) is incomplete.	The Department issued guidance for closed sites in October 2002 and continues to issue guidance for on-going operations. Inventories of operational and non-operational ranges are complete. Additional review and validation is needed to ensure audit trails are sufficient.

Financial Statement Weakness	Description	Status
General Property, Plant and Equipment (PP&E)	The cost and depreciation of DoD General PP&E is not reliably reported due to: (a) a new accounting requirement that went into effect in FY 2003 that classifies military equipment as General PP&E (such costs were previously expensed), (b) a lack of supporting documentation for General PP&E which were purchased many years ago, and (c) 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.	The Department implemented guidance and training to improve property accountability and provide better financial reporting. The Department plans to complete valuations of all known military equipment programs by September 2005. The military equipment baseline will be updated to a single base year in fiscal year 2006. The Department plans to develop a white paper on accounting and reporting for spare parts, based on the practices of other Federal agencies and private sector organizations. The paper will be submitted to the Federal Accounting Standards Advisory Board, with resolution anticipated by March 2005.
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.	The Department is developing policy and processes to help correct this weakness. Implementation of new policy and the Department's business enterprise architecture will eliminate this problem. To improve accountability, accuracy, and reliability, DoD is in the process of creating an on-line government property system to be jointly used by government and industry for recording property in the possession of contractors.
Inventory	The existing inventory valuation at most activities is not reported in accordance with generally accepted accounting principles.	The Department issued a change in policy in fiscal year 2001 to begin valuing inventory at moving-average-cost to comply with historical cost valuation requirements. In fiscal year 2004, the Department chartered the Inventory and Operating Materials and Supplies Working Group to identify and develop processes and methods leading to inventory valuation based on historical costs. This effort involves assessing the Department's major logistics and financial systems—current and future—to determine the adequacy for producing historically-based valuations. The working group is developing valuation techniques where standard methods are not feasible or practical.

Financial Statement Weakness	Description	Status
Operating Materials and Supplies	The Department's systems were designed to expense materials when purchased rather than when consumed.	The Inventory and Operating Materials and Supplies Working Group is addressing this issue by examining the Department's practices, processes, and systems to determine the appropriate Department-wide business rules and systems that will correct this weakness.
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.	The implementation of the Department's business enterprise architecture will correct this weakness.
Statement of Financing	The DoD cannot reconcile budgetary obligations to net cost without making unsupported adjustments.	The implementation of the Department's business enterprise architecture will correct this weakness.

Federal Managers' Financial Integrity Act

The Federal Managers' Financial Integrity Act requires federal agencies to assess the effectiveness of management controls for program, operational, and administrative areas as well as accounting and financial management. Management controls are the organization, policies, and procedures which 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 management controls and to include material weaknesses found in management controls that warrant reporting to a higher level. The Department's fiscal year 2004 Annual Statement of Assurance is provided in the Deputy Secretary's Message at the front of this report.

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 fiscal year 2004, the Department took numerous steps to improve the Department-wide training, awareness, communication, and emphasis for full disclosure and prompt resolution of weaknesses. Early in the year, the Department conducted a Department-wide conference attended by more than 100 representatives from 70% of the Department's components. The Controller of the Office of Management and Budget helped kick off the conference and made the case for the importance of identifying and promptly resolving material weaknesses in the functional area of financial reporting. At the conference, the Department introduced a newly designed DoD scorecard used to measure important elements of the Defense components' feeder statements. These feeder statements are essential in developing the DoD Statement of Assurance. The categories scored in the development of the DoD feeder statements are the timeliness of the statements, accuracy and completeness of the feeder reports, program execution and training to ensure robust assessments of the management controls, full disclosure of material weaknesses, and prompt resolution of previously reported material weaknesses. The scorecard has already improved the timeliness of component feeder statements. In fiscal year 2003, only 48% of the feeder statements were received on time. This fiscal year 88% of the feeder statements were on time.

Beginning at mid-year in fiscal year 2004, the Department began using the automated system, Financial Information Progress System, to quarterly track and update the progress of corrective actions for reported weaknesses. Quarterly tracking has increased the leaderships' awareness of the importance the Department places on prompt resolution of reported weaknesses.

In fiscal year 2004, the Department conducted training briefings for 25 percent of the Defense components. In addition, the Department conducted training at the American Society of Military Comptrollers national training session, the Professional Military Comptroller School, and a Senior Executive Service orientation class.

The Department strongly encourages forthright reporting of material weaknesses in management controls on all operations important to accomplishing the mission of defending our nation from adversaries, foreign or domestic. As weaknesses are corrected, new ones may be identified and the total number of weaknesses can fluctuate. Therefore, the outstanding number of uncorrected weaknesses may not change significantly from one fiscal year to another. The Department monitors corrective activities and does not allow milestone slippage without justification by senior leaders. In fiscal year 2004, the Department notified the leaders of all DoD component activities that failure to correct material weaknesses in a timely manner is unacceptable. One of the main reasons for the inability to correct weaknesses on time has been overly optimistic projections. The Department is emphasizing the importance of using more realistic projections.

The Department uses periodic self-assessments as the basis for the annual statement of assurance and reports management 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."

The Department classifies management control weaknesses into 3 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.

Last fiscal year, the Department had 40 uncorrected Section 2 weaknesses. In fiscal year 2004, the Department reported 17 new weaknesses and corrected 11 weaknesses, leaving 46 uncorrected weaknesses at the end of fiscal year 2004. Of the 17 new weaknesses, 1 is systemic and 16 are material weaknesses. The Department began fiscal year 2004 with 17 financial weaknesses of which 5 were systemic and 12 were material. During the year, the Department corrected 5 relating to financial issues and reported 5 as new material weaknesses, ending the year with a total of 17.

The Department identified 9 areas that affect numerous DoD components as systemic weaknesses. The Department identified the remaining 37 weaknesses as material weaknesses affecting the individual components as indicated on the table below.

In fiscal years 2002, 2003, and 2004, the Department reported one Section 4 System Nonconformance Weakness which encompasses the entire DoD financial system noncompliance with control requirements. The Department also considers DoD financial system's noncompliance as a systemic weakness affecting multiple DoD components. In addition, the auditors have identified DoD financial systems as a material weakness under the requirements of the Chief Financial Officers Act in fiscal years 2002, 2003, and 2004.

The following four tables list the weaknesses grouped differently as Section 2 (corrected or ongoing) and Section 4 (ongoing only).

Table I, Section 2 Corrected Material and Systemic Weaknesses lists 11 corrected during this fiscal year (10 material and 1 systemic weakness).

Table II, Section 2 Systemic Weaknesses – Ongoing lists the nine systemic weaknesses that remained opened at the end of fiscal year 2004, one of which was newly identified this fiscal year.

Table III, Section 2 Material Weaknesses – Ongoing lists the 37 ongoing material weaknesses. Twelve are financial issues of which five are new. Twenty-five are related to non-financial issues of which 11 were newly identified this fiscal year. For these material weaknesses, a sample of the corrective actions was selected for reporting. Each material weakness is required to have a validation as the final action to ensure that the weakness is corrected.

Table IV, **Section 4 Systemic Weaknesses – Ongoing** lists the 1 ongoing Section 4 system nonconformance material weakness.

Table I. Section 2 Corrected Material and Systemic Weaknesses	DoD Component
1. The actual loss of government funds could not always be fully identified because of improper disbursement transaction processing and inadequate documentation. (Material Weakness)	Defense Finance and Accounting Service
2. Due to inadequate supporting documents, freight supply payments are not properly pre-certified before they are made. (Material Weakness)	Defense Finance and Accounting Service
3. Payments less than $2,500 are not always certified and post payment audits are not always performed on electronic vendor payments to verify that the supporting documentation is correct. (Material Weakness)	Defense Finance and Accounting Service

Table I. Section 2 Corrected Material and Systemic Weaknesses (Continued)	DoD Component
4. Adequate management controls were not in place to detect or prevent disbursements in excess of obligations. (Material Weakness)	Office of the Under Secretary of Defense for Comptroller
5. The military pay system has made invalid payments resulting in members separating from service in debt. (Material Weakness)	Defense Finance and Accounting Service
6. Better controls are needed to properly account for proceeds from submarine dismantlement scrap revenues. (Material Weakness)	Defense Threat Reduction Agency
7. Not all DoD components have completed essential continuity of operations plans. (Material Weakness)	Defense Threat Reduction Agency
8. Responsible DoD officials failed to secure host nation telecommunications agreements necessary to maximize the combat effectiveness of warfighters. (Material Weakness)	Department of the Air Force
9. Controls were not adequate to ensure that the program manager of the Joint Chemical Agent Detector—an Acquisition Category III program—reported cost breaches to the acquisition program baseline. (Material Weakness)	Office of the Under Secretary of Defense for Acquisition, Technology and Logistics
10. DoD risks improperly storing Privacy Act information on systems. (Material Weakness)	DoD Counterintelligence Field Activity
11. Acquisition oversight is not always adequate when contracting for DoD services and can result in failure to obtain the best value on individual procurements. (Systemic Weakness) [Management took action to resolve this weakness and reported it closed. However, new concerns identified by auditors during FY 2004 will be reviewed and the impact assessed.]	Office of the Under Secretary of Defense for Acquisition, Technology and Logistics

Table II. 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.

Table II. Section 2 Systemic Weaknesses – Ongoing (Continued)	
Title	**1. Department of Defense Financial Management Systems and Processes (Continued)**
Progress to Date (Continued)	B. Planned Milestones for FY 2005: • Complete the Business Enterprise Architecture (BEA) Increment #1, which includes business processes in support of an unqualified audit opinion. • Perform targeted portfolio management reviews as part of the FY 2005 through FY 2006 planning, programming, and budgeting process. C. Planned Milestones for Beyond FY 2005: • Complete BEA Increment #2, which focuses on business processes that support acquisition practices, total asset visibility, accurate valuation of assets, military health care delivery, and environmental safety and occupational health. • Complete BEA Increment #3, which focuses on business processes that support the planning, programming, budgeting and execution, total force management, and installations management. • Complete targeted portfolio management reviews, which are part of the Department's planning, programming, budgeting, and execution process. **Correction Target Date: 4th Quarter, FY 2007**
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. • Completed the draft revision and informal coordination of the certification and accreditation policy, which improves compliance and provides an enterprise management capability. • Developed and piloted 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.

Table II. Section 2 Systemic Weaknesses – Ongoing (Continued)	
Title	**2. Management of Information Technology and Assurance (Continued)**
Progress to Date (Continued)	B. Planned Milestones for FY 2005: • Revise the security certification and accreditation policy in order to improve compliance and to provide an enterprise management capability. • Incorporate a revised certification and accreditation process, including vulnerability management and complete the piloting process. Continue modular development and deployment of additional services to support the information assurance processes, e.g., investment and resource management. • Award the enterprise licenses for automated IA tools to patch vulnerabilities and prevent malicious modification of Operating Systems. C. Planned Milestones for Beyond FY 2005: • Provide the United States Strategic Command real-time situational awareness of the Department of Defense posture. Provide information assurance management tools as a core enterprise service. **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. • Issued planning guidance that requires the assessment of environmental condition of the operational ranges.

<table>
<tr><th colspan="2">Table II. Section 2 Systemic Weaknesses -- Ongoing</th></tr>
<tr><td></td><td>3. Environmental Liabilities (Continued)</td></tr>
<tr><td>Progress to Date (Continued)</td><td>B. Planned Milestones for FY 2005:
• Develop an inventory of non-Defense Environmental Restoration Program activities.
• Develop the non-Defense Environmental Restoration Program liability estimates.
• Assess the progress made by the Military Services in reporting complete, accurate, and supported environmental liability data during the review of the FY 2004 financial statements.
C. Planned Milestones for Beyond FY 2005:
• Update the site inventories and environmental liability estimates of the Defense Environmental Restoration and the non-Defense Environmental Restoration Programs.
• Assess the progress made by the Military components in reporting complete, accurate, and supported environmental liability data during review of the FY 2005 financial statements.
Correction Target Date: 1st Quarter, FY 2006</td></tr>
<tr><td>Title</td><td>4. Personnel Security Investigations Program</td></tr>
<tr><td>Description of Issue</td><td>The Department of Defense hiring is adversely affected because personnel security investigations are backlogged.</td></tr>
<tr><td>Progress to Date</td><td>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.
B. Planned Milestones for FY 2005:
• 50 percent of the investigations are submitted within the agreed upon timeframes.</td></tr>
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Table II. Section 2 Systemic Weaknesses – Ongoing (Continued)	
Title	**4. Personnel Security Investigations Program (Continued)**
Progress to Date (Continued)	C. Planned Milestones for Beyond FY 2005: • 80 percent of the investigations within the agreed upon timeframe by the end of FY 2005. • 100 percent of the goal for investigations by the end of FY 2006. **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 in FY2004: • Conducted a comprehensive review of planned facilities sustainment programs, resulting in an increase of $85 million in funding for FY 2005. • 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 to update the target date for restoring adequate readiness conditions.

Table II. Section 2 Systemic Weaknesses – Ongoing (Continued)	
Title	**5. Real Property Infrastructure (Continued)**
Progress to Date (Continued)	B. Planned Milestones for FY 2005: • Initiate common reporting of facility conditions. • Set new corporate demolition and disposal targets for removing obsolete and excess assets from the inventories. • Release a real property requirements model that addresses requirements for facility related services, utilities, and leasing. **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 DoD emphasis on proper use of the cards, poorly enforced controls, and lax oversight.
Progress to Date	**<u>Purchase Card Program</u>:** A. Planned Milestones for FY 2005: • Implement a self-certification process to assess the creditworthiness of prospective cardholders at all 1,400 local union bargaining units. • Issue the Charge Card Guidebook, including governing laws and regulations and business rules for purchase, travel, fleet, and air cards. • Begin use of the on-line statement review, approval, and certification. • Make available an enhanced centralized data mining tool to detect fraudulent, wasteful, and abusive card transactions. • Independently verify the fraud detection process. **<u>Travel Card Program</u>:** A. Completed Milestones in FY 2004: • 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.

Table II. Section 2 Systemic Weaknesses – Ongoing (Continued)	
Title	**6. Government Card Program Management (Continued)**
Progress to Date (Continued)	**<u>Travel Card Program (Continued)</u>:** A. Completed Milestones in FY 2004 (Continued): • 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. B. Planned Milestones for FY 2005: • Continue deployment of the travel system. • Implement a data mining pilot program with the Bank of America to flag and review high-risk transactions. • Enhance the travel system to provide visibility of charges and additional controls. • Publish a standard training program. • Develop additional guidelines for management of centrally billed accounts. • Establish a self-certification for creditworthiness in the absence of a credit check.

Table II. Section 2 Systemic Weaknesses – Ongoing (Continued)	
Title	**6. Government Card Program Management (Continued)**
Progress to Date (Continued)	**<u>Travel Card Program (Continued)</u>:** B. Planned Milestones for FY 2005 (Continued): • Continue to implement the premium class travel task force recommendations regarding policies for the Department. • Develop a method for preventing or identifying centrally billed travel tickets claimed for reimbursement on an individual's travel voucher. C. Planned Milestones Beyond FY 2005: • Complete deployment of the travel system. **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 for FY 2004: • 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. • Established metrics. • Issued new guidance for Internal Use Software Financial Management Policy. • Directed the Defense Commissary Agency and the Military Services to reconcile property under the Department's "preponderance of use" policy. The Department has begun a similar initiative with the other Defense agencies. B. Planned Milestones for FY 2005: • Obtain agreement between the Government Accountability Office and the Office of the Inspector General, Department of Defense, on a 1998 real property baseline. • Publish the Federal Acquisition Regulation rule for property in the hands of contractors. • Publish business rules for the military equipment valuation in the Financial Management Regulations. • Reconcile other Defense Agencies' property under the "preponderance of use" rule, which will be issued by Office of the Under Secretary of Defense (Comptroller).

Table II. Section 2 Systemic Weaknesses – Ongoing (Continued)	
Title	**7. Valuation of Plant, Property, and Equipment on Financial Reports (Continued)**
Progress to Date (Continued)	C. Planned Milestones Beyond FY 2005: • Complete the establishment of baseline values for military equipment. • Ensure that the Military Departments assert that property, plant, and equipment ending balances are ready for audit. • Ensure that the Military Department Audit Services complete their reviews and inform the Department of Defense Inspector General that Military Departments are ready for financial statement audits. • Ensure that the audit community completes the audits and the Department receives an unqualified audit opinion. **Correction Target Date: 4th Quarter, FY 2006**
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 for FY 2004: • 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. B. Planned Milestones for FY 2005: • Issue new and revised policies as a result of the inventory working group findings and recommendations. • Resolve issues regarding testing identified by the inventory working group. • Issue a final "unique identification and valuation" rule. • Issue Defense Federal Acquisition Regulation Supplement rule for radio frequency identification.

Table II. Section 2 Systemic Weaknesses – Ongoing (Continued)	
Title	**8. Valuation of Inventory on Financial Reports (Continued)**
Progress to Date (Continued)	C. Planned Milestones Beyond FY 2005: • Extend "unique identification and valuation" rule to legacy items. • Resolve issues concerning testing that are identified by the inventory working group. **Correction Target Date: 2nd Quarter, FY 2006**
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. (**Newly reported: FY 2004)**
Progress to Date	A. Completed Milestones for FY 2004: • Developed and coordinated guidance. • Developed training. • Conducted outreach programs with assisting civilian agencies. B. Planned Milestones for FY 2005: • Issue policy memorandum. • Issue interim rules in the Defense Federal Acquisition Regulation Supplement. • Initiate workforce training. • Begin obtaining reports on the Department of Defense use of non-Department of Defense contracts from assisting civilian agencies. C. Planned Milestones for Beyond FY 2005: • Complete a compliance review regarding the implementation of the policies for proper use of non-Department of Defense contracts. **Correction Target Date: 2nd Quarter, FY 2006**

Table III. Section 2 Material Weaknesses – Ongoing		
Financial Material Weaknesses	**Major Corrective Action(s)** ***A sample of the actions is presented.***	**Indicates Completed or Milestone Date Qtr/FY**
1. Adequate documentation does not always exist to support adjustments used to reconcile general ledger data to budgetary data. (Defense Finance and Accounting Service) **First Reported: FY 2003**	✓ Built crosswalks from the legacy line of accounting to the standard fiscal code to the Defense Departmental Reporting System-Budgetary.	Completed
	✓ Implemented and validated a crosswalk process to map transactions to the appropriate general ledger accounts.	Completed
	✓ Activate the Defense Departmental Reporting System-Budgetary.	2nd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 2nd Quarter, FY 2005**	2nd / 2005
2. Policy for recording, reporting, collecting and reconciling accounts receivable from public and government sources is not always followed. (Defense Finance and Accounting Service) **First Reported: FY 2003**	✓ Monitor monthly and perform quarterly reconciliation.	Completed
	✓ Publish standard accounts receivable operating procedures for Department.	2nd / 2005
	✓ Conduct random review of compliance to policy and procedures.	4th / 2005
	✓ Provide assertion that accounts receivables are ready for audit.	1st / 2006
	✓ Validate that the weakness is corrected. **Correction Target Date: 3rd Quarter, FY 2006**	3rd / 2006
3. 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) **First Reported: FY 2003**	✓ Revise and publish the estimation policy in the DoD financial management guide.	1st / 2005
	✓ Develop adequate procedures and controls for the DoD business enterprise architecture.	1st / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005
4. Suspense account balances with the Treasury trial balances are not fully resolved and reconciled. (Defense Finance and Accounting Service) **First Reported: FY 1997**	✓ Legislation passed to allow DoD to write-off aged suspense accounts to help reduce the balances to zero.	Completed
	✓ Began write-offs.	Completed
	✓ Implement courses of action to reduce account activity to an acceptable level, thus improving the reconciliation process.	4th / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005

Table III. Section 2 Material Weaknesses – Ongoing (Continued)		
Financial Material Weaknesses (Continued)	**Major Corrective Action(s)** ***A sample of the actions is presented.***	**Indicates Completed or Milestone Date** **Qtr/FY**
5. 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) **First Reported: FY 1999**	✓ Updated procedures on how to reconcile DoD balances with the Treasury balances.	Completed
	✓ Conducted the first Department-wide conference highlighting business rules.	Completed
	✓ Expand systems solutions for Treasury reporting.	4th / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005
6. Telecommunication invoices are not always certified and obligations are not pre-validated prior to payment. (Defense Finance and Accounting Service) **First Reported: FY 2001**	✓ Began summary certification process for the Defense information telecommunications.	Completed
	✓ Receive from the Defense Information Telecommunications leadership a formal decision on how to account for the receipt of telecommunication services.	1st / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005
7. Accounts receivable and accounts payable need to be actively managed and reduced to acceptable levels. (Defense Logistics Agency) **First Reported: FY 2002**	✓ Issued standard guidance and procedures for managing accounts receivables and payables.	Completed
	✓ Collected, wrote-off, or closed-out supportable and valid account receivables over two years old except for certain categories.	Completed
	✓ Implement a plan to liquidate valid over aged accounts payable and write-off invalid payables.	1st /2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005
8. 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) **First Reported: FY 2004**	✓ Standardized the procedures for suspending retirement payments when Department suspects the retiree has died.	Completed
	✓ Improved documentation of procedures.	Completed
	✓ Train customer service representatives to differentiate between an account suspended due to death rather than for other reasons.	1st / 2005
	✓ Automate processes for using existing records to determine if payment should be made.	3rd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 3rd Quarter, FY 2005**	3rd / 2005

Table III. Section 2 Material Weaknesses – Ongoing (Continued)		
Financial Material Weaknesses (Continued)	**Major Corrective Action(s)** *A sample of the actions is presented.*	**Indicates Completed or Milestone Date Qtr/FY**
9. 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) **First Reported: FY 2004**	✓ A team was established from all the Services to work in concert with finance for a viable solution to the varied problems.	Completed
	✓ Begin implementing forward compatible pay.	2nd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 3rd Quarter, FY 2005**	3rd / 2005
10. 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 and Accounting Service) **First Reported: FY 2004**	✓ Reviewed current business practices.	Completed
	✓ Establish a plan of action.	1st / 2005
	✓ Implement metrics to measure magnitude of problem and impact of corrective actions.	2nd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 2nd Quarter, FY 2006**	2nd / 2006
11. 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) **First Reported: FY 2004**	✓ Established control mechanisms to confirm receipt of payment data.	Completed
	✓ Developed and distributed standard operating procedures.	Completed
	✓ Initiated system change requirements to automatically compare receipt data in the supply system to payment data.	Completed
	✓ Implement system change.	1st / 2005
	✓ Validate system change and implement corrections as necessary.	1st / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 3rd Quarter, FY 2005**	3rd / 2005
12. 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) **First Reported: FY 2004**	✓ Implemented a daily validation process that compares invoice data to payment data.	Completed
	✓ Modify the contract pay certification process.	2nd / 2005
	✓ Pursue data mining techniques to enhance and automate the comparison of invoices to payments.	2nd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005

Table III. Section 2 Material Weaknesses – Ongoing (Continued)		
Non-Financial Material Weaknesses	**Major Corrective Action(s)** ***A sample of the actions is presented.***	**Indicates Completed or Milestone Date** **Qtr/FY**
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) **First Reported: FY 2002**	✓ Completed the inventory of the enterprise information technology hardware and established a mechanism to maintain it.	Completed
	✓ Publish a capital planning and investment guide that incorporates the portfolio management, enterprise architecture requirements, and information management.	2nd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 3rd Quarter, FY 2005**	3rd / 2005
14. Procedures are not always adequate to ensure that the prices paid for contracts are reasonable. (Defense Logistics Agency) **First Reported: FY 2001**	✓ Conducted reviews to ensure proper documentation of "price-reasonableness."	Completed
	✓ Conduct a management review to assess performance.	1st / 2005
	✓ Validate that the weakness is corrected. **Correction Target date: 2nd Quarter, FY 2005**	2nd / 2005
15. Payments for fuel charges incurred as part of the DoD Fleet Card have been delinquent. (Defense Logistics Agency) **First Reported: FY 2002**	✓ Established an integrated process team for oversight of program management.	Completed
	✓ Establish periodic audit procedures. Develop a plan to ensure oversight responsibilities are adequate.	1st / 2005
	✓ Establish and implement a formal training program for program coordinators and end-users.	1st / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 1st Quarter, FY 2005**	1st / 2005
16. Controls for assessing which employees can receive mass transit benefits are not always adequate. (Defense Logistics Agency) **First Reported: FY 2003**	✓ Obtained Union agreement on mass transit benefits.	Completed
	✓ Validate parking decals. Certify employee participation against the Department of Transportation database.	1st / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 1st Quarter, FY 2005**	1st / 2005
17. The Russian Federation failed to honor commitments associated with the Cooperative Threat Reduction Program. (Defense Threat Reduction Agency) **First Reported: FY 2002**	✓ The Russian Federation has signed the amendments for storage security, weapons transportation security, and chemical weapon elimination.	Completed
	✓ Work with Russian Federation to ensure plans are prepared for further reduction of nerve agents.	3rd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 3rd Quarter, FY 2005**	3rd / 2005

Table III. Section 2 Material Weaknesses – Ongoing (Continued)		
Non-Financial Material Weaknesses (Continued)	**Major Corrective Action(s)** ***A sample of the actions is presented.***	**Indicates Completed or Milestone Date** **Qtr/FY**
18. Existing controls did not ensure that incidents of sexual assault among the cadet population were prevented or reported. (Department of the Air Force) **First Reported: FY 2003**	✓ Completed 138 of 165 corrective actions. Incorporated training to improve the gender climate.	Completed
	✓ Implement remaining action items.	1st / 2005
	✓ Conduct unit compliance inspections to review institutional response to sexual assault and compliance within the instructions.	2nd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005
19. Controls over management of spare parts were not always adequate to meet the warfighter mission. (Department of the Air Force) **First Reported: FY 1999**	✓ 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 the Air Force guidance.	Completed
	✓ Initiated a management plan to enhance spare parts support and identify systematic supply shortfalls.	Completed
	✓ Determined the total spares parts requirement for FY 2004 Program Objective Memorandum.	Completed
	✓ Revised the requirements computation systems to provide more accurate consumption patterns.	Completed
	✓ Included the total spare parts requirement in the FY 2004 Program Objective Memorandum submission.	Completed
	✓ Compare the projected spare part requirements to actual and determine effectiveness of forecasting tools and other corrective actions. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005
20. 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 the awareness of air hazards around aircraft operations. Developed the Department of the Air Force multi-Service training.	Completed
	✓ Revise guidance to include base-level responsibilities, identify a waiver approval process for construction within the clear zones, and encourage each installation to delegate a program manager.	3rd / 2005
	✓ Re-evaluate the Air Installation Compatible Use Zone Program.	2nd / 2006
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2006**	4th / 2006

Table III. Section 2 Material Weaknesses – Ongoing (Continued)		
Non-Financial Material Weaknesses (Continued)	**Major Corrective Action(s)** *A sample of the actions is presented.*	**Indicates Completed or Milestone Date Qtr/FY**
21. 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) **First Reported: FY 2002**	✓ Developed policies and procedures.	Completed
	✓ Legal review of the regulation changes.	1st / 2005
	✓ Publication of the regulatory guidance.	2nd / 2005
	✓ Audit review to validate the effectiveness of corrective actions. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005
22. Current processes for managing workload, linking workload to dollars required, or predicting future manpower requirements have not been established. (Department of the Army) **First Reported: FY 1997**	✓ Validated the missions. Refined the linkage between operating and generating forces.	Completed
	✓ Analyze workload for peacetime and wartime. Link the workload to the operating force.	2nd / 2005
	✓ Ensure that there is accurate documentation to validate the manpower requirements in the official record called the "Table of Distributions and Allowances."	4th / 2005
	✓ Issue a change to the regulation on the approval authority for manpower requirement determinations.	4th / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005
23. 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
	✓ Revised training and readiness reporting procedures to ensure accuracy and consistency.	Completed
	✓ Develop an installation readiness assessment system to support and sustain forces.	3rd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005
24. 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
	✓ Used computer software to develop more effective and efficient delivery techniques to provide instruction.	Completed
	✓ Transition to a curriculum module within the Training Information Management System, which will enable quantitative tracking and analysis.	4th / 2006
	✓ Validate that the weakness is corrected. **Correction Target Date: 1st Quarter, FY 2007**	1st / 2007

Table III. Section 2 Material Weaknesses – Ongoing (Continued)		
Non-Financial Material Weaknesses (Continued)	**Major Corrective Action(s)** *A sample of the actions is presented.*	**Indicates Completed or Milestone Date Qtr/FY**
25. Better management of Active and Reserve recruiting functions is needed to maintain a ready force. (Department of the Navy)	✓ Ensured that the recruiter and classifier errors are corrected or waived in a timely and efficient manner.	Completed
	✓ Validate the corrective measures using an on-site verification.	1st / 2005
First Reported: FY 2001	**Correction Target Date: 1st Quarter, FY 2005**	
26. 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
First Reported: FY 2003	✓ Correct the mobilized unit identification codes.	1st / 2005
	✓ Correct any disconnects between mobilization orders and the data entry.	2nd / 2005
	✓ Interface between the global command and control system and the mobilization deployment integration system to obtain the on-hand data.	2nd / 2006
	✓ Validate that the weakness is corrected.	4th / 2006
	Correction Target Date: 4th Quarter, FY 2006	
27. Lack of sufficient controls to ensure regulation compliance, information management, and records management. (National Reconnaissance Office)	✓ Designed and developed a training program.	Completed
First Reported: FY 2004	✓ Develop a comprehensive plan, budget to address issues, and correct them.	1st / 2005
	✓ Develop and implement records management program.	3rd / 2005
	✓ Design and implement additional specialized training.	1st / 2006
	✓ Synthesize the file plan and records control schedule.	2nd / 2006
	✓ Develop and implement pilot audit and evaluation program.	1st /2007
	✓ Validate that the weakness is corrected.	1st / 2007
	Correction Target Date: 1st Quarter, FY 2007	
28. 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)	✓ Develop draft strategies and implement risk management plans.	1st / 2005
	✓ Submit draft strategies and plans for review and approval.	1st / 2005
	✓ Complete actions required for a clearly defined strategies and implementation plans.	2nd / 2005
	✓ Validate that the weakness is corrected.	2nd / 2005
First Reported: FY 2004	**Correction Target Date: 2nd Quarter, FY 2005**	

Table III. Section 2 Material Weaknesses – Ongoing (Continued)		
Non-Financial Material Weaknesses (Continued)	**Major Corrective Action(s)** *A sample of the actions is presented.*	**Indicates Completed or Milestone Date Qtr/FY**
29. 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
	✓ Developed checklists for validation.	Completed
	✓ Deploy automated application and conduct assessment visits.	4th / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2006**	4th / 2006
30. 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 financial requirements. (Defense Security Cooperation Agency) **First Reported: FY 2004**	✓ Review and coordinate changes to regulations.	3rd / 2005
	✓ Publish handbook.	2nd / 2006
	✓ Validate that the weakness is corrected. **Correction Target Date: 2nd Quarter, FY 2006**	2nd / 2006
31. 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
	✓ Published policy and procedures guidance.	Completed
	✓ Complete validation of policy and procedures and publish final policy.	2nd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 2nd Quarter, FY 2005**	2nd / 2005
32. 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) **First Reported: FY 2004**	✓ Developed a program management training course.	Completed
	✓ Held two pilot training sessions for module 1, which addressed planning and documentation for milestone decision authority review and approval.	Completed
	✓ Hold module 1 training session.	1st / 2005
	✓ Hold pilot training session for module 2, which will address contract and project execution, control and close-out.	2nd / 2005
	✓ Hold module 2 training session.	2nd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 3rd Quarter, FY 2005**	3rd /2005

Table III. Section 2 Material Weaknesses – Ongoing (Continued)		
Non-Financial Material Weaknesses (Continued)	**Major Corrective Action(s)** *A sample of the actions is presented.*	**Indicates Completed or Milestone Date** **Qtr/FY**
33. Inadequate controls to ensure that secondary item repair costs were properly budgeted. (Department of the Air Force) **First Reported: FY 2004**	✓ Developed instructions addressing responsibilities for validating sources of repair used in preparing budgets.	Completed
	✓ Publish revised secondary item repair costs instructions.	2nd / 2005
	✓ Incorporate new procedures in automated budget system to support budget development.	3rd / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005
34. 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 group.	Completed
	✓ Issue detailed documentation requirements and policy.	4th / 2005
	✓ Issue policy decision on freight tracking system.	4th / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2006**	4th / 2006
35. Controls were not always adequate to ensure accountability of automated data processing equipment. (United States Pacific Command) **First Reported: FY 2004**	✓ Disciplinary actions initiated to correct personnel performance issues.	Completed
	✓ Appointed custodians to assist in managing and tracking equipment.	Completed
	✓ Perform 100% wall-to-wall inventory.	4th / 2005
	✓ Validate that the weakness is corrected. **Correction Target Date: 4th Quarter, FY 2005**	4th / 2005
36. Manpower challenges impact the mission accomplishment of military intelligence operations. (Office of the Under Secretary of Defense (Intelligence)) **First Reported: FY 2004**	✓ Identified manpower requirements.	Completed
	✓ Developed documentation for manpower requirements.	Completed
	✓ Validating manpower data to correct weakness. **Correction Target Date: 2nd Quarter, FY 2005**	2nd / 2005
37. 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**	✓ Obtain approval of a transformation roadmap.	1st / 2005
	✓ Publish revised DoD Directive.	2nd / 2005
	✓ Publish DoD Instruction.	3rd / 2006
	✓ Validate that the weakness is corrected. **Corrected Target Date: 4th Quarter, FY 2006**	4th / 2006

Table IV. Section 4 Systemic Weaknesses -- Ongoing	
Description of Issue	**1. DoD 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.
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. B. Planned Milestones for FY 2005: • Complete the Business Enterprise Architecture (BEA) Increment #1, which includes business processes in support of an unqualified audit opinion. • Perform targeted portfolio management reviews as part of the FY 2005 through FY 2006 planning, programming, and budgeting process. C. Planned Milestones for Beyond FY 2005: • Complete BEA Increment #2, which focuses on business processes that support acquisition practices, total asset visibility, accurate valuation of assets, military health care delivery, and environmental safety and occupational health. • Complete BEA Increment #3, which focuses on business processes that support the planning, programming, budgeting and execution, total force management, and installations management. • Complete targeted portfolio management reviews, which are part of the Department's planning, programming, budgeting, and execution process. **Correction Target Date: 4th Quarter, FY 2007**

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act requires federal agencies to conform to the United States 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 does not fully comply with these requirements. However, as part of the Business Management Modernization Program, the Department teamed with IBM to develop an initial version of the business enterprise architecture in April 2003 to help transform business processes and systems. The architecture helps describe how the Department's business processes and systems will integrate to ensure accurate and timely financial information is readily available for decision makers. When the architecture is fully implemented, the Department expects to meet all the requirements of this Act.

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, 2004, the Department had 212 audit reports open for more than 1 year. We are implementing many of these recommendations and the savings are estimated to be $7.9 billion. The Department has already closed out and implemented recommendations from 130 audit reports in fiscal year 2004 with claimed monetary benefits of approximately $255 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 its programs and activities and identify those which may be susceptible to significant erroneous payments.

DoD's fiscal year 2004 survey did not identify any programs or activities where erroneous payments exceeded the established thresholds (i.e., an error rate greater than 2.5 percent and erroneous payments in excess of $10 million), nor were any found to be susceptible to significant risk. Although the Department is currently under these thresholds for all its programs and activities, the Office of Management and Budget established an additional requirement that all programs initially identified in Section 57, "Information on Erroneous Payments," of Circular A-11, perform all the prescribed steps outlined in its guidance. These steps include the production of a statistically valid estimate of the erroneous payments, implementing a plan to reduce the amount and reporting to the President and Congress on progress. For the Department of Defense, these programs are Military Health Benefits and Military Retirement. The results of the review of these programs are highlighted below.

Military Health Benefits. The military health benefits program has numerous prepayment and post payment controls built into the claims processing system to minimize improper payments.
One control is the claims edit system, which rebundles services that should be billed under a single code. Procedure unbundling occurs when two or more procedure codes are used to describe a service when a single comprehensive code exists that accurately describes all services performed. This is a poor practice, one that seeks to increase reimbursement.

An example of this practice is laboratory test unbundling. A laboratory can perform numerous tests from a single blood sample. Separate charges for each test inflates the billing, as illustrated here:

<u>Unbundled Billing</u>	
Cholesterol, serum (82465):	$ 6.98
Lipoprotein (HDL cholesterol) (83718):	$13.14
Triglycerides (84478):	<u>$ 9.24</u>
TOTAL:	**<u>$29.36</u>**
<u>Rebundled (Proper) Billing</u>	
Lipid panel (80061) (includes cholesterol, lipoprotein and triglycerides):	**<u>$21.50</u>**

A cost avoidance of $87.6 million was realized in fiscal year 2003 as a result of the military health benefits program rebundling edits. Anticipating that the trend will continue, the Department projects approximately a 10% increase in the amount of the cost avoidance for fiscal year 2004.

The Department projected $100.1 million of improper payments (underpayments and overpayments) for the military health benefits program – purchased care program – in fiscal year 2004. This represents an error rate of approximately 2.16% of the $4.6 billion in military health benefits program payments made during fiscal year 2004. The 2.16% is a preliminary payment error rate. The final payment error rate is not available until the administrative process associated with the audits has been completed, which is targeted for September 2005. Historically, the final figure has been less than the 2% threshold allowed by contract. In support of this position, last year's DoD Performance and Accountability Report listed the preliminary payment error rate for fiscal year 2003 as 1.36%. The final payment error rate for fee-for-service claims was 0.85%.

Although health benefit dollars are used to also pay for expenditures incurred under the U.S. Family Health Plans and other areas, these were not identified as being susceptible to significant erroneous payments. Therefore, they are excluded.

Military Retirement. The Department conducts various types of prepayment and postpayment reviews for military retirement payments. One example is that all payments more than $9,000 made to retirees and more than $5,500 made to annuitants are reviewed. Another example is a monthly review of the retired military pay file for similar social security numbers, which helps minimize duplicate payments.

The Department projected $34.1 million of improper payments (underpayments and overpayments) for the Military Retirement Program in fiscal year 2004. This represents an error rate of 0.0952% of the $35.8 billion in military retirement payments made during fiscal year 2004.

For further reporting details about the Improper Payments Information Act, see Appendix A.

President's Management Agenda


White House photo by Eric Draper

The Department continues to make progress accomplishing President George W. Bush's Management Agenda. The goal of this Agenda is to improve performance in five key federal management areas. 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.

Strategic Human Capital Management. Even though DoD is engaged in major endeavors overseas, transforming the Department continues to be a priority, as evidenced by the Department's efforts in seeking a National Security Personnel System. Without doubt the flexibility inherent in this system would enable the Department to respond to threats to national interests, while continuing to provide benefits to both DoD military and civilian personnel and link both basic pay and performance incentives directly to the performance measurement process. Further, DoD has developed a Human Resources Strategy which was "cascaded" throughout the Department to ensure that complementary actions are taken across the Department. During FY 2004, the Department also began preparing for the 2005 round of Base Realignment and Closure. Research was conducted to compare current DoD transition tools and outplacement activities to those used in private industry in an effort to minimize adverse effects on our mission and human resources. We instituted formal gap analyses of core mission and critical support occupations. These occupations are analyzed and reported quarterly. No significant gaps have been identified. The Department has also forwarded a Workforce Restructuring Plan to the Office of Management and Budget, describing the organizational plans to meet workforce needs.

Competitive Sourcing. The Department has a goal to compete 226,000 positions by year 2009. DoD far exceeded the Office of Management and Budget's goal of competing 67,800 positions by fiscal year 2004; more than 84,000 positions were competed with an estimated savings of $9.3 billion dollars. In addition, the Department has plans underway for competing more than 9,000 additional positions.

Improving Financial Performance. The Department has three primary initiatives underway to improve its financial performance: the Business Management Modernization Program, Financial Improvement Initiative, and the Financial Management Balanced Scorecard. These initiatives directly respond to financial improvement plans required by the Office of Management and Budget's guidance for the Chief Financial Officer Financial Management 5-Year Plan and Financial Management Systems Plan, as well as the Federal Financial Management Improvement Act's requirement for remediation plans.

Expanding Electronic Government. Of the 25 initiatives identified by the President's Management Council, 18 involve DoD activities. The Department is taking an active role in many of those initiatives. In conjunction with the Office of Management and Budget, the Department will improve management processes relating to the creation and description of business cases for information technology initiatives. The DoD Chief Information Officer is also working closely with Office of Management and Budget on other scorecard elements such as the enterprise architecture, business cases for information technology investments, program management, and security. During the past fiscal year, the Department improved a substantial number of business cases for information technology investments, and made progress on its integrated information technology architectures. The Department also strengthened its information technology security program. The Department is actively engaged with the General Services Administration in the Federal Smart Buy program, which is based on DoD's award-winning Enterprise Software Initiative that has achieved $1.6 billion in cost avoidance since its inception in 1998.

Budget and Performance Integration. The Department uses meaningful performance metrics in managing and justifying program resources. The year 2005 President's budget included performance metrics (to include a Program Assessment Rating Tool for 15 programs) for 40 percent of the Department's resources. Additional efforts are underway to integrate performance metrics into all phases of the Department's planning, programming, budgeting, and execution process.

Summary. The Office of Management and Budget scores the initiatives for each government agency. The scorecard employs a simple grading system: green for success, yellow for mixed results, and red for unsatisfactory. The Department's progress and current status ratings supporting the President's management goals in these five key federal management areas are depicted in the following chart. Further information is available at http://www.results.gov.

The Department cascaded the scoring process to the Services and Defense Agencies this year. The Department has empowered all defense organizations to apply the principles of the President's Management Agenda in a results-oriented manner for their benefit, thus ensuring Department-wide implementation and institutionalization.

The Department is making every effort to implement policies and procedures that accentuate efficiency and sound management principles. The Department is confident this will be reflected positively as it progresses through the coming years.

President's Management Agenda Initiative	Current Status	Progress
Strategic Human Capital Management	Yellow	Green
Competitive Sourcing	Green	Yellow
Improving Financial Performance	Red	Yellow
Expanding Electronic Government	Red	Green
Budget and Performance Integration	Yellow	Green

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Part 2:
Performance Information

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Performance Information

Annual Performance Goals and Results

In Part 1, Management Discussion and Analysis, we presented the year in review for the Department of Defense, including our Performance Highlights. Part 2, Performance Information, describes, in detail, more than 70 metrics in use or under development. They are organized by the Risk Management Framework introduced in Part 1.

Risk Management Framework

Our goal is to make sure investments across the Department are balanced among the four risk areas. Each quadrant of the risk management framework is associated with four outcome goals that define leading indicators of successful performance within that quadrant. By monitoring overall performance trends for these important indicators, we can better frame choices on how to balance risks and thus allocate resources across the entire Department.

Each outcome goal has corresponding metrics to track our performance in meeting these goals. They comprise the balance of Section 2, and are organized as follows:

Organization of Metrics

- **Risk Category**
  - **Outcome Goals**
    - **Performance or Activity metrics**

The metrics track two trends: *where we are* and *where we want to go*. Accordingly, we monitor metrics for both current outputs and developmental initiatives.

Our *performance metrics* track current outputs. They set quantitative, annual targets for performance that are measurable.

Sample Performance Metric

Performance Metric: Satisfaction With Military Health Care Plan	
FY 2003 Actual	FY 2004 Target/Actual
51.2%	≥ 56%/ 53%

Our *activity metrics* track developmental activities. They are usually qualitative and track key milestones or events in lieu of a specific annual performance target. Activities in the Department of Defense performance plan are initiatives to drive change – when complete, they will result in a new baseline or benchmark, define a new capability, or provide a new performance metric.

Sample Activity Metric

Activity Metric: Optimal Officer Career Patterns	
FY 2003	FY 2004
Phase I study complete. Started Phase II.	Published Phase I report.

More than half of the metrics in the FY 2004 performance plan are activity metrics—of those, 36 percent are designed to deliver a new capability in support of the Department's overall goal to transform U.S. forces for the 21st century. Finally, several metrics are labeled as "lagged" or "lagging." These are metrics for which data becomes available only after publication.

These same metrics and others under development enable a robust evaluation of the FY 2005 performance plan contained in the Annual Report to the President and the Congress.

Data Quality (Verification and Validation)

General: The Department of Defense is committed to providing clear and reliable data to those who use it for managing, decision-making and for oversight of DoD programs. The Department also ensures, to the greatest extent possible, the data is quantifiable and verifiable by putting in place internal management controls and by being responsive to the insights provided by the Department's Office of the Inspector General, the General Accounting Office, and others.

Data Integrity Systems and Controls: Performance data for most quantifiable measures are generated as a by product of DoD's routine operations. Surveyed satisfaction data is produced from statistically valid surveys. Accuracy measures come from validated automated systems and are periodically reviewed and analyzed for accuracy. New metrics or metrics under development will be subject to the same data quality requirements once the metric is established.

Detailed performance information is available at www.dod.mil/comptroller/par/fy2004/06-01_Detailed_Performance.pdf

Force Management Risk

Force Management Risk stems from issues affecting the ability to recruit, retain, train, and equip sufficient numbers of quality personnel and sustain the readiness of the force while accomplishing our many operational tasks.

Providing a trained and ready force is the leading *business* of the Department of Defense. The Department must employ the tools of modern commerce to better manage our military and civilian workforce—more flexible compensation packages, contemporary recruiting techniques, improved training.

DoD must guarantee the working and living conditions that will enable our people to perform at their best. The Department must take care of the future—seek out or create the skilled workforce demanded of a 21st century military force.

We must forge a new compact with war-fighters and those who support them, one that honors their service, understands their needs, and encourages them to make national defense a life-long career.

Secretary Rumsfeld, September 10, 2001

The four outcome goals for this risk management quadrant are:

- Maintain a Quality Force
- Ensure sustainable military tempo and maintain workforce satisfaction
- Maintain reasonable force costs
- Shape the force of the future

More than half the metrics supporting these outcome goals are performance metrics for recruiting and retention, health care, and quality of life. The remaining measures are activity metrics focused on improving recruiting and retention by refining tools to look at skills, grade and occupational category, attributes for civilian and military future skills, improving tempo monitoring tools, and developing additional cost indicators.

Outcome Goal: Maintain a Quality Force

A quality force is maintained when you recruit quality people and then retain your best. Longstanding metrics that help gauge aptitude, education, and retention, have helped the Department ensure America has the best force in the world. This outcome goal has eleven metrics.

Performance Metric: Active Component End Strength within 2% of Authorization

Service	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual*	FY 2004 Authorized[a]/ Actual[b]
Army	480,801 (+0.2%)	486,542 (+1.4%)	499,301 ***(+4.0%)***	482,400/ 500,203 ***(+3.7%)***
Navy	377,810 (+1.4%)	383,108 (+1.9%)	382,235 (+1.7%)	373,800/ 375,521 (+0.5%)
Marine Corps	172,934 (+0.2%)	173,733 (+0.7%)	177,779 (+1.6%)	175,000/ 176,202 (+0.7%)
Air Force	353,571 (-1.0%)	368,251 ***(+2.6%)***	375,062 ***(+4.4%)***	359,300/ 379,887 ***(+5.7%)***

[a]In accordance with the FY 2004 National Defense Authorization Act.
[b]The FY 2004 data are as of the 3rd quarter.

Metric Description. Service end strength authorizations are set forth in the National Defense Authorization Act (NDAA) for the fiscal year. Services are required to budget and execute to that end strength by the end of the fiscal year. The Services' actual end strength for each quarter will be evaluated against the authorized strength for that fiscal year. By law, the Service Secretaries may authorize operating up to two percent above the authorized end strength, and the Secretary of Defense may authorize Services to be up to three percent above their authorized end strength for that fiscal year, if determined to be in the national interest. Last year was the first year that quarterly comparisons were made.

Performance Results for FY 2004. The nation continued to operate in a state of National Emergency by Reason of Certain Terrorist Threats in FY 2004. Consequently, the end strength requirements were waived. The Army and Air Force exceeded the three percent criterion again, while the Navy and Marine Corps ended the third quarter within the two percent criterion. In the spring of 2004, the Army received permission from the Secretary of Defense to operate with 512,400 troops, or 30,000 more than authorized. The Air Force instituted two phases of force shaping in FY 2004 to reduce its operating strength; these programs, combined with a programmed reduced accession mission, will allow Air Force to end FY 2005 at the authorized strength level.

Performance Metric: Reserve Component Selected Reserve End Strength (Congressionally Authorized End Strength)

Reserve Component	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Authorized/ Actual [a]
Army National Guard (ARNG)	351, 829 (+0.4%)	351,078 (+0.3%)	351,091 (+0.3%)	350,000/ 342,970 (-2%)
Army Reserve (USAR)	205,628 (+0.2%)	206,682 (+0.8%)	211,890 ***(+3.4%)***	205,000/ 210,630 ***(+2.7%)***
Navy Reserve (USNR)	87,913 (-1.1%)	87,958 (+1.1%)	88,156 (+0.4%)	85,900/ 82,711 ***(-3.7%)***
Marine Corps Reserve (USMCR)	39,810 (+0.6%)	39,905 (+0.9%)	41,046 ***(+3.8%)***	39,600/ 40,127 (+1.3%)
Air National Guard (ANG)	108,485 (+0.4%)	112,075 ***(+3.4%)***	108,137 (+1.4%)	107,030/ 106,781 (-0.2%)
Air Force Reserve (USAFR)	74,869 (+0.7%)	76,632 ***(+2.6%)***	74,754 (-1.1%)	75,800/ 74,369 (-1.9%)
Coast Guard Reserve (USCGR)	7,976 (-0.3%)	7,816 ***(-2.3%)***	7,720 ***(-14.2%)***	10,000/ 7,729 ***(-22.7%)***

[a]The data provided in the FY 2004 column above represents actual results for the fiscal year as of 3rd quarter.

Metric Description. End strength authorizations for each of the seven Reserve components are set forth in the National Defense Authorization Act (NDAA) for the fiscal year. Components are compelled to budget and execute to that end strength by the end of the fiscal year. The component actual end strength for each quarter will be evaluated against the authorized end strengths for that fiscal year. By law, the Secretary of Defense may authorize the components to vary, by no more than 2 percent, their authorized end strength for that fiscal year, if determined to be in the national interest. It should be noted that while under partial mobilization, the Secretary may, as authorized by the President, waive all end strength limitations, if deemed appropriate.

Performance Results for FY 2004. In his Declaration of National Emergency by Reason of Certain Terrorist Threats, the President, among other things, waived the end strength limitations during the time of national emergency. Components, however, have been directed by the Secretary to attempt to meet the 2 percent criterion, though exceptions are authorized based on the operational situation. As of the end of the 3rd quarter of this fiscal year, four components are at, or exceed, the 2 percent variation. Three of those four components are under their authorizations. The primary reason for the shortfall in strength for these three components is a shortfall in recruiting. However, this is by design in the Navy Reserve because the Navy Reserve is downsizing by almost 10,000 people over the next 5 years, with a 2,500 reduction in FY 2005. Also, the Coast Guard Reserve shortfall appears to be exaggerated because of certain strength accounting rules. The Coast Guard Reserve actually has another 1,022 members who are not counted in their strength, but are being counted in the Active Coast Guard strength because of those accounting rules. Additionally, the Coast Guard Reserve budgeted for an end strength of 8,052 instead of the Congressionally authorized 10,000, which makes their end strength achievement seem very low. Finally, the Coast Guard Reserve comes under the new Department of Homeland Security (DHS) and not the Department of Defense (DoD). One component (the Army Reserve) currently exceeds the 2 percent variance goal at +2.7 percent of authorized. The primary reason is directly attributed to the ongoing mobilization. Based on budgeted manpower ramps, the current end strength status may approximate year-end data.

Performance Metric: Active Component Enlisted Recruiting Quality

Category	FY 2001 Actual[a]	FY 2002 Actual[a]	FY 2003 Actual[a]	FY 2004 Target/Actual [b]
Percentage of recruits holding high school diplomas (Education Tier 1)	93	94	95	≥90 / 97
Percentage of recruits in AFQT categories I–IIIA	66	70	72	≥60 / 76
Percentage of recruits in AFQT category IV	1	0.7	0.2	≤4 / 0.2

NOTE: AFQT = Armed Forces Qualification Test. The AFQT is a subset of the standard aptitude test administered to all applicants for enlistment. It measures math and verbal aptitude and has proven to correlate closely with trainability and on the job performance.

[a] Official High School Diploma Graduates performance excludes 4,000 participants in the Army's GED+ pilot program, therefore the actual numbers were adjusted to reflect this factor.

[b] The data provided in the FY 2004 column are as of 3rd quarter.

Metric Description. DoD measures recruiting quality along two dimensions – aptitude and educational achievement of non-prior service recruits. All military applicants take a written enlistment test called the Armed Services Vocational Aptitude Battery (ASVAB). One component of that test is the Armed Forces Qualification Test, or AFQT, which measures math and verbal skills. The table below shows how AFQT percentiles are grouped into categories:

Armed Forces Qualification Test (AFQT) Categories and Corresponding Percentile Score Ranges

AFQT Category	Percentile Score Range
I	93–99
II	65–92
IIIA	50–64
IIIB	31–49
IV	10–30
V	1–9

As shown in the table, those who score at or above the 50th percentile on the AFQT are in categories I-IIIA (CAT I-IIIA). DoD values these higher-aptitude recruits because their training and job performance are superior to those in the lower categories (Category IIIB-IV). DoD also values recruits with a high school diploma because years of research and experience tell us that high school diploma graduates are more likely to complete their initial term of service. Quality benchmarks for recruiting were established in 1992 based on a study conducted jointly by the Department of Defense (DoD) and the National Academy of Sciences.[1] The study produced a model linking recruit quality and recruiting resources to the job performance of enlistees. Based on this study, the Department adopted minimum acceptable quality thresholds: 90 percent in education tier 1 (primarily high school graduates), 60 percent in AFQT categories I–IIIA. The Department does not accept more than 4 percent in AFQT category IV, and does not recruit from category V. Adhering to these benchmarks reduces personnel and training costs, while ensuring the force meets high performance standards.

Performance Results for FY 2004. Through June

[1] *Modeling Cost and Performance for Military Enlistment.* National Research Council, Commission on Behavioral and Social Sciences and Education, Committee on Military Enlistment Standards; Bert F. Green, Jr. and Anne S. Mavor, editors; National Academy Press, Washington; 1994

2004, all Active components are on course to meet or exceed their recruiting quality goals for FY 2004, as they did in FY 2003. The next fiscal year, FY 2005, may be more challenging in a war-time environment with an expanding economy, and a depleted delayed-entry pool of applicants.

Performance Metric: Reserve Component Enlisted Recruiting Quality

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/ Actual[c]
Percentage of recruits holding high school diplomas (Education Tier 1)	89	89	87	≥90/88%[a]
Percentage of recruits in AFQT categories I–IIIA	64	66	66	≥60/66%[b]
Percentage of recruits in AFQT category IV	1	1.1	1.5	≤4/1.4%

NOTE: AFQT = Armed Forces Qualification Test. The AFQT is a subset of the standard aptitude test administered to all applicants for enlistment. It measures math and verbal aptitude and has proven to correlate closely with trainability and on the job performance.

[a] Excludes Navy Reserve and Air National Guard; see discussion in Performance Results paragraph.

[b] Excludes Navy Reserve; see discussion in Performance Results paragraph.

[c] The data provided in the FY 2004 column are as of 3rd quarter (estimate).

Metric Description. Like the active component, the reserve component maintains quality benchmarks of at least 90 percent in education tier 1 (primarily high school graduates), 60 percent in AFQT categories I–IIIA (top 50 percentiles), and not more than 4 percent in AFQT category IV.

Performance Results for FY 2004. The Reserve components, in the aggregate, are meeting their AFQT I-IIIA goal, but not their Tier 1/High School Diploma Graduate (HSDG) goal for enlisted recruit quality in FY 2004. Moreover, all are facing significant recruiting challenges. More emphasis is being placed on the non-prior service market as the number of individuals affiliating with the Reserve components following active duty service has decreased. The Air National Guard and the Navy Reserve continue to improve in reporting recruit quality data. Efforts are ongoing to correct these data issues. Both of these components have historically far exceeded the DoD benchmarks, and we are confident that is still the case. The Army National Guard continues to struggle to meet the Department's quality benchmark for high school diploma graduates. DoD is working with the Army National Guard to examine this issue. The Army National Guard recruit quality will likely continue to remain below the DoD benchmark for the next several years.

Performance Metric: Active Component Enlisted Recruiting Quantity

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual[a]	FY 2004 Target[b] /Actual[c]
Number of enlisted Active Component accessions	196,355	196,472	184,879	181,360/ 128,900

[a] FY 2003 Actual has been adjusted by two to reflect finalized data.

[b] FY 2004 target has changed since last report because of changes in requirements and recruiting behavior.

[c] The data provided in the FY 2004 column are as of the 3rd quarter.

Metric Description. Department-wide targets for active duty enlisted recruiting represent the projected number of new Service members needed each year to maintain statutory military end strengths and appropriate distributions by rank, allowing for discharges, promotions, and anticipated retirements. As personnel trends change during the year, Active component recruiting objectives may be adjusted.

Performance Results for FY 2004. Through June 2004, all Active components are on course to meet or exceed their recruiting quantity goals for FY 2004. Delayed-entry program levels are somewhat depleted, suggesting FY 2005 will be challenging.

Performance Metric: Reserve Component Enlisted Recruiting Quantity

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Annual Tgt/ Actual[a]
Number of enlisted Reserve Component accessions	141,023	147,129	133,075	126,410[b]/ 88,266

[a]The data provided in the FY 2004 are as of the 3rd quarter

[b]Army Reserve and National Guard and Navy Reserve have adjusted their FY 2004 targets downward because trends changed during FY 2003. Therefore, the DoD-wide target decreased from the 139,523 previously reported to 126,410.

Metric Description. Department-wide targets for reserve component enlisted recruiting represents the projected number of new Service members needed each year to maintain statutory military end strengths and appropriate distributions by rank, allowing for discharges, promotions, and anticipated retirements. As personnel trends change during the year, Reserve component recruiting objectives may be adjusted.

Performance Results for FY 2004. Three of the six Reserve components have met or exceeded their FY 2004 year-to-date numeric recruiting goals. Overall, the Reserve components recruited 88,266 through June against a goal of 92,491, or 95 percent of their mission. In a difficult recruiting environment, made more difficult by significantly smaller numbers of individuals who affiliate with the Reserve components following separation from the Active force, the Army National Guard, Air National Guard or Air Force Reserve have failed to achieve their numeric goal. The Department expects that all Reserve components except the Army National Guard will achieve their FY 2004 goal by the end of the fiscal year.

Activity Metric: Manning Levels of Critical Skills

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
The percentage of skills that are deemed critical for retention relative to a DoD-wide benchmark.	No historical data: new metric		Started to define critical skills Services developed list of critical skills	Established common definition for critical skill Tested data collection

[a] The FY 2004 data are final.

Metric Description. The Department is developing a way of measuring how effective we are at recruiting and retaining the military skills most critical to our mission. As a first step, the Department established a common definition and metric to monitor critical skills across the Services. The next step is to test both our data collection methods and the effectiveness of the metric in monitoring manning levels.

To be designated as "critical," a skill must meet two tests: (1) it must be short of its targeted manning and (2) it must be critical to the Service's mission. The metric we are developing monitors each Service's ability to retain members in its top ten critical skills. If the Service retains 95 percent or more of its desired goal for a particular skill, it will be deemed "Green." If the Service retains 86 percent to 94 percent of its goal for a particular skill, it will be deemed "Yellow." If it retains 85 percent or less of its goal for a particular skill, it will be deemed "Red." The Service's overall rating will be no higher than its lowest rated designated critical skill.

Ongoing Research. In fourth quarter FY 2004, Services provided test data for this metric. This test collected information on the top ten most critical skills that meet both parts of the "critical" definition of shortage and mission criticality, as well as data about how well the Service is meeting retention goals for each skill category, and overall manning for each skill. The Department is working to refine the metric definition and its data collection methods.

Timeline for Completion. Beginning in FY 2005, this metric will be added to the monthly Status of Forces review conducted by the Under Secretary of Defense for Personnel and Readiness.

Performance Results for 2004. The Office of Secretary of Defense and Service points of contact refined data collection procedures in July 2004; the Services tested data collection methods in August 2004.

Performance Metric: Critical Skill Recruit Needs

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual [a]
Percentage of accession mission met for all skills	No historical data: new metric			≥95% fill for all skills / 4 of the 63 designated skills (6%) filled less than 95%

Notes:

1. Accession missions for each skill are set by the Services based upon required manning levels in the current and future force and expected losses in training.
2. Data was not collected for this metric prior to FY 2004.

[a] The data provided in the FY 2004 column are as of 3rd quarter.

Metric Description. The Department is now implementing a "critical skill recruit needs" metric. Each Service will annually identify the 10 percent of their skills that are most critical for their recruiting force to focus on in the coming year. At this time, the metric is only applied to active duty enlisted recruits.

"Critical skill recruit needs" receive extra recruiting emphasis though such tools as enlistment bonuses, college funds, and incentives to recruiters. The skill must meet one or more of the following criteria:

- Is crucial to combat readiness
- Is undermanned in the force
- Has unfilled training class seats
- Requires a high volume of recruits
- Has much higher entrance standards than most skills
- Is considered undesirable duty by most recruits

The exact fill rate for each skill will be measured, and each Service will be rated based on the recruit rate of its lowest skill rating.

The working group has initially set its target for recruiting critical skills somewhat above the level applied to determine whether units are "Fully Mission Capable," deciding to rate each skill as "Green" if its recruiting fill is 95 percent or above; "Yellow" if its recruiting fill is 85 percent to 94 percent; and "Red" if its recruiting fill is 84 percent or below. This is an ambitious rating scale and reflects an assumption that operational units will be best equipped to achieve the desired skill match levels if the recruiting system ensures even greater precision in the job mix of each accession cohort. The Department will reassess this issue as our understanding of the process matures.

Performance Results for FY 2004. This measure is new for FY 2004, so predicting the final FY 2004 outcome from third quarter data is difficult. As of the end of third quarter, 4 of 63 designated skills were filled to less than 95 percent. The understanding that our target was very ambitious and all specialties deemed critical skill recruit needs are challenging recruiting tasks, leads us to project from third quarter results that some specialties will not be filled to the desired 95 percent level by year's end.

Performance Metric: Active Component Enlisted Retention Goal

Service	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual[b]	FY 2004 Annual Target /Actual[b,c]
Army				
Initial	20,000	19,433	21,838	23,000/19,782
Mid-career	23,727	23,074	19,509	20,292/16,538
Career	21,255	15,700	12,804	12,808/10,972
Navy				
Initial	56.9%	58.7%	61.8%	56%/57.9%
Mid-career	68.2%	74.5%	76.7%	70%/72.9%
Career	85.0%	87.4%	87.9%	85%/87.8%
Marine Corps				
First term	6,144[a]	6,050	6001	5,990/5,860
Subsequent	5,900[a]	7,258	5815	5,628/6,751
Air Force				
First Term	56.1%	72.1%	60.5%	55%/67%
Mid-career	68.9%	78.3%	72.9%	75%/73%
Career	90.2%	94.6%	95.2%	95%/97%

[a] In FY 2001, the Marine Corps established numeric goals for retention and established subsequent term goals for the first time.

[b] The Services are allowed (due to the National Emergency) to operate with the strength required to prosecute the war on terror. Because of Operation Iraqi Freedom and Operation Enduring Freedom, the Services decided to operate at a higher level than they had planned at the beginning of the year. To get to this higher strength, they increased the retention goals. The Services use retention and recruiting as two levers they can adjust to hit the desired end strength. So, if recruiting is falling short, they increase retention goals. Similarly, if retention is falling short, they may choose to increase recruiting goals. In this case, they chose to adjust retention goals to operate at desired operational strength.

[c] The data provided in the FY 2004 column are as of the 3rd quarter.

Definitions:
Army: Mid-career: 7 to 10 years of service (YOS); career: 10 to 20 YOS
Navy: Mid-career: 6+ to 10 YOS; career 10+ to 14 YOS
Air Force: Mid-career: 6 to 10 YOS; career 10 to 14 YOS

Metric Description. The Services determine, within the zone of eligibility, their annual retention goals. Each Service is given latitude in how they establish their categories, goals within each category, and methods for tracking attainment of those goals. For that reason, two metrics are used: number of people retained (used by the Army and Marine Corps) and the percentage of eligible people retained (used by the Air Force and Navy). The annual goals for either metric are dynamic and can change during the year of execution.

Performance Results for FY 2004. All Services are on track to achieve FY 2004 retention goals. Nonetheless, we are watchful for indications of a downturn. The Department's systematic review of leading indicators for retention is an important business practice to allow for adequate time to adjust resources and meet retention challenges. The Army is pursuing constructive levers (Force Stabilization policy initiatives, reenlistment bonus program updates, and targeted special pays) to influence soldiers and families to reenlist. Through July 2004, approximately 6,700 soldiers have taken advantage of the Present Duty Assignment Selective Reenlistment Bonus by reenlisting to stay with units in Afghanistan, Iraq, or Kuwait. While the Army is using constructive levers to increase retention, the Navy and Air Force are using force-shaping programs to reduce the active duty end strength and retention. The Department expects all Services to meet or exceed retention goals for FY 2004.

Performance Metric: Selected Reserve Component Enlisted Attrition Ceiling

Selected Reserve Component	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Ceiling/ Actual[a]
Army National Guard	20.0	20.6	18.1	18.0/14.1
Army Reserve	27.4	24.6	22.1	28.6/15.6
Navy Reserve	27.6	26.5	26.5	36.0/21.8
Marine Corps Reserve	26.4	26.0	21.4	30.0/21.0
Air National Guard	9.6	7.3	12.7	12.0/9.0
Air Force Reserve	13.4	8.7	17.0	18.0/10.3

[a] The data provided in the FY 2004 are as of the 3rd quarter.

Note: All numbers are percentages representing total losses divided by average strength.

Metric Description. In assessing retention trends in the Reserve components, we use attrition rather than retention rates. Attrition is computed by dividing total losses from the Selected Reserve of a specific component for a fiscal year by the average personnel strength of that component's Selected Reserve for that year. This metric is preferable to retention rates because only a small portion of the Reserve component population is eligible for reenlistment during any given year. In addition to monitoring attrition, we have established annual attrition ceilings for Reserve component personnel. These ceilings, which took effect in FY 2000, represent the maximum number of losses deemed acceptable in a given fiscal year.

Performance Results for FY 2004. The Presidential Declaration of National Emergency by Reason of Certain Terrorist Threats, and accompanying Executive Order, gave the Military Departments the authority to implement "stop loss" programs. They remain in effect as the global war on terror and operations in Iraq continue. The only Military Department pursuing a “stop loss” program is the Army. Depending on the number of members mobilized, this influences attrition rates, since mobilized Army Reserve component members are subject to “stop loss” for the duration of their mobilization, plus a transition period of 90 days after demobilization. Reserve component enlisted attrition remains strong and is well within acceptable limits. There is nothing remarkable or unexpected in attrition figures to date. However, continued vigilance is prudent, especially considering the large rotation of troops in Iraq during FY 2004 and the ongoing Army “stop loss” program.

Activity Metric: Retain Balanced Mix of Non-Commissioned Officer (NCO) Grade/Experience

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004
Number of skills/ experiencing deficiencies Top ten enlisted occupational groups.	No historical data: new metric		Services established a promotion-timing benchmark for 10 most critical enlisted occupational specialties	Completed study of Service retention metrics Began policy revisions to establish a tie between grade and experience

Metric Description. The metric will measure the number occupational skills or groups experiencing deficiencies. The metric will account for grade requirements and the supply of experience emerging from promotion and retention programs. It will also account for promotion bottlenecks that hinder retention. The performance metric will monitor the top ten enlisted occupational skills/groups that fall outside Service-defined promotion boundaries which include the amount the enlisted member has been in the service (time-in-service), and the time the member has been in his or her grade (time-in-grade). Annual goals are dynamic and can adjust from year to year. The goal for this metric is to minimize skill and experience deficiencies. Though a challenging goal, the information is very useful for evaluating our experience and skill mix and to determine where emphasis should be placed in our professional development, promotion, and retention programs.

Ongoing Research. In support of the DoD Military Personnel Human Resources Strategic Plan, the Department is assessing the Services’ current retention metrics to ensure measurement tools are designed to meet force sustainment goals. The study will focus on validating these metrics and identifying changes needed to help improve forecasting occupational skill strength and grade requirements, program review, and personnel planning.

Timeline for Completion. During FY 2005, the Services will establish a long-term baseline/goal to determine the promotion timing benchmark to help focus retention programs and evaluate outcomes. Promotion data is available now; however, the Services need to determine benchmarks for the occupations, such as time-in-service or time-in-grade.

Performance Results for FY 2004. During FY 2004 the Department completed a study of Service retention goal-setting in order to understand how Services establish goals today. Based on the results of this study, the Department began the revision of DoD Directive 1304.20, “Enlisted Personnel Management,” to be published in FY 2005. The planned revision will mark a distinct change in Department policy by establishing that grade and experience should be linked. After the Directive is published, a metric will be established.

Outcome Goal: Ensure Sustainable Military Tempo and Workforce Satisfaction.

As with many goals, where changes in one goal’s outcome correlate to other goals’ outcomes, our success in maintaining workforce satisfaction will have a magnified impact across the force. Seven existing and developmental metrics help the Department care for our most valuable resource: people.

The next two metrics deal with Personnel Tempo. On October 1, 2000, Congress directed the Services to start tracking and reporting individual time away from home (expressed in days), commonly referred to as personnel tempo (PERSTEMPO).

Each of the Services has developed or enhanced existing data collection systems to support the legislative requirements. They will report the number of days each member is deployed with particular emphasis and scrutiny placed on those 10 major occupational groups that have deployed 400+ days out of the preceding two years. The same data is also used to assess PERSTEMPO for the Services and their active and reserve components.

Both metrics under development will incorporate a frequency and duration dimension to PERSTEMPO based on changes to the PERSTEMPO legislation in the FY 2004 National Defense Authorization Act.

The Defense Management Data Center (DMDC) has spent considerable time with Services to ensure that the PERSTEMPO reporting process is working properly. However, validation and verification is a very difficult and expensive process. Although the Services conducted some initial checks to ensure accuracy of data, the onus is largely on the service member to ensure "deployed days" reported on individual Leave and Earnings Statements are accurate. Accordingly, the Department has asked DMDC to crosscheck the accuracy of its PERSTEMPO information with similar information reported by the Defense Finance and Accounting Service who maintains individual Leave and Earnings Statements.

On October 8, 2001, the Department suspended certain PERSTEMPO management processes in accordance with the provisions of the national security waiver set forth in section 991(d) of Title 10, United States Code.

Activity Metric: PERSTEMPO Across Occupational Groups

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
The percentage of an occupational group that surpasses the PERS-TEMPO day constraints.	Services began tracking PERS-TEMPO as directed by Congress.	Published Interim PERS-TEMPO Policy Guidance.	Validated and verified Service data. Consider-ed Global Joint Rotational Policy.	Began tracking frequency and duration of PERS-TEMPO trends. Completed initial tracking metric.

[a] The FY 2004 data are preliminary.

Metric Description. The metric will capture the percentage of an occupational group, as defined by DMDC occupational codes that have exceeded the 400-day PERSTEMPO constraint within the last 730 days and/or the 191-day-consecutive PERSTEMPO constraint, by Service and across the Department. This metric will provide valuable insight into the "high deploying" skills and relate them to the high-deploying/low-density (HD/LD) units, as appropriate.

Ongoing Research. The Department has contracted with LMI, a not-for-profit consulting firm, to define and refine key performance indicators. DMDC has been tasked to provide the data to develop the metrics.

Timeline for Completion. Development of this metric will be complete in FY 2004; data will be reported in FY 2005.

Performance Results for FY 2004. In FY 2004, the Department began tracking PERSTEMPO trends. We expect to establish this metric in time to report on it in FY 2005.

Activity Metric: PERSTEMPO Standards Met

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
The percentage of Active and Reserve Components (by Service) that exceed PERS-TEMPO constraints.	Congression-ally directed PERS-TEMPO reporting began.	Published *Interim Personnel Tempo (PERS-TEMPO) Policy Guidance*.	Validated and verified data. Consider-ed Global Joint Rotational Policy.	Began tracking frequency and duration of PERS-TEMPO trends. Completed initial tracking metrics.

[a] The FY 2004 data are preliminary.

Metric Description. This metric will portray the percentage of the Service Active and Reserve components that exceed the 400-day PERSTEMPO constraint within the last 730 days and/or the 191-day consecutive PERSTEMPO constraint. This metric will provide valuable insight into the "high deploying" tendencies of various Service components.

Ongoing Research. The Department has contracted with LMI, a not-for-profit consulting firm, to help us define and refine key performance indicators.

Timeline for Completion. The LMI study effort is to be completed by end of FY 2004.

Performance Results for FY 2004. In FY 2004 the Department began tracking PERSTEMPO trends. We will complete the metric by the end of the fiscal year.

The next two metrics are part of three to help address quality of life (QoL) stresses on service members and their families. These activity measures respond to the National Security Presidential Directive–2 (February 2001), "Improving Quality of Life," and are in line with Secretary of Defense Guidance to track QoL improvements and give priority to the implementation of QoL initiatives.

The Commitment to Military Life index, in combination with a QoL Social Compact Improvement Index and a QoL Per Capita Cost Metric, helps measure the health of QoL programs and services supporting military members and families.

Current deployments and high personnel tempo necessitate robust QoL support for troops and families. In an effort to mitigate force management risk and enhance workforce satisfaction, the Department must transform QoL to meet the needs of changing demographics and expectations of military members and their families.

Activity Metric: Commitment to Military Life Index

End-State Metric	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Trend data to monitor results in key commitment areas that are predictors of retention and satisfaction.	No historical data: new metric.		• Reviewed corporate commitment literature. • Developed commitment factors reflecting military environment and culture. • Conducted focus groups to validate and expand commitment factors.	• Fielded survey • Developed final commitment index for military service. • Fielded commitment index in April 2004 survey of Guard and Reserve members. • Commitment index included in the August 2004 active duty survey.

[a] The FY 2004 data provided above is preliminary.

Metric Description. The Commitment to Military Life Index is a new indicator that will track the factors that influence and predict commitment to military service for both active duty members and spouses. This index is modeled after an approach used in corporate America to measure employee commitment.

Retention is a critical problem in the military and commitment has been shown to be a primary predictor of retention decisions. Thus, this effort is directed at developing an index of service member commitment to military service that can be used to track commitment periodically over time. The Department is also developing a complementary index of spousal commitment to the military, thereby acknowledging the importance of both the military member and the family in predicting commitment to the military.

The value of the index is to demonstrate the different fluctuations and factors of commitment over time. The commitment indexes contained in the DMDC Reserve component Survey (April 2004) and the DMDC active duty Survey (August 2004) will provide an initial baseline for the commitment index. The index will gain meaning as the factors influencing commitment are tracked over time. The survey instrument will be reviewed and updated as needed and data will be cross-referenced with the QoL Social Compact Improvement Index and

Community QoL Per Capita Cost Metric.

Ongoing Research. Work on the index began by reviewing current literature and other applicable research on commitment and developing a set of commitment factors that reflected the needs and environment of the military and its culture. Additionally the Department developed a strategy for validation of the results. Focus groups were conducted at four military installations during the months of June and July 2002 to validate and expand the factors and to garner the information needed to develop the survey instrument.

Timeline for Completion. The final commitment index survey instrument was developed in March 2004. The survey was fielded for the first time in April 2004.

Performance Results for FY 2004. The Department developed and fielded the final commitment index in the April 2004 DMDC survey of National Guard and Reserve component members. The commitment index was included in the August 2004 active duty survey. The data collected provides baseline commitment data for FY 2005.

Activity Metric: Quality of Life Social Compact Improvement Index

Metric	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Trend data to monitor improvements in leading QoL indicators.	No historical data: new metric.		Developed framework for QoL index	Established baselines and initial performance targets

[a] The FY 2004 data provided above is preliminary.

Metric Description. The Quality of Life (QoL) Social Compact Improvement Index is the second indicator of the three QoL measures.

The index is designed to link QoL programs and services included in the Social Compact. It recognizes the reciprocal partnership that exists between the Department, the service member, and his or her family. The index will track improvements in QoL to ensure the Department underwrites support to families. The index is envisioned to be dynamic with program areas and metrics added or eliminated as data mature and priorities change. It currently includes six major program areas, and we anticipate no more than 10 functional program areas in the index at any one time.

Metrics, baselines, targets and parameters have been established for the six functional areas within the initial index to track improvement in QoL:

- *Housing Assignment:* Percentage of out-of-pocket housing expenses, percentage of E1 to E4 junior enlisted families living on base, and percentage of single E4s and E5s living on base.
- *24/7 toll free family assistance*: Military OneSource - Number of installations with coverage.
- *Voluntary education/Tuition Assistance:* Out-of-pocket education costs, number of enrollments, and number of degrees or diplomas earned.
- *Financial readiness:* Percentage of E1-E4s reporting problems paying bills and percentage of E1-E4s who report they have “difficulty making ends meet” or are “in over their heads.”
- *Childcare:* Number of childcare spaces and percentage of accredited child development centers.
- *DoD Educational Activity (DoDEA):* Pupil-teacher ratio and student achievement scores.

The Office of the Under Secretary of Defense, Military Community and Family Policy will update the performance data annually. Data will be cross-referenced with the Community QoL Per Capita Cost Metric and Commitment to Military Life Index to ensure QoL programs are keeping pace with the changing expectations of military members and families.

