

Section 4:

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Information*



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Management Assurance Details

A summary of the Department’s management assurances over internal management controls for the Federal Managers’ Financial Integrity Act as required by Office of Management and Budget Circular A-123, Management’s Responsibility for Internal Control, is included in Section 1: Management’s Discussion and Analysis. The details for these assurances are included below.

The Department classifies internal management control weaknesses into four categories: The following six tables list the weaknesses grouped as follows:

1. **Section 2 Overall Material Weaknesses:** Weaknesses materially affecting internal management controls that warrant reporting to a higher level and usually affect a single Department component. Includes overall material weaknesses for all functions except financial reporting weaknesses. Includes some financial weaknesses identified through self assessments which were not included in the Department’s statement of assurance over financial reporting under the oversight of the Department Senior Assessment Team.
2. **Section 2 Overall Systemic Weaknesses:** Weaknesses materially affecting internal management controls across organizational and program lines and usually affecting multiple Department components. Includes overall systemic weaknesses for all functions except financial reporting weaknesses. Includes some financial weaknesses identified through self assessments which were not included in the Department’s statement of assurance over financial reporting under the oversight of the Department’s Senior Assessment Team.
3. **Section 4 System Nonconformance Weaknesses:** System nonconformance with government-wide requirements such as the Federal Financial Management Improvement Act as prescribed by the Office of Management and Budget Circular A-127, Financial Management Systems.
4. **Section 2 Financial Reporting Weaknesses:** Weaknesses materially affecting the Department’s financial reporting found during the assessment of internal controls over financial reporting conducted in compliance with the

Office of Management and Budget Circular A-123, Appendix A, for the areas covered in the FY 2006 assessment review to include: investments, real property, military equipment, Federal Employee Compensation Act Liabilities, environmental liabilities, Medicare-Eligible Retiree Health Care Liabilities, appropriations received. Also a limited review occurred for fund balance with Treasury.

The following six tables list the weaknesses grouped as follows:

Table I, Section 2 Corrected Financial and Non-Financial Material Weaknesses lists seven corrected during this fiscal year.

Table II, Section 2 Financial Material Weaknesses Consolidated with Other Similar Weaknesses lists four financial material weaknesses that were consolidated into similar systemic weaknesses.

Tables IIIa and IIIb, Section 2 Overall Financial and Non-Financial Material Weaknesses – Ongoing list the 18 ongoing material weaknesses. Four are financial issues of which one is being newly identified. Fourteen are related to non-financial issues of which six were newly identified this fiscal year. For these material weaknesses, a sample of the corrective actions was selected for reporting. The status dates for FYs 2005 and 2006 are displayed to show any progress in completing the weakness as projected.

Table IV, Section 2 Overall Systemic Weaknesses – Ongoing lists the eleven systemic weaknesses that are outstanding at the end of FY 2006.

Table V, Section 4 System Nonconformance Weaknesses – Ongoing lists one ongoing Section 4 system nonconformance material weakness.

Table VI, Section 2 Financial Reporting Weaknesses lists five outstanding weaknesses as of the end of FY 2006.



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Table I. Section 2 Corrected Overall Material Weaknesses

Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY05	Status Date as Reported in FY06
<p>1. The Defense Logistics Agency's accounts receivable and accounts payable were reduced to acceptable levels. (Defense Logistics Agency)</p> <p>First Reported: FY 2002</p>	- Issued standard guidance and procedures for managing accounts receivables and payables.	Completed	Completed
	- Collected, wrote-off, or closed-out supportable and valid accounts receivables over 2 years old except for certain categories.	Completed	Completed
	- Implemented a plan to liquidate valid over aged accounts payable and write-off invalid payables.	Completed	Completed
	- Validated that the weakness is corrected.	1st Qtr 06	Completed
<p>2. The Department of Army has favorably resolved an issue for processing the line of duty and incapacitation pay, that adversely affected reservists who attempted to receive benefits after their duty obligation was met. (Department of the Army)</p> <p>First Reported: FY 2002</p>	- Developed policies and procedures.	Completed	Completed
	- Conducted legal review of the regulation changes.	Completed	Completed
	- Published the regulatory guidance.	Completed	Completed
	- Conducted audit review to validate the effectiveness of corrective actions.	1st Qtr 06	Completed
<p>3. The Defense Threat Reduction Agency has resolved an issue where the Russian Federation failed to honor its commitments associated with the Cooperative Threat Reduction Program. (Defense Threat Reduction Agency)</p> <p>First Reported: FY 2002</p>	- The Russian Federation signed the amendments for storage security, weapons transportation security, and chemical weapon elimination.	Completed	Completed
	- Worked with the Russian Federation to ensure plans are prepared for further reduction on nerve agents.	1st Qtr 06	Completed
	- Validated that the weakness is corrected.	1st Qtr 06	Completed
<p>4. The Counter Intelligence Activity has reduced to a level of non-materiality instances where planning for periods of crisis were not fully developed. (Office of the Under Secretary of Defense, (Intelligence) Counter-Intelligence Field Activity)</p> <p>First Reported: FY 2005</p>	- Developed and implemented a plan.	2nd Qtr 06	Completed
	- Conducted training.	3rd Qtr 06	Completed
	- Validated that the weakness is corrected.	3rd Qtr 06	Completed



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Table I. Section 2 Corrected Overall Material Weaknesses			
Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY05	Status Date as Reported in FY06
5. The National Defense University has resolved issues where contractors are not always appropriately identifying themselves according to the Federal Acquisition Regulation. (National Defense University) First Reported: FY 2005	- Developed remedial training for contractors.	Completed	Completed
	- Standardized e-mail procedures for contractors.	Completed	Completed
	- Established proper identification.	2nd Qtr 06	Completed
	- Validated that the weakness is corrected. Completed	2nd Qtr 06	Completed
6. The Department of the Army has resolved processes for managing workload, linking workload to dollars required, and 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	Completed
	- Analyzed workload for peacetime and wartime. Linked the workload to the operating force.	Completed	Completed
	- Ensured that there is accurate documentation to validate the manpower requirements in the official record called the "Table of Distribution and Allowances."	Completed	Completed
	- Issued a change to the regulation on the approval authority for manpower requirement determinations.	Completed	Completed
	- Completed audit review to validate that the weakness is corrected. Completed	1st Qtr 06	Completed
7. The Office of the Under Secretary of Defense (Intelligence) has resolved the issue where skill sets to support critical missions were not adequate. First Reported: FY 2005	- Identified the requirement for manpower.	Completed	Completed
	- Developed supporting documentation.	Completed	Completed
	- Obtained senior level approval.	3rd Qtr 06	Completed
	- Validated that the weakness is corrected. Completed	4th Qtr 06	Completed

