

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

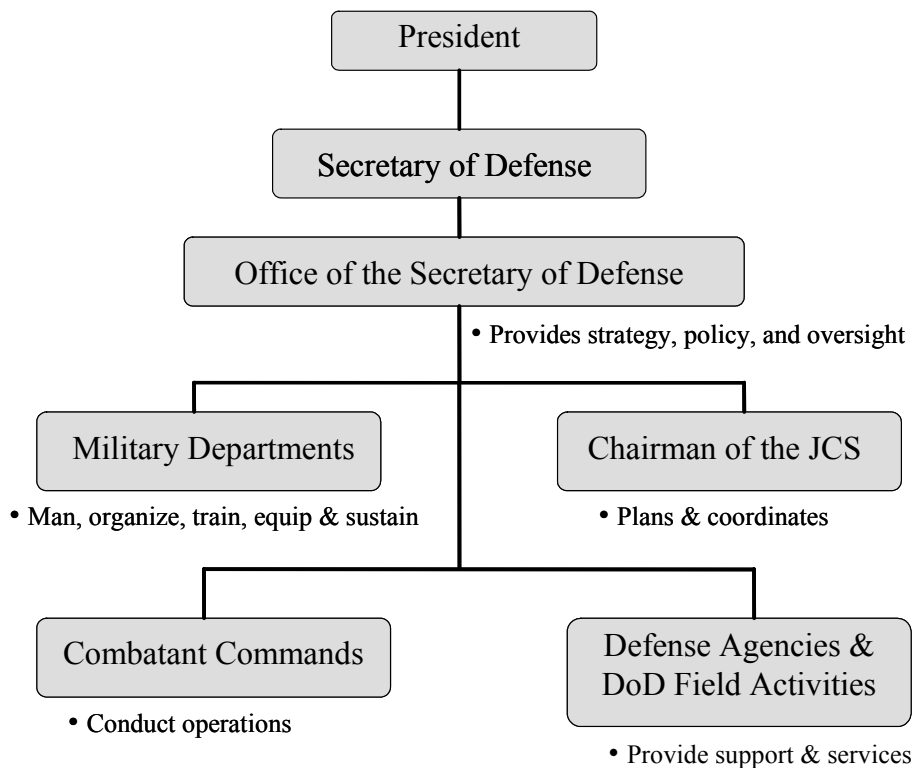
The Department of Defense (DoD) is a Cabinet-level organization that receives orders directly from the President of the United States. The Secretary of Defense is appointed by the President and is responsible for the formulation and execution of defense policy.

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

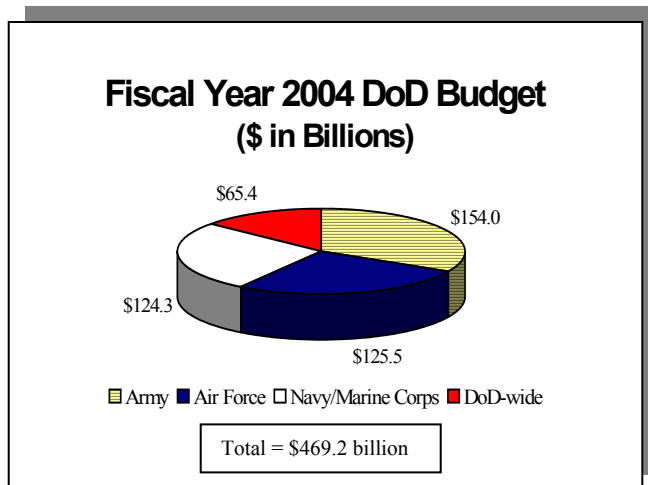
Resources

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

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."



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.

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.