Ongoing Research. Service Social Compact functional area teams have addressed each area impacting QoL for military members and families. Beginning in October 2002, the teams began a series of meetings to update functional area goals, establish achievable targets, outcomes, and long-term strategies. The teams developed performance indicators, and identified data sources. This data was incorporated into the QoL Social Compact Improvement Index. The Social Compact is a 20-year strategy requiring continual review and revision to keep pace with the changing needs of the transforming military. While the Social Compact includes long-term, mid-term and short-term strategies, the index will focus on the short-term. In FY 2004, the Social Compact was modernized to reflect the performance metrics included in the DoD balanced scorecard.

Timeline for Completion. The index is scheduled to be completed in FY 2005.

Performance Results for FY 2004. Baselines and performance targets were established for housing assignment, Military OneSource–1-800 family assistance coverage, voluntary education/tuition assistance, financial readiness, childcare, and DoDEA.

Metric	FY 2003 Baseline	FY 2004 Target
Housing Percentage of out-of-pocket housing expenses	7.5%	3.5%
24/7 Toll Free Family Assistance–Military OneSource Number of installations with coverage	30	300
Off Duty/Voluntary Education **1)** Out-of-pocket education costs **2)** Number of degrees/ diplomas	**1)** Meet DoD policy for per unit cap and annual ceiling **2)** 33,527	**1)** Meet DoD policy for per unit cap and annual ceiling **2)** 34,676
Financial Readiness **1)** Percentage reporting problems paying bills **2)** Percentage reporting having difficulty making ends meet or are in over their heads	**1)** 41.5% **2)** 16.5%	**1)** 39.4% **2)** 15.7%
Child Development 1) Number of spaces 2) Percentage of centers accredited	1) 1,741 2) 90%	1) 4,884 2) 95%
DoDEA **1)** Pupil to Teacher Ratio **2)** Student Achievement – 75% of all students at or above Standard (math, reading, language arts) **3)** Student Achievement –8% or fewer of all students fall below Standard (math, reading, language arts)	**1)** No less than 18.0:1 nor greater than 24.0:1 **2)** Meet or exceed National Standard **3)** Meet or exceed National Standard	**1)** No less than 18.0:1 nor greater than 24.0:1 **2)** Meet or exceed National Standard **3)** Meet or exceed National Standard.

Performance Metric: Satisfaction with Military Health Plan

Metric	FY 2001 Actual[a]	FY 2002 Actual[b]	FY 2003 Actual[c]	FY 2004 Target[d]/Actual [e]
Percentage satisfied with military health plan	44.6%	46.5%	51.2%	≥ 56%/ 53%

[a] Surveys fielded in January, April, and July 2001.

[b] Surveys fielded in October 2001 and January, April, and July 2002.

[c] The civilian average is based on a representative population from the national Consumer Assessment of Health Plans Survey Database (CAHPSD) for the same time period; this is the target for the Military Health System. (Example: A July 2003 survey would be compared to July 2003 data from the CAHPSD.) Due to the nature of the program, only a DoD-level goal is tracked.

[d] The FY 2004 initial goal was the same as the FY 2003 goal; however, after progress tracking for FY 2003, it was determined that the FY 2004 goal needed to be reset to a yearly goal that would likely be achieved and will match the Defense Health Program Performance plan for FY 2004. Accordingly, the goal changed from ≥ Civilian Average to 56%, which represents closing the gap with civilian plans in three years. All future years goals are updated on an annual basis.

[e.] The data provided in the FY 2004 column are as of the 3rd quarter.

Metric Description. A person's satisfaction with his or her health plan is a key indicator of the performance of the Military Health System (MHS) in meeting its mission to provide health care to over eight million eligible beneficiaries. For this metric, the following survey item is used:

> *We want to know your rating of all your experience with your health plan. Use any number from 0 to 10 where 0 is the worst health plan possible, and 10 is the best health plan possible. How would you rate your health plan now?*

Satisfaction is measured as the percentage of respondents (weighted by appropriate sampling weights) who answer 8, 9, or 10.

The survey, fielded quarterly, asks respondents questions about the plan during the prior year. Currently, the results for the year are based on the surveys fielded during the fiscal year, which means the results are actually based on the respondent's interactions with the health system during the prior fiscal year.

The goal established for this metric in FY 2003 is considered a stretch goal that will drive the organization forward, but will likely not be achieved during that year. For FY 2004, the goal has been changed to reflect the desire to make the goal achievable during the current year, while still closing the gap with the civilian sector in three years. These goals are established based on a civilian survey, and will be updated on an annual basis.

Performance Results for FY 2004. The 3rd quarter year-to-date score of 53 percent is 2 percentage points above last year's score and should continue to improve. For the individuals who have chosen to enroll in TRICARE Prime, their scores for the 3rd quarter report met the goal of 56 percent. During the 3rd quarter reporting, all but one enrollment Service managed to meet the goal. In fact, enrollees to the Managed Care Support Contractor not only met the goal for the year, but also surpassed the Civilian Benchmark for each quarter of FY 2004. Continuous increases in enrollment, along with improvement in the score, demonstrates real progress for the program.

Performance Metric: Satisfaction with Access

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/ Actual [a]
Satisfaction with access	81.8%	80.8%	83.0%	>84%/ 82.6%
[a] The data provided in the FY 2004 column are estimated results for the 3rd quarter.				

Metric Description. Access to medical care has always been a significant factor in the overall satisfaction with medical care, and an area for focused improvement. The intent of this metric is to improve satisfaction with access to appointments for those individuals who have chosen to enroll in TRICARE PRIME (similar to a Health Maintenance Organization) within the Military Health System (MHS). This metric is based on a monthly customer satisfaction survey for those individuals who had an outpatient medical visit at a Military Treatment Facility (MTF)—hospital or clinic—during the previous month.[2] Although there are a number of measures related to access, ease of making an appointment by phone has been considered a key measure for access and has been tracked over the last couple of years. The metric is based on Question 10a of the customer satisfaction survey:

> *How would you rate the (Clinic Name) on Ease of Making this Appointment by Phone?*

The percentage of respondents (weighted by appropriate sampling weights) that answer "Good," "Very Good," or "Excellent" on a scale from "Poor" to "Excellent" is computed. The survey is fielded monthly. Because of the fielding period, data collection period, and analysis period, there is a 55-day lag between the appointment date and the posting of data on the web-based reporting site. Reports are produced quarterly. Although information is available by the Military Service branch that is financially responsible for the MTF, only an aggregate MHS score is shown.

Performance Results for FY 2004. Satisfaction with Telephone Access is showing a slight decline for the year. While the score remains fairly high overall, the system will not meet the goal for the year. As DoD transitions to the new TRICARE contracts, the appointment process is also in a state of transition. Appointment scheduling responsibility is moving back to the Military Treatment Facilities (MTFs), Hospitals/Clinics, from the Managed Care Support Contractors. In the long run, this should be an improvement for management of the appointments, but it may cause some problems in the short term. Historically, there has been a problem in trying to identify the problem with access to health care appointments at the MTFs, with two different organizations controlling different parts of the process. With the conversion to full MTF management of the appointment process, it will be easier to identify where problems may exist, so that improvement programs can be instituted if needed. During the migration to new contracts, it is anticipated that satisfaction may initially decrease, but should rebound within a year. All TRICARE regions will be converted by November 1st, 2004. Since data currently available does not yet contain the survey results for the first conversion period, the impact cannot be determined.

[2] The same survey is used for a metric that tracks overall satisfaction with appointments. However, that metric looks at responses to different survey questions and uses scores from all beneficiaries who visited an MTF rather than only TRICARE PRIME enrollees.

Performance Metric: Overall Satisfaction with Appointment

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/ Actual [a]
Overall satisfaction with appointment	88.5%	87.1%	88.4%	>90%/ 87.6%

[a] The data provided in the FY 2004 column are estimated results for the 3rd quarter.

Metric Description. This metric looks at beneficiaries' overall satisfaction with their outpatient medical appointments at a Military Treatment Facility (MTF)—hospital or clinic—during the month. Overall satisfaction with the appointment is affected by numerous factors during the visit including the experience of getting an appointment, the wait time at the appointment, the interaction with the provider, and interactions with the pharmacy or ancillary services. This metric is based on a monthly customer satisfaction survey for those individuals who had an outpatient medical visit at an MTF during the previous month.[3] The metric is based on Question 12 of the customer satisfaction survey:[4]

> *All things considered, how satisfied were you with the (name of clinic) during this visit?*

The percentage of respondents (weighted by appropriate sampling weights) who answer "Good," "Very Good," or "Excellent," on a scale from "Poor" to "Excellent," is computed. The survey is fielded monthly. Because of the fielding period, data collection period, and analysis period, there is a 55-day lag between the appointment date and the posting of data on the web-based reporting site. Results are based on the summation of results for all surveys completed by patients during the year. Although information is available by the Military Service branch that is financially responsible for the MTF, only an aggregate Military Health System (MHS) score is shown.

Performance Results for FY 2004. The objective for this fiscal year was to achieve even higher levels of performance; however the current score surpasses the historical civilian benchmark for this survey. In an effort to improve overall performance on this measure, the Army instituted a provider-level survey program that focuses on individual providers in an attempt to improve the overall score. Since the year is not complete, the full impact of this approach is still unknown. However, preliminary information has not shown significant improvement.

A further review of the survey results shows that while satisfaction remains high for retirees and their family members, satisfaction for active duty members and their families is not as high. The survey shows that some of this is attributable to age differences; older individuals tend to be more satisfied than younger individuals. But even considering age differences, the satisfaction level of active duty family members is largely unchanged from FY 2003 to FY 2004. However, there has been a decrease in satisfaction for active duty members themselves. While the data set does not allow for a more detailed review between active duty personnel and Reservists called up in support of Operation Iraqi Freedom, the timeframe does match.

Outcome Goal: Maintain Reasonable Force Costs.

It is prudent to carefully watch the cost of day-to-activities—those that take place whether America is at war or not. Recruiting, training, pay, and medical costs are examples. This outcome goal has ten metrics to help the Department manage them.

Performance Metric: Cost of Basic Training

Cost Indicator (Constant FY 2004 $)	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual[a]
Cost of basic training per enlisted recruit	$7,393	$8,250	$9,132	$11,462

[a] The FY 2004 are as of the 3rd quarter (final)

[3] The same survey is used for a metric that tracks satisfaction with access. However, that metric looks at responses to different survey questions and uses scores from only TRICARE PRIME enrollees rather than from all beneficiaries who visited an MTF.
[4] Other questions in the survey are used to identify specific areas for improvement.

Metric Description. Basic training is the fundamental introductory and indoctrination training provided to enlisted entrants. Each Service has different training pipelines that take different lengths of time to complete. The cost of basic training is a management cost indicator – performance/production targets are accession-driven and vary by Service and year. Funding requirements are projected by fiscal year in the Department's Future Years Defense Program (via Program Element 804711); this projection includes manpower, support equipment, facilities, and all other costs associated with indoctrinating recruits into military culture, raising their standards of physical conditioning, and instructing them in basic military skills. (Basic training costs do not include expenses associated with initial skills training; initial skills training follows basic training, and its duration and costs vary with each military specialty.)

Performance Results for FY 2004. The basic training cost trend continues to increase by approximately 10 percent per year. Although basic training costs for the Navy, Air Force, and Marines have remained steady for the past several years, the Army's costs have risen dramatically due to mobilization and deployment of large numbers of Army Reserve and National Guard soldiers for Operations Enduring Freedom and Iraqi Freedom. This has required expansion of the training base and its infrastructure. Construction of training barracks in Afghanistan and Iraq have also added to higher costs but they may be removed from FY 2005 training budget data to better represent the cost to train recruits domestically.

The overall increase in Army costs was not entirely due to these factors, however. The increased costs per recruit also reflect the higher costs for TRICARE-FOR-LIFE health care accrual. When coupled with fewer new recruits (accessions), the cost per recruit rises. Without these costs, the Army's cost per recruit would drop to a more reasonable figure.

During the past year, the Department has begun to address anomalies that had existed in the data reporting, thus increasing the integrity of the reporting.

Cost Indicator – Enlisted Training Costs

Enlisted Accession Costs (in 2004 Constant Dollars)	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Estimate
Total Recruit Training Costs	***$1,612M***	***$1,842M***	***$1,932M***	***$2,336M***
Army	$481	$547	$565	$1,066
Navy	$445	$490	$551	$522
Marine Corps	$472	$453	$542	$500
Air Force	$214	$352	$274	$248
Basic Training Input (non-prior enlistees)	***218,084***	***219,998***	***211,543***	***203,855***
Army	86,866	87,405	86,046	78,333
Navy	53,976	46,547	43,919	43,200
Marine Corps	36,600	39,999	37,363	35,822
Air Force	40,642	46,047	44,215	46,000
Average cost per recruit trainee	***$7,393***	***$8,250***	***$9,132***	***$11,462***
Army	$5,533	$6,260	$6,566	$13,529
Navy	$8,247	$10,520	$12,543	$12,081
Marine Corps	$12,905	$11,326	$14,493	$13,972
Air Force	$5,270	$7,062	$6,204	$5,383

Performance Metric: Cost Per Enlisted Recruit - Active Component

Cost Indicator (Constant FY 2004 $)	FY 2000 Actual	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual[b]
Cost-per-Recruit	$11,890[a]	$13,288[a]	$14,030[a]	$14,206

[a] Methodology and data updated from the FY 2003 performance report.

[b] The FY 2003 data are as of the 4th quarter (final).

Metric Description. The metric is a lagged performance indicator designed to analyze costs and trends over time, not set specific annual performance targets. Each year, the Department enlists about 200,000 new recruits for the Active components. These new Service members provide us with the entry-level manning necessary to meet manning and readiness needs. The cost of recruiting is calculated by dividing a Service's total number of accessions (non-prior service + prior service) into the total expenditures for enlisted recruiting. These resources are made up of recruiting personnel compensation, enlistment bonuses, college funds, advertising, communications, recruiting support (vehicles, equipment, computers, supplies and applicant's transportation, food and lodging, etc.), and other appropriations resources within the recruiting command/service (i.e., other procurement and research, development, technology and experiment funding).

Performance Results for FY 2003. As stated earlier, this is a macro-level performance indicator that is used in the analysis of Service programs. Recruiting costs are driven by a host of external variables, such as the state of the economy, unemployment, youth propensity to serve, the posture of the delayed-entry program, etc. Although cost-per-recruit increased annually through FY 2002, it has stabilized at about the 2002 level through the FY 2005 President's Budget.

Performance Metric: Cost Per Enlisted Recruit – Reserve Component

Cost Indicator (Constant FY 2004 $)	FY 2000 Actual	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual[b]
Cost-per-Recruit – Reserve	$6,185[a]	$6,886[a]	$6,473[a]	$7,585

[a] Methodology and data updated from the FY 2003 performance report.

[b] The FY 2003 data are as of the 4th quarter.

Metric Description. The lagged metric is designed as an indicator to analyze costs and trends over time, not to set annual targets for performance. Each year, the Department enlists about 200,000 new recruits for the Active components and about 160,000 for the Reserve components. These new Service members provide us with the entry level manning necessary to meet manning and readiness needs. The cost of recruiting is calculated by dividing a Service's total number of accessions (non-prior service + prior service) into the total expenditures for enlisted recruiting. These resources are made up of recruiting personnel compensation, enlistment bonuses, college funds, advertising, communications, recruiting support (vehicles, equipment, computers, supplies and applicant's transportation, food and lodging, etc.), and other appropriations resources within the recruiting command/service (i.e., other procurement and research, development, technology, and experiment funding).

Performance Results for FY 2003. This macro-level indicator is used in the analysis of Service programs. Recruiting costs are driven by a host of external variables, such as the state of the economy, unemployment, youth propensity to serve. Costs have risen steadily over the past years, but appear to be leveling in the current budget.

Performance Metric: Military Personnel Costs – Enlisted Pay Gap

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual[b]
Percentage of enlisted pay gap closed [a]	23%	47%	61%	71%
Percentage of remaining gap closed (annually)	N/A	31%	25%	26%

[a] Relative to FY 2000 baseline

[b] The FY 2004 data are as of the 4th quarter (final).

Metric Description. The goal of military compensation is to provide sufficient military manpower to provide for the national defense. To achieve this end, military compensation must be competitive. The 9th Quadrennial Review of Military Compensation (QRMC) has determined that military pay that matches the 70th percentile of pay earned by comparably experienced civilian workers is an appropriate short-run measure for assessing whether military pay is competitive with civilian compensation. In the past, whenever military compensation was significantly less than the 70th percentile as compared to civilian pay, recruiting and retention problems arose. It is generally very costly, both in terms of dollars and experience mix, to correct recruiting and retention shortfalls after they have appeared. This metric tracks the percentage of the pay gap closed, since FY 2000, between military pay and the comparable 70th percentile for civilian counterparts.

For officers, the appropriate comparison group is civilians with college degrees and advanced degrees in managerial and professional occupations. The FY 2000 pay gap for officers was eliminated in FY 2002 through a combination of targeted pay increases, across-the-board raises that exceed the average increase in the private sector, and general increases in allowances.

Measurement of the enlisted pay gap is based on civilian pay by education and years of experience and enlisted pay by pay-grade and years of service. There still is a measurable pay gap today for enlisted service members. Therefore, our goal is to close at least 25 percent of the remaining gap annually until the gap is eliminated. After the gap is closed, the goal is to ensure military pay remains commensurate with the 70th percentile of comparable civilians.

Ratings for this metric will be assigned based on the percentage of the enlisted pay gap closed each year. If at least 25 percent of the remaining gap is closed, the result will be rated "Green." If at least 15 percent but not 25 percent is closed, the result will be rated as "Yellow." If the result is less than 15 percent of the remaining gap is closed, the rating will be "Red."

Although a good leading indicator of recruiting or retention trends, this metric alone is not sufficient to gauge the overall efficiency or effectiveness of the military personnel compensation program. Consequently, the Department is also working on monitoring change in total military personnel costs (in current and constant dollars), the probability an enlisted member will remain in service until 15 years, and the average experience at promotion for grades affected by the pay gap.

Performance Results for FY 2004. Military members received an average pay raise of 4.15 percent for FY 2004. The average civilian wage as measured by the Employment Cost Index (Private Industry Wages and Salaries) for this period was 3.2 percent. Mid-career enlisted members received wage increases of 3.7 percent to 6.25 percent. The Basic Allowance for Housing, an important component of Regular Military Compensation, increased by 7 percent for FY 2004. The combination of basic pay and basic allowance for housing increased relative to civilian wages and salaries. As a result, the percentage of the pay gap closed from 61 percent to 71 percent. The Department achieved its goal of closing 25 percent of the remaining gap in FY 2004.

Performance Metric: Community Quality of Life Per Capita Metric

Metric (Current $000)	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual (Budget) [a]
Community Quality of Life Per Capita Cost Metric				
Army	$1,125	$1,180	$1,539	$1,559/1370 (-$189)
Navy	$1,121	$1,269	$1,391	$1,409/1357 (-$52)
USMC	$812	$940	$1,018	$1,031/983 (-$48)
Air Force	$1,507	$1,580	$1,642	$1,663/1718 (+$55)

[a] The FY 2004 data are preliminary.

Metric Description. Quality of Life (QoL) per capita is the third of three metrics that, combined with the QoL Social Compact Improvement and the Commitment to Military Life indices, measures the health of QoL programs and services supporting military members and families. This metric also responds to the National Security Presidential Directive–2 (February 01), "Improving Quality of Life," and is in line with the Secretary of Defense guidance to track QoL improvements and give priority to the implementation of QoL initiatives.

The QoL per capita metric will help us monitor trends in the Department's QoL funding investment per active duty member over time. The Department also will track individual Service progress towards sustaining or improving funding for critical QoL support.

The metric will calculate per capita cost using financial data submitted annually by the Services and annual active duty end strength data. The majority of funding to support Service QoL activities is identified in specific budget and program exhibits submitted to the Office of the Secretary of Defense on an annual basis. The metric will correlate active duty end strength with Service direct operation and maintenance funding for the following programs: morale, welfare and recreation; child care; family centers; voluntary education and tuition assistance; and youth programs.

Performance Results for FY 2004. FY 2004 performance reflects preliminary data based on budget estimates in the 2005 President's budget. The budget estimate reveals a decline in per capita funding for Army, Navy, and Marine Corps QoL programs in FY 2004. The Department is concerned about these planned reductions and will monitor these programs for potential impact on the support provided to troops and their families. FY 2004 actuals will be available in the FY 2006 President's Budget, which will be submitted to Congress in February 2005.

QoL per capita will become the benchmark for QoL investments as the global basing profile changes. The goal is to keep standards high even as the Department closes, realigns, and relocates installations and units to better fit the global defense mission. QoL per capita is a macro-level indicator that must be analyzed in conjunction with the QoL-Social-Compact-Improvement-Index and the Commitment-to-Military-Life-Index to gain insight into the best ways to support and take care of Service members and their families.

Performance Metric: Medical Cost per Enrollee per Month

Metric (Current $000)	FY 2000 Actual	FY 2001 Actual	FY 2002 Actual [b]	FY 2003 Target [c]/Actual [d]
Medical cost per enrollee per Month	No historical data: new metric.[a]		$152	N/A / $170
Percentage change			N/A (First Year Data Reported)	N/A / 11%

[a] Data used to calculate this metric were not available in FY 1999 or 2000. Additionally, since the metric is based on rolling 12-month expenses from the Medical Treatment Facilities, FY 2002 was the first year when data could be reported.

[b] FY 2002 data have been updated to reflect additional purchased care claims and improper allocation of pharmacy expenses in the calculation.

[c] This is a new metric as of FY 2004; thus, no goal was established for FY 2003.

[d] The FY 2003 data are estimated as of the 4th quarter.

Metric Description. This lagged metric looks at how well the Military Health System manages the care for those individuals who have chosen to enroll in a Health Maintenance Organization (HMO)-type of benefit. It is designed to capture aspects of three major management issues: (1) how efficiently the Military Treatment Facility (MTF) is providing care; (2) how efficiently the MTF is managing the demand of its enrollees; and (3) how well the MTF is determining which care should be provided inside the facility versus that purchased from a managed care support contractor.

The measure is constructed based on the workload consumed by the enrollees for any individual month. For each enrollment location, workload is accumulated for each enrollee, and priced out according to care provided in MTFs, claims paid for purchased care, and mail-order pharmacy.

This aggregate measure helps us monitor how well the MHS is managing the care for TRICARE Prime enrollees. It looks at all Prime enrollees, whether at the MTF or with the health support services contractors. The overall measure can be broken into multiple components that allow for review of utilization factors for both direct care and purchased care, and unit cost information for direct care and purchased care. By reviewing this information, MTFs are able to determine the cost of providing care at the MTF, and how many times the enrollee is receiving care. For an efficient Military Health System, the cost per unit needs to be at or below the cost of purchasing the care, and the utilization of services by the enrollees must be controlled. While the top-level measure is used to track overall performance; detailed measures allow for review and management at the local level.

Due to claims processing times, purchased care workload is projected to completion six months after the fiscal year ends; final results will not be available for approximately three years. Purchased care workload does not allocate care delivered overseas to hospital or clinic areas. Therefore overseas workload is excluded. To ensure consistency across program years, purchased care excludes all resource sharing, continued health care benefit plan, and TRICARE-for-Life purchased care workload. Since data will not be available until six months after fiscal year end, this will be a lagging indicator.

Performance Results for FY 2003. Since this was a new metric established during FY 2003, there was no goal for FY 2003 performance. However, when comparing the 11 percent increase in the MHS medical cost per enrollee to the Kaiser Family Foundation health benefits increase of 13.9 percent, one sees slightly better performance for the Military Health System. Without a performance goal for FY 2003, the results become the baseline for further review with FY 2004 performance where issues regarding unit cost, utilization management, and purchased care management will need to be reviewed.

The current method does not adjust for the various expected health care expenditures for different populations, and the methodology will likely be changed in the future. Since enrollment demographics can vary significantly by Service, and across time, it is important to adjust the measure. For example, as more older individuals enroll, the overall average medical expense per enrollee would likely increase. On the other hand, if relatively more young, healthy active duty personnel are enrolled, the overall average medical expense per enrollee would likely decrease. Through the use of adjustment factors, a comparison across Services and across time can be made more meaningful.

Performance Metric: TRICARE Prime Outpatient Market Share

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Target/Actual
TRICARE Prime outpatient market share (MTF Enrolled)	84.4%	81.0%	N/A [a]/75.1% [b]

[a] This is a new performance measure.

[b] Data are estimated as of the 4th quarter.

Metric Description. Outpatient encounters represent the majority of contacts between the Military Health System (MHS) and its beneficiaries. Accordingly, the market-share metric—a lagging indicator—looks at how much of the care is delivered in the direct system rather than being purchased. There is a large fixed manpower cost related to maintaining the medical readiness mission. Therefore it is vital for proper program management to use resources efficiently and effectively during peacetime operations. Thus, the goal is to have Military Treatment Facilities (MTFs) achieve the targets established in their business plans for each year. Although medical care can be purchased at numerous locations throughout the United States and in overseas locations, the focus of this measure is on enrollees in the United States. Overseas activities are currently excluded from the measure since purchased care data is not available in sufficient detail. Due to the extensive medical capabilities of hospitals compared with ambulatory clinics, the market-share percentage will vary by MTF and military Service.

Over the past couple of years, the downsizing of small hospitals into ambulatory care clinics has affected the clinical capabilities of these facilities, and market share has decreased. This reduction is expected to continue for the next couple of years until the direct-care system stabilizes.

Market-share percentages for the Services are shown based on direct-care workload compared to total purchased-care plus direct-care workload for MTF TRICARE Prime enrollees. This metric will be based on relative value units (RVUs)[5] to more accurately compare the relative complexity of care instead of just a visit count.

Like the previous metric, purchased-care workload is projected to completion six months after the fiscal year ends, and final results will not be available for approximately three years. Overseas workload is also excluded here. To ensure consistency across the program years, purchased care excludes all resource sharing, continued health care benefit plan, and TRICARE-for-Life purchased-care workload. Since data will not be available until six months after fiscal year end, this will also be a lagging indicator.

To compensate for factors that cannot be controlled under current program rules, the metric was changed in FY 2004 to focus just on the Medical Treatment Facility TRICARE Prime enrollees. Rules under the TRICARE Prime enrollee program provide more oversight for the MTF in managing the overall health and utilization of this population. During FY 2003, each MTF provided a business plan indicating how much care their enrollees would demand from both direct care and purchased care. This information will be used to set the goal for the FY 2004 TRICARE Prime outpatient market-share metric.

Performance Results for FY 2003. As indicated previously, this metric has been updated for FY 2004 to focus specifically on the TRICARE Prime market. The previous metric targets were:

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Target/Actual
Outpatient market share (Enrolled and Non-enrolled)	77%	74%	≥74% / 71%

Direct-care workload in FY 2003 represented only 71 percent of total ambulatory workload for areas surrounding MTFs. While there was some decrease

[5] Developed by the Centers for Medicare and Medicaid Services, RVUs approximate the physician resources used during the visit. For example, a returning visit by a patient with a simple problem might be 0.17 RVUs, whereas arthroscopic surgery of the knee might be 16.00 RVUs.

in workload at the MTFs, the most significant reason for the change in market share was related to increases in purchased care. This was due to (1) increases in overall utilization by eligible beneficiaries; (2) the call up of Reserve component members and the addition of their family members to the beneficiary population; and (3) the deployment of MTF specialists to Operation Iraqi Freedom.

With the increased cost of health care benefits in the private sector, the rich benefit offered by the Military Health System attracted more unique users who never used the benefit in the past. A number of those individuals dropped their other health insurance. Due to the limited expansion capabilities of the MTFs, these two factors added to the increase in purchased care during the year.

Additionally, due to the current operations, DoD experienced a change in available providers and a significant increase in Reserve component beneficiaries, including Reserve component family members. These family members are not traditional users of the Military Health System, and the majority of their care is purchased care. The influx of Reserve component users was not anticipated when the performance target for FY 2003 was established.

Performance Results for FY 2004. This is a lagging indicator. Final analysis of the FY 2004 results will be completed by the next reporting cycle.

Performance Metric: Primary Care Provider Productivity

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual[b]
Relative Value Units (RVUs) per primary care provider per day	13.6	13.8[a]	14.0	≥14.5 / 14.1

[a] FY 2002 has been updated to a final number from the 13.6 estimate reported in the 2003 Annual Defense Report.

[b] The FY 2004 data are estimated as of the 3rd quarter.

Metric Description. To run a premier Health Maintenance Organization (HMO), the critical focus area is primary care. The primary care provider frequently is the first medical interaction between the beneficiary and the HMO. In this role, the primary care provider is responsible for the majority of preventive care to keep beneficiaries healthy and away from more costly specialty care. While the HMO has a goal to reduce the overall number of encounters per beneficiary, an additional goal is to ensure that the dollars spent on medical care are used efficiently.

The targets for this metric represent stretch goals that were instituted to move the organization forward, but likely will not be achieved in FY 2003 or FY 2004. This metric looks at the complexity of care and the number of patients seen by the primary care providers each day, with a goal of increasing the complexity, number, or both, of patients seen each day by the provider.

Like the previous metric, this one also uses relative value units (RVU) to measure the complexity of care to approximate physician resources used during a visit.

Due to the nature of its reporting, the metric results will lag actual performance by one quarter.

Performance Results for FY 2004. Improvements in productivity have continued in FY 2004, but the system is not expected to meet the "stretch" goal of 14.5 RVUs. Currently two of the three Services are at or approaching the goal for the year. The goal is more aggressive than the historical trend. The desire is to move the organization forward in a manner that requires dramatic improvements to the system.

Even with the possibility that two of the Services may reach their individual goals, there are a number of issues that cause problems when interpreting the results. First, there has been an emphasis to improve medical coding and to enforce medical coding guidelines that have resulted in a 6 percent decrease in the average level of complexity being reporting in the medical record. That drives down the RVUs used in the numerator of the metric.

Additionally, as part of the effort to improve coding and overall operations at an MTF, a new clinical information system began deployment during the year. Part of the reason for adjusting the goal at the beginning of the year was the expectation that this would have a small impact on the performance related to physician training and implementation. However, the impact appears to be much larger than expected. Concerns with the performance of the system have placed a temporary hold on future deployments and the full impact is not known.

Since these factors can have a significant impact on the overall performance, the fact that two of the three Services are approaching their goals represents a positive improvement in performance. The aggressive nature of the goals will likely result in performance below the goal level, but the

Department expects performance to continue to improve.

Performance Metric: Civilian Force Costs

Civilian force costs (Current Year $000)	FY 2001 Actual [b]	FY 2002 Actual [c]	FY 2003 Actual[e]	FY 2004 Projected [f]
Total [a]	42,258,733	44,867,328	47,227,585	48,803,246
Basic pay	31,887,999	33,376,576	34,947,575	36,532,535
Premium pay [d]	1,985,502	—	—	—
Overtime pay	—	1,173,810	1,215,873	834,760
Holiday pay	—	53,772	46,787	46,052
Other pay	—	1,119,919	1,105,238	1,146,133
Benefit pay	8,066,742	8,822,937	9,501,778	10,010,975
Separation pay	318,490	320,049	410,333	232,790

[a] Totals may not add due to rounding.

[b] FY 2001 data are from DoD component summary of President's Budget FY 2003.

[c] FY 2002 data are from FY 2004 President's Budget.

[d] Premium pay includes overtime pay, holiday pay, and other pay. It was reported only as an aggregate number in FY 2001.

[e] FY 2003 through FY 2005 data are from FY 2005 President's Budget, OP 08 Exhibit.

[f] FY 2004 is projected based on FY 2005 President's Budget, OP 08 Exhibit (February 2004), and represents actual results as of the 2nd quarter.

Metric Description. In the past, civilian force costs reflected those reported annually to the Office of Personnel Management (OPM) in the 1351 Report, "Work Years and Personnel Costs." However, this resource is not timely. Currently, OPM has FY 2001 costs available to its users, and FY 2002 is still being analyzed and not yet available. No call has been made for FY 2003 data. Beginning in FY 2004, DoD sought a more useful alternative and determined that the OP 08 Exhibit of the President's Budget provided a better source of current and projected workforce cost data. Consequently, beginning in FY 2002, premium pay costs are presented with more specificity in these categories: overtime, holiday, and other pay.

Although this metric provides only a broad overview of civilian compensation costs, it may become a baseline for evaluating National Security Personnel System (NSPS) costs. However, it is not an effective measure of the success of any individual personnel program or benefit. For example, additional benefit costs do not indicate successful use of recruitment or retention incentives. Furthermore, increased recruitment bonus or retention allowance payments would only measure usage rates, not the change in recruitment or retention based on payment of the incentive.

The metric monitors trends in the following pay categories:

- **Basic pay** (Office of Management and Budget (OMB) Object Classes 11.1 and 11.3) represents the aggregate personnel compensation for full-time permanent, full-time temporary, and part-time/intermittent appointments.
- **Premium pay** (OMB Object Class 11.5) represents personnel compensation for: overtime, holiday, Sunday, night differential, hazardous duty, post differential, staffing differential, supervisory differential, physicians comparability allowance, remote work site allowance, cash awards, and other.
- **Benefit pay** (OMB Object Class 12.1) represents personnel compensation for: health insurance, life insurance, retirement, social security, workers' compensation, uniform allowances, overseas allowances, non-foreign cost-of-living allowance (COLA), retention allowance, recruitment bonus, relocation bonus, and other.
- **Separation pay** (OMB Object Class 13.0) represents personnel compensation to involuntarily separated employees and payments made through the $25,000 voluntary separation incentive pay program (e.g., buyout bonuses).

Performance Results for FY 2004. In FY 2004, DoD changed the source of our civilian cost trend data to increase the timeliness of reporting. The Department also is displaying workforce costs in "constant dollars" to more clearly define trends in compensation. Currently, the trend is relatively a flat line. Full-Time Equivalent work years were added to the metric in order to tie dollars and work years together for a more complete representation, i.e. civilian force cost per Full-Time Equivalent work-year.

Activity Metric: Total Costs for Contractor Support

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Trend data showing the percentage increase or decrease in costs associated with contract support	No historical data: new metric		Army assigned pilot program to contractor manpower and costs	Implement pilot program within Army.
[a] The FY 2004 data are preliminary.				

Metric Description. The contractor workforce is important to accomplishing the Department's mission. Contractor costs will grow as DoD continues its efforts to balance personnel investments by outsourcing non-core functions, allowing us to return military manpower to operational tasks that can only be performed by a trained soldier, sailor, airman, or Marine.

The purpose of the contract support cost indicator is to provide visibility into the total funding burden of contracted personnel across the Department. To do this, we must find ways to capture data about the contracted work performed, the associated costs, and the unit supported. This information is needed to satisfy fiscal accountability standards as well to help us discover where our contractor investments overlap, allowing us to propose alternative solutions, as needed.

Unfortunately, our existing financial and procurement systems do not capture contractor workforce data such as direct labor hours, direct labor costs, and the unit supported. Thus, we are working to establish a systematic method to capture this data across DoD; the final cost indicator will allow us to monitor the trends in contracted direct labor costs for all military Services.

Ongoing Research. In summer 2002, the Department approved an Army pilot program to capture contractor manpower and associated costs. The Army is testing a Contractor Manpower Reporting Application, documenting lessons learned, and developing a proposal for DoD-wide use.

Timeline for Completion. The Army Pilot program is scheduled for completion in September 2006. Likewise, a DoD-wide version of the program is completing its final steps with implementation expected by 2008.

Performance Results for FY 2004. At the time of writing, the Army was awaiting Secretary of the Army approval to issue and implement guidance to the field.

Outcome Goal: Shape the Force of the Future.

America needs a force trained and ready to meet future asymmetric threats and international challenges. We know that status quo personnel policies won't suffice, so we will need modern personnel systems, and better ways to use the Reserve component.

The eight metrics described here, which include discussions of the Civilian and Military Human Resource Strategic Plans, provide ways to ensure DoD shapes itself to effectively meet future challenges.

Activity Metric: Active Component/Reserve Component Force Mix

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
Benchmark of the proper balance between Active and Reserve Component Forces	No historical data: new metric		Identified force rebalancing requirements	Identified areas of stress on the force Identified areas which can be civilianized
[a] The FY 2004 data are final.				

Metric Description. The FY 2001 Quadrennial Defense Review directed a comprehensive study of the proper mix of Active and Reserve component (AC/RC) forces. That study was completed in December 2002. It concluded we could enhance overall military capability by rebalancing both AC/RC force mix and mission assignments.

The purpose of this rebalancing is to create a structure which uses the Reserve component more effectively. Some initiatives in support of rebalancing will likely require legislative changes and take several years to implement.

Ongoing Research. A variety of initiatives are underway. A study of the stress on the Reserve component forces examined all specialties mobilized for current operations (Operations Noble Eagle/Enduring Freedom/Iraqi Freedom) and comparing the data against previous operations (Desert Shield/Desert Storm) and recent Presidential Reserve Call-ups (Bosnia, Kosovo, Southwest Asia). The study measured stress using three factors: frequency of call-ups; duration of call-ups; and percentage of inventory used (i.e., how much of the force capability was employed). The results of this study helped us better balance the Army's AC/RC capabilities mix in the FY 2005 budget. We also identified over 100,000 positions that could be realigned to reduce the need for involuntary Reserve component mobilization and relieve the stress on high-demand Reserve component capabilities.

We also are exploring other alternatives to mitigate stress on the force. Some of these alternatives will require legislative or policy changes to implement. For example, we are pursuing the concept of "reachback." Reachback is defined as the ability to connect electronically to sites in the Continental United States or other locations around the world to accomplish essential tasks and missions in an effort to reduce the number of forward-deployed personnel needed to support combat troops during an operation.

We are looking beyond near-term efficiencies to address stress on the force. We are planning to put in place better global force management and Reserve component mobilization processes, new technologies, and more modular units to underpin the force's transformation. These actions will not only relieve stress on the force today, but will have long lasting, positive impacts on our ability to manage peak demands on our military in the future.

Other working groups are exploring ways to streamline processes and policies, such as the mobilization process and force management policies, which might also mitigate stress on the force. Successes here may reduce the need for certain force rebalancing actions.

Finally, the Secretary of Defense identified 148 "Stress on the Force" actions to be addressed by future action plans and metrics.

Timeline for Completion. Our timeline for completing this metric has been adjusted to December 2004 to allow for the many ongoing actions to mature. We are also in the process of identifying up to 300,000 military positions for possible "civilianization."

Performance Results for FY 2004. During FY 2004, more detailed and frequent "stress on the force" analyses have been conducted, with enhanced data accuracy. They have provided insight into those areas where force rebalancing is necessary.

Supported by these “stress” analyses, up to 30,000 military billets will have been restructured by the end of FY 2004. Up to 10,000 military infrastructure positions will have been identified for civilianization by the end of FY 2004. Legislative proposals to reduce stress on the force through enhanced volunteerism have been submitted in the Department’s FY 2005 Omnibus bill.

Performance Metric: Military Human Resource Strategic Plan

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual[a]
Percentage of scheduled tasks completed	No historical data: new metric	1	7	80%[b]/100%

[a] FY 2004 data are as of the 4th quarter (estimate).

[b] In 2002, 25 funded or in-house studies were programmed to be completed by the end of FY 2005. However, in 2003, this metric was changed to be consistent with the Civilian Human Resource Strategic Plan metric. Beginning with FY 2004, the measure is the percentage of tasks (funded or in-house) scheduled for completion that we completed during the fiscal year.

Metric Description. This metric compares the number of tasks scheduled for completion under the Military Human Resources Plan with those actually completed. If 80 percent of tasks are completed, the result is considered “on track” for achieving plan goals. Beginning in FY 2004, the percentage target will be calculated by dividing the number of projects completed in a fiscal year by the number scheduled to be completed that fiscal year. As described below, tasks are removed from the plan as they are completed.

The Military Human Resources Strategic Plan has six main goals:

- Increase the willingness of the American public to recommend military service to our youth.
- Recruit the right number of quality people.
- Develop, sustain, and retain the force.
- Seamlessly transition members to and from Active and Reserve status.
- Develop a flexible, integrated human resources management information system.
- Sustain continuous human resource process improvement.

Each goal has subordinate objectives and actions. The plan is a living document, so the number of tasks varies from year to year. As studies of new ideas or proposals are completed, one of four actions is taken: the idea is abandoned (typically because it is ineffective or inefficient); legislation is requested to implement the idea; the idea is implemented and applicable metrics established; or the idea is scheduled for further study. A task that resulted in a decision for action is considered completed, and removed from the plan. New ideas also are added to the document. In FY 2002, the plan contained a total of 40 tasks. Currently, there are 30 resourced tasks associated with the six goals in the plan. Of these tasks, 7 are on-going actions, 7 were completed in FY 2003; 16 tasks are scheduled for completion in FY 2004 or FY 2005.

This plan establishes priorities for the next several years:

- Accessing enlisted personnel with the right level of education and aptitude.
- Ensuring the force is manned with the right number of military members in the appropriate skills.
- Implementing a two-year pilot program, putting into place an “up-and-stay” promotion process for certain high-investment specialties.

Performance Results for FY 2004. We expect to achieve 100 percent of our goal by completing all 10 scheduled tasks; one task previously scheduled for FY 2004 was expanded in scope and extended until FY 2005. In addition, we used in-house resources to develop a set of leading indicators the Department can use to predict recruiting and retention problems.

Activity Metric: Implement New Reserve Component Management Paradigm

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
A new baseline for managing Reserve Component forces	No historical data: new metric		Established goals such as promoting volunteerism and reachback capabilities. Employed five initiatives geared to support creating a seamless flow between Active and Reserve Components.	Introduced legislative proposals. Introduced linguist program.
[a] The FY 2004 data are final.				

Metric Description. The FY 2001 Quadrennial Defense Review directed a comprehensive review of the use of Reserve component forces. That study, completed in December 2002, proposed a concept called "continuum of service." Under this concept, a Reservist who normally trains 38 days a year could volunteer to move to full-time service for a period of time – or some increased level of service between full-time and his or her normal Reserve component commitment, without abandoning civilian life. Similarly, an active duty Service member could request transfer into the Reserve component for a period of time, or some status in between, without jeopardizing his or her full-time career and opportunity for promotion. Military retirees with hard-to-find skills could return on a flexible basis and create opportunities for others with specialized skills to serve.

The purpose of the new management paradigm is to create a comprehensive management system that will better facilitate flow between Active and Reserve component service, and enhance Reserve component usage. Some of the initiatives in the study recommended will require legislative, policy, or regulatory changes and, therefore, will take several years to implement.

Ongoing Research. Our efforts are geared to support: (1) creating a seamless flow between Active and Reserve components forces; (2) encouraging volunteerism and establishing new affiliation programs; (3) simplifying rules for accessing, employing, and separating Reserve component personnel; (4) increasing flexibility of the Reserve component compensation system; and (5) enhancing combined Active and Reserve component career development.

We have not settled on a means for measuring the success of this new paradigm. Possible metrics are: (1) number of approved tasks completed (on time) compared with the number of approved tasks; (2) percentage of legislative proposals approved; and (3) number of force management initiatives identified by each Service to better integrate and remove barriers compared with the number approved.

However, at this time, these do not appear to provide valid evaluation tools for effectively measuring the efforts undertaken to implement the continuum of service concept. Efforts to determine valid, useful performance measures will continue as we move forward with these multiple initiatives.

Timeline For Completion. Undetermined at this time because specific measures have not yet been developed.

Performance Results for FY 2004. During FY2004 we established the Army's 09L (Arabic linguist/translator) program. Two hundred three individuals have been recruited into the program; 102 of them have been sent to training; 52 have completed (or are in) training. Approximately 25 members have graduated and have been deployed to Iraq or Afghanistan.

The civilian employer information requirement has met legal requirements and is now on-line. The system allows for direct input by the Reserve component member. Data collection is in its initial stages.

Certain Service-specific programs have been initiated, such as the Air Force's additional blended/associated units; Air Force-sponsored Reserve component base operations and support; the Army's "stressed" career fields initiative; the Navy's Sea Warrior program; and the Marine Corps' increased use of volunteers.

The Department has submitted a series of FY 2005 legislative proposals in its Omnibus Bill to enhance Reserve component use, promote volunteerism, and provide flexibility in management.

Overall, there has been significant activity in this area, but we have not yet determined how to measure progress since we have not yet determined the optimum outcome required for long-term, high-level performance.

Activity Metric: Identify Future Critical Skills

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
Outcome goals that establish standards for emerging critical skills.	No historical data: new metric.		Established common definitions of critical fill needs. Considered alternative metric development.	Agreed to common definition of critical skills. Identified most critical needs for recruitment and retention.

[a] The FY 2004 data are preliminary.

Metric Description. We need to be able to identify those skills which will be critical to the future force with enough lead time to ensure that, when they are needed, there are Service members in these skills who are trained and ready. The skill and experience combinations that are deemed critical will vary from Service to Service. Because of this variability, it is not possible for us to fully understand what makes these skill/experience combinations so important. Without this knowledge, we cannot adequately assess our capability to identify, recruit, train, retain, and sustain service members in these skills.

Ongoing Research. The Officer and Enlisted Personnel Management (OEPM) Directorate is responsible for designating a common set of criteria for "critical skills." In addition to a set of common criteria, each Service will use its own criteria to determine those skills, or skill/experience combinations, that are critical to individual Service missions.

As part of Phase I of the study to understand how to set future critical skills, we sought to establish a metric to track progress on determining current "critical skills." In Spring 2004, we established a common definition of "critical skill." By the end of FY 2004, a metric for "critical skills" should be in place. The metric will provide a comprehensive list of the most common critical skills across the Department. While the final product will be Service-specific; the final list will meet a common DoD definition of "critical skill."

Phase II of the study will review the Services' transformation programs and the Department's vision of military strategy and responsibilities for the next 25 years. Specifically, we will need to address what skills are going to be required to support this future strategy and which of those skills will be catalogued as "critical" (e.g., foreign area specialists, information operators, space experts) based on the criteria established in the study. The follow-on questions are many, such as: How will personnel be recruited in these skills? What programs will be required? Will we need special incentives? Could more wide-spread use of lateral entry options ease skill shortages? Is the training base adequately resourced with experienced personnel to provide entry level and advanced training? What retention incentives are going to be required to retain them? What jobs and education are required to provide for a viable and rewarding career path?

This metric has a "yes" or "no" outcome. We are not positing that in order to answer "yes" for the metric that the answer be a list of critical skills and plans and programs outlined to answer all the questions addressed; rather, the desired outcome is a planning document which lays out what has to be accomplished in order for the Department to begin the process to recruit, train, retain and sustain personnel for a future critical skill.

Timeline for completion. Three months after the Phase I study is complete, we will draft a study plan for Phase II. A final report will be published six months after the Phase II study begins.

Performance Results for FY 2004. A DoD-wide definition of "critical skill" was established in Spring 2004, and the corresponding metric will be complete during 2004.

Activity Metric: Optimal Officer Career Patterns

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
Percentage of officers on optimal career path for retention	No historical data: new metric.		Phase I of RAND study complete. Started Phase II.	Published Phase 1 report.

[a] The FY 2004 data are preliminary.

Metric Description. Objective 3.4 of the Military Personnel Human Resources Strategic Plan is to "conduct studies on officer career and promotion management that will extend time in job and service tenure." Consequently, we commissioned a study to assess the management and policy implication of potential changes in officer career management, given officer requirements. We expect legislative changes will be required to implement such changes.

Ongoing Research. RAND is currently conducting a study to develop alternative management processes, plans, and policies that consider:

- The cap on officer career lengths
- The feasibility and advisability of longer assignments
- The effects of different grade and position tenures on retention or performance
- Past officer assignment length patterns
- Patterns of promotion and career tenure
- Existing system dynamics military manpower models to reflect selected changes to current officer management
- The implications of selected changes to policy for officers' career paths
- The need for different or additional compensation and incentives to support any changes in existing personnel practices.

Phase I of the study addressed General and Flag Officer careers; Phase II is addressing careers of officers in the grade of Colonel and below.

After Phase II is complete, an implementation plan will be developed. This plan may depend on legislative requests and policy changes.

Timeline for Completion: The Phase I study was completed in July 2003 and the report published in January 2004. The Phase II study began at the end of FY 2003. The final report, "Future Officer Force Modeling and Analysis," is expected by the end FY 2005. As appropriate, policy or legislative changes will be compiled in FY 2005 and FY 2006, and metrics developed in FY 2006. The timeline has slipped by approximately one year, because the scope of the project was increased to include at least one Air Force community, in addition to Army and Navy communities.

Performance Results for FY 2004. The Phase I RAND report was published in January 2004. So far this year, two Phase II communities have been modeled: Navy Surface Warfare Officers and Army Infantry. Progress reports were completed in January and June 2004 and subsequently passed to the Army and Navy.

Performance Metric: Civilian Human Resources Strategic Plan

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual
Percentage of Civilian HR Strategic Plan tasks completed	No historical data: new metric	90% (26 of 29 tasks completed)	98% (40 of 41 tasks completed) (includes three FY 2002 carryover tasks)	80%/53% (32 of 60 tasks completed) [a] (includes one FY 2003 carryover task)
[a] The FY 2004 data are as of the 3rd quarter (final)				

Metric Description. Good human capital management is one of the key tenets of the Department's transformation initiative. The DoD Civilian Human Resources Strategic Plan is the roadmap that provides direction and outlines the standards for achieving those transformational results. This plan links to agency mission and goals that cascade throughout the Department. We measure progress quarterly.

We judge success by comparing the number of tasks scheduled to the number completed on a quarterly and annual basis. To be rated as successful, 80 percent of tasks scheduled must be completed annually. (This target changed in FY 2003 to be consistent with how progress under the Military Personnel Human Resources Strategic Plan was being measured.) To provide more qualitative information about the overall effect of our annual activities, we are now working to replace task-dependent *output* measures with task-dependent *outcome* measures.

The process of refreshing the strategic plan is dynamic and necessary to ensure implementation of any requirements levied by law, policy, or best practice. The total number of tasks identified for any given reporting period is not static over time, but remains fairly consistent in the short term.

Our strategic planning process is effectively integrated with the combined program and budget and Unified Legislative Budget processes. The Human Resources Strategic Planning Senior Steering Group meets at least annually to refresh the plan and ensure that new and emerging initiatives are considered and receive the highest level of support and recognition.

Performance Results for FY 2004. As of the end of the third quarter of FY 2004, 32 of 60 activities were completed. As of the date of publication, the Department exceeded the FY2004 scheduled quarterly expectations and expected to meet 4th quarter expectations by completing at least 21 of 26 scheduled activities. One exception will be to carryover the Department's scheduled July 2004 fielding of the DoD Civilian Satisfaction Survey to October 2004. The FY 2004 target of 66 was adjusted by four to reflect the shift in National Security Personnel System responsibilities to a Program Executive Office. Two tasks were moved to FY 2005.

Activity Metric: Civilian Recruiting Cycle Time

End-State Metric	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Trend data to monitor the number of days appropriated fund positions are vacant.	No historical data: new metric		• Draft Performance Measures • Benchmark with Fortune 500	• Issue reporting requirements for measure • Integrate OPM reporting requirements into DoD reporting requirements.

[a] The FY 2004 data provided above is preliminary.

Metric Description. This measure provides a standard performance metric and a standard data collection method for evaluating the efficiency of civilian recruiting cycle time across the Department. It is linked to the Office of Personnel Management (OPM) Human Capital Standards for Success, the Office of Management and Budget (OMB) scorecard, and is benchmarked to the "time to fill" metric used by Fortune 500 companies. Once data is collected, the Department will be able to determine, for appropriated fund placement actions, the average number of days from the date the position became vacant to the effective date of the placement action.

The time it takes to fill a vacancy can seriously affect an organization's ability to accomplish its mission. OPM's Human Resources Management (HRM) Accountability System Standards issued on January 4, 2002, lists "time to hire" as an example of a measure of human resources operational efficiency. The HRM Accountability System Standards may be viewed at: *http://www.opm.gov/account/standards.asp*.

Ongoing Research. On May 6, 2004, OPM imposed a new requirement to report on their 45-day hiring model. The OPM model tracks the number of working days from the date the vacancy announcement closed to the date the job offer was made. Since the OPM 45-day hiring requirement is a subset of the DoD "Time to Fill Metric" DoD plans to combine the DoD and OPM requirements into a single reporting requirement.

Timeline for Completion. This metric is scheduled to be fielded in FY 2005.

Performance Results for FY 2004. Representatives from Office of the Secretary of Defense (OSD) and the components participated in a working group to develop standard performance metrics for human resources as part of the DoD Civilian Human Resources Strategic Plan. This group considered the various aspects of a metric that would measure civilian recruiting cycle time, and revised the performance measures to mirror human resources metrics used by Key Fortune 500 organizations.

Activity Metric: Meeting Civilian Critical Fill Goals

Metric	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Number of critical positions encumbered as compared to number of critical positions authorized equals percentage.	No historical data: new metric		• Reviewed previously identified DoD critical positions, by core mission and critical support occupations • Issued reporting requirements	• Analyzed data at DoD and Component level. • Reported results of analysis

[a] The FY 2004 data are preliminary.

Metric Description. This measure monitors the fill rate of critical positions by core mission occupations and critical support occupations. Core mission occupations are those that most directly affect the Department's ability to accomplish its mission over the long term. Critical support occupations are those that provide support for the core mission occupations.

The ability of an organization to fill critical positions in support of its core functions affects how efficiently and effectively it can accomplish its mission. Thus, fill rate is an integral part of human capital management. As early as 1999, the Government Accountability Office asked us to list our core mission and critical support occupations. We subsequently surveyed the Military Departments and Defense Agencies to identify core mission and critical support occupations and identified 13 core mission occupations and 23 critical support occupations:

Core Mission Occupations		Critical Support Occupations	
Occupational Series	Series Title	Occupational Series	Series Title
0602	Medical Officer	0018	Safety and Occupational Health
0800	Engineering Professions	0080	Security Administration
1101	General Business	0083	Police
1102	Contracting	0085	Guard
1152	Production Control	0201	Personnel Management
1300	Physical Science Professions	0260	Equal Employment Opportunity
1520	Mathematics	0301	Miscellaneous Administration
1550	Computer Science	0343	Management Analyst
1910	Quality Assurance	0346	Logistics Management
2001	General Supply	0391	Telecommunications Manager
2003	Supply Management	0501	Financial Administration
2010	Inventory Management	0505	Financial Management
2030	Distribution Management	0510	Accounting
		0560	Budget Analyst
		1670	Equipment Specialist
		1710	Education and Vocational Training
		1712	Training Instruction
		1811	Criminal Investigating
		2101	Transportation Specialist
		2130	Traffic Management
		2150	Transportation Operations
		2161	Marine Cargo
		2210	Computer Specialist

Ongoing Research. Due to changing mission requirements and the variety of missions within DoD, the Military Departments have been asked to review the DoD list of critical positions and provide, by FY 2005, their "Top Ten List" of short-term critical mission occupations. Currently, we have no reliable, consolidated, automated system for collecting position authorization data; we continue to explore automated methodologies.

Timeline for Completion. By the end of FY 2005, we will develop civilian fill targets by occupation, as well as short-term "Top Ten" lists of critical positions by Service and defense agency.

Performance Results for FY 2004. As of the 3rd quarter FY 2004, the overall fill rate for core mission occupations was 96.98 percent, and for critical support occupations was 99.83 percent. The Services and defense agencies fill rates were:

Core Mission occupations -
- Army – 102.88%
- Navy – 101.15%
- Air Force – 80.13%
- Defense agencies – 93.02%

Critical Support occupations –
- Army – 106.99%
- Navy – 99.62%
- Air Force – 81.14%
- Defense agencies – 95.16%

Operational Risk

Operational risk results from factors shaping the ability to achieve military objectives in a near-term conflict or other contingency.

In simplest terms, it is about whether we can overcome today's threats—about our ability to create plans that can be adapted quickly as events unfold, train for the next mission, and supply the warfighters with what they need *now*. It is about achieving near-term objectives, not long-term outcomes—thus, it is an important dimension of the defense strategy, but not the entire strategy.

> ***"Most agree that to win the global war on terror, our Armed Forces need to be flexible, light and agile—so they can respond quickly to sudden changes. "***
>
> ***Secretary Rumsfeld***
> ***February 5, 2003***

The four outcome goals of this risk management quadrant help the Secretary of Defense answer the following questions:

- Do we have the right forces available?
- Are our force postured to succeed?
- Are our forces currently ready?
- Are our forces employed consistent with our strategic priorities?

All of the measures in this quadrant are activity metrics and reflect efforts currently underway within the Department to develop new joint baselines, new joint capabilities, or new performance metrics for joint readiness.

Outcome Goal: Do we have the right forces available?

A pivotal tenet—to be able to respond rapidly, set conditions for deterrence, or swiftly defeat an adversary—is having the right forces in the right place at the right time. This means having:

- Forces forward stationed, or in-theater rotating forces. *First Responders*
- Forces that fly-in or fall-in on prepositioned equipment. *Immediate Response*
- Forces that flow quickly into theater *Rapid Response*

The following metric is under development but is designed to help the Department follow this tenet.

Activity Metric: Operational Availability

End-state Metric (New Baseline)	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Integrated data and management systems that can be used to assess percentage of force ready for specific joint tasks	No historical data: new metric.			• Tested prototype process for Global Force Management system. • Approved adaptive planning concept and prototype. • Developed two current and two future analytic baselines.

[a] The FY 2004 data are preliminary.

Metric Description. Today we increasingly rely on forces that are capable of both symmetric and asymmetric responses to current and potential threats. We must prevent terrorists from doing harm to our people, our country, and our friends and allies. We must be able to rapidly transition our military forces to post-hostilities operations, and identify and deter threats to the United States while standing ready to assist civil authorities in mitigating the consequences of a terrorist attack or other catastrophic event. These diverse requirements will demand that we integrate and leverage other elements of national power, such as strengthened international alliances and partnerships.

To meet these new missions, and to hedge against an uncertain future, we are developing a broader portfolio of capabilities, and realigning our forces using a building-block approach to match those capability portfolios with mission goals. Among the most important initiatives are:

- *Global Force Management*. This initiative will provide a database and management system that can be used to monitor U.S. force postures worldwide. It will account for ongoing operations and constantly changing unit availability, and will allow us to do the kinds of analyses needed to ensure we allocate the right force for specific missions, at the right place and time.

- *Adaptive Planning*. Our goal is to produce war and contingency plans that are more timely, adaptive, and responsive to the current security environment, thus providing relevant options to the President and Secretary of Defense. We are working toward having a networked capability to produce plans on demand via the global information grid by 2008.

- *Analytic Baselines*. To guide analyses for both the near- and far-term, we are creating a set of common scenarios and data. These analytic baselines will underpin our strategic assessments, and guide decisions on joint warfighting issues and policy.

Ongoing Research. See the discussion of these activities elsewhere in this document.

Timeline for Completion. These and related initiatives, including the Defense Readiness Reporting System, are slated to complete development and enter fielding during FY 2005 through FY 2008.

Performance Results for FY 2004. During FY 2004, we made steady, positive progress in establishing Global Force Management, notably by making the U.S. Joint Forces Command responsible for developing global, joint sourcing solutions for conventional forces in support of Combatant Commander requirements – independent of unit assignment to a specific Combatant Command. We also made progress toward our adaptive planning goals by using the concept to construct force flows for the Operational Availability 2004 simulation models (THUNDER, Integrated Theater Engagement Model, and Joint Integrated Contingency Model). Finally, we began work on a study entitled, "Operational Availability FY 2005 (OA 05)." To support this study, we will develop two future-year analytic baselines: Major Combat Operation-1 and the Baseline Security Posture. In addition, other major combat operations studies, as well as small-scale contingency studies, will use the OA-05-developed Baseline Security Posture for analysis. A more detailed discussion of each of these three initiatives is provided in separate metrics.

Outcome Goal: Are our forces postured to succeed?

The ability to globally manage the location and apportionment of air, sea, and land forces and do so in a manner that meets worldwide commitments, while strengthening our ability to meet security challenges, is the focus of efforts being measured to have our forces postured to succeed.

Activity Metric: Global Force Management

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
Real-time operational availability and risk assessment to guide decisions on how to source joint force capabilities	No historical data: new metric.		Developed Global Force Management construct.	Established Force Management Functional Capabilities Board. Tested prototyped process to source FY 2005-2006 commitment.

[a] The FY 2004 data are final.

Metric Description. In 2003, the Secretary of Defense directed the Chairman of the Joint Chiefs of Staff to develop an integrated force assignment, apportionment, and allocation methodology. The Secretary also directed the U.S. Joint Forces

Command (USJFCOM) to develop a means for monitoring joint force operational availability. In response, we have initiated the Global Force Management (GFM) process, designed to continuously manage the process that provides forces to conduct operational missions (called "sourcing"). It uses analytically based availability and readiness management methodologies. GFM provides comprehensive insight into U.S. force postures worldwide, and accounts for ongoing operations and constantly changing unit availability. GFM leverages the most responsive, best-positioned force at the time of need; it forms the basis of Joint Presence Policy that guides the allocating of Service forces that rotate into theater. GFM provides senior decision-makers the means to assess risk in terms of forces available for Combatant Commanders' war plans and likely stress on the force. When mature, this metric will describe our ability to rapidly source joint force capabilities with the right units providing the right capability.

Ongoing Research. There are several ongoing initiatives in support of GFM. The Joint Staff is leading the standardization and web-enabling of Service and Combatant Command force structure data as a key enabler to reliable, visible, and responsive global force availability information. In another GFM-related initiative, USJFCOM is assuming the role of the primary joint force provider and thus the single voice to source commitments. A final initiative is the codification of the Global Force Management Board – this Joint Staff-led study team is establishing the roles, missions, and functions of this board that will support the GFM process.

Timeline For Completion. The Global Force Management Data Initiative is expected to achieve initial operational capability by FY 2006. By December 2004, USJFCOM requirements in support of the joint force provider functions will be determined and the GFM Board will be codified.

Performance Results for FY 2004. During FY 2004, we made steady, positive progress in establishing GFM. A major development was the decision by the Secretary to establish USJFCOM as the primary joint force provider. USJFCOM is now responsible for developing global, joint sourcing solutions for conventional forces in support of Combatant Commander requirements – independent of unit assignment to a specific Combatant Command. We also integrated the previously stove-piped assignment, allocation and apportionment processes under a single integrated document entitled *Global Force Management.* This document is a critical step in attaining the GFM goals of ensuring the most available, best positioned force supports Combatant Commander requirements, while measuring risk incurred to standing contingencies and plans based on sourcing recommendations. A final development this year was the establishment of the Force Management Functional Capabilities Board under the Joint Capabilities Integration and Development System process. This board oversees a myriad of GFM actions to ensure validated operational requirements are supported, and to provide the military advice to the Secretary on force management issues.

Activity Metric: Theatre Security Cooperation

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Annual assessment of how theater security cooperation plans are contributing to DoD strategic goals	No historical data: new metric.		Initial security cooperation guidance developed and approved. Combatant commands and Services developed strategies.	FY 2005 plans completed. FY 2004 strategies successfully completed.

[a] The FY 2004 data are final.

Metric Description. Recently, we initiated a comprehensive security cooperation strategy review that focused the activities of Combatant Commands, the Services, and defense agencies on the common goals that we need to achieve if we are to build the right defense partnerships with friends and allies. Security cooperation embraces all defense interactions with foreign defense establishments, and is our primary means of building relationships that promote specific U.S. security interests. Security cooperation activities help our allies develop military capabilities for self-defense and coalition operations. They also provide information, intelligence, and peacetime access to enroute infrastructure and other access in the event of a contingency. Theater security cooperation is a subset of defense security cooperation and encompasses activities Combatant Commands conduct to further our national goals and priorities.

Ongoing Research. We are currently researching appropriate assessment metrics to determine effectiveness of the security cooperation program, and evaluating the capabilities required for security cooperation. This analysis will help us shape an associated Joint Operating Concept.

Timeline for Completion. Initial metrics are slated for completion during FY 2005, in time to be used to develop the FY 2006 plans.

Performance Results for FY 2004. In FY 2004, we continued to focus efforts on the six major defense policy themes: combating terrorism, influencing the direction of key powers, transforming the relationships with key powers, cooperating with parties to regional disputes, supporting realignment, and strengthening alliances for the future. Combatant Commands successfully executed the first generation of theater security cooperation plans. A detailed assessment of completed FY 2004 strategies was used as a point of departure for updating FY 2005 plans. The most important result from FY 2004's theater security cooperation efforts is that the Services, functional and Combatant Commands, and defense agencies are coordinating their security cooperation efforts. This has created a collaborative planning environment and improved the quality of the overall security cooperation program.

Outcome Goal: Are our forces currently ready?

The most basic information the President and Secretary of Defense must know about America's Armed Forces is whether they are ready to perform their next mission.

To enhance current readiness reporting, four metrics are currently under development in support of this outcome goal. One helps leadership assess our ability to produce plans that are more timely, adaptive, and responsive to the current security environment. One helps create a foundation for strategic analyses. Another tells us how well we are learning lessons from current operations, and another fundamentally changes the way force readiness issues are measured, reported, and resolved.

Activity Metric: Adaptive Planning

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
Percentage of deliberate and crisis plans networked as "living plans" in a collaborative joint command and control environment	No historical data: new metric.		Tested prototype of adaptive planning tool	Approved adaptive planning concept and matured operational prototype.

[a] The FY 2004 data are final.

Metric Description. As a result of a Combatant Commander's conference, the Secretary of Defense directed the Chairman of the Joint Chiefs of Staff to develop a new system to replace existing deliberate and crisis planning methods. The goal is to produce plans that are more timely, adaptive, and responsive to the current security environment, providing relevant options to the President and Secretary of Defense. Our long-term goal is to have a networked capability to produce plans on demand via the global information grid by 2008.

Adaptive planning will be implemented in three phases. The initiation phase (now through FY 2006) will deploy new tools and exercise portions of the adaptive planning construct on select priority plans. The implementation phase (FY 2006 - 2008) will produce electronic plans for all contingencies in a collaborative joint command and control (JC2) environment. The integration phase (beyond FY 2008) will produce and continually update "living" plans in a collaborative JC2 environment.

Ongoing Research. The Chairman has established an implementation working group to provide direction to adaptive planning activities and procedures. We continue to test and refine the web-based Collaborative Force Sustainment and Transportation (CFAST) tool to build campaign plans. We are also developing other tools to enable a collaborative planning environment. Adaptive planning efforts continue to be synchronized with numerous other Department transformational initiatives such as Global Force Management, the Standing Joint Force Headquarters, and the Defense Readiness Reporting System.

Timeline for Completion. Implementation plan, initial tools assessment, and CFAST version 3.0 should be complete by FY 2005. CFAST version 3.0 is a key component to successful testing of adaptive planning in its initiation phase.

Performance Results for FY 2004. The Department made significant progress advancing the adaptive planning concept. The Secretary approved the concept and we established a team to ensure successful implementation throughout the Department. The U.S. Joint Forces Command conducted a formal test and evaluation of CFAST that resulted in modifications, improvements, and corrections to identified flaws. The Joint Staff used adaptive planning to construct force flows for the Operational Availability FY 2004 simulation models (THUNDER, Integrated Theater Engagement Model, and Joint Integrated Contingency Model). CFAST significantly decreased the planning time, increased the force flow accuracy and prototyped the collaborative planning environment.

Activity Metric: Analytic Baselines

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
Number and quality of analytic baselines used to support the Quadrennial Defense Review and other major department studies.	No historical data: new metric		Developed two future baselines.	Developed two current and two future baselines.
[a] The FY 2004 data are final.				

Metric Description. In his annual planning guidance, the Secretary of Defense directed that we create a foundation for strategic analyses that relied on common scenarios and data. These analytic baselines are intended to provide senior staff responsive and analytically sound insights to help them make decisions on joint warfighting issues and policy. Analytic baselines support readily available and collaboratively generated analyses, documentation, and results for use throughout the Department. They are a common starting point for the Department's most important studies. The current-year baselines accelerate the deliberate planning process and are based on existing Combatant Commander war planning efforts and concepts of operation; future-year baselines are primarily developed for use in Department-wide studies such as Operational Availability FY 2005.

Ongoing Research. The Joint Staff is currently conducting Operational Availability FY 2005 (OA 05). To support this study, we will develop two future-year analytic baselines: Major Combat Operation-1 (MCO-1), "Swiftly Defeat the Effort," and the Baseline Security Posture (BSP). Additionally, other MCO and small-scale contingency studies will use the OA-05-developed BSP baseline for analysis.

Timeline for Completion. A current-year baseline is under development with a final report due early FY 2005. In mid-FY 2005, a second current-year baseline is tentatively scheduled to support the development of a Combatant Commander's Concept of Operations Plan (CONPLAN). The OA-05 study will develop two future-year baselines, with the final report due December 2005.

Performance Results for FY 2004. Two Combatant Commanders developed current-year baselines in FY 2004 to support development of their contingency plans. The OA-04 study produced future-year analytic baselines for two separate "Swiftly Defeat the Effort" campaigns.

Activity Metric: Operational Lessons Learned

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
Percentage of lessons-learned captured, analyzed, and implemented to improve joint warfighting capabilities.	No historical data: new metric.	Released lessons learned develop-ment concept.	Released DoD Training Transfor-mation Impleme n-tation Plan.	Approved enhanced Joint Lessons Learned Program Study.
[a] The FY 2004 data are final.				

Metric Description. The Secretary of Defense and the Chairman of the Joint Chiefs of Staff have both highlighted the importance of an effective joint lessons-learned program. The *DoD Training Transformation Plan (June 2003)* identifies the need to ensure that lessons-learned are integrated into the development of new training processes and systems (see www.t2net.org). To do this, lessons-learned from operational missions must be systematically captured and injected into the full range of preparatory and planning activities, ongoing experimentation, concept development, doctrine, and joint tactics, techniques, and procedures development. To be effective, lessons-learned must be implemented at the lowest organizational level. When mature, this metric will monitor our progress toward effectively enhancing joint warfighting capability by quickly distributing and incorporating relevant operational lessons-learned.

Ongoing Research. The Joint Staff finalized lessons-learned from Operation Iraqi Freedom and introduced the first five, priority lessons-learned into the Joint Capabilities Integration and Development System. The Chairman directed the U.S. Joint Forces Command (USJFCOM) to expand the lessons-learned program by collecting and analyzing lessons-learned data collected by Combatant Commands, Services, and defense agencies.

Performance Results for FY 2004. During FY 2004, the Enhanced Joint Lessons Learned Program (JLLP) Study was completed; this initiative analyzes existing capabilities to capture lessons-learned and develop alternative courses of action. USJFCOM established the Joint Center for Operational Analysis–Lessons Learned; joint lessons-learned specialists were placed in the individual Services' lessons-learned centers to assist with the collection, analysis, and distribution processes. The Joint Staff began updating the Joint Lessons-Learned Program instruction to reflect the changes in the collection, analysis, implementation and follow-up procedures to include the replacement of the Remedial Action Program with the institutionalized Doctrine, Organization, Training, Material, Leadership, Personnel and Facilities (DOTMLPF) change processes. The Joint Staff and USJFCOM sponsored the Worldwide Joint Lessons-Learned Conference in July 2004 to shape evolving policies, demonstrate success stories already impacting warfighters, receive input from allies, and promulgate changes to the overall lessons-learned program.

Activity Metric: DoD Readiness Reporting System (DRRS) Implementation

End-state Metric (New Baseline)	FY 2001	FY 2002	FY 2003	FY 2004 [a]
A new DoD-wide readiness reporting system	No historical data: new metric		Awarded develop ment contract.	Reached Initial operating capability. Conducted technical capability review. Provided an operational version.

[a] The FY 2004 data are preliminary.

Metric Description. The 2001 Quadrennial Defense Review directed us to fundamentally change the way force readiness issues are measured, reported, and resolved. DoD Directive 7730.65, *DoD Readiness Reporting System* (DRRS), signed on June 3, 2002, launched a series of important changes to policy and procedures that will allow us to develop and field a new readiness reporting and assessment system. The Secretary of Defense receives periodic updates on progress toward fully implementing DRRS across the Department.

When mature, DRRS will provide a capabilities-based, adaptive, near-real-time readiness reporting system for all military units. *Readiness will be assessed from the perspective of the Combatant Commanders.* This is important because Combatant Commanders first describe their roles and responsibilities in terms of mission essential tasks (METs), assigned missions, and core tasks, and then they assess their ability to conduct these tasks.

Ongoing Research. The Under Secretary of Defense for Personnel and Readiness is managing a comprehensive research effort being conducted by several development teams:

- Booz Allen Hamilton (development team)
- Camber Corporation (training readiness development team)
- Dynamics Research Corporation (plan-to-task study team)
- Alion Science and Technology (development team)

- Computer Sciences Corporation (functional architecture)
- Northrop Grumman (munitions requirements)

Timeline for Completion. DRRS achieved initial operational capability at the end of FY 2004; full operational capability is expected by the end of 2007.

Performance Results for FY 2004. The Under Secretary of Defense for Personnel and Readiness is managing a comprehensive research effort being conducted by several development teams. In FY 2004, a project office and development team was identified and employed; the team has successfully demonstrated that DRRS 1.0 is operational. They also completed concept of operations, project management, and strategic plans; conducted an initial DRRS functionality test; established an initial DRRS network infrastructure; and developed a readiness markup language (RML) specification. An initial scenario-to-unit METs methodology was completed and the Enhanced Status of Resources and Training System (ESORTS) prototype was fielded. The team also successfully conducted a technical capability review of the "Build MET," "Assess MET," "TurboMET," and "Portal" applications. Finally, a DRRS Support Center was established at U.S. Pacific Command.

Outcome Goal: Are our forces employed consistent with our strategic priorities?

As our defense strategy changes, it is important to update our operation and contingency plans accordingly. When there are large changes, such as the Department's decision to leverage joint training and operations, it means new concepts and tools must be developed to enhance the planning process.

The following measures are designed to help us gauge our success at achieving this goal.

Activity Metric: Joint Concepts

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
Number of concepts approved to link strategic guidance to warfighting capabilities	No historical data: new metric		Joint Operations Concepts construct approved.	Endorsed 2 of 4 Joint Operating Concepts. Approved 5 functional concepts.

[a] The FY 2004 data are final.

Metric Description. Joint concepts guide the transformation of the joint force so that it is prepared to operate successfully over the next 10-20 years. The Joint Operations Concepts (JOpsC) document describes how the future military will operate as we transition from a threat-based to a capabilities-based force. It provides the operational context for the transformation of the U.S. Armed Forces by bridging the gap between strategic guidance and the Department's resourcing strategy for capabilities. JOpsC also assists in structuring joint force experimentation and assessment activities that we use to validate capabilities-based requirements. It is the overarching framework that defines the construct for the development of subordinate Joint Operating Concepts, Joint Functional Concepts, and Joint Integrating Concepts.

Joint Operating Concepts (JOCs):

- major combat operations,
- stability operations,
- homeland security, and
- strategic deterrence...

…describe how a Joint Force Commander will plan, prepare, deploy, employ, and sustain a joint force to accomplish a strategic objective for a given operation. Each concept identifies broad principles and essential capabilities and provides the operational context for JFC and JIC development and experimentation.

Joint Functional Concepts (JFCs):

- joint command and control,
- battlespace awareness,
- force application,
- focused logistics, and
- protection...

…describe how a Joint Force Commander will integrate a set of related military tasks to attain required capabilities.

Finally, the Joint Integrating Concepts (JICs):

- undersea superiority,
- joint forcible entry,
- joint urban operations,
- global strike,
- sea basing,
- joint command and control,
- integrated air and missile defense, and
- joint logistics…

…describe how a Joint Force Commander integrates functional means to achieve operational objectives. They integrate essential battlespace effects with concepts of operation to transition from what needs to be done—to how to actually do it.

Ongoing Research. The Joint Staff is revising the JOpsC with stakeholders from across the Department. The JOCs, JFCs, and JICs are being developed or revised by various working groups. The Joint Staff and U.S. Joint Forces Command are introducing a process to schedule experimentation on approved JICs.

Timeline For Completion. The JOpsC, JOCs, and JFCs are planned to be on a two-year update cycle. The Chairman approved a plan to revise the JOpsC for Secretary of Defense approval by March 2005, and to revise the JOCs by early FY 2006. The current JFCs and three new JFCs (net-centric warfare, force management, and training management) are scheduled to be complete by early FY 2005, with an update scheduled by the end of FY 2006. The JICs are in various stages of development.

Performance Results for FY 2004. During FY 2004, two of four JOCs (homeland security and strategic deterrence) were endorsed by the Chairman and forwarded to the Secretary for approval. The remaining two JOCs (major combat operations, stability operations) are being staffed for the Chairman's endorsement. The Joint Requirements Oversight Council approved all five JFCs. Work began on the eight JICs in FY 2004.

Activity Metric: Enhanced Planning Process (EPP)

End-state Metric (New baseline)	FY 2001	FY 2002	FY 2003	FY 2004
An annual assessment of issues and alternatives for providing the Department's highest priority joint capabilities.	No historical data: new metric			• EPP chartered by Secretary of Defense. • Resource guidance captures EPP results.

Metric Description. For the first time in FY 2004, major planning and resource issues presented for decision to the Secretary of Defense were formulated and assessed using an improved collaborative joint planning process—called the Enhanced Planning Process or EPP. By considering needs and costs simultaneously, the EPP was able to propose cost-effective programmatic options for achieving the Department's strategic policy objectives. Accordingly, the EPP underpins the framework of executable Joint Programming Guidance (JPG). The JPG provides shared planning and resource assumptions used in annual updates to the defense program and budget.

An analytic baseline is being developed in concert with the Chairman of the Joint Chiefs of Staff and the Under Secretary of Defense for Policy. This baseline will establish common planning assumptions to be used in warfighting models, acquisition analysis, and other shared analysis tools.