Table II. Section 2 Consolidated Overall Material Weaknesses			
Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY05	Status Date as Reported in FY06
1. Instances where an ineffective process prevents ensuring that disbursements and collections by service providers are properly recorded. (Defense Intelligence Agency) First Reported: FY 2005	- Established adequate staffing.	Completed	Completed
	- Establish a baseline for reconciliation.	4th Qtr 06	4th Qtr 07
	- Reconcile the Fund Balance with Treasury account.	1st Qtr 07	1st Qtr 09
	- Validate that the weakness is corrected. Consolidated into Financial Reporting Weakness #5 at Table VI	4th Qtr 07	4th Qtr 09



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Table II. Section 2 Consolidated Overall Material Weaknesses

Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY05	Status Date as Reported in FY06
2. The Fund Balance with Treasury accounts for the Defense Agencies and Navy cannot always be accurately reconciled. (Defense Finance and Accounting Service)	- Developed a plan and milestones that address controls, reconciliation, and assertion that the accounts are ready to audit.	1st Qtr 06	Completed
	- Implemented full operational capability of financial system (Columbus Cash Accountability System).	2nd Qtr 06	Completed
	- Reconciled disbursements.	3rd Qtr 06	Completed
	- Modified business procedures to eliminate incorrect subheads on transactions.	4th Qtr 06	Completed
	- Perform validation of identified actions for selected Defense Agencies.	1st Qtr 07	2nd Qtr 07
	- Validate that the weakness is corrected.	3rd Qtr 07	3rd Qtr 07
First Reported: FY 2005	Consolidated into Financial Reporting Weakness #5 at Table VI.		
3. Accounts Payable were not always accurately recorded in a timely manner. (Department of the Navy)	- Defined scope and created plan to correct problem.	Completed	Completed
	- Conducted training.	1st Qtr 06	Completed
	- Collected requirements to modify the workflow process.	2nd Qtr 06	Completed
	- Modify the workflow and systems to accurately record accounts payable.	1st Qtr 07	4th Qtr 09
	- Ensure that corrective actions are working.	3rd Qtr 07	1st Qtr 10
	- Assert that the account is ready to audit.	1st Qtr 08	3rd Qtr 10
	- Conduct audit to validate that the weakness is corrected.	2nd Qtr 08	1st Qtr 11
First Reported: FY 2005	Consolidated into Overall Systemic Weakness #11 at Table IV.		
4. The accounts payable do not always accurately reflect the liabilities associated with the actual receipt of goods and services in the appropriate time period. (Defense Finance Accounting Service)	- Reviewed current business practices.	Completed	Completed
	- Established a plan of actions.	Completed	Completed
	- Implemented metrics to measure magnitude of problem and impact of corrective actions.	2nd Qtr 06	Completed
	- Certify and implement procedures for capturing and reporting accounts payable.	-	2nd Qtr 07
	- Cleanup accounting systems at the transaction level.	-	3rd Qtr 08
	- Validate that the weakness is corrected.	1st Qtr 07	4th Qtr 08
First Reported: FY 2004	Consolidated into Overall Systemic Weakness #11 at Table IV.		

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Table IIIa. Section 2 Overall Financial Material Weaknesses - Ongoing

Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY05	Status Date as Reported in FY06
1. Adequate documentation does not always exist to support adjustments used to reconcile general ledger data to budgetary data. (Defense Finance & 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	Completed
	- Implemented and validated a crosswalk process to map transactions to the appropriate general ledger accounts.	Completed	Completed
	- Activated the Defense Departmental Reporting System-Budgetary.	Completed	Completed
	- Implement the Defense Departmental Reporting System-Budgetary.	-	1st Qtr 07
	- Begin reporting exclusively through the Defense Departmental Reporting System-Budgetary		2nd Qtr 07
	- Validate that the weakness is corrected	2nd Qtr 06	3rd Qtr 07
Revised Correction Target Date: 3rd Qtr, FY 2007			
2. Policy for recording, reporting, collecting and reconciling accounts receivable from public and government sources is not always followed. (Defense Finance & Accounting Service) First Reported: FY 2003	- Monitored monthly and performed quarterly reconciliation.	Completed	Completed
	- Conducted random review of compliance to policy and procedures.	2nd Qtr 06	Completed
	- Published standard accounts receivable operating procedures for Department.	4th Qtr 06	Completed
	- Validate the accounting events in the accounting systems.	-	2nd Qtr 07
	- Provide assertion that accounts receivables are ready for audit and validate that the weakness is corrected.	2nd Qtr 07	4th Qtr 07
Revised Correction Target Date: 4th Qtr, FY 2007			
3. Lack of controls to accurately reconcile obligation of the foreign military sales with budgetary authority. (Department of the Air Force) First Reported: FY 2006	- Identified scope of project.	-	Completed
	- Complete the accounting reconciliation and reprioritize workload.	-	3rd Qtr 07
	- Implement reprogramming changes recommended by the working group.	-	1st Qtr 08
	- Validate that the weakness is corrected.	-	1st Qtr 08
Correction Target Date: 1st Qtr, FY 2008			



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Table IIIa. Section 2 Overall Financial Material Weaknesses - Ongoing

Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY05	Status Date as Reported in FY06
4. There are instances where unsupported adjustments are being made to the general ledger accounts. (Defense Logistics Agency) First Reported: FY 2005	- Launched agency-wide effort to properly establish codes and correctly use them.	Completed	Completed
	- Reviewed procedures to maintain supporting documentation.	1st Qtr 06	Completed
	- Implement procedures to perform reconciliation.	1st Qtr 06	3rd Qtr 07
	- Review and validate accounts payable.	-	2nd Qtr 08
	- Validate that the weakness is corrected.	4th Qtr 06	4th Qtr 08
	Revised Correction Target Date: 4th Qtr, FY 2008		

Table IIIb. Section 2 Overall Non-Financial Material Weaknesses - Ongoing

Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY05	Status Date as Reported in FY06
5. Instances where inefficiencies occurred in planning for and paying for joint training exercises due to inadequate controls. (Joint Staff) First Reported: FY 2006	- Issue guidance.	-	1st Qtr 07
	- Report results.	-	2nd Qtr 07
	- Validate that the weakness is corrected.	-	3rd Qtr 07
	Correction Target Date: 3rd Qtr, FY 2007		
6. Inadequate controls to effectively manage pharmaceuticals. (Department of the Air Force) First Reported: FY 2005	- Issued policy.	Completed	Completed
	- Implemented system modifications to alert medical personnel of inappropriate procurement sources and to track backorder status.	2nd Qtr 06	Completed
	- Published procedures to manage procurement of pharmaceuticals.	3rd Qtr 06	Completed
	- Review the effectiveness of corrective actions.	3rd Qtr 07	3rd Qtr 07
	- Validate that the weakness is corrected.	3rd Qtr 07	3rd Qtr 07
	Correction Target Date: 3rd Qtr, FY 2007		