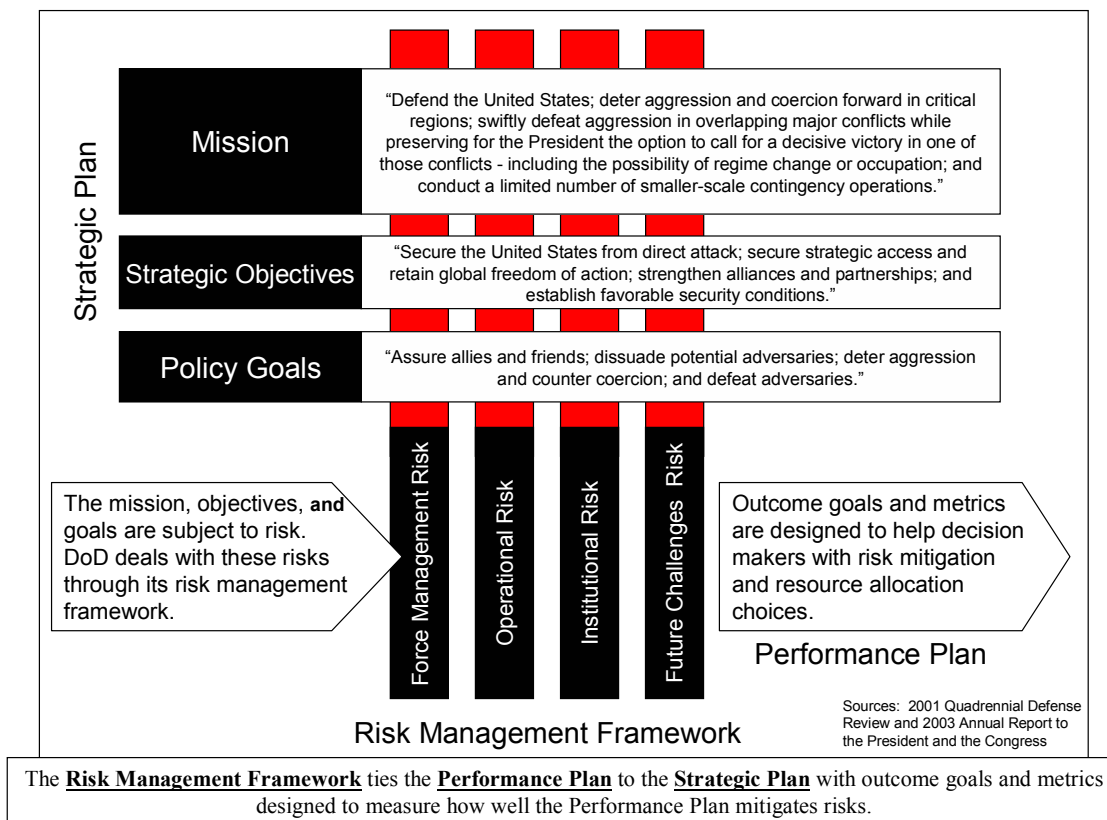
An F-15E Strike Eagle receives fuel from a 908th Expeditionary Aerial Refueling Squadron KC-10 Extender during a mission over Iraq. *U.S. Air Force photo by Senior Master Sgt. Mark Moss*

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.



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
<p>Release of Business Enterprise Architecture Version 2.3 <i>Updates all business enterprise architecture work activities, information, system functions and interchanges needed to support the defined enterprise business process model.</i></p>	November 2004
<p>Release of Business Enterprise Architecture Version 2.4 <i>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.</i></p>	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.

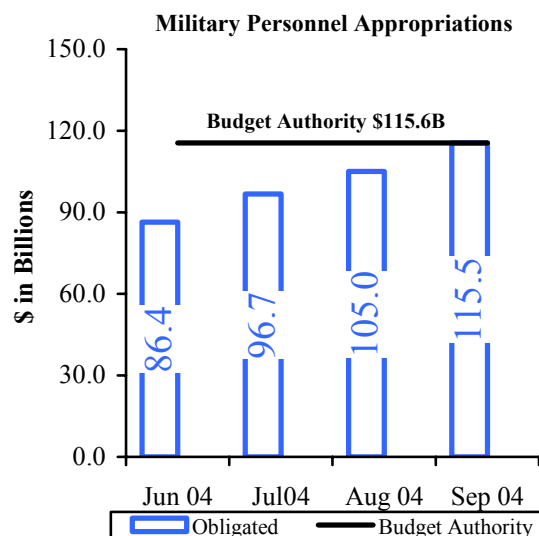
Financial Management Balanced Scorecard. The Department’s Financial Management Balanced Scorecard is aligned with the risk management framework established in the Department’s strategic plan. The Scorecard provides the framework for

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.