Ongoing Research. An analytic baseline is being developed in concert with the Chairman of the Joint Chiefs of Staff and the Under Secretary of Defense for Policy. This baseline will establish common planning assumptions to be used in warfighting models, acquisition analysis, and other shared analysis tools.

Timeline for Completion. The first EPP was completed in May 2004 as a proof-of-concept. The full test of the EPP will occur during the next quadrennial defense review cycle, scheduled to begin during FY 2005.

Performance Results for FY 2004. The EPP supported the FY 2005 combined program and budget review. Twelve major issues,[6] plus 15 issues consolidated from the Combatant Commanders Integrated Priority Lists (IPLs), were examined by

[6] Defined as program changes of interest.

means of the new process. Given the timeline and scope of the major issues, only two of the 12 were resolved in the FY 2005 President's Budget; the remainder have been carried over to the FY 2006 cycle. However, all IPL issues were resolved and solutions directed in the JPG.

Institutional Risk

Institutional risk stems from the management practices and controls that affect the efficiency with which resources are used and that shape the effectiveness of the Defense establishment.

Just as we must transform America's military capability to meet changing threats, we must transform the way the Department works and what it works on. A new idea ignored may be the next threat overlooked. Every dollar squandered on waste is one denied to the warfighter.

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We have the ability—and, therefore, the responsibility—to reduce waste and improve operational efficiency on our own.

Secretary Rumsfeld
September 10, 2001

The four outcome goals for this risk management quadrant are:

- Streamlined decision process, improved financial management, and acquisition excellence.
- Overhead and direct costs are managed.
- Readiness and quality of key facilities are improved.
- Realigned support to the warfighter.

Just over half the metrics in the institutional risk management quadrant are performance metrics. They track improvements in facility quality and recapitalization rates, cost growth for major acquisition programs, logistics response time, and the status of technology objectives. The activities in this quadrant focus on developing new facility baselines and new management tools.

Outcome Goal: Streamline the decision process, improve financial management, and drive acquisition excellence.

We know that we must transform the way the Department works and on what it works. This means taking clear, specific action to streamline our decision process—our leaders cannot act wisely unless they can get the information they need, *when they need it.*

The Secretary's performance priorities for institutional excellence are to…

- Streamline DoD processes,
- Optimize intelligence capabilities, and
- Enhance the Interagency process, focus, and integration.

We know that the technology revolution has not yet fully taken hold in the defense economy, and that financial systems are decades old and incompatible with one another. We know from the 1998 BRAC that we have 25 percent more installation and facilities capacity than we need, costing an unnecessary $3 billion to $4 billion dollars annually.

The President's Management Agenda – has set targets for the Department of Defense in each of five government-wide initiatives to improve management and service to our citizens.

- Human Capital
- Improved Financial Performance—BMMP
- Competitive Sourcing
- E-Government
- Budget and Performance and Performance Integration

This means we must…

- Drive change from the top.
- Set measurable goals.
- Standardize and integrate business processes and financial management systems agency wide.
- Achieve Acquisition Excellence.

The next four measures will help lead the way.

Performance Metric: Support Acquisition Excellence Goals

Metric (Excellence Goal)	FY 2001	FY 2002	FY 2003	FY 2004[a]
Acquisition Excellence with Integrity	Progress demonstrated in the following DoD scorecard metrics: Major Defense Acquisition Program (MDAP) Cycle Time, MDAP Acquisition Cost Growth, and MDAP operations and sustainment (O&S) Cost Growth.			
Logistics: Integrated and Efficient	Progress demonstrated in the following DoD scorecard metric: Customer Wait Time.			
Systems Integration & Engineering for Mission Success	No historical data for FY 2001-2002; established goal but did not measure data for FY 2003.			• Established senior-level forum. • Established framework and formal plan. • Developed 3 continuous-learning courses.
Technology Dominance	No historical data for FY 2001-2002. Progress FY 2003 to present demonstrated via the following DoD scorecard metrics: Balanced and Focused Science and Technology and Status of Defense Technology Objectives.			
Resources Rationalized	No historical data for FY 2001-2002. Progress FY 2003 to present demonstrated via the following DoD scorecard metric: Base Realignment and Closure 2005.			
Industrial Base Strengthen-ed	No historical data for FY 2001-2002. In FY 2003, increased competition by relieving contractors from covering government shortfalls in research and development.			• Identified industrial base issues in battle space awareness and command and control. • Published roadmap for Transforming the Industrial Base.
Motivated, Agile Workforce	No historical data for FY 2001-2002. In FY 2003, supported Civilian Acquisition Workforce Personnel Demonstration (AcqDemo) Project.			Transitioned from the AcqDemo Project to the National Security Personnel System.

[a]The FY 2004 information is preliminary.

Metric Description. The focus of the Department in the area of acquisition, technology and logistics has changed from one of "reform" to "excellence." "Excellence" stresses making the current system function better, and then institutionalizing the improved process. The Department faces many challenges in identifying, retailoring, and institutionalizing the system's strengths to perform better.

We are working to achieve three primary outcomes:

- Leveling the playing field for all contractors, giving us greater exposure to new ideas.
- Invigorating the fiscal well being of the defense industry by rewarding good performance.
- Encouraging the strong competition vital to maintaining a healthy industrial base.

Performance Results for FY 2004. Our results for this fiscal year include:

1. *Acquisition Excellence with Integrity* – Our long-term objective is to shorten the system acquisition cycle by using evolutionary acquisition and spiral development, maximizing the use of mature and commercial technology, and expanding the use of technology demonstrations. At the same time, we are striving to increase the accuracy and credibility of cost estimates and thus fund all Major Defense Acquisition Programs (MDAPs) at the Cost Analysis Improvement Group (CAIG) estimate, if appropriate. We plan to bring a joint capabilities perspective to acquisition, and will conduct senior leadership reviews of each functional capability area.[7] Next, we will enforce the results of senior leadership reviews in the resource process as we transition from "systems-focused" to "capabilities-based" Defense Acquisition Executive Summary reviews. The metrics we are using to measure progress against this goal are MDAP Cycle Time, MDAP Acquisition Cost Growth, and MDAP Operations and Support (O&S) Cost Growth. They are described in detail later.

2. *Logistics: Integrated and Efficient* – The Department is striving for integrated and efficient logistics. We will adopt initiatives that reduce logistics handoffs and ensure reliable delivery of products and services; develop weapon-system support strategies based on performance-based logistics; design logistics requirements using high-reliability systems; reduce the deployable logistics footprint of operational and support forces;

[7] Force protection, battle space awareness, command & control, focused logistics, network-centric warfare, force management, joint training, and force application make up the eight functional area capabilities.

and reduce logistics costs of operations. The Customer Wait Time metric is used to measure progress against this goal; it is described in detail later.

3. *Systems Integration and Engineering for Mission Success* – We need to focus our systems integration and engineering activities on mission success. To do this, we need to employ integrated architectures, plans, and roadmaps, and establish a clear mission context for Defense Acquisition Board reviews. It is important that we continue to foster interoperability, enhancements to joint and coalition capabilities, and improve the systems engineering environment. We need to sustain a professional systems engineering workforce, and give them the policies and analytic tools they need to assess system readiness. We must continue to conduct high-standard operational tests and evaluations. Finally, we need to aggressively work to reduce life-cycle costs. The metric we will use to measure progress for this goal has not yet been established.

4. *Technology Dominance* – To dominate in future conflicts, we must have technologically superior military systems. To achieve this dominance, we will employ activities such as fully leveraging Advanced Concept Technology Demonstrations, closely linking high pay off science and technology efforts to enhance joint warfighting capabilities and align with strategic defense initiatives. We need to establish a new science and technology career field to better focus human capital resources. The metrics used to measure progress against this goal are Maintain a Balanced and Focused Science and Technology Program and Monitor the Status of Defense Technology Objectives.

5. *Resources Rationalized* – We are working to enhance our joint warfighting capabilities by funding key programs sufficiently, rationalizing infrastructure, and pursuing fundamental business process improvements. These improvements include business process streamlining, outsourcing, and competitive sourcing. The result will be a re-sized and reconfigured facilities footprint. BRAC 2005 will help us measure our progress toward this goal. The BRAC is described in detail later in this report.

6. *Industrial Base Strengthened* – One of our enduring goals is to ensure a defense industrial base that is focused on and capable of supporting 21st century warfighting. To do this, we are establishing cross-feed mechanisms for major industrial base assessments, evaluating industrial sufficiency for key capabilities, developing industrial policy that creates and retains surge capacity for essential materials, and accessing emerging suppliers for innovative solutions. The metric for this goal has not yet been established.

7. *Motivated, Agile Workforce* – We are continuing the Congressionally mandated DoD Civilian Acquisition Workforce Personnel Demonstration (AcqDemo) project. AcqDemo is designed to give employees a flexible, responsive personnel system that rewards contributions and provides line managers with greater authority over personnel actions. Key features of the demonstration project include streamlined hiring, broad banding,[8] a simplified classification system, and a personnel system that links compensation to employees' contributions to the mission through annual performance appraisals. The Department will be transitioning personnel from the AcqDemo Project into the National Security Personnel System (NSPS) in FY 2005. During this transition, we will be integrating best practices from the AcqDemo into the NSPS. Additional information on the AcqDemo initiatives is at www.acq.osd.mil/acqdemo.

Activity Metric: Improve the Transparency of Component Submissions

[8] Broad banding collapses a number of salary ranges within a traditional salary structure into a few broad bands.

for Alignment of Program Review to Strategic Trades

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
A DoD-wide transactional data collection process	No historical data new metric		Established initial database integration criteria.	Established single collection point for operation and maintenance data.
Streamlined Planning, Programming, Budgeting and Execution (PPBE) process			• Streamlined and combined the program and budget review. • Instituted streamlined process for developing the FY 2005 budget.	Continued with streamlining effort, placing more emphasis on planning and less on resourcing decisions.

[a] The FY 2004 information is final.

Metric Description. Improving the transparency of component program and budget submissions will help ensure our resource plans comply with the Secretary's strategic guidance. It will provide our senior-level decision makers with the insight they need to make better-informed decisions. This is because transparency fosters an agreement of facts. Accordingly, alternatives and the associated trade space can be bounded by the agreed-upon facts. This, in turn, provides a consistent baseline that serves as a common point of departure for making resource trades.

To achieve a consistent baseline, we must first streamline the flow of data. Each data element should be collected only once by a single authoritative source collection system and reused as needed. The agreement of all parties on data accuracy, validity, and source authority facilitates this "collect-once" capability

Our efforts to improve transparency have been under way for several years. However, we have never documented or quantified metrics we can use to monitor our progress. Accordingly, evidence of our success to date is mostly anecdotal. However, one area where we can measure progress is in our Programming Data Requirements (PDR) data collection and reuse initiative, which we hope will serve as the pilot for the development of measures to be applied more broadly.

To determine how accurate our resource data are, we will rely on fiscal and budgetary controls, combined with assessments of whether the data comply with strategic guidance. Where possible, we have established business rules to ensure existing data structures are used appropriately. We also will validate data by having analysts and subject-matter experts monitor particular groups of resources or programs. A major tenet of the Streamlined Planning, Programming, Budgeting, and Execution process is the disciplined review of component programs to ensure resource compliance with strategic guidance.

Ongoing Research. Refining the submission of programming and budgeting data are tasks in progress with the Services, defense agencies, and the DoD Comptroller. Streamlining the data flow to eliminate dual submissions between budget and programming systems will reduce workload and improve data quality. Requirements will be standardized and reduced. PDR data requirements have been reduced from 139 distinct formats in FY 2000 to 39 distinct formats in the FY 2003 cycle. This degree of reduction needs to be achieved in other areas as permitted by legal and external agency reporting requirements.

Evaluating, validating, and improving the current program and budget data structures will significantly contribute to the alignment of programming and budgeting activities. The data structures must facilitate compliance with reporting requirements; better support business and policy decisions; allow for easier management of the structures to ensure validity of the data; and support the overlay of taxonomies for specific analytic purposes in support of strategic reviews.

Connections to the lower-level, component-maintained source data would provide further transparency as issues arise. The solution should provide the ability for analysts supporting a decision maker to find data at a finer level of detail maintained by the components.

The criteria that we will use to measure improvement in transparency might include:

- Data requirements: the reduction in the number of distinct data requirements requested at each point in the cycle.
- Data structure management: the level of human effort required annually to keep the structure accurate; the amount of time and effort to create a new element.

- Consistency of program reporting: the degree to which resource plans provide a non-ambiguous result when viewed from different perspectives; the time to create new mappings and the accuracy of the mappings to emerging requirements.

Timeline for Completion. The DoD Business Management Modernization Program **(**BMMP) has set a target of full deployment of the systems supporting this metric by 2010; a unified information architecture will be implemented by FY 2008.

Performance Results for FY 2004. Database integration efforts are ongoing. For example, we now have a single collection system for operations and maintenance data that feeds decisions for both the program and budget development.

Activity Metric: Increase Visibility of Trade Space

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Estimates of the cost of trade guidance within the context of the overall Defense Program.	No historical data: new metric.		Conducted Joint Defense Capabilities Study.	• Published strategic planning guidance. • Initiated enhanced planning process. • Issued joint programming guidance using initial analytical findings.
[a] The FY 2004 data are final.				

Metric Description. The annual planning guidance of the Secretary of Defense is the primary tool for directing how defense programs and budgets will be shaped. Previous guidance provided a list of projects of interest, and it set priorities across the defense program. However, it did so with little fidelity. The result was fiscally unsound and unclear planning guidance. This made it difficult to ensure compliance.

In FY 2003, we dramatically increased the Secretary's ability to influence Service and agency programs and budgets directly by restructuring the annual guidance update to clarify where more risk or less risk should be taken across the defense program. This revised structure directed the Services and agencies to apply explicit criteria for risk management, and to align their resource plans accordingly. Then, during the annual program and budget review, any resource proposal that varied from guidance was corrected in the President's Budget.

During the next planning cycle, we further strengthened the guidance as a resource decision tool by adding more details on how Services and defense agencies were expected to meet the Secretary's intent within fiscal constraints. The guidance—renamed Strategic Planning Guidance or SPG—marked the first attempt to estimate the direct cost of program priorities with the context of the overall defense program. However, shortfalls still exist. It is still difficult to develop a truly independent cost estimate of planning priorities, or to accurately assess all the variables associated with estimating the potential trade space created by accepting increased risk in some areas of the defense program. The SPG replaces the policy and strategy sections of the old consolidated defense guidance.

The newly initiated Enhanced Planning Process (EPP) will provide a continuous, open and collaborative analytic forum to closely examine issues of greatest interest to the Secretary. The EPP is intended to produce programmatic recommendations that will be documented in a new annual publication—the Joint Programming Guidance (JPG). The JPG replaces the programmatic elements of the old consolidated defense guidance.

Ongoing Research. The Department continues to improve this performance metric but several factors will influence progress:

- Defining "visibility" and its gradations. We need the ability to accurately estimate the costs associated with programmatic and budget trades. We must be able to frame the trade space discussion within the context of the overall defense program. We must also ensure we are clear about the impact of making trades within and among the four risk management areas of the defense strategy.

- Developing an index for measuring compliance. One approach to measuring increased visibility is measuring its effect (output)—that is, the degree of compliance. This metric might be measured in dollars failing to conform to guidance or in the number of issues of noncompliance that are raised in the program and budget review. Either index can provide a trend to show progress in achieving visibility of the trade space.

- Classification and the pre-decisional nature of document. The Secretary's planning guidance is pre-decisional, and thus not releasable. In addition, much of the guidance is classified. It is likely that some or portions of any trade-space metric would also be subject to these restrictions.

Timeline for Completion. Proposed metrics are expected to be developed by December 31, 2004.

Performance Results for FY2004. The inaugural SPG dramatically improved the Secretary's ability to shape the investment choices made by the Services and defense agencies by assigning specific priorities that have to be achieved within fiscal constraints. It identified areas for accepting increased risk or divesture in order to stay within those constraints. It also directed several analytic efforts be undertaken during the remainder of FY 2004 and in FY 2005 to gain insight into how programs must be structured to achieve synergy in joint operations, and how performance metrics can be better defined to help evaluate programs in a joint context. The JPG used the initial findings of the EPP studies to describe specific program changes and priorities to guide the FY 2006 President's Budget and FY 2006- 2011 Future Years Defense Program.

Activity Metric: Provide Explicit Guidance for Program and Budget Development

End-state Metric (New Baseline)	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Revised planning, programming, and budgeting decision process	No historical data: new metric.		Conducted DoD-wide study of joint defense capabilities.	• Combined the program/budget review process. • Implemented new joint perspective in planning and program guidance. • Added execution reviews to formal process.

[a] The FY 2004 data are final.

Metric Description. Section 113 of Title 10, U.S. Code, requires the Secretary of Defense to give the heads of the Military Departments and defense agencies the resource levels projected to be available for the period of time for which national security objectives, policies, and military missions established as priorities under the defense strategy are to be effective. In March 2003, the Secretary of Defense chartered a broad review of our planning and resource decision process. A study team chaired by the Honorable E.C. "Pete" Aldridge, former Under Secretary of Defense, explored ways to make the existing defense decision process less cumbersome, more responsive, and more helpful to the Secretary's attempt to focus on managing and enhancing joint capabilities.

The Joint Defense Capabilities Study was completed in November 2003. It recommended focusing the Secretary's annual planning and programming guidance on high-level strategic issues, and framing resource alternatives as capabilities rather than programs. The study also recommended that actual results become a formal part of the overall assessment process. Accordingly, the DoD Planning, Programming, and Budgeting System (PPBS) added a final "Execution" phase to the overall process to become the PPB***E***S.

Ongoing Research. We have enhanced our planning process to focus on issues that are strategic and joint, and address core military capabilities. Our goal is to use disciplined, joint analysis to propose programmatic alternatives and subsequently formulate joint program and budget guidance.

Timeline for Completion. The revised process will have its first full proof-of-concept for the next quadrennial defense review cycle, which will begin in FY 2005.

Performance Results for FY 2004. During FY 2004, we published our revised planning guidance—the Strategic Planning Guidance, which documented key resource planning assumptions for formulating resource plans. We also released the first Joint Programming Guidance, which described program areas where planners should either accept or reduce risk. Finally, we combined the program and budget review, and increased our emphasis on integrating lessons-learned into the overall decision process. For example, Services and defense agencies could not make major changes from the approved FY 2004 defense baseline for FY 2005 absent an explicit rationale that considered actual performance results.

Outcome Goal: Manage overhead and direct costs.

By carefully managing overhead and direct costs, the Department ensures resources are directed to accomplishing its mission, and conducting its most important core functions. The following metrics help us monitor achievement of this outcome goal.

> ***Fully half our resources go to infrastructure and overhead, and in addition to draining resources from warfighting, these costly and outdated systems, procedures and programs stifle innovation as well.***
>
> ***Secretary Rumsfeld, September 10, 2001***

The Department manages this outcome goal with the help of two important metrics:

- Reduce the percentage of the DoD budget spent of infrastructure. By doing so, the Department ensures maximum resources are allocated to our mission, core competencies, and critical functions.
- Link Defense resources to key performance goals. Closely related to the first metric, this metric gauges our progress toward the use of automated techniques for transforming vast amounts of data into usable resource allocation information.

Performance Metric: Reduce Percentage of DoD Budget Spent on Infrastructure

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Target/Actual	FY 2004 Target
Percentage of DoD budget spent on infrastructure	46	44	42/42	41
Note: This is a lagged indicator. Projections are based on the FY 2005 President's Budget Future Years Defense Program.				

Metric Description. The share of the defense budget devoted to infrastructure is one of the principal measures the Department uses to gauge progress toward achieving its infrastructure reduction goals. A downward trend in this lagged metric indicates that the balance is shifting toward less infrastructure and more mission programs. In tracking annual resource allocations, we use mission and infrastructure definitions that support macro-level comparisons of DoD resources. The definitions are based on the 2001 *Quadrennial Defense Review* (QDR), the Future Years Defense Program (FYDP), and an Institute for Defense Analyses report (*DoD Force and Infrastructure Categories: A FYDP-Based Conceptual Model of Department of Defense Programs and Resources, September 2002*) prepared for the Office of the Secretary of Defense. The definitions are consistent with the Goldwater-Nichols Department of Defense Reorganization Act of 1986 (P.L. 99-433). This act requires that combat units, and their organic support, be routinely assigned to the Combatant Commanders and that the Military Departments retain the activities that create and sustain those forces. This feature of U.S. law provides the demarcation line between forces (military units assigned to Combatant Commanders) and infrastructure (activities retained by the Military Departments). In addition to more precisely distinguishing forces from infrastructure, the force subcategories have been updated to reflect current operational concepts. The infrastructure subcategories, likewise, have been updated and streamlined.

Performance Results for FY 2003. FY 2004 accomplishments will be available by the second quarter of FY 2005. In FY 2003, we allocated about 42 percent of total obligational authority to infrastructure activities, down from about 44 percent in the preceding year. The reduction in percentage terms stems from two sources. First, the Department continued to increase its allocation of resources to forces in fighting the global war on terror and meeting other operational requirements. Second, efficiencies have resulted from QDR and defense reform initiatives, including savings from previous base realignment and closure rounds, strategic and competitive sourcing initiatives, and privatization and reengineering efforts. We expect a continued reduction in expenditures on infrastructure as a share of the defense budget in FY 2004 and FY 2005.

The following tables illustrate, by mission and infrastructure categories, their relative share of DoD Total Obligation Authority (TOA).

Department of Defense

TOA by Force and Infrastructure Category

Constant FY 2005 $ (Billions)

	FY 2000	FY 2001	FY 2002	FY 2003
Mission Categories				
Expeditionary Forces	135	141	151	197
Deterrence & Protection Forces	8	9	13	14
Other Forces	30	32	34	49
Defense Emergency Response Fund	0	0	14	1
Forces Total	**173**	**183**	**213**	**261**
Infrastructure Categories				
Force Installations	24	24	27	34
Communications & Information	5	5	6	8
Science & Technology Program	9	9	10	11
Acquisition	9	9	9	9
Central Logistics	21	19	20	27
Defense Health Program	20	18	26	23
Central Personnel Administration	11	11	8	12
Central Personnel Benefits Programs	8	8	9	9
Central Training	27	27	30	34
Departmental Management	15	16	17	20
Other Infrastructure	3	8	3	4
Infrastructure Total	**151**	**154**	**166**	**190**
Grand Total	**324**	**337**	**379**	**451**
Infrastructure as a Percentage of Total	**47%**	**46%**	**44%**	**42%**

Source: FY 2005 President's Budget and associated FYDP with Institute for Defense Analyses FYDP normalization adjustments.

Note: TOA = Total Obligational Authority

Mission and Infrastructure Categories Used for Tracking the Portion of the DoD Budget Spent on Infrastructure
Mission Categories
Expeditionary forces. Operating forces designed primarily for non-nuclear operations outside the United States. Includes combat units (and their organic support) such as divisions, tactical aircraft squadrons, and aircraft carriers.
Deterrence and Protection Forces. Operating forces designed primarily to deter or defeat direct attacks on the United States and its territories. Also includes agencies engaged in U.S. international policy activities under the direct supervision of the Office of the Secretary of Defense.
Other forces. Includes most intelligence, space, and combat-related command, control, and communications programs, such as cryptologic activities, satellite communications, and airborne command posts.
Infrastructure Categories
Force installations. Installations at which combat units are based. Includes the Services and organizations at these installations necessary to house and sustain the units and support their daily operations. Also includes programs to sustain, restore, and modernize buildings at the installations and protect the environment.
Communications and information infrastructure. Programs that provide secure information distribution, processing, storage, and display. Major elements include long-haul communication systems, base computing systems, Defense Enterprise Computing Centers and detachments, and information assurance programs.
Science and technology program. The program of scientific research and experimentation within the Department of Defense that seeks to advance fundamental science relevant to military needs and determine if the results can successfully be applied to military use.
Acquisition. Activities that develop, test, evaluate, and manage the acquisition of military equipment and supporting systems. These activities also provide technical oversight throughout a system's useful life.
Central logistics. Programs that provide supplies, depot-level maintenance of military equipment and supporting systems, transportation of material, and other products and services to customers throughout DoD.
Defense health program. Medical infrastructure and systems, managed by the Assistant Secretary of Defense for Health Affairs, that provide health care to military personnel, dependents, and retirees.
Central personnel administration. Programs that acquire and administer the DoD workforce. Includes acquisition of new DoD personnel, station assignments, provisions of the appropriate number of skilled people for each career field, and miscellaneous personnel management support functions, such as personnel transient and holding accounts.
Central personnel benefit programs. Programs that provide benefits to service members. Includes family housing programs; commissaries and military exchanges; dependent schools in the United States and abroad; community, youth, and family centers; child development activities; off-duty and voluntary education programs; and a variety of ceremonial and morale-boosting activities.
Central training. Programs that provide formal training to personnel at central locations away from their duty stations (non-unit training). Includes training of new personnel, officer training and service academies, aviation and flight training, and military professional and skill training. Also includes miscellaneous other training-related support functions.
Departmental management. Headquarters whose primary mission is to manage the overall programs and operations of DoD and its components. Includes administrative, force, and international management headquarters, and defense-wide support activities that are centrally managed. Excludes headquarters elements exercising operational command (which are assigned to the "other forces" category) and management headquarters associated with other infrastructure categories.
Other infrastructure. Programs that do not fit well into other categories. They include programs that (1) provide management, basing, and operating support for DoD intelligence activities; (2) conduct navigation, meteorological, and oceanographic activities; (3) manage and upgrade DoD-operated air traffic control activities; (4) support warfighting, war-gaming, battle centers, and major modeling and simulation programs; (5) conduct medical contingency preparedness activities not part of the defense health program; and (6) fund joint exercises sponsored by the Combatant Commanders (COCOMs) or JCS directed. Also included in this category are centralized resource adjustments that are not allocated among the programs affected (e.g., foreign currency fluctuations, commissary resale stocks, and force structure deviations).

Activity Metric: Link Defense Resources to Key Performance Goals

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Common resource data lexicon	No historical data: new metric			Developed draft data framework and common business rules.

[a] The FY 2004 information is final.

Metric Description. In FY 2003 we opened a program office dedicated to combining or aligning program and budget databases that previously had been managed separately. We are now engaged in a major review of the Department's program and budget data structure. This review, to be completed during FY 2005, will ensure our common resource management database:

- More directly aligns with Congressional and other external reporting requirements,
- Better supports internal business and policy decisions by allowing an overlay of issue taxonomies that support strategy development and reviews, and,
- More easily manages data structures and improves our ability to validate data.

This review covers almost 4,000 areas. We will modernize or replace outdated activity definitions, and consolidate or create others. Already we are seeing that today's new strategic approach is merging and blurring the traditional lines between tooth (deployable operational units) and tail (non-deploying units and central support). When the study is complete, we will have a more flexible analysis interface with defense data, allowing us to build alternative ways of mapping our programming data structure and making it easier to crosswalk performance results to resource investments.

Ongoing Research. Two working groups comprising representatives from each Service, a lead policy office, and select defense agencies are reviewing the data structures and definitions for DoD's program data and acquisition resource data.

Timeline for Completion. By the end of FY 2006, we will develop standard data definitions to be used throughout the Department and implement a revised data framework that allows a unified program and budget data architecture.

Performance Results for FY 2004. During FY 2004, we conducted extensive line-by-line reviews of the existing data structure, and developed:

- A draft programming and budget framework based upon the four quadrants of the DoD risk management framework,
- Draft business rules for using the program and budget framework, and,
- A common set of DoD business definitions.

Outcome Goal: Improve the readiness and quality of key facilities.

For too long, we neglected our facilities, postponing all but the most urgent repairs and upgrades until the long term health of our entire support infrastructure was in jeopardy. Therefore, over the past several years, we've invested substantial sums in sustaining, restoring, and modernizing—cutting the previous recapitalization rate by almost a third and improving our sustainment rate.

The Secretary's mandate to transform America's defense for the 21st century will be impossible unless we shed unneeded infrastructure now on our books, and streamline operations at remaining facilities. On 15 November 2002, Secretary Rumsfeld signed a memorandum establishing the process for recommending base closures and realignments in 2005. The goal is to present recommendations to Congress by May 2005.

Four metrics are designed to help the Department achieve this outcome goal.

Activity Metric: Base Realignment and Closure (BRAC) in FY2005

End-state Metric (New Baseline)	FY 2001	FY 2002	FY 2003	FY 2004[a]
A new DoD facility footprint	BRAC cited as a key element of DoD transforma-tion.	Legislative authority for BRAC establish-ed.	• 2005 BRAC initiated by the Secretary of Defense. • Manage-ment structure and seven joint cross-service groups established.	• Final selection criteria establish-ed. • Data collection and certifica-tion begun.

[a] The FY 2004 data are final.

Metric Description. An early priority of the Secretary of Defense was to transform America's defense for the 21st century by shifting defense planning from the "threat-based" model that had dominated thinking to a "capabilities-based" model for the future. Our transformation charter reinforced our long-standing commitment to streamlining and upgrading of defense infrastructure by explicitly calling for "…another round of infrastructure reductions to reduce unneeded facilities." Accordingly, we were able to persuade Congress to grant authority in the FY 2002 National Defense Authorization Act for a Base Realignment and Closure (BRAC) round in 2005.

On November 15, 2002, the Secretary signed a memorandum entitled, "Transformation Through Base Realignment and Closure," that officially initiated the process for BRAC 2005. The document outlines the expectations and importance of reshaping DoD's infrastructure to better support future force structure. It established two senior level groups to manage and oversee the process, provided for the analysis of common business-oriented functions separate from service-unique functions, and required specific delineation of functions to receive joint analysis within 150 days.

An Infrastructure Executive Council, headed by the Deputy Secretary of Defense, provide policy and oversight. A lower-level Infrastructure Steering Group, headed by the Under Secretary of Defense for Acquisition, Technology and Logistics, oversees the joint analysis of common business-oriented support functions and ensures those efforts are coordinated with Service reviews of service specific operation functions.

Each of the Services and defense agencies have established procedures and designated appropriate personnel to certify that data and information collected for use in the BRAC 2005 analyses are accurate and complete. This certification process is subject to audit by the Government Accountability Office and DoD auditors.

Ongoing Research. The Secretary, in his memo kicking off the 2005 BRAC process, directed that joint teams be created to review common business-oriented functions. Subsequently, the Secretary approved seven Joint Cross-Service Groups and associated functions for joint review.

Timeline for Completion. We will provide any needed revisions to the 20-year force structure plan to Congress not later than March 15, 2005. By May 16, 2005, we will send closure and realignment recommendations to the BRAC Commission and congressional defense committees.

Performance Results for FY 2004. We met our milestones for the fiscal year by providing the final BRAC base selection criteria to Congress in February 2004; we also began collecting and certifying facility data. Our projection of the Department's 20-year force structure and the necessary associated infrastructure and excess capacity was provided to Congress with the FY 2005 President's Budget. This report also certified the need for BRAC 2005 and that an additional round of BRAC would result in annual net savings for each Military Department no later than FY 2011.

We also developed an Internal Control Plan and a data certification process to satisfy statutory requirements for use of certified data in developing closure and realignment recommendations. The Military Departments and Joint Cross-Service Groups also completed development of their respective Internal Control Plans. Military Department auditors and auditors from the DoD Inspector General reviewed these plans.

Performance Metric: Eliminate Inadequate Family Housing by 2007

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual[c]	FY 2004 Target[b]/Actual
Number of inadequate family housing units	170,314	143,608	119,980	93,294/NA[d]
Percentage of total family housing units[a]	59	53	47	NA[d]

[a] Targets are not established for the percentage of total family housing units.
[b] Targets were based on Service military construction and family housing budget estimates for FY 2005.
[c] Changes reported reflect final budget numbers.
[d] FY 2004 results not available until after the FY 2006 President's Budget is submitted.

Metric Description. Our goal is to eliminate all inadequate family housing in the continental United States by the end of FY 2007 (and by FY 2009 for overseas bases). In general, inadequate housing is any unit that requires a major repair, component upgrade, component replacement, or total upgrade. Each Service has evaluated its housing and identified inadequate units. Each Service has then developed a plan to eliminate inadequate housing through a combination of traditional military construction, operations and maintenance support, and privatization. The plans are updated annually with the President's Budget.

Performance Results for FY 2004. Through the end of FY 2003, we reduced inadequate family housing by 23,628 units through revitalization, demolition, and privatization. The total number of inadequate housing eliminated through privatization from the start of the program through FY 2003 is 44,961. Results for FY 2004 will not be available until the President's Budget for FY 2006 is submitted to Congress in February 2005.

Performance Metric: Fund to a 67-year Recapitalization Rate by 2007

Metrics	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 [a,c] Actual
Facilities recapitalization metric–FRM (years)	192	101	149	111
Facilities sustainment model–FSM	70%[b]	89%[b]	93%	94%

[a] Three defense agencies (Defense Logistics Agency, DoD Education Activity, and Tri-Care Medical Activity) were included beginning in FY 2004, but excluded in previous years.

[b] Estimated (FSM was first fielded in FY 2003)

[c] The FY 2004 data are as of the FY 2005 President's Budget.

Metric Description. The facilities recapitalization metric (FRM) measures the rate at which an inventory of facilities is being recapitalized. The term "recapitalization" means to restore or modernize facilities. Recapitalization may (or may not) involve total replacement of individual facilities; recapitalization often occurs incrementally over time without a complete replacement.

The performance goal for FRM equals the average expected service life (ESL) of the facilities inventory (estimated to be 67 years, based on benchmarks developed by a panel of Defense engineers – see the installations portion of the 1997 *Quadrennial Defense Review*). The ESL, in turn, is a function of facilities sustainment. "Sustainment" means routine maintenance and repair necessary to achieve the ESL. To compute a normal ESL, full sustainment levels must be assumed. Less than full sustainment results in a reduced ESL. For this reason, the metrics for facilities recapitalization and facilities sustainment are unavoidably linked and should be considered together.

Sustainment levels required to achieve a normal ESL are benchmarked to commercial per unit costs; for example, $1.94 per square foot annually is needed to properly sustain the aircraft maintenance hangar inventory for a 50-year life cycle. The facilities sustainment model (FSM) adjusts these costs to local areas and assigns the costs to DoD components and funding sources.

The recapitalization rate—measured by FRM in years—is compared to service life benchmarks for various types of facilities. For example, the ESL of a pier is 75 years, and the ESL of a dental clinic is 50 years (again, provided the facilities are fully sustained during that time). The average of all the ESL benchmarks, weighted by the value of the facilities represented by each benchmark, is 67 years. Weighting is required to normalize the ESL. For example, without weighting, 50 years is the ESL of a hypothetical inventory consisting of administrative buildings (75-year ESL) and fences (25-year ESL). But fences are insignificant compared to administrative buildings—DoD has $22 billion worth of administrative buildings, but only $3 billion worth of fences and related structures—and should not have equal weight. The ESL of this hypothetical inventory when weighted by plant replacement value is 68 years, not 50 years.

For evaluating planned performance, both metrics (FSM and FRM) are converted to dollars (annual funding requirements) and compared to funded programs in the DoD Future Years Defense Program (FYDP). The sustainment rate can be measured through execution; the recapitalization rate, which is primarily—but not exclusively—a function of multi-year military construction appropriations, is not tracked for execution on an annual basis.

Performance Results for FY 2004. These metrics do not capture "actual" expenditures, as the term "actual" is normally understood. For recapitalization, there is no reporting process for determining the "actual" (i.e., executed) recapitalization rate in a given year, and there is little reason to do so. Appropriations for military construction projects—which make up the bulk of the recapitalization investment—are good for five years, and are typically executed over more than one year. Additionally, Congressional additions, rescissions, reprogrammings, and late project adjustments all alter the "actual" recapitalization rate. There is no system as yet to capture these changes at the DoD level, and an annual rate of execution for military construction appropriations has little meaning.

For sustainment, a system is in place to capture the "actual" sustainment expenditure at the DoD level. However, FY 2003 was the first year for the system and the initial results are unreliable. In FY 2003, and continuing into FY 2004, the global war on terror has skewed execution results such that they are presently not useful. The DoD execution tracking system, as currently used, is unable to properly distinguish sustainment expenses for the normal DoD facilities inventory from sustainment expenses strictly related to contingency operations. For example, the system cannot tell the difference between sustaining facilities at Langley Air Force Base (AFB) and sustaining contingency facilities in Iraq. The facilities at Langley AFB are part of the computed DoD sustainment requirement, but the palaces in Iraq are not; hence, the reported execution totals cannot be properly compared to the budgeted or targeted rates. This issue has impacted heavily on the Air Force. On the other hand, the war has also drawn off sustainment funding for other non-sustainment purposes, making the estimated execution rate somewhat unusual. This issue has impacted the Army most heavily. All these issues are presently being addressed so that in the future, perhaps as early as FY 2005 or 2006, execution results for sustainment will be more reliable. For this report, the table above continues to show budgeted rates, not executed rates.

The results shown for FY 2004—111-year recapitalization rate and 94 percent sustainment rate—demonstrate continuing improvement from FY 2003. However, these results are projected based on budget values—actual execution may be different. Final execution results will be as of the FY 2006 President's Budget. One of the most notable accomplishments, which is not visible in the table, is that all the military Services and major defense agencies are funded equally at 95 percent of standard, DoD-wide benchmarks. The only exception remains the Defense Logistics Agency (DLA), which is funded via working capital funds. Special studies are underway to determine a solution for DLA, especially for the fuels infrastructure that is under DLA's purview.

Although performance, as measured by the budgeted recapitalization and sustainment rates, continued to improve from FY 2001 levels, the targets (67-year recapitalization rate and full sustainment) were not achieved in either budget. As a result of not achieving full sustainment levels, the estimated service life of the inventories (67 years) suffered another incremental reduction. As a result of not achieving a 67-year recapitalization rate, obsolescence in the facilities inventories increased incrementally. The cumulative and compounding effect of these shortfalls is measured by the number of deteriorated, obsolete, or otherwise inadequate facilities (referred to as C-3 or C-4 facilities in DoD readiness terminology) reported in the Department's readiness reports. Two thirds of facility classes are reported as having serious deficiencies that adversely impact mission performance.

Because of the way these metrics are constructed, the underperforming results in earlier years do not directly affect the sustainment and recapitalization performance targets for FY 2005 and FY 2006. The goal for sustainment remains full sustainment. For example, a 6 percent shortfall in programmed sustainment in FY 2004 cannot be offset with 6 percent overage in FY 2005. The interim goal for recapitalization remains 67 years, even though past performance has already reduced the service life of the facilities inventory. The direct effect of under-sustainment and under-recapitalization is captured in an accelerated—and more costly—recapitalization rate required to restore readiness to adequate levels by 2010.

Activity Metric: Restore Readiness of Key Facilities by 2010

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Percentage of DoD facilities restored to a high state of military readiness	No historical data: new metric.		Chartered effort to standardize facility records and improve Installations Readiness Report (IRR) summaries.	Implemented revised condition reporting process. Began IRR re-engineering. Conducted a special study to determine whether the FY 2010 goal is still achievable.

[a] The FY 2004 data are preliminary.

Metric Description. Our goal, first articulated with the 1997 update to the defense strategy, is to restore facilities readiness as currently measured by the Installations Readiness Report (IRR) to a readiness rating of at least C-2 (defined as adequate condition), such that the sum of all necessary restoration and modernization costs is ≥10 percent but ≤20 percent of the average replacement value of the facility by the end of FY 2010.

The existing IRR is a summary of ratings by facility class. While serving as a good indicator of general conditions, the IRR does not itself provide a way to determine appropriate investment levels or to target investments. There is no relationship between the official real property inventories and the IRR, which limits confidence in the IRR ratings. In addition, the IRR, with its emphasis on readiness rather than just condition, may skew the costs needed to restore facilities to adequate conditions. The goal is to eliminate deteriorated, obsolete, or otherwise inadequate facilities by accelerating recapitalization and restoring key facilities to at least an adequate condition (C-2). An earlier estimate based only on summary IRR ratings indicates that the FY 2010 goal might be achievable for most of the military Services if resources are made available for a full sustainment program coupled with accelerated recapitalization. However, a more precise and auditable condition assessment mechanism is needed to assess overall funding requirements and to track progress.

Ongoing Research. The Office of the Under Secretary of Defense for Installations and Environment is conducting a special study of facilities restoration. A revised condition reporting process, similar to a facilities condition index commonly found in other government agencies, has been developed by a cross-Department working group under the Installations Policy Board, and is in the process of being implemented. However, this will require coding of more than 500,000 individual facility records and will be addressed in phases over about two years. This process will standardize reporting by individual facility record in real property inventories, which will provide improved data quality and better support readiness ratings. Draft policy has been developed in financial management regulations and in an updated DoD Instruction 4165.14 on real property reporting. The first round of new data is expected to be available in October 2004 from the Department of the Navy. Additional data will follow from the Departments of the Army and Air Force.

Timeline for Completion. A standard for common condition reporting was completed in November 2002. The first common condition reports are to be released in October 2004. During 2005, we will develop a concept for mission-impact rating (M-ratings), and complete an initial validation and verification of the new condition factor (Q-rating). A complete submission of common conditions reports is scheduled for October 2005. The first report under the new system is planned for January 2006.

Performance Results for FY 2004. During FY 2004, we began adding a mission impact factor (M-rating) to the new condition factor (Q-rating), so that the readiness of facilities to support various missions at specific locations can be computed in a less subjective and more standardized, auditable, and automated way.

We also began incorporating facilities and installation information into the Defense Readiness Reporting System (which is simultaneously being re-engineered), such that facilities will be more closely integrated with other readiness reporting methodologies.

We began reporting Q-ratings for Navy and Marine Corps inventories; the first reports are expected at the close of the fiscal year. The Army and Air Force are re-designing their systems during FY 2004 to accommodate Q-ratings and will report to the Office of Secretary of Defense within 12 months following the close of the fiscal year.

We also awarded a contract to upgrade the facilities recapitalization metric, which assists in forecasting funding requirements to restore readiness from a simple metric to a more robust web-based model. New benchmarks are under development that may impact the timeline for achieving the FY 2010 goal.

Finally, we re-initiated a DoD-level facilities demolition and disposal program, which will assist in accelerating achievement of the C-2 equivalency goal.

Outcome Goal: Realign support to the warfighter.

The Department continues to transform its business processes and infrastructure to both enhance the capabilities and creativity of its employees and free up resources to support the warfighter. Transformation of our military forces hinges on being able to reduce redundancy, focus organizations on executive goals, flatten hierarchies, and cut cycle times in the decision and delivery processes. Finding ways to make real progress in these areas will result in gains in technology transfer and drive more effective operational performance.

Three current metrics and one metric under development will help us support the warfighter.

Performance Metric: Reduce Customer Wait Time (Days)

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/ Actual [a]
Customer wait time (in days)	18	16	19	15/24
[a] The FY 2004 data are as of the 2nd quarter.				

Metric Description. Customer wait time (CWT) measures the elapsed time from when a customer orders an item of material to its receipt. The customer's order may be filled from assets on hand at the customer's military installation or naval vessel, or through the DoD wholesale logistics system. For purposes of this enterprise-level metric, CWT data includes orders for spare and repair parts ordered by organizational maintenance activities. CWT data captured for orders below enterprise level are maintained by each of the military Services and the Defense Logistics Agency.

Performance Results for FY 2004. Through the second quarter of FY 2004, we experienced an average CWT of 24 days. We do not expect to realize much reduction in CWT until the conclusion of Operation Iraqi Freedom.

Performance Metric: Reduce Major Defense Acquisition Program (MDAP) Annual Rate of Acquisition Cost Growth

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target[b]
Percentage annual growth	+13.9[a]	+6.4	+5.0	Downward trend toward 0%

[a]The December Selected Acquisition Report (SAR), which reflects the President's budget, is used for calculating acquisition cost growth. There were no December 2000 SARs, because a Future Years Defense Program was not included in the FY 2002 President's Budget. Thus, the FY 2001 actual reflects acquisition cost growth for a two-year period (FY 2000 and FY 2001).

[c]Results for FY 2004 will be available in April 2005.

Metric Description. Acquisition cost growth measures the amount that acquisition costs grow from year to year. It is computed by taking the difference between the acquisition costs in the current-year's President's Budget and the previous-year's budget, divided by the acquisition costs for the previous-year's budget, expressed as a percentage. The population is all Major Defense Acquisition Programs (MDAPs) common to both current-year and previous-year budgets. A dollar-weighted average is calculated for the common MDAPs and adjusted for inflation and changes in quantity. Acquisition cost growth can occur for various reasons, including technical risk, schedule slips, programmatic changes, or overly optimistic cost estimates. The Department's reform initiatives seek to reduce cost growth from all sources, providing an output target for procurement managers of individual systems, as well as for the aggregate procurement programs of the individual Services. The objective is to be on a downward trend toward the ultimate goal of no (0 percent) acquisition cost growth. Managerial responses are expected to include both specific cost-control initiatives and process changes.

Performance Results for FY 2004. Results for FY 2004 will be available with the release of the SARs in April 2005.

Performance Metric: Reduce Major Defense Acquisition Program (MDAP) Acquisition Cycle Time

Metric (months)	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target[a]
Acquisition cycle time (for new starts from FY 1992 through FY 2001)	102	103	102	<99
Acquisition cycle time (for new starts after FY 2001)	Not applicable		76	<66
[a] Results for FY 2004 will be available in April 2005.				

Metric Description. Acquisition cycle time is the elapsed time, in months, from program initiation—when the Department makes a commitment to develop and produce a weapon system—until the system attains initial operational capability (IOC). This metric measures the average cycle time across all Major Defense Acquisition Programs (MDAPs). During the 1960s, a typical defense acquisition took seven years (84 months) to complete. By 1996, a similar acquisition required 11 years (132 months) to complete. To reverse this trend, the Department established an objective to reduce the average acquisition cycle time for MDAPs started since 1992 to less than 99 months, a reduction of 25 percent. DoD achieved that initial objective through rapid acquisition with demonstrated technology, time-phased requirements and evolutionary development, and integrated test and evaluation. To continue to improve, the Department now seeks to reduce the average cycle time to less than 66 months for all MDAPs started after FY 2001. To achieve that objective, the Department is introducing improvements to development and production schedules similar to those it initiated for managing system performance and cost. Rapid development and fielding of weapon systems—leveraging new technologies faster—will enable U.S. forces to stay ahead of potential adversaries.

Performance Results for FY 2004. FY 2004 results will not be available until the release of the SARs with the FY 2006 President's Budget in April of 2005.

Activity Metric: Reduce Major Defense Acquisition Program (MDAP) Operating & Support (O&S) Cost Growth

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
Percentage of annual cost growth	No historical data: new metric		Established metric baseline by collecting data to establish the first data point.	Collecting data to establish the second data point on which to determine growth.
[a]The FY 2004 data are preliminary.				

Metric Description. Operating and support (O&S) costs are those resources required to operate and support a system, subsystem, or major component during its useful life in the operational inventory. This metric measures the amount that O&S costs for Major Defense Acquisition Programs grow from year to year. It is computed by taking the difference between the total O&S cost estimates reported in the current-year Selected Acquisition Report (SAR) against the previous-year's SAR, then dividing by the total O&S cost estimates reported in the previous-year SAR, expressed as a percentage. The population is all MDAPs common to both current-year and previous-year budgets that report O&S cost estimates in the SAR. A dollar-weighted average is calculated for the common MDAPs.

Estimated O&S cost growth can occur for various reasons, including technical or programmatic changes, changes in the support strategy/concept, or overly optimistic cost estimates. The objective is no (0 percent) O&S cost growth. Managerial responses are expected to include both specific cost-control initiatives and process changes.

Ongoing Research. Data on MDAP O&S cost growth estimates are collected from SARs submitted by the Department to the Congress pursuant to Section 2432, Title 10, U.S. Code. SARs summarize the latest estimates of cost, schedule, and technical status. Subsequent quarterly exception reports are required only for those programs experiencing unit cost increases of at least 15 percent or schedule delays of at least six months. Quarterly SARs are also submitted for initial reports, final reports, and for programs that are re-baselined at major milestone decisions.

To further develop this metric, the Consolidated Acquisition Reporting System (CARS) was modified to produce a new data table in the SAR. This new table contains the data needed to measure the O&S cost growth metric.

Timeline for Development. The data to populate this table is collected from the December SARs.

Performance Results for FY 2004. FY 2004 results will not be available until the release of SARs in April 2005.

Future Challenges Risk

Future challenges risk derives from issues affecting the ability to invest in new capabilities and develop new operational concepts needed to dissuade or defeat mid- to long-term military challenges.

By definition, transformation is the enduring process of change. It is not about change for its own sake, nor is it about canceling the pursuit of one technology for another. Accordingly, static measures of success can mislead or misinform—today's "right" solution may as easily be a barrier as a gateway to tomorrow's innovation. How then do we know if we are, in fact, "transforming" to meet the future? The most reliable barometer of transformation in the defense community is to observe how the culture is changing. How and why are things done differently than in the past? How are those changes redefining what we believe we need to accomplish next?

We are working to promote a culture that rewards unconventional thinking—a climate where people have freedom and flexibility to take risks and try new things…one that does not wait for threats to emerge and be "validated," but rather anticipates them before they emerge—and develops and deploys new capabilities quickly, to dissuade and deter those threats.

Secretary Rumsfeld
February 5, 2003

The four outcome goals we are pursuing in this risk management quadrant are:

- Drive innovative joint operations.
- Develop more effective organizations
- Define and develop transformational capabilities
- Define skills and competencies for the future

The majority of the measures in this risk management quadrant are activity metrics that focus on developing new measurement tools for intelligence, networked information, and new warfare concepts. The remaining performance metrics monitor science and technology investments, training transformation, and technology development.

Outcome Goal: Drive Innovative Joint Operations.

The Department continues to develop the ability to integrate combat organizations with forces capable of responding rapidly to events that occur with little or no warning. These joint forces are scalable and task-organized into modular units to allow the Combatant Commanders to draw on the appropriate forces to deter or defeat an adversary.

The development and incorporation of joint operating concepts is our leading priority for transformation. Joint forces, which are lighter, more lethal and maneuverable, survivable, and more readily deployed and employed in an integrated fashion, are ripe with opportunities for concept innovation.

Measuring our progress towards these goals, as well as measuring how the military Services' budget proposals demonstrate innovation and experimentation, helps advance innovative joint operations.

Activity Metric: Experiment with New Warfare Concepts

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
Percentage of goals met	No historical data: new metric	Developed guidance.	Released guidance.	• Conducted four major experimentation exercises. • Submitted joint experimentation plan for approval. • Fielded Standing Joint Force Headquarters prototypes.

[a] The FY 2004 data are final.

Metric Description. The goal of the Department's experimentation program is to rapidly convert innovative warfighting concepts to prototypes to fielded capabilities. Accordingly, the April 2003 Transformation Planning Guidance directed the development of the Joint Concept Development and

Experimentation (JCDE) Campaign Plan to describe the role of joint experimentation as a major generator of transformational change.

JCDE follows two paths: joint concept development and joint prototyping.

- The joint concept development program explores innovative concepts for improving future joint warfighting. These concepts result from an iterative experimentation program that relies on frequent, small-scale sets of experiments conducted in a joint wargaming environment. Once concepts prove viable, they are transferred to the prototype team.
- The joint prototype program improves current warfighting capabilities and matures new capabilities through continuous experimentation as part of Combatant Command joint exercise programs. JCDE will identify capabilities proposals for rapid prototyping and provide actionable recommendations for future resource investments based on experimentation results.

Ongoing Research. The Joint Operations Concept is the overarching concept of how the joint force intends to operate in the next 10-20 years; it is currently being developed with associated functional and integrating concepts. The primary prototype under development is the Standing Joint Force Headquarters, with associated prototypes for a collaborative information environment, an operational net assessment, effects-based operations, a Joint Interagency Coordination Group, a joint fires initiative, and a common relevant operating picture. Other prototype efforts include the joint deployment process and joint intelligence, surveillance, and reconnaissance.

Timeline for Completion. The Secretary is expected to sign the JCDE Campaign Plan in FY 2005. The concepts development schedule is contained in the Joint Operations Concepts activity metric description. Prototypes are at various stages of development.

Performance Results for FY 2004. The JCDE Campaign Plan was approved by the Chairman of the Joint Chiefs of Staff and submitted to the Secretary of Defense. As of the end of the 3rd quarter of FY 2004, the U.S. Joint Forces Command co-sponsored four major exercises with each of the Services that included multi-national partners. We have substantially improved experimentation results by increasing the participation of Combatant Commands and inter-agency representatives. Standing Joint Force Headquarters prototypes were introduced at each of the regional Combatant Commands; the exception is the U.S. Central Command, where participation has been delayed due to ongoing contingency operations. The results from Unified Course 04, Thor's Hammer, Multinational Experiment 3, and Unified Engagement 04 exercises will be incorporated into developing concepts, further experiments, or introduced as prototypes.

Performance Metric: Maintain Balanced and Focused Science and Technology

Metric	FY 2001	FY 2002	FY 2003	FY 2004[a]
	Percentage of S&T budget			
Basic research	16%	14.8%	14%	12.8%
Applied research	42.7%	42%	38%	35.9%
Advanced technology development	41.3%	43.2%	48%	51.3%
[a] The FY 2004 data are final				

Metric Description. The DoD science and technology (S&T) program consists of research and development investments in Basic Research, Applied Research, and Advanced Technology Development.[9] This metric is designed to ensure a balanced and focused investment by funding these at 15 percent, 35 percent, and 50 percent, respectively, of the total annual S&T budget.

Determining the right level of investment is not a precise science; rather it is a strategic decision. Our ultimate objective is to fund S&T at a level adequate to ensure our technological superiority—specifically, sufficient to provide the technology foundation we need to modernize our forces, and to develop the "leap ahead" technologies that produce transformational capabilities. Accordingly, we must continue to invest broadly in defense-relevant technologies, because it is not possible to predict in which areas the next breakthroughs will occur or what specific capabilities will be required to meet the challenges of the uncertain future.

Performance Results for FY 2004. The balance achieved between the funding levels for FY 2005 in

[9] Basic Research falls under Budget Activity (BA) 1, Applied Research under BA 2, and Advanced Technology Development under BA 3.

Basic Research, Applied Research, and Advanced Technology Development is sufficiently close to the DoD goals.

Outcome Goal: Develop more effective organizations.

Being ready and capable of changing our organizations to meet current and future challenges is the hallmark of an agile Department. These metrics are designed to measure that capability and guide improvements.

Activity Metric: Enhance Homeland Defense and Consequence Management

End-state Metric (New baseline)	FY 2001	FY 2002	FY 2003	FY 2004[a]
Strategy and an associated resource and technology roadmap.	No historical data: new metric		• Established an Assistant Secretary for Homeland Defense. • Established U.S. Northern Command.	• Began developing first homeland defense strategy. • Developed initial resource and technology roadmaps.

[a] The FY 2004 data are final.

Metric Description. Our highest priority is protecting the U.S. homeland from attack—we must be able to succeed at the full range of tasks associated with an active defense-in-depth that includes military operations in forward regions, the U.S. approaches, the U.S. homeland, and the global commons. Specifically, we must be able to:

- Conduct military missions to prevent, deter, defend, and defeat attacks on the United States, our population, and our defense critical infrastructure (homeland defense).
- Support civil authorities directed by the President or Secretary of Defense as part of a comprehensive national response to prevent and protect against terrorist incidents or manage the consequences of attack or disaster (homeland security).
- Enhance contributions of domestic and foreign partners to homeland security and homeland defense.

Ongoing Research. To guide our efforts to meet the challenges of the post-9/11 threat environment, the Secretary of Defense directed the development of the first comprehensive, defense-wide strategy for homeland defense and civil support. This new strategy will rely on an integrated threat assessment to define DoD's strategic goals, key objectives, and core capabilities for homeland defense and civil support. The strategy also will describe associated force structure, technology, and resource implications.

By providing an overarching suite of strategic goals aligned with resource and technology plans, we will add coherence and direction to the disparate activities across the Department that currently deter and prevent attacks, protect critical defense and designated civilian infrastructure, provide situational understanding, and prepare for and respond to incidents.

The completed strategy will articulate a number of actions for immediate implementation to transform DoD's capabilities for homeland defense and civil support in each of the core capability areas:

- Maximum threat awareness,
- Interdiction and defeat of threats at safe distance,
- Mission assurance,
- Improved interagency and international capabilities, and
- Consequence management (managing the consequences of a chemical, biological, radiological, nuclear or explosive incident).

Timeline for Completion. We expect to complete the strategy by the first quarter of FY 2005.

Performance Results for FY 2004. The initial research and writing of a comprehensive homeland defense strategy is ongoing. Real world events such as the G-8 Summit at Sea Island, Georgia, the national political conventions, and the period of heightened threat during August 2004 have delayed coordination of the document. The completion of the strategy is set for the early part of FY 2005.

Activity Metric: Establish a Standing Joint Force Headquarters

End-state Metric (New baseline)	FY 2001	FY 2002	FY 2003	FY 2004[a]
The ability to rapidly execute transformational command and control functions for joint force operations.	Development of Standing Joint Force Headquarters (SJFHQ) directed in 2001 Quadrennial Defense Review	Concept released.	• Experiments conducted • Implementation guidelines developed	SJFHQ established and staffed

[a] The FY 2004 data are final.

Metric Description. In 2003, the Secretary of Defense directed Geographic Combatant Commands (GCC) to establish Standing Joint Force Headquarters (SJFHQ) by FY 2005. These SJFHQs reflect standards established by U.S. Joint Forces Command (USJFCOM) and incorporate the lessons learned from the Millennium Challenge '02 joint exercises. Each GCC has a 58-person core SJFHQ that serves as a planning staff during day-to-day operations. In the event of a crisis, the in-place SJFHQ is immediately prepared to execute command and control functions for the integrated employment of air, land, maritime, and information forces. The SJFHQ is made up of joint-trained personnel skilled in using computer-based analysis tools and joint information and processes. To operate in the field, each deployable SJFHQ must have a Deployable Joint Command and Control (DJC2) capability.

Timeline For Completion. All the regional Combatant Commands will have SJFHQ organizations established in FY 2005; the exception is the U.S. Central Command, where participation has been delayed by the ongoing contingency. As an operational reserve to the GCCs, USJFCOM will establish a deployable surge-capable SJFHQ during FY 2005.

Performance Results for FY 2004. The Secretary of Defense approved an exemption to the 15 percent major headquarters personnel reduction for the GCCs that allowed them to retain 58 personnel to man their SJFHQ organization. Subsequently, the Department approved $1.6M per GCC for the operations and maintenance of their SJFHQs. The GCCs conducted initial training, procured appropriate facilities, and installed garrison equipment for their SJFHQs. The GCCs have completed plans to conduct a full-scale joint training event in FY 2005 that will serve as the "graduation" event for their new joint command and control capability. The DJC2 program delivered an initial concept and procedures development set to USJFCOM in September 2004 and is on schedule to deliver the first operational set to U.S. Pacific Command in FY 2005. USJFCOM also developed draft Standard Operating Procedures and Tactics, Techniques, and Procedures for the 58-person core element.

Performance Metric: Transform DoD Training

Metric	FY 2001	FY 2002	FY 2003	FY 2004 Target/Actual [a]
Percentage of military officers in critical positions certified as joint-trained or educated	No historical data: new metric.			50% / 52%

[a] The FY 2004 data are as of the 3rd quarter.

Metric Description. Our vision for training transformation is to provide dynamic, capabilities-based training in support of national security requirements across the full spectrum of service, joint, interagency, intergovernmental, and multinational operations. In 2003, the Secretary of Defense tasked the Under Secretary of Defense for Personnel and Readiness with overseeing the initiative across the Department. When the initiative was launched in FY 2003, our metrics were activity-based and measured progress toward milestone tasks. Starting in FY 2004, we began transitioning to outcome-based measures.

Our long-term goal is to be able to measure training "value" by evaluating (1) throughput, (2) innovation, and (3) transparency of training. These three performance indicators align with the Department's risk management scorecard, and provide a framework for possible DoD-wide reporting.

One of the leading indicators of training transformation is the overall percentage of the force that have received joint-certified training or had joint education. A higher percentage correlates to increased performance in jobs that require knowledge of joint capabilities, such as joint or combined command and control and tactics. Although the entire force is not measurable at this time, the critical positions filled by officers at Combatant Command staffs are currently being measured.

To be joint-certified, an officer must complete a two-year joint duty assignment. An officer is considered to have received joint education if he or she graduates from a course certified as Joint Professional Military Education Phase 2.

Our goal for FY 2009 is to ensure that all deployable units are trained at Joint National Training Center-certified events, and that all individual personnel receive relevant and certified joint education. We also are developing specific outcome measures of training value to assess the efficiency and effectiveness of primary sources of joint education and training for both individual and unit based training evolutions. Measures are being developed for each of the three leading initiatives of training transformation:

- *Joint Knowledge Development and Distribution Capability* (JKDDC) metrics will focus on the ability to think intuitively joint and to create a "reach back" capability, and subsequently to assess the associated effect on the forces' readiness.
- *Joint National Training Center* (JNTC) measures will evaluate the live, virtual, and constructive joint training environment and its ability to increase unit readiness prior to arrival at the Combatant Commands.
- *Joint Assessment and Enabling Capability* (JAEC) metrics will consider the overall outputs of the JNTC, JKDDC, and transformation as a whole. They will use the JAEC architecture to assess throughput, innovation, and transparency of training, education, and experience in individual and unit categories.

Performance Results for FY 2004. The JAEC had planned on shifting exclusively toward outcome-based metrics in 2004, but the policies and infrastructure required to measure outcomes against their associated standards do not yet exist. By the end of FY 2005, the JAEC will have performed its first block assessment of training transformation, and expects to have a complete set of outcome-based measures and assessments by that time. Currently, the JAEC is using a combination of activity-based measures (milestones) and outcome-based measures where they are available. The completion of the Defense Integrated Manpower and Human Resources System and Defense Readiness Reporting System databases will be the primary data sources for JAEC assessments.

The JKDDC is on track to receive initial operating capability by January 2005. During FY 2004, we verified the JKDDC requirement and created a distribution federation.

The JNTC is on track to achieve initial operating capability by October 2004. At that time, the U.S. Joint Forces Command will have certified that the types of training we are doing are appropriate and responsive to the needs of the Combatant Commanders. In the long term, after the JNTC has achieved its initial operating capability and we have a validated ability to provide an appropriate level of joint context, The Joint Warfighting Center will work with the Combatant Commands and Services to identify and qualify organizations that can conduct JNTC-accredited events. This effort will require the continued close cooperation between JNTC-accreditation representatives at Joint Warfighting Center and their Combatant Command and Service counterparts. The JNTC accreditation process is expected to continue through full operational capability in FY 2009.

Outcome Goal: Define and develop transformational capabilities.

The metrics that will help us achieve the ability to know whether we are transforming along the right path are all under development. Nevertheless, achieving this goal is one that must be pursued despite the challenges of foreseeing future threats.

Activity Metric: Deny Enemy Advantages and Exploit Weaknesses

End-state Metric	FY 2002	FY 2003	FY 2004[a]
Explicit strategic outcomes and effectiveness measures for DoD counter-intelligence activities	Established the Defense Counter-intelligence Field Activity	Established an Under Secretary of Defense for Intelligence	• Developed, managed and executed the polygraph program in support of Joint Task Force Guantánamo Bay, Cuba. • Identified 22 directives and instructions related to counterintelligence for revision. • Implemented common DoD policy for special access programs, industrial security, and safeguarding of biological select agents and toxins. • Developed standards for horizontal integration activities. • Established an Intelligence Campaign Plan concept and timeline for implementation.

[a] The FY 2004 data are final.

Metric Description. Denying enemy advantages and exploiting weaknesses is at the core of the work by the Under Secretary of Defense for Intelligence. Our long-term goal is to establish strategic outcomes and efficiency measures to help us gauge the effectiveness of our intelligence activities, and thus improve our training and associated program structures. However, intelligence is a vast enterprise. Many domestic, international, and organizational variables contribute to the success of the overall program. Thus, the task of developing enduring outcome goals and measures involves a significant amount of developmental research and analysis.

There are four fundamental areas that contribute to the success of any counterintelligence program: (1) ensuring that the defense intelligence security, strategy, policy and processes are aligned for maximum effectiveness and efficiency; (2) ensuring the horizontal integration of defense intelligence activities – that is, the communication among and within agencies – promotes increased information sharing; (3) aligning counterintelligence plans and architectures with the goals of military operations and overall national security; and (4) supporting the warfighter in the most efficient and effective manner possible.

Our horizontal integration roadmap attempts to rationalize all these activities within a single framework. Specifically, horizontal integration describes the processes and capabilities to acquire, synchronize, correlate, and deliver to the National Security Community (defense, intelligence, and homeland security) the kind of timely, comprehensive, and integrated information needed to improve decision-making and subsequently operational effectiveness. The kinds of data integrated within the horizontal integration framework extend across all missions, all disciplines, and all domains. However, the full effect and potential of such integration will be realized only when there is a mission-centric construct focused on outcomes, and data "usability" maximizes value to consumers across the national security enterprise. We also must ensure all consumable data meet network-centric standards and are broadly available to all users. This means providing end-to-end management and integration of information and intelligence functions.

The centerpiece of our ongoing initiative to remodel defense intelligence is a new intelligence concept known as Intelligence Campaign Planning or ICP. ICP is a comprehensive methodology for integrating intelligence into a Combatant Commander's adaptive planning and operations process. The ICP will make intelligence an operational and shaping tool for the commander, not just a supporting staff function. Accordingly, this approach will help integrate intelligence into the commander's adaptive planning process by:

- Producing a complete ICP that can be used by a Theater Director of Intelligence (J2) for campaign design, operational plan(s), operational sequencing, and operational synchronization.
- Enabling intelligence estimates to flow dynamically and continuously throughout all phases of an operation;
- Creating a global ISR (intelligence, surveillance, and reconnaissance) process

that is adaptable, agile, and flexible enough to support commanders at every echelon.

- Establishing a network-centric approach to collection, analysis, and dissemination.

Ongoing Research: The cornerstone of horizontal integration efforts is a common lexicon and understanding of the problem. Therefore, the first priority for this overall suite of activities is to complete a definitive review of all existing policies or directives relating to counterintelligence. The review is being conducted within the collaborative framework for intelligence activities provided by our recently established horizontal integration roadmap.

Timeline for Completion: The policy review and final approval of the horizontal integration roadmap will be completed by the end of FY 2005.

Performance Results for 2004: Progress is underway in each of our four main areas of counterintelligence activity:

- *Ensuring that the defense intelligence security, strategy, policy, and processes are aligned.* Over the last year, we identified 22 directives and instructions related to counterintelligence that need to be revised or rewritten. We also worked with various agencies to address policy shortfalls and develop consistent, defense-wide intelligence policy for special access programs, industrial security, and for safeguarding select biological agents and toxins. The goals and standards for successful horizontal integration were reflected in the Secretary's annual planning guidance, in our national space policy for space support missions, and in the strategic plans and architectures of the combat support agencies. Through the end of this fiscal year, we will extend these goals and standards into other policy documents, including personnel evaluations and congressional responses.
- *Ensuring the horizontal integration of defense intelligence activities.* During FY 2004, and in response to a Congressionally directed action, we developed an ISR Roadmap. The ISR Roadmap is now in mid-level coordination, and should be issued in early FY 2005. This roadmap cuts across the defense intelligence community and synchronizes a large number of ISR platforms and capabilities that require integration. In addition, the Under Secretary for Intelligence now chairs the ISR Integration Council that oversees integration policy for defense ISR activities. We also launched the Demonstration and Exercise Project designed to champion or sponsor Advanced Technology Demonstrations that could enhance intelligence horizontal integration. A series of tabletop "war games" were conducted to identify issues and explore cross-functional insights and innovative ideas.
- *Aligning counterintelligence plans and architectures with the goals of military operations and overall national security.* During the past fiscal year, we began a study of Pentagon counterintelligence needs, and we are working closely with Pentagon security officials to complete the study and resolve any shortfalls. The early findings of another study of the DoD counterintelligence polygraph program provided insights when we were asked to develop, manage, and execute the polygraph program in support of the Joint Task Force Guantánamo Bay.
- *Support to the warfighter.* During FY 2004, we directed the U.S. Joint Forces Command to provide a fielded ICP capability within 2 years. We also developed the Joint Intelligence Operations Center organizational concept, which is designed to integrate the intelligence function of the Combatant Commander's intelligence and operations staffs. Finally, we initiated a study of insider threats, using a model developed by one of the national labs.

Activity Metric: Make Information Available on a Network that People Depend On and Trust

End-state Metric	FY 2001	FY 2002	FY 2003	FY2004 [a]
• Number of systems that support the Internet Protocol Version 6 (IPv6) • Number of systems that meet information assurance standards	No historical data: new metric			Began transition of selected systems and weapons to IPv6.

[a] The FY 2004 data are final.

Metric Description. Moving information securely, quickly, and accurately, is a vital combat multiplier. Our ability to build a worldwide information net, populate it with information needed by military commanders, and then use the network for command

and control has been limited by the amount of information that can flow through the network and be processed at any given time. In response, we have set a goal to build a Global Information Grid (GIG) to allow us to:

- Achieve a ubiquitous, secure, and robust network.
- Eliminate bandwidth, frequency, and computing capability limitations.
- Deploy collaborative capabilities and other performance support tools.
- Secure and assure the network and the information.

Ongoing Research. The Director, Strategic Resource Planning for the Assistant Secretary of Defense for Networks and Information Integration is currently working with the Deputy CIO and the MITRE Corporation to develop outcome and output metrics to measure progress toward achieving the strategic planning goals of DoD's Information Technology (IT) Plan.

Timeline for Completion. Metric development should be complete by the end of FY 2005.

Performance Results for FY 2004. In March 2004, the Secretary of Defense issued guidance for the implementation of measures for building the GIG transport. Components were directed to use the Internet Protocol Version 6 (IPv6) Transition Plan to ensure IPv6 is implemented on appropriate IT, C4ISR (command, control, communications, computers and intelligence, surveillance, and reconnaissance), and weapons systems, with a goal of transitioning all defense systems to IPv6 by CY 2008.

Performance Metric: Monitor the Status of Defense Technology Objectives

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual[e]
Percentage of defense technology objectives (DTOs) evaluated as progressing satisfactorily toward goals[a]	96	97	96	>70/94
DTO evaluated in biannual review[b]	180	149[c]	163[c]	180
Total number of DTOs[b,c,d]	326	401	386	404

[a] "Progressing satisfactorily" includes DTOs rated as "green" or "yellow."

[b] The number of DTOs evaluated and the total number of DTOs are provided for information only; no targets are established.

[c] The numbers for DTOs evaluated in FY 2002 and FY 2003 were transposed in the FY 2003 PAR.

[d] The total number of DTOs is the sum of all DTOs contained in the Joint Warfighting Science and Technology Plan and the Defense Technology Area Plan, dated February of the calendar year prior to the fiscal year the reviews are conducted.

[e] The FY 2004 data are final.

Metric Description. Technological superiority has been, and continues to be, a cornerstone of our national military strategy. Technologies such as radar, jet engines, nuclear weapons, night vision, smart weapons, stealth, the Global Positioning System, and vastly more capable information management systems have changed warfare dramatically. Today's technological edge allows us to decisively prevail across a broad spectrum of conflicts and with relatively few casualties. Maintaining this technological edge has become even more important as the size of U.S. forces decreases and high-technology weapons are now readily available on the world market. Future warfighting capabilities will be substantially determined by today's investment in science and technology (S&T).

Our S&T investments are focused and guided through a series of defense technology objectives (DTOs) developed by senior planners working for the Secretary of Defense, the Chairman of the Joint Chiefs of Staff, the Military Departments, and defense agencies. Each of these objectives highlights a specific technological advancement that will be developed or demonstrated, the anticipated date the technology will be available, the specific benefits that should result from the technological advance, and the funding required (and funding sources) to achieve the new capability. These objectives also specify milestones to be reached and approaches to be used, quantitative metrics that will indicate progress, and the customers who will benefit when the new technology is eventually fielded. This metric measures the percentage of DTOs that are progressing satisfactorily toward the goals established for them.

Technology Area Review and Assessment (TARA) teams—independent peer review panels composed of approximately six experts in relevant technical fields from U.S. government agencies, private industry, and academia—assess the DTOs for each program every two years. The reviews are conducted openly; observation by stakeholders (typically, senior S&T officials, members of the joint staff, and technology customers) is welcomed.

The TARA teams assess the objectives in terms of three factors—budget, schedule, and technical performance—and rate the programs as follows:

- *Green*—progressing satisfactorily toward goals.
- *Yellow*—generally progressing satisfactorily, but some aspects of the program are proceeding more slowly than expected.
- *Red*—doubtful that any of the goals will be attained.

The benefits of these ratings are many. Not only do they reflect the opinions of independent experts, but also they are accepted and endorsed by stakeholders. These reviews result in near real-time adjustments being made to program plans and budgets based on the ratings awarded.

The TARA Chairman's findings are briefed to the Defense S&T Advisory Group (DSTAG) for further resolution of programmatic and technical issues. Adjustments are made to program plans and budgets based on the ratings and recommendations from the DSTAG. The DTO ratings are semi-quantitative metrics.

Performance Results for FY 2004. The Department met its performance target and no shortfall is projected for FY 2005. Although actual performance continues well above target, the target will be maintained at 70 percent due to the inherent high risk of failure in technology development.

Activity Metric: Populate the Network with New, Dynamic Sources of Information to Defeat the Enemy

End-state Metric	FY 2001	FY 2002	FY 2003	FY2004 [a]
Percentage of DoD information available via net-centric solutions.	No historical data: new metric.			• Published net-centric checklist. • Began portfolio management.

[a] The FY 2004 data are final.

Metric Description: Our military commanders use information of all kinds—not only intelligence data—to "see" the battle space, and thus outwit and overcome our adversaries. The net-centric enterprise architecture we are building will allow commanders to engage the network at anytime from anywhere using a military version of the Internet search engine, without needing cumbersome base support. Data will be posted and ready for download and analysis as soon as it arrives, anywhere on the network. The metric being developed will ultimately measure progress toward this goal.

The mission of DoD's Chief Information Officer (CIO) is to support the Secretary's transformation goals by advancing net-centric operation through policies, program oversight, and resource allocations. The key attributes of the CIO's strategy are:

- Ensuring data are visible, available, and usable—when and where needed—to accelerate decision-making.
- "Tagging" all data (intelligence, non-intelligence, raw, and processed) with metadata to enable discovery of data by users.
- Posting all data to shared spaces to provide access to all users except when limited by security, policy, or regulations.
- Advancing interoperability from point-to-point interfaces to "many-to-many" exchanges typical of a modern network environment.

Ongoing Research. The CIO for the Department is the Assistant Secretary for Network Information and Integration. The CIO heads a defense-wide effort to define processes for assessing a program's transition to a net-centric environment. The CIO also helps Services, defense agencies, and program managers incorporate net-centric attributes, implement data information assurance strategies, and align programs with the Joint Technical Architecture and the Net-Centric Operations Warfare Reference Model. This will ensure priorities and transition plans of all defense activities are in line with Global Information Grid (GIG) enterprise services within their respective programs. The Director, Strategic Resource Planning is responsible for developing this metric, working with the Deputy CIO and the MITRE Corporation.

Timeline for Completion. This metric will be completed in FY 2005.

Performance Results for FY 2004. The July 2003 CIO memorandum, "Joint Net Centric Capabilities," directed the review of any C4ISR (command, control, communication, computers, intelligence, surveillance and reconnaissance) programs affecting one of 13 specific activities.

In February 2004, the Net-Centric Checklist was issued to assist program managers in understanding net-centric attributes required for programs to move into the GIG's net-centric environment.

In March 2004, the Secretary of Defense approved DoD-wide guidance for populating the GIG with data, and directed compliance with the CIO net-centric data strategy, the GIG architecture, and the Net-Centric Operations and Warfare Reference Model. Services and defense agencies were directed to apply the business rules established by the Department's common enterprise domains, and to integrate Net-Centric Enterprise Services to avoid duplicating capabilities.

That same month, the Deputy Secretary issued "Information Technology Portfolio Management," which institutionalized portfolio management for information technology. This will ensure information technology solutions are analyzed, selected, controlled, and evaluated consistent with the GIG Integrated Architecture.

Outcome Goal: Define skills and competencies for the future.

The Department has launched a two-phase research initiative to define a conceptual framework for the development of skills, knowledge, and competencies necessary for a networked organization employing mature information age capabilities. Paramount to the research objectives is understanding key aspects of human and organizational behaviors. Basic research completed in Phase I highlighted the key relationships between the Physical, Information, and Cognitive Domains for Network Centric Operations (NCO). Phase II research, which is ongoing, is expected to identify a series of behavioral trends and key competencies that can then be incorporated within the Universal Joint Task List and the Joint Training Master Plan.

These efforts and others will be measured by the following metrics.

Activity Metric: Attract, Recruit, Retain, and Reward High Quality People from Government, Industry, and Academia

End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004 [a]
• Recruiting and retention targets for specific skills • Percentage fill by skill category	No historical data: new metric			• Designated the Office of the USD for Intelligence as a Defense Civilian Intelligence Personnel System organization. • Developed an interim policy for common human resources system for DoD intelligence community.

[a] The FY 2004 data are preliminary.

Metric Description. To accomplish our ambitious goals, the defense intelligence community needs the best people we can find. We need people with broad and varied experiences who are agile problem solvers, who can operate in an environment that changes as the threat changes**.**

Legislation such as the National Security Personnel System (NSPS) will give us the ability to hire the people we need. Accordingly, on May 2, 2004, the Deputy Secretary of Defense designated the Under Secretary of Defense for Intelligence (USD(I)) as a Defense Civilian Intelligence Personnel System (DCIPS) organization, dedicated to attracting the best and brightest to careers in defense intelligence. The authorities granted by the NSPS and DCIPS will allow us to tie performance to the defense intelligence strategy, and strive to improve job satisfaction by providing clear direction and quantitative objectives against which an employee can measure his or her progress.