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Table IIIb. Section 2 Overall Non-Financial Material Weaknesses - Ongoing

Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY05	Status Date as Reported in FY06
7. Inadequate controls to ensure that systems engineering plans meet technical objectives. (Missile Defense Agency) First Reported: FY 2006	- Completed a draft of the plan.	-	Completed
	- Coordinated plan for review.	-	Completed
	- Complete and issue plan and guidance.	-	1st Qtr 07
	- Audit the plan.	-	3rd Qtr 07
	- Validate that the weakness is corrected. Correction Target Date: 3rd Qtr, FY 2007	-	3rd Qtr 07
8. Instances where civilian premium payments, such as overtime pay, were not properly processed and authorized. (United States Transportation Command) First Reported: FY 2006	- Conducted timekeeper training on a quarterly basis.	-	Completed
	- Conducted supervisor training on a bi-annual basis.	-	Completed
	- Review policies for employee overtime and compensatory time.	-	1st Qtr 07
	- Validate that the weakness is corrected. Correction Target Date: 1st Qtr, FY 2007	-	1st Qtr 07
9. The Department'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 the Department 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	Completed
	- Published a capital planning and investment guide that incorporates the portfolio management, enterprise architecture requirements, and information management.	1st Qtr 06	Completed
	- Ensure senior management performs oversight for selecting appropriate projects governed by Enterprise Architecture.	-	1st Qtr 07
	- Publish instruction to institutionalize the information technology portfolio management.	-	1st Qtr 07
	- Validate that the weakness is corrected. Revised Correction Target Date: 1st Qtr, FY 2007	1st Qtr 06	1st Qtr 07
10. Instances where programs have deviated from cost and schedule thresholds of the acquisition program baseline. (Office of the Secretary of Defense, TRICARE Management Activity) First Reported: FY 2006	- Established an internal configuration control board.	-	Completed
	- Received funding.	-	Completed
	- Approve proper authority.	-	2nd Qtr 07
	- Validate that the weakness is corrected. Correction Target Date: 2nd Qtr, FY 2007	-	2nd Qtr 07



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Table IIIb. Section 2 Overall Non-Financial Material Weaknesses - Ongoing

Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY05	Status Date as Reported in FY06
11. Inadequate controls on funds availability. (Office of the Secretary of Defense, Washington Headquarter Service) First Reported: FY 2006	- Issue guidance.	-	2nd Qtr 07
	- Reengineer processes for future operations.	-	1st Qtr 09
	- Validate that the weakness is corrected. Corrected Target Date: 1st Qtr, FY 2009	-	1st Qtr 09
12. Inadequate controls to implement a continuity planning program. (Department of the Navy) First Reported: FY 2006	- Fifty percent implementation of the continuity program according to guidance.	-	1st Qtr 07
	- Full implementation.	-	1st Qtr 07
	- Develop continuity plans.	-	3rd Qtr 07
	- Validate that the weakness is corrected. Correction Target Date: 3rd Qtr, FY 2007	-	3rd Qtr 07
13. Automated management tools are needed to ensure accountability of Reserve component personnel from home 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	Completed
	- Corrected the mobilized unit identification codes.	Completed	Completed
	- Corrected any disconnects between mobilization orders and the data entry.	Completed	Completed
	- Interfaced between the global command and control system and the mobilization deployment integration system to obtain the on-hand data.	Completed	Completed
	- Complete audit review.	2nd Qtr 06	2nd Qtr 07
	- Validate that the weakness is corrected. Revised Correction Target Date: 2nd Qtr, FY 2007	4th Qtr 06	2 nd Qtr 07
14. Lack of clearly defined strategies or implementation plans has caused program inefficiencies for both the Chemical Demilitarization and the Nuclear Weapons Physical Security Programs. (Office of the Under Secretary of Defense for Acquisition, Technology and Logistics) First Reported: FY 2004	- Developed draft strategies and implement risk management plans.	Completed	Completed
	- Submitted draft strategies and plans for review and approval.	Completed	Completed
	- Completed actions required for a clearly defined strategies and implementation plans.	Completed	Completed
	- Submit final transition plan to leadership.	2nd Qtr 06	2nd Qtr 07
	- Validate that the weakness is corrected. Revised Corrected Target Date: 2nd Qtr, FY 2007	2nd Qtr 06	2nd Qtr 07

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Table IIIb. Section 2 Overall Non-Financial Material Weaknesses - Ongoing

Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY05	Status Date as Reported in FY06
15. Inadequate controls have caused instances of inaccurate accountability for equipment sold to foreign countries. (Defense Security Cooperation Agency) First Reported: FY 2004	- Set record keeping standards.	Completed	Completed
	- Developed checklists for validation.	Completed	Completed
	- Deployed automated application and conducted assessment visits.	Completed	Completed
	- Continue establishing a baseline and consolidate the data recommended by the Government Accountability Office report.	-	1st Qtr 07
	- Conduct final assessment visits and validate that the weakness is corrected. Revised Correction Target Date: 1st Qtr, FY 2007	4th Qtr 06	1st Qtr 07
16. Lack of policy and clear delineation of organizations and responsibilities puts the organization at risk for security violations, duplication of efforts, delays in program activities, and confusion over requirements. (Defense Security Cooperation Agency) First Reported: FY 2004	- Reviewed and coordinated changes to regulations.	Completed	Completed
	- Inspect and assess physical security.	-	1st Qtr 07
	- Publish handbook.	2nd Qtr 06	2nd Qtr 07
	- Validate that the weakness is corrected. Revised Correction Target Date: 2nd Qtr, FY 2007	2nd Qtr 06	2nd Qtr 07
	17. Controls were not always adequate over exported Defense articles from initial shipment point to receipt by foreign customers. (Defense Security Cooperation Agency) First Reported: FY 2004	- Actively participated with interagency working groups.	Completed
- Confirmation that the Bureau of Customs and Border Protection received adequate information on shipments.		3rd Qtr 06	Completed
- Issue detailed documentation requirements and policy.		2nd Qtr 06	2nd Qtr 07
- Issue policy decision on freight tracking system.		4th Qtr 06	4th Qtr 07
- Validate that the weakness is corrected. Revised Correction Target Date: 4th Qtr, FY 2007		4th Qtr 06	4th Qtr 07
18. Adequate policies to mandate the appropriate proficiency in foreign languages are necessary to more adequately support the global war on terror. (Office of the Under Secretary of Defense (Personnel and Readiness)) First Reported: FY 2004	- Obtained approval of a transformation roadmap.	Completed	Completed
	- Published revised Department Directive.	Completed	Completed
	- Publish revised Department Instruction.	3rd Qtr 06	1st Qtr 07
	- Validate that the weakness is corrected. Revised Correction Target Date: 1st Qtr, FY 2007	4th Qtr 06	1st Qtr 07