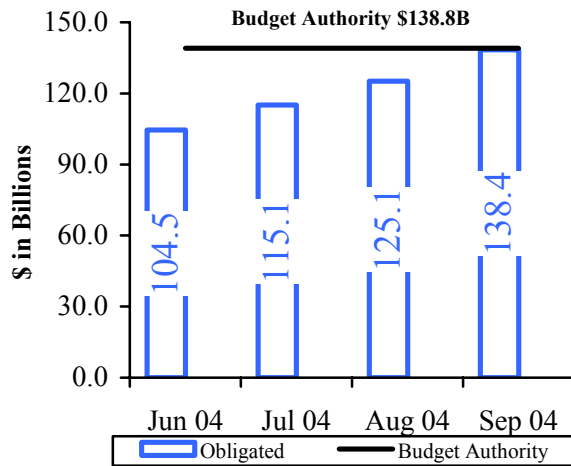
Budget and financial indicators are used to monitor and guide financial management reform and target resources to areas where DoD needs to drive better stewardship of financial resources.

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.

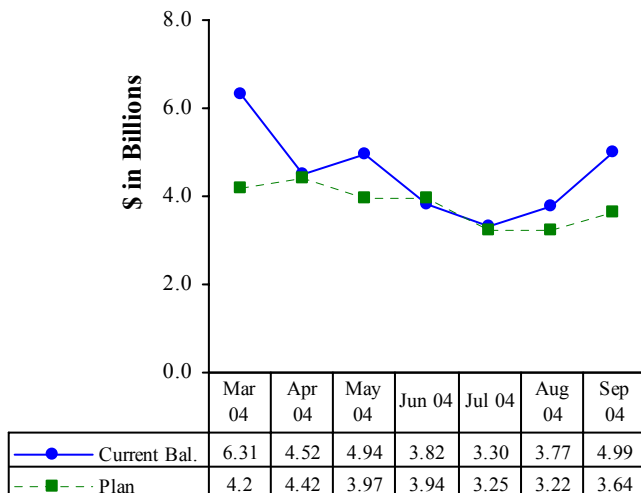


Operation and Maintenance Appropriations



Defense Working Capital Fund Cash Management

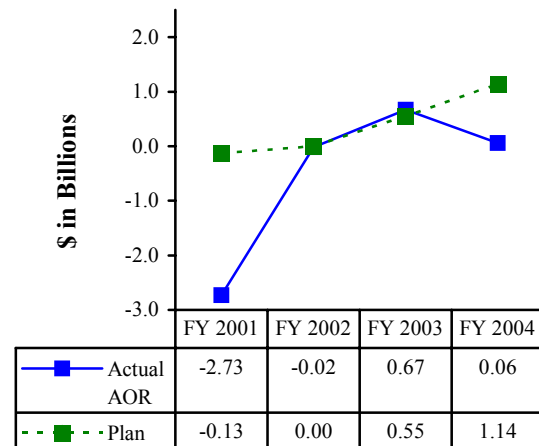
Cash Management within the Defense Working Capital Fund is defined as the ability to maintain sufficient liquidity to meet current obligations and accurately forecast cash requirements. The Department transferred \$3.8 billion in fiscal year 2004 to Operation and Maintenance appropriations. Cash is inflated 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.



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.



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.

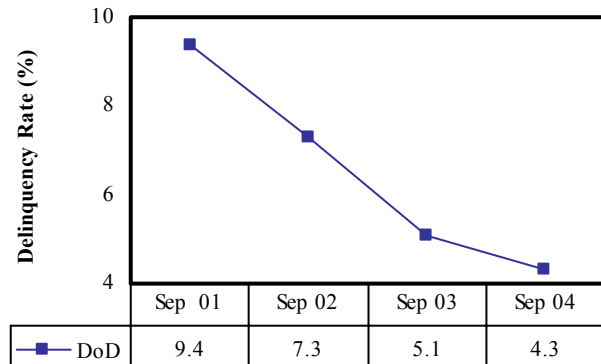
The Department’s goal was to reduce delinquent receivables (more than 30 days old) by 25 percent in fiscal year 2004. The Department has two types of delinquent receivables: receivables with the public (i.e., individuals, contractors, local and foreign governments, etc.) and intragovernmental receivables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

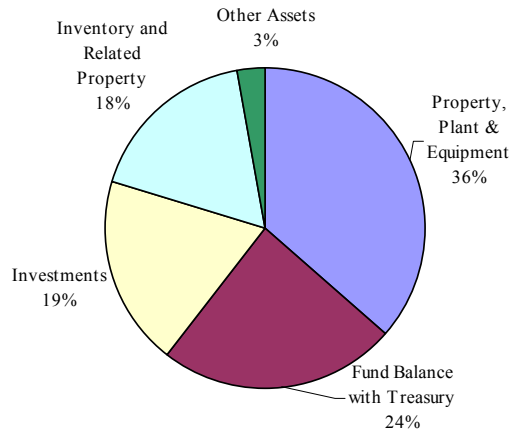
DoD Travel Card Program Individually Billed Accounts Delinquency Rates

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.