A key first step – and an ongoing effort – is the development of an overarching directive establishing a common human resources system for the DoD intelligence community.

Ongoing Research. Develop community goals and standards for subcomponents of the DCIPS common human resource program.

Timeline for Completion. Development work will continue through the end of FY 2005, with initial fielding slated for FY 2006.

Performance Results for 2004. The DCIPS covers the Department of Defense, the National Security Agency, the Defense Intelligence Agency, the National Geospatial Agency, the National Reconnaissance Office, the Military departments, the Office of the Under Secretary of Defense for Intelligence, the Counterintelligence Field Activity, and the General Counsel. During FY 2004, a working group from all of these agencies and components completed 11 subchapters of an overarching policy plan. This plan will serve as interim authority to implement the process pending formal coordination and publishing of the subsequent chapters.

Performance Metric: Strategic Transformation Appraisal

Metric	FY 2001	FY 2002	FY 2003	FY 2004 [a]
Assessment of “gaps” or adjustments needed to remain on track	No historical data: new metric		Published first Transformational Planning Guidance	Completed first strategic transformation appraisal
[a] The FY 2004 data are as of the 4th Quarter (estimate)				

Metric Description. The Department’s overall transformation roadmaps address activities, processes, resources, and incentives to foster and promote innovation and transformational activities, including concept-based experimentation processes, education and training programs, and the use of operational prototypes. Each Service also prepares an individual roadmap, which is updated annually. Defense agencies submit their annual roadmap updates to the U.S. Joint Forces Command, which develops a consolidated “joint” roadmap. Each year, the Office of Force Transformation evaluates the progress and plans reported in the individual and joint roadmaps, and produces an assessment of “gaps” or adjustments indicated for future action. These roadmaps point to a shared future vision and provide actionable language for implementation. They complement the program and budget process, ensuring coherence between resource allocation decisions and future concept development and experimentation, and provide a baseline for managing transformational change within the force. Additionally, they articulate the Service and defense agency strategies for implementing and managing the “risk” embodied in transformation.

Performance Results for FY 2004. The Office of Force Transformation completed its first Strategic Transformation Appraisal in January 2004. The appraisal assesses defense-wide trends in transformation and recommends plan or resource adjustments to maintain progress toward the Secretary’s transformation priorities. The January 2004 appraisal showed where information-age trends are taking the Department:

FY 2003 versus FY 2004 Strategic Appraisal

FY 2003	FY 2004
• More expeditionary • More networked • Designed to leverage the exterior positions • Leverage increasingly persistent intelligence, surveillance, and reconnaissance • Tighter sensor-shooter timelines • Value information superiority • Joint interoperability at the operational level • Focus on unmanned capabilities	• Lighter, more agile, easily deployable units • Knowledge-enabled warfare • Improve vertical / horizontal intelligence distribution • Strengthen intelligence capabilities for the 21st century • Joint force synergy • Demand-centered intelligence • Jointness to the lowest appropriate level • Substitution of capital for labor

Beginning in FY 2005, the appraisal will be submitted each November to the Secretary of Defense.

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Part 3:
Financial Information

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Message from the Chief Financial Officer

November 15, 2004

The past year has been an important and challenging year for the Department of Defense. We have continued to vigorously fight the global war on terror, while simultaneously transforming the Department to accomplish our mission with ever greater effectiveness.

Our ability to defend our citizens and allies is heavily dependent on being able to obtain and supply the proper resources to our warfighters. Every dollar is important and the way we manage those dollars makes a difference in how successfully we accomplish our mission.

I realize the important responsibility that the Department's financial community has in supplying financial information to those who make decisions about how best to equip and deploy our troops. For this reason, I am committed to transforming the Department's financial community. We have a long way to go, but we are well on the way.

During the past year, the Department made progress on many fronts. We improved the timeliness of our reporting by preparing quarterly financial statements in 21 days and by completing the year-end reporting process in 45 days. During this time, we improved the quality of financial statement data, as evidenced by an increasing number of favorable audit results.

Looking ahead, I see a need for action that is both immediate and long term. Through the Business Management Modernization Program, the Department is overhauling the processes and tools that are used to conduct business. This is an enormous effort that will take time, but will yield tremendous benefits across the entire Department.

Our long term modernization, however, does not stop us from taking immediate action. Each major component within DoD has prepared improvement plans to identify major challenges in financial management and reporting. These plans are key tools for identifying targets of opportunity as we move into a transformed business environment.

I am fully committed to improving the Department's financial management. I will ensure we continue to build on the accomplishments in achieving an unqualified audit opinion on our financial statements and ultimately providing timely, accurate, and reliable financial information to our decision makers.

Tina W. Jonas

Principal Financial Statements and Notes

The principal financial statements included in this report have been prepared in accordance with the requirements of the Chief Financial Officers Act of 1990 (P.L. 101-576), the Government Management Reform Act of 1994 and the Office of Management and Budget's (OMB) Bulletin 01-09, "Form and Content of Agency Financial Statements." The responsibility for the integrity of the financial information included in these statements rests with management of the U.S. Department of Defense. The Department's fiscal years 2004 and 2003 principal financial statements were audited by the Office of Inspector General. The auditors' report accompanies the principal statements.

The Department's principal financial statements for fiscal years 2004 and 2003 consisted of the following:

The **Consolidated Balance Sheet**, which present as of September 30, 2004 and 2003 those resources owned or managed by DoD which are available to provide future economic benefits (assets); amounts owed by DoD that will require payments from those resources or future resources (liabilities) and residual amounts retained by DoD, comprising the difference (net position).

The **Consolidated Statement of Net Cost**, which present the net cost of DoD operations for the years ended September 30, 2004 and 2003. DoD's net cost of operations includes the gross costs incurred by DoD less any exchange revenue earned from DoD activities.

The **Consolidated Statement of Changes in Net Position**, which present the change in DoD's net position resulting from the net cost of DoD operations, budgetary financing sources other than exchange revenues and other financing sources for the years ended September 30, 2004 and 2003.

The **Combined Statement of Budgetary Resources**, which present the budgetary resources available to DoD during FY 2004 and 2003, the status of these resources at September 30, 2004 and 2003, and the outlay of budgetary resources for the years ended September 30, 2004 and 2003.

The **Combined Statement of Financing**, which reconcile the net cost of operations with the obligation of budgetary resources for the years ended September 30, 2004 and 2003.

The **Consolidated Statement of Custodial Activity**, which present the sources and disposition of nonexchange revenues collected or accrued by DoD on behalf of other recipient entities for the years ended September 30, 2004 and 2003.

Limitations of Financial Statements. The following limitations apply to the preparation of the fiscal year 2004 financial statements:

The principal financial statements have been prepared to report the financial position and results of operations of the Department of Defense, pursuant to the requirements of 31 U.S.C. 3515 (b). The statements are prepared from the books and records of the Department in accordance with OMB Bulletin 01-09 and to the extent possible generally accepted accounting principles. The statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Department of Defense
Agency Wide
CONSOLIDATED BALANCE SHEET
As of September 30, 2004 and 2003
($ in Millions)

	2004 Consolidated	2003 Consolidated Restated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	$ 287,685.5	$ 251,544.1
Non-Entity Seized Iraqi Cash	113.4	278.1
Non-Entity-Other	1,800.0	239.8
Investments (Note 4)	231,069.7	205,376.0
Accounts Receivable (Note 5)	1,118.3	1,066.6
Other Assets (Note 6)	1,011.9	105.0
Total Intragovernmental Assets	$ 522,798.8	$ 458,609.6
Cash and Other Monetary Assets (Note 7)	$ 2,178.1	$ 1,534.9
Accounts Receivable (Note 5)	7,427.8	7,299.9
Loans Receivable (Note 8)	70.7	64.0
Inventory and Related Property (Note 9)	213,219.4	205,544.6
General Property, Plant and Equipment (Note 10)	440,898.6	446,308.9
Investments (Note 4)	406.5	217.8
Other Assets (Note 6)	21,486.3	21,729.6
TOTAL ASSETS	$ 1,208,486.2	$ 1,141,309.3
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 1,888.4	$ 101.4
Debt (Note 13)	591.8	698.2
Environmental Liabilities (Note 14)	0.0	0.0
Other Liabilities (Note 15 & Note 16)	10,726.9	9,739.1
Total Intragovernmental Liabilities	$ 13,207.1	$ 10,538.7
Accounts Payable (Note 12)	$ 28,309.0	$ 27,863.8
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,569,704.7	1,429,565.5
Environmental Liabilities (Note 14)	64,367.2	61,490.6
Loan Guarantee Liability (Note 8)	34.4	25.9
Other Liabilities (Note 15 and Note 16)	34,491.2	30,154.0
Debt Held by Public	0.0	0.0
TOTAL LIABILITIES	$ 1,710,113.6	$ 1,559,638.5
NET POSITION		
Unexpended Appropriations (Note 18)	$ 243,813.9	$ 218,869.5
Cumulative Results of Operations	(745,441.3)	(637,198.7)
TOTAL NET POSITION	$ (501,627.4)	$ (418,329.2)
TOTAL LIABILITIES AND NET POSITION	$ 1,208,486.2	$ 1,141,309.3

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF NET COST

For the periods ended September 30, 2004 and 2003

($ in Millions)

	2004 Consolidated	2003 Consolidated
Program Costs		
Intragovernmental Gross Costs	$ 23,574.5	$ 11,748.3
(Less: Intragovernmental Earned Revenue)	(15,429.0)	(13,239.0)
Intragovernmental Net Costs	$ 8,145.5	$ (1,490.7)
Gross Costs With the Public	619,573.8	526,288.4
(Less: Earned Revenue From the Public)	(22,354.4)	(12,507.1)
Net Costs With the Public	$ 597,219.4	$ 513,781.3
Total Net Cost	$ 605,364.9	$ 512,290.6
Cost Not Assigned to Programs	0.0	0.0
(Less: Earned Revenue Not Attributable to Programs)	0.0	0.0
Net Cost of Operations	$ 605,364.9	$ 512,290.6

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended September 30, 2004 and 2003

($ in Millions)

	2004 Consolidated	2003 Consolidated Restated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ (621,610.7)	$ (946,947.7)
Prior period adjustments (+/-)		
Prior Period Adjustments - Restated (+/-)	(15,588.0)	10,534.8
Beginning Balance, Restated	(637,198.7)	(936,412.9)
Prior Period Adjustments - Not Restated (+/-)	699.5	383,074.9
Beginning Balances, as adjusted	(636,499.2)	(553,338.0)
Budgetary Financing Sources:		
Appropriations received	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	(13.0)
Appropriations used	478,621.1	431,548.0
Nonexchange revenue	1,469.7	931.2
Donations and forfeitures of cash and cash equivalents	7.0	24.4
Transfers-in/out without reimbursement (+/-)	10,568.6	1,329.2
Other budgetary financing sources (+/-)	4,511.5	(2,867.4)
Other Financing Sources:		
Donations and forfeitures of property	0.4	4.6
Transfers-in/out without reimbursement (+/-)	(2,848.6)	(6,702.1)
Imputed financing from costs absorbed by others	4,092.5	3,866.9
Other (+/-)	0.6	308.1
Total Financing Sources	496,422.8	428,429.9
Net Cost of Operations (+/-)	605,364.9	512,290.6
Ending Balances	$ (745,441.3)	$ (637,198.7)

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended September 30, 2004 and 2003

($ in Millions)

	2004 Consolidated	2003 Consolidated Restated
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 192,955.8	$ 177,282.6
Prior period adjustments (+/-)		
Prior Period Adjustments - Restated (+/-)	25,913.7	0.0
Beginning Balance, Restated	218,869.5	177,282.6
Prior Period Adjustments - Not Restated (+/-)	0.0	0.0
Beginning Balances, as adjusted	218,869.5	177,282.6
Budgetary Financing Sources:		
Appropriations received	512,194.5	477,036.7
Appropriations transferred-in/out (+/-)	485.6	1,217.8
Other adjustments (rescissions, etc) (+/-)	(9,114.6)	(5,137.1)
Appropriations used	(478,621.1)	(431,530.5)
Nonexchange revenue	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0
Other Financing Sources:		
Donations and forfeitures of property	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0
Other (+/-)	0.0	0.0
Total Financing Sources	24,944.4	41,586.9
Net Cost of Operations (+/-)		
Ending Balances	$ 243,813.9	$ 218,869.5

Department of Defense
Agency Wide
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 582,010.7	$ 546,761.4
Borrowing authority	0.1	0.0
Contract authority	34,855.8	28,109.0
Net transfers (+/-)	(519.3)	1,000.3
Other	0.0	0.0
Unobligated balance:		
Beginning of period	256,659.0	217,722.3
Net transfers, actual (+/-)	782.0	204.3
Anticipated Transfers Balances	0.0	0.0
Spending authority from offsetting collections:		
Earned	0.0	0.0
Collected	146,274.3	135,587.2
Receivable from Federal sources	(79.7)	(714.6)
Change in unfilled customer orders	0.0	0.0
Advance received	360.5	(30.6)
Without advance from Federal sources	980.0	11,000.9
Anticipated for the rest of year, without advances	0.0	0.0
Transfers from trust funds	0.0	0.0
Subtotal	147,535.1	145,842.9
Recoveries of prior year obligations	33,681.9	22,841.9
Temporarily not available pursuant to Public Law	(10.0)	0.0
Permanently not available	(40,338.0)	(33,730.4)
Total Budgetary Resources	$ 1,014,657.3	$ 928,751.7

Department of Defense
Agency Wide
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 568,053.7	$ 522,562.4
Reimbursable	152,658.9	147,147.8
Subtotal	720,712.6	669,710.2
Unobligated balance:		
Apportioned	58,631.0	55,052.0
Exempt from apportionment	183,488.1	180,704.3
Other available	0.3	(0.1)
Unobligated Balances Not Available	51,825.3	23,285.3
Total, Status of Budgetary Resources	$ 1,014,657.3	$ 928,751.7
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	$ 214,371.9	$ 181,919.4
Obligated Balance transferred, net (+/-)	(14.1)	(23.9)
Obligated Balance, Net - end of period:		
Accounts receivable	(10,136.8)	(10,216.4)
Unfilled customer order from Federal sources	(39,402.0)	(38,422.1)
Undelivered orders	228,801.3	213,597.8
Accounts payable	53,470.6	49,412.6
Outlays:		
Disbursements	667,755.1	604,105.8
Collections	(146,634.7)	(135,556.8)
Subtotal	521,120.4	468,549.0
Less: Offsetting receipts	(46,546.4)	(43,294.0)
Net Outlays	$ 474,574.0	$ 425,255.0

Department of Defense
Agency Wide
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
NONBUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 0.0	$ 0.0
Borrowing authority	114.6	50.5
Contract authority	0.0	0.0
Net transfers (+/-)	0.0	0.0
Other	0.0	0.0
Unobligated balance:		
Beginning of period	21.8	104.0
Net transfers, actual (+/-)	0.0	0.0
Anticipated Transfers Balances	0.0	0.0
Spending authority from offsetting collections:		
Earned	0.0	0.0
Collected	17.4	56.2
Receivable from Federal sources	(0.6)	(90.0)
Change in unfilled customer orders	0.0	0.0
Advance received	0.0	0.0
Without advance from Federal sources	47.2	35.8
Anticipated for the rest of year, without advances	0.0	0.0
Transfers from trust funds	0.0	0.0
Subtotal	64.0	2.0
Recoveries of prior year obligations	0.0	1.9
Temporarily not available pursuant to Public Law	0.0	0.0
Permanently not available	20.7	(0.2)
Total Budgetary Resources	$ 221.1	$ 158.2

Department of Defense
Agency Wide
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 196.6	$ 136.4
Reimbursable	0.0	0.0
Subtotal	196.6	136.4
Unobligated balance:		
Apportioned	1.4	1.3
Exempt from apportionment	0.0	0.0
Other available	0.0	(0.1)
Unobligated Balances Not Available	23.1	20.6
Total, Status of Budgetary Resources	$ 221.1	$ 158.2
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	$ 29.9	$ (95.1)
Obligated Balance transferred, net (+/-)	0.0	0.0
Obligated Balance, Net - end of period:		
Accounts receivable	0.0	(0.6)
Unfilled customer order from Federal sources	(83.1)	(35.8)
Undelivered orders	238.8	66.3
Accounts payable	0.0	0.0
Outlays:		
Disbursements	24.1	63.6
Collections	(17.4)	(56.2)
Subtotal	6.7	7.4
Less: Offsetting receipts	0.0	0.0
Net Outlays	$ 6.7	$ 7.4

Department of Defense
Agency Wide
COMBINED STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 720,909.2	$ 669,846.5
Less: Spending authority from offsetting collections and recoveries (-)	(181,281.0)	(168,688.6)
Obligations net of offsetting collections and recoveries	539,628.2	501,157.9
Less: Offsetting receipts (-)	(46,546.4)	(43,294.0)
Net obligations	493,081.8	457,863.9
Other Resources		
Donations and forfeitures of property	0.4	4.6
Transfers in/out without reimbursement (+/-)	(2,848.6)	(6,702.1)
Imputed financing from costs absorbed by others	4,092.5	3,866.9
Other (+/-)	0.6	308.1
Net other resources used to finance activities	1,244.9	(2,522.5)
Total resources used to finance activities	494,326.7	455,341.4
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered Orders (-)	(13,925.6)	(37,435.1)
Unfilled Customer Orders	1,387.4	11,006.1
Resources that fund expenses recognized in prior periods	(2,637.4)	(686.3)
Budgetary offsetting collections and receipts that do not affect net cost of operations	2,645.4	929.3
Resources that finance the acquisition of assets	(86,943.6)	(72,984.9)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Less: Trust or Special Fund Receipts Related to Exchange	(10.0)	0.0
Other (+/-)	2,855.5	6,623.6
Total resources used to finance items not part of the net cost of operations	(96,628.3)	(92,547.3)
Total resources used to finance the net cost of operations	397,698.4	362,794.1

Department of Defense
Agency Wide
COMBINED STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	514.8	662.7
Increase in environmental and disposal liability	3,864.6	2,033.6
Upward/Downward reestimates of credit subsidy expense (+/-)	14.9	0.0
Increase in exchange revenue receivable from the public (-)	(73.8)	(6.6)
Other (+/-)	139,064.9	95,403.2
Total components of Net Cost of Operations that will require or generate resources in future periods	143,385.4	98,092.9
Components not Requiring or Generating Resources:		
Depreciation and amortization	42,249.2	55,274.7
Revaluation of assets or liabilities (+/-)	(5,712.6)	6,299.4
Other (+/-)		
Trust Fund Exchange Revenue	(24,285.4)	(23,792.5)
Cost of Goods Sold	41,421.8	0.0
Operating Material & Supplies Used	4,655.9	0.0
Other	5,952.2	13,622.0
Total components of Net Cost of Operations that will not require or generate resources	64,281.1	51,403.6
Total components of net cost of operations that will not require or generate resources in the current period	207,666.5	149,496.5
Net Cost of Operations	605,364.9	512,290.6

Department of Defense
Agency Wide
COMBINED STATEMENT OF CUSTODIAL ACTIVITY
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
SOURCE OF COLLECTIONS		
Deposits by Foreign Governments	$ 11,237.5	$ 9,971.6
Seized Iraqi Cash	118.3	808.9
Other Collections	0.0	0.0
Total Cash Collections	$ 11,355.8	$ 10,780.5
Accrual Adjustments (+/-)	$ 0.9	$ 0.7
Total Custodial Collections	$ 11,356.7	$ 10,781.2
DISPOSITION OF COLLECTIONS		
Disbursed on Behalf of Foreign Governments and International Organizations	$ 9,998.8	$ 10,118.8
Seized Assets Disbursed on behalf of Iraqi People	283.1	530.8
Increase (Decrease) in Amounts to be Transferred	1,239.5	(146.5)
Collections Used for Refunds and Other Payments	0.0	0.0
Retained by The Reporting Entity	0.0	0.0
Seized Assets Retained for Support of the Iraqi People	(164.7)	278.1
Total Disposition of Collections	$ 11,356.7	$ 10,781.2
NET CUSTODIAL COLLECTION ACTIVITY	$ 0.0	$ 0.0

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the "Chief Financial Officers Act of 1990," expanded by the "Government Management Reform Act of 1994," and other appropriate legislation. The financial statements have been prepared from the books and records of the Department in accordance with the "DoD Financial Management Regulation," Office of Management and Budget Bulletin No. 01-09, "Form and Content of Agency Financial Statements," and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the Department is responsible. Information relative to classified assets, programs, and operations has been excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified.

The Department is unable to fully implement all elements of GAAP and Office of Management and Budget Bulletin No. 01-09 due to limitations of its financial management processes and systems, including nonfinancial systems and processes that feed into the financial statements. The Department derives its reported values and information for major asset and liability categories largely from nonfinancial systems, known as feeder systems, such as inventory systems and logistic systems. These systems were designed to support reporting requirements that focus on maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The Department continues to implement process and system improvements addressing these limitations.

1.B. Mission of the Reporting Entity

The National Security Act of 1947 established the Department of Defense. The Department's mission is to organize, train, and equip armed forces to deter aggression and, if necessary, defeat aggressors against the United States and its allies. Fiscal Year (FY) 2004 is the ninth year that the Department has prepared audited DOD Agency-wide financial statements as required by the Chief Financial Officers Act and Government Management Reform Act. Auditors are required to audit the financial statements of the following stand-alone reporting entities: (1) Army General Fund, (2) Army Working Capital Fund, (3) Navy General Fund, (4) Navy Working Capital Fund, (5) Air Force General Fund, (6) Air Force Working Capital Fund, (7) Military Retirement Fund, (8) DoD Medicare-Eligible Retiree Health Care Fund, and (9) U.S. Army Corps of Engineers (Civil Works).

In addition to the nine stand-alone reporting entities, separate columns in the combining/consolidating statements are included with the financial information of the "Other Defense Organizations General Funds" and "Other Defense Organizations Working Capital Funds." The Office of the Inspector General will not issue separate audit opinions on the statements of the Other Defense Organizations; instead, the financial statements and records of those organizations will be included in the audit performed to support the opinion issued on the DoD Agency-wide financial statements.

Also, the Department requires the following Defense Agencies to prepare internal stand-alone annual financial statements to be audited by certified public accounting firms: (1) Defense Logistics Agency, (2) Defense Finance and Accounting Service, (3) Defense Information Systems Agency, (4) Defense Contract Audit Agency, (5) Defense Commissary Agency, (6) Defense Security Service, and (7) Defense Threat Reduction Agency.

1.C. Appropriations and Funds

The Department receives its appropriations and funds as general, working capital (revolving funds), trust, special, and deposit funds. The Components use these appropriations and funds to execute their missions and report on resource usage.

General funds are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and military construction accounts.

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

Special fund accounts are used to process government receipts earmarked for a specific purpose.

Deposit funds are used to record amounts held temporarily until ownership is determined. The Department is acting as an agent or a custodian for funds awaiting distribution, for example payroll taxes.

Working capital funds (WCF) receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial cost of products and services. The activities provide goods and services on a reimbursable basis. Receipts derived from operations generally are available in their entirety for use without further congressional action.

1.D. Basis of Accounting

For FY 2004, the Department's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Department's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the Department's legacy systems were designed to record information on a budgetary basis.

The Department has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with all elements of GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Government Standard General Ledger (USSGL). Until all of the Department's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, the DoD's financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjusted for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, the Department identifies program costs based upon the major appropriation groups provided by the Congress. The Department is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

The Department receives congressional appropriations as financing sources for general funds (annual and a multi-year basis). When authorized, these appropriations are supplemented by revenues generated by sales of goods or services. The Department recognizes revenue as a result of costs incurred or services performed on behalf of other federal agencies and the public. The Department recognizes revenue when earned where systems allow for it. In other instances, revenue is recognized when bills are issued.

The Department does not include non-monetary support provided by U.S. allies for common defense and mutual security in its list of other financing sources that appears in the Statement of Financing. The U.S. has cost-sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port.

1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the Department's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities and unbilled revenue. The Department's expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when items are either purchased or issued to users. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses. Net increases or decreases in unexpended appropriations are recognized as a change in the net position. Certain expenses, such as annual and military leave earned but not taken, are expensed in the period that payment is made. The Department adjusts operating expenses as a result of the elimination of balances between DoD Components.

1.G. Accounting for Intragovernmental Activities

The Department, as an agency of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Department.

Public Debt

The Department's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debts and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the Department of the Treasury does not allocate such interest costs to the benefiting agencies.

Inter/Intra Governmental Elimination

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within the Department or between two or more federal agencies. However, the Department cannot accurately identify most of its intragovernmental transactions by customer because DoD's systems do not track buyer and seller data needed to match related transactions. For FY 1999 and beyond, seller entities within the Department provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD intragovernmental balances were then eliminated. The Department is to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with the existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the Department and other federal agencies. In May 2004, the FMS issued the Treasury Financial Manual Part 2 – Chapter 4700 "Agency Reporting Requirements for the Financial Report of the United States Government." The Department is not able to fully implement the policies and procedures in this manual related to reconciling intragovernmental assets, liabilities, revenues, and expenses for nonfiduciary transactions. The Department, however, is able to implement the policies and procedures contained in the "Intragovernmental Fiduciary Transactions Accounting Guide," as updated by the "Federal Intragovernmental Transactions Accounting Policies and Procedures Guide," which has been updated and reissued on September 24, 2004. Both documents provide guidance for reconciling Intragovernmental transactions pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DoL), and benefit program transactions with the OPM.

1.H. Transactions with Foreign Governments and International Organizations

Each year, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, the Department has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Customers are required to make payments in advance.

1.I. Funds with the U.S. Treasury

The Department's monetary financial resources are maintained in U.S. Treasury accounts. The Defense Finance and Accounting Service (DFAS), the Military Services, the U.S. Army Corps of Engineers (USACE) disbursing stations, and the Department of State financial service centers process the majority of cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on check issues, electronic fund transfers, and interagency transfers and deposits.

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account. Differences between the Department's recorded balance in the FBWT accounts and the Treasury's FBWT accounts sometimes result and are subsequently reconciled.

1.J. Foreign Currency

Cash is the total of cash resources under the control of the Department of Defense, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Cash available for agency use includes petty cash funds and cash held in revolving funds, which will not be transferred into the U.S. Government General Fund. Foreign currency consists of the total U.S. dollar equivalent of both purchased and non-purchased foreign currencies held in foreign currency fund accounts. The majority of cash and all foreign currency is classified as non-entity and, therefore, restricted.

The amounts for cash and foreign currency reported consist primarily of cash held by Disbursing Officers to carry out their paying, collecting and foreign currency accommodation exchange missions. Cash seized during Operation Iraqi Freedom is restricted for use to assist the Iraqi people and support the reconstruction of Iraq.

The Department conducts a significant portion of its operations overseas. The Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations (operation and maintenance, military personnel, military construction, family housing operation and maintenance, and family housing construction). The gains and losses are computed as the variance between the exchange rate at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The Department does not separately identify currency fluctuations.

1.K. Accounts Receivable

As presented in the Balance Sheet statement, accounts receivable includes accounts, claims, and refunds receivable from other Federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The Department does not recognize an allowance for estimated uncollectible amounts from other Federal agencies. Claims against other Federal agencies are to be resolved between the agencies (per Code of Federal Regulations 4CFR 101.)

DoD Components use a variety of techniques for estimating the Allowance for Uncollectible Accounts Receivable from the public. While the exact details differ among the Components, estimates are usually based on either a percentage of actual prior-year write-offs or a percentage of aged receivables from the public.

1.L. Loans Receivable

The Department operates a loan guarantee program authorized by the National Defense Authorization Act for FY 1996 Public Law 104-106, Statute 186, Section 2801. The Act includes a series of authorities that allow the Department to work with the private sector to renovate military housing. The Department's goals are to obtain private capital to leverage government dollars, make efficient use of limited resources, and use a variety of private sector approaches to build and renovate military housing faster and at a lower cost to American taxpayers.

The Act also provides the Department with a variety of authorities to obtain private sector financing and expertise to improve military housing. The Department uses these authorities individually or in combination. They include guarantees, both loan and rental; conveyance/leasing of existing property and facilities; differential lease payments; investments, both limited partnerships and stock/bond ownership; and direct loans. In addition, the "Federal Credit Reform Act of 1990" governs all amended direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees.

1.M. Inventories and Related Property

Most of the Department's inventories are currently reported at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, the DoD Components have transitioned, and are continuing to transition, their inventory to the moving average cost method. Upon full implementation, the Department will be compliant with SFFAS No. 3. Approximately 5 percent of inventories are now reported at moving average cost.

The Department manages only military or government-specific materiel under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DoD materiel management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The Department holds materiel based on military need and support for contingencies. Therefore, the Department does not attempt to account separately for "Inventory held for sale" and "Inventory held in reserve for future sale" based on SFFAS No. 3 definitions.

Related property includes OM&S and stockpile materials. OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, and procured by general fund appropriations such as ammunition and engines, are generally accounted by the consumption method and reported on the balance sheet as OM&S. When current systems cannot fully support the consumption method, the Department uses the purchase method - that is, materials and supplies are expensed when purchased. For FY 2004, the Department expensed significant amounts using the purchase method either because the systems could not support the consumption method or because management deemed that the item is in the hands of the end user.

The Department determined that the recurring high dollar value of Operating Materials & Supplies in need of repair is material to the financial statements and requires a separate reporting category. Many high dollar items managed, such as aircraft engines, are categorized as OM&S rather than military equipment by DoD activities.

The Department implemented new policy in FY 2002 to account for condemned materiel only, as "Excess, Obsolete, and Unserviceable." The net value of condemned materiel is zero, because the costs of disposal are greater than the potential scrap value. Potentially redistributable materiel, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in "Held for Use" or "Held for Repair" categories according to its condition.

Past audit results identified uncertainties about the completeness and existence of quantities used to produce the reported values of inventory. Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the Department. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. It is more economical to repair than to procure these inventory items. Because the Department often relies on weapon systems and machinery no longer in production, the Department supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Finally, work in process balances include costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs. Work in process also includes the value of finished products or completed services pending the submission of bills to the customer. The work in process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including the amount withheld from payment to ensure performance, and the amount paid to other government plants for accrued costs of end items of materiel ordered but not delivered. Work in process includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services.

1.N. Investments in U.S. Treasury Securities

The Department reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment using the effective interest rate method or another method obtaining similar results. The Department's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities.

The Department invests in both marketable and non-marketable securities. Marketable securities are investments trading on a public market. The two types of non-marketable securities are par value and market-based intragovernmental securities. The Bureau of Public Debt issues non-marketable par value intragovernmental securities. Non-marketable, market-based intragovernmental securities mimic marketable securities, but are not traded publicly.

The Department's Net Investments are supported by various Trust Funds in each of the reporting entities. These Trust Funds are comprised of Military Retirement Trust Fund (MRF), Medicare-Eligible Retiree Health Care Fund (MERHCF), Other Defense Organizations General Fund (ODO GF), donations (Gift Funds), and the United States Army Corps of Engineers (USACE).

1.O. General Property, Plant and Equipment

SFFAS No. 23 establishes new generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in Federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades for accounting periods beginning after September 30, 2002. The Department uses data from the Bureau of Economic Analysis to calculate a value for military equipment.

General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of $100,000. Also, DoD requires capitalization of improvement costs over the DoD capitalization threshold of $100,000 for General PP&E. The Department depreciates all General PP&E, other than land, on a straight-line basis.

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for FYs 1993, 1994, and 1995, respectively, and an estimated useful life of 2 or more years. These assets remain capitalized and reported on WCF financial statements. General PP&E previously capitalized at amounts below $100,000 were written off General Fund financial statements in FY 1998.

The USACE Civil Works General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost exceeds $25,000. One exception is all buildings and structures related to hydropower projects are capitalized regardless of cost. During 2003, the Corps increased its buildings and structures threshold from $0 to $25K for all Civil Works appropriations with the exception of Revolving Fund and Power Marketing Agency (PMA) assets. All Civil Works buildings and structures currently capitalized under $25,000 (excluding Revolving Fund and PMA) were expensed in FY 2003 and removed from the Corps of Engineers Financial Management System (CEFMS). Beginning in FY 2004 all Civil Works Buildings and Structures under $25,000 are expensed except for PMA assets.

When it is in the best interest of the government, the Department provides government property necessary to contractors to complete contract work. The Department either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E exceeds the DoD capitalization threshold, it must be reported on the Department's Balance Sheet.

Regardless, the Department is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Department reports only the government property in the possession of contractors that is maintained in the DoD's property systems. Currently the Department does not plan to show contractor-held property as a separate line-item in Note 10.

To bring the DoD into fuller compliance with federal accounting standards, the Department has issued new property accountability and reporting regulations that require the DoD Components to maintain, in their property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards.

1.P. Advances and Prepayments

The Department records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. In addition, when the Department receives the related goods and services, it recognizes advances and prepayments as expenses.

1.Q. Leases

Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), the Department records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The Department records the amounts as the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the governmental incremental borrowing rate at the inception of the lease. DoD as the lessee receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are charged to expense over the lease term as it becomes payable.

Office space is the largest component of operating leases. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Inter-service Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. Equipment leases have a variety of lease terms, which are not expected to be renewed upon expiration. Other operating leases are generally one-year leases. The Department expects to continue to reduce the level of owned assets while increasing the number of leased assets. The Department will strive to displace commercial leases with more economical GSA leases.

1.R. Other Assets

The Department conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the Department provides financing payments. One type of financing payment that the Department makes for real property is based upon a percentage of completion. In accordance with SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported on the General PP&E line and in General PP&E, Net.

The Federal Acquisition Regulation allows the Department to make financing payments, under fixed price contracts, that are not based on a percentage of completion. The Department reports these financing payments as advances or prepayments in the "Other Assets" line item. The Department treats these payments as advances or prepayments because the Department becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the Department is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the Department for the full amount of the advance.

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The DoD recognizes contingencies as liabilities when past events or exchange transactions occur, a future loss is probable and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The Department's loss contingencies arise as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft, ship and vehicle accidents, medical malpractice, property or environmental damages, and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for the Department's assets. This type of liability has two components: nonenvironmental and environmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon the Department's policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of the Federal Government." The Department recognizes nonenvironmental disposal liabilities for National Defense PP&E nuclear-powered assets when placed into service. Such amounts are developed in conjunction with, and not easily separately identifiable from, environmental disposal costs.

1.T. Accrued Leave

The Department reports as liabilities civilian annual leave and military leave that has been accrued and not used as of the balance sheet date. The liability reported at the end of the accounting period reflects the current pay rates.

1.U. Net Position

Net position consists of unexpended appropriations and cumulative results of operations.

Unexpended Appropriations represent amounts of authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative Results of Operations represents the difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY1998, these results included the cumulative amount of donations and transfers of assets in and out without reimbursement.

1.V. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. DoD purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. The DoD's fixed assets decrease by not renewing a treaty or not reaching agreements. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any non-retrievable capital assets. This takes place after negotiations between the U.S. and the host country have determined the amount to be paid to the U.S. for such capital investments.

1.W. Comparative Data

Financial statement fluctuations greater than 10 percent are generally explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

The Department obligates funds to provide goods and services for outstanding orders not yet delivered. The financial statements do not reflect this liability for payment for goods and services not yet delivered.

1.Y. Problem Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. Intransit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities' outstanding accounts payable balance.

The Department of Defense policy is to allocate supported undistributed disbursements between federal and nonfederal categories based on the percentage of Federal and nonfederal accounts payable. The majority of the DoD Components reported following this allocation procedure. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities.

Note 2.	Nonentity Assets

As of September 30	2004		2003	
(Amounts in millions)				
1. Intragovernmental Assets				
A. Fund Balance with Treasury	$	1,913.5	$	517.9
B. Accounts Receivable		8.2		2.0
C. Total Intragovernmental Assets	$	1,921.7	$	519.9
2. Nonfederal Assets				
A. Cash and Other Monetary Assets	$	2,079.6	$	1,393.0
B. Accounts Receivable		5,107.7		5,063.4
C. Other Assets		0.6		126.0
D. Total Non-Federal Assets	$	7,187.9	$	6,582.4
3. Total Nonentity Assets	$	9,109.6	$	7,102.3
4. Total Entity Assets	$	1,199,376.6	$	1,134,207.0
5. Total Assets	$	1,208,486.2	$	1,141,309.3

Nonentity assets are assets for which the Department maintains stewardship accountability and responsibility to report, but are not available for use in the operations.

Fluctuations

Nonentity Fund Balance with Treasury (FBWT) increased $1.4 billion (269 percent). The majority of this increase is attributable to collections exceeding disbursements by $1.2 billion for Foreign Military Sales (FMS). The FMS Trust Fund receives funds in advance from foreign customers based on future requirement forecasts. The FMS collections from the foreign customers are based on initial deposit requirements and the quarterly billing statement that forecasts advance cash requirements.

Nonentity intragovernmental accounts receivable increased $6.2 million (310 percent). The fluctuation is attributable to the partial resolution of abnormal account receivable balances. These balances were created by cross-walk problems during the implementation of the Air Force General Funds' General Accounting and Finance System-Rehost (GAFS-R) in FY 2004. Research is on-going to resolve these cross-walk issues.

Cash and other monetary assets increased a net $686.6 million (49 percent). This increase is primarily due to increased support to the Operation Iraqi Freedom and Operation Enduring Freedom.

Intragovernmental Assets

Fund Balance with Treasury

The Nonentity Fund Balance with Treasury is comprised of three elements: Iraqi Custodial Fund, the FMS Trust Fund, and deposit and suspense accounts. The Iraqi Custodial Fund represents Iraqi cash seized by coalition forces during Operation Iraqi Freedom. These funds will be used to support the Iraqi people. Under authority of the Arms Export and Control Act, the FMS Trust Fund receives collections from foreign governments that are dedicated specifically to FMS purchases. The deposit and suspense accounts represent income tax withholding not yet disbursed to the Treasury or to state or local authorities.

Accounts Receivable

This amount represents receivables from cancelled year appropriations. The receivables will be returned to the Treasury as miscellaneous receipts once collected.

Non-Federal Assets

Cash and Other Monetary Assets

Cash and other monetary assets consist of cash held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange missions. Foreign currency is valued using the Department of Treasury Prevailing Rate of Exchange.

Accounts Receivable

Receivables are primarily related to Navy General Fund advance payments made to contractors and the associated accrued interest, which remains in litigation. In addition, the USACE reports that its non-federal nonentity accounts receivable include long-term receivables due from state and local municipalities for water storage contracts, hydraulic mining, and the leasing of land for flood control purposes. The balance of the amounts reported as nonentity non-federal accounts receivable represents accrued interest, penalties, fines and administrative fees receivable, accounts receivable due from active duty members, and accounts receivable due to appropriation accounts which are in a closed status. The Department neither derives nor receives any benefit from these collections, but incurs the cost of administering them. The receivables will be returned to the Treasury as miscellaneous receipts once collected.

Other Assets

Other nonentity assets primarily represent outstanding travel advances for the Air Force General Fund.

Note 3.	Fund Balance with Treasury

As of September 30		2004		2003
(Amounts in millions)				
1. Fund Balances				
A. Appropriated Funds	$	267,067.5	$	238,052.2
B. Revolving Funds		9,036.3		11,131.1
C. Trust Funds		1,955.5		559.0
D. Other Fund Types		11,539.6		2,319.7
E. Total Fund Balances	$	289,598.9	$	252,062.0
2. Fund Balances Per Treasury Versus Agency				
A. Fund Balance per Treasury	$	293,082.2	$	251,682.0
B. Fund Balance per Department of Defense		289,598.9		252,062.0
3. Reconciling Amount	$	3,483.3	$	(380.0)

Reporting Entity (Amounts in millions)		**Fund Balance with Treasury FY 2004**		**Fund Balance per Entity Books FY 2004**		**Reconciling Amount FY 2004**		**Reconciling Amount FY 2003**
Navy GF	$	83,080	$	82,094	$	986	$	
Air Force GF		61,498		60,601		897		
Army GF		89,549		89,549				
ODO GF		50,263		49,207		1,056		(314)
Corps of Engineers		2,907		2,387		520		(66)
MERHCF		5		5				
MRF		21		21				
Air Force WCF		1,704		1,051		653		1,742
Army WCF		948		948				
ODO WCF		2,246		2,875		(629)		(1,742)
Navy WCF		861		861				
Total	**$**	**293,082**	**$**	**289,599**	**$**	**3,483**	**$**	**(380)**

Analysis of Reconciling Amounts

For the Defense Agencies, the Department of Defense reconciles at the agency-wide level, since Defense Treasury Index 97 funds allotted at limit level complicate the Department's ability to reconcile at the defense agency level. The Department continues to improve internal methodology to properly account for their funds at the entity level.

The Department of Defense shows a reconciling net difference of $3.5 billion with the Department of the Treasury, which is comprised of:

- $986 million, for the Navy General Fund, that represents receipt account transactions unavailable to the Department of the Navy and canceling appropriated authority withdrawn by the Department of the Treasury at the end of the fiscal year;
- $897 million, for the Air Force General Fund, that represents the preclosing amount of Miscellaneous Receipt Accounts and Canceling Account balances on the entity records and not on the Treasury Trial Balance;

- $1.1billion, for the Other Defense Organizations (ODO) - General Fund, that includes a negative balance of $373.3 million in unsupported undistributed disbursements and collections reported at the departmental level but not yet recorded by the applicable agency. The remaining reconciling balance represents canceling appropriation authority withdrawn by the Department of the Treasury at the end of the fiscal year;

- $520 million that represents receipt accounts closed by the U.S. Army Corps of Engineers. The closure is not yet reflected on the Department of the Treasury report;

- $653 million, for the United States Transportation Command, that is recorded as Fund Balance with Treasury in the Air Force Working Capital Fund. The accounting for these funds is actually performed within the entity books of the ODO Working Capital Fund. For financial reporting, the Fund Balance with Treasury for the ODO Working Capital Fund is adjusted downward to reconcile with the Air Force Working Capital Fund;

- ($629) million which is primarily due to the downward adjustment to the Fund Balance with Treasury for the ODO Working Capital Fund to reflect that the cash reporting to the Department of the Treasury for the United States Transportation Command is done through the Air Force Working Capital Fund.

Other Information Related to Fund Balance with Treasury

Total Fund Balance

Total Fund Balance with Treasury increased approximately $37.5 billion (15 percent). Funding from appropriations increased by approximately $29 billion (12 percent). The increase is primarily attributable to an increase of $25.7 billion in the Army General Fund and $3.5 billion in the Navy General Fund for various purposes such as Operation Enduring Freedom and Operation Iraqi Freedom.

The Army General Fund increase also includes approximately $38.3 million in Vested Iraqi Cash. This cash represents frozen Iraqi deposits in the United States and is vested in accordance with the International Emergency Economic Powers Act, Section 1701, and is used in support of the Iraqi people. Since the beginning of the war, Army has collected $1.7 billion in Vested Iraqi Cash and has disbursed $1.7 billion benefiting the Iraqi people as follows:

	Disbursed ($ in millions)
Iraqi Salaries	$1,184.9
Repair/Reconstruction/Humanitarian Assistance	140.9
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	360.0
Total Disbursed	**$1,685.8**

The Trust Funds increased approximately $1.4 billion (250 percent) due primarily to an increase in the ODO - General Fund as a result of Foreign Military Sales Trust Fund Collections exceeding Foreign Military Sales Trust Fund Disbursements.

The Other Fund Types increased approximately $9.2 billion (396 percent) principally due to an $8.9 billion increase in the Iraqi Relief and Reconstruction Fund.

Disclosures Related to Suspense/Budget Clearing Accounts

As of September 30	2002	2003	2004	(Decrease)/ Increase from FY 2003 - 2004
(Amounts in millions)				
Account				
F3875	$ (490.1)	$ (628.8)	$ (608.5)	$ 20.3
F3880	(3.8)	(6.0)	(1.4)	4.6
F3882	(37.3)	(21.6)	(59.5)	(37.9)
F3885	(185.0)	(399.5)	(118.2)	281.3
F3886	5.1	0.2	0.2	0.0
Total	$ (711.1)	$ (1,055.7)	$ (787.4)	$ 268.3

A description of the suspense and budget clearing accounts and their respective balances follows:

The F3875 and F3885 suspense clearing accounts represent the primary sources of the overall negative balance. Account F3875 reported a negative balance of approximately $608.5 million that represents the Disbursing Officer's (DO) suspense. Account F3885, that includes the Interfund/Intragovermental Paying and Collection (IPAC) suspenses, reported a negative balance of approximately $118.2 million. Account F3886 has a positive balance of approximately $0.2 million represented by the Thrift Savings Plan suspense. These three suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation.

The F3880 suspense account reported a negative balance of approximately $1.4 million. This amount represents the balance of Treasury checks that (1) have either been lost by the payee and need to be reissued, (2) have never been cashed by the payee, or (3) have been cancelled by the Treasury and need to be transferred to the original appropriation.

The F3882 suspense account reported a negative balance of approximately $59.5 million. This account was established for the Uniformed Services Thrift Savings Plan in FY 2002. The amounts in this account represent a timing difference between the posting of the Thrift Savings Plan deductions by the National Finance Center and the posting of these same amounts in the military accounting systems in the following month.

On September 30 of each fiscal year, most of the uncleared suspense/budget clearing account balances are reduced to zero (as required by the Department of the Treasury) by transferring the balances to appropriation accounts. On October 1 of the following fiscal year, the uncleared suspense/clearing account balances are reestablished.

Under the authority of Section 1009 of Public Law 107-314, "Clearance of Certain Transactions Recorded in Treasury Suspense Accounts and Resolution of Certain Check Issue Discrepancies," the Department of Defense cancelled $414.1 million net and $625.5 million absolute from suspense accounts. The impact on the financial statements of canceling this amount was that this net amount was no longer in suspense and, therefore, was not transferred to appropriation accounts.

Problem Disbursements and In-Transit Disbursements

(Amounts in millions)	September 2002	September 2003	September 2004	(Decrease)/ Increase from 2003 to 2004
1. Total Problem Disbursements				
A. Absolute Unmatched Disbursements	$ 858.0	$ 854.3	$ 734.6	$ -119.7
B. Negative Unliquidated Obligations	122.0	124.9	94.8	-30.1
2. Total In-Transit Disbursements, Net	$ 4,550.0	$ 4,675.5	$ 5,197.8	$ 522.3

The DoD reported $734.6 million (absolute value) in Unmatched Disbursements (UMD), which is a decrease of $119.7 million. A UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

The DoD reported $94.8 million (absolute value) in Negative Unliquidated Obligations (NULOs), which is a decrease of $30.1 million. A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These problem disbursements represent the absolute value of disbursements of DoD funds that have been reported by a disbursing station to the Department of the Treasury. However, these problem disbursements have not yet been precisely matched against the specific source obligation that gave rise to the disbursements. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The DoD reported $5.2 billion (net) for In-Transits, which is an increase of $522.3 million. The In-Transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

The elimination of both problem disbursements and aged In-Transits is one of the highest financial management priorities of the Under Secretary of Defense (Comptroller). The DFAS has efforts underway to improve the systems, resolve all previous problem disbursements, and to process all in-transit disbursements in a timely manner.

Note 4.	Investments and Related Interest

As of September 30	2004					2003
	Cost	Amortization Method	Amortized (Premium/ Discount)	Investments, Net	Market Value Disclosure	Investments, Net
(Amounts in millions)						
1. Intragovernmental Securities:						
A. Non-Marketable, Market-Based	242,578.3	Effective Interest	(15,508.8)	227,069.5	238,639.5	201,741.0
B. Subtotal	$ 242,578.3		$ (15,508.8)	$ 227,069.5	$ 238,639.5	$ 201,741.0
C. Accrued Interest	$ 4,000.2			$ 4,000.2	$ 4,000.2	$ 3,635.0
D. Total Intragovernmental Securities	$ 246,578.5		$ (15,508.8)	$ 231,069.7	$ 242,639.7	$ 205,376.0
2. Other Investments:	$ 406.5		0.0	$ 406.5	N/A	$ 217.8

The amortization method used for non-marketable, market-based securities is effective interest. The Other Investments represent limited partnerships, entered into on behalf of the U.S. Government by the Army and Navy in support of the Military Housing Privatization Initiative authorized by Public Law 104-106, Stat. 186, on February 11, 1996. These investments do not require Market Value Disclosure.

Intragovernmental Securities

Net Investments increased by $25.7 billion (13 percent) in Non-Marketable, Market-Based securities. The increase is primarily due to positive cash flows of $20.1 billion for the Medicare-Eligible Retiree Health Care Fund and $5.4 billion for the Military Retirement Fund.

Other Investments

Other Investments increased $188.7 million (87 percent) due to new investments in limited partnerships by the Army ($93.0 million) and Navy ($95.7 million) to support military housing. A summary of the Department's total investments in these limited partnerships follow:

Installation	Amount Invested	Month Invested
Beaufort/Paris ISL/Quantico	$ 97.2	October 2003
Ft. Campbell, Kentucky	52.2	January 2004
Ft. Hood, Texas	52.0	November 2001
Ft. Bragg, North Carolina	49.4	December 2003
Ft. Stewart, Georgia	37.4	February 2004
South Texas, Texas	29.4	February 2002
Honolulu, Hawaii	25.0	May 2004
New Orleans Naval Complex, Louisiana	23.1	October 2001
San Diego, California	20.9	June 2003
Everett NAS, Washington	12.2	December 2000
Kingsville NAS, Texas	4.3	December 2000
Ft. Hamilton, New York	2.2	May 2004
Ft. Detrick, Maryland	1.3	September 2004
	406.5	

Note 5. Accounts Receivable

As of September 30	2004			2003
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in millions)				
1. Intra-governmental Receivables:	$ 1,118.3	N/A	$ 1,118.3	$ 1,066.6
2. Non-Federal Receivables (From the Public):	$ 8,028.3	$ (600.5)	$ 7,427.8	$ 7,299.9
3. Total Accounts Receivable:	$ 9,146.6	$ (600.5)	$ 8,546.1	$ 8,366.5

Note 6. Other Assets

As of September 30	2004	2003
(Amounts in millions)		
1. Intragovernmental Other Assets:		
A. Advances and Prepayments	$ 1,011.9	$ 105.0
B. Total Intragovernmental Other Assets	$ 1,011.9	$ 105.0
2. Non-Federal Other Assets:		
A. Outstanding Contract Financing Payments	$ 18,451.6	$ 18,868.7
B. Other Assets (With the Public)	3,034.7	2,860.9
C. Total Non-Federal Other Assets	$ 21,486.3	$ 21,729.6
3. Total Other Assets:	$ 22,498.2	$ 21,834.6

Fluctuations

Total Intragovernmental Advances and Prepayments increased $906.9 million (864 percent). Improved business processes allowed the Department in FY 2004 to capture advances to others with other federal agencies.

Note 7.	Cash and Other Monetary Assets

As of September 30	2004	2003
(Amounts in millions)		
1. Cash	$ 1,811.1	$ 1,290.8
2. Foreign Currency (non-purchased)	367.0	244.1
3. Total Cash, Foreign Currency, & Other Monetary Assets	$ 2,178.1	$ 1,534.9

Fluctuations

Total Cash, Foreign Currency and Other Monetary Assets increased $643.2 million (42 percent) primarily resulting from increases in cash on hand to support Operation Iraqi Freedom and Operation Enduring Freedom. Cash increased by $520.3 million (40 percent). This increase was primarily due to increases of $388.1 million for the Army General Fund and $166.9 million for the Air Force General Fund.

Overall foreign currency increased by $122.9 million (50 percent). This fluctuation was primarily the result of an increase of $182.6 million for the Army General Fund due to additional requirements for foreign currency to support Army military operations. This increase was offset by a decrease of $56.2 million for the Navy General Fund as a result of the Navy drawdown related to Operation Iraqi Freedom. In addition, the U.S. Army Corps of Engineers received additional foreign currency from the Republic of Korea for reimbursable work to be performed. The foreign currency is primarily required to (1) pay foreign vendors, (2) provide cash for agents in support of deployed tactical units, and (3) provide currency for exchange of U.S. dollars for troops stationed overseas to support Operation Iraqi Freedom and Operation Enduring Freedom.

Other Information

The majority of cash and all foreign currency is classified as nonentity and its use is, therefore, restricted. Approximately $1.7 billion in cash and $367 million in foreign currency are restricted.

Note 8.	Direct Loan and/or Loan Guarantee Programs

Direct Loan and/or Loan Guarantee Programs: The entity operates the following direct loan and/or Loan guarantee program(s):

Military Housing Privatization Initiative

Armament Retooling & Manufacturing Support Initiative

The "Federal Credit Reform Act of 1990" (CRA) governs all amended direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees. Direct loans are reported at the net present value of the following cash flows:

- Loan disbursements;
- Repayments of principal; and
- Payments of interest and other payments by or to the Department over the life of the loan after adjusting for estimated defaults, prepayments, fees, penalties and other recoveries

Loan guarantee liabilities are reported at the net present value of the following cash flows:

- Payments by the Department to cover defaults and delinquencies, interest subsidies, or other payments; and
- Payments to the Department including origination and other fees, penalties, and recoveries.

Military Housing Privatization Initiative

The Military Housing Privatization Initiative (MHPI) includes both Direct Loan and Loan Guarantee Programs. The Department obtains private sector capital to leverage government dollars. The Department provides protection against specific risks, such as base closure or member deployment, for the private sector partner. The Loan Guarantee Program is authorized by the National Defense Authorization Act for FY 1996, Public Law (P.L.) 104-106 Statute 186, Section 2801.

Armament Retooling and Manufacturing Support Initiative

The Armament Retooling and Manufacturing Support Initiative (ARMS), authorized by Title 10 USC 4551-4555, is a Loan Guarantee Program. The program is designed to encourage commercial use of the Army's Inactive Ammunition Plants through many incentives for businesses willing to locate to a government ammunition production facility. The production capacity of these facilities is greater than current military requirements; however, this capacity may be needed by the military in the future. The revenues from the property rental are used to pay for the operation, maintenance and environmental clean up at the facilities. The resulting savings in overhead costs lower the production cost of the goods manufactured and fund environmental clean up at no cost to the government.

The US Department of Agriculture Rural Business-Cooperative Service (RBS) and the Department of the Army established a Memorandum of Understanding (MOU) to furnish services to the Army in connection with the ARMS Initiative Loan Guarantee Program (AILG) pursuant to Section 193 of the Armament Retooling and Manufacturing Support Act of 1992 (P.L. 102-484), as amended (10 USC 2501 note). The National Defense Authorization Act for Fiscal Year 1995 (P.L. 103-337) authorized the Army to enter into this MOU with RBS pursuant to 31 USC 1535. The RBS has the necessary programmatic and administrative services and provides other services required to administer the AILG Program. Therefore, to ensure service to the public and for protection of the federal interests and rights, it was necessary for the Army to obtain service from the RBS.

Direct Loans Obligated After FY 1991

As of September 30	2004	2003
(Amounts in millions)		
Military Housing Privatization Initiative:		
A. Loans Receivable Gross	$ 141.5	$ 129.1
B. Allowance for Subsidy Cost (Present Value)	(70.8)	(65.1)
C. Value of Assets Related to Direct Loans	$ 70.7	$ 64.0
Total Loans Receivable:	$ 70.7	$ 64.0

Subsidy costs are recognized when direct loans are disbursed to borrowers and are re-estimated each year as of the date of the financial statements. The allowance for subsidy cost is the difference between the outstanding principal of the loans and the present value of their net cash flows. New loans in the amount of $12.4 million were disbursed relating to housing at Camp Pendleton, California. The increase in the allowance for subsidy for new loans was proportionate to the increase in new loans receivable. The allowance was also adjusted for subsidy re-estimates and subsidy amortization totaling $2.6 million. Subsidy amortization is the net of interest revenue and interest expense. FY 2004 subsidy amortization represents the difference between net borrowing from the Treasury and loans receivable.

Gross direct loans disbursed for the MHPI program from inception consists of the following:

		(in millions)
Dyess Air Force Base, Texas	$	28.9
Elmendorf Air Force Base, Alaska		48.0
Lackland Air Force Base, Texas		10.6
Warner-Robins Air Force Base, Georgia		22.3
Camp Pendleton Marine Corps Base, California		29.4
Kingsville Air Force Base, Texas		2.5
Total		**141.7**
Less: Previous Principal Repayments		(0.2)
Loans Receivable Gross	**$**	**141.5**

Total Amount of Direct Loans Disbursed

As of September 30	2004	2003
(Amounts in millions)		
Direct Loan Program		
Military Housing Privatization Initiative:	$ 12.4	$ 36.7
Total	$ 12.4	$ 36.7

New direct loans disbursed had a decrease of $24.3 million (66 percent). This change is due to the reduced number of direct loans issued. The demand for direct loans by private developers varies from year to year depending upon the progression of planned construction and renovation and upon economic factors unrelated to the operations of the Department of Defense.

Total direct loans disbursed in FY 2004 for the MHPI program are:

		(in millions)
Camp Pendleton Marine Corps Base, California	$	12.4
Total Direct Loans Disbursed	$	12.4

Subsidy Expense for Post-1991 Direct Loans

As of September 30 (Amounts in millions)					
2004	**Interest Differential**	**Defaults**	**Fees**	**Other**	**Total**
1.Subsidy Expense for New Direct Loans Disbursed:					
MilitaryHousing Privatization Initiative	$ 7.7	$ 0.5	$ 0.0	$ 0.0	$ 8.2
Total	$ 7.7	$ 0.5	$ 0.0	$ 0.0	$ 8.2
2003	**Interest Differential**	**Defaults**	**Fees**	**Other**	**Total**
2.Subsidy Expense for New Direct Loans Disbursed:					
Military Housing Privatization Initiative	$ 19.2	$ 4.1	$ 0.0	$ 0.0	$ 23.3
Total	$ 19.2	$ 4.1	$ 0.0	$ 0.0	$ 23.3
2004	**Modifications**	**Interest Rate Reestimates**	**Technical Reestimates**	**Total Re-estimates**	**Total**
3.Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	$ (0.7)	$ (2.0)	$ 0.1	$ (1.9)	$ (2.6)
Total	$ (0.7)	$ (2.0)	$ 0.1	$ (1.9)	$ (2.6)

	2004	2003
4Total Direct Loan Subsidy Expense:		
Military Housing Privatization Initiative	$ 5.6	$ 23.3
Total	$ 5.6	$ 23.3

The interest rate and default cost values represent the amounts for the loans disbursed in FY 2004. These rates are established for each individual loan. The interest rate re-estimate for subsidy cost is an adjustment to subsidy cost from the assumed interest rates used in the budget preparations to the interest rates that are applicable to the periods in which the loans are disbursed. Technical/default re-estimate is an adjustment to subsidy cost based on the latest projections of defaults, delinquencies, recoveries, prepayments or other cash flow components.

The decline in the reporting of Interest Rate Differential Costs and Default Costs is proportional to the number of loans disbursed. The $17.7 million decrease in the direct loan subsidy expense primarily resulted from the reduction in loans disbursed. Additionally, subsidy expense was impacted by a downward re-estimate of subsidy for loans disbursed in prior fiscal years and subsidy allowance amortization. The subsidy rate differs for each project, from 66 percent for Camp Pendleton Marine Corps Base, California to 43 percent for Elmendorf Air Force Base, Alaska. This difference has a direct impact on the variance from FY 2003 to FY 2004.

Subsidy Rate for Direct Loans

	Interest Differential	Defaults	Fees	Other	Total
Military Housing Privatization Initiative	24.26%	9.96%	0.00%	0.00%	34.22%

Subsidy rates pertain to the loan agreements contracted during the current fiscal year. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans disbursed in the current year could result from disbursement of loans from both current and prior-year loan agreements.

Subsidy rates for FY 2004 are included in the FY 2005 Presidential Budget Federal Credit Supplement and are published at the following website:

http://www.whitehouse.gov/omb/budget/fy2005/pdf/cr_supp.pdf

Schedule for Reconciling Subsidy Cost Allowance Balances for Post-1991 Direct Loans

Beginning Balance, Changes and Ending Balance	2004	2003
(Amounts in millions)		
1. Beginning Balance of the Subsidy Cost Allowance	$ 65.1	$ 41.8
2. Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component		
A. Interest Rate Differential Costs	$ 7.7	$ 19.2
B. Default Costs (Net of Recoveries)	0.5	4.1
C. Total of the above Subsidy Expense Components	$ 8.2	$ 23.3
3. Adjustments		
A. Subsidy Allowance Amortization	(0.6)	0.0
B. Total of the above Adjustment Components	$ (0.6)	$ 0.0
4. Ending Balance of the Subsidy Cost Allowance before Re-estimates	$ 72.7	$ 65.1
5. Add or Subtract Subsidy Re-estimates by Component		
A. Interest Rate Re-estimate	$ (2.0)	$ 0.0
B. Technical/default Re-estimate	$ 0.1	0.0
C. Total of the above Re-estimate Components	$ (1.9)	$ 0.0
6. Ending Balance of the Subsidy Cost Allowance	$ 70.8	$ 65.1

Defaulted Guaranteed Loans from Post-1991 Guarantees

As of September 30, 2004, the Department had no defaulted guaranteed loans.

Guaranteed Loans Outstanding

As of September 30	Outstanding Principal, Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
Guaranteed Loans Outstanding:		
1. Military Housing Privatization Initiative	$ 389.0	$ 389.0
2. Armament Retooling & Manufacturing Support Initiative	$ 27.1	$ 24.3
3. Total	$ 416.1	$ 413.3

Guaranteed Loans Outstanding for the MHPI program as of the end of September 30, 2004 consist of the following:

	(in millions)
Warner-Robins Air Force Base, Georgia	$ 25.6
Fort Carson Army Installation, Colorado	147.0
Kirtland Air Force Base, New Mexico	74.0
Wright Patterson Air Force Base, Ohio	65.0
Elmendorf Air Force Base, Alaska	48.0
Lackland Air Force Base, Texas	29.4
Total	**$ 389.0**

Liability for Post-1991 Loan Guarantees, Present Value

As of September 30 (Amounts in millions)	2004	2003
Loan Guarantee Program Title		
1. Military Housing Privatization Initiative	$ 22.1	$ 24.6
2. Armament Retooling & Manufacturing Support Initiative	12.3	1.3
3. Total	$ 34.4	$ 25.9

<u>MHPI</u>

The $2.5 million (10 percent) decrease is attributable to a technical reestimate of the subsidy. For additional information, see Note 8.L, Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees. There were no new guaranteed loans created in FY 2004.

<u>ARMS</u>

Total loan guarantee liabilities increased $11.0 million (846 percent) primarily due to the new FY 2004 loan obligation and a liability for an impending loss claim. There were no new guaranteed loans created in FY 2004.

Subsidy Expense for Post-1991 Loan Guarantees

As of September 30					
(Amounts in millions)					
2004	Interest Differential	Defaults	Fees	Other	Total
1. Subsidy Expense for New Loan Guarantees Disbursed:					
Armament Retooling and Manufacturing Support Initiative	$ 0.0	0.2	(0.1)	0.0	0.1
Total	$ 0.0	$ 0.2	$ (0.1)	$ 0.0	$ 0.1
2003	Interest Differential	Defaults	Fees	Other	Total
2. Subsidy Expense for New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	$ 0.0	$ 11.3	$ 0.0	$ 0.0	$ 11.3
Armament Retooling and Manufacturing Support Initiative	$ 0.0	0.1	(0.0)	0.0	0.1
Total	$ 0.0	$ 11.4	$ 0.0	$ 0.0	$ 11.4
2004	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
3. Loan Guarantee Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 1.9	$ 0.0	$ (4.4)	$ 0.0	$ (2.5)
Armament Retooling and Manufacturing Support Initiative	0.0	0.0	7.5	0.0	7.5
Total	$ 1.9	$ 0.0	$ 3.1	$ 0.0	$ 5.0

4. Total Loan Guarantee Subsidy Expense	2004	2003
Military Housing Privatization Initiative	$ (2.5)	$ 11.3
Armament Retooling and Manufacturing Support Initiative	7.6	0.1
Total	$ 5.1	$ 11.4

MHPI

The MHPI created no new loan guarantees during FY 2004; however, MHPI had a $2.5 million downward re-estimate, resulting in the negative subsidy expense.

ARMS

ARMS created no new loan guarantees during FY 2004. The change in ARMS subsidy expense is due primarily to an upward subsidy re-estimate. For additional information, see Note 8.L, Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees.

Subsidy Rate for Loan Guarantees

	Interest Supplements	Defaults	Fees and other Collections	Other	Total
Loan Guarantees:					
1. Military Housing Privatization Initiative:	0.00%	9.65%	0.00%	0.00 %	9.65%
2. Armament Retooling & Manufacturing Support Initiative	0.00%	4.97%	-1.60%	0.00 %	3.37%

MHPI

The subsidy rates disclosed pertain only to loan agreements made during the current fiscal year. These rates cannot be applied to the direct loans disbursed during the current fiscal year to yield the subsidy expense. The subsidy expense for new loans reported in the current year result from disbursements of loans from both current year loan agreements and prior year(s) loan agreements. The subsidy expense reported in the current year also includes modifications and reestimates.

These FY 2004 loan guarantee subsidy rates are published in the FY 2005 Federal Credit Supplement at the following web site:

http://www.whitehouse.gov/omb/budget/fy2005/pdf/cr_supp.pdf

Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees

Beginning Balance, Changes and Ending Balance	2004	2003
(Amounts in millions)		
1. Beginning Balance of the Loan Guarantee Liability	$ 25.9	$ 14.1
2. Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component		
A. Default Costs (Net of Recoveries)	0.2	11.4
B. Fees and Other Collections	(0.1)	0.0
C. Total of the above Subsidy Expense Components	$ 0.1	$ 11.4
3. Adjustments		
A. Fees Received	$ 0.0	$ 0.4
B. Interest Accumulation on the Liability Balance	5.3	0.0
C. Total of the above Adjustments	$ 5.3	$ 0.4
4. Ending Balance of the Loan Guarantee Liability before Re-estimates	$ 31.3	$ 25.9
5. Add or Subtract Subsidy Re-estimates by Component		
A. Technical/default Re-estimate	$ 3.1	$ 0.0
B. Total of the above Re-estimate Components	$ 3.1	$ 0.0
6. Ending Balance of the Loan Guarantee Liability	$ 34.4	$ 25.9

Loan guarantee liabilities are re-estimated each year as of the date of the financial statements. As of result of the re-estimations for FY 2004, MHPI had a downward subsidy re-estimate of $4.4 million and ARMS had an upward subsidy re-estimate of $7.5 million. Funding for the upward loan subsidy re-estimate is expected in the next fiscal year. The downward re-estimate will be returned to the Treasury.

Administrative Expense

Administrative Expense is limited to separately identified expenses administered to direct and guaranteed loans. DoD does not maintain a separate program to capture the expenses related to direct and guaranteed loans only for the MHPI.

Administrative Expense for the ARMS is a fee paid to theU.S.Department of Agriculture RBS for administering the loan guarantees under the ARMS, which is a joint program. Administrative Expense for the ARMS is immaterial to the DoD financial statements.

Note 9.	Inventory and Related Property

As of September 30	2004	2003
(Amounts in millions)		
1. Inventory, Net	$ 68,207.9	$ 64,365.4
2. Operating Materials & Supplies, Net	143,489.7	139,351.2
3. Stockpile Materials, Net	1,521.8	1,828.0
4. Total	$ 213,219.4	$ 205,544.6

Inventory, Net

As of September 30	2004 Inventory, Gross Value	2004 Revaluation Allowance	2004 Inventory, Net	2003 Inventory, Net	Valuation Method
(Amounts in millions)					
1. Inventory					
A. Available and Purchased for Resale	$ 75,931.7	$ (33,557.2)	42,374.5	$ 42,216.0	LAC, MAC
B. Held for Repair	30,027.6	(5,369.7)	24,657.9	20,206.3	LAC, MAC
C. Excess, Obsolete, and Unserviceable	5,368.1	(5,368.1)	0.0	0.0	NRV
D. Raw Materials	21.3	0.0	21.3	9.8	MAC,SP,LAC
E. Work in Process	1,154.2	0.0	1,154.2	1,933.3	AC
F. Total	$ 112,502.9	$ (44,295.0)	68,207.9	$ 64,365.4	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses
SP = Standard Price
NRV = Net Realizable Value
MAC = Moving Average Cost
AC = Actual Cost

Generally, there are no restrictions on the use, sale, or disposition of inventory except in the following situations:

- Distributions without reimbursement are made when authorized by Department of Defense directives.
- War reserve materiel includes fuels and subsistence items that are considered restricted.
- Inventory, with the exception of safety stocks, may be sold to foreign, state and local governments, private parties, and contractors in accordance with current policies and guidance or at the direction of the President.

General Composition of Inventory

Inventory includes spare and repair parts, clothing and textiles, and fuels held for sale by the Defense Working Capital Funds. Inventory is tangible personal property that is:

- Held for sale, or held for repair for eventual sale.
- In the process of production for sale.
- To be consumed in the production of goods for sale or in the provision of services for a fee.

Restatement of Prior Year Balance

Inventory, Net and Total Inventory and Related Property include a prior-year adjustment and restatement of $11.4 billion for fiscal year 2003. The restatement of the 2003 comparative balances is due to Inventory valuation changes and errors recorded by the Air Force. Refer to Note 20 – Statement of Changes in Net Position for additional information.

Operating Materials and Supplies, Net

As of September 30	2004			2003	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in millions)					
1. OM&S Categories:					
A. Held for Use	$ 127,765.1	$ 0.0	$ 127,765.1	$ 122,732.3	SP, LAC
B. Held for Repair	18,035.4	(2,310.8)	15,724.6	16,618.9	SP, LAC
C. Excess, Obsolete, and Unserviceable	3,128.9	(3,128.9)	0.0	0.0	NRV
D. Total	$ 148,929.4	$ (5,439.7)	$ 143,489.7	$ 139,351.2	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost adjusted for holding gains and losses

NRV = Net Realizable Value

SP = Standard Price

Generally, there are no restrictions on the use or disposition of operating materials and supplies.

General Composition of Operating Materials and Supplies

Operating Materials and Supplies includes spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally managed aircraft engines held for consumption by General Funds. Generally, there are no restrictions on the use or disposition of operating materials and supplies.

Fluctuations

OM&S increased by $4.1 billion (3 percent). The primary factors are as follows:

The Army General Fund reported its OM&S increased by $5.1 billion. The net increase is attributable to an increase in Missile Procurement, Army OM&S reported by the U. S. Army Aviation and Missile Command and an increase being reported in the Worldwide Ammunition Reporting System (WARS). The Missile Procurement's increase is the result of movement of funding from Procurement, Defense-wide to Missile Procurement, Army for the Patriot Advance Capability 3 in support of the global war on terror. The WARS increase is the result of Operation Iraqi Freedom, movement to uses other than basic load and training, retrograde and asset movement from troops to ammunition storage points, and Central Command inventory reconciliation.

The Air Force General Fund reported a decrease of $1.1 billion because of a change in methodology for valuing its OM&S. In FY 2003, uninstalled motors were valued at Latest Acquisition Cost while in FY 2004, they were valued at Moving Average Cost. Many of the old uninstalled missile motors reported in FY 2003 as excess have been refurbished and are now being reported as "held for use," and some motors have been destroyed.

Stockpile Materials, Net

As of September 30	2004 Stockpile Materials Amount		2004 Allowance for Gains (Losses)		2004 Stockpile Materials, Net		2003 Stockpile Materials, Net		Valuation Method
(Amounts in millions)									
1. Stockpile Materials Categories:									
A. Held for Sale	$	1,427.7	$	0.0	$	1,427.7	$	1,691.8	AC,LCM
B. Held in Reserve for Future Sale		94.1		0.0		94.1		136.2	AC,LCM
C. Total	$	1,521.8	$	0.0	$	1,521.8	$	1,828.0	

Legend for Valuation Methods:
AC = Actual Cost LCM = Lower of Cost or Market

Fluctuations

Stockpile, Net decreased $306.2 million (16.7 percent). The National Stockpile Fund reported the decrease of $42.1 million in its inventory held in reserve for future use is due to a systemic programming error in 2003 which was subsequently corrected. The decrease of $264.1 million in inventory held for sale is the result of material sales in FY 2004. Since the National Stockpile mission does not call for replenishing inventories, there will always be an annual decline of inventory.

General Composition of Stockpile Materials

Stockpile materials are strategic and critical materials held due to statutory requirements, for use in national defense, conservation or national emergencies. All materials held by the Defense National Stockpile (DNS) are classified as Materials Held in Reserve until congressional action declares the materials are no longer required to be stockpiled, and are available for sale on the open market. When DNS receives authorization to offer materials for sale, DNS removes the materials from Material Held in Reserve and reclassifies them as Material Held for Sale. Disposals cannot be made from the stockpile except under the following situations: (1) necessary upgrading, refining, or processing; (2) necessary rotation to prevent deterioration; (3) determination as excess with potential financial loss if retained; and (4) as authorized by law.

Note 10. General PP&E, Net

As of September 30	2004					2003
	Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in millions)						
1. Major Asset Classes:						
A. Land	N/A	N/A	$ 10,103.0	N/A	$ 10,103.0	$ 9,663.4
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,446.9	$ (91,463.2)	67,983.7	76,388.0
C. Leasehold Improvements	S/L	lease term	139.1	(96.3)	42.8	96.2
D. Software	S/L	2-5 Or 10	6,051.9	(3,555.9)	2,496.0	2,392.7
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0
G. Assets Under Capital Lease[1]	S/L	lease term	585.9	(379.2)	206.7	233.6
H. Construction-in- Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3
I. Other			83.1	(3.1)	80.0	92.5
J. Total General PP&E			$ 1,388,610.3	$ (947,711.7)	$ 440,898.6	$ 446,308.9

[1] See Note 15 on Capital Lease Liability for additional information

Legend for Valuation Methods:
S/L = Straight Line N/A = Not Applicable

Fluctuations

General Property, Plant and Equipment (PP&E) decreased $5.4 billion (1 percent). The significant changes are summarized below:

Buildings, Structures and Facilities decreased 8.4 billion (11 percent). The majority of this decrease was the result of an error in Navy General Fund data captured for FY 2003 accumulated depreciation. This error was corrected in FY 2004.

Leasehold Improvements reflected a net decrease of $53.4 million (56 percent). The decrease is primarily attributable to the DFAS Working Capital Fund's one-time reclassification of $48.3 million from Buildings, Structures and Facilities to Leasehold Improvements in FY 2003.

In FY 2004, the Department elected to display Military Equipment and General Equipment on separate lines for reporting purposes. The breakdown of the FY 2003 balance is a net book value of $13 billion for General Equipment and $325.1 billion for Military Equipment, therefore the true increase in General Equipment is $3 billion. This increase is the result of the procurement of new equipment and better recognition of existing equipment.

Assets Under Capital Lease

As of September 30	2004	2003
(Amounts in millions)		
1. Entity as Lessee, Assets Under Capital Lease:		
A. Land and Buildings	$ 574.6	$ 574.6
B. Equipment	11.3	2.6
C. Accumulated Amortization	(379.2)	(343.6)
D. Total Capital Leases	$ 206.7	$ 233.6

Assets Under Capital Lease consist primarily of leases for the Section 801 Family Housing Program.

Fluctuations

Assets Under Capital Lease decreased $26.9 million (12 percent). This change is due to normal depreciation expense in FY 2004.

Other Disclosures

Imputed interest was necessary to reduce net minimum lease payments to the present value calculated at the incremental borrowing rate at the inception of the leases.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2004	2003
(Amounts in millions)		
1. Intragovernmental Liabilities		
A. Accounts Payable	$ 9.2	$ 0.0
B. Debt	15.0	18.2
C. Other	5,303.1	4,814.5
D. **Total Intragovernmental Liabilities**	$ 5,327.3	$ 4,832.7
2. Non-Federal Liabilities		
A. Accounts Payable	$ 695.8	$ 0.0
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,348,776.0	1,233,557.2
C. Environmental Liabilities	60,979.4	58,047.6
D. Other Liabilities	15,158.0	12,552.1
E. **Total Non-Federal Liabilities**	$ 1,425,609.2	$ 1,304,156.9
3. Total Liabilities Not Covered by Budgetary Resources	$ 1,430,936.5	$ 1,308,989.6
4. Total Liabilities Covered by Budgetary Resources	$ 279,177.1	$ 250,648.9
5. Total Liabilities	$ 1,710,113.6	$ 1,559,638.5

Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered by realized budgetary resources as of the Balance Sheet date. For additional disclosures see Note 17 for Military Retirement Benefits and Other Employment Related Actuarial Liabilities, and Note 14 for Environmental Liabilities.

Fluctuations

Intragovernmental Accounts Payable

Intragovernmental Accounts Payable increased $9.2 million. In accordance with Treasury guidance Accounts Payable from Cancelled Appropriations moved from Intragovernmental Other Liabilities to Accounts Payable. This change became effective in FY 2004.

Intragovernmental Debt

Debt decreased $3.2 million (17.6 percent) as a result of debt reduction payments by the U.S. Army Corps of Engineers and U.S. Transportation Command of $2.0 million and $1.2 million, respectively.

Intragovernmental – Other

Intragovernmental Liabilities-Other (not covered by budgetary resources) increased $488.6 million (10 percent) and consist primarily of contractor debt and associated accrued interest receivable, workmen's compensation, judgment fund liabilities, and other custodial liabilities.

Other liabilities reported by the U.S. Army Corps of Engineers increased because Uncollected Custodial Liability totaling $65.2 million is reported with Liabilities Not Covered by Budgetary Resources. The liability was previously reported with Liabilities Covered by Budgetary Resources.