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Table IV. Section 2 Overall Systemic Weaknesses - Ongoing

Title	1. Department of Defense Financial Management Systems and Processes
Description of Issue	<p>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. In addition, the Department has reported this issue as non-compliance with the Federal Financial Management Improvement Act of 1996 and as non-conformance with Section 4 of the Federal Managers Financial Integrity Act of 1982.</p>
Progress to Date	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • Established five core business mission areas: financial management, human resources management, weapon system lifecycle management, real property and installation lifecycle management, and materiel supply and service management. These business areas, working together, will unify the Department's business transformation efforts. • Established six initial business enterprise priorities: financial visibility, acquisition program visibility, materiel transaction visibility, personnel visibility, real property accountability, and common supplier engagement to guide the initial direction of transformation activities. • Defined six core financial capabilities in support of the financial visibility priority, and established performance measures to monitor and guide activities that led to the full development and maintenance of those capabilities. The six capabilities are: forecast, plan, program and budget; management of financial assets and liabilities; managerial accounting; funds allocation, collection, control, and disbursement; management of general ledger; and financial reporting. • Identified five initiatives to support the financial visibility priority: standard financial information structure, business enterprise information services, Defense cash accountability system, intra-governmental transaction system, and the program budget framework. The initial list of potential initiatives was narrowed to five in order to ensure adequate and appropriate focus and resource allocation is made that will yield the highest likelihood for success. Chartered the Defense Business System Management Committee to oversee transformation in the five core business mission areas. • Published Version 3.0 of the business enterprise architecture, which includes the standard financial information structure. • Published the Department's enterprise transition plan in September 2005. The enterprise transition plan will reflect the goals, objectives, and implementation strategies to create an integrated picture of the Department's business transformation. • Published in a report to Congress the first update to the enterprise transition plan on progress made in business transformation. • The business transformation agency of the Department oversees the Investment Review Boards, which as the authoritative body, reviews and decides investment priorities for all Defense business systems. These Investment Review Boards greatly enhanced the Department's ability to meet the FY 2005 Ronald W. Reagan National Defense Authorization Act to review all business system investments, at least annually, and certify as compliant the business system modernizations over \$1,000,000.

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Table IV. Section 2 Overall Systemic Weaknesses - Ongoing

	<p>B. Planned Milestones for FY 2007 and beyond:</p> <ul style="list-style-type: none"> • Update the enterprise transition plan and financial improvement and audit readiness plan every 6 months to ensure the components have the most up to date guidance available in planning for business transformation, which is being continuously updated and refined. • Update the business enterprise architecture Version 3.1 and integrate it into the enterprise transition plan. • Integrate the standard financial information structure Phase 1 into the business enterprise information services to create a shared business intelligence environment. The business enterprise information services will include a corporate general ledger when the legacy accounting system transactions, which have been cross-walked to the standard financial information structure, can be recorded. The business transformation agency will work closely with the targeted accounting systems to ensure a common understanding and implement Phase 1 elements of the standard financial information structure. • Implement Phase 2 of the standard financial information structure into the framework for a statement of net cost. Phase 2 will define segments of responsibility, provide links to support the consolidation of financial statements, and provide a corporate level view of major operations and responsibility segments. • Align and integrate the program budget framework initiative with Phases 1 and 2 of the standard financial information structure to create a direct link between the Department’s plans, programs, and budgets with execution and performance data. • Align the financial visibility performance measures to the strategic plan’s goals and measures. • Update the business enterprise architecture to Version 4.0 and integrate it into the enterprise transition plan. <p>Correction Target Date: 4th Qtr, FY 2015</p>
<p>Title</p>	<p>2. Management of Information Technology and Assurance</p>
<p>Description of Issue</p>	<p>The Department of Defense information systems are potentially vulnerable to an information warfare attack. In addition, the Department has reported this issue 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"> • Issued the Department of Defense Information Assurance Training and Certification Manual which provides guidance for identification and certification of personnel conducting information assurance functions within the Department. • Directed the Department-wide use of the public key infrastructure token common access card for logon to information networks. • Awarded the enterprise license for the host-based security solutions software, which includes tools to support policies, centralized management of host-based computer network defense capabilities, and the prevention of unauthorized access to files and information. • Completed the formal coordination of the revised security certification and accreditation policy to improve compliance and provide an enterprise management capability. Directed components to appropriately report all security weaknesses identified in their annual reviews. • Developed an on-line knowledge service providing detailed guidelines, standards, and tools for security certification and accreditation. • Completed the draft Version 1.1 of the information assurance component of the Global Information Grid architecture. • Made available the enterprise automated certification and accreditation capability of the enterprise mission assurance support system. Pilots of the enterprise mission assurance support system are ongoing at multiple components. • Reported 87.1 percent of the systems certified and accredited in the Federal Information Security Management Act report. • Issued the Defense assurance certification and accreditation process in a policy memorandum which is pending review and further synchronization with the certification and assurance revitalization process.



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	<p>B. Planned Milestones for FY 2007 and Beyond:</p> <ul style="list-style-type: none"> • Achieve 100 percent capability to log onto the Department networks using the public key infrastructure token. • Complete updating the database of the Defense civilian personnel system with detailed information and assurance for the military workforce. • Provide the United States Strategic Command a real-time situational awareness of the Department of Defense information assurance posture. • Publish the final version of the information assurance component of the Global Information Grid architecture. • Incorporate changes to the Department of Defense military personnel databases to support the information assurance workforce management program which will accommodate any delays in the Defense integrated military human resource system. • Sponsor the information assurance management tools at a Defense enterprise computing center. • Achieve 100 percent security certification and accreditation for the Department of Defense systems. • Continue the development of the information assurance component of the Global Information Grid architecture and implement the information assurance capabilities. • Continue to identify and track information assurance for both civilian and military personnel. <p>Correction Target Date: 3rd Qtr, FY 2007</p>
Title	3. Valuation of General Personal Property
Description of Issue	The Department of Defense does not currently meet Federal Accounting Standards for the financial reporting of personal property. Documentation for personal property is neither accurate nor reliable. (Newly reported: FY 2006)
Progress to Date	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • Identified the universe of general equipment for the National Geospatial-Intelligence Agency. • Revised and published the Department of Defense Instruction, "Equipment and Administrative Property." • Completed documents for functional requirements of the Defense property accountability system.
	<p>B. Planned Milestones for FY 2007 and beyond:</p> <ul style="list-style-type: none"> • Publish the concept of operations. • Establish the Department of Defense property council. • Identify the universe of general equipment for Army, Navy, Marine Corps, and the Defense Logistics Agency. • Determine values for the Defense Logistics Agency general equipment. • Identify the universe of general equipment for Air Force. • Ensure that the National Geospatial-Intelligence Agency determines values for general equipment. • Ensure that Army, Navy, and Marine Corps determine values for general equipment. • Submit the National Geospatial-Intelligence Agency assertion package, asserting that it is ready for audit. • Complete a technical refresh of Defense property accountability system. • Submit the Defense Logistics Agency assertion package, asserting that it is ready for audit. • Submit the Army assertion package. • Determine values for general equipment for Air Force. • Submit the assertion packages for Navy and Marine Corps. • Complete the National Geospatial-Intelligence Agency audit. • Complete the Army audit. • Recertify and accredit the Air Force management system. • Complete the Defense Logistics Agency audit. • Complete the Navy and Marine Corps audit. • Submit the Air Force assertion package. • Complete the Air Force audit. <p>Correction Target Date: 3rd Qtr, FY 2017</p>