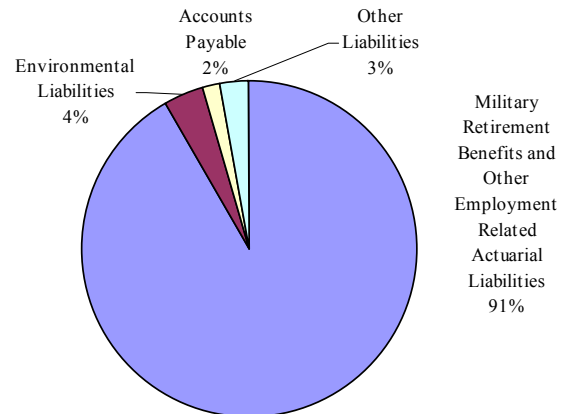
Increased funding to fight the global war on terror caused the Fund Balance with Treasury to increase \$37.5 billion.

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.

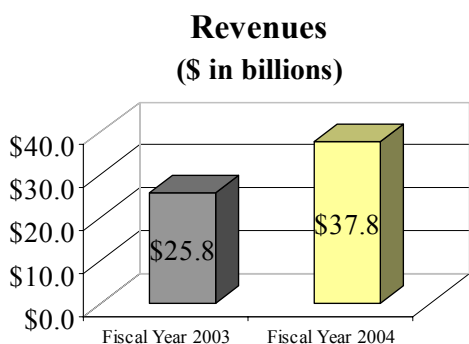
Liabilities

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.

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.

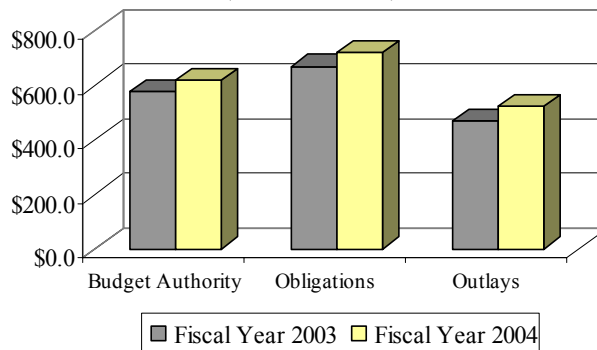


Budget Authority. This is the authority provided by law to incur financial obligations that will result in outlays. Specific forms of budget authority include appropriations, borrowing authority, contract authority, and appropriation transfers from other agencies. The Combined Statement of Budgetary 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	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • 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)
<p>Progress to Date (Continued)</p>	<p>B. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none"> • 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. <p>C. Planned Milestones for Beyond FY 2005:</p> <ul style="list-style-type: none"> • 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. <p align="center">Correction Target Date: 4th Quarter, FY 2007</p>
Title	2. Management of Information Technology and Assurance
<p>Description of Issue</p>	<p>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.</p>
<p>Progress to Date</p>	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • 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)
<p>Progress to Date (Continued)</p>	<p>B. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none"> • 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. <p>C. Planned Milestones for Beyond FY 2005:</p> <ul style="list-style-type: none"> • 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. <p align="center">Correction Target Date: 3rd Quarter, FY 2007</p>
Title	3. Environmental Liabilities
<p>Description of Issue</p>	<p>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.</p>
<p>Progress to Date</p>	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • 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 II. Section 2 Systemic Weaknesses -- Ongoing

3. Environmental Liabilities (Continued)	
Progress to Date (Continued)	<p>B. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none"> • 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. <p>C. Planned Milestones for Beyond FY 2005:</p> <ul style="list-style-type: none"> • 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. <p align="center">Correction Target Date: 1st Quarter, FY 2006</p>
Title	4. Personnel Security Investigations Program
Description of Issue	The Department of Defense hiring is adversely affected because personnel security investigations are backlogged.
Progress to Date	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • 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. <p>B. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none"> • 50 percent of the investigations are submitted within the agreed upon timeframes.