Federal Employees Compensation Act and Unemployment Compensation liabilities increased $153 million and $69 million respectively, due to the increase in personnel supporting the war in Iraq. The Navy GF increase of $53.0 million resulted from interest recorded and due to the Treasury from pending litigation on the A-12 program. Additionally, Navy GF liabilities increased $66 million because of improved processes for recording receipt of funds from cancelled appropriations that are due to the Treasury.

Non-Federal Accounts Payable

Non-Federal Accounts Payable increased $695.8 million. In accordance with Treasury guidance, Accounts Payable from Cancelled Appropriations were moved from Non-Federal Other Liabilities to Accounts Payable.

Military Retirement Benefits and Other Employment-Related Actuarial Liabilities

Military Retirement Benefits and Other Employment Related Actuarial Liabilities increased by $115.2 billion (9 percent). This is related to an increase in the actuarial liability of $140.1 billion that is offset by an increase of $24.9 billion in the value of assets available to pay benefits.

Non-Federal Other

Non-Federal Other Liabilities (not covered by budgetary resources) increased $2.6 billion (21 percent).

The Defense Health Program (DHP) reports an increase in the amount of $1.3 billion. The increase is attributable to the Incurred But Not Reported (IBNR) Liability. This liability is an estimated liability for medical claims incurred by the Defense Health Plan, but not yet reported. The DoD Office of the Actuary developed this estimate based on historical data showing medical claims by incurred date and paid date. This estimate also included factors such as administrative costs associated with the incurred but not reported claims, medical inflation, and the rate of beneficiary utilization of Defense medical services. The population base of this estimate is non-Medicare-eligible beneficiaries of the DHP. This includes non-Medicare-eligible active duty military personnel and family members, as well as non-Medicare-eligible military retirees, dependents and survivors. The remaining change relates to multiple entities that individually do not comprise 10 percent of the total change.

The Defense Security Cooperation Agency Foreign Military Sales (FMS) Trust Fund reported an increase of $1.2 billion in custodial liability. This increase is related to the change in the net custodial cash balance. The liability represents net advances received from the foreign customers less the funds expensed on their behalf. When the cash balance increases, a corresponding liability is created. However, the FMS customer retains ownership of the cash. Until the funds are expended, a liability is created to anticipate the possible refund of the money to the customers. Fluctuations of this nature are due to normal business practices and are not uncommon for the FMS program. The remaining change relates to multiple entities that individually do not comprise 10 percent of the total change.

Other Information Related to Liabilities Not Covered By Budgetary Resources

Non-Federal Other Liabilities (not covered by budgetary resources) consist primarily of the following:

	(in millions)
Unfunded Annual Leave	$ 7,991.5
Non-environmental Disposal Liabilities	2,443.7
Contingent Liabilities	1,456.3
Other Unfunded Employment-Related Liabilities	1,793.6
Custodial Liability	1,352.2
Other	130.7
Total	**$15,158.0**

Total Liabilities Covered by Budgetary Resources

Prior period had been adjusted upward for $1 billion (reference to Note 20). In December 1994, the Office of the Under Secretary of Defense (Comptroller), OUSD(C), decentralized cash management responsibilities. In this decentralization, the Navy Working Capital Fund received over $1.0 billion in undistributed disbursements. DoD reclassified this amount from Other Liabilities to Cumulative Results. Specifically, the adjustment takes into consideration the guidance provided by SFAS 16, APB 20, and SFFAS No.21, all of which address the treatment of errors and disclosure of prior period adjustments.

Note 12.	Accounts Payable

As of September 30	2004						2003	
	Accounts Payable		Interest, Penalties, and Administrative Fees		Total		Total	
(Amounts in millions)								
1. Intragovernmental Payables:	$	1,888.4		N/A	$	1,888.4	$	101.4
2. Non-Federal Payables (to the Public):	$	28,307.2	$	1.8	$	28,309.0	$	27,863.8
3. Total	$	30,195.6	$	1.8	$	30,197.4	$	27,965.2

Intragovernmental accounts payable consist of amounts owed to other federal agencies for goods or services ordered and received but not paid. Interest, penalties, and administrative fees are not applicable to intragovernmental payables. Nonfederal payables (to the public) are payments to nonfederal entities.

Fluctuations

Intragovernmental Accounts Payable

Intragovernmental accounts payable increased $1.8 billion, (1,762 percent).

Improved business processes and implementation of estimating methodologies allowed DoD agencies to record accounts payable with agencies outside DoD. These new processes resulted in an increase of intragovernmental accounts payable for the following entities:

Army General Fund	$738.7 million
Navy General Fund	$396.6 million
Navy Working Capital Fund	$43.7 million
Air Force General Fund	$542.4 million

Note 13.	Debt

As of September 30	2004			2003
(Amounts in millions)	Beginning Balance	Net Borrowings	Ending Balance	Ending Balance
1. Public Debt:				
A. Held by Government Accounts	N/A	N/A	N/A	N/A
B. Held by the Public	N/A	N/A	N/A	N/A
C. Total Public Debt	N/A	N/A	N/A	N/A
2. Agency Debt:				
A. Debt to the Treasury	$ 81.3	$ 4.2	$ 85.5	$ 81.3
B. Debt to the Federal Financing Bank	616.9	(110.6)	506.3	616.9
C. Total Agency Debt	$ 698.2	$ (106.4)	$ 591.8	$ 698.2
3. Total Debt:	$ 698.2	$ (106.4)	$ 591.8	$ 698.2
4. Classification of Debt:				
A. Intragovernmental Debt			$ 591.8	$ 698.2
B. Non-Federal Debt			N/A	N/A
C. Total Debt			$ 591.8	$ 698.2

Fluctuations

Debt to the Treasury

The outstanding debt consists of interest and principal payments due to the Treasury. The $4.2 million (5 percent) increase in Debt to the Treasury consists of a $6.2 million increase to a loan subsidy program related to the Family Housing Improvement Fund's Military Housing Privatization Initiative (MHPI), offset by a $2.0 million decrease to the U.S. Army Corps of Engineers promissory notes with the Treasury Fund Capital Improvements to the Washington Aqueduct.

The MHPI combines funds borrowed from the Treasury with appropriated funds (direct loan subsidy appropriation) to provide direct loans to private developers to build or renovate military family housing. A $6.2 million (10 percent) increase in Debt to the Treasury is primarily due to borrowing money from the Treasury to cover direct loans related to military family housing at Camp Pendleton Marine Corps Base and six Air Force bases. See Note 8 for additional information regarding direct loans for the MHPI.

During FY's 1997, 1998, and 1999, the U.S. Army Corps of Engineers executed three promissory notes totaling $75.0 million with the Department of the Treasury. The funds provided by these notes were used for capital improvements to the Washington Aqueduct. Arlington County; Falls Church, Virginia; and the District of Columbia provide funding to repay the debt. There was a net decrease in debt of $2.0 million (12 percent) resulting in a balance due to the Treasury of $15.4 million.

Debt to the Federal Financing Bank

Debt owed to the Federal Financing Bank (FFB) decreased by $110.6 million (18 percent). This decrease is primarily due to the payments made to reduce the outstanding debt principal amount for the Department of the Navy Transportation Activity Group ($109.3 million) and the U.S. Transportation Command ($1.3 million).

As part of the Afloat Prepositioning Force program, the Department of the Navy makes loan repayments to the FFB on behalf of ship owners in lieu of capital lease payments to the ship owners. The FFB is reporting a debt in the amount of $506.3 million for the Transportation Activity, which represents an outstanding principal balance of $498.6 million and accrued interest payable of $7.7 million.

The debt on the part of U.S. Transportation Command consists of the principal and accrued interest balances left on the Military Sealift Command's (MSC) T-5 program that provides ships for time charter to the MSC to meet requirements not available in the marketplace. The ships were financed with approximately 30 percent equity investments and 70 percent debt borrowings. The debt is in the form of loans from the FFB to the vessel owners. In order to simplify the payments, the FFB transfers funds from the Navy Working Capital fund to itself and applies these funds to the vessel owners' loans. This is done semi-annually. The MSC records the equity payments upon receipt of invoices. The balance due to the FFB ($1.3 million) was paid in full in July 2004. The MSC purchased all but the Darnell class T-5 ships.

Note 14.	Environmental Liabilities and Disposal Liabilities

As of September 30	2004			2003
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in millions)				
1. Environmental Liabilities – Non Federal				
A. Accrued Environmental Restoration (DERP funded) Costs:				
1. Active Installations--Environmental Restoration (ER)	$1,752.0	$9,116.2	$10,868.2	$11,833.8
2. Active Installations--ER for Closed Ranges	63.3	7,645.7	7,709.0	4,362.1
3. Formerly Used Defense Sites (FUDS) -- ER	341.0	3,980.3	4,321.3	4,239.4
4. FUDS--ER for Transferred Ranges	149.3	13,935.0	14,084.3	13,624.4
B. Other Accrued Environmental Costs (Non-DERP funds)				
1. Active Installations--Environmental Corrective Action	52.3	517.3	569.6	561.0
2. Active Installations--Environmental Closure Requirements	16.0	162.5	178.5	103.6
3. Active Installations--Environ. Response at Active Ranges	62.5	217.1	279.6	276.3
4. Other	0.4	8.8	9.2	50.0
C. Base Realignment and Closure (BRAC)				
1. BRAC Installations--Environmental Restoration (ER)	670.6	2,450.3	3,120.9	3,616.6
2. BRAC Installations--ER for Transferring Ranges	11.3	524.6	535.9	511.6
3. BRAC Installations--Environmental Corrective Action	15.3	152.5	167.8	187.9
4. Other	209.3	0.0	209.3	190.4

D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0.0	5,693.0	5,693.0	5,565.0
2. Nuclear Powered Submarines	42.4	5,146.3	5,188.7	4,888.9
3. Other Nuclear Powered Ships	86.5	201.0	287.5	269.1
4. Other National Defense Weapons Systems	5.8	266.1	271.9	297.1
5. Chemical Weapons Disposal Program	1,096.9	9,672.6	10,769.5	10,810.3
6. Other	103.0	0.0	103.0	103.1
2. Total Environmental Liabilities:	$ 4,677.9	$ 59,689.3	$ 64,367.2	$ 61,490.6

Service Component – Environmental Restoration (Clean up) Liabilities and Environmental Disposal Liabilities (Amounts in millions)	Army	Navy	Air Force	ODO
1. Environmental Liabilities:				
A. Non-Federal:				
1. Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) funded) Costs:				
a. Active Installations-Environmental Restoration (ER)	$ 3,520.4	$ 2,841.5	$ 4,225.2	$ 281.1
b. Active Installations--ER for Closed Ranges	5,781.1	583.0	1,344.9	
c. Formerly Used Defense Sites (FUDS) –ER	4,321.3			
d. FUDS--ER for Transferred Ranges	14,084.3			
2. Other Accrued Environmental Costs (Non-DERP funds)				
a. Active Installations--Environmental Corrective Action	259.0		182.4	128.2
b. Active Installations--Environmental Closure Requirements	51.2		112.3	15.0
c. Active Installations--Environ. Response at Active Ranges	267.6			12.0
d. Other				9.2
3. Base Realignment and Closure (BRAC)				
a. BRAC Installations--Environmental Restoration (ER)	597.4	1,110.7	1,379.7	33.1
b. BRAC Installations--ER for Transferring Ranges	480.1	55.8		
c. BRAC Installations--Environmental Corrective Action	25.0		142.8	
d. Other	209.3			
4. Environmental Disposal for Weapon Systems Programs				
a. Nuclear Powered Aircraft Carriers		5,693.0		
b. Nuclear Powered Submarines		5,188.7		
c. Other Nuclear Powered Ships		287.5		
d. Other National Defense Weapon Systems		271.9		

		271.9		
e. Chemical Weapons Disposal Program	10,769.5			
f. Other				103.0
5. Total Non-Federal Environmental Liabilities:	$ 40,366.2	$16,032.1	$ 7,387.3	$ 581.6

Others Category Disclosure Comparative Table

Types	September 30, 2004 (in millions)
Other Accrued Environmental Costs (Non-DERP funds)	
Defense Commissary Agency	**$ 9.2**
Base Realignment and Closure	
Army's prior BRAC unliquidated obligations that cannot be identified to a specific program	**$ 209.3**
Environmental Disposal for Weapons Systems Programs-Other	
DoD Component Level Accounts National Defense Stockpile - ODO	**$ 103.0**

The Department of Defense (DoD) is required to clean up contamination resulting from past waste disposal practices, leaks, spills and other past activity, which have created a public health or environmental risk. The department accomplishes this effort in coordination with regulatory agencies, and if applicable, with other responsible parties, and current property owners. The Department is also required to recognize closure and post-closure costs for its General Property, Plant, and Equipment (PP&E) and environmental corrective action costs for current operations. Each of the Department's major reporting entities is responsible for tracking and reporting all required environmental information related to environmental restoration costs, other accrued environmental costs, disposal costs of weapons systems, and environmental costs related to the base realignment and closures (BRAC) actions that have taken place in prior years.

The Department is currently using two independently validated estimating models in addition to engineering estimates. Validation of the models was performed in accordance with DoD Instruction 5000.61. The models are the Remedial Action Cost Engineering Requirements (RACER) model and the Department of Navy Cost-to-Complete (CTC) module of the Navy Normalization of Data System (NORM). Additionally, cost estimates are based on the following: (1) historic comparable project, (2) a specific bid or independent government cost estimate for the project, (3) site level data, and (4) annual cost-to-complete estimate. The cost-to-complete estimate is prepared in the Defense Environmental Restoration Program (DERP).

The DoD has clean up requirements for the DERP sites at active and BRAC installations and formerly used defense sites (FUDS), non-DERP at active installations, weapon systems programs, and chemical weapons disposal programs. The DoD follows the Comprehensive Environmental Response, Compensation Liability Act (CERCLA) and the Superfund Amendment and Reauthorization Act (SARA) to clean up DERP-eligible contamination. Non-DERP eligible contamination cleanup is performed in accordance with the Resource Conservation and Recovery Act (RCRA). The Army is the DoD Executive Agent for cleaning up contamination at sites formerly used by DoD. The CERCLA and RCRA require DoD to clean up contamination in coordination with regulatory agencies, other responsible parties, and current property owners. Failure to comply with agreements and legal mandates can put DoD at risk of fines and penalties.

The Chemical Weapons Disposal Program is based on the FY 1986 National Defense Authorization Act (PL 99-145, as amended by subsequent acts) that directed the DoD to destroy the unitary chemical stockpile by April 29, 2004. The current guidelines for destruction are based on the Chemical Weapons Convention (CWC) treaty. The United

States ratified the treaty in April 1997 and, according to the terms outlined, the United States must destroy its declared stockpile of chemical weapons by April 2007. The Army, as Executive Agent within the DoD, provides policy, direction, and oversight for both the Chemical Stockpile Program and the Non-Stockpile Chemical Materiel Project. As such, the Army is responsible for the safe and economical disposal of the U.S. stockpile of lethal and incapacitating chemical warfare agents and munitions. The program objective is to destroy the U.S. stockpile of unitary chemical agents and munitions in accordance with the public law and the schedules approved by the Defense Acquisition Decision Memorandum dated September 26, 2001, and updated in the April 2003 Acquisition Program Baseline.

The clean up requirements for nuclear-powered aircraft carriers, submarines, and other nuclear ships are based on several significant laws, which affect the Department's conduct of environmental policy and regulations. The Atomic Energy Act of 1954, as amended, assures the proper management of source, special nuclear, and byproduct material. As in all cases with nuclear power, the Department coordinates actions with the Department of Energy. The Nuclear Waste Policy Act of 1982 required all owners and generators of high-level nuclear waste and spent nuclear fuel, to pay their respective shares of the full cost of the program. Finally, the Low Level Radioactive Waste Policy Amendments Act of 1986 provides for the safe and efficient management of low-level radioactive waste.

The estimated total clean up cost for the current operating period is assigned based on the amount of the current year appropriation and unliquidated obligations that will be expended within 12 months from the Balance Sheet date. The noncurrent clean up cost is the portion of the clean up cost that will be expended more than 12 months from the Balance Sheet date.

The DoD has not identified any unamortized portion of the estimated total clean up cost associated with General Property, Plant and Equipment (PP&E). The Department's Financial Management Regulation requires the unamortized clean up cost associated with PP&E to be recognized. The Department is working with the Military Departments to ensure the regulation is properly implemented.

The Department had changes in estimation resulting from overlooked or previously unknown contaminants, better site characterization with sampling, cost avoidance rerun, re-estimation based on different assumptions and/or escalation, and re-estimation of costs based on lessons learned. Regulatory related changes include addition of range rule/munitions requirements, additional or extended long-term monitoring requirements or 5 year reviews, no further action agreement with the regulator, and risk-based corrective action. Technology related changes include additional contamination level sampling, additional or extended remedial action operation, additional sites and incomplete site data, and technical solution changes.

The Active Installations – ER for Closed Ranges increased $3.3 billion (77 percent). The Department of Army reported an increase of $2.6 billion that resulted from additional site level data collected from the Army range inventory. The Department of Navy reported an increase of $241.7 million due to adding 10 new sites at Concord and Seal Beach, California, an estimate increase for Vieques, Puerto Rico, escalation of cost estimates, and cost growth in preliminary findings. The Department of Air Force also reported an increase of $506.7 million that resulted from the identification of 20 additional sites.

Active Installations – Environmental Closure Requirements increased $74.9 million (72 percent). The variance is primarily due to an increase of $45.8 million in the Department of Air Force, $15.0 million in DoD Component Level Accounts, and a $14.1 million increase in the Department of Army. The increase for the Department of Air Force is attributable to a change in the amortization calculation that is now amortizing amounts over the life of an asset rather than assessing the liability in the year of disposal. The increase for the DoD Component Level Accounts is attributable to a reclassification from Other Accrued Environmental Costs (Non-DERP funds) – Other to Active Installations Environmental Closure Requirements. The increase for the Department of the Army is attributable to receipt of an updated Environmental Program Requirements (EPR) report with improved cost estimates and site changes, as well as the addition of previously omitted Class Zero estimates.

Other Accrued Environmental Costs (Non-DERP funds) - Other decreased $40.8 million (81 percent). A decrease of $35 million is attributable to a reclassification from Non-DERP Other to Active Installations-Environmental Restoration and Active Installations-Environmental Closure Requirements within a DoD Component Level

Account. An additional decrease of $1.5 million is also attributable to a reclassification from Non-DERP Other to Active Installations- Environmental Corrective Action within the Defense Threat Reduction Agency (DTRA). The remaining decrease of $4.4 million for the Defense Commissary Agency (DeCA) Surcharge entity is the result of a revised estimate used to calculate the noncurrent environmental clean up costs.

The BRAC Installations – Environmental Restoration (ER) decreased $495.7 million (14 percent). The decrease is primarily due to a $78.6 million increase reported by the Department of Army and a $529.4 million decrease reported by the Department of Air Force. The increase reported by the Department of the Army is due to the increased remediation efforts required. The decrease reported by the Department of Air Force resulted from implementation of a new cost estimating and reporting policy that limits the liability to 25 years of remediation action operations along with five years of long term monitoring.

The BRAC Installations – Environmental Corrective Action liability decreased $20.1 million (11 percent). The variance is primarily due to a decrease of $23.1 million reported by the Department of Army. This decrease reflects changes in cleanup actions required at a site.

Base Realignment and Closure (BRAC) – Other increased $18.9 million (10 percent). The variance is attributable to the Department of Army and reflects additional estimates previously omitted.

Note 15.	Other Liabilities

As of September 30 (Amounts in millions)	2004 Current Liability	2004 Noncurrent Liability	2004 Total	2003 Total
1. Intragovernmental:				
A. Advances from Others	$ 749.6	$ 0.0	$ 749.6	$ 272.5
B. Deposit Funds and Suspense Account Liabilities	561.6	0.0	561.6	372.3
C. Disbursing Officer Cash	2,071.8	0.0	2,071.8	1,509.4
D. Accounts Payable--Cancelled Appropriations	0.0	0.0	0.0	7.0
E . Judgement Fund Liabilities	278.1	101.7	379.8	591.4
F. FECA Reimbursement to the Department of Labor	600.5	831.7	1,432.2	1,420.8
G. Other Liabilities	3,794.8	1,737.1	5,531.9	5,565.7
H. Total Intragovernmental Other Liabilities	$ 8,056.4	$ 2,670.5	$ 10,726.9	$ 9,739.1

As of September 30 (Amounts in millions)	2004 Current Liability	2004 Noncurrent Liability	2004 Total	2003 Total
2. Non-Federal:				
A. Accrued Funded Payroll and Benefits	$ 9,581.2	$ 1,290.6	$ 10,871.8	$ 9,118.0
B. Advances from Others	1,741.4	0.2	1,741.6	1,167.3
C. Deferred Credits	4.2	0.0	4.2	9.7
D. Deposit Funds and Suspense Accounts	322.6	0.0	322.6	105.3
E. Temporary Early Retirement Authority	1.0	1.1	2.1	8.5
F. Nonenvironmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	0.0	565.8	565.8	574.9
(2) Excess/Obsolete Structures	84.0	351.3	435.3	394.9
(3) Conventional Munitions Disposal	0.0	1,325.9	1,325.9	1,198.8
(4) Other	0.0	0.0	0.0	0.0
G. Accounts Payable Cancelled Appropriations	0.0	0.0	0.0	602.3
H. Accrued Unfunded Annual Leave	7,991.5	0.0	7,991.5	7,645.3
I. Capital Lease Liability	50.5	249.4	299.9	336.4
J. Other Liabilities	9,365.2	1,565.3	10,930.5	8,992.6
K. Total Non-Federal Other Liabilities	$ 29,141.6	$ 5,349.6	$ 34,491.2	$ 30,154.0
3. Total Other Liabilities:	$ 37,198.0	$ 8,020.1	$ 45,218.1	$ 39,893.1

Fluctuations - Federal

Intragovernmental Other Liabilities Fluctuation Analysis

Intragovernmental Other Liabilities increased $987.8 million (10 percent). The following items contributed to the majority of the overall change:

Advances from Others (Line 1.A.)
Advances from Others increased $477.1 million (175 percent). The Air Force General Fund (GF) increased $478.3 million and is the principal reason for the overall increase. The Air Force increase is due to the timing of the receipt and execution of orders in the Research, Test, Development, and Evaluation (RDT&E) classified program, causing variations in the year-end balances.

Deposit Funds and Suspense Account Liabilities (Line 1.B.)

Deposit Funds and Suspense Account Liabilities increased $189.3 million (51 percent). The following items contributed to the majority of the overall change:

- Navy GF increased $33.6 million. The increase is due to the reclassification of unsupported undistributed collections from accounts payable to other liabilities.
- Army GF increased $69.9 million. The majority is attributable to an increase in the miscellaneous suspense and deposit funds for the following reasons:
  - Increase in Army Member Savings Deposits as a result of an increase in deployed soldiers who are drawing imminent danger pay. The soldiers are authorized to deposit funds and later withdraw the funds with interest.
  - Withheld State Income Taxes
  - Small Escrow Accounts due to the increase of soldiers using the post office and the Army Air Force Exchange Service in Kuwait and Iraq.
- Other Defense Organizations (ODO) GF increased $98.5 million. The increase occurred in the following activities:
  - Thrift Savings Plan Clearing Account: Increase of $43.1 million is related to normal business practices. The government acts in a fiduciary capacity by collecting money from civilian pay, providing matching funds, and disbursing the funds to the plan administrator. The balance in this account is predicated on collections (i.e., the amount of employee participation in a given pay period).
  - Small Escrow Deposit Fund: Increase of $55.4 million is related to normal business practices of the Defense Reutilization Management Office (DRMO). The DRMO is responsible for the disposition of government property. Any remuneration is deposited in the Small Escrow Deposit Fund until transferred to the appropriate organization.

Disbursing Officer Cash (Line 1.C)

Disbursing Officer Cash increased $562.4 million (37 percent). The following items contributed to the majority of the overall change:

- Army GF increased $573.0 million to support Operation Iraqi Freedom and Operation Enduring Freedom.
- Air Force GF increased $37.8 million. The increase is to support Operation Iraqi Freedom.
- Navy GF decreased $48.1 million. The decrease is the result of the Navy drawdown from Operation Iraqi Freedom and subsequent events. The expansion of the ATM at Sea and Navy Cash programs in FY 2004 also contributed to the decrease of Disbursing Officer Cash because Disbursing Officers do not need as much cash on hand.

Accounts Payable - Cancelled Appropriations (Line 1. D)

ODO GF decreased $7.0 million. During FY 2003, Missile Defense Agency's cancelled year unearned revenue was reclassified to accounts payables.

Judgment Fund Liabilities (Line 1.E.)

Judgment Fund Liabilities decreased $211.6 million (36 percent). The majority of the decrease is due to the settlement of claims in litigation as follows:

- Air Force GF decreased $150.3 million because the Air Force reimbursed the Treasury for amounts paid on their behalf.
- Army GF decreased $61.3 million and is based on judgment fund liabilities guidance for the Notification and Federal Employment Antidiscrimination and Retention Act of 2002.
- Navy GF decreased $7.3 million due to aggressive efforts to identify outstanding judgments.

Fluctuations - Non-Federal

Total Non-Federal Fluctuation Analysis

Non-Federal Other Liabilities increased $4.3 billion (14 percent). The following items contributed to the majority of the overall change:

Accrued Funded Payroll and Benefits (Line 2. A.)

Accrued Funded Payroll and Benefits increased $1.8 billion (19 percent). The following items contributed to the majority of the overall change:

- ODO GF increased $1.3 billion. The majority of the change is associated with the increase of "Incurred but not Reported Liability" for the Defense Health Program (DHP). This amount is an estimated liability for medical claims incurred by the DHP, but not reported. The DoD Office of the Actuary developed this estimate based on historical data showing medical claims by incurred date and paid date. This estimate also included factors such as administrative costs associated with the incurred but not reported claims, medical inflation, and the rate of beneficiary utilization of medical services.
- Air Force GF increased $299.6 million. The change is attributable to the increase in the number of military personnel activated in support of the war.

Advances from Others (Line 2.B.)

Advances from Others increased $574.3 million (49 percent). The following items contributed to the majority of the overall change:

- Army GF increased $160.5 million. The increase is due to military construction in South Korea. The U.S.Army Corps of Engineers (USACE) Pacific Ocean Division received these advances that are for various construction projects.
- Navy Working Capital Fund (WCF) increased $282.6 million. The increase is primarily attributable to a reclassification in the component business area in order to adjust for trading partner differences.
- USACE increased $28.9 million. The increase is due to an increase in customer orders from the public. A large percent of the increase in customer orders occurred in the New York and Honolulu districts. The New York district received an advance for the assessment of security of New York City's public water supply and the Honolulu district received advances for a variety of local projects.

Deferred Credits (Line 2.C.)

Deferred Credits decreased $5.5 million (57 percent). The decrease is attributable to the National Defense Stockpile Trust Fund. Deferred credits represent customer payments received for materials that have not yet been shipped. During FY 2004, customers required accelerated deliveries, which resulted in a reduction of deferred credits.

Deposit Funds and Suspense Accounts (Line 2.D.)

Deposit Funds and Suspense Accounts increased $217.3 million (206 percent). The majority of the increase is attributed to the reclassification of unsupported undistributed collections to deposit funds and suspense accounts.

Temporary Early Retirement Authority (Line 2.E.)

Temporary Early Retirement Authority decreased $6.4 million (75 percent). The following items contributed to the majority of the overall change:

- Air Force GF decreased $3.6 million. The decrease is due to the termination of the program.
- Army GF decreased $.3 million. The decrease is due to the termination of the program.
- Navy GF decreased $2.2 million.

Nonenvironmental Disposal Liabilities - Excess/Obsolete Structures (Line 2.F.2.)

Excess/Obsolete Structures increased $40.4 million (10 percent).

- Air Force GF increased $21.3 million. The increase is attributable to the recently completed housing market analysis that better defined the Air Force's surplus of inadequate housing inventory. Modifications in future year demolition strategy account for the change in disposal liability.
- Navy GF increased $19.0 million. The change is a result of additional buildings and facilities/utilities identified for disposal.

Nonenvironmental Disposal Liabilities - Conventional Munitions Disposal (Line 2.F.3.)

Conventional Munitions Disposal decreased $127.1 million (11 percent). The following items contributed to the majority of the overall change:

- Army GF increased $133.0 million due to a stockpile expansion of 7,258 tons.
- Air Force GF decreased $5.9 million. The decrease is due to a policy change during FY 2004 that transferred accounting responsibility for all disposal costs to the Department of the Army for inclusion in its financial statements. The Air Force no longer reports this activity.

Accounts Payable – Cancelled Appropriations (Line 2.G.)

Accounts Payable – Cancelled Appropriations decreased $602.3 million to $0. Cancelled accounts payable was correctly reported as part of other liabilities in FY 2003. Treasury mapping changes implemented in June 2004 required all entities to report cancelled accounts payable as part of accounts payable beginning in the 3rd Quarter of FY 2004.

Capital Lease Liability (Line 2.I)

Capital Lease Liability decreased $36.5 million (11 percent). The following items contributed to the majority of the overall change:

- Air Force GF decreased $28.2 million. The change is the result of a decrease in leases held by the Air Force in FY 2004.
- Army GF decreased $11.7 million. The change is a result of normal payments made against the lease liability.
- ODO GF increased $3.3 million. The change is a result of the increase in leased equipment.

Other Liabilities (Line 2.J.)

Other Liabilities increased $1.9 billion (22 percent). The following items contributed to the majority of the overall change:

- Navy WCF increased $1.1 billion. The majority of the change is due to the reclassification of an abnormal balance and an increase in depot level reparable carcass returns.
- ODO GF increased $1.6 billion. The majority of the change occurred in the Foreign Military Sales (FMS) Trust Fund due to a change in the net custodial cash balance. The custodial liability represents net collections received from the foreign customers less the funds disbursed on their behalf.
- Army GF decreased $712.7 million. The majority of the decrease was attributable to a NATO program, which Army incorrectly reported in FY 2003. For FY 2004, the Other Defense Organizations correctly reported this liability, which resulted in a decrease for Army GF.
- Air Force WCF decreased $278.7 million. The decrease is primarily attributable to the Depot Maintenance Activity Group (DMAG). The phase-out of contracts in the DMAG has resulted in a decline in material, labor, and overhead accruals.

Other Disclosures

In FY 2004 the DoD made a prior period adjustment to reclassify $1.0 billion of undistributed disbursements from other liabilities to cumulative results of operations. See Note 20 for further information.

Intragovernmental Other Liabilities by Entity

Intragovernmental Other Liabilities (Line 1.K) for 4th Quarter, FY 2004 ($millions)			
Entity	**Current Liability**	**Non Current Liability**	**Total Liability**
AF GF	317.6		317.6
AF WCF	8.6		8.6
Army GF	276.8		276.8
Army WCF	6.6		6.6
MRF		0.9	0.9
Navy GF	2,885.0		2,885.0
Navy WCF	42.6		42.6
ODO GF	112.9	10.3	123.2
ODO WCF	20.9		20.9
USACE	123.8	1,725.9	1,849.7
Total	3,794.8	1,737.1	5,531.9

Non-Federal Other Liabilities by Entity

Non-Federal Other Liabilities (Line 2.M.) for 4th Quarter, FY 2004 ($millions)			
Entity	**Current Liability**	**Non Current Liability**	**Total Liability**
AF GF	0.9	308.8	309.7
AF WCF	1,446.5		1,446.5
Army GF	1,051.6	742.2	1,793.8
Army WCF	42.5		42.5
MRF	0.2		0.2

Navy GF	150.6	81.4	232.0
Navy WCF	4,113.7	0.0	4,113.7
ODO GF	2,238.5	429.2	2,667.7
ODO WCF	181.5	3.7	185.2
USACE	139.2		139.2
Total	9,365.2	1,565.3	10,930.5

Capital Lease Liability

As of September 30	2004				2003
	Asset Category				
(Amounts in millions)	Land and Buildings	Equipment	Other	Total	Total
1. Future Payments Due:					
A. 2004	$ 66.2	$ 0.2	$ 0.0	$ 66.4	$ 67.4
B. 2005	65.9	0.1	0.0	66.0	66.4
C. 2006	60.1	1.0	0.0	61.1	66.1
D. 2007	47.5	3.5	0.0	51.0	60.2
E. 2008	43.9	0.0	0.0	43.9	47.5
F. After 5 Years	129.3	0.0	0.0	129.3	184.4
G. Total Future Lease Payments Due	$ 412.9	$ 4.8	$ 0.0	$ 417.7	$ 492.0
H. Less: Imputed Interest Executory Costs	117.8	0.0	0.0	117.8	155.6
I. Net Capital Lease Liability	$ 295.1	$ 4.8	$ 0.0	$ 299.9	$ 336.4
2. Capital Lease Liabilities Covered by Budgetary Resources:				$ 219.4	$ 326.1
3. Capital Lease Liabilities Not Covered by Budgetary Resources:				$ 80.5	$ 127.2

Comparison of Capital Leases between Year-end FY 2003 and FY 2004				
($ amounts in millions)				
Future Payments Due	**YE 2004**	**YE 2003**	**Increase/ Decrease**	**% Change**
A. 2004	66.4	67.4	(1.0)	1.5
B. 2005	66.0	66.4	(0.4)	0.6
C. 2006	61.1	66.1	(5.0)	7.6
D. 2007	51.0	60.2	(9.2)	15.3
E. 2008	43.9	47.5	(3.6)	7.6
F. After 5 Years	129.3	184.3	(55.0)	29.8
G. Total Future Lease Payments Due	417.8	492.0	(74.2)	15.1
H. Less Imputed Interest Executory Costs	117.9	155.6	(37.7)	24.2
I. Net Capital Lease Liability	299.8	336.4	(36.6)	10.9
Capital Lease Liability Covered by Budgetary Resources	219.4	326.1	(106.7)	32.7
Capital Lease Liability Not Covered by Budgetary Resources	80.5	127.2	(46.7)	36.7

For the Department of Defense, all leases prior to FY 1992 are funded on an annual basis and subject to the availability of funds. Non-current amounts for these leases are shown as Not Covered by Budgetary Resources.

Leases originating after FY 1992 are required to be fully funded in the year of their inception. Therefore, budgetary resources show the present value of those lease payments as “covered.”

Note 16.	Commitments and Contingencies

Legal Contingencies:

The Department is a party in various administrative proceedings and legal actions which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. Others may be payable from the Department's resources, either directly or by reimbursement to the Judgment Fund. Based on information currently available, however, it is management's opinion that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on the Department.

For FY 2003, the materiality threshold for reporting litigation, claims, or assessments was $73.4 million and for FY 2004 the threshold was $100.7 million. Cases, meeting this threshold, were reported on the Department's legal representation letter. The amounts reported in the legal representation letter represent the maximum amounts of any potential liability of the Government based on the amounts claimed. Management does not consider it to be at all likely that the Government will be liable for such maximum amounts.

The Department is aggressively contesting the claimed liability of the Government in each of the litigation, claims or assessments in its legal representation letter. Except as indicated below, the Department is unable to predict the likely outcome or the amount of liability because most of the litigation, claims, or assessments are in the preliminary stage. For the case identified below, a loss to the Government is probable. It is likely that the United States will have to pay some amount of damages. It is impossible to predict the outcome of the litigation on the question of damages with any degree of certainty. Therefore, the ultimate liability of the Government on this case and the other reported legal representation letter cases cannot be reasonably estimated at this time.

A contractor filed an appeal with the Armed Services Board of Contract Appeals (ASBCA) in August 1998, of the Contracting Officer's denial of its agency-level claim. The contractor is seeking a total of $279 million ($164 million damages for "value of service" and $115 million damages for "loss of revenues") for government noncompliance on the license agreement during November 1994 through September 1997. A hearing on entitlement was held before the ASBCA in May 2000. The ASBCA issued its decision on March 2001, finding that the Government had breached the terms of the license agreement. The burden is now on the contractor to prove its claimed damages. A hearing on damages has not been scheduled nor has the Defense Contract Audit Agency audited the contractor's claim.

Other Commitments and Contingencies

In addition, the Department has other contingent liabilities primarily consisting of the Chemical Demilitarization Non-Stockpile Disposal of $9 billion (the estimated cost of destroying buried chemical munitions) and Environmental Restoration of $846.7 million. These liabilities are not accrued in the Department's financial statements.

Note 17. Military Retirement Benefits and Other Employment Related Actuarial Liabilities

As of September 30	2004				2003
	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
(Amounts in millions)					
1. Pension and Health Benefits:					
A. Military Retirement Pensions	$ 834,582.1	6.25%	$ (181,133.1)	$ 653,449.0	$ 560,032.7
B. Military Retirement Health Benefits	221,242.0	6.25%	0.0	221,242.0	206,839.4
C. Medicare-Eligible Retiree Benefits	504,073.8	6.25%	(38,085.9)	465,987.9	457,987.8
D. Total Pension and Health Benefits	$ 1,559,897.9		$ (219,219.0)	$ 1,340,678.9	$ 1,224,859.9
2. Other:					
A. FECA	$ 6,958.7		$ 0.0	$ 6,958.7	$ 7,596.1
B. Voluntary Separation Incentive Programs	1,593.6	4.0%	(701.6)	892.0	930.1
C. DoD Education Benefits Fund	1,254.5	5.3%	(1,008.1)	246.4	171.1
D. Total Other	$ 9,806.8		$ (1,709.7)	$ 8,097.1	$ 8,697.3
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$ 1,569,704.7		$ (220,928.7)	$ 1,348,776.0	$ 1,233,557.2

Fluctuations

The unfunded liability for Military Retirement Benefits and Other Employment Related Actuarial Liabilities increased $115.2 billion (9 percent). The net increase resulted from an increase in the actuarial liability of $140.1 billion that is offset by an increase of $24.9 billion in the value of assets available to pay benefits.

The unfunded actuarial liability for Military Retirement Pensions increased $93.4 billion (17 percent). The variance is attributable to an increase of $98.5 billion in the overall liability for the Military Retirement Fund (MRF) that is offset by an increase of $5.1 billion in the value of assets available to pay benefits. Additional information is contained in the Military Retirement paragraph.

The unfunded actuarial liability for the DoD Education Benefits Fund increased $75.2 million (44 percent). The increase is the result of an increase in the actuarial liability that is offset by an increase in the value of the assets available to pay benefits. Additional information is discussed in the DoD Education Benefits Fund paragraph.

Other Disclosures

In December 2003, the estimate of the actuarial liabilities as of October 1, 2002, for the covered benefits for the U.S. Coast Guard participants in the Medicare-Eligible Retiree Health Care Fund was revised from $5 billion to $7.8 billion. The increase in the transfer from the U.S. Coast Guard to the Medicare-Eligible Retiree Health Care Fund (MERHCF) of $2.8 billion is recorded on the financial statements as a decrease to the Gross Costs with the Public.

Military Retirement

The increase in the actuarial liability is primarily the result of an amendment to the MRF Plan established by the National Defense Authorization Act for FY 2004 for new concurrent receipt benefits.

The Military Retirement System is a single-employer, defined benefit plan. Administrative costs of the Fund are not ascertainable. Projected revenues into the Fund, authorized by PL 98-94, come from three sources: Interest earnings on Fund assets, monthly DoD contributions, and annual contributions from the Treasury Department. The monthly DoD contributions are determined as a percentage (approved by the DoD Retirement Board of Actuaries) of basic pay. The contribution from the Treasury is paid into the Fund at the beginning of each fiscal year, and represents the amortization of the unfunded liability for service performed prior to October 1, 1984, as well as the amortization of actuarial gains and losses that have arisen since then. Beginning with FY 2005, the Treasury will also make an annual contribution to the Fund that represents the normal cost amount for the new concurrent receipt provisions of the 2004 National Defense Authorization Act. The Board determines the Treasury's contribution and the Secretary of Defense directs the Secretary of Treasury to make the payment.

The long-term economic assumptions for each valuation are set by the DoD Retirement Board of Actuaries. The long-term assumptions for the FY 2003 valuation were 6.25 percent interest, 3.0 percent Consumer Price Index, and 3.75 percent salary increase. The long-term economic assumptions did not change for the FY 2004 valuation. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience. Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year valuation results as reported in the DoD office of Actuary Valuation of the Military Retirement System. In calculating the FY 2004 roll-forward amount, the following assumptions were used:

	Inflation	Salary	Interest
Fiscal Year 2004	2.1 percent (actual)	3.7 percent (actual)	6.25 percent
Fiscal Year 2005	2.4 percent (estimated)	3.5 percent (estimated)	6.25 percent
Long-Term	3.0 percent	3.75 percent	6.25 percent

For purposes of the Fund's financial reporting, this roll-forward process is applied annually.

Actuarial Cost Method Used: Aggregate entry-age normal method.
Market Value of Investments in Market-Based and Marketable Securities: $199.2 billion

		Amounts (in millions) FY 04	FY 03
A.	Beginning of Year Accrued Liability	$736,061.6	726,915.4
B.	Normal Cost Liability	12,857.2	13,719.4
C.	Plan Amendment Liability	81,062.7	880.3
D.	Assumption Change Liability	(32.5)	(4,626.3)
E.	Benefit Outlays	(36,623.5)	(35,716.8)
F.	Interest on Pension Liability	45,272.4	44,755.2
G.	Actuarial Loss (Gain)	(4,015.8)	(9,865.7)
H.	End-of-Year Accrued Liability (A+B+C+D+E+F+G)	$834,582.1	$736,061.6
I.	Net Change in Actuarial Liabilities (B+C+D+E+F+G)	$98,520.5	$9,146.2

Military Retirement Health Benefits (MRHB)

The unfunded actuarial liability for the Military Retirement Health Benefits increased $14.4 billion. The increase is attributable to an increase in the overall actuarial liability.

Change in Defense Health Program MRHB Actuarial Liability

	Amounts (in millions)
Actuarial Liability as of 09/30/03 (DoD pre-Medicare + all uniformed services Medicare cost-basis effect)	$206,839.4
Expected Normal Cost for FY04	7,421.8
Expected Benefit Payments for FY04	(6,939.3)
Interest Cost for FY04	12,942.3
Actuarial (gains)/losses due to other factors	11,564.9
Actuarial (gains)/losses due to changes in trend assumptions	(10,587.1)
Actuarial Liability as of 09/30/04 (DoD pre-Medicare + all uniformed services Medicare cost-basis effect)	$221,242.0

Assumptions in Calculation of DHP Liability:
Interest Rate: 6.25%

Medical Trend

Medicare Inpatient:	5.1% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Outpatient:	6.8% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Direct Care):	9.7% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Purchased Care):	14.6% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Non-Medicare Inpatient:	5.9% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Non-Medicare Outpatient:	8.4% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Non-Medicare Prescriptions:	11.3% from FY03 to FY04, ultimate rate of 6.25% in 2028.

Other Information

The "DHP" liability includes pre-Medicare liabilities for the Department of Defense, plus a cost-basis effect related to the direct care portion of Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2004 liability is:

	Amounts (in millions)
DoD	$220,865.0
Coast Guard	334.0
Public Health Service	40.0
NOAA	3.0
Total	$ 221,242.0

Liabilities for direct care in the Military Retirement Health Benefits are valued at a higher cost basis as established by the Governmental Accountability Office (GAO). As a result, the Medicare portion of the Military Retirement Health Benefits liability is approximately $16.9 billion higher than the corresponding liability for the MERHCF. This $16.9 billion amount is included in the DHP liability.

Actuarial gains/losses due to other factors include new population data, other actuarial experience being different from assumed, and actuarial assumption changes other than the change in trend assumptions.

Actuarial Cost Method Used for DHP Actuarial Liability. Aggregate Entry-Age Normal

Medicare-Eligible Retiree Benefits

The unfunded actuarial liability increased $8 billion. The increase is attributable to an increase of $27.9 billion in the actuarial liability that is offset by an increase of $19.9 billion in the value of assets available to pay benefits.

Changes in MERHCF Actuarial Liability

	Amounts (in millions)
Actuarial Liability as of 09/30/03 (all uniformed services Medicare)	$476,170.3
Expected Normal Cost for FY04	10,187.8
Expected Benefit Payments for FY04	(5,911.8)
Interest Cost for FY04	29,892.2
Actuarial (gains)/losses due to other factors	(1,430.6)
Actuarial (gains)/losses due to changes in trend assumptions	(4,834.1)
Actuarial Liability as of 09/30/04 (all uniformed services Medicare)	504,073.8
Change in Actuarial Liability	27,903.5

Assumptions in Calculation of MERHCF Liability
Interest Rate: 6.25%

Medical Trend

Medicare Inpatient:	5.1% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Outpatient:	6.8% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Direct Care):	9.7% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Purchased Care):	14.6% from FY03 to FY04, ultimate rate of 6.25% in 2028.

The MERHCF liability includes Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2004, liability is:

	Amounts (in millions)
DoD	$493,717.0
Coast Guard	9,263.7
Public Health Service	1,024.9
NOAA	68.2
Total	$ 504,073.8

FY 2003 Service contributions to the MERHCF were:

	Amounts (in millions)
DoD	$7,918.8
Coast Guard	192.3
Public Health Service	27.4
NOAA	1.2
Total	$8,139.7

Assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience. Claims cost assumptions for direct care were based on actual experience; assumptions for purchased care were developed from industry-based cost estimates adjusted to approximate the military retired population.

Projected revenues into the Medicare Eligible Retiree Health Care Fund, authorized by Chapter 56 of Title 10, United States Code, come from three sources: interest earnings on Fund assets, monthly Uniformed Services contributions, and annual contributions from the Treasury Department. The monthly contributions are determined as a per capita amount (approved by the DoD Medicare Eligible Retiree Health Care Board of Actuaries) times end strength. The contribution from the Treasury is paid into the Fund at the beginning of each fiscal year and represents the amortization of the unfunded liability for service performed prior to October 1, 2002, as well as the amortization of actuarial gains and losses that have arisen since then. The Board determines the Treasury's contribution, and the Secretary of Defense directs the Secretary of Treasury to make the payment.

The actuarial liability reported above does not include $491.3 million in incurred but not reported liabilities as of September 30, 2004. These liabilities are disclosed in the Liabilities Not Covered and Covered by Budgetary Resources note, and the Other Liabilities note.

Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year's results. For purposes of the Fund's financial reporting, this process is applied annually.

Actuarial Cost Method Used for MERHCF Liability: Aggregate Entry-Age Normal
Market Value of Investments in Market-Based and Marketable Securities: $39.2 billion

Federal Employees Compensation Act (FECA)

The unfunded liability for FECA decreased 8 percent.

Assumptions

The actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DoD at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined by using historical benefit payment patterns to predict the future payments. Cost-of-living adjustments and medical inflation factors are also included in the calculation of projected future benefits. Consistent with past practices, these projected annual benefit payments are then discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

Year 1	3.84%
Year 2	4.35%
Year 3 and thereafter	4.35%

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost-of-living adjustments or COLAs) and medical inflation factors (consumer price index-medical, or CPIMs) were applied to the calculation of projected future benefits. These factors were also used to adjust historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections for various charge back years (CBY) were as follows:

CBY	COLA	CPIM
2004	2.30%	3.21%
2005	2.00%	3.54%
2006	1.83%	3.64%
2007	1.97%	3.80%
2008+	2.17%	3.92%

The model's resulting projections were critically analyzed to insure that the estimates were reliable. The analysis was primarily based on two tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments, and (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year, as calculated for the current projection to the liability-payment ratio calculated for the prior projection.

Voluntary Separation Incentive Programs (VSI)

The unfunded actuarial liability decreased $38.1 million. The decrease is the net result of a decrease of $96.5 million in the actuarial liability, and a decrease of $58.4 million in the value of assets available to pay benefits.

The VSI program was established by Public Law 102-190. The intent of this program was to reduce the number of military personnel on active duty. This plan was offered to personnel with a minimum of six years of service who did not qualify for retirement. The incentive payments are spread over a period equivalent to twice the years of active service. The annual payment is based on 2.5 percent of the person's basic pay at the time they left service multiplied by the number of years of service. The September 30, 2004, VSI Actuarial Present Value of Projected Plan Benefits (Actuarial Liability) was calculated at an assumed annual interest rate of 4 percent.

Since the VSI program is discontinued for new takers, each year the Actuarial Liability is expected to decrease with benefit outlays, and increase with interest cost. In the absence of (1) actuarial gains and losses, and (2) assumption changes, a decrease of $91.2 million in the Actuarial Liability was expected during FY 2004. The September 30, 2004, Actuarial Liability includes changes due to experience, which resulted in a net gain of $5.3 million. This reflects the new population on which the September 30, 2004, Actuarial Liability is based, as well as other economic experience being different than assumed.

The Present Value of Projected Plan Benefits (Actuarial Liability) for the VSI Fund, as of September 30, 2004, is $1.6 billion. It has been calculated as in prior years; namely, as the present value, as of September 30, 2004, of all remaining VSI payments.

Market Value of Investments in Market-based and Marketable Securities: $731.2 million.

DoD Education Benefits Fund

The 44 percent increase in the DoD Education Benefits unfunded actuarial liability is the combined result of an increase of $46.4 million in the actuarial present value of the plan benefits, and a decrease of $28.7 million in the value of the assets available to pay benefits. The modified estimate of the present value of benefits (PVB) for the DoD Education includes more complete experience. The increase in the actuarial liability is the result of an increase of $64 million due to an additional year of new entrants and calculating the present value of the stream of projected future benefits as of a year later, and a PVB decrease of $18 million related to a higher interest rate assumption (5.3 percent versus 4.4 percent).

The Education Benefits Fund was established by Public Law 98-525. The program is designed to accumulate funds for the Educational Assistance program to promote the recruitment and retention of members for the All-Volunteer Forces program and the Total Force Concept of the Armed Forces and aid in the readjustment of members of the Armed Forces to civilian life after separation from military service.

Market Value of Investments in Market-based and Marketable Securities: $1 billion

Note 18. Unexpended Appropriations

As of September 30		2004		2003
(Amounts in millions)				
1. Unexpended Appropriations:				
A. Unobligated, Available	$	45,234.9	$	56,764.8
B. Unobligated, Unavailable		14,434.3		5,069.9
C. Unexpended Obligations		184,144.7		157,034.8
D. Total Unexpended Appropriations	$	243,813.9	$	218,869.5

Unexpended appropriations represent the amount of budget authority remaining for disbursement against current or future obligations. Unobligated balances represent the cumulative amount of budgetary authority that has not been set aside to cover outstanding commitments and obligations. Unobligated balances are classified as available or unavailable. Unobligated balances associated with appropriations expiring at fiscal year-end remain available only for obligation adjustments until the account is closed. Unexpended obligations represent funds that have been obligated for goods that have not been received or services that have not been performed.

Unexpended Obligations reported as a component of Unexpended Appropriations include both Undelivered Orders-Unpaid and Undelivered Orders-Paid for direct appropriated funds only. This amount is distinct from line 12, Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but Not Yet Provided, on the Statement of Financing. Line 12 includes the change during the fiscal year in Unexpended Obligations against budget authority from all Military Services.

Fluctuations

Unexpended Appropriations increased $24.9 billion (11 percent). This increase is primary the result of a 6 percent increase in Appropriations Received by the Department of Defense.

Unobligated, Available decreased $11.5 billion (20 percent) and evidenced an emphasis on obligating available funds. This decrease directly impacted the Unexpended Obligations which increased $27.1 billion (17 percent). The $15.6 billion difference between the two accounts is shown in Undelivered Orders reported on the Statement of Budgetary Resources.

Unobligated, Unavailable increased $9.4 billion (185 percent). An increase of $6.4 billion is mainly attributable to Title IX of the Department of Defense Appropriations Act that provided additional funding for FY 2004 and FY 2005. The additional funding is to support antiterrorism base operations and force protection needs, training, recruiting, and security requirements. The $6.4 billion of Unavailable balances will become available for obligation in FY 2005. The remaining increase of $1.3 billion is attributable to appropriation authority that is canceled 5 years after the funds are in an expired status.

Note 19. Statement of Net Cost

This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

For General Funds, the amounts presented in the Statement of Net Cost (SoNC) are based on obligations and disbursements and therefore may not, in all cases, reflect actual accrued costs. While the Department's Working Capital Funds (WCFs) generally record transactions on an accrual basis, the systems do not always capture actual costs in a timely manner. As such, information presented in the SoNC is based on budgetary obligation, disbursement, and collection transactions, as well as non-financial feeder systems, adjusted to record known accruals for major items such as payroll expenses, accounts payable, and environmental liabilities.

Fluctuations

Intragovernmental Gross Costs increased $11.8 billion (101 percent).

The Army GF increased by $5.4 billion as a result of the Presidential approval of the Emergency Wartime Supplemental Appropriations Act (PL 108-11). Congressional funding for the global war on terror was received through appropriated and supplemental funding in FY 2004. An increase in Operation and Maintenance appropriations funded approximately one-third of antiterrorism base operations and force protection needs.

The Air Force GF and Navy GF increased $2.7 billion and $4.1 billion respectively, resulting from recognizing expenses from the Intragovernmental Reporting and Analysis System (IRAS) that were not recognized in prior years. The IRAS allows the military services to better compare trading partner activity with other Federal agencies. As a result, the Air Force GF and Navy GF were able to identify and record expenses with these agencies in FY 2004.

Intragovernmental Earned Revenue increased $2.2 billion (17 percent).

The Medicare-Eligible Retiree Health Care and the Military Retirement Funds increased $768.6 million and $126.3 million, respectively. These increases resulted from increased interest and investment balances during FY 2004.

The Air Force GF increased $626.3 million due to larger spending authority earned in the O&M and RDT&E appropriations. The O&M increase was due to a concerted effort in August and September 2004, at the Major Command level to properly code the reimbursable transactions in the accounting system to better reflect the total amount of goods and services provided to other DoD organizations.

USACE's $128.5 million increase is attributed to improvements to its process of identifying trading partner elimination data for other Corps revenue in the revolving fund. The Corps developed system queries to identify trading partners for labor and other transactions reimbursed from military and other civil appropriations. Revenue had previously been included as intra-entity eliminations.

Gross Costs with the Public increased $93.3 billion (18 percent).

The Army GF increased by $24.1 billion as a result of the Presidential approval of the Emergency Wartime Supplemental Appropriations Act (PL 108-11). Congressional funding for the global war on terror was received through appropriated and supplemental funding in FY 2004. The increase supports the incremental costs of Reserve forces on active duty in a war zone versus peacetime training. Additionally, the military pay appropriations received a 3.7 percent pay increase for all soldiers and a pay raise of up to 6.25 percent for selected military pay grades.

Medicare Eligible Retiree Health Care Fund decreased $38.2 billion. During FY 2003, a one-time charge was incurred to cumulatively include reservists' benefits in the actuarial liability that had previously been omitted. The expense caused a sharp increase in FY 2003, which resulted in a negative variance when compared to FY 2004 expenses.

Military Retirement Fund increased $91.1 billion because of amendments by the 2004 National Defense Authorization Act for the new concurrent receipt benefits resulting in a substantial plan amendment liability increase in FY 2004.

The Navy GF increased $15.7 billion. This is a result of an increase in depreciation costs from recognizing Military Equipment in FY 2003 and continuing into FY 2004 and an increase in depreciation costs for buildings, structures, and utilities resulting from changes to the depreciation model used.

Earned Revenue from the Public increased $9.8 billion (79 percent).

The re-mapping of the USSGL Account 7190, Other Gains, from the Gross Cost with the Public line to the Earned Revenue from the Public line during FY 2004 has caused an increase. In prior years, these gains were not included with Earned Revenue from the Public. This re-mapping caused increases in the Army WCF of $4.5 billion, the Navy GF of $1.4 billion, and Air Force GF of $995.4 million. Defense Logistics Agency GF had an increase of $853.0 million related to increased energy cost and additional requirements for supplies for increased troop support.

Gross Cost and Earned Revenue by Budget Functional Classification

As of September 30 (Amounts in millions) **Budget Functional Classification**	2004 Gross Cost	2004 (Less: Earned Revenue)	2004 Net Cost	2003 Net Cost
1. Department of Defense Military (051)	$ 468,482.6	$ (25,481.7)	$ 443,000.9	$ 401,028.9
2. Water Resources by U.S. Army Corps of Engineers (301)	9,427.1	(977.5)	8,449.6	9,308.0
3. Pollution Control and Abatement by US. Army Corps of Engineers (304)	124.9	0.0	124.9	140.2
4. Federal Employees Retirement and Disability, Department of Defense Military Retirement Fund (602)	135,662.9	(10,124.7)	125,538.2	34,547.5
5. Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund (702)	317.1	(35.8)	281.3	285.4
6. Medicare Eligible Retiree Health Care Fund (551)	29,133.7	(1,163.7)	27,970.0	66,980.6
7. Total	$ 643,148.3	$ (37,783.4)	$ 605,364.9	$ 512,290.6

Gross Cost to Generate Intragovernmental Revenue and Earned Revenue (Transactions with Other Federal—Non-DoD—Entities) by Budget Functional Classification

As of September 30	2004			2003
(Amounts in millions)	Gross Cost to Generate Intra-governmental Revenue	(Less: Earned Revenue)	Net Cost	Net Cost
Budget Functional Classification				
1. Department of Defense Military (051)	$ 22,410.5	$ (3,495.2)	$ 18,915.3	$ 8,409.5
2. Water Resources by U.S. Army Corps of Engineers (301)	890.8	(609.6)	281.2	277.4
3. Pollution Control and Abatement by US. Army Corps of Engineers (304)	2.5	0.0	2.5	2.4
4. Federal Employees Retirement and Disability Department of Defense Military Retirement Trust Fund (602)	0.0	(10,124.7)	(10,124.7)	(9,998.4)
5. Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund (702)	270.7	(35.8)	234.9	213.5
6. Medicare Eligible Retiree Health Care Fund (551)	0.0	(1,163.7)	(1,163.7)	(395.1)
7. Total	$ 23,574.5	$ (15,429.0)	$ 8,145.5	$ (1,490.7)

The Department's accounting systems do not capture cost data in a manner that enables the Department to determine if the cost was incurred to generate intragovernmental revenue. Therefore, the Department was unable to complete this note. The Department is in the process of upgrading its financial and feeder systems and will be addressing this issue.

Benefit Program Expenses

(Amounts in millions)	2004	2003
1. Service Cost	$ 30,466.8	$ 28,100.2
2. Period Interest on the Benefit Liability	88,107.0	82,253.8
3. Prior (or past) Service Cost	81,062.7	880.3
4. Period Actuarial Gains or (Losses)	6,086.0	20,509.8
5. Gains/Losses Due to Changes in Medical Inflation Rate Assumption	(15,421.2)	9,206.0
6. Total Benefit Program Expense	$ 190,301.3	$ 140,950.1

Amounts for Foreign Military Sales (FMS) Program Procurements from Contractors

Revenue and expense amounts pertaining to FMS items provided by DoD contractors are not reported in the Statement of Net Cost. However, we estimate the amount of such revenue and expense to be $8 billion (80 percent of $10 billion CFY Trust Funds Disbursed). A Statement of Custodial Activity is provided which reports the amounts of cash collections and disbursements of the FMS Trust Fund through the 4th Quarter FY 2004.

Stewardship Assets

Stewardship assets include Heritage Assets, Stewardship Land, Non-Federal Physical Property, and Investments in Research and Development. The current-year cost of acquiring, constructing, improving, reconstructing or renovating stewardship assets are included in the SoNC. Material yearly investment amounts related to stewardship assets are provided in the Required Supplemental Stewardship Information section of this financial statement.

Suborganization Program Costs

The Department of Defense (DoD) is in the process of reviewing available data and attempting to develop a cost reporting methodology that fulfills the need for cost information required by SFFAS No. 4. Until cost-allocating processes and expanded intra-DoD eliminating capabilities are incorporated into the accounting processes, the usefulness of further sub-organization-reported (major command) net costs is limited. Therefore, no additional statements of sub-organization cost at lower levels are presented with these statements.

Note 20.	Statement of Changes in Net Position

As of September 30	Cumulative Results of Operations 2004	Unexpended Appropriations 2004	Cumulative Results of Operations 2003	Unexpended Appropriations 2003
(Amounts in millions)				
1. Prior Period Adjustments Increases (Decreases) to Net Position				
Beginning Balance:				
A. Changes in Accounting Standards	$ 699.5	$ 0.0	$ 383,130.0	$ 0.0
B. Errors and Omissions in Prior Year Accounting Reports	(14,543.3)	25,913.7	11,524.4	0.0
C. Other Prior Period Adjustments	(1,044.7)	0.0	(1,044.7)	0.0
D. Total Prior Period Adjustments	$ (14,888.5)	$ 25,913.7	$ 393,609.7	$ 0.0
2. Imputed Financing:				
A. Civilian CSRS/FERS Retirement	$ 1,658.6	$ 0.0	$ 1,717.2	$ 0.0
B. Civilian Health	2,248.7	0.0	1,948.4	0.0
C. Civilian Life Insurance	22.4	0.0	20.9	0.0
D. Judgment Fund	162.8	0.0	180.4	0.0
E. Total Imputed Financing	$ 4,092.5	$ 0.0	$ 3,866.9	$ 0.0

Prior Period Adjustments

The Department of Defense recorded $14.8 billion (net) in prior period adjustments to Cumulative Results of Operations (CRO) and $25.9 billion to Unexpended Appropriations. These adjustments consist of the following:

During FY 2003, the Navy General Fund overstated Appropriations Used by $25.9 billion, resulting in an overstatement of CRO and an understatement of Unexpended Appropriations. In FY 2004, the Navy General Fund recorded a prior period adjustment (restated) to the beginning CRO and Unexpended Appropriations balances, moving the $25.9 billion from CRO to Unexpended Appropriations.

In FY 2004, the Air Force Working Capital Fund continued to change its inventory valuation method from Latest Acquisition Cost to Moving Average Cost. The result of these changes were a prior period adjustment (restated) of $0.7 billion to clear the Inventory-Allowance account, and a prior period adjustment (restated) of $11.3 billion that was posted to resolve accumulated errors from previous years.

In December 1994, the Office of the Under Secretary of Defense (Comptroller), OUSD(C), decentralized cash management responsibilities. In this decentralization, the Navy Working Capital Fund received $1.0 billion in undistributed disbursements. During FY 2004, DoD reclassified this amount from Other Liabilities to Cumulative Results.

All adjustments comply with guidance provided by SFAS 16, APB 20, and SFFAS No.21, all of which address the treatment of errors and disclosure of prior period adjustments.

Imputed Financing

The amounts remitted to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System (CSRS), the Federal Employees' Retirement System (FERS), the Federal Employees' Health Benefits (FEHB) program, and the Federal Employees' Group Life Insurance (FEGLI) program do not fully cover the government's cost to provide these benefits. An imputed cost is recognized as the difference between the government's cost of providing these benefits to employees and contributions made by and for them. The OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for computation of imputed financing cost. The DFAS provides the costs to the Office of the Under Secretary of Defense (Personnel and Readiness) for validation. Approved imputed costs are provided to the reporting components for inclusion in their financial statements.

Fluctuations

Cumulative Results of Operations

There were no rescissions or Other Adjustments (Line 4.C.) impacting Budgetary Financing Sources.

Budgetary Financing Sources, Appropriations Used (Line 4.D.) increased $47.1 billion due to the recognition of Iraqi transfer accounts that do not require budgetary entries because the budgetary impact of the transfer accounts is reported by the transferring entity. The United States Army Corps of Engineers (USACE) will use these funds for reconstruction in Iraq.

Budgetary Financing Sources, Nonexchange Revenue (Line 4.E.) increased $0.5 billion due to the collection of taxes and interest into the USACE Trust Fund.

Budgetary Financing Sources, Donations and Forfeitures of Cash and Cash Equivalents (Line 4.F.) decreased $.02 billion due to a reduction in donations.

Budgetary Financing Sources, Transfers-in/out Without Reimbursement (Line 4.G.) increased $9.2 billion due largely to the transfer in of funds from the Executive Office of the President for Iraqi Relief and Reconstruction Fund.

Budgetary Financing Sources, Other Budgetary Financing Sources (Line 4.H.) increased $7.9 billion. The increase represents adjustments to bring the proprietary accounts into agreement with the budgetary accounts. Due to system deficiencies, there are unreconciled differences between the budgetary and proprietary trial balances. The net effect of these adjustments is reflected in Other Budgetary Financing Sources on the Statement of Net Position.

Other Financing Sources, Donations and Forfeitures of Property (Line 5.A.) decreased $4.0 million as a result of an overall decrease in donations and forfeitures of property.

Other Financing Sources, Transfers-in/out without reimbursement (Line 5.B.) increased by $3.9 billion. The majority of the difference was attributable to the Medicare-Eligible Retiree Health Care Fund (MERHCF). In December 2003, the estimate of the actuarial liabilities as of October 1, 2002 for the covered benefits for the U.S. Coast Guard participants in the MERHCF was revised from $5.0 billion to $7.8 billion. The increase in the transfer from the U.S. Coast Guard to the MERHCF of $2.8 billion was recognized in the 1st Quarter, FY 2004.

Other Financing Sources, Other (Line 5.D.) decreased by $0.3 billion due to a change in the accounting treatment for collections in the General Fund Proprietary Interest Receipt Account. Due to the change, a contra revenue account was established.

Unexpended Appropriations

Overall, Budgetary Financing Sources have increased due to the global war on terror (GWOT). Since March 2003, Congress has approved supplemental funding and increased the Department's FY 2004 appropriations to support these efforts in addition to the war in Iraq. This increased funding supports war-fighting readiness, force protection, procurement of helicopters, development of future combat systems, and war reserves. The additional funding also supports the incremental costs of Reserve forces on active duty in a war zone versus peacetime training. The increased appropriations also support antiterrorism base operations, training, recruiting, and security.

Note 21.	Statement of Budgetary Resources

As of September 30	2004	2003
(Amounts in millions)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 233,505.4	$ 215,000.2
2. Available Borrowing and Contract Authority at the End of the Period	25,314.3	21,150.6

Fluctuations

The Net Amount of Budgetary Resources Obligated for Undelivered Orders increased $18.5 billion (8.6 percent). This increase was mainly due to an increase in FY 2004 budget authority. This increase was directly influenced by the Emergency Wartime Supplemental Appropriations Act that was approved in FY 2003, and the congressional funding for the global war on terror (GWOT) received in FY 2004.

Available Borrowing and Contract Authority at the End of the Period increased a net of $4.1 billion (19.7 percent). This increase was mainly attributable to the increased authority to buy spares to support increased maintenance efforts in support of the contingency missions Operations Enduring Freedom, Iraqi Freedom, and Noble Eagle and to incur obligations for foreign military sales administrative expenses.

Before the war in Iraq began in March 2003, the Department of Defense (DoD) had been supporting the GWOT. Since March 2003, the Congress has approved supplemental funding and increased the Department's FY 2004 appropriations to support the GWOT in addition to the war in Iraq. Accordingly, most of the Statement of Budgetary Resources (SBR) line items changed substantially due to funding provided for the GWOT which includes, but is not limited to, Operations Enduring Freedom, Iraqi Freedom, and Noble Eagle. This increased funding supports war-fighting readiness, force protection, procurement of helicopters, development of future combat systems, and war reserves. The additional funding also supports the incremental costs of Reserve forces serving on active duty in a war zone rather than during peacetime training. The military members received an across-the-board 3.7 percent base pay increase plus a pay raise of up to 6.25 percent for certain military pay grades. The Congress also increased the rates for incentive pay, family separation allowance, and special pay for duty subject to hostile fire or imminent danger. These increased appropriations also support antiterrorism base operations and force protection needs, training, recruiting, and security requirements.

The SBR also reflects an increase in borrowing authority. This authority is used for capital improvements to the Washington DC Aqueduct. Local jurisdictions provide funding to repay the debt. The borrowing authority that was converted to cash was not correctly recorded for FYs 2000 and 2001. The Department made an adjustment in the 4th Quarter, FY 2004 to reflect this correction.

The Department reported a significant increase in net transfers of budget authority, net transfers of unobligated balances, advances received, funds permanently not available, and unobligated balances not available. The majority of the net transfers of budget authority represent transfers for the operating expenses of the Coalition Provisional Authority in Iraq, first reported during 4th Quarter, FY 2003, and increased activity due to the increased funding received in support of Operations Enduring Freedom, Iraqi Freedom, Noble Eagle, and Army Transformation. The majority of the net transfers of unobligated balances represent funds that were transferred to Operation and Maintenance from the Operation Iraqi Freedom Fund and the Iraqi Relief and Reconstruction Fund. The advances received represent the increase in reimbursable authority related to the support of land force readiness, including environmental conservation, pollution prevention, and base communications. The funds permanently not available represent the enacted rescissions of prior-year funds from the Operation Iraqi Freedom Fund. The increase in unobligated balances not available is attributable to both the Iraqi Freedom Fund and the classified components.

The nonbudgetary section of the SBR, which reports activity for the Military Housing Privatization Initiative, reflected significant variances regarding borrowing authority, net transfers of unobligated balances, receivables and collections related to spending authority from offsetting collections, and funds permanently not available. Those variances were due to the authority to borrow from the Treasury for new direct loans that did not exist in FY 2003; accounting errors made in FY 2003, but corrected in FY 2004; and the obligation, but not liquidation, of these new direct loans.

Other Information Related to the Statement of Budgetary Resources

Permanent Indefinite Appropriations

The Department of Defense received the following permanent indefinite appropriations:

- Department of the Army General Gift Fund (10 USC 2601(b)(1))
- Department of the Navy General Gift Fund (10 USC 2601(b)(2))
- Department of the Air Force General Gift Fund (10 USC 2601 (b)(3))
- Foreign National Employees Separation Pay Account, Defense (10 USC 1581)
- United States Naval Academy Gift and Museum Fund (10 USC 6973-4)
- Ship Stores Profits, Navy (10 USC 7220, 31 USC 1321)
- Midshipmen’s Store (10 USC 2665)
- Burdensharing Contributions Account (10 USC 2350j)
- Forest Program (10 USC 2665)
- Department of Defense Base Closure Account (10 USC 2687 note)
- Medicare Eligible Retiree Health Care Fund (10 USC 1111)
- Military Retirement Fund (10 USC 1461)
- Education Benefits Fund (10 USD 2006)
- Reserve Mobilization Income Insurance Fund (RII) (10 USC 12528)
- Host Nation Support for U.S. Relocation Activities (10 USD 2350k)
- National Defense Sealift Fund (10 USC 2218)
- Environmental Restoration, Navy (10 USD 2702)
- Hydraulic Mining Debris Reservoir (33 USC 683)
- Maintenance and Operation of Dams and Other Improvements of Navigable Waters (16 USC 810(a))
- Payments to States (33 USC 701c-3)
- Wildlife Conservation (16 USC 670-670f)
- Ainsworth Bequest (IAW 31 USC 1321)

Reconciliation Differences

There is a difference of $4.7 billion between undelivered orders (UDOs) reported on line 1 above ($233.5 billion) and the amount of UDOs reported on line 14C, Undelivered Orders, on the SBR ($228.8 billion). This difference is mainly attributable to the process of reporting UDOs with advances. Line 1 reports UDOs with advances, but the SBR does not. Both lines include upward and downward adjustments of prior-year UDOs. In addition, the SBR reports transferred obligations for UDOs without advances, but line 1 above does not.

There is a difference of $69.8 billion between appropriations received that are reported on the SBR ($582.0 billion) and appropriations received that are reported on the Statement of Changes in Net Position ($512.2 billion). This difference is attributable to the process used by the Trust Funds in accounting for their receipts in USSGL account 4114, Appropriated Trust or Special Fund Receipts. Generally, Trust Funds do not receive appropriations.

The Department of the Treasury issues annual warrants to pay amortized amounts for the unfunded actuarial liabilities for the Military Retirement Trust Fund (MRF) and the Medicare-Eligible Retiree Health Care Fund (MERHCF). These amounts are credited to the Other Defense Organizations (ODO) - General Funds and expended from this General Fund to the MRF and MERHCF in accordance with the Office of Management and Budget (OMB) guidance.

Amounts recorded as Appropriations Received, excluding interest earned, on the Statement of Budgetary Resources for the Medicare Eligible Retiree Health Care Fund, the Military Retirement Fund, the Education Benefits Fund, and the Voluntary Separation Incentive Program are also reported as Appropriations Received by the Army, Navy, Air Force, and Other Defense Organizations General Funds, because of the way the funds are received from the Department of the Treasury. The Office of Management and Budget is aware and approves of this duplicate reporting. Ongoing discussions with OMB and the Department of the Treasury have resulted in a change for MERHCF so that this duplication will not occur in future reporting periods. However, there is no planned resolution for MRF.

Intra-entity Transactions

The SBR includes intra-entity transactions because the statements are presented as combined and combining.

Apportionment Categories

Direct Obligations – Apportionment Categories

Reporting Entity	Category A ($millions)	Category B ($millions)	Exempt from Apportionment ($millions)
Army General Fund	148,242.2	4,348.7	
Navy General Fund - see disclosure	132,268.5		
Air Force General Fund	74,410.9	55,500.3	2.1
Air Force Working Capital Fund – see disclosure	2.0		
US Army Corps of Engineers	5,571.0		44.2
Military Retirement Fund	37,152.6		
Medicare-Eligible Retiree Health Care Fund	5,196.8		
Other Defense Organizations – General Fund	103,590.3	814.6	
Other Defense Organizations – Working Capital Fund	1,106.1		
Totals	507,540.4	60,663.6	46.3

Reimbursable Obligations – Apportionment Categories

Reporting Entity	Category A ($millions)	Category B ($millions)	Exempt from Apportionment ($millions)
Army General Fund	23,475.0		
Navy General Fund - see disclosure	8,886.3		
Air Force General Fund	1,101.0	3,346.4	
Army Working Capital Fund	14,006.2		
Navy Working Capital Fund		24,316.4	
Air Force Working Capital Fund – see disclosure	17,272.0		
US Army Corps of Engineers	5,456.3		1.5
Other Defense Organizations – General Fund – see disclosure	3,992.4		
Other Defense Organizations – Working Capital Fund	50,805.5		
Totals	124,994.7	27,662.8	1.5

Note 22. Statement of Financing

Statement of Financing Adjustments

Due to the Department's financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. Differences between budgetary and proprietary data are a previously identified deficiency. To bring the Statement of Financing into balance with the Statement of Net Cost, the following adjustments (absolute value) were made:

	(in millions)
Resources That Finance the Acquisition of Assets	$ 7,723.3
Other Components Not Requiring or Generating Resources	$ 1,838.7
Revaluation of Assets or Liabilities	$ 498.6
Statement of Net Cost*	$ 11.1

*The U.S. Army Corps of Engineers adjusted the Statement of Net Cost instead of the Statement of Financing.

Fluctuations

Transfers In/Out Without Reimbursement decreased by $3.9 billion primarily due to the reduction of transfer-in amounts from other federal agencies. In FY 2003 the U.S. Coast Guard and National Oceanic and Atmospheric Administration (NOAA) transferred $6.6 billion in actuarial liabilities to the Medicare-Eligible Retiree Health Care Fund. In FY 2004 the U.S. Coast Guard revised their estimate and transferred an additional $2.8 billion to the fund.

Resources That Fund Expenses Recognized in Prior Period relates to the reduction in the estimates for unfunded liabilities. The $2.0 billion decrease in unfunded liabilities is due primarily to the reduction in environmental liabilities by the Department of Air Force, contingent liabilities by the Department of the Army, and FECA liabilities by the Department of Navy. For further disclosure, see Note 14 for environmental liabilities, Note 15 for contingent liabilities and Note 17 for FECA unfunded liabilities. Corrections to properly classify decreases in unfunded liabilities also contributed to the variance.

Resources That Finance the Acquisition of Assets increased by $14.0 billion due to $ 2.2 billion of new acquisitions by U.S. Special Operations Command (SOCOM), and actions to correctly report expenses within the statement. In FY 2004 actions were taken to discontinue the netting of cost of goods sold against inventory purchases, resulting in a $ 40.0 billion increase in inventory acquisition. This increase was partially offset by the $32.4 billion decrease in acquisition of military equipment by Army, Navy, and Air Force General Funds. U.S. Army Corps of Engineers corrected the reporting of asset transfers and revaluation, resulting in an additional $3.1 billion increase. Increases in acquisitions appear as a negative amount on the Statement of Financing because budgetary expenditures for assets that are capitalized on the Balance Sheet are subtracted from total obligations in order to reconcile budgetary obligations with the net cost of operations.

Other Resources That Do Not Offset Net Cost of Operations – Other consists primarily of a $2.8 billion liability transferred in from the U.S. Coast Guard to the Medicare-Eligible Retiree Health Care Fund. Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations are primarily an offset to Transfers-In/Out Without Reimbursement.

Components Requiring Resources in Future Periods – Other consists of unfunded expenses relating to contingent liabilities, actuarial and other unfunded employment-related liabilities. The $43.7 billion increase resulted primarily from changes in actuarial liabilities for the Military Retirement Fund, Medicare-Eligible Retiree Health Care Fund, and the Defense Health Program.

The $13.0 billion decrease in depreciation and amortization was due primarily to decreases in depreciation reported by the Department of the Army, the Department of the Air Force, and U.S. Special Operations Command.

Revaluation of Assets or Liabilities decreased $12.0 billion, primarily due to the implementation of the General Accounting and Finance System – Rehost (GAFS-R) by the Air Force General Fund. The implementation resulted in a decrease of $2.6 billion in reporting gains and losses on inventory valuation. The Air Force Working Capital Fund reported a decrease of $5.7 billion that resulted from correctly reporting gains and losses on inventory valuation. The Navy General Fund reported a decrease of $2.1 billion primarily due to a decrease in the amount of operating materials and supplies used for Operations Enduring Freedom and Iraqi Freedom in FY 2004.

Components Not Requiring Resources in Future Periods – Other consists of expenses not requiring budgetary resources reported by the Department of the Army for the Iraqi Relief and Reconstruction Fund, the adjustment by the Other Defense Organization General Fund to bring the Statement of Financing into balance with the Statement of Net Cost, write-off of capitalized non-federal cost share projects by the U.S. Army Corps of Engineers, and the Air Force Working Capital Funds' adjustment to correctly report cost of good sold in the statements.