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Table IV. Section 2 Overall Systemic Weaknesses - Ongoing	
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"> • The Office of Management and Budget issued a policy on the reciprocal recognition of existing personnel security clearances in an effort to ensure that background investigations or other requirements are only done when actually required. • The Clearance Verification System, operated and maintained by the Office of Personnel Management, went into initial operation. The Clearance Verification System is the central index for investigative and clearance information within the government. Until the final architecture and requirements are determined and implemented, the Department will maintain its linkage between the joint personnel adjudication system and the Office of Personnel Management security investigations index to share investigative and clearance information on Department of Defense personnel. • The President approved the new adjudication guidelines for determining eligibility for access to classified information and other types of protected information. These guidelines were implemented in FY 2006.
	<p>B. Planned Milestones for FY 2007 and beyond:</p> <ul style="list-style-type: none"> • Implement the electronic questionnaire for investigative processing for submission of national security investigations to the Office of Personnel Management. • Evaluate the Air Force predictive model for military and civilian investigative requirements for application throughout the Department. • Complete 80 percent of all Department of Defense investigations within 90 days with no case over a year old. • Receive completed investigations electronically from the Office of Personnel Management. • Adequately staff adjudication facilities to meet mission needs. • Adjudicate 80 percent of completed investigations within 30 days. • Develop a strategic plan for the Department of Defense personnel security program. • Implement an automated continuing evaluation system. • Update yearly security forms. • Complete 90 percent of all applications for a personnel security clearance. Complete the investigation in 40 days and the adjudication in 20 days. <p>Correction Target Date: 4th Qtr, FY 2007</p>



Section 4: Other Accompanying Information

Table IV. Section 2 Overall Systemic Weaknesses - Ongoing

Table IV. Section 2 Overall Systemic Weaknesses - Ongoing	
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:</p> <ul style="list-style-type: none"> • Refined the use of the reporting metrics for sustainment and recapitalization of used property infrastructure. • Completed the common reporting of facility condition in the annual submission of real property inventory data and an independent study to validate the methodology of the process. • Deployed the facilities recapitalization model to predict the average annual dollar amount required to update and renew the inventory of facilities on a continual, ongoing basis. • Published the Department of Defense Instruction, "Real Property Inventory and Forecasting," which details guidance for performing the requirements for real property inventory. • Implemented new corporate demolition and disposal procedures that will more adequately capture the net effect on the inventory by eliminating excess and obsolete facilities. • Deployed a test version of the facilities operations model that predicts the requirements for facility-related services, utilities, and leasing. • Reported the facilities data in the Defense readiness reporting system to reflect the impact of facilities on mission readiness. • Completed the Department's reporting of inventory for the federal property profile. • Continued the analytical efforts for developing and implementing the means for identifying facility deficits and for projecting new facility requirements. • Integrated military family housing into other metrics.
	<p>B. Planned Milestones for FY 2007:</p> <ul style="list-style-type: none"> • Capture real property inventory data elements as prescribed by the Federal Real Property Council for use in the submission to the federal real property profile. • Use metrics and systems' tools already in place to evaluate progress toward goals. <p>Correction Target Date: 1st Qtr, FY 2008</p>

Section 4: Other Accompanying Information



Table IV. Section 2 Overall Systemic Weaknesses - Ongoing

Table IV. Section 2 Overall Systemic Weaknesses - Ongoing	
Title	6. Government Card Program Management
Description of Issue	Instances of misuse, abuse, and fraud in respect to purchase and travel card use, and centrally billed accounts have been attributed to inadequate Department of Defense emphasis on proper use of the cards, poorly enforced controls, and lax oversight.
Progress to Date	<p>Purchase Card Program:</p> <p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • Cancelled unnecessary cards and reduced workloads on billing officials so that they can perform, timely, and complete reviews of all card transactions. • Developed a comprehensive purchase card concept of operations that the components use as a guide to oversee their programs. • Completed initial field tests of centralized data mining capability to detect fraudulent, wasteful, and abusive card transactions. • Implemented new disciplinary guidelines, specifically targeted to card misuse, and aggressively, prosecuted known fraud cases. • Completed all internal administrative and policy recommendations that were developed internally (to include the Department of Defense charge card task force recommendations) to address purchase card misuse. • Developed a Defense-wide provisioning capability that will provide a web-based means for system users to document and update management and system hierarchies. The purchase card program management office will be the first user of this provisioning capability. • Developed the authorization, issuance, and maintenance capability for the purchase card program management office. Capability will provide an interface to initiate and approve requests for issuance, suspension, or cancellation of purchase card accounts and will have interfaces to the card issuing banks, which create and maintain the purchase card accounts. • Solicited for data mining capability.
	<p>B. Planned Milestones for FY 2007:</p> <ul style="list-style-type: none"> • Complete Spiral 1 development testing of authorization, issuance, and mining capabilities. • Complete operational testing of provisioning capability. • Initial operating capability of authorization, issuance, and maintenance.
Progress to Date	<p>Travel Card Program:</p> <p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • Implemented a data mining pilot program with the Bank of America and Visa Corporation to flag and review high risk transactions. • Published a standard training guide. • Developed additional guidelines for management of centrally billed accounts. • Continued to implement premium class travel task force recommendations regarding policies for the Department. • Developed a method for identifying and preventing reimbursements for centrally billed travel tickets claimed on an individual's travel voucher. • Collected approximately \$3 million through salary offset. • Closed 6,967 accounts upon review of separation and retirement lists. • Formed the Defense Travel Management Office.