Table II. Section 2 Systemic Weaknesses – Ongoing (Continued)

Title	4. Personnel Security Investigations Program (Continued)
Progress to Date (Continued)	<p>C. Planned Milestones for Beyond FY 2005:</p> <ul style="list-style-type: none"> • 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. <p align="center">Correction Target Date: 4th Quarter, FY 2006</p>
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	<p>A. Completed Milestones in FY2004:</p> <ul style="list-style-type: none"> • 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)
<p>Progress to Date (Continued)</p>	<p>B. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none"> • 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. <p align="center">Correction Target Date: 1st Quarter, FY 2008</p>
Title	6. Government Card Program Management
<p>Description of Issue</p>	<p>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.</p>
<p>Progress to Date</p>	<p><u>Purchase Card Program:</u></p> <p>A. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none"> • 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. <p><u>Travel Card Program:</u></p> <p>A. Completed Milestones in FY 2004:</p> <ul style="list-style-type: none"> • 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)
<p>Progress to Date (Continued)</p>	<p><u>Travel Card Program (Continued):</u></p> <p>A. Completed Milestones in FY 2004 (Continued):</p> <ul style="list-style-type: none"> • 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. <p>B. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none"> • 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)
<p>Progress to Date (Continued)</p>	<p><u>Travel Card Program (Continued):</u></p> <p>B. Planned Milestones for FY 2005 (Continued):</p> <ul style="list-style-type: none"> • 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. <p>C. Planned Milestones Beyond FY 2005:</p> <ul style="list-style-type: none"> • Complete deployment of the travel system. <p align="center">Correction Target Date: 4th Quarter, FY 2006</p>
Title	7. Valuation of Plant, Property, and Equipment on Financial Reports
<p>Description of Issue</p>	<p>The Department of Defense is unable to accurately report the value of property, plant, and equipment on its financial statements.</p>
<p>Progress to Date</p>	<p>A. Completed Milestones for FY 2004:</p> <ul style="list-style-type: none"> • 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. <p>B. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none"> • 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)	<p>C. Planned Milestones Beyond FY 2005:</p> <ul style="list-style-type: none"> • 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. <p align="center">Correction Target Date: 4th Quarter, FY 2006</p>
Title	8. Valuation of Inventory on Financial Reports
Description of Issue	The valuation of inventory is not always correctly reported.
Progress to Date	<p>A. Completed Milestones for FY 2004:</p> <ul style="list-style-type: none"> • 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. <p>B. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none"> • 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)
<p>Progress to Date (Continued)</p>	<p>C. Planned Milestones Beyond FY 2005:</p> <ul style="list-style-type: none"> • Extend “unique identification and valuation” rule to legacy items. • Resolve issues concerning testing that are identified by the inventory working group. <p align="center">Correction Target Date: 2nd Quarter, FY 2006</p>
Title	9. Improper Use of Non-Department of Defense Contracting Vehicles
<p>Description of Issue</p>	<p>Non-Department of Defense contracting vehicles have been used improperly to procure services or supplies. (Newly reported: FY 2004)</p>
<p>Progress to Date</p>	<p>A. Completed Milestones for FY 2004:</p> <ul style="list-style-type: none"> • Developed and coordinated guidance. • Developed training. • Conducted outreach programs with assisting civilian agencies. <p>B. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none"> • 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. <p>C. Planned Milestones for Beyond FY 2005:</p> <ul style="list-style-type: none"> • Complete a compliance review regarding the implementation of the policies for proper use of non-Department of Defense contracts. <p align="center">Correction Target Date: 2nd Quarter, FY 2006</p>

Table III. Section 2 Material Weaknesses – Ongoing

Financial Material Weaknesses	Major Corrective Action(s) <i>A sample of the actions is presented.</i>	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.	2 nd / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 2nd Quarter, FY 2005	2 nd / 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.	2 nd / 2005
	✓ Conduct random review of compliance to policy and procedures.	4 th / 2005
	✓ Provide assertion that accounts receivables are ready for audit.	1 st / 2006
	✓ Validate that the weakness is corrected. Correction Target Date: 3rd Quarter, FY 2006	3 rd / 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.	1 st / 2005
	✓ Develop adequate procedures and controls for the DoD business enterprise architecture.	1 st / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 4th Quarter, FY 2005	4 th / 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.	4 th / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 4th Quarter, FY 2005	4 th / 2005