Note 23. Statement of Custodial Activity

During Operation Iraqi Freedom, the U.S. Government seized assets from the Iraqi Government that will be used in support of the Iraqi people. As of September 30, 2004, $113.4 million of monetary seized assets remain to be disbursed in support of the Iraqi people. The Statement of Custodial Activity displays only the current year activity. During FY 2004 Iraqi cash disbursed exceeded the amount seized by $164.7 million. The $690.6 million decrease in Seized Iraqi Cash, the $247.8 million decrease in Seized Assets Disbursed on behalf of Iraqi People, and the $442.8 million decrease in Seized Assets Retained for Support of the Iraqi People are due to the Army seizing and disbursing less Iraqi assets in FY 2004.

Seized Iraqi Cash

(in millions)	During FY 2004	Cumulative from inception
Source of Collections		
Seized Iraqi Cash	$ **118.3**	$ **927.2**
Disposition of Collections		
Iraqi Salaries	0.7	30.9
Repair/Reconstruction/Humanitarian Assistance	273.0	443.6
Iraqi Ministry Operations (Ministry of Finance, etc.)	9.3	263.9
Fuel/Supplies	0.0	75.4
Total Disbursed on behalf of the Iraqi People	283.0	813.8
Retained for Future Support of the Iraqi People	(164.7)	113.4
Total Disposition of Collections	**118.3**	**927.2**
Net Custodial Collection Activity	$ 0.0	$ 0.0

Fluctuations

The increase in the line for Deposits by Foreign Governments of $1.3 billion (12.7 percent) is primarily due to increase in cash received for the Foreign Military Sales (FMS) programs.

The increase in the line Increase in Amounts to be Transferred of $1.4 million (946 percent) is primarily due to the net increase in custodial cash (collection sources less disposition) in FY 2004 for the FMS Trust Fund and represents a custodial liability. This amount is comprised of collections received from the foreign customers less the funds disbursed on their behalf.

Under authority of the Arms Export and Control Act, the FMS Trust Fund receives collections from foreign governments that are dedicated specifically to FMS purchases. Funds collected into the Trust Fund are in advance of the performance of services or sale of articles. These advance collections constitute a fiduciary relationship with the countries and are outside the Federal budget.

FMS neither recognizes nor reports revenue. The only exception is cost clearing accounts, which are reflected in all other components of the Audited Financial Statements except the Statement of Custodial Activity. Since various DoD Components actually perform the services and sell the articles, recognition of revenue and expense occurs in the financial statements of the applicable DoD Components.

Note 24.	Other Disclosures

Operating Leases – DoD as Lessee

As of September 30		2004							2003	
(Amounts in millions)										
Future Payments Due: Fiscal Year		Land and Buildings		Equipment		Other		Total		Total
2005	$	141.6	$	0.2	$	114.8	$	256.6	$	96.6
2006		140.3		0.0		117.1		257.4		95.5
2007		141.6		0.0		119.5		261.1		97.5
2008		139.4		0.0		121.8		261.2		98.5
2009		139.3		0.0		124.3		263.6		97.4
After 5 Years		64.1		0.0		0.0		64.1		73.5
Total Future Lease Payments Due	$	766.3	$	0.2	$	597.5	$	1,364.0	$	559.0

Fluctuations

The increase of $805 million (144 percent) in total future lease payments due is attributable to two main causes. The first is an increase in the number of high-cost leases entered into by the Air Force in support of contingency operations for the war effort as reflected in the Other category. The second cause reflects the Department's efforts to establish and refine the estimated cost of the remaining leases and expiration of leases for the Land and Buildings category.

Consolidating and Combining Financial Statements

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($ in Millions)

	Army General Fund	Navy General Fund	Air Force General Fund
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 89,297.4	$ 81,874.8	$ 60,547.7
Non-Entity Seized Iraqi Cash	113.4	0.0	0.0
Non-Entity-Other	137.8	219.1	53.3
Investments (Note 4)	1.5	9.5	0.7
Accounts Receivable (Note 5)	461.8	250.6	690.0
Other Assets (Note 6)	556.4	272.7	443.9
Total Intragovernmental Assets	$ 90,568.3	$ 82,626.7	$ 61,735.6
Cash and Other Monetary Assets (Note 7)	$ 1,525.1	$ 234.9	$ 311.3
Accounts Receivable (Note 5)	492.4	2,896.0	978.9
Loans Receivable (Note 8)	0.0	0.0	0.0
Inventory and Related Property (Note 9)	37,647.7	53,340.7	51,340.2
General Property, Plant and Equipment (Note 10)	113,111.6	151,679.5	117,954.4
Investments (Note 4)	0.0	0.0	0.0
Other Assets (Note 6)	3,351.5	5,000.3	10,809.6
TOTAL ASSETS	$ 246,696.6	$ 295,778.1	$ 243,130.0
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 1,706.7	$ 1,437.6	$ 1,900.4
Debt (Note 13)	0.0	0.0	0.0
Environmental Liabilities (Note 14)	0.0	0.0	0.0
Other Liabilities (Note 15 & Note 16)	2,402.9	3,984.8	1,726.5
Total Intragovernmental Liabilities	$ 4,109.6	$ 5,422.4	$ 3,626.9
Accounts Payable (Note 12)	$ 9,460.2	$ 1,395.0	$ 7,707.2
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,632.8	1,575.8	1,163.4
Environmental Liabilities (Note 14)	40,366.2	16,032.0	7,387.2
Loan Guarantee Liability (Note 8)	12.3	0.0	0.0
Other Liabilities (Note 15 and Note 16)	8,669.2	4,020.8	4,602.5
Debt Held by Public	0.0	0.0	0.0
TOTAL LIABILITIES	$ 64,250.3	$ 28,446.0	$ 24,487.2
NET POSITION			
Unexpended Appropriations (Note 18)	$ 73,238.3	$ 79,161.8	$ 49,660.7
Cumulative Results of Operations	109,208.0	188,170.3	168,982.1
TOTAL NET POSITION	$ 182,446.3	$ 267,332.1	$ 218,642.8
TOTAL LIABILITIES AND NET POSITION	$ 246,696.6	$ 295,778.1	$ 243,130.0

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	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 948.5	$ 861.2	$ 1,051.1
Non-Entity Seized Iraqi Cash	0.0	0.0	0.0
Non-Entity-Other	0.0	0.0	0.0
Investments (Note 4)	0.0	0.0	0.0
Accounts Receivable (Note 5)	444.9	857.6	576.4
Other Assets (Note 6)	0.1	0.0	0.0
Total Intragovernmental Assets	$ 1,393.5	$ 1,718.8	$ 1,627.5
Cash and Other Monetary Assets (Note 7)	$ 0.0	$ 0.0	$ 0.0
Accounts Receivable (Note 5)	13.5	26.2	103.1
Loans Receivable (Note 8)	0.0	0.0	0.0
Inventory and Related Property (Note 9)	13,916.7	19,239.2	21,025.5
General Property, Plant and Equipment (Note 10)	899.4	3,895.5	1,197.7
Investments (Note 4)	0.0	0.0	0.0
Other Assets (Note 6)	265.1	717.2	789.0
TOTAL ASSETS	$ 16,488.2	$ 25,596.9	$ 24,742.8
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 159.0	$ 243.9	$ 256.8
Debt (Note 13)	0.0	506.3	0.0
Environmental Liabilities (Note 14)	0.0	0.0	0.0
Other Liabilities (Note 15 & Note 16)	67.7	114.9	243.1
Total Intragovernmental Liabilities	$ 226.7	$ 865.1	$ 499.9
Accounts Payable (Note 12)	$ 372.1	$ 1,862.6	$ 497.5
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	305.0	1,168.2	238.7
Environmental Liabilities (Note 14)	0.0	0.0	0.0
Loan Guarantee Liability (Note 8)	0.0	0.0	0.0
Other Liabilities (Note 15 and Note 16)	213.5	5,679.1	1,616.3
Debt Held by Public	0.0	0.0	0.0
TOTAL LIABILITIES	$ 1,117.3	$ 9,575.0	$ 2,852.4
NET POSITION			
Unexpended Appropriations (Note 18)	$ 0.1	$ 0.0	$ 0.0
Cumulative Results of Operations	15,370.8	16,021.9	21,890.4
TOTAL NET POSITION	$ 15,370.9	$ 16,021.9	$ 21,890.4
TOTAL LIABILITIES AND NET POSITION	$ 16,488.2	$ 25,596.9	$ 24,742.8

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	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 20.7	$ 2,378.4	$ 47,825.5
Non-Entity Seized Iraqi Cash	0.0	0.0	0.0
Non-Entity-Other	0.0	8.2	1,381.6
Investments (Note 4)	187,962.5	2,741.9	1,768.4
Accounts Receivable (Note 5)	(0.1)	520.3	238.5
Other Assets (Note 6)	0.0	0.0	121.3
Total Intragovernmental Assets	$ 187,983.1	$ 5,648.8	$ 51,335.3
Cash and Other Monetary Assets (Note 7)	$ 0.0	$ 1.0	$ 7.0
Accounts Receivable (Note 5)	25.3	1,906.4	647.0
Loans Receivable (Note 8)	0.0	0.0	70.7
Inventory and Related Property (Note 9)	0.0	61.8	1,573.5
General Property, Plant and Equipment (Note 10)	0.0	28,448.5	19,473.8
Investments (Note 4)	0.0	0.0	406.5
Other Assets (Note 6)	0.0	0.0	302.8
TOTAL ASSETS	$ 188,008.4	$ 36,066.5	$ 73,816.6
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 0.0	$ 103.4	$ 705.3
Debt (Note 13)	0.0	15.4	70.1
Environmental Liabilities (Note 14)	0.0	0.0	0.0
Other Liabilities (Note 15 & Note 16)	0.9	2,058.6	343.4
Total Intragovernmental Liabilities	$ 0.9	$ 2,177.4	$ 1,118.8
Accounts Payable (Note 12)	$ 0.0	$ 570.3	$ 2,044.8
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	834,582.1	0.0	224,438.9
Environmental Liabilities (Note 14)	0.0	0.0	525.1
Loan Guarantee Liability (Note 8)	0.0	0.0	22.1
Other Liabilities (Note 15 and Note 16)	3,120.5	646.1	4,693.4
Debt Held by Public	0.0	0.0	0.0
TOTAL LIABILITIES	$ 837,703.5	$ 3,393.8	$ 232,843.1
NET POSITION			
Unexpended Appropriations (Note 18)	$ 0.0	$ 396.4	$ 40,827.5
Cumulative Results of Operations	(649,695.1)	32,276.3	(199,854.0)
TOTAL NET POSITION	$ (649,695.1)	$ 32,672.7	$ (159,026.5)
TOTAL LIABILITIES AND NET POSITION	$ 188,008.4	$ 36,066.5	$ 73,816.6

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	Other Defense Organizations Working Capital Funds	DoD Medicare-Eligible Retiree Health Care Fund	Combined Total
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 2,875.2	$ 5.0	$ 287,685.5
Non-Entity Seized Iraqi Cash	0.0	0.0	113.4
Non-Entity-Other	0.0	0.0	1,800.0
Investments (Note 4)	0.0	38,585.2	231,069.7
Accounts Receivable (Note 5)	2,306.2	0.0	6,346.2
Other Assets (Note 6)	10.4	0.0	1,404.8
Total Intragovernmental Assets	$ 5,191.8	$ 38,590.2	$ 528,419.6
Cash and Other Monetary Assets (Note 7)	$ 98.8	$ 0.0	$ 2,178.1
Accounts Receivable (Note 5)	331.0	8.0	7,427.8
Loans Receivable (Note 8)	0.0	0.0	70.7
Inventory and Related Property (Note 9)	15,074.1	0.0	213,219.4
General Property, Plant and Equipment (Note 10)	4,238.2	0.0	440,898.6
Investments (Note 4)	0.0	0.0	406.5
Other Assets (Note 6)	250.8	0.0	21,486.3
TOTAL ASSETS	$ 25,184.7	$ 38,598.2	$ 1,214,107.0
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 596.5	$ 0.1	$ 7,109.7
Debt (Note 13)	0.0	0.0	591.8
Environmental Liabilities (Note 14)	0.0	0.0	0.0
Other Liabilities (Note 15 & Note 16)	183.6	0.0	11,126.4
Total Intragovernmental Liabilities	$ 780.1	$ 0.1	$ 18,827.9
Accounts Payable (Note 12)	$ 4,270.1	$ 129.2	$ 28,309.0
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	526.0	504,073.8	1,569,704.7
Environmental Liabilities (Note 14)	56.7	0.0	64,367.2
Loan Guarantee Liability (Note 8)	0.0	0.0	34.4
Other Liabilities (Note 15 and Note 16)	738.5	491.3	34,491.2
Debt Held by Public	0.0	0.0	0.0
TOTAL LIABILITIES	$ 6,371.4	$ 504,694.4	$ 1,715,734.4
NET POSITION			
Unexpended Appropriations (Note 18)	$ 529.1	$ 0.0	$ 243,813.9
Cumulative Results of Operations	18,284.2	(466,096.2)	(745,441.3)
TOTAL NET POSITION	$ 18,813.3	$ (466,096.2)	$ (501,627.4)
TOTAL LIABILITIES AND NET POSITION	$ 25,184.7	$ 38,598.2	$ 1,214,107.0

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($ in Millions)

	Elimination	2004 Consolidated	2003 Consolidated
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 0.0	$ 287,685.5	$ 251,544.1
Non-Entity Seized Iraqi Cash	0.0	113.4	278.1
Non-Entity-Other	0.0	1,800.0	239.8
Investments (Note 4)	0.0	231,069.7	205,376.0
Accounts Receivable (Note 5)	5,227.9	1,118.3	1,066.6
Other Assets (Note 6)	392.9	1,011.9	105.0
Total Intragovernmental Assets	$ 5,620.8	$ 522,798.8	$ 458,609.6
Cash and Other Monetary Assets (Note 7)	$ 0.0	$ 2,178.1	$ 1,534.9
Accounts Receivable (Note 5)	0.0	7,427.8	7,299.9
Loans Receivable (Note 8)	0.0	70.7	64.0
Inventory and Related Property (Note 9)	0.0	213,219.4	205,544.6
General Property, Plant and Equipment (Note 10)	0.0	440,898.6	446,308.9
Investments (Note 4)	0.0	406.5	217.8
Other Assets (Note 6)	0.0	21,486.3	21,729.6
TOTAL ASSETS	$ 5,620.8	$ 1,208,486.2	$ 1,141,309.3
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 5,221.3	$ 1,888.4	$ 101.4
Debt (Note 13)	0.0	591.8	698.2
Environmental Liabilities (Note 14)	0.0	0.0	0.0
Other Liabilities (Note 15 & Note 16)	399.5	10,726.9	9,739.1
Total Intragovernmental Liabilities	$ 5,620.8	$ 13,207.1	$ 10,538.7
Accounts Payable (Note 12)	$ 0.0	$ 28,309.0	$ 27,863.8
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	0.0	1,569,704.7	1,429,565.5
Environmental Liabilities (Note 14)	0.0	64,367.2	61,490.6
Loan Guarantee Liability (Note 8)	0.0	34.4	25.9
Other Liabilities (Note 15 and Note 16)	0.0	34,491.2	30,154.0
Debt Held by Public	0.0	0.0	0.0
TOTAL LIABILITIES	$ 5,620.8	$ 1,710,113.6	$ 1,559,638.5
NET POSITION			
Unexpended Appropriations (Note 18)	$ 0.0	$ 243,813.9	$ 218,869.5
Cumulative Results of Operations	0.0	(745,441.3)	(637,198.7)
TOTAL NET POSITION	$ 0.0	$ (501,627.4)	$ (418,329.2)
TOTAL LIABILITIES AND NET POSITION	$ 5,620.8	$ 1,208,486.2	$ 1,141,309.3

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CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Army General Fund	Navy General Fund	Air Force General Fund
Program Costs			
A. Military Personnel			
Intragovernmental Gross Costs	$ 8,816.1	$ 7,398.5	$ 319.2
(Less: Intragovernmental Earned Revenue)	(372.0)	(417.5)	(315.3)
Intragovernmental Net Costs	$ 8,444.1	$ 6,981.0	$ 3.9
Gross Costs With the Public	38,206.5	29,004.4	29,708.4
(Less: Earned Revenue From the Public)	18.8	0.0	(106.6)
Net Costs With the Public	$ 38,225.3	$ 29,004.4	$ 29,601.8
Total Net Cost	$ 46,669.4	$ 35,985.4	$ 29,605.7
B. Operation and Maintenance			
Intragovernmental Gross Costs	$ 8,721.6	$ 1,862.7	$ 16,887.0
(Less: Intragovernmental Earned Revenue)	(10,871.3)	(5,166.3)	(4,385.4)
Intragovernmental Net Costs	$ (2,149.7)	$ (3,303.6)	$ 12,501.6
Gross Costs With the Public	62,739.8	44,129.8	28,465.4
(Less: Earned Revenue From the Public)	(832.2)	(47.3)	(644.5)
Net Costs With the Public	$ 61,907.6	$ 44,082.5	$ 27,820.9
Total Net Cost	$ 59,757.9	$ 40,778.9	$ 40,322.5
C. Procurement			
Intragovernmental Gross Costs	$ 826.4	$ 0.6	$ 652.5
(Less: Intragovernmental Earned Revenue)	(778.5)	(767.2)	(265.4)
Intragovernmental Net Costs	$ 47.9	$ (766.6)	$ 387.1
Gross Costs With the Public	17,237.5	33,100.3	27,232.0
(Less: Earned Revenue From the Public)	(64.6)	(249.0)	(401.5)
Net Costs With the Public	$ 17,172.9	$ 32,851.3	$ 26,830.5
Total Net Cost	$ 17,220.8	$ 32,084.7	$ 27,217.6

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Other Defense Organizations General Funds	Combined Total	Elimination
Program Costs			
A. Military Personnel			
Intragovernmental Gross Costs		$ 16,533.8	$ 0.0
(Less: Intragovernmental Earned Revenue)		(1,104.8)	0.0
Intragovernmental Net Costs		$ 15,429.0	$ 0.0
Gross Costs With the Public		96,919.3	0.0
(Less: Earned Revenue From the Public)		(87.8)	0.0
Net Costs With the Public		$ 96,831.5	$ 0.0
Total Net Cost		$ 112,260.5	$ 0.0
B. Operation and Maintenance			
Intragovernmental Gross Costs	$ 14,129.0	$ 41,600.3	$ 4,037.5
(Less: Intragovernmental Earned Revenue)	(2,163.5)	(22,586.5)	(1,174.3)
Intragovernmental Net Costs	$ 11,965.5	$ 19,013.8	$ 2,863.2
Gross Costs With the Public	37,483.9	172,818.9	0.0
(Less: Earned Revenue From the Public)	(372.8)	(1,896.8)	0.0
Net Costs With the Public	$ 37,111.1	$ 170,922.1	$ 0.0
Total Net Cost	$ 49,076.6	$ 189,935.9	$ 2,863.2
C. Procurement			
Intragovernmental Gross Costs	$ 544.0	$ 2,023.5	$ 0.6
(Less: Intragovernmental Earned Revenue)	(13.2)	(1,824.3)	0.0
Intragovernmental Net Costs	$ 530.8	$ 199.2	$ 0.6
Gross Costs With the Public	2,125.5	79,695.3	0.0
(Less: Earned Revenue From the Public)	0.3	(714.8)	0.0
Net Costs With the Public	$ 2,125.8	$ 78,980.5	$ 0.0
Total Net Cost	$ 2,656.6	$ 79,179.7	$ 0.6

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Consolidated	2003 Consolidated
Program Costs		
A. Military Personnel		
Intragovernmental Gross Costs	$ 16,533.8	$ 22,150.7
(Less: Intragovernmental Earned Revenue)	(1,104.8)	(1,053.1)
Intragovernmental Net Costs	$ 15,429.0	$ 21,097.6
Gross Costs With the Public	96,919.3	88,284.4
(Less: Earned Revenue From the Public)	(87.8)	(454.3)
Net Costs With the Public	$ 96,831.5	$ 87,830.1
Total Net Cost	$ 112,260.5	$ 108,927.7
B. Operation and Maintenance		
Intragovernmental Gross Costs	$ 37,562.8	$ 46,197.3
(Less: Intragovernmental Earned Revenue)	(21,412.2)	(14,568.5)
Intragovernmental Net Costs	$ 16,150.6	$ 31,628.8
Gross Costs With the Public	172,818.9	143,349.5
(Less: Earned Revenue From the Public)	(1,896.8)	(2,450.4)
Net Costs With the Public	$ 170,922.1	$ 140,899.1
Total Net Cost	$ 187,072.7	$ 172,527.9
C. Procurement		
Intragovernmental Gross Costs	$ 2,022.9	$ 3,106.4
(Less: Intragovernmental Earned Revenue)	(1,824.3)	(1,775.6)
Intragovernmental Net Costs	$ 198.6	$ 1,330.8
Gross Costs With the Public	79,695.3	59,034.8
(Less: Earned Revenue From the Public)	(714.8)	(380.3)
Net Costs With the Public	$ 78,980.5	$ 58,654.5
Total Net Cost	$ 79,179.1	$ 59,985.3

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Army General Fund	Navy General Fund	Air Force General Fund
D. Research, Development, Test & Evaluation			
Intragovernmental Gross Costs	$ 2,588.3	$ 0.0	$ 791.7
(Less: Intragovernmental Earned Revenue)	(2,703.0)	(307.5)	(2,553.6)
Intragovernmental Net Costs	$ (114.7)	$ (307.5)	$ (1,761.9)
Gross Costs With the Public	8,684.5	14,466.7	20,987.1
(Less: Earned Revenue From the Public)	(123.5)	0.0	(174.5)
Net Costs With the Public	$ 8,561.0	$ 14,466.7	$ 20,812.6
Total Net Cost	$ 8,446.3	$ 14,159.2	$ 19,050.7
E. Military Construction/Family Housing			
Intragovernmental Gross Costs	$ 2,340.9	$ 0.0	$ 200.9
(Less: Intragovernmental Earned Revenue)	(3,267.7)	(741.2)	0.8
Intragovernmental Net Costs	$ (926.8)	$ (741.2)	$ 201.7
Gross Costs With the Public	1,956.0	8,910.4	585.4
(Less: Earned Revenue From the Public)	(144.2)	(35.3)	0.0
Net Costs With the Public	$ 1,811.8	$ 8,875.1	$ 585.4
Total Net Cost	$ 885.0	$ 8,133.9	$ 787.1
F. Military Retirement Fund			
Intragovernmental Gross Costs			
(Less: Intragovernmental Earned Revenue)			
Intragovernmental Net Costs			
Gross Costs With the Public			
(Less: Earned Revenue From the Public)			
Net Costs With the Public			
Total Net Cost			

Department of Defense
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CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Military Retirement Fund	Other Defense Organizations General Funds	DoD Medicare-Eligible Retiree Health Care Fund
D. Research, Development, Test & Evaluation			
Intragovernmental Gross Costs		$ 3,211.7	
(Less: Intragovernmental Earned Revenue)		(417.0)	
Intragovernmental Net Costs		$ 2,794.7	
Gross Costs With the Public		12,398.4	
(Less: Earned Revenue From the Public)		4.6	
Net Costs With the Public		$ 12,403.0	
Total Net Cost		$ 15,197.7	
E. Military Construction/Family Housing			
Intragovernmental Gross Costs		$ 175.3	
(Less: Intragovernmental Earned Revenue)		0.0	
Intragovernmental Net Costs		$ 175.3	
Gross Costs With the Public		530.3	
(Less: Earned Revenue From the Public)		0.6	
Net Costs With the Public		$ 530.9	
Total Net Cost		$ 706.2	
F. Military Retirement Fund			
Intragovernmental Gross Costs	$ 0.0		$ 1,380.7
(Less: Intragovernmental Earned Revenue)	(42,384.5)		(25,342.4)
Intragovernmental Net Costs	$ (42,384.5)		$ (23,961.7)
Gross Costs With the Public	135,662.9		29,133.7
(Less: Earned Revenue From the Public)	0.0		0.0
Net Costs With the Public	$ 135,662.9		$ 29,133.7
Total Net Cost	$ 93,278.4		$ 5,172.0

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Combined Total	Elimination	2004 Consolidated
D. Research, Development, Test & Evaluation			
Intragovernmental Gross Costs	$ 6,591.7	$ 9.3	$ 6,582.4
(Less: Intragovernmental Earned Revenue)	(5,981.1)	0.0	(5,981.1)
Intragovernmental Net Costs	$ 610.6	$ 9.3	$ 601.3
Gross Costs With the Public	56,536.7	0.0	56,536.7
(Less: Earned Revenue From the Public)	(293.4)	0.0	(293.4)
Net Costs With the Public	$ 56,243.3	$ 0.0	$ 56,243.3
Total Net Cost	$ 56,853.9	$ 9.3	$ 56,844.6
E. Military Construction/Family Housing			
Intragovernmental Gross Costs	$ 2,717.1	$ 0.5	$ 2,716.6
(Less: Intragovernmental Earned Revenue)	(4,008.1)	0.0	(4,008.1)
Intragovernmental Net Costs	$ (1,291.0)	$ 0.5	$ (1,291.5)
Gross Costs With the Public	11,982.1	0.0	11,982.1
(Less: Earned Revenue From the Public)	(178.9)	0.0	(178.9)
Net Costs With the Public	$ 11,803.2	$ 0.0	$ 11,803.2
Total Net Cost	$ 10,512.2	$ 0.5	$ 10,511.7
F. Military Retirement Fund			
Intragovernmental Gross Costs	$ 1,380.7	$ 1,380.7	$ 0.0
(Less: Intragovernmental Earned Revenue)	(67,726.9)	(56,438.6)	(11,288.3)
Intragovernmental Net Costs	$ (66,346.2)	$ (55,057.8)	$ (11,288.4)
Gross Costs With the Public	164,796.6	0.0	164,796.6
(Less: Earned Revenue From the Public)	0.0	0.0	0.0
Net Costs With the Public	$ 164,796.6	$ 0.0	$ 164,796.6
Total Net Cost	$ 98,450.4	$ (55,057.8)	$ 153,508.2

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

		2003 Consolidated
D. Research, Development, Test & Evaluation		
Intragovernmental Gross Costs	$	6,813.1
(Less: Intragovernmental Earned Revenue)		(5,607.8)
Intragovernmental Net Costs	$	1,205.3
Gross Costs With the Public		50,076.1
(Less: Earned Revenue From the Public)		(180.6)
Net Costs With the Public	$	49,895.5
Total Net Cost	$	51,100.8
E. Military Construction/Family Housing		
Intragovernmental Gross Costs	$	4,069.6
(Less: Intragovernmental Earned Revenue)		(2,242.4)
Intragovernmental Net Costs	$	1,827.2
Gross Costs With the Public		3,723.7
(Less: Earned Revenue From the Public)		(551.6)
Net Costs With the Public	$	3,172.1
Total Net Cost	$	4,999.3
F. Military Retirement Fund		
Intragovernmental Gross Costs	$	0.0
(Less: Intragovernmental Earned Revenue)		(10,393.5)
Intragovernmental Net Costs	$	(10,393.5)
Gross Costs With the Public		111,921.6
(Less: Earned Revenue From the Public)		0.0
Net Costs With the Public	$	111,921.6
Total Net Cost	$	101,528.1

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Army General Fund	Navy General Fund	Air Force General Fund
G. Civil Works			
Intragovernmental Gross Costs			
(Less: Intragovernmental Earned Revenue)			
Intragovernmental Net Costs			
Gross Costs With the Public			
(Less: Earned Revenue From the Public)			
Net Costs With the Public			
Total Net Cost			
H. Working Capital Funds			
Intragovernmental Gross Costs			
(Less: Intragovernmental Earned Revenue)			
Intragovernmental Net Costs			
Gross Costs With the Public			
(Less: Earned Revenue From the Public)			
Net Costs With the Public			
Total Net Cost			
I. Other			
Intragovernmental Gross Costs	$ 12,166.8	$ 29,910.0	$ 10,058.7
(Less: Intragovernmental Earned Revenue)	10,604.1	4,126.9	2,516.7
Intragovernmental Net Costs	$ 22,770.9	$ 34,036.9	$ 12,575.4
Gross Costs With the Public	(19,962.5)	(32,765.2)	(10,472.3)
(Less: Earned Revenue From the Public)	(6.4)	(2,971.1)	(397.4)
Net Costs With the Public	$ (19,968.9)	$ (35,736.3)	$ (10,869.7)
Total Net Cost	$ 2,802.0	$ (1,699.4)	$ 1,705.7

Department of Defense
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CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
G. Civil Works			
Intragovernmental Gross Costs			
(Less: Intragovernmental Earned Revenue)			
Intragovernmental Net Costs			
Gross Costs With the Public			
(Less: Earned Revenue From the Public)			
Net Costs With the Public			
Total Net Cost			
H. Working Capital Funds			
Intragovernmental Gross Costs	$ 2,848.0	$ 5,435.0	$ 5,399.8
(Less: Intragovernmental Earned Revenue)	(8,456.1)	(21,698.9)	(11,888.5)
Intragovernmental Net Costs	$ (5,608.1)	$ (16,263.9)	$ (6,488.7)
Gross Costs With the Public	8,161.3	17,915.6	8,674.8
(Less: Earned Revenue From the Public)	(4,951.1)	(613.5)	(891.4)
Net Costs With the Public	$ 3,210.2	$ 17,302.1	$ 7,783.4
Total Net Cost	$ (2,397.9)	$ 1,038.2	$ 1,294.7
I. Other			
Intragovernmental Gross Costs			
(Less: Intragovernmental Earned Revenue)			
Intragovernmental Net Costs			
Gross Costs With the Public			
(Less: Earned Revenue From the Public)			
Net Costs With the Public			
Total Net Cost			

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	US Army Corps of Engineers	Other Defense Organizations General Funds	Other Defense Organizations Working Capital Funds
G. Civil Works			
Intragovernmental Gross Costs	$ 1,020.8		
(Less: Intragovernmental Earned Revenue)	(1,234.8)		
Intragovernmental Net Costs	$ (214.0)		
Gross Costs With the Public	8,658.7		
(Less: Earned Revenue From the Public)	(368.0)		
Net Costs With the Public	$ 8,290.7		
Total Net Cost	$ 8,076.7		
H. Working Capital Funds			
Intragovernmental Gross Costs			$ 3,684.6
(Less: Intragovernmental Earned Revenue)			(35,646.6)
Intragovernmental Net Costs			$ (31,962.0)
Gross Costs With the Public			40,186.8
(Less: Earned Revenue From the Public)			(7,332.4)
Net Costs With the Public			$ 32,854.4
Total Net Cost			$ 892.4
I. Other			
Intragovernmental Gross Costs		$ 31,646.8	
(Less: Intragovernmental Earned Revenue)		36.8	
Intragovernmental Net Costs		$ 31,683.6	
Gross Costs With the Public		16,427.7	
(Less: Earned Revenue From the Public)		(1,651.4)	
Net Costs With the Public		$ 14,776.3	
Total Net Cost		$ 46,459.9	

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Combined Total	Elimination	2004 Consolidated
G. Civil Works			
Intragovernmental Gross Costs	$ 1,020.8	$ 127.5	$ 893.3
(Less: Intragovernmental Earned Revenue)	(1,234.8)	(625.2)	(609.6)
Intragovernmental Net Costs	$ (214.0)	$ (497.7)	$ 283.7
Gross Costs With the Public	8,658.7	0.0	8,658.7
(Less: Earned Revenue From the Public)	(368.0)	0.0	(368.0)
Net Costs With the Public	$ 8,290.7	$ 0.0	$ 8,290.7
Total Net Cost	$ 8,076.7	$ (497.7)	$ 8,574.4
H. Working Capital Funds			
Intragovernmental Gross Costs	$ 17,367.4	$ 13,986.5	$ 3,380.9
(Less: Intragovernmental Earned Revenue)	(77,690.1)	(76,350.8)	(1,339.3)
Intragovernmental Net Costs	$ (60,322.7)	$ (62,364.3)	$ 2,041.6
Gross Costs With the Public	74,938.5	0.0	74,938.5
(Less: Earned Revenue From the Public)	(13,788.4)	0.0	(13,788.4)
Net Costs With the Public	$ 61,150.1	$ 0.0	$ 61,150.1
Total Net Cost	$ 827.4	$ (62,364.3)	$ 63,191.7
I. Other			
Intragovernmental Gross Costs	$ 83,782.3	$ 129,900.5	$ (46,118.2)
(Less: Intragovernmental Earned Revenue)	17,284.5	(14,854.2)	32,138.7
Intragovernmental Net Costs	$ 101,066.8	$ 115,046.3	$ (13,979.5)
Gross Costs With the Public	(46,772.3)	0.0	(46,772.3)
(Less: Earned Revenue From the Public)	(5,026.3)	0.0	(5,026.3)
Net Costs With the Public	$ (51,798.6)	$ 0.0	$ (51,798.6)
Total Net Cost	$ 49,268.2	$ 115,046.3	$ (65,778.1)

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2003 Consolidated
G. Civil Works	
Intragovernmental Gross Costs	$ 760.9
(Less: Intragovernmental Earned Revenue)	(481.1)
Intragovernmental Net Costs	$ 279.8
Gross Costs With the Public	9,467.0
(Less: Earned Revenue From the Public)	(298.6)
Net Costs With the Public	$ 9,168.4
Total Net Cost	$ 9,448.2
H. Working Capital Funds	
Intragovernmental Gross Costs	$ 3,160.4
(Less: Intragovernmental Earned Revenue)	(1,075.6)
Intragovernmental Net Costs	$ 2,084.7
Gross Costs With the Public	71,205.9
(Less: Earned Revenue From the Public)	(7,632.6)
Net Costs With the Public	$ 63,573.3
Total Net Cost	$ 65,658.0
I. Other	
Intragovernmental Gross Costs	$ (74,510.2)
(Less: Intragovernmental Earned Revenue)	23,958.7
Intragovernmental Net Costs	$ (50,551.5)
Gross Costs With the Public	(10,774.6)
(Less: Earned Revenue From the Public)	(558.7)
Net Costs With the Public	$ (11,333.3)
Total Net Cost	$ (61,884.8)

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Army General Fund	Navy General Fund	Air Force General Fund
J. Total Program Costs			
Intragovernmental Gross Costs	$ 35,460.1	$ 39,171.8	$ 28,910.0
(Less: Intragovernmental Earned Revenue)	(7,388.4)	(3,272.8)	(5,002.2)
Intragovernmental Net Costs	$ 28,071.7	$ 35,899.0	$ 23,907.8
Gross Costs With the Public	108,861.8	96,846.4	96,506.0
(Less: Earned Revenue From the Public)	(1,152.1)	(3,302.7)	(1,724.5)
Net Costs With the Public	$ 107,709.7	$ 93,543.7	$ 94,781.5
Total Net Cost	$ 135,781.4	$ 129,442.7	$ 118,689.3
Cost Not Assigned to Programs	0.0	0.0	0.0
(Less:Earned Revenue Not Attributable to Programs)	0.0	0.0	0.0
Net Cost of Operations	$ 135,781.4	$ 129,442.7	$ 118,689.3

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
J. Total Program Costs			
Intragovernmental Gross Costs	$ 2,848.0	$ 5,435.0	$ 5,399.8
(Less: Intragovernmental Earned Revenue)	(8,456.1)	(21,698.9)	(11,888.5)
Intragovernmental Net Costs	$ (5,608.1)	$ (16,263.9)	$ (6,488.7)
Gross Costs With the Public	8,161.3	17,915.6	8,674.8
(Less: Earned Revenue From the Public)	(4,951.1)	(613.5)	(891.4)
Net Costs With the Public	$ 3,210.2	$ 17,302.1	$ 7,783.4
Total Net Cost	$ (2,397.9)	$ 1,038.2	$ 1,294.7
Cost Not Assigned to Programs	0.0	0.0	0.0
(Less:Earned Revenue Not Attributable to Programs)	0.0	0.0	0.0
Net Cost of Operations	$ (2,397.9)	$ 1,038.2	$ 1,294.7

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
J. Total Program Costs			
Intragovernmental Gross Costs	$ 0.0	$ 1,020.8	$ 49,706.8
(Less: Intragovernmental Earned Revenue)	(42,384.5)	(1,234.8)	(2,556.9)
Intragovernmental Net Costs	$ (42,384.5)	$ (214.0)	$ 47,149.9
Gross Costs With the Public	135,662.9	8,658.7	68,965.8
(Less: Earned Revenue From the Public)	0.0	(368.0)	(2,018.7)
Net Costs With the Public	$ 135,662.9	$ 8,290.7	$ 66,947.1
Total Net Cost	$ 93,278.4	$ 8,076.7	$ 114,097.0
Cost Not Assigned to Programs	0.0	0.0	0.0
(Less:Earned Revenue Not Attributable to Programs)	0.0	0.0	0.0
Net Cost of Operations	$ 93,278.4	$ 8,076.7	$ 114,097.0

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Other Defense Organizations Working Capital Funds	DoD Medicare-Eligible Retiree Health Care Fund	Combined Total
J. Total Program Costs			
Intragovernmental Gross Costs	$ 3,684.6	$ 1,380.7	$ 173,017.6
(Less: Intragovernmental Earned Revenue)	(35,646.6)	(25,342.4)	(164,872.1)
Intragovernmental Net Costs	$ (31,962.0)	$ (23,961.7)	$ 8,145.5
Gross Costs With the Public	40,186.8	29,133.7	619,573.8
(Less: Earned Revenue From the Public)	(7,332.4)	0.0	(22,354.4)
Net Costs With the Public	$ 32,854.4	$ 29,133.7	$ 597,219.4
Total Net Cost	$ 892.4	$ 5,172.0	$ 605,364.9
Cost Not Assigned to Programs	0.0	0.0	0.0
(Less:Earned Revenue Not Attributable to Programs)	0.0	0.0	0.0
Net Cost of Operations	$ 892.4	$ 5,172.0	$ 605,364.9

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Elimination	2004 Consolidated	2003 Consolidated
J. Total Program Costs			
Intragovernmental Gross Costs	$ 149,443.1	$ 23,574.5	$ 11,748.3
(Less: Intragovernmental Earned Revenue)	(149,443.1)	(15,429.0)	(13,239.0)
Intragovernmental Net Costs	$ 0.0	$ 8,145.5	$ (1,490.7)
Gross Costs With the Public	0.0	619,573.8	526,288.4
(Less: Earned Revenue From the Public)	0.0	(22,354.4)	(12,507.1)
Net Costs With the Public	$ 0.0	$ 597,219.4	$ 513,781.3
Total Net Cost	$ 0.0	$ 605,364.9	$ 512,290.6
Cost Not Assigned to Programs	0.0	0.0	0.0
(Less:Earned Revenue Not Attributable to Programs)	0.0	0.0	0.0
Net Cost of Operations	$ 0.0	$ 605,364.9	$ 512,290.6

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Army General Fund	Navy General Fund	Air Force General Fund
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 100,631.6	$ 222,565.2	$ 161,327.7
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0.0	(25,913.7)	0.0
Beginning Balance, Restated	100,631.6	196,651.5	161,327.7
Prior Period Adjustments - Not Restated (+/-)	0.0	0.0	0.0
Beginning Balances, as adjusted	100,631.6	196,651.5	161,327.7
Budgetary Financing Sources:			
Appropriations received	0.0	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	127,335.1	120,198.1	124,687.0
Nonexchange revenue	5.1	0.0	8.8
Donations and forfeitures of cash and cash equivalents	4.7	0.0	2.2
Transfers-in/out without reimbursement (+/-)	13,189.6	166.0	671.0
Other budgetary financing sources (+/-)	2,540.4	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	400.8	11.9	311.1
Imputed financing from costs absorbed by others	882.1	585.2	663.6
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	144,357.8	120,961.2	126,343.7
Net Cost of Operations (+/-)	135,781.4	129,442.7	118,689.3
Ending Balances	$ 109,208.0	$ 188,170.0	$ 168,982.1
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 47,674.7	$ 50,781.2	$ 50,742.3
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0.0	25,913.7	0.0
Beginning Balance, Restated	47,674.7	76,694.9	50,742.3
Prior Period Adjustments - Not Restated (+/-)	0.0	0.0	0.0
Beginning Balances, as adjusted	47,674.7	76,694.9	50,742.3
Budgetary Financing Sources:			
Appropriations received	149,547.7	123,918.0	125,480.7
Appropriations transferred-in/out (+/-)	4,745.3	455.1	(454.5)
Other adjustments (rescissions, etc) (+/-)	(1,394.4)	(1,708.0)	(1,420.9)
Appropriations used	(127,335.1)	(120,198.1)	(124,687.0)
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0	0.0
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	25,563.5	2,467.0	(1,081.7)
Net Cost of Operations (+/-)			
Ending Balances	$ 73,238.2	$ 79,161.9	$ 49,660.6

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	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 13,883.7	$ 18,136.8	$ 11,537.1
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0.0	(1,044.7)	11,370.5
Beginning Balance, Restated	13,883.7	17,092.1	22,907.6
Prior Period Adjustments - Not Restated (+/-)	0.0	0.0	699.4
Beginning Balances, as adjusted	13,883.7	17,092.1	23,607.0
Budgetary Financing Sources:			
Appropriations received	0.0	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	231.2	130.4	0.0
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	(1,448.6)	(287.8)	(580.9)
Other budgetary financing sources (+/-)	175.9	(419.8)	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.1	0.0
Imputed financing from costs absorbed by others	130.8	544.9	159.0
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	(910.7)	(32.2)	(421.9)
Net Cost of Operations (+/-)	(2,397.9)	1,038.2	1,294.7
Ending Balances	$ 15,370.9	$ 16,021.7	$ 21,890.4
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 12.0	$ 0.0	$ 0.0
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0.0	0.0	0.0
Beginning Balance, Restated	12.0	0.0	0.0
Prior Period Adjustments - Not Restated (+/-)	0.0	0.0	0.0
Beginning Balances, as adjusted	12.0	0.0	0.0
Budgetary Financing Sources:			
Appropriations received	219.3	130.4	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	(231.2)	(130.4)	0.0
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0	0.0
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	(11.9)	0.0	0.0
Net Cost of Operations (+/-)			
Ending Balances	$ 0.1	$ 0.0	$ 0.0

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	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ (556,416.7)	$ 34,289.5	$ (186,977.2)
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0.0	0.0	(0.1)
Beginning Balance, Restated	(556,416.7)	34,289.5	(186,977.3)
Prior Period Adjustments - Not Restated (+/-)	0.0	0.0	0.1
Beginning Balances, as adjusted	(556,416.7)	34,289.5	(186,977.2)
Budgetary Financing Sources:			
Appropriations received	0.0	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	0.0	4,079.0	99,256.5
Nonexchange revenue	0.0	1,434.5	0.1
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.1
Transfers-in/out without reimbursement (+/-)	0.0	315.0	6.1
Other budgetary financing sources (+/-)	0.0	(3.9)	2,100.4
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.4	0.0
Transfers-in/out without reimbursement (+/-)	0.0	(1.6)	(726.0)
Imputed financing from costs absorbed by others	0.0	239.5	583.3
Other (+/-)	0.0	0.6	0.0
Total Financing Sources	0.0	6,063.5	101,220.5
Net Cost of Operations (+/-)	93,278.4	8,076.7	114,097.0
Ending Balances	$ (649,695.1)	$ 32,276.3	$ (199,853.7)
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 0.0	$ 636.8	$ 43,245.7
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0.0	0.0	0.0
Beginning Balance, Restated	0.0	636.8	43,245.7
Prior Period Adjustments - Not Restated (+/-)	0.0	0.0	0.0
Beginning Balances, as adjusted	0.0	636.8	43,245.7
Budgetary Financing Sources:			
Appropriations received	0.0	3,854.1	105,674.5
Appropriations transferred-in/out (+/-)	0.0	18.4	(4,278.7)
Other adjustments (rescissions, etc) (+/-)	0.0	(33.9)	(4,557.4)
Appropriations used	0.0	(4,079.0)	(99,256.5)
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0	0.0
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	0.0	(240.4)	(2,418.1)
Net Cost of Operations (+/-)			
Ending Balances	$ 0.0	$ 396.4	$ 40,827.6

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	Other Defense Organizations Working Capital Funds	DoD Medicare-Eligible Retiree Health Care Fund	Combined Total
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 17,492.5	$ (458,080.9)	$ (621,610.7)
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0.0	0.0	(15,588.0)
Beginning Balance, Restated	17,492.5	(458,080.9)	(637,198.7)
Prior Period Adjustments - Not Restated (+/-)	0.0	0.0	699.5
Beginning Balances, as adjusted	17,492.5	(458,080.9)	(636,499.2)
Budgetary Financing Sources:			
Appropriations received	0.0	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	2,703.7	0.0	478,621.1
Nonexchange revenue	21.2	0.0	1,469.7
Donations and forfeitures of cash and cash equivalents	0.0	0.0	7.0
Transfers-in/out without reimbursement (+/-)	(1,461.8)	0.0	10,568.6
Other budgetary financing sources (+/-)	118.5	0.0	4,511.5
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.4
Transfers-in/out without reimbursement (+/-)	(1.6)	(2,843.3)	(2,848.6)
Imputed financing from costs absorbed by others	304.1	0.0	4,092.5
Other (+/-)	0.0	0.0	0.6
Total Financing Sources	1,684.1	(2,843.3)	496,422.8
Net Cost of Operations (+/-)	892.4	5,172.0	605,364.9
Ending Balances	$ 18,284.2	$ (466,096.2)	$ (745,441.3)
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ (136.9)	$ 0.0	$ 192,955.8
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0.0	0.0	25,913.7
Beginning Balance, Restated	(136.9)	0.0	218,869.5
Prior Period Adjustments - Not Restated (+/-)	0.0	0.0	0.0
Beginning Balances, as adjusted	(136.9)	0.0	218,869.5
Budgetary Financing Sources:			
Appropriations received	3,369.8	0.0	512,194.5
Appropriations transferred-in/out (+/-)	0.0	0.0	485.6
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	(9,114.6)
Appropriations used	(2,703.7)	0.0	(478,621.1)
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0	0.0
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	666.1	0.0	24,944.4
Net Cost of Operations (+/-)			
Ending Balances	$ 529.2	$ 0.0	$ 243,813.9

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	Elimination	2004 Consolidated	2003 Consolidated
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 0.0	$ (621,610.7)	$ (946,947.7)
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0.0	(15,588.0)	10,534.8
Beginning Balance, Restated	0.0	(637,198.7)	(936,412.9)
Prior Period Adjustments - Not Restated (+/-)	0.0	699.5	383,074.9
Beginning Balances, as adjusted	0.0	(636,499.2)	(553,338.0)
Budgetary Financing Sources:			
Appropriations received	0.0	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	(13.0)
Appropriations used	0.0	478,621.1	431,548.0
Nonexchange revenue	0.0	1,469.7	931.2
Donations and forfeitures of cash and cash equivalents	0.0	7.0	24.4
Transfers-in/out without reimbursement (+/-)	0.0	10,568.6	1,329.2
Other budgetary financing sources (+/-)	0.0	4,511.5	(2,867.4)
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.4	4.6
Transfers-in/out without reimbursement (+/-)	0.0	(2,848.6)	(6,702.1)
Imputed financing from costs absorbed by others	0.0	4,092.5	3,866.9
Other (+/-)	0.0	0.6	308.1
Total Financing Sources	0.0	496,422.8	428,429.9
Net Cost of Operations (+/-)	0.0	605,364.9	512,290.6
Ending Balances	$ 0.0	$ (745,441.3)	$ (637,198.7)
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 0.0	$ 192,955.8	$ 177,282.6
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0.0	25,913.7	0.0
Beginning Balance, Restated	0.0	218,869.5	177,282.6
Prior Period Adjustments - Not Restated (+/-)	0.0	0.0	0.0
Beginning Balances, as adjusted	0.0	218,869.5	177,282.6
Budgetary Financing Sources:			
Appropriations received	0.0	512,194.5	477,036.7
Appropriations transferred-in/out (+/-)	0.0	485.6	1,217.8
Other adjustments (rescissions, etc) (+/-)	0.0	(9,114.6)	(5,137.1)
Appropriations used	0.0	(478,621.1)	(431,530.5)
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0	0.0
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	0.0	24,944.4	41,586.9
Net Cost of Operations (+/-)			
Ending Balances	$ 0.0	$ 243,813.9	$ 218,869.5

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COMBINING STATEMENT OF BUDGETARY RESOURCES
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	Army General Fund	Navy General Fund	Air Force General Fund
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 149,559.9	$ 123,948.5	$ 125,483.8
Borrowing authority	0.0	0.0	0.0
Contract authority	0.0	0.0	0.0
Net transfers (+/-)	2,517.1	425.1	(29.4)
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	8,212.9	14,695.1	9,190.0
Net transfers, actual (+/-)	4,698.3	196.0	245.9
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	18,740.0	7,706.7	8,117.6
Receivable from Federal sources	412.7	(360.3)	317.6
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	306.6	56.0	188.1
Without advance from Federal sources	1,896.9	467.5	(110.0)
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	21,356.2	7,869.9	8,513.3
Recoveries of prior year obligations	13,996.7	13,757.0	1,431.1
Temporarily not available pursuant to Public Law	0.0	0.0	0.0
Permanently not available	(1,394.4)	(1,708.8)	(1,437.7)
Total Budgetary Resources	$ 198,946.7	$ 159,182.8	$ 143,397.0
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 152,590.9	$ 132,268.5	$ 129,913.3
Reimbursable	23,475.0	8,886.3	4,447.4
Subtotal	176,065.9	141,154.8	134,360.7
Unobligated balance:			
Apportioned	21,458.6	13,973.1	8,072.6
Exempt from apportionment	13.4	0.0	2.7
Other available	0.1	0.0	0.0
Unobligated Balances Not Available	1,408.7	4,054.9	961.0
Total, Status of Budgetary Resources	$ 198,946.7	$ 159,182.8	$ 143,397.0
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ 46,482.9	$ 63,520.9	$ 50,541.6
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	(1,893.4)	(537.6)	(1,476.6)
Unfilled customer order from Federal sources	(12,713.2)	(2,803.0)	(827.4)
Undelivered orders	56,509.6	63,723.8	42,309.8
Accounts payable	15,119.4	3,473.0	11,505.4
Outlays:			
Disbursements	149,220.1	126,955.3	131,752.4
Collections	(19,046.6)	(7,762.7)	(8,305.7)
Subtotal	130,173.5	119,192.6	123,446.7
Less: Offsetting receipts	(63.3)	(115.0)	(115.4)
Net Outlays	$ 130,110.2	$ 119,077.6	$ 123,331.3

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	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 219.3	$ 130.4	$ 0.0
Borrowing authority	0.0	0.0	0.0
Contract authority	2,106.4	355.2	684.4
Net transfers (+/-)	(1,448.6)	0.0	0.0
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	2,093.6	4,513.4	607.1
Net transfers, actual (+/-)	0.0	(287.8)	(580.9)
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	12,265.9	23,926.8	17,824.8
Receivable from Federal sources	(53.8)	249.3	(186.4)
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	(17.2)	90.1	(173.2)
Without advance from Federal sources	(128.9)	(1,724.7)	(733.9)
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	12,066.0	22,541.5	16,731.3
Recoveries of prior year obligations	499.7	0.0	3.2
Temporarily not available pursuant to Public Law	0.0	0.0	0.0
Permanently not available	0.0	(186.5)	(36.7)
Total Budgetary Resources	$ 15,536.4	$ 27,066.2	$ 17,408.4
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 0.0	$ 0.0	$ 2.0
Reimbursable	14,006.2	24,316.4	17,271.9
Subtotal	14,006.2	24,316.4	17,273.9
Unobligated balance:			
Apportioned	1,530.2	2,650.8	134.4
Exempt from apportionment	0.0	0.0	0.0
Other available	0.0	0.1	0.1
Unobligated Balances Not Available	0.0	98.9	0.0
Total, Status of Budgetary Resources	$ 15,536.4	$ 27,066.2	$ 17,408.4
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ 1,898.3	$ 3,274.1	$ 3,317.3
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	(462.6)	(590.4)	(958.8)
Unfilled customer order from Federal sources	(4,522.7)	(7,031.5)	(3,265.5)
Undelivered orders	8,334.7	6,892.1	6,610.2
Accounts payable	618.7	4,968.6	2,370.0
Outlays:			
Disbursements	11,619.4	24,827.2	16,752.4
Collections	(12,248.6)	(24,016.9)	(17,651.6)
Subtotal	(629.2)	810.3	(899.2)
Less: Offsetting receipts	0.0	0.0	0.0
Net Outlays	$ (629.2)	$ 810.3	$ (899.2)

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	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 42,256.8	$ 5,141.2	$ 106,800.7
Borrowing authority	0.0	0.1	0.0
Contract authority	0.0	0.0	496.5
Net transfers (+/-)	0.0	206.9	(2,190.4)
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	176,029.0	1,850.2	17,664.3
Net transfers, actual (+/-)	0.0	28.5	(2,062.8)
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	0.0	5,212.1	4,494.0
Receivable from Federal sources	0.0	64.1	233.6
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	0.0	29.7	17.7
Without advance from Federal sources	0.0	272.6	404.5
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	0.0	5,578.5	5,149.8
Recoveries of prior year obligations	0.0	0.0	3,941.1
Temporarily not available pursuant to Public Law	0.0	(10.0)	0.0
Permanently not available	0.0	(29.1)	(4,567.6)
Total Budgetary Resources	$ 218,285.8	$ 12,766.3	$ 125,231.6
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 37,152.6	$ 5,615.2	$ 104,208.3
Reimbursable	0.0	5,457.8	3,992.4
Subtotal	37,152.6	11,073.0	108,200.7
Unobligated balance:			
Apportioned	0.0	1,234.1	8,403.6
Exempt from apportionment	181,133.1	459.1	1,716.7
Other available	0.1	0.0	(0.1)
Unobligated Balances Not Available	0.0	0.1	6,910.7
Total, Status of Budgetary Resources	$ 218,285.8	$ 12,766.3	$ 125,231.6
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ 2,963.0	$ 1,007.6	$ 32,302.0
Obligated Balance transferred, net (+/-)	0.0	0.0	(14.1)
Obligated Balance, Net - end of period:			
Accounts receivable	0.0	(224.7)	(1,066.7)
Unfilled customer order from Federal sources	0.0	(1,907.8)	(1,367.2)
Undelivered orders	0.0	2,022.9	29,705.5
Accounts payable	3,120.2	1,148.3	5,149.6
Outlays:			
Disbursements	36,995.4	10,705.3	103,488.0
Collections	0.0	(5,241.7)	(4,511.8)
Subtotal	36,995.4	5,463.6	98,976.2
Less: Offsetting receipts	(18,189.0)	(1,592.3)	(1,129.0)
Net Outlays	$ 18,806.4	$ 3,871.3	$ 97,847.2

Department of Defense
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COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Other Defense Organizations Working Capital Funds	DoD Medicare-Eligible Retiree Health Care Fund	2004 Combined
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 3,369.8	$ 25,100.3	$ 582,010.7
Borrowing authority	0.0	0.0	0.1
Contract authority	31,213.3	0.0	34,855.8
Net transfers (+/-)	0.0	0.0	(519.3)
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	3,621.0	18,182.4	256,659.0
Net transfers, actual (+/-)	(1,455.2)	0.0	782.0
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	47,986.4	0.0	146,274.3
Receivable from Federal sources	(756.5)	0.0	(79.7)
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	(137.3)	0.0	360.5
Without advance from Federal sources	636.0	0.0	980.0
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	47,728.6	0.0	147,535.1
Recoveries of prior year obligations	53.1	0.0	33,681.9
Temporarily not available pursuant to Public Law	0.0	0.0	(10.0)
Permanently not available	(30,977.2)	0.0	(40,338.0)
Total Budgetary Resources	$ 53,553.4	$ 43,282.7	$ 1,014,657.3
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 1,106.1	$ 5,196.8	$ 568,053.7
Reimbursable	50,805.5	0.0	152,658.9
Subtotal	51,911.6	5,196.8	720,712.6
Unobligated balance:			
Apportioned	967.0	206.6	58,631.0
Exempt from apportionment	163.1	0.0	183,488.1
Other available	0.0	0.0	0.3
Unobligated Balances Not Available	511.7	37,879.3	51,825.3
Total, Status of Budgetary Resources	$ 53,553.4	$ 43,282.7	$ 1,014,657.3
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ 8,796.4	$ 267.8	$ 214,371.9
Obligated Balance transferred, net (+/-)	0.0	0.0	(14.1)
Obligated Balance, Net - end of period:			
Accounts receivable	(2,926.0)	0.0	(10,136.8)
Unfilled customer order from Federal sources	(4,963.7)	0.0	(39,402.0)
Undelivered orders	12,559.9	132.8	228,801.3
Accounts payable	5,868.2	129.2	53,470.6
Outlays:			
Disbursements	50,237.1	5,202.5	667,755.1
Collections	(47,849.1)	0.0	(146,634.7)
Subtotal	2,388.0	5,202.5	521,120.4
Less: Offsetting receipts	0.0	(25,342.4)	(46,546.4)
Net Outlays	$ 2,388.0	$ (20,139.9)	$ 474,574.0

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($ in Millions)

		2003 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$	546,761.4
Borrowing authority		0.0
Contract authority		28,109.0
Net transfers (+/-)		1,000.3
Other		0.0
Unobligated balance:		
Beginning of period		217,722.3
Net transfers, actual (+/-)		204.3
Anticipated Transfers Balances		0.0
Spending authority from offsetting collections:		
Earned		0.0
Collected		135,587.2
Receivable from Federal sources		(714.6)
Change in unfilled customer orders		0.0
Advance received		(30.6)
Without advance from Federal sources		11,000.9
Anticipated for the rest of year, without advances		0.0
Transfers from trust funds		0.0
Subtotal		145,842.9
Recoveries of prior year obligations		22,841.9
Temporarily not available pursuant to Public Law		0.0
Permanently not available		(33,730.4)
Total Budgetary Resources	$	928,751.7
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$	522,562.4
Reimbursable		147,147.8
Subtotal		669,710.2
Unobligated balance:		
Apportioned		55,052.0
Exempt from apportionment		180,704.3
Other available		(0.1)
Unobligated Balances Not Available		23,285.3
Total, Status of Budgetary Resources	$	928,751.7
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	$	181,919.4
Obligated Balance transferred, net (+/-)		(23.9)
Obligated Balance, Net - end of period:		
Accounts receivable		(10,216.4)
Unfilled customer order from Federal sources		(38,422.1)
Undelivered orders		213,597.8
Accounts payable		49,412.6
Outlays:		
Disbursements		604,105.8
Collections		(135,556.8)
Subtotal		468,549.0
Less: Offsetting receipts		(43,294.0)
Net Outlays	$	425,255.0

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	Army General Fund	Navy General Fund	Air Force General Fund
NONBUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 0.0	$ 0.0	$ 0.0
Borrowing authority	0.0	0.0	0.0
Contract authority	0.0	0.0	0.0
Net transfers (+/-)	0.0	0.0	0.0
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	1.2	0.0	0.0
Net transfers, actual (+/-)	0.0	0.0	0.0
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	0.2	0.0	0.0
Receivable from Federal sources	0.0	0.0	0.0
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	0.0	0.0	0.0
Without advance from Federal sources	0.0	0.0	0.0
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	0.2	0.0	0.0
Recoveries of prior year obligations	0.0	0.0	0.0
Temporarily not available pursuant to Public Law	0.0	0.0	0.0
Permanently not available	0.0	0.0	0.0
Total Budgetary Resources	$ 1.4	$ 0.0	$ 0.0
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 0.0	$ 0.0	$ 0.0
Reimbursable	0.0	0.0	0.0
Subtotal	0.0	0.0	0.0
Unobligated balance:			
Apportioned	1.4	0.0	0.0
Exempt from apportionment	0.0	0.0	0.0
Other available	0.0	0.0	0.0
Unobligated Balances Not Available	0.0	0.0	0.0
Total, Status of Budgetary Resources	$ 1.4	$ 0.0	$ 0.0
Relationship of Obligations to Outlays:			
Obligated Balance, Net ? beginning of period	$ 0.0	$ 0.0	$ 0.0
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	0.0	0.0	0.0
Unfilled customer order from Federal sources	0.0	0.0	0.0
Undelivered orders	0.0	0.0	0.0
Accounts payable	0.0	0.0	0.0
Outlays:			
Disbursements	0.0	0.0	0.0
Collections	(0.2)	0.0	0.0
Subtotal	(0.2)	0.0	0.0
Less: Offsetting receipts	0.0	0.0	0.0
Net Outlays	$ (0.2)	$ 0.0	$ 0.0

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	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
NONBUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 0.0	$ 0.0	$ 0.0
Borrowing authority	0.0	0.0	0.0
Contract authority	0.0	0.0	0.0
Net transfers (+/-)	0.0	0.0	0.0
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	0.0	0.0	0.0
Net transfers, actual (+/-)	0.0	0.0	0.0
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	0.0	0.0	0.0
Receivable from Federal sources	0.0	0.0	0.0
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	0.0	0.0	0.0
Without advance from Federal sources	0.0	0.0	0.0
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	0.0	0.0	0.0
Recoveries of prior year obligations	0.0	0.0	0.0
Temporarily not available pursuant to Public Law	0.0	0.0	0.0
Permanently not available	0.0	0.0	0.0
Total Budgetary Resources	$ 0.0	$ 0.0	$ 0.0
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 0.0	$ 0.0	$ 0.0
Reimbursable	0.0	0.0	0.0
Subtotal	0.0	0.0	0.0
Unobligated balance:			
Apportioned	0.0	0.0	0.0
Exempt from apportionment	0.0	0.0	0.0
Other available	0.0	0.0	0.0
Unobligated Balances Not Available	0.0	0.0	0.0
Total, Status of Budgetary Resources	$ 0.0	$ 0.0	$ 0.0
Relationship of Obligations to Outlays:			
Obligated Balance, Net ? beginning of period	$ 0.0	$ 0.0	$ 0.0
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	0.0	0.0	0.0
Unfilled customer order from Federal sources	0.0	0.0	0.0
Undelivered orders	0.0	0.0	0.0
Accounts payable	0.0	0.0	0.0
Outlays:			
Disbursements	0.0	0.0	0.0
Collections	0.0	0.0	0.0
Subtotal	0.0	0.0	0.0
Less: Offsetting receipts	0.0	0.0	0.0
Net Outlays	$ 0.0	$ 0.0	$ 0.0

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	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
NONBUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 0.0	$ 0.0	$ 0.0
Borrowing authority	0.0	0.0	114.6
Contract authority	0.0	0.0	0.0
Net transfers (+/-)	0.0	0.0	0.0
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	0.0	0.0	20.6
Net transfers, actual (+/-)	0.0	0.0	0.0
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	0.0	0.0	17.2
Receivable from Federal sources	0.0	0.0	(0.6)
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	0.0	0.0	0.0
Without advance from Federal sources	0.0	0.0	47.2
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	0.0	0.0	63.8
Recoveries of prior year obligations	0.0	0.0	0.0
Temporarily not available pursuant to Public Law	0.0	0.0	0.0
Permanently not available	0.0	0.0	20.7
Total Budgetary Resources	$ 0.0	$ 0.0	$ 219.7
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 0.0	$ 0.0	$ 196.6
Reimbursable	0.0	0.0	0.0
Subtotal	0.0	0.0	196.6
Unobligated balance:			
Apportioned	0.0	0.0	0.0
Exempt from apportionment	0.0	0.0	0.0
Other available	0.0	0.0	0.0
Unobligated Balances Not Available	0.0	0.0	23.1
Total, Status of Budgetary Resources	$ 0.0	$ 0.0	$ 219.7
Relationship of Obligations to Outlays:			
Obligated Balance, Net ? beginning of period	$ 0.0	$ 0.0	$ 29.9
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	0.0	0.0	0.0
Unfilled customer order from Federal sources	0.0	0.0	(83.1)
Undelivered orders	0.0	0.0	238.8
Accounts payable	0.0	0.0	0.0
Outlays:			
Disbursements	0.0	0.0	24.1
Collections	0.0	0.0	(17.2)
Subtotal	0.0	0.0	6.9
Less: Offsetting receipts	0.0	0.0	0.0
Net Outlays	$ 0.0	$ 0.0	$ 6.9

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COMBINING STATEMENT OF BUDGETARY RESOURCES
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	Other Defense Organizations Working Capital Funds	DoD Medicare-Eligible Retiree Health Care Fund	2004 Combined
NONBUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 0.0	$ 0.0	$ 0.0
Borrowing authority	0.0	0.0	114.6
Contract authority	0.0	0.0	0.0
Net transfers (+/-)	0.0	0.0	0.0
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	0.0	0.0	21.8
Net transfers, actual (+/-)	0.0	0.0	0.0
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	0.0	0.0	17.4
Receivable from Federal sources	0.0	0.0	(0.6)
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	0.0	0.0	0.0
Without advance from Federal sources	0.0	0.0	47.2
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	0.0	0.0	64.0
Recoveries of prior year obligations	0.0	0.0	0.0
Temporarily not available pursuant to Public Law	0.0	0.0	0.0
Permanently not available	0.0	0.0	20.7
Total Budgetary Resources	$ 0.0	$ 0.0	$ 221.1
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 0.0	$ 0.0	$ 196.6
Reimbursable	0.0	0.0	0.0
Subtotal	0.0	0.0	196.6
Unobligated balance:			
Apportioned	0.0	0.0	1.4
Exempt from apportionment	0.0	0.0	0.0
Other available	0.0	0.0	0.0
Unobligated Balances Not Available	0.0	0.0	23.1
Total, Status of Budgetary Resources	$ 0.0	$ 0.0	$ 221.1
Relationship of Obligations to Outlays:			
Obligated Balance, Net ? beginning of period	$ 0.0	$ 0.0	$ 29.9
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	0.0	0.0	0.0
Unfilled customer order from Federal sources	0.0	0.0	(83.1)
Undelivered orders	0.0	0.0	238.8
Accounts payable	0.0	0.0	0.0
Outlays:			
Disbursements	0.0	0.0	24.1
Collections	0.0	0.0	(17.4)
Subtotal	0.0	0.0	6.7
Less: Offsetting receipts	0.0	0.0	0.0
Net Outlays	$ 0.0	$ 0.0	$ 6.7

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For the periods ended September 30, 2004 and 2003
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		2003 Combined
NONBUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$	0.0
Borrowing authority		50.5
Contract authority		0.0
Net transfers (+/-)		0.0
Other		0.0
Unobligated balance:		
Beginning of period		104.0
Net transfers, actual (+/-)		0.0
Anticipated Transfers Balances		0.0
Spending authority from offsetting collections:		
Earned		0.0
Collected		56.2
Receivable from Federal sources		(90.0)
Change in unfilled customer orders		0.0
Advance received		0.0
Without advance from Federal sources		35.8
Anticipated for the rest of year, without advances		0.0
Transfers from trust funds		0.0
Subtotal		2.0
Recoveries of prior year obligations		1.9
Temporarily not available pursuant to Public Law		0.0
Permanently not available		(0.2)
Total Budgetary Resources	$	158.2
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$	136.4
Reimbursable		0.0
Subtotal		136.4
Unobligated balance:		
Apportioned		1.3
Exempt from apportionment		0.0
Other available		(0.1)
Unobligated Balances Not Available		20.6
Total, Status of Budgetary Resources	$	158.2
Relationship of Obligations to Outlays:		
Obligated Balance, Net ? beginning of period	$	(95.1)
Obligated Balance transferred, net (+/-)		0.0
Obligated Balance, Net - end of period:		
Accounts receivable		(0.6)
Unfilled customer order from Federal sources		(35.8)
Undelivered orders		66.3
Accounts payable		0.0
Outlays:		
Disbursements		63.6
Collections		(56.2)
Subtotal		7.4
Less: Offsetting receipts		0.0
Net Outlays	$	7.4

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COMBINING STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
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	Army General Fund	Navy General Fund	Air Force General Fund
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations incurred	$ 176,066.0	$ 141,154.9	$ 134,360.7
Less: Spending authority from offsetting collections and recoveries (-)	(35,353.0)	(21,626.9)	(9,944.3)
Obligations net of offsetting collections and recoveries	140,713.0	119,528.0	124,416.4
Less: Offsetting receipts (-)	(63.3)	(115.0)	(115.4)
Net obligations	140,649.7	119,413.0	124,301.0
Other Resources			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers in/out without reimbursement (+/-)	400.8	11.9	311.1
Imputed financing from costs absorbed by others	882.1	585.2	663.6
Other (+/-)	0.0	0.0	0.0
Net other resources used to finance activities	1,282.9	597.1	974.7
Total resources used to finance activities	141,932.6	120,010.1	125,275.7
Resources Used to Finance Items not Part of the Net Cost of Operations			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered Orders (-)	(12,185.1)	1,796.2	201.3
Unfilled Customer Orders	2,203.4	523.5	78.1
Resources that fund expenses recognized in prior periods	(870.8)	(115.1)	(896.1)
Budgetary offsetting collections and receipts that do not affect net cost of operations	63.4	0.0	115.4
Resources that finance the acquisition of assets	(9,901.0)	(12,412.2)	(16,068.4)
Other resources or adjustments to net obligated resources that do not affect net cost of operations			
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0.0	0.0	0.0
Other (+/-)	(400.8)	(11.9)	(311.1)
Total resources used to finance items not part of the net cost of operations	(21,090.9)	(10,219.5)	(16,880.8)
Total resources used to finance the net cost of operations	120,841.7	109,790.6	108,394.9
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:			
Components Requiring or Generating Resources in Future Period:			
Increase in annual leave liability	95.3	188.3	137.7
Increase in environmental and disposal liability	3,103.7	427.5	0.0
Upward/Downward reestimates of credit subsidy expense (+/-)	10.9	0.0	0.0
Increase in exchange revenue receivable from the the public (-)	0.0	0.0	0.0
Other (+/-)	63.6	193.2	53.2
Total components of Net Cost of Operations that will require or generate resources in future periods	3,273.5	809.0	190.9
Components not Requiring or Generating Resources:			
Depreciation and amortization	9,815.6	17,475.9	9,847.7
Revaluation of assets or liabilities (+/-)	515.0	1,114.0	(938.1)
Other (+/-)			
Trust Fund Exchange Revenue	0.0	(30.3)	0.0
Cost of Goods Sold	0.0	0.0	0.0
Operating Material & Supplies Used	0.0	271.0	3,919.0
Other	1,335.8	12.3	(2,725.1)
Total components of Net Cost of Operations that will not require or generate resources	11,666.4	18,842.9	10,103.5
Total components of net cost of operations that will not require or generate resources in the current period	14,939.9	19,651.9	10,294.4
Net Cost of Operations	135,781.6	129,442.5	118,689.3

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COMBINING STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
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	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations incurred	$ 14,006.2	$ 24,316.4	$ 17,274.0
Less: Spending authority from offsetting collections and recoveries (-)	(12,565.7)	(22,541.6)	(16,734.5)
Obligations net of offsetting collections and recoveries	1,440.5	1,774.8	539.5
Less: Offsetting receipts (-)	0.0	0.0	0.0
Net obligations	1,440.5	1,774.8	539.5
Other Resources			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers in/out without reimbursement (+/-)	0.0	0.1	0.0
Imputed financing from costs absorbed by others	130.8	544.9	159.0
Other (+/-)	0.0	0.0	0.0
Net other resources used to finance activities	130.8	545.0	159.0
Total resources used to finance activities	1,571.3	2,319.8	698.5
Resources Used to Finance Items not Part of the Net Cost of Operations			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered Orders (-)	(2,497.7)	1,142.5	(951.1)
Unfilled Customer Orders	(146.1)	(1,634.6)	(907.1)
Resources that fund expenses recognized in prior periods	(23.3)	(241.6)	(36.4)
Budgetary offsetting collections and receipts that do not affect net cost of operations	0.0	0.0	0.0
Resources that finance the acquisition of assets	(6,214.5)	(5,045.2)	(2,686.2)
Other resources or adjustments to net obligated resources that do not affect net cost of operations			
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0.0	0.0	0.0
Other (+/-)	6.9	(0.1)	0.0
Total resources used to finance items not part of the net cost of operations	(8,874.7)	(5,779.0)	(4,580.8)
Total resources used to finance the net cost of operations	(7,303.4)	(3,459.2)	(3,882.3)
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:			
Components Requiring or Generating Resources in Future Period:			
Increase in annual leave liability	1.4	0.0	0.0
Increase in environmental and disposal liability	0.0	0.0	0.0
Upward/Downward reestimates of credit subsidy expense (+/-)	0.0	0.0	0.0
Increase in exchange revenue receivable from the the public (-)	0.0	0.0	0.0
Other (+/-)	0.2	0.0	0.0
Total components of Net Cost of Operations that will require or generate resources in future periods	1.6	0.0	0.0
Components not Requiring or Generating Resources:			
Depreciation and amortization	82.9	255.2	259.3
Revaluation of assets or liabilities (+/-)	257.5	42.9	(5,660.4)
Other (+/-)			
Trust Fund Exchange Revenue	0.0	0.0	0.0
Cost of Goods Sold	5,003.8	4,160.7	5,866.5
Operating Material & Supplies Used	0.0	0.0	325.6
Other	(440.1)	38.4	4,386.0
Total components of Net Cost of Operations that will not require or generate resources	4,904.1	4,497.2	5,177.0
Total components of net cost of operations that will not require or generate resources in the current period	4,905.7	4,497.2	5,177.0
Net Cost of Operations	(2,397.7)	1,038.0	1,294.7

Department of Defense
Agency Wide
COMBINING STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations incurred	$ 37,152.6	$ 11,073.0	$ 108,397.0
Less: Spending authority from offsetting collections and recoveries (-)	0.0	(5,578.4)	(9,155.0)
Obligations net of offsetting collections and recoveries	37,152.6	5,494.6	99,242.0
Less: Offsetting receipts (-)	(18,189.0)	(1,592.3)	(1,129.0)
Net obligations	18,963.6	3,902.3	98,113.0
Other Resources			
Donations and forfeitures of property	0.0	0.4	0.0
Transfers in/out without reimbursement (+/-)	0.0	(1.6)	(726.0)
Imputed financing from costs absorbed by others	0.0	239.5	583.3
Other (+/-)	0.0	0.6	0.0
Net other resources used to finance activities	0.0	238.9	(142.7)
Total resources used to finance activities	18,963.6	4,141.2	97,970.3
Resources Used to Finance Items not Part of the Net Cost of Operations			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered Orders (-)	0.0	(400.2)	377.2
Unfilled Customer Orders	0.0	302.2	469.4
Resources that fund expenses recognized in prior periods	0.0	(55.3)	(306.3)
Budgetary offsetting collections and receipts that do not affect net cost of operations	0.0	1,592.3	874.3
Resources that finance the acquisition of assets	0.0	(1,684.0)	(3,542.1)
Other resources or adjustments to net obligated resources that do not affect net cost of operations			
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0.0	(10.0)	6.1
Other (+/-)	0.0	1.6	726.0
Total resources used to finance items not part of the net cost of operations	0.0	(253.4)	(1,395.4)
Total resources used to finance the net cost of operations	18,963.6	3,887.8	96,574.9
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:			
Components Requiring or Generating Resources in Future Period:			
Increase in annual leave liability	0.0	0.0	92.1
Increase in environmental and disposal liability	0.0	0.0	333.4
Upward/Downward reestimates of credit subsidy expense (+/-)	0.0	0.0	4.0
Increase in exchange revenue receivable from the the public (-)	0.0	0.0	1.4
Other (+/-)	98,520.5	51.0	14,853.2
Total components of Net Cost of Operations that will require or generate resources in future periods	98,520.5	51.0	15,284.1
Components not Requiring or Generating Resources:			
Depreciation and amortization	0.0	2,373.5	1,610.0
Revaluation of assets or liabilities (+/-)	0.0	(822.2)	(475.4)
Other (+/-)			
Trust Fund Exchange Revenue	(24,195.5)	0.0	(59.6)
Cost of Goods Sold	0.0	0.0	370.7
Operating Material & Supplies Used	0.0	0.0	32.1
Other	(10.3)	2,586.6	760.0
Total components of Net Cost of Operations that will not require or generate resources	(24,205.8)	4,137.9	2,237.8
Total components of net cost of operations that will not require or generate resources in the current period	74,314.7	4,188.9	17,521.9
Net Cost of Operations	93,278.3	8,076.7	114,096.8

Department of Defense
Agency Wide
COMBINING STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
($ in Millions)

	Other Defense Organizations Working Capital Funds	DoD Medicare-Eligible Retiree Health Care Fund	2004 Combined
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations incurred	$ 51,911.6	$ 5,196.8	$ 720,909.2
Less: Spending authority from offsetting collections and recoveries (-)	(47,781.6)	0.0	(181,281.0)
Obligations net of offsetting collections and recoveries	4,130.0	5,196.8	539,628.2
Less: Offsetting receipts (-)	0.0	(25,342.4)	(46,546.4)
Net obligations	4,130.0	(20,145.6)	493,081.8
Other Resources			
Donations and forfeitures of property	0.0	0.0	0.4
Transfers in/out without reimbursement (+/-)	(1.6)	(2,843.3)	(2,848.6)
Imputed financing from costs absorbed by others	304.1	0.0	4,092.5
Other (+/-)	0.0	0.0	0.6
Net other resources used to finance activities	302.5	(2,843.3)	1,244.9
Total resources used to finance activities	4,432.5	(22,988.9)	494,326.7
Resources Used to Finance Items not Part of the Net Cost of Operations			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered Orders (-)	(1,437.7)	29.0	(13,925.6)
Unfilled Customer Orders	498.6	0.0	1,387.4
Resources that fund expenses recognized in prior periods	(92.5)	0.0	(2,637.4)
Budgetary offsetting collections and receipts that do not affect net cost of operations	0.0	0.0	2,645.4
Resources that finance the acquisition of assets	(29,390.0)	0.0	(86,943.6)
Other resources or adjustments to net obligated resources that do not affect net cost of operations			
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	(6.1)	0.0	(10.0)
Other (+/-)	1.6	2,843.3	2,855.5
Total resources used to finance items not part of the net cost of operations	(30,426.1)	2,872.3	(96,628.3)
Total resources used to finance the net cost of operations	(25,993.6)	(20,116.6)	397,698.4
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:			
Components Requiring or Generating Resources in Future Period:			
Increase in annual leave liability	0.0	0.0	514.8
Increase in environmental and disposal liability	0.0	0.0	3,864.6
Upward/Downward reestimates of credit subsidy expense (+/-)	0.0	0.0	14.9
Increase in exchange revenue receivable from the the public (-)	(75.2)	0.0	(73.8)
Other (+/-)	33.3	25,296.7	139,064.9
Total components of Net Cost of Operations that will require or generate resources in future periods	(41.9)	25,296.7	143,385.4
Components not Requiring or Generating Resources:			
Depreciation and amortization	529.1	0.0	42,249.2
Revaluation of assets or liabilities (+/-)	254.1	0.0	(5,712.6)
Other (+/-)			
Trust Fund Exchange Revenue	0.0	0.0	(24,285.4)
Cost of Goods Sold	26,020.1	0.0	41,421.8
Operating Material & Supplies Used	108.2	0.0	4,655.9
Other	16.6	(8.0)	5,952.2
Total components of Net Cost of Operations that will not require or generate resources	26,928.1	(8.0)	64,281.1
Total components of net cost of operations that will not require or generate resources in the current period	26,886.2	25,288.7	207,666.5
Net Cost of Operations	892.6	5,172.1	605,364.9

Department of Defense
Agency Wide
COMBINING STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2003 Combined
Resources Used to Finance Activities:	
Budgetary Resources Obligated	
Obligations incurred	$ 669,846.5
Less: Spending authority from offsetting collections and recoveries (-)	(168,688.6)
Obligations net of offsetting collections and recoveries	501,157.9
Less: Offsetting receipts (-)	(43,294.0)
Net obligations	457,863.9
Other Resources	
Donations and forfeitures of property	4.6
Transfers in/out without reimbursement (+/-)	(6,702.1)
Imputed financing from costs absorbed by others	3,866.9
Other (+/-)	308.1
Net other resources used to finance activities	(2,522.5)
Total resources used to finance activities	455,341.4
Resources Used to Finance Items not Part of the Net Cost of Operations	
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided	
Undelivered Orders (-)	(37,435.1)
Unfilled Customer Orders	11,006.1
Resources that fund expenses recognized in prior periods	(686.3)
Budgetary offsetting collections and receipts that do not affect net cost of operations	929.3
Resources that finance the acquisition of assets	(72,984.9)
Other resources or adjustments to net obligated resources that do not affect net cost of operations	
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0.0
Other (+/-)	6,623.6
Total resources used to finance items not part of the net cost of operations	(92,547.3)
Total resources used to finance the net cost of operations	362,794.1
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:	
Components Requiring or Generating Resources in Future Period:	
Increase in annual leave liability	662.7
Increase in environmental and disposal liability	2,033.6
Upward/Downward reestimates of credit subsidy expense (+/-)	0.0
Increase in exchange revenue receivable from the the public (-)	(6.6)
Other (+/-)	95,403.2
Total components of Net Cost of Operations that will require or generate resources in future periods	98,092.9
Components not Requiring or Generating Resources:	
Depreciation and amortization	55,274.7
Revaluation of assets or liabilities (+/-)	6,299.4
Other (+/-)	
Trust Fund Exchange Revenue	(23,792.5)
Cost of Goods Sold	0.0
Operating Material & Supplies Used	0.0
Other	13,622.0
Total components of Net Cost of Operations that will not require or generate resources	51,403.6
Total components of net cost of operations that will not require or generate resources in the current period	149,496.5
Net Cost of Operations	512,290.6

Department of Defense
Agency Wide
COMBINING STATEMENT OF CUSTODIAL ACTIVITY
For the perioeds ended September 30, 2004 and 2003 ($ in Millions)

		Army General Fund	Military Retirement Fund	Other Defense Organizations General Funds	2004 Combined	2003 Combined
SOURCE OF COLLECTIONS						
Deposits by Foreign Governments	$	0.0	0.0	11,237.5	11,237.5	9,971.6
Seized Iraqi Cash		118.3	0.0	0.0	118.3	808.9
Other Collections		0.0	0.0	0.0	0.0	0.0
Total Cash Collections	$	118.3	0.0	11,237.5	11,355.8	10,780.5
Accrual Adjustments (+/-)	$	0.0	0.9	0.0	0.9	0.7
Total Custodial Collections	$	118.3	0.9	11,237.5	11,356.7	10,781.2
DISPOSITION OF COLLECTIONS						
Disbursed on Behalf of Foreign Governments and International Organizations	$	0.0	0.0	9,998.8	9,998.8	10,118.8
Seized Assets Disbursed on behalf of Iraqi People		283.1	0.0	0.0	283.1	530.8
Increase (Decrease) in Amounts to be Transferred		0.0	0.9	1,238.6	1,239.5	-146.5
Collections Used for Refunds and Other Payments		0.0	0.0	0.0	0.0	0.0
Retained by The Reporting Entity		0.0	0.0	0.0	0.0	0.0
Seized Assets Retained for Support of the Iraqi People		-164.7	0.0	0.0	-164.7	278.1
Total Disposition of Collections	$	118.4	0.9	11,237.4	11,356.7	10,781.2
NET CUSTODIAL COLLECTION ACTIVITY	$	-0.1	0.0	0.1	0.0	0.0

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Required Supplementary Stewardship Information

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Heritage Assets

DEPARTMENT OF DEFENSE CONSOLIDATED HERITAGE ASSETS For Fiscal Year Ended September 30, 2004					
Categories	Unit of Measure	As of 10/01/03	Additions	Deletions	As of 9/30/04
Museums	Each	156	10		166
Monuments & Memorials	Each	1,543	544		2,087
Cemeteries & Archeological Sites	Sites	25,702		8	25,694
Buildings & Structures	Each	19,249	4,284		23,533
Major Collections	Each	11	1		12

Heritage Assets are real and personal property with national importance due to significant historical, natural, cultural, educational, artistic, or architectural value. Heritage Assets can include buildings on the National Registry of Historical Buildings, museums and/or their collections, art and other collections, archival records, cemeteries, monuments and memorials, and archeological sites.