Section 4: Other Accompanying Information

Table IV. Section 2 Overall Systemic Weaknesses - Ongoing

	<p>B. Planned Milestones for FY 2007:</p> <ul style="list-style-type: none"> • Enhance the Defense travel system by providing visibility of the charges and additional controls. • Complete the travel card program assessment. • Develop a web based tool for tracking the approvals of premium class travel. • Complete component audits concerning unused tickets, improper payments, and premium class travel. • Form governance boards for policy and regulatory changes. • Continue monitoring travel card performance through monthly metric reviews. • Issue guidance to the components for developing plans of action and milestones in expanding the use of individually billed accounts within the Department of Defense for official travel expenses. <p>Correction Target Date: 4th Qtr, FY 2007</p>
Title	7. 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:</p> <ul style="list-style-type: none"> • Updated the Department of Defense Financial Management Regulation, Volume 11B, Chapter 5. • Issued policy for "Accounting for Inventory Held for Repair in Working Capital Funds" memorandum dated August 4, 2003. • Convened an inventory working group, charged with developing a baseline for inventory valuation, establishing methodologies for valuing inventory, and testing the existence and completeness of assertions. • Developed the methodologies for valuing inventory; identified systems that are compliant with and could sustain moving average cost inventory valuations; developed processes to baseline compliant systems and sustain those baselines using moving average cost methodology; and developed timelines and approaches to completing baselines for all systems to include testing existence and completing assertions. • Worked with the Federal Accounting Standards Advisory Board to interpret and apply standards to the Department's processes. • Issued an update to the policy on unique identification of assets memorandum for new equipment, major modifications, and reprocurement of equipment and spares. • Issued an interim Defense federal acquisition regulation supplement on item unique identification memorandum entitled, "Item Unique Identification and Valuation." • Issued the policy on radio frequency identification memorandum entitled, "Radio Frequency Identification Policy Update." • Published the Defense federal acquisition regulation supplement clause governing application of passive radio frequency identification in the federal register for public comments. • Issued the final item unique identification rule published for the Defense federal acquisition regulation supplement. • Included the valuation requirements in the enterprise transition plan. • Included milestones for completion in the financial improvement and audit readiness plan.
	<p>B. Planned Milestones for FY 2007 and beyond:</p> <ul style="list-style-type: none"> • Update the financial improvement and audit readiness plan. • Publish the Defense federal acquisition regulation supplement clause governing the application of tags to remaining commodities and locations. • Ensure the solicitations and contracts for government furnished property meet the item unique identification requirements. • Publish the in-transit inventory accountability policy. • Extend the item unique identification to legacy items. • Implement systems and processes to sustain baselines. <p>Correction Target Date: 4th Qtr, FY 2016</p>

Section 4: Other Accompanying Information



Table IV. Section 2 Overall Systemic Weaknesses - Ongoing	
Title	8. Improper use of Non-Department of Defense Contracting Vehicles
Description of Issue	Non-Department of Defense contracting vehicles have been used improperly to procure services or supplies.
Progress to Date	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • Commenced workforce training with continuous learning module established on the Defense Acquisition University website and additional roadshow training. • Conducted outreach programs with assisting civilian agencies. • Issued a policy memorandum. • Issued an interim rule to implement requirements of the Ronald W. Reagan National Defense Authorization Act for FY 2005. • Reported on the Department's use of non-Department contracts from assisting civilian agencies. • Completed a compliance review regarding implementing policy regarding the proper use of non-Department contracts. • Issued guidance on the proper use of interagency agreements for non-Department contracts under authority other than the Economy Act. • Established a joint task force.
	<p>B. Planned Milestones for FY 2007:</p> <ul style="list-style-type: none"> • Issue a policy memorandum on "Severable Services." • Expand the utilization of interagency acquisition website. • Establish a senior level memorandum of agreement with the General Services Administration, the Department of the Interior, and the National Aeronautics and Space Administration. • Establish a senior level memorandum of agreement with the Department of the Treasury, the National Institutes of Health, and the Department of Veterans Affairs. <p>Correction Target Date: 2nd Qtr, FY 2007</p>



Section 4: Other Accompanying Information

Table IV. Section 2 Overall Systemic Weaknesses - Ongoing

Table IV. Section 2 Overall Systemic Weaknesses - Ongoing	
Title	9. Department of Defense Contracting for Services
Description of Issue	The Office of the Inspector General, Department of Defense and the Government Accountability Office, have identified deficiencies in the policy for, and the execution of, procurement for services.
Progress to Date	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> Resolved overpayment issues identified in the Department of Defense Inspector General report. The Army reviewed all logistic civil augmentation plan contract orders to ensure that contracts are within scope and backlog of undefinitized orders eliminated. Developed new procedures to ensure prompt completion. Revised the policy on the proper use of other agencies' contracts to include conducting surveillance of services procured from other agencies' contracts. Published an updated policy on how to appoint and train contracting officer representatives. The Defense Acquisition University updated the contractor officer representatives training. Established working groups that were identified in the improvement plan. Implemented the improvement plan and initiated periodic status briefs on the improvement plan and systemic weaknesses to senior Defense leadership. Issued a policy memorandum on the performance based services acquisition and required progress reports on performance based services acquisition training for individuals participating in the preparation of performance based work statements. Developed metric goals and thresholds for the strategic sourcing program. Developed a concept of operations for the Department of Defense strategic sourcing. Updated the plan for improving the Government Accountability Office high risk areas of contract management. Published guidance regarding procedures for and use of, waivers to competitive requirements. Reviewed and updated the policy on quality assurance surveillance and written oversight plans. Published the Acquisition, Technology and Logistics Workforce Human Capital Strategic Plan. Established goals for FY 2006 and beyond on the competition of task and delivery orders under multiple award contracts. Published policy entitled "Management Structure for the Procurement of Contract Services," which implements the National Defense Authorization Act for FY 2006 requirements. Designated senior officials who are required to ensure that their service contract review processes and data collection requirements support adequate contract surveillance. Reviewed component data for the top 20 acquisitions of services. Designated that senior officials verify that their service contract review processes and data collection requirements adequately support contract surveillance.
	<p>B. Planned Milestones for FY 2007:</p> <ul style="list-style-type: none"> Address the Government Accountability Office high risk areas in training or policy requirements. Review the guidance procedures for task orders, competition, price reasonableness determinations, and quality assurance surveillance in response to weaknesses identified in the Department's self assessment. Implement the spend analysis of the initial acquisition. Process 51 percent of invoices applicable to each military department office through wide area work flow. Complete component self assessments of pricing techniques, performance based services acquisition, and quality assurance surveillance and written oversight plans. Complete 80 percent of the training for personnel who develop statements of work. <p>Correction Target Date: 4th Qtr, FY 2007</p>