Table III. Section 2 Material Weaknesses – Ongoing (Continued)

Financial Material Weaknesses (Continued)	Major Corrective Action(s) <i>A sample of the actions is presented.</i>	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.	4 th / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 4th Quarter, FY 2005	4 th / 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.	1 st / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 4th Quarter, FY 2005	4 th / 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.	1 st / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 4th Quarter, FY 2005	4 th / 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.	1 st / 2005
	✓ Automate processes for using existing records to determine if payment should be made.	3 rd / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 3rd Quarter, FY 2005	3 rd / 2005

Table III. Section 2 Material Weaknesses – Ongoing (Continued)

Financial Material Weaknesses (Continued)	Major Corrective Action(s) <i>A sample of the actions is presented.</i>	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.	2 nd / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 3rd Quarter, FY 2005	3 rd / 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.	1 st / 2005
	✓ Implement metrics to measure magnitude of problem and impact of corrective actions.	2 nd / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 2nd Quarter, FY 2006	2 nd / 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.	1 st / 2005
	✓ Validate system change and implement corrections as necessary.	1 st / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 3rd Quarter, FY 2005	3 rd / 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.	2 nd / 2005
	✓ Pursue data mining techniques to enhance and automate the comparison of invoices to payments.	2 nd / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 4th Quarter, FY 2005	4 th / 2005

Table III. Section 2 Material Weaknesses – Ongoing (Continued)

Non-Financial Material Weaknesses	Major Corrective Action(s) <i>A sample of the actions is presented.</i>	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.	2 nd / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 3rd Quarter, FY 2005	3 rd / 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.	1 st / 2005
	✓ Validate that the weakness is corrected. Correction Target date: 2nd Quarter, FY 2005	2 nd / 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.	1 st / 2005
	✓ Establish and implement a formal training program for program coordinators and end-users.	1 st / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 1st Quarter, FY 2005	1 st / 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.	1 st / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 1st Quarter, FY 2005	1 st / 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.	3 rd / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 3rd Quarter, FY 2005	3 rd / 2005

Table III. Section 2 Material Weaknesses – Ongoing (Continued)

<p align="center">Non-Financial Material Weaknesses (Continued)</p>	<p align="center">Major Corrective Action(s) <i>A sample of the actions is presented.</i></p>	<p align="center">Indicates Completed or Milestone Date Qtr/FY</p>
<p>18. Existing controls did not ensure that incidents of sexual assault among the cadet population were prevented or reported. (Department of the Air Force)</p> <p>First Reported: FY 2003</p>	<p>✓ Completed 138 of 165 corrective actions. Incorporated training to improve the gender climate.</p>	<p>Completed</p>
	<p>✓ Implement remaining action items.</p>	<p>1st / 2005</p>
	<p>✓ Conduct unit compliance inspections to review institutional response to sexual assault and compliance within the instructions.</p>	<p>2nd / 2005</p>
	<p>✓ Validate that the weakness is corrected.</p> <p align="center">Correction Target Date: 4th Quarter, FY 2005</p>	<p>4th / 2005</p>
<p>19. Controls over management of spare parts were not always adequate to meet the warfighter mission. (Department of the Air Force)</p> <p>First Reported: FY 1999</p>	<p>✓ 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.</p>	<p>Completed</p>
	<p>✓ Initiated a management plan to enhance spare parts support and identify systematic supply shortfalls.</p>	<p>Completed</p>
	<p>✓ Determined the total spares parts requirement for FY 2004 Program Objective Memorandum.</p>	<p>Completed</p>
	<p>✓ Revised the requirements computation systems to provide more accurate consumption patterns.</p>	<p>Completed</p>
	<p>✓ Included the total spare parts requirement in the FY 2004 Program Objective Memorandum submission.</p>	<p>Completed</p>
	<p>✓ Compare the projected spare part requirements to actual and determine effectiveness of forecasting tools and other corrective actions.</p> <p align="center">Correction Target Date: 4th Quarter, FY 2005</p>	<p>4th / 2005</p>
<p>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)</p> <p>First Reported: FY 2000</p>	<p>✓ Raised the awareness of air hazards around aircraft operations. Developed the Department of the Air Force multi-Service training.</p>	<p>Completed</p>
	<p>✓ 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.</p>	<p>3rd / 2005</p>
	<p>✓ Re-evaluate the Air Installation Compatible Use Zone Program.</p>	<p>2nd / 2006</p>
	<p>✓ Validate that the weakness is corrected.</p> <p align="center">Correction Target Date: 4th Quarter, FY 2006</p>	<p>4th / 2006</p>