Museums. Buildings that house collection-type items include artwork, archeological artifacts, archival materials, and other historical artifacts. The primary use of such buildings is the preservation, maintenance and display of collection-type Heritage Assets.

Monuments and Memorials. Sites and structures built to honor and preserve the memory of significant individuals, groups, and/or events in history.

Cemeteries and Archeological Sites. Land on which gravesites of prominent historical figures, honored individuals, and/or items of archeological significance are located.

Buildings and Structures. Includes buildings and structures that are listed on, or are eligible for listing on, the National Register of Historic Places, including Multi-Use Heritage Assets. For tally purposes, these buildings do not include museums.

Major Collections. Significant collections that are maintained outside of a museum.

The processes used to establish items as having heritage significance vary among categories and types of assets. Experts' opinion, criteria such as listing on the National Register of Historic Places, and Federal statutes, all play a significant role in characterizing these assets.

The Army museum system, the Navy-wide Heritage Asset Management System, and the Air Force Museums and Heritage Centers, along with historical property, are registered and displayed in numerous locations. Some of these entities also contain items of historical interest, while some are specific to the general locality.

Stewardship Land

DEPARTMENT OF DEFENSE CONSOLIDATED
STEWARDSHIP LAND
For Fiscal Year Ended September 30, 2004
(Acres in Thousands)

Land Use	As of 10/01/03	Additions	Deletions	As of 9/30/04
1. Mission	16,682	--	18	16,664
2. Parks and Historic Sites	1	--	--	1
Total	16,683			16,665

Stewardship Land is land that is not acquired for, or in connection with, items of General Property, Plant and Equipment. All land, regardless of its use, provided to the Department from the Public Domain, or at no cost, is classified as Stewardship Land. Stewardship Land is reported in physical units (acres) rather than cost or fair value.

Nonfederal Physical Property

DEPARTMENT OF DEFENSE CONSOLIDATED
NONFEDERAL PHYSICAL PROPERTY
Annual Investments in State and Local Governments
For Fiscal Years 2000 through 2004
(In Millions of Dollars)

Categories	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Transferred Assets:					
National Defense Mission Related	$5	$95	$7	$85	$54
Funded Assets:					
National Defense Mission Related	$7	$20	$21	$11	$18
Total	$12	$115	$28	$96	$72

The Department incurs investments in Nonfederal Physical Property for the purchase, construction, or major renovation of physical property owned by state and local governments, including major additions, alterations, and replacements, and the purchase of major equipment; and the purchase or improvement of other physical assets. In addition, Nonfederal Physical Property Investments include federally-owned physical property transferred to state and local governments.

Investment values included in this report are based on Nonfederal Physical Property outlays (expenditures). Outlays are used because current DoD accounting systems are unable to capture and summarize costs in accordance with Federal Accounting Standards Advisory Board requirements.

Investments in Research and Development

DEPARTMENT OF DEFENSE CONSOLIDATED
INVESTMENTS IN RESEARCH AND DEVELOPMENT
Annual Investments in Research and Development
For Fiscal Years 2000 through 2004
(In Millions of Dollars)

Categories	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
1. Basic Research	$812	$1,311	$1,356	$1,444	$1,554
2. Applied Research	3,095	3,843	4,311	4,388	4,639
3. Development					
A. Advanced Technology Development	3,753	4,383	4,604	5,080	6,178
B. Demonstration and Validation	6,557	8,166	10,525	11,928	14,779
C. Engineering and Manufacturing Development	8,353	8,831	9,500	11,234	14,633
D. Research, Development, Test & Evaluation Management Support	2,954	2,946	3,351	3,210	4,188
E. Operational Systems Development	10,124	11,000	11,804	12,289	14,906
4. Other	1,906	--	--	--	--
Total	$37,554	$40,480	$45,451	$49,573	$60,897

Investment values included in this report are based on Research, Development, Test and Evaluation (RDT&E) outlays (expenditures). Outlays are used because current DoD accounting systems are unable to capture and summarize costs in accordance with the Federal Accounting Standards Advisory Board requirements.

DoD Research and Development programs are classified in the following categories: Basic Research, Applied Research, and Development. The following table presents representative program examples for each of the major R&D categories and highlights outcomes.

Department of Defense
Investment in Research and Development

Basic Research

Systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts

- Without specific applications, processes, or products in mind

Major Program Areas	*Outcomes*
Defense Research Sciences	■ Provides new technologies for the Army's Future Force, and fosters innovation in niche areas where investment is lacking due to limited markets.
University and Industry Research Centers	■ Leverages research in the private sector through Collaborative Technology Alliances, Centers of Excellence, and the University Affiliated Research Centers. Partners with academia, entertainment and gaming industries to leverage innovation research and concepts for training and design.
Converting Waste Heat into Electricity	■ A new discovery in semiconductor technology involving the right combination of ultra pure lead, antimony, silver, and tellurium for a material (called LAST) that is significantly more efficient for high temperature power generation than existing thermoelectric materials.
Improved Semiconductor Devices	■ Enables improved electronics that can perform in harsh environments. Possible applications include: remote-sensing platforms, light-emitting diodes, laser diodes for optical data storage, solar-blind shield surveillance systems, and biological agent detectors.
Human Assisted Neural Devices	■ Detects and decodes signals in the brain so the brain's motor signals can control directly a machine; dramatically improves capabilities in prosthetics.
Photonics Research	■ A device that combines functionality of a transistor and a laser; this light-emitting transistor amplifies weak electrical signals and converts electrical signals to light.

Applied Research	
Applied Research Systematic study to understand the means to meet a recognized specific national security requirement • Systematic application of knowledge to develop useful materials, devices, and system or methods	
Major Program Areas	***Outcomes***
Materials Technology	■ Matures materials technology for armor and armaments lethality and survivability capabilities to be fielded in the Future Combat Systems and Future Force systems. ■ Translates new nanomaterials concepts into applications to increase performance and reduce weight of soldier support equipment, armor, armaments, aircraft, and ground combat vehicles.
Combat Vehicle and Automotive Technology	■ Improves survivability, mobility, sustainability, and maintainability of Army ground vehicles. ■ Supports transformation goals by reducing reliance on heavy passive armor using a layered approach, substituting long-rang situational awareness, multi-spectral signature reduction, active protection systems and advanced lightweight armor. ■ Advanced technologies for critical power, propulsion and electric components, including energy storage, power distribution and pulse forming networks.
Shallow-depth Phased-array Radar	■ Develops electronic components and subsystems for use in shallow-depth phased-array radar antennas, at 1/5 the cost of conventional antennas, which have direct application to advanced unmanned aerial vehicles and fighter aircraft.
Long Term Storage of Blood Products	■ Researches nature's mechanisms for protecting cells from environmental stress, such as dehydration. • Approaches found that will dramatically increase the storage life of blood platelets from 5 days of refrigeration to 2 years of dry storage. • Develops next phase approach for red blood cells, changing the paradigm of medical care at the front lines.
High Productivity Computing Systems (HPCS)	■ Provides economically-viable, highly productive computing systems for the national security and industrial user communities. ■ Demonstrates approximately 100 times more bandwidth than conventional technologies.

Development

Takes what has been discovered or learned from basic and applied research and uses it to establish:

- technological feasibility
- assessment of operability
- production capability

- Development is comprised of five stages:
  - Advanced technology development
  - Advanced component development and prototypes
  - System development and demonstration
  - RDT&E management support
  - Operational systems development

Major Program Areas	*Outcomes*
Test Ranges and Facilities and RDT&E Management Support	■ Sustains the Department's required developmental test and evaluation capability and operates the developmental test activities required by weapons systems developers. • Operates White Sands Missile Range (NM), Aberdeen Test Center (MD), Yuma Proving Ground (AZ), Aviation Technical Test Center (AL) and Redstone Arsenal (AL). • Supports R&D efforts and includes test ranges, military construction, maintenance support of laboratories, and O&M of test aircraft and ships. • Funds the planning, improvements and modernization for three national asset test centers. o Two efforts utilizing these unique test capabilities are the Propulsion Wind Tunnel Upgrade at Arnold Engineering Development Center and the Threat Simulator Development/Low Radar Cross Section threat modeling and simulation • Provides resources for test planning and safety verification and confirmation. • Achieved successful launches of military satellites, utilizing Titan and Atlas & Delta. • Develops the Family of Advanced Beyond Line of Sight Terminals (FAB-T) to provide robust, secure, strategic and tactical global communications for nuclear and conventional forces.
Electronic Warfare Advanced Technology	■ Provides technologies for a secure, mobile, wireless network that operates in diverse and complex terrain. ■ Also matures: • Protection technologies for tactical wireless networks • Smart communication technologies to enable network and control of unmanned systems shortening the sensor-decider-engagement time to defeat critical targets.

Clearing Antennas	■ Tests a concept to reduce the number of antennas used for receiving and transmitting radio-frequency signals, mitigating interference and reducing costly support systems.
Missile and Rocket Advanced Technology	■ Emphasizes smaller, lighter weight, more affordable missiles. ■ Demonstrates advanced tactical missiles, real-time hardware-in-the-loop simulations, and multi-role seeker technology efforts. ■ Improves target location accuracy in clutter, lightweight missile launchers, precision guidance, hypervelocity missile flight, and missile communications.
Hybrids on the High Sea: Fuel Cells for Future Ships	■ Works to bring hybrid electric ships to the high seas by developing innovative propulsion systems based on fuel-cell technology for efficient generation of electrical power and greater design flexibility.
Advanced Component Development and Prototypes	■ Comprises programs of system specific advanced technology integration efforts in an operational environment. • Demonstrates Fighter Aircraft Command and Control Enhancement, providing improved, beyond-line-of-sight command and control line with fighter aircraft.
Space Based Infrared System (SBIRS)	■ Continues development for the Transformational Satellite Communications System (TSAT), the next-generation communication satellite. ■ Delivers the Counter Communications System, now operational, which is a transportable ground-based system that denies adversary satellite communications through reversible, non-destructive methods.
System Demonstration and Engineering Development (SD&ED)	■ Further develops projects which have not received approval for full production: • Space Based Infrared System Increment 1 Mission Control System (MCS), which reduces manpower by 58% and operations and maintenance costs by 25% • F/A-22 Raptor program, continuing development of the Air Force's next-generation air dominance fighter. Significant accomplishments include: o Completion of Fatigue Testing through 2.68 lifetimes o Commencement of Initial Operational Test and Evaluation o Completion of multiple supersonic AMRAAM and AIM-9 missile shots o Exceeding over 3,100 flight test missions • F-35 Joint Strike Fighter program, developing a family of strike fighter aircraft with maximum commonality among the variants to minimize life cycle costs. Significant accomplishments include: o Completion of the Air System Design Integration and Maturity Review o Pratt & Whitney F135 First Engine to Test o General Electric F136 First Engine to Test

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Required Supplementary Information

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Real Property Deferred Annual Sustainment and Restoration

Sustainment is the maintenance and repair activities necessary to keep the Department's real property (buildings, structures, and utilities) in good working order. It includes regularly scheduled adjustments and inspections, preventive maintenance tasks, and emergency response and service calls for minor repairs. It also includes major repairs or replacement of facility components (usually accomplished by contract) that are expected to occur periodically throughout the life cycle of facilities. This work includes regular roof replacement, refinishing of wall surfaces, repairing and replacement of heating and cooling systems, replacing tile and carpeting, and similar types of work. It does not include environmental compliance costs, facility leases, or other tasks associated with facilities operations (such as custodial services, grounds services, waste disposal, and the provision of central utilities). The Department's fiscal year 2004 sustainment requirements were $7.8 billion and DoD received $5.7 billion to fund these requirements leaving a deferred sustainment requirement of $2.1 billion this year. The Department's deferred sustainment trend for the past few years is summarized in the table below:

Annual Deferred Sustainment Trend ($ Millions)					
Property Type	**FY 2000***	**FY 2001**	**FY 2002**	**FY 2003**	**FY 2004**
Buildings, Structures, and Utilities	$629	$2,036	$1,762	$1,555	$2,127

* = Army data only

Restoration is the restoration of the Department's real property (buildings, structures, and utilities) to such a condition that it may be used for its designated purpose. Restoration includes repair or replacement work to restore facilities damaged by inadequate sustainment, excessive age, natural disaster, fire, accident, or other causes. *Modernization* is the alteration or replacement of facilities solely to implement new or higher standards, to accommodate new functions, or to replace building components that typically last more than 50 years (such as the framework or foundation).

The Department's restoration and modernization requirements have steadily increased over the past few years from $41.2 billion in fiscal year 2002, to $67.2 billion in fiscal year 2003, to $73.6 billion this year.

Military Equipment Deferred Maintenance

Depot maintenance requirements for military equipment are developed during the annual budget process. The depot maintenance requirements for individual items are determined by considering numerous factors. Analysis factors include: changes in the fleet size or in-use inventory; the date of last overhaul or operating hours since last overhaul; the current maintenance engineering plan expressed as a time interval or as an operational factor; and the planned operating tempo expressed in miles, flying hours, or steaming hours.

The depot maintenance cost for each major program is determined using costing models. Fiscal constraints determine requirements that are funded. The deferred maintenance numbers reported in the table below reflect the difference in funding received versus these requirements.

Military Equipment Type	Deferred Maintenance ($ Millions)
Aircraft	$148.5
Ships	$97.6
Missiles	$201.2
Combat Vehicles	$168.8
Other Weapon Systems	$511.1
Total	**$1,127.2**

Intragovernmental Accounts

The intragovernmental amounts displayed in the following schedules, Part A, B, and C represent transactions between the Department and other federal entities.

Schedule, Part A: DoD Intragovernmental Entity Assets as of September 30, 2004

Balances reflect amounts on the books of DoD Components in regard to transactions with other federal entities

(Amounts in Millions)	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Investments:	Other:
Unidentifiable Federal Agency Entity (Other than DoD entities)	00		$0.1		
Architect of the Capitol	01		$0.2		
Library of Congress	03		$0.1		$0.9
Government Printing Office	04		$1.2		$0.0
The Judiciary	10		$0.1		
Executive Office of the President	11		$0.7		
Department of Agriculture	12		$6.6		$0.9
Department of Commerce	13		$8.3		$17.5
Department of the Interior	14		$356.3		$783.0
Department of Justice	15		$26.7		$1.8
Department of Labor	16		$5.8		$0.1
United States Postal Service	18		$0.6		
Department of State	19		$50.8		
Department of the Treasury	20	$289,598.9	$19.6	$231,069.7	$2.2
Nuclear Regulatory Commission	31		$0.4		
Smithsonian Institution	33		$1.6		$0.0
Department of Veterans Affairs	36		$17.2		
General Service Administration	47		$36.5		
National Science Foundation	49		$7.3		$2.2
Securities and Exchange Commission	50		$0.5		
Central Intelligence Agency	56		$15.5		
Federal Emergency Management Agency	58		$64.3		
National Labor Relations Board	63		$0.3		
Environmental Protection Agency	68		$31.1		$6.0
Department of Transportation	69		$90.0		$145.3
Homeland Security	70		$207.5		$17.9
Agency for International Development	72		$3.8		
Small Business Administration	73		$1.2		$2.3
Department of Health and Human Services	75		$36.2		$0.2
National Aeronautics and Space Administration	80		$52.0		$21.6
Armed Forces Retirement Home	84		$0.3		
Department of Housing and Urban Development	86		$0.1		
Department of Energy	89		$44.9		$10.0
Selective Service System	90		$0.2		
Department of Education	91		$0.3		
Independent Agencies	95		$20.2		
The General Fund of the Treasury	99		$9.8		
Total		**$ 289,598.9**	**$ 1,118.3**	**$ 231,069.7**	**$ 1,011.9**

Schedule, Part B: DoD Intragovernmental Entity Liabilities as of September 30, 2004 Balances reflect amounts on the books of DoD Components in regard to transactions with other federal entities				
(Amounts in Millions)	**Treasury Index**	**Accounts Payable**	**Debts/Borrowings From Other Agencies**	**Other:**
Library of Congress	03	$1.0		
Government Printing Office	04	$7.0		
Executive Office of the President	11	$0.0		$230.2
Department of Agriculture	12	$14.4		$0.1
Department of Commerce	13	$9.9		$34.2
Department of the Interior	14	$39.2		$1.2
Department of Justice	15	$3.8		$0.2
Department of Labor	16	$154.5		$1,672.7
United States Postal Service	18	$1.2		
Department of State	19	$33.5		$2.6
Department of the Treasury	20	$267.5	$591.8	$459.1
Office of Personnel Management	24	$45.9		$262.3
Federal Communications Commission	27	$4.9		
Social Security Administration	28	$0.0		$1.5
Nuclear Regulatory Commission	31	$0.1		
Department of Veterans Affairs	36	$19.8		$0.1
General Service Administration	47	$932.8		$40.9
National Science Foundation	49	$3.6		
Central Intelligence Agency	56	$0.0		$0.5
Federal Emergency Management Agency	58	$0.0		$0.1
Tennessee Valley Authority	64	$10.1		
Environmental Protection Agency	68	$25.6		
Department of Transportation	69	$24.2		$1.0
Homeland Security	70	$59.0		$74.7
Agency for International Development	72	$7.9		$0.3
Small Business Administration	73	$0.2		$0.0
Department of Health and Human Services	75	$2.7		$51.3
National Aeronautics and Space Administration	80	$38.8		$264.3
Department of Housing and Urban Development	86	$0.1		$3.1
Department of Energy	89	$161.5		$58.3
Department of Education	91	$0.1		$0.6
The General Fund of the Treasury	99	$19.1		$7,567.6
Total		**$ 1,888.4**	**$ 591.8**	**$ 10,726.9**

Schedule, Part C: DoD Intragovernmental Revenues as of September 30, 2004

Balances reflect amounts on the books of DoD Components in regard to transactions with other federal entities

(Amounts in Millions)	Treasury Index	Earned Revenue
Unidentifiable Federal Agency Entity (Other than DoD entities)	00	$0.1
Architect of the Capitol	01	$4.7
Library of Congress	03	$1.6
Government Printing Office	04	$1.5
General Accounting Office	05	$0.5
Other Legislative Branch Agencies	09	
The Judiciary	10	$0.1
Executive Office of the President	11	$928.3
Department of Agriculture	12	$89.5
Department of Commerce	13	$52.0
Department of the Interior	14	$88.1
Department of Justice	15	$238.2
Department of Labor	16	$9.2
United States Postal Service	18	$2.3
Department of State	19	$193.8
Department of the Treasury	20	$11,187.6
Office of Personnel Management	24	$0.1
Social Security Administration	28	$0.2
Federal Trade Commission	29	$0.4
Nuclear Regulatory Commission	31	$2.5
Smithsonian Institution	33	$11.9
Department of Veterans Affairs	36	$50.4
Pennsylvania Avenue Development Corp	42	$0.2
General Service Administration	47	$43.3
National Science Foundation	49	$82.3
Securities and Exchange Commission	50	$0.5
Advisory Commission on Intergovernmental Relations	55	$0.3
Central Intelligence Agency	56	$48.4
Federal Emergency Management Agency	58	$78.8
Railroad Retirement Board	60	$0.1
Tennessee Valley Authority	64	$0.8
Environmental Protection Agency	68	$118.3
Department of Transportation	69	$388.6
Homeland Security	70	$1,074.2
Agency for International Development	72	$81.9
Small Business Administration	73	$0.2
Department of Health and Human Services	75	$153.0
Independent Agencies	76	$0.3
National Aeronautics and Space Administration	80	$324.5
Export-Import Bank of the United States	83	$0.1
Department of Housing and Urban Development	86	$8.4
National Archives and Records Administration	88	$0.1
Department of Energy	89	$113.2
Selective Service System	90	$0.1
Department of Education	91	$1.5
Independent Agencies	95	$46.9
The General Fund of the Treasury	99	($146.3)
Total		**$15,282.7**

Schedule, Part D: DoD Intragovernmental Revenues as of September 30, 2004

(Amounts in Millions)	Budget Function Code	Gross Cost
Department of Defense Military	51	$22,410.5
Water Resources by U.S. Army Corps of Engineers	301	$890.8
Pollution Control and Abatement by U.S. Army Corps of Engineers	304	$2.5
Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund	702	$270.7
Total		**$23,574.5**

Schedule, Part E: DoD Intragovernmental Nonexchange Revenues as of September 30, 2004

($Amounts in Millions)	Treasury Index	Transfers In	Transfers Out
Executive Office of the President	11	$10,253.6	
Department of Agriculture	12		$0.8
Department of Commerce	13		$0.1
Department of the Interior	14	$69.1	$0.4
Department of the Treasury	20		$4.1
General Service Administration	47		$0.0
Tennessee Valley Authority	64		$1.9
Department of Transportation	69	$2.8	
Homeland Security	70	($2,843.3)	$0.2
Department of Energy	89	$246.7	
The General Fund of the Treasury	99	$774.0	$775.5
Total		**$8,502.9**	**$783.0**

STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

DEPARTMENT OF DEFENSE YEAR ENDING SEPTEMBER 30, 2004 ($ IN MILLIONS)		Military Retirement Fund	DoD Medicare-Eligible Retiree Health Care Fund	Other	Research, Development, Test & Evaluation	Civil Works	Operation and Maintenance
BUDGETARY FINANCING ACCOUNTS							
BUDGETARY RESOURCES							
Budget Authority:							
Appropriations received	$	42,256.8	25,100.3	55,133.3	61,784.4	5,141.2	182,105.8
Borrowing authority		0.0	0.0	0.0	0.0	0.1	0.0
Contract authority		0.0	0.0	496.5	0.0	0.0	0.0
Net transfers (+/-)		0.0	0.0	-3,239.9	-161.7	206.9	4,720.2
Other		0.0	0.0	0.0	0.0	0.0	0.0
Unobligated balance:							
Beginning of period		176,029.0	18,182.4	11,873.3	6,815.6	1,850.2	4,325.3
Net transfers, actual (+/-)		0.0	0.0	-3,616.7	-27.0	28.5	6,469.6
Anticipated Transfers Balances		0.0	0.0	0.0	0.0	0.0	0.0
Spending authority from offsetting collections:							
Earned		0.0	0.0	0.0	0.0	0.0	0.0
Collected		0.0	0.0	1,561.4	6,264.0	5,212.1	23,519.8
Receivable from Federal sources		0.0	0.0	112.1	11.1	64.1	942.8
Change in unfilled customer orders		0.0	0.0	0.0	0.0	0.0	0.0
Advance received		0.0	0.0	13.1	282.0	29.7	32.6
Without advance from Federal sources		0.0	0.0	87.2	931.9	272.6	614.8
Anticipated for the rest of year, without advances		0.0	0.0	0.0	0.0	0.0	0.0
Transfers from trust funds		0.0	0.0	0.0	0.0	0.0	0.0
Subtotal		0.0	0.0	1,773.8	7,489.0	5,578.5	25,110.0
Recoveries of prior year obligations		0.0	0.0	1,039.3	2,337.9	0.0	14,279.7
Temporarily not available pursuant to Public Law		0.0	0.0	0.0	0.0	-10.0	0.0
Permanently not available		0.0	0.0	-3,609.1	-892.1	-29.1	-2,149.6
Total Budgetary Resources	$	218,285.8	43,282.7	59,850.5	77,346.1	12,766.3	234,861.0
Obligations incurred:	$						
Direct		37,152.6	5,196.8	26,230.3	62,366.3	5,615.2	200,759.2
Reimbursable		0.0	0.0	24,233.7	6,822.1	5,457.8	11,646.5
Subtotal		37,152.6	5,196.8	50,464.0	69,188.4	11,073.0	212,405.7
Unobligated balance:							
Apportioned		0.0	206.6	2,754.2	8,717.0	1,234.1	15,722.5
Exempt from apportionment		181,133.1	0.0	1,732.8	0.0	459.1	0.0
Other available		0.1	0.0	0.0	0.0	0.0	0.0
Unobligated Balances Not Available		0.0	37,879.3	4,899.4	-559.3	0.1	6,732.7
Total, Status of Budgetary Resources	$	218,285.8	43,282.7	59,850.4	77,346.1	12,766.3	234,860.9
Relationship of Obligations to Outlays:							
Obligated Balance, Net - beginning of period	$	2,963.0	267.8	9,396.4	25,116.2	1,007.6	68,720.3
Obligated Balance transferred, net (+/-)		0.0	0.0	0.0	-1.5	0.0	-12.6
Obligated Balance, Net - end of period:			0.0				
Accounts receivable		0.0	0.0	-268.6	-655.6	-224.7	-3,223.1
Unfilled customer order from Federal sources		0.0	0.0	-250.6	-2,950.6	-1,907.8	-8,261.1
Undelivered orders		0.0	132.8	2,918.1	29,028.1	2,022.9	67,700.7
Accounts payable		3,120.2	129.2	5,205.5	1,811.5	1,148.3	15,388.5
Outlays:							
Disbursements		36,995.4	5,202.5	51,017.5	63,788.8	10,705.3	193,671.0
Collections		0.0	0.0	-1,574.5	-6,546.0	-5,241.7	-23,552.4
Subtotal		36,995.4	5,202.5	49,443.0	57,242.8	5,463.6	170,118.6
Less: Offsetting receipts		-18,189.0	-25,342.4	-1,307.3	0.0	-1,592.3	0.0
Net Outlays	$	18,806.4	-20,139.9	48,135.7	57,242.8	3,871.3	170,118.6

STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

DEPARTMENT OF DEFENSE YEAR ENDING SEPTEMBER 30, 2004 ($ IN MILLIONS)		Procurement	Military Personnel	Military Construction/ Family Housing	Working Capital Funds	2004 Combined	2003 Combined
BUDGETARY FINANCING ACCOUNTS							
BUDGETARY RESOURCES							
Budget Authority:							
Appropriations received	$	82,247.4	117,516.5	7,005.4	3,719.5	582,010.7	546,761.4
Borrowing authority		0.0	0.0	0.0	0.0	0.1	0.0
Contract authority		0.0	0.0	0.0	34,359.2	34,855.8	28,109.0
Net transfers (+/-)		709.1	-1,402.1	96.9	-1,448.6	-519.3	1,000.3
Other		0.0	0.0	0.0	0.0	0.0	0.0
Unobligated balance:							
Beginning of period		21,248.9	966.2	4,533.0	10,835.2	256,659.0	217,722.3
Net transfers, actual (+/-)		857.5	-413.3	-192.7	-2,323.9	782.0	204.3
Anticipated Transfers Balances		0.0	0.0	0.0	0.0	0.0	0.0
Spending authority from offsetting collections:							
Earned		0.0	0.0	0.0	0.0	0.0	0.0
Collected		2,155.4	1,531.5	4,026.2	102,003.9	146,274.3	135,587.2
Receivable from Federal sources		-255.0	-338.8	131.5	-747.3	-79.7	-714.6
Change in unfilled customer orders		0.0	0.0	0.0	0.0	0.0	0.0
Advance received		34.9	0.0	205.9	-237.7	360.5	-30.6
Without advance from Federal sources		296.7	14.8	713.4	-1,951.5	980.0	11,000.9
Anticipated for the rest of year, without advances		0.0	0.0	0.0	0.0	0.0	0.0
Transfers from trust funds		0.0	0.0	0.0	0.0	0.0	0.0
Subtotal		2,232.0	1,207.5	5,077.0	99,067.4	147,535.1	145,842.9
Recoveries of prior year obligations		5,180.5	9,028.7	1,259.6	556.0	33,681.9	22,841.9
Temporarily not available pursuant to Public Law		0.0	0.0	0.0	0.0	-10.0	0.0
Permanently not available		-1,450.5	-495.0	-512.2	-31,200.4	-40,338.0	-33,730.4
Total Budgetary Resources	$	111,024.9	126,408.5	17,267.0	113,564.4	1,014,657.3	928,751.7
Obligations incurred:	$						
Direct		94,810.7	128,073.8	6,740.7	1,108.1	568,053.7	522,562.4
Reimbursable		-3,952.2	-3,829.7	5,880.7	106,400.1	152,658.9	147,147.8
Subtotal		90,858.5	124,244.1	12,621.4	107,508.2	720,712.6	669,710.2
Unobligated balance:							
Apportioned		19,137.4	977.0	4,599.7	5,282.5	58,631.0	55,052.1
Exempt from apportionment		0.0	0.0	0.0	163.1	183,488.1	180,704.3
Other available		0.0	0.0	0.0	0.0	0.3	-0.1
Unobligated Balances Not Available		1,029.0	1,187.5	46.0	610.6	51,825.3	23,285.3
Total, Status of Budgetary Resources	$	111,024.9	126,408.6	17,267.1	113,564.4	1,014,657.3	928,751.7
Relationship of Obligations to Outlays:							
Obligated Balance, Net - beginning of period	$	74,419.4	7,825.8	7,369.3	17,286.1	214,371.9	181,919.4
Obligated Balance transferred, net (+/-)		0.0	0.0	0.0	0.0	-14.1	-23.9
Obligated Balance, Net - end of period:							
Accounts receivable		-328.8	-252.2	-246.1	-4,937.8	-10,136.8	-10,216.4
Unfilled customer order from Federal sources		-1,712.9	-13.9	-4,521.6	-19,783.4	-39,402.0	-38,422.1
Undelivered orders		78,721.7	2,617.5	11,262.5	34,396.8	228,801.3	213,597.8
Accounts payable		6,083.2	5,906.1	852.7	13,825.5	53,470.6	49,412.6
Outlays:							
Disbursements		77,292.3	115,107.6	10,538.7	103,436.1	667,755.1	604,105.8
Collections		-2,190.3	-1,531.5	-4,232.1	-101,766.2	-146,634.7	-135,556.8
Subtotal		75,102.0	113,576.1	6,306.6	1,669.9	521,120.4	468,549.0
Less: Offsetting receipts		0.0	-115.4	0.0	0.0	-46,546.4	-43,294.0
Net Outlays	$	75,102.0	113,460.7	6,306.6	1,669.9	474,574.0	425,255.0

STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

DEPARTMENT OF DEFENSE YEAR ENDING SEPTEMBER 30, 2004 ($ IN MILLIONS)		Military Retirement Fund	DoD Medicare-Eligible Retiree Health Care Fund	Other	Research, Development, Test & Evaluation	Civil Works	Operation and Maintenance
NONBUDGETARY FINANCING ACCOUNTS							
BUDGETARY RESOURCES							
Budget Authority:							
Appropriations received	$	0.0	0.0	0.0	0.0	0.0	0.0
Borrowing authority		0.0	0.0	114.6	0.0	0.0	0.0
Contract authority		0.0	0.0	0.0	0.0	0.0	0.0
Net transfers (+/-)		0.0	0.0	0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	0.0	0.0	0.0
Unobligated balance:							
Beginning of period		0.0	0.0	21.8	0.0	0.0	0.0
Net transfers, actual (+/-)		0.0	0.0	0.0	0.0	0.0	0.0
Anticipated Transfers Balances		0.0	0.0	0.0	0.0	0.0	0.0
Spending authority from offsetting collections:							
Earned		0.0	0.0	0.0	0.0	0.0	0.0
Collected		0.0	0.0	17.4	0.0	0.0	0.0
Receivable from Federal sources		0.0	0.0	-0.6	0.0	0.0	0.0
Change in unfilled customer orders		0.0	0.0	0.0	0.0	0.0	0.0
Advance received		0.0	0.0	0.0	0.0	0.0	0.0
Without advance from Federal sources		0.0	0.0	47.2	0.0	0.0	0.0
Anticipated for the rest of year, without advances		0.0	0.0	0.0	0.0	0.0	0.0
Transfers from trust funds		0.0	0.0	0.0	0.0	0.0	0.0
Subtotal		0.0	0.0	64.0	0.0	0.0	0.0
Recoveries of prior year obligations		0.0	0.0	0.0	0.0	0.0	0.0
Temporarily not available pursuant to Public Law		0.0	0.0	0.0	0.0	0.0	0.0
Permanently not available		0.0	0.0	20.7	0.0	0.0	0.0
Total Budgetary Resources	$	0.0	0.0	221.1	0.0	0.0	0.0
Obligations incurred:	$						
Direct		0.0	0.0	196.6	0.0	0.0	0.0
Reimbursable		0.0	0.0	0.0	0.0	0.0	0.0
Subtotal		0.0	0.0	196.6	0.0	0.0	0.0
Unobligated balance:							
Apportioned		0.0	0.0	1.4	0.0	0.0	0.0
Exempt from apportionment		0.0	0.0	0.0	0.0	0.0	0.0
Other available		0.0	0.0	0.0	0.0	0.0	0.0
Unobligated Balances Not Available		0.0	0.0	23.1	0.0	0.0	0.0
Total, Status of Budgetary Resources	$	0.0	0.0	221.1	0.0	0.0	0.0
Relationship of Obligations to Outlays:							
Obligated Balance, Net - beginning of period	$	0.0	0.0	29.9	0.0	0.0	0.0
Obligated Balance transferred, net (+/-)		0.0	0.0	0.0	0.0	0.0	0.0
Obligated Balance, Net - end of period:							
Accounts receivable		0.0	0.0	0.0	0.0	0.0	0.0
Unfilled customer order from Federal sources		0.0	0.0	-83.1	0.0	0.0	0.0
Undelivered orders		0.0	0.0	238.8	0.0	0.0	0.0
Accounts payable		0.0	0.0	0.0	0.0	0.0	0.0
Outlays:							
Disbursements		0.0	0.0	24.1	0.0	0.0	0.0
Collections		0.0	0.0	-17.4	0.0	0.0	0.0
Subtotal		0.0	0.0	6.7	0.0	0.0	0.0
Less: Offsetting receipts		0.0	0.0	0.0	0.0	0.0	0.0
Net Outlays	$	0.0	0.0	6.7	0.0	0.0	0.0

STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

DEPARTMENT OF DEFENSE YEAR ENDING SEPTEMBER 30, 2004 ($ IN MILLIONS)		Procurement	Military Personnel	Military Construction/ Family Housing	Working Capital Funds	2004 Combined	2003 Combined
NONBUDGETARY FINANCING ACCOUNTS							
BUDGETARY RESOURCES							
Budget Authority:							
Appropriations received	$	0.0	0.0	0.0	0.0	0.0	0.0
Borrowing authority		0.0	0.0	0.0	0.0	114.6	50.5
Contract authority		0.0	0.0	0.0	0.0	0.0	0.0
Net transfers (+/-)		0.0	0.0	0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	0.0	0.0	0.0
Unobligated balance:							
Beginning of period		0.0	0.0	0.0	0.0	21.8	104.0
Net transfers, actual (+/-)		0.0	0.0	0.0	0.0	0.0	0.0
Anticipated Transfers Balances		0.0	0.0	0.0	0.0	0.0	0.0
Spending authority from offsetting collections:							
Earned		0.0	0.0	0.0	0.0	0.0	0.0
Collected		0.0	0.0	0.0	0.0	17.4	56.2
Receivable from Federal sources		0.0	0.0	0.0	0.0	-0.6	-90.0
Change in unfilled customer orders		0.0	0.0	0.0	0.0	0.0	0.0
Advance received		0.0	0.0	0.0	0.0	0.0	0.0
Without advance from Federal sources		0.0	0.0	0.0	0.0	47.2	35.8
Anticipated for the rest of year, without advances		0.0	0.0	0.0	0.0	0.0	0.0
Transfers from trust funds		0.0	0.0	0.0	0.0	0.0	0.0
Subtotal		0.0	0.0	0.0	0.0	64.0	2.0
Recoveries of prior year obligations		0.0	0.0	0.0	0.0	0.0	1.9
Temporarily not available pursuant to Public Law		0.0	0.0	0.0	0.0	0.0	0.0
Permanently not available		0.0	0.0	0.0	0.0	20.7	-0.2
Total Budgetary Resources	$	0.0	0.0	0.0	0.0	221.1	158.2
Obligations incurred:	$						
Direct		0.0	0.0	0.0	0.0	196.6	136.4
Reimbursable		0.0	0.0	0.0	0.0	0.0	0.0
Subtotal		0.0	0.0	0.0	0.0	196.6	136.4
Unobligated balance:							
Apportioned		0.0	0.0	0.0	0.0	1.4	1.3
Exempt from apportionment		0.0	0.0	0.0	0.0	0.0	0.0
Other available		0.0	0.0	0.0	0.0	0.0	-0.1
Unobligated Balances Not Available		0.0	0.0	0.0	0.0	23.1	20.6
Total, Status of Budgetary Resources	$	0.0	0.0	0.0	0.0	221.1	158.2
Relationship of Obligations to Outlays:							
Obligated Balance, Net - beginning of period	$	0.0	0.0	0.0	0.0	29.9	-95.1
Obligated Balance transferred, net (+/-)		0.0	0.0	0.0	0.0	0.0	0.0
Obligated Balance, Net - end of period:							
Accounts receivable		0.0	0.0	0.0	0.0	0.0	-0.6
Unfilled customer order from Federal sources		0.0	0.0	0.0	0.0	-83.1	-35.8
Undelivered orders		0.0	0.0	0.0	0.0	238.8	66.3
Accounts payable		0.0	0.0	0.0	0.0	0.0	0.0
Outlays:							
Disbursements		0.0	0.0	0.0	0.0	24.1	63.6
Collections		0.0	0.0	0.0	0.0	-17.4	-56.2
Subtotal		0.0	0.0	0.0	0.0	6.7	7.4
Less: Offsetting receipts		0.0	0.0	0.0	0.0	0.0	0.0
Net Outlays	$	0.0	0.0	0.0	0.0	6.7	7.4

Required Supplementary Information
Segment Information

As of September 30, 2004 ($ in Millions)	Defense Information Systems Agency	Defense Commissary Agency	Joint Logistics Systems Center	Defense Security Service	Defense Logistics Agency	Defense Finance & Accounting Service	U.S. Transportation Command	Total
PART A.								
1. Fund Balance	$0.0	$271.9	$0.0	($24.0)	$0.0	$0.0	$652.7	$900.6
2. Accounts Receivable	$395.1	$49.0	$0.0	$0.3	$1,810.5	$22.4	$823.6	$3,100.9
3. Property Plant and Equipment	$350.0	$27.8	$119.5	$24.3	$1,708.3	$841.6	$1,135.9	$4,207.4
4. Other Assets	$3.3	$442.4	$0.0	$0.0	$14,920.4	$0.1	$68.0	$15,434.2
5. TOTAL ASSETS	**$748.4**	**$791.1**	**$119.5**	**$0.6**	**$18,439.2**	**$864.1**	**$2,680.2**	**$23,643.1**
6. Liabilities Due and Payable for Goods and Services Receiv	$919.6	$523.8	($0.6)	$1.5	$2,555.7	$173.7	$1,193.0	$5,366.7
7. Deferred Revenue	$0.0	$0.0	$0.0	$52.8	$128.5	$0.0	$0.7	$182.0
8. Other Liabilites	($22.8)	$302.4	$0.4	$29.1	$667.9	$150.1	$197.2	$1,324.3
9. TOTAL LIABILITIES	**$896.8**	**$826.2**	**($0.2)**	**$83.4**	**$3,352.1**	**$323.8**	**$1,390.9**	**$6,873.0**
10. Unexpended Appropriations	$0.0	$17.5	$0.0	$0.0	$0.0	$0.0	$0.0	$17.5
11. Cumulative Results of Operations	($148.4)	($52.6)	$119.7	($82.9)	$15,087.2	$540.3	$1,289.3	$16,752.6
12. TOTAL NET POSITION	($148.4)	($35.1)	$119.7	($82.9)	$15,087.2	$540.3	$1,289.3	$16,770.1
13. TOTAL LIABILITIES AND NET POSITION	**$748.4**	**$791.1**	**$119.5**	**$0.5**	**$18,439.3**	**$864.1**	**$2,680.2**	$23,643.1
PART B.								
1. The Full Cost of Goods and Services Provides	$3,331.7	$6,372.8	($0.6)	$228.1	$27,271.4	$1,710.4	$8,034.4	$46,948.2
2. The Related Exchange Revenue	($3,362.4)	($5,263.4)	$0.0	($221.6)	($27,453.4)	($1,728.2)	($8,026.1)	($46,055.1)
3. The Excess of Costs Over Exchange Revenue	**($30.7)**	**$1,109.4**	**($0.6)**	**$6.5**	**($182.0)**	**($17.8)**	**$8.3**	**$893.1**

Narrative Related to Segment Information

- **Defense Information Systems Agency**

  The Defense Information Systems Agency (DISA) is a Defense Working Capital Fund (DWCF) entity. The Defense Megacenters and the Communications Information Services Activity provide data processing, telecommunication, and information systems service and support to the Department and other federal government customers under a revolving fund concept. DISA's major customers are the Army, Navy, Air Force, DLA, and DFAS.

- **Defense Commissary Agency**

  The Commissary Operations Fund finances the cost of operations for retail stores, command and region headquarters, and the operations support center. This fund also receives appropriated funds annually.

  The Commissary Resale Stock Fund finances the purchases of inventory for resale items to be sold to commissary patrons. Revenues from sales are used to replace inventory sold.

- **Joint Logistics Systems Center**

  On August 18, 1997, the Acting Under Secretary of Defense (Comptroller) approved the decision to terminate Joint Logistics Systems Center. All of its programs and responsibilities were returned to the individual components. FY 2004 is the seventh year JLSC operated as a residual activity. There was minimal financial activity during fiscal year 2004.

- **Defense Security Service**

  Effective October 1, 1998, Defense Security Service (DSS) was transferred from a direct appropriation to a separate activity group in the DWCF. This transfer also reflected a name change from the Defense Investigative Service to the DSS. Full implementation of the DSS as a DWCF entity began with fiscal year 2000.

  The DSS was chartered to administer two major programs: Personnel Security Investigations (PSI) and National Industrial Security Programs (NISP). The mission of the PSI program is to conduct background investigations on individuals assigned to or affiliated with the Department. The purpose of the NISP is to ensure that private industry, while performing on government contracts, properly safeguards classified information in its possession. The DSS also administers the Key Asset Protection Program and the Arms, Ammunition, and Explosives Program.

- **Defense Logistics Agency**

  The Defense Logistics Agency (DLA) is a combat support agency responsible for worldwide logistics support throughout the DoD. The primary focus of DLA is to provide logistics support to the war fighter. In addition, DLA provides support to relief efforts during times of national emergency. DLA's major DoD customers are the Army, Navy, and Air Force. Other major federal government customers include the Department of Agriculture and the Department of Transportation. The DLA organization has active entity sub-organizations funded through the DWCF. These sub-organizations are referred to as activity groups and are as follows:

  - The Supply Management Activity Group (Supply helps carry out its mission by procuring, managing and supplying consumable items to Military Departments, other DoD Components, federal agencies and selected foreign governments.

  - The Distribution Depot Activity Group (Distribution receives, stores, and distributes commodities, principal end items, and depot level reparables for the Military Departments, other DoD Components, federal agencies, and selected foreign governments.

  - The Defense Reutilization and Marketing Service Activity Group (DRMS provides utilization services which include receiving, classifying, segregating, demilitarizing, accounting for, and reporting excess material for screening, lotting, merchandising, and sale. They also have the mission of hazardous property disposal and the economic recovery of precious metals from excess and surplus precious metal-bearing material.

  - The Information Services Activity Group provides information management support. The mission of this information services business is to provide integrated information management support by delivering products and services of increasing quality and decreasing cost, on time and within budget.

  - The Defense Automated Printing Service Activity Group (DAPS) is responsible for document automation and printing within the DoD, encompassing electronic conversion, retrieval, output, and distribution of digital and hardcopy.

- **Defense Finance and Accounting Service**

  Defense Finance and Accounting Service (DFAS) was created in 1991. The mission of DFAS is to provide responsive, professional finance and accounting service to the Department. DFAS has prepared the annual financial statements as required by the CFO Act and the GMRA since 1994.

- **U.S. Transportation Command**

  Secretary of Defense memorandum, dated February 14, 1992, prescribed the creation of a consolidated service transportation command. United States Transportation Command (USTRANSCOM) represents the single DoD financial manager for all common-user transportation. Its components include Headquarters, USTRANSCOM (HQTRANS); (Military) Surface Deployment and Distribution Command (SDDC); Military Sealift Command (MSC); Air Mobility Command (AMC); and, Defense Courier Service (DCS). The Army and Navy continue to manage their own service-unique transportation functions.

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Other Accompanying Information

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Department of Defense – Appropriations, Funds, and Accounts

Department of the Army:

21*0390	Chemical Agents and Munitions Destruction, Army
21*0720	Family Housing Construction, Army
21* 0725	Family Housing Operation and Maintenance, Army
21X0810	Environmental Restoration
21*7020	Family Housing, Army Construction
21*7025	Operation & Maintenance, Family Housing
21X1705	National Board for the Promotion of Rifle Practice, Army
21X1805	Salaries and Expenses, Cemeterial Expenses, Army
21*2010	Military Personnel, Army
21*2020	Operation and Maintenance, Army
21*2031	Aircraft Procurement, Army
21*2032	Missile Procurement, Army
21*2033	Procurement of Weapons and Tracked Combat Vehicles, Army
21*2034	Procurement of Ammunition, Army
21*2035	Other Procurement, Army
21*2040	Research, Development, Test, and Evaluation, Army
21*2050	Military Construction, Army
21*2060	National Guard Personnel, Army
21*2065	Operation and Maintenance, Army National Guard
21*2070	Reserve Personnel, Army
21*2080	Operation and Maintenance, Army Reserve
21*2085	Military Construction, Army National Guard
21*2086	Military Construction, Army Reserve
21X4275	Arms Initiative Guaranteed Loan Financing
21X4528	Working Capital Fund, Army Conventional Ammunition
21X5095	Wildlife Conservation, etc., Military Reservations, Army
21X5098	Restoration, Rocky Mountain Arsenal, Army
21X5194	Department of Defense (DoD), 50th Anniversary of World War II Commemoration Account, Army
21X5285	DoD, Forest Products Program, Army
21X5286	National Science Center, Army
21X8063	Bequest of Major General Fred C. Ainsworth Library, Walter Reed Army Medical Center
21X8927	Department of the Army General Gift Fund
21*6xxx	(Nonentity) Deposit Fund Accounts

Department of the Navy:

17X0380	Coastal Defense Augmentation, Navy
17*0703	Family Housing, Navy and Marine Corps
17*0730	Family Housing Construction, Navy and Marine Corps
17*0735	Family Housing Operation and Maintenance, Navy and Marine Corps
17X0810	Environmental Restoration, Navy
17*1105	Military Personnel, Marine Corps
17*1106	Operation and Maintenance, Marine Corps
17*1107	Operation and Maintenance, Marine Corps Reserve
17*1108	Reserve Personnel, Marine Corps
17*1109	Procurement, Marine Corps
17*1205	Military Construction, Navy
17*1235	Military Construction, Naval Reserve
17X1236	Payments to Kaho'Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
17*1319	Research, Development, Test, and Evaluation, Navy
17*1405	Reserve Personnel, Navy
17*1453	Military Personnel, Navy
17*1506	Aircraft Procurement, Navy
17*1507	Weapons Procurement, Navy
17*1508	Procurement of Ammunition, Navy and Marine Corps
17*1611	Shipbuilding and Conversion, Navy
17*1804	Operation and Maintenance, Navy
17*1806	Operation and Maintenance, Navy Reserve
17*1810	Other Procurement, Navy
17 3041	Recoveries Under the Foreign Military Sales Program
17 3210	General Fund Proprietary Receipts , Defense Military, Not Otherwise Classified
17*4557	National Defense Sealift Fund, Navy
17X5095	Wildlife Conservation, etc., Military Reservations, Navy
17X5185	KahoOlawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
17X5429	Rossmoor Liquidating Trust Settlement Account
17X8423	Midshipmen's Store, United States Naval Academy
17X8716	Department of the Navy General Gift Fund
17X8723	Ships Stores Profits, Navy
17X8733	United States Naval Academy General Gift Fund
17*6xxx	(Nonentity) Deposit Fund Accounts

Department of the Air Force:

57*0704	Family Housing, Air Force
57*0740	Family Housing Construction, Air Force
57*0745	Family Housing Operation and Maintenance, Air Force
57*0810	Environmental Restoration, Air Force
57X1999	Unclassified Receipts and Expenditures, Air Force
57*3010	Aircraft Procurement, Air Force
57*3011	Procurement of Ammunition, Air Force
57*3020	Missile Procurement, Air Force
57*3080	Other Procurement, Air Force
57*3300	Military Construction, Air Force
57*3400	Operation and Maintenance, Air Force
57*3500	Military Personnel, Air Force
57*3600	Research, Development, Test, and Evaluation, Air Force
57*3700	Reserve Personnel, Air Force
57*3730	Military Construction, Air Force Reserve
57*3740	Operation and Maintenance, Air Force Reserve
57*3830	Military Construction, Air National Guard
57*3840	Operation and Maintenance, Air National Guard
57*3850	National Guard Personnel, Air Force
57X5095	Wildlife Conservation, etc., Military Reservations, Air Force
57*6xxx	(Nonentity) Deposit Fund Accounts
57X8418	Air Force Cadet Fund
57X8928	Department of the Air Force General Gift Fund

Department of Defense Working Capital Funds:

97X4930.001	Army Working Capital Fund (WCF)
97X4930.002	Navy WCF
97X4930.003	Air Force WCF
97X4930.005	U.S. Transportation Command (USTRANSCOM) WCF
97X4930.004	Defense Commissary Agency WCF
97X4930.005	Defense Logistics Agency WCF
97X4930.005	Defense Finance and Accounting Service WCF
97X4930.005	Joint Logistics Systems Center WCF
97X4930.005	Management Systems Support Office/Corporate Information Management
97X4930.005	Defense Information Systems Agency WCF
97X4930.005	Defense Technical Information Services Center
97X4930.005	Defense Security Services WCF
97X4930.005	Headquarters Account
97X4930.005	Component Level Adjustment

Note: The USTRANSCOM WCF is included in Other Defense Organizations WCF for financial statement purposes.

Other Defense Organizations:

11X8242	Foreign Military Sales Trust Fund (Cost clearing accounts only)
97*0040	Payments to Military Retirement Fund, Defense
97X0100	Operation and Maintenance, Defense-Wide
97*0100	Operation and Maintenance, Defense-Wide
97*0101	Contingencies, Defense
97*0102	Claims, Defense
97*0103	Base Realignment and Closure Account, Part I, Defense
97*0104	Court of Military Appeals, Defense
97*0105	Drug Interdiction and Counter-Drug Activities, Defense
97*0106	Goodwill Games, Defense
97*0107	Office of the Inspector General
97*0108	Emergency Expenses, Defense Account
97X0110	Persian Gulf Regional Defense Fund, Defense
97*0115	Corporate Information Management (Business Process Reengineering)
97*0116	Summer Olympics, Defense
97*0118	Overseas Contingency Operations Fund
97X0118	Overseas Contingency Operations Fund
97*0130	Defense Health Program, Defense
97*0131	Real Property Maintenance, Defense
97X0132	Claims, Mount Pinatubo, Defense
97*0132	Claims, Mount Pinatubo, Defense
97*0133	Payment to Coast Guard, Defense
97X0134	Former Soviet Union Threat Reduction, Defense
97*0135	Military Training, Equipment and Associated Support Transfer Fund, Defense
97*0136	Depot level Maintenance and Repair Transfer Fund, Defense
97*0137	Spares, Repairs and Associated Logistical Support Transfer Fund, Defense
97*0138	New Horizons Exercise Transfer Fund, Defense
97*0139	Operational Rapid Response Transfer Fund, Defense
97*0140	Military Construction Transfer Fund, Defense
97*0141	Iraq Freedom Fund, Defense
97*0300	Procurement, Defense-Wide
97*0350	National Guard and Reserve Equipment, Defense
97X0360	Defense Production Act Purchases, Defense
97*0360	Defense Production Act Purchases, Defense
97*0370	North Atlantic Treaty Organization Cooperative Defense Fund
97X0390	Chemical Agents and Munitions Destruction, Defense
97*0390	Chemical Agents and Munitions Destruction, Defense
97X0400	Research, Development, Test, and Evaluation, Defense-Wide
97*0400	Research, Development, Test, and Evaluation, Defense-Wide
97*0450	Developmental Test and Evaluation, Defense
97*0460	Operational Test and Evaluation, Defense
97*0500	Military Construction, Defense-Wide
97X0510	Base Realignment and Closure Account, Part II, Defense
97*0706	Family Housing, Defense-Wide

Other Defense Organizations (Continued):

97*0760	Family Housing Construction, Defense-Wide
97*0765	Family Housing Operation and Maintenance, Defense-Wide
97*0800	Special Foreign Currency Program, Defense
97X0801	Foreign Currency Fluctuations, Defense
97X0803	Foreign Currency Fluctuation, Construction, Defense
97X0804	North Atlantic Treaty Organization Investment Programs Defense
97X0810	Environmental Restoration, Defense
97X0811	Environmental Restoration, Formerly Used Defense Sites, Defense
97X0819	Humanitarian Assistance, Defense
97*0819	Humanitarian Assistance, Defense
97*0827	World University Games, Defense
97*0828	Defense Reinvestment for Economic Growth, Defense
97*0829	World Cup USA, Defense
97*0832	Special Olympics - World Games
97*0834	DoD Family Housing Improvement Fund
97X0850	Payments to DoD Medicare Eligible Retiree Health Care Fund
97X8035	Defense Export Loan Guarantee Program Account
97X8036	DoD Military Unaccompanied Housing Improvement Program
97X8038	Support for International Sporting Competitions, Defense
97*0839	Quality of Life Enhancement, Defense
97*0840	OPLAN 34A-35 P.O.W. Payment
97*3296	Pinatubo Disaster Relief Fund
97X3910	ADP Equipment Management Fund, Defense
97X4090	Homeowners Assistance Fund, Defense
97*4090	Homeowners Assistance Fund, Defense
97X4093	William Langer Jewel Bearing Plant Revolving Fund, Defense
97*4166	Family Housing Improvement Fund, Direct Loan Financing Account
97*4167	Family Housing Improvement Fund, Guaranteed Loan Financing Account
97*4168	Defense Expense Loan Guarantee Financing Program
97*4179	Reserve Mobilization Fund
97X4555	National Defense Stockpile Transaction Fund, Defense
97X4931	Buildings Maintenance Fund
97X4950	Pentagon Reservation Maintenance Revolving Fund
97X4965	Emergency Response Fund, Defense
97X5187	Defense Cooperation Account, Defense
97X5188	Disposal of Department of Defense Real Property
97X5189	Lease of DoD Real Property
97X5193	DoD Overseas Military Facility Investment Recovery Account
97X5195	Use of Proceeds from the Transfer or Disposition of Commissary Facilities, Defense
97X5196	Theater Missile Defense Cooperation Account, Defense
97X5472	DoD, Medicare Eligible Retiree Health Care Fund
97X8097	DoD Military Retirement Fund
97X8098	DoD, Education Benefits Fund

Other Defense Organizations (Continued):

97*8164	Surcharge Collections, Sales of Commissary Stores
97X8165	Foreign National Employees Separation Pay Account, Defense
97X8168	National Security Education Trust Fund
97*8238	Kuwait Civil Reconstruction Trust Fund
97X8311	Uniformed Services University of the Health Sciences Gift Fund
97X8335	Voluntary Separation Incentive Trust Fund
97X8337	Host Nation Support for U.S. Relocation Activities, Defense
97*6xxx	(Nonentity) Deposit Fund Accounts

U.S. Army Corps of Engineers:

96*1039	Construction, National Parks Service
96*1105	State and Private Forestry, Forest Service
96*2020	Manu'a Islands, Department of Army
96*2050	Levee Restoration Program, Economic Development Administration
96X3112	Flood Control, Mississippi River and Tributaries, Corps of Engineers, Civil
96X3121	General Investigations, Corps of Engineers, Civil
96X3122	Construction, General, Corps of Engineers, Civil
96X3123	Operation and Maintenance, General, Corps of Engineers, Civil
96*3123	Operation and Maintenance, General, Corps of Engineers, Civil
96X3124	General Expenses, Corps of Engineers, Civil
96*3124	General Expenses, Corps of Engineers, Civil
96X3125	Flood Control and Coastal Emergencies, Corps of Engineers, Civil
96*3125	Flood Control and Coastal Emergencies, Corps of Engineers, Civil
96X3126	General Regulator Functions, Corps of Engineers, Civil
96X3128	Washington Aqueduct Capital Improvements, Corps of Engineers (Borrowing Authority)
96*3129	Payments to the South Dakota Terrestrial Wildlife Habitat Restoration Trust Fund
96X3130	Formerly Utilized Sites Remedial Action Program (FUSRAP)
96*4045	Bonneville Power Administration
96X4902	Revolving Fund, Corps of Engineers, Civil
96X5007	Special Recreation Use Fees, Corps of Engineers, Civil
96X5066	Hydraulic Mining in California, Debris Fund
96X5090	Payments to States, Flood Control Act of 1954
96X5125	Maintenance and Operation of Dams and Other Improvements of Navigable Waters
96X5483	San Gabriel Basin Restoration Fund
96X5493	Fund for Non-Federal Use of Disposal Facilities, Corps of Engineers
96X8217	South Dakota Terrestrial Wildlife Habitat Restoration Trust Fund
96X8333	Coastal Wetlands Restoration Trust Fund
96X8861	Inland Waterways Trust Fund
96X8862	Rivers and Harbors Contributed and Advance Funds, Corps of Engineers, Civil
96X8863	Harbor Maintenance Trust Fund
96X8868	Oil Spill Research, Corps of Engineers, Civil Nonentity Funds:

U.S. Army Corps of Engineers (Continued):

96*6xxx	(Nonentity) Deposit Fund Accounts
96 12X1105	State and Private Forestry, Forest Service
96 13X2050	Economic Development Administration
96 14X1039	Construction National Park Service
96 21X2020	Operation and Maintenance, Army, American Samoa Projects
96 89X4045	Bonneville Power Administration
96 72*1021	Development Assistance, Agency for International Development
96 69X8083	Federal Aid Highways

Note: The USACE is executive agency for the Inland Waterways Trust Fund and the Harbor Maintenance Trust Fund.

The following are applicable to multiple DoD Reporting Entities:

F3875	Budget Clearing Account (Suspense)
F3878	Budget Clearing Account (Deposits)
F3879	Undistributed Letter of Credit Differences
F3880	Unavailable Check Cancellations and Overpayments
F3885	Undistributed Intragovernmental Payments
F3886	Civilian Thrift Savings Plan

Note: Appropriations shown with an asterisk (*) in the third position of the appropriation symbol indicates the appropriation may be single-year, multi-year or no-year.

Note: Appropriations shown with an (X) in the third position of the appropriation symbol indicates the appropriation is a "no-year" appropriation.

Funds Appropriated to the President
Administered by the Department of Defense

BALANCE SHEET As of September 30, 2004 ($ in Millions)		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
ASSETS							
Fund Balance With Treasury	$	75.1	1,803.7	5.0	16.7	-	34.5
Accounts Receivable		-	-	31.8	-	-	-
Other Assets		-	-	-	-	-	-
Loans Receivable		-	-	223.4	-	3,271.9	934.3
Inventory and Related Property, Net		-	-	-	-	-	-
Other Assets		-	-	-	-	-	-
Total Assets	**$**	**75.1**	**1,803.7**	**260.2**	**16.7**	**3,271.9**	**968.8**
LIABILITIES							
Debt	$	-	-	228.3	-	3,271.9	647.1
Other Liabilities		-	-	31.9	-	-	321.7
Accounts Payable		26.0	0.6	(0.0)	-	-	-
Other Liabilities		-	-	-	-	-	-
Total Liabilities	**$**	**26.0**	**0.6**	**260.2**	**-**	**3,271.9**	**968.8**
NET POSITION							
Unexpended Appropriation	$	49.1	1,801.6	-	-	-	-
Cumulative Results of Operations		-	1.5	-	16.7	-	-
Total Net Position	**$**	**49.1**	**1,803.1**	**-**	**16.7**	**-**	**-**
Total Liabilities and Net Position	**$**	**75.1**	**1,803.7**	**260.2**	**16.7**	**3,271.9**	**968.8**

Funds Appropriated to the President
Administered by the Department of Defense

STATEMENT OF NET COST As of September 30, 2004 ($ in Millions)		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
Program Costs:							
Intragovernmental Gross Cost	$	-	-	11.2	-	138.6	86.3
Less: Intragovernmental Earned Revenue		-	-	-	-	-	-
Intragovernmental Net Costs		-	-	11.2	-	138.6	86.3
Gross Costs With the Public		80.5	5,302.3	346.0	-	56.6	(139.7)
Less: Earned Revenues From The Public		-	(0.0)	(11.2)	(90.7)	(684.9)	31.6
Net Cost With the Public	**$**	**80.5**	**5,302.3**	**334.8**	**(90.7)**	**(628.3)**	**(108.1)**
Total Net Costs	**$**	**80.5**	**5,302.3**	**346.0**	**(90.7)**	**(489.7)**	**(21.8)**
Costs not Assigned to Programs		-	-	-	-	-	-
Less: Earned Revenues not Attributable to Programs		-	-	-	-	-	-
Net Cost of Operations	**$**	**80.5**	**5,302.3**	**346.0**	**(90.7)**	**(489.7)**	**(21.8)**

Funds Appropriated to the President
Administered by the Department of Defense

STATEMENT OF CHANGES IN NET POSITION **As of September 30, 2004** **($ in Millions)**		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
Cumulative Results of Operations							
Beginning Balance	$	-	(4.1)	346.0	(91.8)	(546.3)	117.9
Prior Period Adjustments (+/-)		-	(4.1)	346.0	(91.8)	(546.3)	117.9
Beginning Balance, as adjusted	$	-	(4.1)	346.0	(91.8)	(546.3)	117.9
Budgetary Financing Sources							
Appropriation Received	$	-	-	-	-	-	-
Appropriations Transferred in/out (+/-)		-	-	-	-	-	-
Other Adjustments (rescissions, etc.) (+/-)		-	-	-	-	-	-
Appropriations Used		80.5	5,307.9	-	5,444.9	56.6	-
Nonexchanged Revenue		-	-	-	-	-	-
Donations and Forfeitures of Cash and Cash Equivalents		-	-	-	-	-	-
Transfers in/out Without Reimbursement (+/-)		-	-	-	-	-	-
Other Budgetary Financing Sources (+/-)		-	-	-	-	-	-
Other Financing Sources:							
Donations and forfeitures of property	$	-	-	-	-	-	-
Transfers in/out Without Reimbursement (+/-)		-	-	(0.0)	(149.7)	-	(139.7)
Imputed financing from costs absorbed by others		-	-	-	-	-	-
Other (+/-)		-	-	-	-	-	-
Total Financing Sources	$	80.5	5,307.9	(0.0)	5,295.2	56.6	(139.7)
Net Cost of Operations (+/-)	$	80.5	5,302.3	346.0	5,124.5	(489.7)	(21.8)
Ending Balances	$	-	1.5	-	78.9	-	-
Unexpended Appropriations							
Beginning Balance	$	41.7	2,487.5	-	2,529.2	-	-
Prior Period Adjustments (+/-)		41.7	2,487.5	-	2,529.2	-	-
Beginning Balance, as adjusted	$	41.7	2,487.5	-	2,529.2	-	-
Budgetary Financing Sources							
Appropriation Received	$	91.7	4,581.0	-	4,729.3	56.6	-
Appropriations Transferred in/out (+/-)		-	66.5	-	66.5	-	-
Other Adjustments (rescissions, etc.) (+/-)		(3.8)	(25.4)	-	(29.3)	-	-
Appropriations Used		(80.5)	(5,307.9)	-	(5,444.9)	(56.6)	-
Nonexchanged Revenue		-	-	-	-	-	-
Donations and Forfeitures of Cash and Cash Equivalents		-	-	-	-	-	-
Transfers in/out Without Reimbursement (+/-)		-	-	-	-	-	-
Other Budgetary Financing Sources (+/-)		-	-	-	-	-	-
Other Financing Sources:							
Donations and forfeitures of property	$	-	-	-	-	-	-
Transfers in/out Without Reimbursement (+/-)		-	-	-	-	-	-
Imputed financing from costs absorbed by others		-	-	-	-	-	-
Other (+/-)		-	-	-	-	-	-
Total Financing Sources	$	7.4	(685.8)	-	(678.5)	-	-
Net Cost of Operations (+/-)	$	49.1	-	-	-	-	-
Ending Balances	$	49.1	1,801.6	-	1,850.7	-	-

Funds Appropriated to the President
Administered by the Department of Defense

STATEMENT OF BUDGETARY RESOURCES As of September 30, 2004 ($ in Millions)		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
Budgetary Financing Accounts							
Budgetary Resources							
Budget Authority							
Appropriation Received	$	91.7	4,581.0	-	-	56.6	-
Borrowing Authority		-	-	-	-	-	-
Contract Authority		-	-	-	-	-	-
Net Transfers (+/-)		-	66.5	-	-	-	-
Other		-	-	-	-	-	-
Unobligated Balance							
Beginning of Period		4.8	0.4	-	26.8	0.0	-
Net Transfers, Actual (+/-)		-	-	-	(10.0)	-	-
Anticipated Transfer Balances		-	-	-	-	-	-
Spending Authority from Offsetting Collections							
Earned		-	-	-	-	-	-
Collected		-	0.0	-	0.0	352.8	-
Receivable from Federal Sources		-	-	-	-	-	-
Change in unfilled Customer Orders		-	-	-	-	-	-
Advance Received		-	-	-	-	-	-
Without advance from Federal Sources		-	-	-	-	-	-
Anticipated for the rest of the Year, Without Advances		-	-	-	-	-	-
Transfers from Trust Funds		-	-	-	-	-	-
Subtotal	$	-	0.0	-	0.0	352.8	-
Recoveries of Prior Year Obligations		10.6	2.4	-	-	-	-
Temporarily Not Available Pursuant to Public Law		-	-	-	-	-	-
Permanently Not Available		(3.8)	(25.4)	-	-	(342.6)	-
Total Budgetary Resources	$	103.1	4,624.9	-	16.8	66.8	-
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred							
Direct	$	95.4	4,624.6	-	-	66.7	-
Reimbursable		-	-	-	0.0	-	-
Subtotal	$	95.4	4,624.6	-	0.0	66.7	-
Unobligated Balance							
Apportioned		1.8	0.0	-	-	-	-
Exempt from Apportionment		-	-	-	-	-	-
Other Available		-	0.0	-	-	-	-
Unobligated Balances Not Available		5.9	0.3	-	16.7	-	-
Total, Status of Budgetary Resources	$	103.2	4,624.9	-	16.8	66.7	-
Relationship of Obligations to Outlays							
Obligated Balance, Net - Beginning of Period	$	59.6	2,483.6	-	-	-	-
Obligated Balance Transferred, Net (+/-)		-	-	-	-	-	-
Obligated Balance, Net - End of Period:							
Accounts Receivable		-	-	-	-	-	-
Unfilled Customer Order from Federal Sources		-	-	-	-	-	-
Undelivered Orders		41.4	1,802.8	-	-	-	-
Accounts Payable		26.0	0.6	-	-	-	-
Outlays							
Disbursements		77.1	5,302.4	-	0.0	66.7	-
Collections		-	(0.0)	-	(0.0)	(352.8)	-
Subtotal	$	77.1	5,302.4	-	0.0	(286.1)	-
Less: Offsetting Receipts		-	-	-	-	-	-
Net Outlays	$	77.1	5,302.4	-	0.0	(286.1)	-

Funds Appropriated to the President
Administered by the Department of Defense

STATEMENT OF BUDGETARY RESOURCES **As of September 30, 2004** **($ in Millions)**		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
NONBUDGETARY FINANCING ACCOUNTS							
BUDGETARY RESOURCES							
Budget Authority							
Appropriation Received	$	-	-	-	-	-	-
Borrowing Authority		-	-	6.9	-	-	70.4
Contract Authority		-	-	-	-	-	-
Net Transfers (+/-)		-	-	-	-	-	-
Other		-	-	-	-	-	-
Unobligated Balance							
Beginning of Period		-	-	2.7	-	-	45.1
Net Transfers, Actual (+/-)		-	-	-	-	-	-
Anticipated Transfer Balances		-	-	-	-	-	-
Spending Authority from Offsetting Collections							
Earned		-	-	-	-	-	-
Collected		-	-	37.7	-	-	940.9
Receivable from Federal Sources		-	-	-	-	-	-
Change in unfilled Customer Orders		-	-	-	-	-	-
Advance Received		-	-	-	-	-	-
Without advance from Federal Sources		-	-	-	-	-	-
Anticipated for the rest of the Year, Without Advances		-	-	-	-	-	-
Transfers from Trust Funds		-	-	-	-	-	-
Subtotal	$	-	-	37.7	-	-	940.9
Recoveries of Prior Year Obligations		-	-	-	-	-	-
Temporarily Not Available Pursuant to Public Law		-	-	-	-	-	-
Permanently Not Available		-	-	(0.2)	-	-	(850.8)
Total Budgetary Resources	$	-	-	47.2	-	-	205.6

Funds Appropriated to the President
Administered by the Department of Defense

STATEMENT OF FINANCING **As of September 30, 2004** **($ in Millions)**		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
Resources Used to Finance Activities:							
Budgetary Resources Obligated							
Obligations Incurred	$	95.4	4,624.5	42.2	0.0	66.7	171.1
Less: Spending Authority from Offsetting Collections and Recoveries (-)		(10.6)	(2.4)	(37.7)	(0.0)	(352.8)	(940.9)
Obligations Net of Offsetting Collections and Recoveries	$	84.9	4,622.1	4.5	0.0	(286.1)	(769.8)
Less: Offsetting Receipts (-)		-	-	-	-	-	-
Net Obligations	$	**84.9**	**4,622.1**	**4.5**	**0.0**	**(286.1)**	**(769.8)**
Other Resources							
Donations and Forfeitures of Property	$	-	-	-	-	-	-
Transfers In/Out Without Reimbursement (+/-)		-	-	-	(10.0)	-	(139.7)
Imputed Financing from Costs Absorbed by Others		-	-	-	-	-	-
Other (+/-)		-	-	346.0	(90.7)	(203.6)	117.9
Net Other Resources Used to Finance Activities		-	-	346.0	(100.7)	(203.6)	(21.8)
Total Resources Used to Finance Activities	$	**84.9**	**4,622.1**	**350.5**	**(100.7)**	**(489.7)**	**(791.6)**
Resources Used to Finance Items not part of the Net Cost of Operations:							
Change in Budgetary Resources Obligated for Goods, Services, and Benefits ordered but not yet provided							
Undelivered Orders (-)	$	(4.4)	680.2	-	-	-	81.9
Unfilled Customer Orders		-	-	-	-	-	-
Resources that fund expenses recognized in Prior Periods		-	-	-	-	-	-
Budgetary Offsetting Collections and Receipts that do not affect Net Cost of Operations		-	-	37.7	-	-	940.9
Resources that Finance the Acquisition of Assets		-	-	(42.2)	-	-	(253.0)
Other Resources or Adjustments to net Obligated Resources that do not affect Net Costs of Operations							
Less: Trust or Special Fund Receipts related to exchange in the Entity's Budget (-)		-	-	-	-	-	-
Other (+/-)		-	-	0.0	10.0	-	139.7
Total Resources Used to Finance Items not part of the Net Cost of Operations	$	**(4.4)**	**680.2**	**(4.5)**	**10.0**	**-**	**909.5**
Total Resources Used to Finance the Net Cost of Operations	$	**80.5**	**5,302.3**	**346.0**	**(90.7)**	**(489.7)**	**117.9**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period							
Components Requiring or Generating Resources in Future Periods							
Increase in Annual Leave Liability	$	-	-	-	-	-	-
Increase in Environmental and Disposal Liability		-	-	-	-	-	-
Upward/Downward Reestimates of Credit Subsidy Expense (+/-)		-	-	(0.0)	-	-	(139.7)
Increase in Exchange Revenue Receivable from the Public (-)		-	-	-	-	-	-
Other (+/-)		-	-	-	-	-	-
Total Components of Net Cost of Operations that will require or generate Resources in Future Periods	$	**-**	**-**	**(0.0)**	**-**	**-**	**(139.7)**
Components Not Requiring or Generating Resources							
Depreciation and Amortization	$	-	-	-	-	-	-
Revaluation of Assets or Liabilities (+/-)		-	-	-	-	-	-
Other (+/-)		-	-	-	-	-	-
Total Components of Net Cost of Operations that will not Require or Generate Resources	$	**-**	**-**	**-**	**-**	**-**	**-**
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$	**-**	**-**	**(0.0)**	**-**	**-**	**(139.7)**
Net Cost of Operations	$	**80.5**	**5,302.3**	**346.0**	**(90.7)**	**(489.7)**	**(21.8)**

Independent Auditors' Report on the Principal Statements

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

November 12, 2004

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE
(COMPTROLLER)/CHIEF FINANCIAL OFFICER

SUBJECT: Independent Auditor's Report on the Fiscal Year 2004 DoD Agency-Wide Financial Statements (Report No. D-2005-017)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires Federal agency Inspectors General appointed under the Inspector General Act of 1978, as amended, to audit their respective agency's financial statements or determine that "an independent external auditor" should conduct such audits. Pursuant to this statutory authority, the undersigned Inspector General of the Department of Defense assumed responsibility for auditing the accompanying DoD Agency-Wide Consolidated Balance Sheet as of September 30, 2004 and 2003, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, the Combined Statement of Financing, and the Statement of Custodial Activity for the fiscal years then ended.