Section 4: Other Accompanying Information



Table IV. Section 2 Overall Systemic Weaknesses - Ongoing

Table IV. Section 2 Overall Systemic Weaknesses - Ongoing	
Title	10. Federal Procurement Data Reporting
Description of Issue	The new Federal Procurement Data System is not fully functional causing inaccurate procurement reporting data and increased costs required for continued maintenance of legacy systems.
Progress to Date	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • Established a joint Federal Procurement Data System-Next Generation migration team. • Identified outstanding requirements to the General Services Administration, necessary to transition to the new system. • Certified the contract writing systems that directly report to the new system. • Certified that all FY 2005 data has been submitted to the Federal Procurement Data System-Next Generation. • Completed testing to ensure that data from FY 1997– 2004 has been appropriately migrated from the original source system.
	<p>B. Planned Milestones for FY 2007:</p> <ul style="list-style-type: none"> • Certify that all FY 2006 data has been submitted to the Federal Procurement Data System-Next Generation. • Receive certification from the General Services Administration that the Federal Procurement Data System-Next Generation attained full operating capability. • Initiate decommissioning of component feeder systems. • Complete migration from the current reporting environment to the Federal Procurement Data System-Next Generation. <p>Correction Target Date: 2nd Qtr, FY 2007</p>
Title	11. Department of Defense Accounts Payable
Description of Issue	The Department of Defense does not meet accounting standards for the financial reporting of public accounts payable because of its inability to support balances due to a lack of standard procedures for recording, reporting, and reconciling the amounts between the financial, accounting, and reporting systems.
Progress to Date	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • Establish a plan of action and milestones. • Name accounts payable as a focus area in the financial improvement and audit readiness plan for concerted effort and attention to corrective action milestones. • Develop a monthly report and tool for reconciling accounts payable balances between the financial, accounting, and reporting systems.



Section 4: Other Accompanying Information

Table IV. Section 2 Overall Systemic Weaknesses - Ongoing

	<p>B. Planned Milestones for FY 2007 and Beyond:</p> <ul style="list-style-type: none"> • Ensure implementation of the standard guidance provided in the Department of Defense Financial Management Regulation, Volume 4, Chapter 9, Accounts Payable. • Identify and document accounts payable universe. • Establish and implement the processes to initiate and record accounts payable in a timely manner. • Complete the Office of Management and Budget Circular A-123 requirement for the annual assessment on internal controls over financial reporting. • Identify the costs and submit budget requirements for preferred solutions. • Coordinate and obtain the approvals from appropriate offices (Investment Review Boards, Defense Business Systems Management Committee). • Obtain funding for the preferred solution. • Ensure the cleanup of the Department's legacy systems. • Ensure all material audit recommendations were addressed. • Identify and document the preferred solution's key processes, internal controls, and risk assessments. • Populate the accounts payable reconciliation tool with data from major financial systems. • Populate the accounts payable reconciliation tool with data from the remaining financial systems. • Complete implementation of the accounts payable repository at the transaction level for budgetary and proprietary reporting. • Implement the preferred solution for intragovernmental accounts payable. • Submit assertion packages for the components. • Complete all audits. <p>Correction Target Date: 4th Qtr, FY 2015</p>
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Table V. Section 4 System Nonconformance Weaknesses - Ongoing

Title	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	See Table IV, number 1 above, for progress explanation.

Section 4: Other Accompanying Information



Table VI. Section 2 Financial Reporting Weaknesses	
Title	1. Valuation of Military Equipment Assets
Description of Issue	The Department's inability to accurately report the financial value of military equipment supports the probability of material misstatement in financial reporting.
Progress to Date	<p>A. Completed Milestones</p> <ul style="list-style-type: none"> • Documented the acquisition costs for military equipment acquired for 1,101 military equipment programs. • Implemented a core system capability to value and depreciate military equipment assets. • Reported the updated acquisition and disposal costs on the 3rd Quarter, FY 2006 financial statements. • Developed and delivered training classes for updating baseline valuations.
	<p>B. Planned Milestones for FY 2007 and Beyond:</p> <ul style="list-style-type: none"> • Use the baseline valuation methodologies for FY 2006 year-end close. • Conduct initial operational testing and loading of data for the first military equipment increment of the Capital Asset Management System to obtain full operational capability. • Achieve initial operating capability for the second increment of the Capital Asset Management System – Military Equipment. • Transfer responsibility for acquisition cost valuation to the Military Services. • Complete audit of baseline values. <p>Correction Target Date: 1st Qtr, FY 2010</p>



Section 4: Other Accompanying Information

Table VI. Section 2 Financial Reporting Weaknesses

Title	2. Valuation of Real Property Assets
Description of Issue	The Department of Defense does not have adequate internal controls in place to provide assurance that real property assets are identified and properly reported in its financial reports.
Progress to Date	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • Published a revision to the Department of Defense Financial Management Regulation, Volume 4, Chapter 6, "General Property, Plant, and Equipment" that codifies the Statement of Federal Financial Accounting Standards. • Issued a revised capitalization threshold that capitalizes 99 percent of real property assets. • Standardized the core data elements for a real property inventory repository and issued the Department of Defense Instruction 4165.14, "Real Property Inventory and Forecasting." • Received the Military Services' plans for implementing the real property inventory repository requirements to streamline the business processes, standardize data elements, and put into practice the business rules as depicted in the Department of Defense business enterprise architecture. • Conducted a business process reengineering of the construction in progress to identify sustainable business processes and management controls that will improve reliability for construction in progress cost information.
	<p>B. Planned Milestones for FY 2007 and Beyond:</p> <ul style="list-style-type: none"> • Validate the Military Services' implementation of standardized data reporting for real property assets. • Develop a common Department-wide real property baseline methodology. • Revise guidance on standardized transactions for acceptance and transfer of real property assets. • Inspect cost and purchase documents of selected assets for existence, pricing, and ownership rights. • Check the United States Standard General Ledger posting of asset accounts to ensure correct posting logic and categorization. • Continue to monitor Military Services' progress toward implementing the real property inventory requirements and business processes to ensure consistency with the enterprise transition plan. • Validate that the Military Services have updated and developed new policies and procedures for real property accountability and real property financial reporting. Validate that the Military Services have initiated implementation of sustainable procedures. • Validate that the Military Services have completed implementation of the real property inventory requirements of sustainable business processes, standard data elements, and consistent management controls. Validate that the Military Services have begun monitoring the operational effectiveness of these processes and systems. <p>Correction Target Date: 4th Qtr, FY 2009</p>