Table III. Section 2 Material Weaknesses – Ongoing (Continued)

Non-Financial Material Weaknesses (Continued)	Major Corrective Action(s) <i>A sample of the actions is presented.</i>	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.	1 st / 2005
	✓ Publication of the regulatory guidance.	2 nd / 2005
	✓ Audit review to validate the effectiveness of corrective actions. Correction Target Date: 4th Quarter, FY 2005	4 th / 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.	2 nd / 2005
	✓ Ensure that there is accurate documentation to validate the manpower requirements in the official record called the “Table of Distributions and Allowances.”	4 th / 2005
	✓ Issue a change to the regulation on the approval authority for manpower requirement determinations.	4 th / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 4th Quarter, FY 2005	4 th / 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.	3 rd / 2005
	✓ Validate that the weakness is corrected. Correction Target Date: 4th Quarter, FY 2005	4 th / 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.	4 th / 2006
	✓ Validate that the weakness is corrected. Correction Target Date: 1st Quarter, FY 2007	1 st / 2007

Table III. Section 2 Material Weaknesses – Ongoing (Continued)

Non-Financial Material Weaknesses (Continued)	Major Corrective Action(s) <i>A sample of the actions is presented.</i>	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) First Reported: FY 2001	✓ 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.	1 st / 2005
	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) First Reported: FY 2003	✓ Modified the global command and control system to allow data entry at all the mobilization stations.	Completed
	✓ Correct the mobilized unit identification codes.	1 st / 2005
	✓ Correct any disconnects between mobilization orders and the data entry.	2 nd / 2005
	✓ Interface between the global command and control system and the mobilization deployment integration system to obtain the on-hand data.	2 nd / 2006
	✓ Validate that the weakness is corrected.	4 th / 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) First Reported: FY 2004	✓ Designed and developed a training program.	Completed
	✓ Develop a comprehensive plan, budget to address issues, and correct them.	1 st / 2005
	✓ Develop and implement records management program.	3 rd / 2005
	✓ Design and implement additional specialized training.	1 st / 2006
	✓ Synthesize the file plan and records control schedule.	2 nd / 2006
	✓ Develop and implement pilot audit and evaluation program.	1 st / 2007
	✓ Validate that the weakness is corrected.	1 st / 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) First Reported: FY 2004	✓ Develop draft strategies and implement risk management plans.	1 st / 2005
	✓ Submit draft strategies and plans for review and approval.	1 st / 2005
	✓ Complete actions required for a clearly defined strategies and implementation plans.	2 nd / 2005
	✓ Validate that the weakness is corrected.	2 nd / 2005
Correction Target Date: 2nd Quarter, FY 2005		

Table III. Section 2 Material Weaknesses – Ongoing (Continued)