The financial statements are the responsibility of DoD management. DoD is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Fiscal Year 2004 financial statements of DoD because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance With Laws and Regulations. The Report on Internal Control and Compliance With Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

Disclaimer of Opinion on the Financial Statements

The Under Secretary of Defense (Comptroller)/Chief Financial Officer acknowledged to us that (1) the FY 2004 DoD Agency-Wide Financial Statements would not substantially conform to generally accepted accounting principles and (2) DoD financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2004. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Inspector General of the Department of Defense to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. DoD has also acknowledged, and prior audits have identified, the material weaknesses listed in the Summary of Internal Control. These material weaknesses also

"A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." - Constitution of the United States, Article I, Section 9

affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the principal financial statements.[1] As described above, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

Summary of Internal Control

In planning our audit, we considered DoD internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance. However, previously identified reportable conditions,[2] all of which are material, continued to exist in the following areas:

- Financial Management Systems;
- Fund Balance with Treasury;
- Inventory;
- Operating Materials and Supplies;
- General Property, Plant, and Equipment (PP&E);
- Government-Furnished Material and Contractor-Acquired Material;
- Environmental Liabilities;
- Intragovernmental Eliminations;
- Other Accounting Entries;
- Statement of Net Cost; and
- Statement of Financing.

A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance that are material in relation to the financial statements would be prevented or detected on a timely basis. Our internal control work would not necessarily disclose all material weaknesses. See the Attachment for additional details on material internal control weaknesses.

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[1] The annual financial statements include the principal financial statements, management discussion and analysis, consolidating and combining financial statements, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

[2] Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

"A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." - Constitution of the United States, Article I, Section 9

Summary of Compliance With Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged, and prior audits confirm, that instances of noncompliance continue to exist. The Under Secretary of Defense (Comptroller)/Chief Financial Officer acknowledged to us that DoD financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether DoD was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) are met; and
- complying with applicable laws and regulations.

We provided a draft of this report to personnel in the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer who provided technical comments, which have been incorporated as appropriate. These officials expressed their continuing commitment to address the problems this report outlines.

Joseph E. Schmitz Inspector General Department of Defense	Paul J. Granetto Paul J. Granetto, CPA Assistant Inspector General Defense Financial Auditing Service

Attachment:
As stated

"A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." - Constitution of the United States, Article I, Section 9

Report on Internal Control and Compliance With Laws and Regulations

Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, management acknowledged that previously identified reportable conditions, all of which are material, continue to exist. The following financial management deficiencies are indications of material weaknesses in internal control that may adversely affect any decision by DoD that is based, in whole or in part, on information that is inaccurate because of these deficiencies. Financial information reported by DoD also may contain misstatements resulting from these deficiencies.

Financial Management Systems. Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, "Objectives of Federal Financial Reporting," requires financial management systems controls that are adequate to ensure that transactions are executed in accordance with budgetary and financial laws and other requirements, are consistent with the purposes authorized, and are recorded in accordance with Federal accounting standards. SFFAC No. 1 also requires that financial management systems controls ensure that assets are properly safeguarded to deter fraud, waste, and abuse; and that performance measurement information is adequately supported. The Under Secretary of Defense (Comptroller)/Chief Financial Officer acknowledged that many DoD financial management systems do not substantially comply with Federal financial management systems requirements. DoD financial management and feeder systems were not designed to adequately support various material amounts on the financial statements. These systemic deficiencies in financial management and feeder systems and inadequate DoD business processes result in the inability to collect and report financial and performance information that is accurate, reliable, and timely.

Fund Balance with Treasury. DoD is required by the Treasury Financial Manual and DoD Financial Management Regulation 7000.14-R, to resolve financial and accounting inconsistencies to accurately report Fund Balance with Treasury. However, inconsistencies continue to exist related to in-transit disbursements, unmatched disbursements, negative unliquidated obligations, unreconciled differences in suspense accounts, and unreconciled differences between U.S. Treasury records and DoD accounting records.

Inventory. DoD is required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property," to use historical cost or the latest acquisition cost adjusted for holding gains and losses or moving average cost for valuing Inventory. However, DoD acknowledged that the existing inventory valuation at most activities does not

Attachment

approximate historical cost. Additionally, DoD does not distinguish between Inventory Held for Sale and Inventory Held in Reserve for Future Sale, as required by SFFAS No. 3.

Operating Materials and Supplies. SFFAS No. 3 also states that Operating Materials and Supplies must be expensed when the items are consumed. DoD has acknowledged that significant amounts of Operating Materials and Supplies were expensed when purchased instead of when they were consumed. In addition, DoD acknowledged that significant amounts of Operating Materials and Supplies in the possession of contractors were not included in the Operating Materials and Supplies account balance.

General Property, Plant, and Equipment. DoD is required by SFFAS No. 6, "Accounting for Property, Plant, and Equipment," to record PP&E at acquisition cost, capitalize improvement costs, and recognize depreciation expense. However, DoD has acknowledged that it is unable to accurately report the value of PP&E on its financial statements. DoD legacy property and logistic systems were not designed to capture acquisition cost, costs of modifications and upgrades, or calculate depreciation. In addition, value of DoD PP&E is not reliably reported because of a lack of supporting documentation.

Government-Furnished Material and Contractor-Acquired Material. SFFAS No. 11, "Amendments to Accounting for Property, Plant, and Equipment," requires that property and equipment in the possession of a contractor for use in accomplishing a contract be considered Government property. Government property should be accounted for based on the nature of the item, regardless of who has possession. DoD has acknowledged, and prior audits confirm, that it is unable to comply with applicable requirements for Government-Furnished Materials and Contractor Acquired-Materials. As a result, the value of DoD property and material in the possession of contractors is not reliably reported.

Environmental Liabilities. DoD acknowledged that guidance and audit trails for estimating environmental liabilities are incomplete. Environmental liability estimates were unreliable because activities did not have effective controls in place to ensure that adequate audit trails and supporting documentation for estimates exist, and that they comply with established guidance in developing estimates and maintain reliable feeder and coordination systems. In addition, material uncertainties exist related to environmental cleanup because of incomplete documentation for cleanup costs.

Intragovernmental Eliminations. DoD acknowledged that it made unverifiable adjustments because of the inability to reconcile most intragovernmental transactions. For example, the Defense Finance and Accounting Service-Indianapolis entered more than $59 billion in unsupported adjustments to Army intragovernmental accounts to bring them into agreement with related amounts reported by its trading partners.

Other Accounting Entries. DoD acknowledged that it continues to enter material amounts of unsupported accounting entries. For example, the Defense Finance and Accounting Service-Indianapolis recorded $204.8 billion (excluding adjustments for intragovernmental transactions) in unsupported accounting entries to prepare the FY 2004 Army General Fund Financial Statements.

Attachment

Statement of Net Cost. SFFAC No. 2, "Entity and Display," requires the Statement of Net Cost to provide an understanding of the net costs of each organization and each program. In addition, the Statement of Net Cost should provide gross and net cost information that can be related to the amounts of outputs and outcomes for the programs and/or organization. DoD acknowledged the following deficiencies related to the Statement of Net Cost.

- The amounts presented for General Funds may not report actual accrued costs.
- Although the funds are generally recorded on an accrual basis for Working Capital Funds, as is required by generally accepted accounting principles, the systems do not always capture actual costs in a timely manner.
- Current financial processes and systems do not capture and report accumulated costs for major programs based on performance measures as required by the Government Performance and Results Act.
- DoD accounting systems do not capture cost data in a manner that enables DoD to determine if the costs were incurred to generate intragovernmental revenue.
- DoD accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Consequently, DoD was unable to reconcile intra-governmental revenue balances with its trading partners.

Statement of Financing. SFFAS No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting," states that the Statement of Financing should reconcile resources obligated during the period to the net cost of operations. However, DoD acknowledged that it is unable to reconcile budgetary obligations to net costs without making adjustments. Specifically, budgetary data are not in agreement with proprietary expenses. DoD disclosed in Note 22 that the Statements of Financing and Net Cost were adjusted by $10,071.7 million (absolute value) to bring them into agreement. Lastly, DoD presented the Statement of Financing on a combined basis instead of a consolidated basis as required by Office of Management and Budget (OMB) Bulletin No. 01-09, "Form and Content of Agency Financial Statements."

Compliance With Laws and Regulations

Management is responsible for compliance with existing laws and regulations related to financial reporting. Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continued to exist. Therefore, we did not determine whether DoD was in compliance with selected provisions of all applicable laws and regulations related to financial reporting. Our objective was not to, and we do not, express an opinion on compliance with applicable laws and regulations.

Attachment

Statutory Financial Management Systems Reporting Requirements. DoD is required to comply with the following financial management systems reporting requirements.

- Section 3512, title 31, United States Code, incorporates the reporting requirements of the FMFIA of 1982 and requires DoD to evaluate its systems and to annually report whether those systems are in compliance with requirements prescribed by the Comptroller General.

- The Federal Financial Management Improvement Act (FFMIA) of 1996 requires DoD to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. The FFMIA also requires DoD to develop a remediation plan when its financial management systems do not comply with Federal financial management systems requirements. The remediation plan is to include remedies, resources required, and milestones.

For FY 2004, DoD did not fully comply with the statutory reporting requirements identified in these provisions. Specifically, DoD acknowledged that many of its critical financial management and feeder systems did not comply substantially with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2004. In an attempt to remedy these long-standing financial management systems deficiencies, DoD is developing a DoD-Wide Business Enterprise Architecture. However, the Business Enterprise Architecture falls short of meeting the requirements of a remediation plan under the FFMIA because the architecture does not identify the resources required to correct the noncompliance with Federal financial management system requirements. Until the architecture is fully developed and implemented, DoD will continue to be unable to fully comply with the statutory reporting requirements. We did not perform tests of compliance for these requirements.

Antideficiency Act. Title 31, section 1341 of the United States Code states that an officer or employee of the United States Government may not "make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation;" or "involve either government in a contract or obligation for the payment of money before an appropriation is made unless otherwise authorized by law." During FY 2004 DoD completed 33 investigations of potential violations of the Antideficiency Act, and determined that 21 were actual violations.

In response to violations of the Antideficiency Act, title 31, sections 1351 and 1349 require DoD to immediately report the nature of violations to the President and Congress and to take appropriate disciplinary action against those responsible for the violations. In a recent audit of Antideficiency Act cases closed in FYs 2002 and 2003,[3] we identified that DoD was not reporting Antideficiency Act violations to the President and Congress in a timely manner. Additionally, the audit identified that DoD Components did not consistently take appropriate

[3] OIG DoD Audit Report No. D-2005-0003, "DoD Antideficiency Act Reporting and Disciplinary Process," October 14, 2004

Attachment

disciplinary action against personnel responsible for violations of the Antideficiency Act. Our review of Antideficiency Act investigations closed in FY 2004 showed that delays continue; however, DoD is taking aggressive action to significantly reduce the time to investigate and report violations.

Prompt Payment Act. The Prompt Payment Act requires DoD to maintain an internal control environment in accordance with OMB Circular A-123 "Management Accountability and Control." In prior audit reports, we identified outstanding deficiencies in the DoD internal control environment as it relates to payments. Specifically, deficiencies related to access and accountability for resources, recording, and documentation have not been corrected.

Audit Disclosures

We did not perform audit work related to the following selected provisions of laws and regulations: Government Performance and Results Act, Debt Collection Improvement Act, Federal Credit Reform Act, and the Pay and Allowance System for Civilian Employees.

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance because previous audit reports contained recommendations for corrective actions.

Attachment

Part 4:
Inspector General Summary of Management Challenges

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Inspector General Summary of Management Challenges

The Reports Consolidation Act of 2000, Public Law 106-531, permits the Secretary of Defense to submit a consolidated report to the President, to the Director of the Office of Management and Budget, and to Congress within 150 days of the end of the fiscal year, which "shall include a statement prepared by the agency's inspector general that summarizes what the inspector general considers to be the most serious management and performance challenges facing the agency, and briefly assesses the agency's progress in addressing those challenges." In the 2003 Annual Report to the President and the Congress, the Secretary of Defense described the competing demands among three difficult challenges: winning the global war on terror, preparing for threats that develop in this decade, and continuing to transform for threats that will develop beyond 2010. The Report discusses the difficulty of making choices among the competing challenges and presents a risk management framework to guide DoD decision-making. The management challenges that the Inspector General identified, based on audits, investigations, and inspections, fall into nine major areas. These areas, which were identified in the DoD Performance and Accountability Reports for Fiscal Years 2002 and 2003, remain significant challenges. The challenge areas, summarized here and in past Performance Accountability Reports, are as follows:

- Joint Warfighting and Readiness,
- Homeland Defense,
- Human Capital,
- Information Technology Management,
- Acquisition Processes and Contract Management
- Financial Management,
- Health Care,
- Logistics, and
- Infrastructure and Environment.

These challenge areas fit into the risk management framework described in the 2003 Annual Report, that is, force management risk, operational risk, institutional risk and future challenge risk. The risk framework is further divided as follows:

Force Management Risk

- *Maintain quality workforce*
- *Ensure sustainable military TEMPO and maintain workforce satisfaction*
- *Maintain reasonable force costs*
- *Shape the force of the future*

Operational Risk

- *Have the right forces available*
- *Posture the forces to succeed*
- *Provide a ready force*
- *Employ forces consistent with strategic priorities*

Institutional Risk

- *Streamline the decision process, improve financial management, drive acquisition excellence*
- *Manage overhead and direct costs*
- *Improve the readiness and quality of key facilities*
- *Realign support to the warfighter*

Future Challenges Risk

- *Drive innovative joint operations*
- *Develop more effective organizations*
- *Define and develop transformational capabilities*
- *Define skills and competencies for the future*

The Department's risk management framework, and the associated outcome goals were discussed previously in the "Performance Highlights" section. The following discussion of the nine management challenge areas identifies affected outcome goals.

Joint Warfighting and Readiness

- *Have the right forces available*
- *Posture the forces to succeed*
- *Provide a ready force*
- *Drive innovative joint operations*

U.S. forces continue to transform to meet the new and evolving threats, traditional and asymmetrical. Operations Iraqi Freedom and Enduring Freedom reinforced the need for the Services to continue to train together and in combination to fight as a team. The experiences gained in those operations, together with the ongoing efforts aimed at transforming U.S. forces, create an atmosphere of change and evolution unlike any experienced in a long time. Each factor individually, as well as collectively, challenges the DoD to ensure that U.S. forces are ready to carry out their assigned missions, while addressing their immediate needs. Many of the other management challenge areas encompass those functions that support joint warfighting and readiness issues.

Discussion

The Office of the Inspector General (OIG) services to the Department included a number of projects in joint warfighting and readiness. The OIG's review of DoD's management of network-centric warfare (NCW) focused on the NCW implementation within the DoD and specific NCW initiatives ongoing within the Services. Although DoD components had undertaken steps to incorporate NCW into DoD, DoD still needed to improve its approach to integrating NCW. DoD can assist the integration of NCW by providing the leadership, direction, and planning that will be required for the successful integration of NCW.

In response to allegations of fraud, waste, and abuse made to the DoD Hotline, the OIG reviewed the use of cargo aircraft in the U.S. Central Command area of responsibility. Although the OIG did not substantiate the allegations, it did identify that external factors that the DoD had no control over directly affected operating efficiencies.

The OIG summarized 27 reports on security controls over biological agents, issues reported by the Offices of the Inspectors General of the Departments of Agriculture, Army, Defense, Energy, Health and Human Services, and Veterans Affairs. The summary identified nine systemic problems: physical security, personnel access controls, inventory accountability and controls, contingency plans, registration with the Centers for Disease Control and Prevention (CDC), import and export of agents, safety and security training, management oversight, and policies and procedures. Corrective actions, as recommended in the 27 reports, were initiated by those agencies.

The increasing threat of terrorist actions against U.S. military and civilian populations demonstrates the need to enhance the safety of military forces in the United States and overseas. DoD installations at home and abroad must plan for and be prepared to execute the necessary actions to protect U.S. personnel and assets against natural disasters or those of human origin. The OIG visited selected installations and reported that the installations did not have formal force protection programs, and their antiterrorism plans and training did not meet DoD requirements. Another OIG effort identified weaknesses in disaster preparedness and consequence management plans, training and exercise programs, and equipping and host nation support at the installation level in relation to disaster preparedness and consequence management programs. The OIG recommended that the U.S. European Command and the Service components improve installation disaster preparedness and consequence management programs at installations in the U.S. European Command.

Inspector General Assessment of Progress

The Department has made progress in joint warfighting and readiness. Actions to establish the Office of Force Transformation and to develop transformation plans for each of the Services are commendable. Those efforts look to the future and assist the Department in continuing to address traditional threats while evolving to address non-traditional threats to the United States.

The DoD audit community continues to contribute to the Department's efforts to enhance joint warfighting and readiness. The OIG, GAO, the Army Audit Agency, the Naval Audit Service, and the Air Force Audit Agency have each covered topics related to improving the ability of the armed forces to respond to threats to the United States. Topics such as the need for DoD management to establish guidelines and policy for network-centric warfare, the progress on the Army's new Stryker system, the mobilization and use of Reserve component personnel, and the use and maintenance of pre-positioned materiels have all received coverage. For every report that identified an issue needing attention, the Department is taking positive actions to increase its warfighting ability and readiness posture.

The Inspector General Summary of Management Challenges in the FY 2003 DoD Performance and Accountability Report noted that the Department lacks comprehensive policy, guidance and training concerning the roles, missions, functions, and relationships of Combatant Command Inspectors General. During FY 2004, the OIG DoD worked with the Joint Staff, Combatant Command, and Military Department Inspectors General to begin the development of policy, guidance, and training required by these Inspectors General. These initiatives will greatly enhance the abilities of these Inspectors General to perform their duties in support of the Combatant Commands. A new DoD Directive and Instruction codifying Joint IG authority, policy, and procedures, and Joint Inspector General Orientation Course Charter are being coordinated.

Homeland Defense

- *Improve readiness and quality of key facilities*
- *Provide a ready force*
- *Employ forces consistent with strategic priorities*

The global war on terror continues to heighten the level of threat from adversaries to the United States. Those adversaries may use weapons of mass destruction, such as chemical or biological weapons or they may attempt to use information warfare to attack the Defense information structure. Because of those threats, homeland defense is a priority across the federal government. The Department established an Assistant Secretary of Defense for Homeland Defense and the U.S. Northern Command as part of an effort to coordinate Departmental homeland defense policy and resources. Additional initiatives with the common goal of protecting the United States work towards coordinating policy and resources at the federal level with the Department of Homeland Security.

Discussion

The importance of a robust intelligence program within the government and especially within DoD has gained increased visibility. The Department will be particularly challenged during the upcoming year as the Administration and Congress act to implement the recommendations in the Final Report of the National Commission on Terrorist Attacks Upon the United States. During FY 2004, the OIG increased the size of its Office of Deputy Inspector General for Intelligence in recognition of the increased importance of this critical area. Classified reports issued by this office and the defense intelligence agencies' Inspectors General have made recommendations to improve the responsiveness of DoD intelligence to the terrorist threat.

Guarding against the threat to critical DoD information systems remains a significant challenge. In September 2003, the Assistant Secretary of Defense for Homeland Defense (ASD(HD)) assumed responsibility for Critical Infrastructure Protection (CIP) oversight. Subsequently, the ASD(HD) requested the Office of the Inspector General to evaluate the CIP organization and policy; validate the efficiency and effectiveness of vulnerability assessment methodologies; and review procedures related to vulnerability assessments for data collection and analysis. The OIG Inspections and Evaluations Directorate began an evaluation of the Defense Critical Infrastructure Program in 2004 with emphasis on assets exposed to high risk.

The OIG conducted an evaluation of installation disaster preparedness and consequence management that focused on the ability of installations in the European theater to deter, recover from, and protect critical operations and personnel from natural and created disasters. The OIG reported opportunities to improve theater-level monitoring programs and Service component planning, training, exercises, and equipment related to the program.

For FY 2004, the annual statutory requirement to audit export controls focused on the Department's policies and procedures for preventing the transfer of technologies and technical information with potential military application to countries and entities of concern. The OIG reported that the Department needs to improve its policies and procedures for identifying unclassified export-controlled technology and preventing unauthorized disclosure to foreign nationals at contractor, university, and federally funded research and development centers. The report disclosed weaknesses on exporting technology that underscore the need for continued emphasis in this area.

The Cooperative Threat Reduction Program was initiated to reduce the threat posed by weapons of mass destruction in the former Soviet Union by providing assistance to former Soviet states in building facilities and operating programs to safeguard, transport, and ultimately destroy chemical, biological, and nuclear weapons, delivery systems, and infrastructure. Adequate controls for the program are vital to ensuring that the limited program funds are used effectively. The OIG identified that a facility constructed with Department funds might not be fully used because implementing agreements between the United States and Russia do not clearly address the amounts and types of fissile material to be stored at a facility. In addition, construction delays for the chemical weapons destruction facility may result because the implementing agreement did not require Russia to obtain the necessary construction permits in a timely manner and there are risks that the land allocation for the destruction facility may be rescinded due to violations of Russian environmental laws. The Department reviewed and renegotiated, when appropriate, implementing agreements with Russia to ensure that controls are in place for Department-funded construction and use of facilities.

In conjunction with the Inspectors General of the Defense Intelligence Agency, the National Geospatial-Intelligence Agency, the National Reconnaissance Office and the National Security Agency, the OIG also assessed the adequacy and effectiveness of the DoD intelligence agencies' information assurance policies and procedures. We have made numerous recommendations to improve their information assurance programs. Each of the DoD intelligence agencies has taken aggressive steps to improve its information assurance posture, but more improvements are needed.

Inspector General Assessment of Progress

The Department has made progress improving homeland defense. Establishing the Assistant Secretary of Defense for Homeland Defense and the U.S. Northern Command to execute the mission of homeland defense and civil support are laudatory actions. Those new organizations seek appropriate avenues to address threats to the United States. The DoD audit community and the criminal investigative community have contributed to the Department's efforts to enhance homeland security. OIG, GAO, and Army Audit Agency reported on topics such as the need for changes in DoD management style to effectively transform the department, the challenges of implementing a secure global information grid, the challenges of implementing the Federal Information Security Management Act of 2002, and changes necessary to implement installation antiterrorism and consequence management programs at installations. The Department responded to the reports with positive actions to better protect American installations within the United States and abroad.

The safeguarding and control of U.S. nuclear weapons is a key area associated with Homeland security. The OIG has initiated a series of projects to assess the policies, practices, and capabilities for security control over and access to U. S. nuclear weapons. During FY 2004 the OIG issued two reports on the need to make improvements in this critical area. As a result of these reports the Department has initiated actions to increase security over nuclear weapons and better monitor the reliability of U. S. personnel with access to the weapons.

Human Capital

- *Maintain quality workforce*
- *Ensure sustainable military TEMPO and maintain workforce satisfaction*
- *Maintain reasonable force costs*
- *Shape the force of the future*

The challenges in human capital are multifaceted. The Department must ensure that civilian and military workforces are appropriately sized, well trained and motivated, held to high standards of integrity, encouraged to engage in intelligent risk taking, and capable of functioning in an integrated work environment and handling the emerging technologies and threats of the 21st century. Those challenges involve ensuring the Department's workforce planning is focused on acquiring, developing, and retaining a total workforce to meet the needs of the future, to include the contractor workforce. Additionally, as one of the nation's largest employers, the Department has a responsibility to promote a safe workplace.

The Department employs more than 3.38 million civilian and military personnel, with an annual financial investment of more than $100 billion. Managing such a large workforce plus contractor personnel confronts the Department with the need to identify and maintain a balanced level of skills to maintain core defense capabilities and meet increasing challenges and threats. Without focused recruiting, knowledge management programs, and a transparent personnel system, DoD may have difficulty hiring, developing, training, and retaining high quality people to become skilled soldiers, workers, managers, and leaders. In June 2004, Secretary Rumsfeld identified the need for shifting to a more joint training environment to ensure that all individuals, units, staffs and organizations - civilian and military - receive timely and effective joint education and training to accomplish the joint tasks that support operational needs.

Discussion

Recent evaluations conducted by the OIG assessed DoD efforts to combat trafficking in persons in Bosnia-Herzegovina and Kosovo and in Korea. Trafficking in Persons (TIP) is a global problem that enslaves thousands of people. The Department faces a significant challenge to develop and implement training and awareness programs that will ensure both military and contractor personnel fully understand, recognize, and take appropriate action in regard to this serious crime. In accordance with the National Security Presidential Directive (NSPD-22), DoD IG is assisting the Under Secretary of Defense for Personnel and Readiness to develop an awareness and training campaign for all DoD personnel on trafficking in persons that clearly explains the worldwide problem of TIP as it relates to DoD. As a continuing effort, the Inspector General of the Department of Defense will be conducting evaluation visits to various regions of the world to assess DoD's efforts to combat the trafficking in persons challenge.

The Department needs to develop uniform policies, guidelines, and standards for sexual assault prevention, reporting, response, and accountability. In February 2004, in response to reports of alleged sexual assaults on service members in Iraq and Kuwait, the Secretary of Defense directed the Under Secretary of Defense for Personnel and Readiness (USD(P&R)) to undertake a 90-day review of all DoD and Service sexual assault policies and programs, and recommend changes necessary to increase prevention, promote reporting, enhance the quality and support provided to victims, and improve accountability of offender actions. To accomplish this task, the USD(P&R) established the Department of Defense Care for Victims of Sexual Assaults Task Force. In April 2004, the Task Force published their report, identified 35 key findings, and proposed 9 broad recommendations for immediate, near-term, and long-term corrective actions. In September 2004, the USD(P&R) convened the DoD Care for Victims of Sexual Assault Conference, which is tasked to develop action plans to implement the Task Force recommendations. As requested by Conference organizers, OIG representatives were invited as observers. The OIG will continue to monitor the progress of implementing the Task Force recommendations and suggest a program evaluation process.

During fiscal year 2004, the GAO issued 14 reports addressing Human Capital issues including the use of new hiring flexibilities, assessing training and development programs, and performance management. Of particular interest to DoD was an assessment of civilian personnel planning. The report found that despite DoD's efforts to take steps in developing and implementing civilian workforce needs, the DoD strategic plans generally lacked some key elements essential to successful workforce planning. The plans did not include a gap analysis between critical skills and competencies currently needed by the workforce and those needed in the future. According to its strategic plan for fiscal years 2004-2009, the GAO plans to continue reviewing DoD human capital, focusing on readiness; military training; human capital management of civilians, Active duty, and Reserve components; and the potential for the Services to more efficiently and effectively organize and deploy forces.

The DoD audit community issued 16 reports addressing the management of human capital. The OIG reported that the Marine Corps staffing levels for enlisted warfighting positions remained vacant upon deployment, putting Marines at higher risk because of increased demands on limited personnel resources. In another report, the OIG discussed the DoD reporting on the President's Management Agenda initiative for strategic management of human capital to the Office of Management and Budget. Although adequate documentation existed to support DoD progress against the DoD Civilian Human Resources Strategic Plan, DoD did not have complete supporting documentation for DoD progress against the DoD Restructuring Plan.

In one effort pertaining to workforce satisfaction the OIG reported on DoD implementation of the Voting Assistance Program, as directed in Section 1566, chapter 80 of title 10, United States Code. The Federal Voting Assistance Program Office continued to provide a variety of valuable resources and assistance to voting assistance officers and uniformed absentee voters in 2003. However, opportunities exist to improve the DoD voting assistance program. The OIG recommended expediting revisions to DoD guidance, providing command emphasis, and improving oversight of the program.

The Military Department audit agencies issued reports concluding that although Air Force civilian personnel officials generally filled non-competitive requests for personnel fills, untimely fills of competitive actions resulted in prolonged vacancies of up to 132 days that hindered mission accomplishment and contributed to workforce stress. Another report concluded that the Navy had been unable to develop or field integrated information systems necessary to support the Navy's future human capital needs due in part to the lack of an overarching human resources management strategic plan for the Navy.

In May 2003, the Secretary of Defense challenged the Department's leadership to reduce the number of preventable mishaps and accidents by "at least 50% in the next two years." In response to this challenge, the USD(P&R) created the Defense Safety Oversight Council. This forum meets regularly and reviews safety initiatives, metrics, and best practices of the military departments and OSD. The OIG participates in this forum as an advisor. In August 2004, the USD(P&R) requested Inspector General assistance to evaluate the DoD safety program, to include such considerations as policies, organizational structure, culture, and safety programs at the installation level. In response to this request, the OIG Inspections and Evaluations Directorate is assembling a team of safety experts that will evaluate the Department's safety program and recommend best practices that may be used to help achieve the Secretary's accident reduction goal.

Inspector General Assessment of Progress

Overall, the Department has improved management of human capital. The Department is developing the National Security Personnel System (NSPS), the system designed to change how the Department hires, pays, promotes, disciplines, and fires its civilian workforce. The NSPS establishes personnel practices in DoD that parallel personnel practices in the private sector. The Department appointed a senior executive and Program Executive Officer to oversee NSPS design, planning, assessment, and implementation. Representatives from the Department have met with employees, unions, and other affected parties and have formed working groups to identify and develop options and alternatives for NSPS. The Department also developed a military training plan to transform from a deliberative, risk-averse culture to a more adaptive, risk-mitigating culture. In June 2004, DoD published the DoD Training Transformation Implementation Plan. The plan provides a dynamic, capabilities-based training program that emphasizes crisis-action planning, joint force organization, and mission rehearsal.

Recognizing that human capital is a crucial area for the Department, the OIG dedicated an audit team to focus on this area and, along with the Service audit agencies, established the Human Capital Joint Audit Planning Group. In May 2004, the OIG announced a review of the Enterprise Management of DoD Human Capital, a top-down look at human capital management in the Department.

With regard to improving awareness within DoD of the importance in combating Trafficking in Persons, the Department has initiated aggressive efforts to address this issue. During the course of the OIG assessment in Korea, the Commander of U.S. Forces Korea responded promptly to OIG recommendations to improve its training program. On January 30, 2004, the Deputy Secretary of Defense sent a memorandum throughout the Department of Defense emphasizing the President's call that "all Departments of the United States Government will take a 'zero tolerance' approach to trafficking in persons." This memo was augmented by the September 16, 2004, memorandum from Secretary Rumsfeld directing "commanders at all levels to ensure their units are trained to understand and recognize indicators of this serious crime."

Information Technology Management

- *Streamline the decision process, improve financial management, drive acquisition excellence*

The key to success on the modern battlefield and in internal business activities is the ability to produce, collect, process, and distribute information. Data must be accurate, timely, secure, and in usable form.

The huge scale, unavoidable complexity, and dynamic nature of DoD activities make them heavily dependent on information technology. That dependence has proven to be a major challenge because DoD management techniques have not kept pace with the continual growth in information user requirements and the shortened life spans of technologies before obsolescence. Much of the DoD success in meeting the Secretary of Defense's priorities and the major management challenges will depend on effective and efficient information technology management.

Discussion

During fiscal year 2004, 24 audits indicated a wide range of management issues in systems selected for review. The important systems for which management improvements were recommended included the U.S. Army Corps of Engineers Financial Management System and the U.S. Army Corps of Engineers Enterprise Infrastructure Services.

In addition, auditors reported that the Department made progress developing the DoD business enterprise architecture necessary to respond to Office of Management and Budget and congressional requirements and to support DoD transforming initiatives. The OIG reported that DoD did not adequately report information technology investments to the Office of Management and Budget in support of the DoD Budget Request for FY 2005. The component Chief Information Officers and Chief Financial Officers did not always include required information in submitted reports. For example, Capital Investment Reports did not completely respond to one or more required data elements addressing security funding, certification and accreditation, training, and security plans. Consequently, the quality of the DoD information on security reported to the Office of Management and Budget had limited value and did not demonstrate that DoD was effectively managing its proposed information technology investments for FY 2005.

An OIG report on the Collaborative Force-Building, Analysis, Sustainment, and Transportation System discussed that management control documentation was not prepared to justify the initiation of the system, compare budgeted and actual costs, measure performance requirements, track scheduled and actual timelines, or ensure that existing system capabilities were considered. The U.S. Joint Forces Command is conducting a "Quick Look and Final Capability Needs Analysis" to determine the appropriate documentation requirements for the system.

Inspector General Assessment of Progress

The Department has made progress addressing the information technology management challenge. The Business Management Modernization Program was established in 2003 in recognition of the need to manage information technology systems acquisitions and modernization from an enterprise perspective. That program has provided oversight to instill discipline in the acquisition and modernization process. Further, in response to the President's Management Agenda initiative on Expanded Electronic Government, the Department has also increased the quality of business cases and visibility into its information technology portfolio. The Department received audit reports issued by OIG on Information Technology Management in a positive manner and made changes to areas needing attention.

Acquisition Processes and Contract Management

- *Streamline the decision process, improve financial management, drive acquisition excellence*

The DoD buys the most numerous and various goods and services in the world. In FY 2003, DoD spent $231 billion on acquisitions. On average, every working day DoD issues more than 22,000 contract actions valued at $841 million and makes more than 140,000 credit card transactions valued at $37 million. The Department has approximately 1,500 weapon acquisition programs with a collective life value of $2.1 trillion. Department spending to procure services from the private sector grew to $123 billion in FY 2003 and continued to expand in FY 2004. The management challenge is to provide required materiel and services that are superior in performance, high in quality, sufficient in quantity, and reasonable in cost despite this enormous scale. Every acquisition dollar that is not prudently spent results in a dollar that is not available to fund the top priorities of the Secretary of Defense.

Discussion

During FY 2004, the DoD internal audit community and the GAO issued 154 reports that addressed a range of continuing acquisition problems. The Defense Contract Audit Agency continued to assist contracting officers through contract audits that identified more than $7 billion of questioned costs and funds. In FY 2004, savings from these questioned costs helped to reduce the program costs and the need for additional appropriations.

The Department must be vigilant in investigating procurement fraud and violations of procurement integrity rules to optimize the financial resources appropriated for national defense. The investigations of violations of the Procurement Integrity Act by the former Principal Deputy Secretary of the Air Force for Acquisition and Management and the former Chief Financial Officer for the Boeing Company and their impact on acquisition programs highlight the need for continued training for acquisition professionals. Adverse actions taken by very few people can cause delay for major acquisition programs, impede quick delivery of new capabilities to the warfighter, and adversely affect the public perception of the integrity of the acquisition process.

The OIG reviewed the Air Force planned acquisition of 100 Boeing KC-767A Tanker aircraft. The report identified a variety of shortcomings in the approach the Air Force used to reach a multi-billion dollar agreement to acquire the aircraft and recommended various changes before DoD allows the program to proceed. The report identified statutory requirements and other issues pertaining to the current program structure and procurement strategy that required resolution before continuing the acquisition. An overarching problem was that the Air Force did not properly execute its fiduciary responsibility to ensure that a fair and reasonable price was achieved and that warfighter needs were met.

The OIG reviewed the negotiations by the former Principal Deputy Assistant Secretary of the Air Force for Acquisition and Management for the North Atlantic Treaty Organization Airborne Warning and Control Systems Mid-Term Modernization Program, "Global Solution." The report identified that senior-level Air Force managers did not use appropriate business and contracting procedures during negotiations with The Boeing Company. The Air Force awarded a contract modification without knowing whether the $1.32 billion cost was fair and reasonable. Air Force actions to renegotiate the contract should result in a substantial price reduction.

The DoD audit community continued to identify ways that the Department could improve acquisition of weapon system programs, including the following examples:

- Better negotiate contract terms (OIG audit of Air Force C-130J aircraft contract with a cost of $2.6 billion);
- Update acquisition program baselines, obtain satisfactory operational test results, and prepare life cycle cost estimates before making investment decisions (OIG audits of the CH-47F Improved Cargo Helicopter and the Joint Chemical Agent Detector);
- Develop better processes and controls for cost estimating (Naval Audit Service audits of 18 programs' cost estimate increases at Naval Air Systems Command and Naval Sea Systems Command for a total of $15 billion during the life cycles); and
- Implement effective management controls (OIG audits of 27 acquisition category II and III programs valued at $18.3 billion).

Military conflicts have almost always resulted in unforeseen contracting problems that compel contract policy and procedural changes. An example from the current conflict is the planning for acquisition support that the Office of Reconstruction and Humanitarian Assistance (replaced by the CPA) required to perform its mission. A review of 24 contracts, valued at $122 million, showed that supplies and services were quickly acquired but that contracting rules were either circumvented or liberally interpreted. Lack of attention to proper contracting procedures resulted in less than the best contracting solution or price for post-war occupation and humanitarian relief operations. The Deputy Secretary of Defense responded to the situation by designating an office to study post-war strategy and to establish responsibilities, policies, and procedures for acquisitions to support future post-war occupations and relief operations.

Improving management of the growing volume of service contracts is a challenge. An OIG review of purchases on 113 contracts valued at $17.8 billion for professional and management support services identified inadequate competition (28 percent), inadequate contract surveillance (67 percent), and inadequate basis for price reasonableness determinations (88 percent). The report highlighted that little had improved since a review in FY 2000 identified similar problems. The Acting Under

Secretary of Defense for Acquisition, Technology, and Logistics and the Services responded by initiating numerous corrective actions to ensure that future acquisitions for services are properly awarded and administered. An OIG review of $415 million of task orders for the Cooperative Threat Reduction Program and the Defense Threat Reduction Agency identified $78 million of task orders associated with the Defense Threat Reduction Agency's Cooperative Threat Reduction (CTR) program had been awarded without citation of an exception to the fair opportunity to compete. The CTR program office adopted procedures to ensure that exceptions are cited for all task orders wherein contractors will not be allowed to compete.

The Inspectors General of the General Services Administration and Department of Interior identified task orders that DoD activities improperly issued against information technology supply schedule contracts. Defense activities issued task orders on General Services Administration contracts valued at about $150 million to information technology contractors with no expertise in the required services. Work was actually performed by subcontractors at an additional cost of $10 million.

The Defense auditing community has significantly contributed to the Department's aggressive pursuit of savings through use of credit cards and reduced vulnerability to misuse. In reports and testimony, the OIG and GAO identified a need to increase focus on negotiating discounts and leveraging its $7.2 billion in DoD purchase card spending to achieve savings. Efforts of the OIG data mining group and purchase card program office of DoD have increased senior leadership involvement and improved management controls over the purchase card program. The Department has reduced the number of purchase cards 47 percent, from 214,000 to 114,000.

Inspector General Assessment of Progress

Overall, the Department has made progress over the past decade in improving the acquisition process toward achieving acquisition excellence. The OIG has contributed to Department efforts to improve acquisition processes through numerous recommendations. Despite progress, the growing volume of acquisitions, the decrease in the number of acquisition personnel, and the numerous annual changes in regulations and processes for the acquisition professional make this a long-term challenge. During the past year, the Department has had to react to previously unidentified problems related to: acquisition of major systems such as the KC-767A Tanker aircraft and C-130J aircraft, contracting for Operation Iraqi Freedom, and use of multiple-award schedule contracts from other Federal agencies.

Financial Management

- *Streamline the decision process, improve financial management, drive acquisition excellence*

The Department's financial statements are the most complex and diverse in the world. Its FY 2003 financial statements included $1.1 trillion in assets and $1.6 trillion in liabilities. In FY 2004, the Defense Finance and Accounting Service (DFAS) processed the following payments on behalf of the Department: 12.6 million contractor invoices, 6.9 million travel payments, payments to 5.9 million people (including benefits to retirees and families), $127.3 million in accounting transactions, $455 billion in disbursements, and $13.5 billion in foreign military sales. In addition, DFAS managed $226.5 billion in military retirement trust fund. The Department prepares and obtains an audit opinion for the Department-wide financial statements and nine component financial statements. It also prepares the financial statements for three intelligence agencies.

Discussion

The Department faces financial management challenges that are complex, long-standing, and pervade virtually all its business operations, affecting the ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting and policy decisions. The challenges have obstructed the Department from receiving an unqualified opinion on its financial statements. The Office of Management and Budget anticipates that the Department would be one of three agencies that will not receive an unqualified opinion in FY 2004. In its June 30, 2004, Executive Branch Management Scorecard, the Office of Management Budget gave the Department an unsatisfactory rating for financial performance.

The GAO identified three high-risk areas in the Department (financial management, systems modernization, and inventory management) that directly affect the Department's ability to attain an unqualified audit opinion on its financial statements. The OIG identified 11 material control weaknesses that also directly impact the Department's ability to attain an unqualified opinion including: financial management systems; fund balance with treasury; inventory; operating material and supplies; property, plant and equipment; government-furnished material and contractor-acquired material; environmental liabilities; intragovernmental eliminations; accounting entries; statement of net cost; and statement of financing. The Department's high-risk areas and material control weaknesses will prevent the federal government from achieving an unqualified opinion on the FY 2004 consolidated financial statements.

Of the high-risk areas and material control weaknesses, the most significant is the Department's financial management systems. The Department currently relies on an estimated 4,000 systems, including accounting, acquisition, logistics, personnel, and management systems, to perform its business operations. Many financial management systems do not comply substantially with Federal financial management system requirements. The systems have little standardization across the Department, multiple systems perform the same task and identical data is stored in multiple systems. The systems are inefficient because personnel must manually enter data into multiple systems and execute many work-arounds and off-line records to translate data from one system to another.

In the National Defense Authorization Act for FY 2003, Congress required the Department to develop a business enterprise architecture and a transition plan to implement it. The Act requires the business enterprise architecture to describe an information infrastructure that would enable the Department to achieve specific capabilities such as complying with Federal accounting, financial management, and reporting requirements; integrating accounting, budgeting, and information systems; and routinely providing timely, accurate, and reliable financial and management data for management decision making. The Department has delivered several versions of the business enterprise architecture and transition plan but much work remains. For example, GAO reported that documentation describing the rationale for business enterprise architecture choices, and acquisition and portfolio investment management decisions is inadequate.

The President's Management Agenda also contains initiatives for improving the Department's financial performance. The President's Management Agenda directs the Office of Management and Budget to work with the Department to provide reliable, timely, and useful information to support operating, budgeting, and policy decisions. The initiatives to ensure reliability include obtaining and sustaining unqualified audit opinions for the Department and its components. Timeliness initiatives include re-engineering reporting processes, instituting quarterly financial statements, and accelerating end-of-year reporting. Initiatives for enhancing usefulness include requiring comparative financial reporting, and reporting specific financial performance measures.

The OIG provided audit service and advice to the Department with the goal of improving financial performance and obtaining an unqualified opinion on financial statements. The OIG is an independent advisory member on the Financial Improvement Executive Steering Committee (the Committee) that monitors and directs the Department's Financial Improvement Plan process.

Examples of specific audit services that the OIG provided in FY 2004 include the following.

The OIG reviewed Comptroller reimbursement procedures of coalition support funds expended to support the global war on terror. Management controls were not adequate to support coalition countries' reimbursement requests and determine whether requests were reasonable and claimed costs were in the context of U.S. National Security Strategy. The Comptroller issued guidance clarifying the documentation required and established procedures to coordinate reimbursement requests with the Department of State to confirm that proposed reimbursements are consistent with the U.S. National Security Strategy.

The OIG studied the Department costs incurred for monitoring satellite launches and contractor reimbursement. The Department did not adequately adjust estimates given to the satellite contractors to reflect actual costs or allocate indirect costs among all Departmental services rendered. In addition, costs to monitor satellite launches did not always match supporting documentation. The Office of the Under Secretary of Defense for Policy adjusted satellite contractor billings to reflect actual costs and established procedures to ensure that supporting documentation matches those costs incurred.

Inspector General Assessment of Progress

The Department's progress in financial management is demonstrated by its emphasis on developing effective, efficient financial systems that produce accurate, timely, and reliable financial statements. The Department has very ambitious goals for improving its financial performance and reporting. The Office of the Under Secretary of Defense (Comptroller)\Chief Financial Officer established 22 independent financial statement audit committees to oversee the annual audits and to provide a forum to discuss and resolve accounting and auditing issues. An OIG representative is an advisory (nonvoting) member on the committees.

Health Care

- *Maintain quality workforce*
- *Ensure sustainable military TEMPO and maintain workforce satisfaction*
- *Maintain reasonable force costs*

The DoD military health system challenge is to provide high quality health care in peacetime and wartime. The DoD military health system must provide quality care for approximately 9.2 million eligible beneficiaries within fiscal constraints and price growth pressure that have made cost control difficult in the public and private sectors. The DoD challenge is magnified because the military health system must also provide health support for the full range of military operations. The DoD military health system was funded at $29.8 billion in FY 2004, including $17.3 billion in the Defense Health Program appropriation, $6.9 billion in the Military Departments' military personnel appropriations, $.2 billion in military construction, and $5.4 billion in the DoD Medicare-Eligible Retiree Health Care Fund to cover the costs of health care for Medicare-eligible retirees, retiree family members and survivors.

Discussion

The primary peacetime challenges for the DoD military health system in FY 2005 will be completing the transition to the new TRICARE managed care contracts, completing the Base Realignment and Closure process, and ensuring compliance with the Health Insurance Portability and Accountability Act (HIPAA).

By removing the retail pharmacy program from the new TRICARE managed care support contracts and consolidating the program into a single pharmacy benefits manager, DoD continues its progress toward developing a fully integrated pharmacy program. A challenge this year will be implementing federal ceiling prices and federal supply schedule prices, using electronic data interchange technology in the retail pharmacy program. The federal ceiling prices and federal supply schedule prices, currently available for the military treatment facility and mail order pharmacy programs, should allow DoD to realize millions of dollars of savings in retail pharmacy costs. To make the pharmacy benefit more cost effective and to comply with the FY 2000 National Defense Authorization Act, the Department is implementing a uniform formulary process.

The results of the Base Realignment and Closure initiative will affect the numbers and types of medical facilities in the DoD military health system. The ongoing evaluation of transformational options may result in a realignment of capabilities and resources to increase the effectiveness of the military health system. HIPAA includes provisions for privacy and security of patient health information. Those provisions will be implemented in two phases. HIPAA required that procedures to ensure the privacy of patient health information be implemented by April 2003. Compliance with the requirement to safeguard patient health information requires completing tasks in FY 2004 in order for safeguards to be in place by the spring of FY 2005.

A major challenge in medical readiness will be completing a medical readiness review overseen by a steering group co-chaired by the offices of the USD(P&R) and the Director, Program Analysis and Evaluation. The review will identify medical readiness capabilities required by the National Security Strategy and warfighting transformation and examine delivery procedures for wartime and peacetime. Ongoing readiness challenges include readiness of the forces and readiness of the medical staff and units. Readiness of the forces means ensuring that all deployable forces are individually medically ready to perform their missions before deploying, while deployed, and upon their return. Readiness of the medical staff and units means ensuring that medical staff can perform at all echelons of operation and the units have the right mix of skills, equipment sets, logistics support, and evacuation capabilities. The Department developed six key elements for measuring individual readiness and the Military Departments are implementing systems to report on those elements.

The health care system also faces the challenge of increased joint operations. The FY 2004 National Defense Authorization Act authorized temporary provisions to expand TRICARE health and dental coverage for Reserve component members and families. The temporary health care benefits are scheduled to end December 3l, 2004. The new benefits presented a significant implementation challenge to the Department. If the benefits are continued, the Department will face a peacetime challenge due to the increased number of beneficiaries. The readiness challenge of keeping reservists medically ready to deploy continues due to the frequency and duration of reserve deployments.

The President's Management Agenda for FY 2002 identified nine agency-specific initiatives. One of the specific initiatives was the coordination of the DoD and the Department of Veterans Affairs medical programs and systems. Effective October 1, 2003, DoD and Veterans Affairs each must contribute $15 million to the DoD-Veterans Affairs Health Care Sharing Incentive Fund to finance future sharing initiatives. In addition, DoD was required to contribute $3 million in FY 2003, $6 million in FY 2004, and $9 million in later years to cover a "health care resources sharing and coordination project." We believe the sharing requirement will benefit both agencies and reduce costs.

Inspector General Assessment of Progress

The Department has made progress improving health care while attempting to control costs. The Department made significant progress implementing new TRICARE contracts. TRICARE is transitioning from 12 regions and 7 contracts in the United States to 3 regions and 3 contracts. Contracts for all three regions, valued at $6.4 billion, were awarded in August 2003. The transition is scheduled for completion in November 2004. The contracts provide incentives for customer satisfaction and include the contractors as partners in support of medical readiness.

The Department also made progress toward a fully integrated pharmacy program. The Medical Joint Cross Service Group made significant progress in developing the base realignment and closure process for medical facilities.

The Department also made progress implementing HIPAA. A military health system-wide training program was developed and a working group was established to address HIPAA requirements for contractors.

During FY 2004, the DoD audit community issued 26 reports on health care issues such as medical goods and services contracts, pharmaceutical inventory management, information security, government purchase cards, military eyewear costs, DoD/VA sharing agreements, third party collections, medical readiness reporting, marketing, military treatment facility downsizing, and physician productivity.

Logistics

- *Streamline the decision process, improve financial management, drive acquisition excellence*
- *Manage overhead and direct costs*

The purpose of logistics is to reliably provide the warfighter the right materiel at the right time to support continuous combat effectiveness of the deployed force. DoD logistics support operations for supplies, transportation, and maintenance cost more than $90 billion annually. Logistics support involves approximately 700,000 military and civilian personnel and several thousand private sector firms to maintain more than 300 ships; 15,000 aircraft and helicopters; 330,000 ground combat and tactical vehicles; and hundreds of thousands of additional mission support assets. In addition, the Department maintains an inventory of such items as clothing, engines, and repair parts valued at an estimated $67 billion to support the warfighter.

Discussion

During FY 2004, the DoD audit community reported a broad range of logistics issues. Topics included asset visibility, performance-based logistics, maintenance depot materiel control, and inventory requirements determination.

In one report, the OIG discussed improving the controls over materiel designated for or sent to disposal. Materiel that was reported as shipped to disposal was not recorded as received at the Defense Reutilization and Marketing Service or accounted for on inventory records. Navy disposal transactions valued at $134.3 million had $39 million worth of transactions that were not recorded on accountable supply records and were vulnerable to loss and undetected theft.

DoD guidance requires that each Military Department aggressively pursue performance based logistics and submit a plan outlining their strategies. The OIG reported that the Military Departments' implementation of performance based logistics might not be achieving goals to improve readiness for weapon systems or to reduce logistics support costs. Overall, the Military Departments were implementing performance based logistics strategies for weapons systems, sub-systems, and components; however, with the exception of Navy headquarters, their efforts were inconsistent, processes were inadequate and uncoordinated, and results were undeterminable.

Inspector General Assessment of Progress

The Department has made progress towards being a superior logistics provider through numerous initiatives to improve logistics. That progress is tempered by the sheer magnitude of logistics operations that makes it a long-term challenge. The DoD audit community continually provides services to the Department in evaluating new business processes and identifying processes for reform.

Major logistics initiatives include Force-centric Logistics Enterprise, DoD Business Management Modernization Program, Performance Based Logistics, and Base Realignment and Closure. The Force-centric Logistics Enterprise initiative is a comprehensive program to integrate logistics with operational planning and to meet warfighter requirements for more agile and rapid support. Force-centric Logistic Enterprise is focused on near-term collaborative initiatives that directly improve warfighter support, address known structural problems, and accelerate achieving the Department's long-range vision of Focused Logistics. The primary objective of the DoD Business Management Modernization Program is to change DoD business processes in logistics and financial systems to achieve efficiencies, and in the process to eliminate redundant and non-compatible systems. The objectives of the Performance Based Logistics initiative are to compress the supply chain, eliminate non-value-added steps, and improve readiness for major weapons systems and commodities. The objective of the Base Realignment and Closure initiative is to realign the DoD military base structure and examine and implement opportunities for greater joint activity. The OIG is providing audit services to evaluate the logistics initiatives and to support Base Realignment and Closure Joint Cross Service Groups that are analyzing common business-oriented functions for supply, storage, and industrial functions.

Infrastructure and Environment

- *Improve readiness and quality of key facilities*
- *Manage overhead and direct costs*
- *Realign support to the warfighter*

The challenge in managing approximately 4,700 military installations and other DoD sites is to provide modern, habitable, and well-maintained facilities, which cover a spectrum from test ranges to housing. The Department's review of our defense and security needs resulted in transforming our force structure and prompting a corresponding new base structure.

The challenge of a new base structure is complicated by the need to minimize spending on infrastructure so funds can be used instead on defense capability. Unfortunately, the Department has an obsolescence crisis in facilities and environmental requirements have continually grown. Furthermore, the Department maintains an estimated 25 percent more base capacity than needed to support its forces which diverts scarce resources from critical areas.

Discussion

Transformation through Base Realignment and Closure poses a significant challenge and opportunity for the Department. Base Realignment and Closure 2005 should eliminate excess physical capacity and transform DoD infrastructure into a more efficient structure for greater joint activity. As part of the challenge, the Department must meet the timelines established in law and use certified data that are accurate and complete to develop recommendations. Another critical aspect of the Base Realignment and Closure is to have a fair and accurate process that will withstand GAO, Base Realignment and Closure Commission and public scrutiny.

The Department is the largest steward of properties in the world, responsible for more than 29 million acres in the United States and abroad with a physical plant of 586,000 buildings and other structures valued at approximately $646 billion. Those installations and facilities are critical to supporting our military forces and must be properly sustained and modernized to be productive assets. The goal of the Department is a 67-year replacement cycle for facilities and the current program would achieve that level in FY 2008. The replacement cycle was reduced from a re-capitalization rate of 192 years in FY 2001 to 136 years in FY 2004.

As of the 2nd Quarter, FY 2004, the Military Departments owned 1,867 electric, water, wastewater, and natural gas systems worldwide. The Department has implemented an aggressive program to complete privatization decisions on all the water, sewage, electric, and gas utility systems by September 2005. In addition, although installation commanders must strive to operate more efficiently, they must do so without sacrificing their ability to operate in the event of a terrorist attack on our homeland. Comprehensive plans for preventing sabotage and responding to attacks on water and power at military installations will be complicated by civilian control of utilities.

As of June 30, 2004, DoD has an estimated $61.1 billion in environmental liabilities. The Department continues to correct past material control deficiencies in identifying and tracking sites with environmental liabilities and maintaining audit trails for financial liability estimates. The Department needs to improve documentation and supervisory review of environmental liability estimates.

The DoD audit agencies issued 24 reports on infrastructure and environmental issues during FY 2004. The agencies reported on topics such as military construction projects, residual value of facilities at overseas bases, Base Realignment and Closure, recycling operations, energy management, and land use controls and monitoring at formerly used defense sites.

Inspector General Assessment of Progress

The Department has made progress this year in defining all of the infrastructure problems as it works toward making recommendations for realignment and closure in the Base Realignment and Closure 2005 process. That progress comes after decades of struggle with aging and excess infrastructure. The oversight and breadth of Base Realignment and Closure 2005 far exceeds prior Base Realignment and Closure efforts in 1989, 1991, 1993, and 1995.

Part 5:
Appendixes

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Appendix A: Improper Payments Information Act of 2002

As discussed in Part 1 "Management Discussion and Analysis," the Department conducted a review of the improper payments relating to the Military Retirement and Military Health Benefits programs per the Office of Management and Budget (OMB) guidance. Results of the review follow.

1. *Describe your agency's risk assessment(s), performed subsequent to compiling your full program inventory. List the risk-susceptible programs (i.e., programs that have a significant risk of improper payments based on OMB guidance thresholds) identified through your risk assessments. Be sure to include the programs previously identified in the former Section 57 of OMB Circular A-11.*

The Department reviewed all of its programs and activities and determined that nine programs/activities were susceptible to erroneous payments. Risk assessments were performed for each of the nine programs/activities identified by the Department as being susceptible to erroneous payments. The risk assessments addressed the strength of the internal controls in place to prevent improper payments (such as prepayment reviews), system weaknesses identified internally or by outside audit activities, voluntary returns of overpayments by vendors, etc. None of the programs/activities identified were found to be susceptible to high risk. Two of these programs were previously identified in Section 57 of OMB Circular A-11. These are Military Retirement and Military Health Benefits.

2. *Describe the statistical sampling process conducted to estimate the improper payment rate for each program identified.*

The statistical sampling process used for the two programs that were previously identified in Section 57 of OMB Circular A-11 are outlined below:

Military Retirement. Using the fiscal year (FY) 2003 file size and the estimated rate of erroneous payments as a baseline, Military Retired and Annuitant Pay is conducting a random sample, which will yield an annual estimate with a probability level of 95% and a sample precision of plus or minus 2.5%. The size of the random sample will vary monthly depending on the number of retiree death transactions recorded. Once the number of accounts is known, a random sample of the monthly population is determined. The randomly selected accounts are then audited to determine if the account was overpaid once the member's death was reported to us. The audit provides an average amount of overpayment per account as well as the average number of accounts overpaid per month. The rate overpaid is multiplied by the population overpaid to arrive at an estimated monthly amount overpaid, which is then annualized. Improper payments found through other sources, situation reports, internal tracking and other required audits, are added to this figure to determine the final annual estimation of improper payments for the program.

Military Health Benefits. To determine the statistically valid estimate of the annual amount of erroneous payments, the Department uses the following sampling methodology to pull TRICARE Encounter Data records for the Annual Target Health Care Cost audits of the Managed Care Support Services contracts.

For each contract option period, a statistically valid sample of claims with care end dates within the specified option period is selected for payment error auditing. Variable sampling, using stratified sampling with optimum allocation, is used to calculate the sample size for the payment errors. The sample size is determined with a 90% confidence level and 1% precision.

Twelve sample strata are used with claims ranging from \$100 to less than \$100,000. Another stratum consists of all claims \$100,000 and over. Claims with a cost less than \$100 are not sampled. Claims with a cost of greater than \$100 but less than \$100,000 are broken down into 12 strata. A formula is applied to calculate the sample size for each stratum. A finite population correction is then applied to each stratum sample size with the final sample size calculated by summing all the corrected stratum sample sizes. Finite population correction is first applied on each stratum, before the summation of sample sizes of all strata. A minimum sample size of 30 is forced into each stratum. If the stratum universe count is less than 30, all the claims in that stratum are audited. The audit process for payment samples projects universe value based on the audit results. The samples are separately projected to the universe of claims for each quarter. The results of these projections are then combined into the following categories: Total number of claims in the universe, government payment estimation, correct government payment, error amount and the estimated error percent in the universe of claims. The percent of overpayments is applied to all the payments to determine the amount of allowable cost. The percent will be recovered based on total overpayments--not net of underpayments. In other words, there is "zero tolerance" for errors.

3. *Explain the corrective actions your agency plans to implement to reduce the estimated rate of improper payments. Include in this discussion what is seen as the cause(s) of errors and the corresponding steps necessary to prevent future occurrences. If efforts are already underway, and/or have been ongoing for some length of time, it is appropriate to include that information in this section.*

Military Retirement. With the large population size served, the complexity of entitlements, and volume of transactions, the Military Retired and Annuitant Pay programs are at risk of making improper payments. While the total elimination of improper payments is virtually impossible, the Department has implemented and continues to explore methods to minimize these amounts. In this regard, Military Retired and Annuitant Pay, in coordination with the Social Security Administration, is implementing a death match process, which should significantly reduce the amount of improper payments. This process allows Military Retired and Annuitant Pay to receive death notice information through an automated system match on military retirees. The death notification process, in many cases, will prevent the payment system from generating an improper payment. Other initiatives, such as improved quality control measures, system enhancements and the automation of manual processes, are also underway to further streamline the processing and maintenance of Retired Pay accounts.

Military Health Benefits. The Medical Health Benefits program currently audits statistically valid samples that over the years have consistently produced an error rate of less than the 2 percent standard contained in the TRICARE contracts—an amount less than the 2.5 percent threshold allowed by the Improper Payments Information Act as implemented by the Office of Management and Budget. The TRICARE Management Agency audits payments, extrapolates the results of the payments to the universe and disallows the full amount of the extrapolated total representing a statistical projection of overpayments.

The cause(s) of errors in health care claims processing is related to both improperly submitted claims by the provider community, as well as a minimal degree of human error that can be expected with handling a large volume of claims within the tight time parameters established through the Prompt Payment Act. Minimizing the error rate is accomplished through statistically valid samples with financial penalties assessed to the contractor making the disbursement on behalf of the Department. The construct of the managed care contracts effectively reduces improper payments to zero.

Appendix A: Improper Payments Information Act of 2002

4. The following table summarizes the Department's improper payment reduction outlook for each of these programs from FY 2004 through FY 2007.

Improper Payment (IP) Reduction Outlook FY 2004 – FY 2007

Program	FY 04 Outlays	FY 04 IP %	FY 04 IP $	FY 05 IP %	FY 06 IP %	FY 07 IP %
Military Retirement (Note 1)	$35.8 billion	.0952%	$34.1 million	.0922%	.0892%	.0862%
Military Health Benefits (Note 2)	$4.6 billion	2.16%	$100.1 million	2.0%	2.0%	2.0%

Footnotes:

Note 1. Military retired and annuitant pay is projecting a decrease in the percentage of improper payments for the upcoming fiscal years.

Note 2. The FY 2004 data which reports a 2.16 percent payment error rate is subject to change as additional information is received. The 2.16 percent is not the final figure. Once all the audits have completed the administrative process by September 2005, historically the final overall percentage has been below the contractual requirement that the payment error rate shall not exceed 2 percent. Last year's DoD Performance and Accountability Report listed the preliminary error rate for FY 2003 as 1.36 percent (the most current percent available at the time the report was required). The final payment error rate for fee-for-service claims was 0.85 percent--well below the 2 percent threshold and considerably lower than the l.36 percent originally reported.

5. *Discuss your agency's Recovery Auditing effort, if applicable, including the amount of recoveries expected, the actions taken to recover them, and the business process changes and internal controls instituted and/or strengthened to prevent further occurrences.*

Since the start of the program in FY 1996, the Department has collected over $17.8 million. Of this amount, $6.3 million was recovered in FY 2004 alone. Similar recoveries are expected in FY 2005. The increase in recoveries is related to the ability of the Department to electronically provide all of the disbursing information requested by the recovery auditing vendor. Prior to that time, the vendor was limited to finding this information manually. Most of the recoveries occurred on disbursements made by the Defense Logistics Agency. The Naval Supply Systems Command accounted for approximately $500,000. The Defense Information Systems Agency, Naval Air Systems Command, and the Defense Commissary Agency have issued contracts for recovery auditing services. As there were no significant findings by the recovery auditing vendor at Defense Commissary Agency, the option year of the contract was not exercised.

Recovery auditing claims follow the same collection procedures as other overpayments. Once an overpayment is identified, a demand letter is sent to the vendor. If reimbursement is not received within 35 days, offsetting procedures are initiated on future invoices. If no additional invoices are received, the claim is sent to Defense Finance and Accounting Service Debt Management Office.

The Defense Finance and Accounting Service Internal Review Office is responsible for the Department's post-payment audit function. Within 180 days of payment, the Internal Review Office reviews disbursements to identify overpayments and recommend corrective actions to minimize future overpayments.

6. *Describe the steps the agency has taken and plans to take (including time line) to ensure that agency managers (including the agency head) are held accountable for reducing and recovering improper payments.*

Certifying Officer Legislation currently in effect holds certifying and disbursing officers accountable for government funds. Pecuniary liability attaches automatically when there is a fiscal irregularity, i.e. (a) a physical loss of cash, vouchers, negotiable instruments, or supporting documents or (b) an erroneous payment. Pecuniary liability for accountable officials attaches if a commander/director determines that an erroneous payment was the result of the accountable official's negligence. For certifying officers and disbursing officers, there is a presumption of negligence and those individuals bear the burden of proof in establishing the absence of negligence; i.e., they must produce evidence to establish that there was no contributing fault or negligence on their part. A presumption of negligence does not apply to accountable officials. Efforts to recover from the recipient must be undertaken in accordance with the debt collection procedures prescribed in Volume 5, Chapters 29 and 30 of the Department of Defense Financial Management Regulation.

In addition, the Department is establishing performance metrics to track and reduce erroneous payments. These metrics will include all programs/activities that the Department has identified as having a risk of erroneous payments.

7. *Describe whether the agency has the information systems and other infrastructure it needs to reduce improper payments to the levels the agency has targeted.*

The Department maintains the infrastructure needed to monitor erroneous payments for the Military Retirement and Military Health Benefits programs:

Military Retirement. At the current time Military retired and annuitant pay has the information and infrastructure needed to reduce improper payments.

Military Health Benefits. The TRICARE Management Agency has a national claims database that captures fee-for-service claims for care rendered and paid for by TRICARE. Derived from data forwarded by TRICARE Managed Care Support Contractors in a specific format that is run against a specific set of quality control edits, the database maintains information on covered beneficiaries and the care each receives. The extensive data requirement contributes to data integrity and the fiscal soundness of a single audit trail and allows for close oversight of the claims paid by TRICARE. In addition, TRICARE Management Agency has had performance standards in place for a number of years and contractors have continually met or exceeded them. Contractors already have a financial incentive to pay claims correctly and to stay below 2 percent, given that the agency will not fund unallowable costs (overpayments) submitted by its contractors making the disbursements.

8. *A description of any statutory or regulatory barriers which may limit the agencies' corrective actions in reducing improper payments.*

Military Retirement. Two barriers impede the agency's ability to take corrective actions in reducing improper payments, the Federal Acquisition Regulation and the Retired and Annuitant Pay service contract. On January 28, 2002, the servicing of Retired and Annuitant Pay came under the purview of a private contractor, ACS Government Services, later taken over by Lockheed Martin Government Services. Although most functions remain unchanged from when the government performed these functions, there are now contractual limits to the government's involvement in the day-to-day operations of Retired and Annuitant Pay. The Continuing Government Activities office was formed to oversee the Retired and Annuitant Pay contract, to ensure the contractual requirements are followed, however, the government can no longer direct how the work is accomplished. In order to bring about an operational change, both the government and the contractor must come to an agreement as to how to effectuate a change and who will fund a change. Any deviation from the current contract requires a contract modification, which is detailed in the Federal Acquisition Regulation.

Military Health Benefits. There are currently no statutory or regulatory barriers that limit the Department's corrective actions for this program. In addition, as previously mentioned erroneous payments are continually less than the 2 percent error rate for this program.

Appendix B: Glossary

Acronym	Full Name
AC	Actual Cost
AC/RC	Active Component/Reserve Component
AFRIMS	Air Force Restoration Information Management System
AFRL	Air Force Research Lab
AILG	Armament Retooling & Manufacturing Support Initiative (ARMS) Initiative Loan Guarantee
AOC	Area of Concern
AOR	Accumulated Operating Results
ARMS	Armament Retooling & Manufacturing Support Initiative
ASBCA	Armed Services Board of Contract Appeals
ASVAB	Armed Services Vocational Aptitude Battery
ATM	Automated Teller Machine
BMMP	Business Management Modernization Program
BRAC	Base Realignment and Closure
CAIG	Cost Analysis Improvement Group
CAM	Contractor Acquired Material
CARS	Consolidated Acquisition Reporting System
CBY	Charge Back Years
CEFMS	Corps of Engineers Financial Management System
CERCLA	Comprehensive Environment Response, Compensation Liability Act
CERPS	Centralized Expenditure & Reimbursement Processing System
CFAST	Collaborative Force Sustainment and Transportation
CFO	Chief Financial Officer
CIO	Chief Information Officer
CIP	Construction in Progress
COLA	Cost of Living Adjustment
CONPLAN	Concept of Operations Plan
CPI	Consumer Price Index
CPIM	Consumer Price Index-Medical
CRA	Credit Reform Act
CRO	Cumulative Results of Operations
CSRR	Common Submarine Radio Room
CSRS	Civil Service Retirement System
CTA	Collaborative Technology Alliances
CTC	Cost to Complete
CWC	Chemicals Weapons Convention
CWT	Customer Wait Time
DAAS	Defense Automatic Addressing System
DAB	Defense Acquisition Board
DAES	Defense Acquisition Executive Summary
DeCA	Defense Commissary Agency
DELMAR	Data Element Management/Accounting Reporting System
DERP	Defense Environmental Restoration Program
DERF	Defense Emergency Response Fund
DFAS	Defense Finance & Accounting Service

Appendix B: Glossary

Acronym	Full Name
DHP	Defense Health Program
DHS	Department of Homeland Security
DJC2	Deployable Joint Command and Control
DLA	Defense Logistics Agency
DMAG	Depot Management Activity Group
DMDC	Defense Manpower Data Center
DNS	Defense National Stockpile
DoD	Department of Defense
DoL	Department of Labor
DOTMLPF	Doctrine, Organization, Training, Material, Leadership, Personnel & Facilities
DRMO	Defense Reutilization Management Office
DRRS	DoD Readiness Reporting System
DSTAG	Defense Science and Technology Advisory Group
DT	Developmental Test
DTAP	Defense Technology Area Plan
DTO	Defense Technology Objective
DTRA	Defense Threat Reduction Agency
EPP	Enhanced Planning Process
EPR	Environmental Program Requirements
ER	Environmental Restoration
ESL	Expected Service Life
ESORTS	Enhanced Status of Resources and Training System
FBWT	Fund Balance With Treasury
FCRA	Federal Credit Reform Act
FECA	Federal Employees' Compensation Act
FEGLI	Federal Employees' Group Life Insurance Program
FEHB	Federal Employees' Health Benefits
FERS	Federal Employees' Retirement System
FFB	Federal Financing Bank
FMS	Financial Management Service
FMS	Foreign Military Sales
FMSTF	Foreign Military Sales Trust Fund
FRM	Facilities Recapitalization Metric
FSM	Facilities Sustainment Model
FUDS	Formerly Used Defense Sites
FY	Fiscal Year
FYDP	Future Years Defense Program
GAAP	Generally Accepted Accounting Principles
GAFS-R	General Accounting and Finance System-Rehost
GAO	Government Accountability Office
GCC	Geographic Combatant Commands
GF	General Fund
GFM	Government Furnished Material
GIG	Global Information Grid
GMRA	Government Management Reform Act
GPRA	Government Performance Results Act

Appendix B: Glossary

Acronym	Full Name
GSA	General Service Administration
GWOT	Global War on Terror
HD/LD	High Density/Low Density
HMO	Health Management Organization
HSDG	High School Diploma Graduate
IBNR	Incurred But Not Reported
ICP	Intelligence Campaign Plan
IOC	Initial Operational Capability
IPAC	Intragovernmental Paying and Collection
IPL	Integrated Priority Lists
IRAS	Intragovernmental Review and Analysis System
IRR	Incremental Revenue Recognition
IRR	Installations Readiness Report
IT	Information Technology
JAEC	Joint Assessment and Enabling Capability
JCDE	Joint Concepts Development and Experimentation
JCS	Joint Chiefs of Staff
JLLP	Joint Lessons Learned Program
JFC	Joint Functional Concepts
JIC	Joint Integrating Concepts
JKDDC	Joint Knowledge Development and Distribution Capability
JNTC	Joint National Training Center
JOC	Joint Operating Concepts
JOpsC	Joint Operations Concepts
JPG	Joint Programming Guidance
LAC	Latest Acquisition Cost
LCM	Lower of Cost or Market
LLRW	Low Level Radioactive Waste
MAC	Moving Average Cost
MAFR	Merged Accounting & Fund Reporting System
MDAP	Major Defense Acquisition Program
MERHCF	Medicare-Eligible Retiree Health Care Fund
MET	Mission Essential Tasks
MHPI	Military Housing Privatization Initiative
MHS	Military Health System
MILSATCOM	Military Satellite Communications
MOU	Memorandum of Understanding
MRF	Military Retirement Fund
MRS	Military Retirement System
MSC	Military Sealift Command
MTF	Military Treatment Facility
NACTEK	Naval Commercial Test Kit
NAWC	Naval Air Warfare Center
NDAA	National Defense Authorization Act
NDPP&E	National Defense Property, Plant & Equipment
NE	Not Evaluated

Appendix B: Glossary

Acronym	Full Name
NOAA	National Oceanic and Atmospheric Administration
NORM	Navy Normalization of Data Systems
NSPS	National Security Personnel System
NULO	Negative Unliquidated Obligations
NRV	Net Realizable Value
O&S	Operation and Support
OA	Operational Availability
ODO	Other Defense Organizations
ODO-GF	Other Defense Organizations – General Fund
OM&S	Operating Materials & Supplies
OMB	Office of Management and Budget
OEPM	Officer and Enlisted Personnel Management
OPM	Office of Personnel Management
OSD	Office of the Secretary of Defense
OUSD	Office of the Under Secretary of Defense
PDR	Programming Data Requirement
PERSTEMPO	Personnel Tempo
P.L.	Public Law
PMA	Power Marketing Agency
PPBS	Planning, Programming and Budgeting System
PP&E	Property, Plant & Equipment
PVB	Present Value of Benefits
QDR	Quadrennial Defense Review
QoL	Quality of Life
QRMC	Quadrennial Defense Review of Military Compensation
RACER	Remedial Action Cost Engineering Requirements
RBS	Rural Business-Cooperative Service
RCRA	Resource Conservation & Recovery Act
RDT&E	Research, Development, Test and Evaluation
RFQ	Request for Quotations
RML	Readiness Markup Language
RVU	Relative Value Units
S&T	Science and Technology
SAR	Selected Acquisition Report
SARA	Superfund Amendment & Reauthorization Act
SBR	Statement of Budgetary Resources
SFFAS	Statement of Federal Financial Accounting Standards
SJFHQ	Standing Joint Force Headquarters
SMAG	Supply Management Activity Group
SOCOM	Special Operations Command
SoNC	Statement of Net Cost
SP	Standard Price
SPG	Strategic Planning Guidance
SUVOS	Semiconductor Ultraviolet Optical Sources
TARA	Technology Area Review and Assessment
TSAT	Transformational Satellite Communications System

Appendix B: Glossary

Acronym	Full Name
TSP	Thrift Savings Plan
TOA	Total Obligation Authority
UDO	Undelivered Orders
UMD	Unmatched Disbursements
USACE	United States Army Corps of Engineers
USDA	United States Department of Agriculture
USD(I)	Under Secretary of Defense for Intelligence
USJFCOM	United States Joint Forces Command
USSGL	United States Standard General Ledger
USSOCOM	United States Special Operations Command
VAN	Value Added Network
VSI	Voluntary Separation Incentive
WARS	Worldwide Ammunition Reporting System
WCF	Working Capital Fund

Appendix C: Internet Links

Topic	Internet Link
Department of Defense Internet Links	
Department of Defense (DoD)	www.defenselink.mil
DoD Performance and Accountability Report	www.dod.mil/comptroller/par
Detailed Performance Information	www.dod.mil/comptroller/par/fy2004/06-01_Detailed_Performance.pdf
DoD Quadrennial Defense Review (2001)	www.defenselink.mil/pubs/qdr2001.pdf
DoD Business Management Modernization Program	www.dod.mil/comptroller/bmmp/pages/index.html
DoD Annual Defense Report (2003)	www.defenselink.mil/execsec/adr2003/
DoD Budget (2004)	www.dod.mil/comptroller/defbudget/fy2004/index.html
Office of the Secretary of Defense	www.defenselink.mil/osd/
Joint Chiefs of Staff	www.dtic.mil/jcs/
Department of the Army	www.army.mil
Department of the Navy	www.navy.mil
U.S. Marine Corps	www.usmc.mil
Department of the Air Force	www.af.mil
Combatant Commands	www.defenselink.mil/sites/u.html#unified
DoD Agencies	www.defenselink.mil/sites/a.html#agencies
DoD Field Activities	www.defenselink.mil/sites/f.html#fldacts
DoD Organization	www.defenselink.mil/odam/omp/pubs/GuideBook/ToC.htm
Joint Doctrine Electronic Library	www.dtic.mil/doctrine/jel/new_pubs/jp0_2.pdf
External Internet Links	
Topic	**Internet Link**
Office of Personnel Management (OPM)	www.opm.gov/account
FirstGov.gov	www.first.gov
Results.gov	www.results.gov

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