<p align="center">Non-Financial Material Weaknesses (Continued)</p>	<p align="center">Major Corrective Action(s) <i>A sample of the actions is presented.</i></p>	<p align="center">Indicates Completed or Milestone Date Qtr/FY</p>
<p>29. Inadequate controls have caused instances of inaccurate accountability for equipment sold to foreign countries. (Defense Security Cooperation Agency)</p> <p>First Reported: FY 2004</p>	✓ Set record keeping standards.	Completed
	✓ Developed checklists for validation.	Completed
	✓ Deploy automated application and conduct assessment visits.	4 th / 2005
	<p>✓ Validate that the weakness is corrected.</p> <p align="center">Correction Target Date: 4th Quarter, FY 2006</p>	4 th / 2006
<p>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)</p> <p>First Reported: FY 2004</p>	✓ Review and coordinate changes to regulations.	3 rd / 2005
	✓ Publish handbook.	2 nd / 2006
	<p>✓ Validate that the weakness is corrected.</p> <p align="center">Correction Target Date: 2nd Quarter, FY 2006</p>	2 nd / 2006
<p>31. Policies and procedures were not always adequate for processing other non-recurring requirement transactions. (Defense Logistics Agency)</p> <p>First Reported: FY 2004</p>	✓ Reviewed current policies and procedures.	Completed
	✓ Published policy and procedures guidance.	Completed
	✓ Complete validation of policy and procedures and publish final policy.	2 nd / 2005
	<p>✓ Validate that the weakness is corrected.</p> <p align="center">Correction Target Date: 2nd Quarter, FY 2005</p>	2 nd / 2005
<p>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)</p> <p>First Reported: FY 2004</p>	✓ 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.	1 st / 2005
	✓ Hold pilot training session for module 2, which will address contract and project execution, control and close-out.	2 nd / 2005
	✓ Hold module 2 training session.	2 nd / 2005
	<p>✓ Validate that the weakness is corrected.</p> <p align="center">Correction Target Date: 3rd Quarter, FY 2005</p>	3 rd / 2005

Table III. Section 2 Material Weaknesses – Ongoing (Continued)

<p align="center">Non-Financial Material Weaknesses (Continued)</p>	<p align="center">Major Corrective Action(s) <i>A sample of the actions is presented.</i></p>	<p align="center">Indicates Completed or Milestone Date Qtr/FY</p>
<p>33. Inadequate controls to ensure that secondary item repair costs were properly budgeted. (Department of the Air Force)</p> <p>First Reported: FY 2004</p>	✓ Developed instructions addressing responsibilities for validating sources of repair used in preparing budgets.	Completed
	✓ Publish revised secondary item repair costs instructions.	2 nd / 2005
	✓ Incorporate new procedures in automated budget system to support budget development.	3 rd / 2005
	✓ Validate that the weakness is corrected.	4 th / 2005
Correction Target Date: 4th Quarter, FY 2005		
<p>34. Controls were not always adequate over exported Defense articles from initial shipment point to receipt by foreign customers. (Defense Security Cooperation Agency)</p> <p>First Reported: FY 2004</p>	✓ Actively participated with interagency working group.	Completed
	✓ Issue detailed documentation requirements and policy.	4 th / 2005
	✓ Issue policy decision on freight tracking system.	4 th / 2005
	✓ Validate that the weakness is corrected.	4 th / 2006
Correction Target Date: 4th Quarter, FY 2006		
<p>35. Controls were not always adequate to ensure accountability of automated data processing equipment. (United States Pacific Command)</p> <p>First Reported: FY 2004</p>	✓ 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.	4 th / 2005
	✓ Validate that the weakness is corrected.	4 th / 2005
Correction Target Date: 4th Quarter, FY 2005		
<p>36. Manpower challenges impact the mission accomplishment of military intelligence operations. (Office of the Under Secretary of Defense (Intelligence))</p> <p>First Reported: FY 2004</p>	✓ Identified manpower requirements.	Completed
	✓ Developed documentation for manpower requirements.	Completed
	✓ Validating manpower data to correct weakness.	2 nd / 2005
Correction Target Date: 2nd Quarter, FY 2005		
<p>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))</p> <p>First Reported: FY 2004</p>	✓ Obtain approval of a transformation roadmap.	1 st / 2005
	✓ Publish revised DoD Directive.	2 nd / 2005
	✓ Publish DoD Instruction.	3 rd / 2006
	✓ Validate that the weakness is corrected.	4 th / 2006
Corrected Target Date: 4th Quarter, FY 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	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • 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. <p>B. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none"> • 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. <p>C. Planned Milestones for Beyond FY 2005:</p> <ul style="list-style-type: none"> • 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. <p align="center">Correction Target Date: 4th Quarter, FY 2007</p>

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:

Unbundled Billing

Cholesterol, serum (82465):	\$ 6.98
Lipoprotein (HDL cholesterol) (83718):	\$13.14
Triglycerides (84478):	<u>\$ 9.24</u>
TOTAL:	<u>\$29.36</u>

Rebundled (Proper) Billing

Lipid panel (80061) (includes cholesterol, lipoprotein and triglycerides):	<u>\$21.50</u>
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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

successful implementation of the President's Management Agenda.

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

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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