Section 4: Other Accompanying Information

Table VI. Section 2 Financial Reporting Weaknesses	
Title	3. Reporting of Environmental Liabilities
Description of Issue	The Department of Defense internal controls for reporting environmental liabilities do not provide assurance that cleanup costs for all of its ongoing, inactive, closed, and disposal operations are identified, consistently estimated, and appropriately reported.
Progress to Date	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • Issued guidance to accomplish an initial inventory of operational ranges inventory and assess the environmental condition of the operational ranges. • Reported the operational range inventory to Congress in February of FY 2004. • Revised the Department of Defense Financial Management Regulation to add procedures for recognizing liabilities and reporting on operational ranges and munitions response areas. • Completed the final inventory of munitions sites (other than operational ranges). • Developed and issued an interim change to the regulation that requires the reconciliation of real property and environmental site records. • Developed and coordinated guidance on how to conduct operational range assessments. • Developed and coordinated guidance on how to report and forecast real property inventory. • Formed an environmental liabilities policy workgroup, with representation from the Department components, to assist in implementing the new environmental liabilities' policy and guidance. The workgroup is improving standardization of business processes across the components. • Published the "Best Practices Guide for Environmental Liabilities" which provides best practices for preparing for an audit and proper accounting that supports environmental liabilities in financial statements. • Issued guidance for recognizing, measuring, and reporting environmental liabilities not eligible for the defense environmental restoration program funding (i.e., non-defense environmental restoration program guidance), November 15, 2005. This guidance allows the components to develop procedures for identifying and estimating future liabilities not previously addressed under current programs. • The Department of Navy completed a "fence-to-fence" survey of all Navy installations and estimated the environmental disposal liabilities for all conventional and nuclear ships and submarines. • Through the environmental liabilities workgroup, the components provided input to an updated and standardized key milestone plan within the financial improvement and audit readiness plan to help identify a critical path to achieve a clean audit. • Updated the guidelines for Note 14, Environmental and Disposal Liabilities, of the consolidated financial statements to meet the new disclosure requirements and improve Department-wide reporting. • The Department of the Navy completed a "fence-to-fence" survey and developed preliminary cost estimates of the environmental liabilities for the non-defense environmental restoration program at all the Department of Navy installations. <p>B. Planned Milestones for FY 2007 and Beyond:</p> <ul style="list-style-type: none"> • Identify the universe of environmental liabilities' candidate units, facilities, and property where environmental issues have been identified. • Document that all property plant and equipment records have been reviewed and properly recorded for environmental liabilities. • Complete and document initial estimates for all sites in the environmental liabilities universe. • Develop policies and procedures to identify, calculate, and record closing and disposal costs for environmental liabilities. • Develop and implement internal controls for identifying, calculating, and recording closing and disposal costs for environmental liabilities. <p>Correction Target Date: 2nd Qtr, FY 2009</p>



Section 4: Other Accompanying Information

Table VI. Section 2 Financial Reporting Weaknesses

Table VI. Section 2 Financial Reporting Weaknesses	
Title	4. Reporting of Defense Health Care Liabilities
Description of Issue	The military health care current financial processes cannot collect accurate cost and performance information to produce reliable Department of Defense health care financial reports and actuarial liabilities.
Progress to Date	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • Established procedures requiring the Military Service medical facilities to submit monthly reports on the quality of their medical records. • Published a Department-wide policy on how to code medical records. • Developed a reconciliation process for reviewing expense data at Military Service medical facilities.
	<p>B. Planned Milestones for FY 2007 and Beyond:</p> <ul style="list-style-type: none"> • Construct records that contain data that tracks supplementary patient services and matches to the patient's initial contact with the provider. • Fully install a coding compliance editor system within all the military treatment facilities. • Develop a process for the distribution of funds using the "prospective payment method." • Incorporate the use of Medicare rates into the Medicare-Eligible Retiree Health Care Fund distribution plan for patient encounters and incorporate the use of Medicare rates for estimating actuarial liability. • Implement systems that will reconcile source data used in actuarial estimates with financial records. • Purchase and install a commercial off-the-shelf pharmacy system to interface with the health care accounting system. <p>Correction Target Date: 2nd Qtr, FY 2009</p>



Section 4: Other Accompanying Information

Table VI. Section 2 Financial Reporting Weaknesses	
Title	5. Fund Balance with Treasury
Description of Issue	The Department of Defense is unable to reconcile cash account balances to the Department of the Treasury cash account balances.
Progress to Date	<p>A. Completed Milestones:</p> <ul style="list-style-type: none"> • Documented transaction processes such as reconciling, tracking, and reporting clearing accounts. Also documented payments of intra-governmental accounts. • Developed reports to identify the amount of adjustments prepared each quarter. • Ensured the cash reconciliation system was used as a reconciliation tool for funds. • Determined the proper solution for resolving a \$238 million negative cash balance. • Established operating procedures to ensure timely updates of edit tables. • Developed clear definitions for a balanced scorecard measure and monthly in-transit disbursements report to ensure consistency among the reports. • Implemented full operational capability of the cash reconciliation system. • Documented the entire reconciliation process for the Treasury Index 97 general fund, including specific procedures of the various reconciliations within the overall process. • Modified interfund business procedures to eliminate the use of incorrect "default" subheads on transactions. • Completed research, reconciliation, and resolution of the Treasury Index 97 general fund departmental adjustments. • Developed a procedure to reduce the number of days required to post entries to the accounts. <p>B. Planned Milestones for 2007 and Beyond:</p> <ul style="list-style-type: none"> • Identify and document processes and controls that significantly impact the Fund Balance with Treasury balances. • Perform risk control assessments to identify potential weakness areas. • Develop corrective action plans to mitigate identified weaknesses. • Test critical systems and implement compensating controls to mitigate deficiencies and produce accurate Fund Balance with Treasury transactions. <p>Correction Target Date: 3rd Qtr, FY 2008</p>

Note: In some instances, there may be date inconsistencies between the PAR and Component source information. The Department will review this matter and make appropriate adjustments as needed during FY 2007.



Section 4: Other Accompanying Information

Auditor-Identified Financial Statement Weaknesses

Audits performed by the Department Inspector General identified several financial statement material weaknesses. A material weakness is a technical term referring to an identified problem that may impact the accuracy and reliability of financial information. The majority of the auditor-identified weaknesses and corrective actions are reported as material internal control weaknesses by the Department in this section. The auditor-identified material weaknesses not individually included in the Department's inventory of material weaknesses are Intragovernmental Eliminations, Accounting Entries, Government Property and Material in the Possession of Contractors, and Operating Materials and Supplies. Resolving these material weaknesses requires the initiatives, system solutions, and corrective actions developed and outlined in the Department's Financial Improvement and Audit Readiness Plan and the Department's Enterprise Transition Plan discussed in Section 1: Management's Discussion and Analysis.

Inspector General's Summary of Management and Performance Challenges

Based on audits, investigations, and inspections, the Inspector General (IG) identified six management and performance challenges for FY 2006 compared to the nine challenges reported for FY 2005. In identifying the six challenges the Office of the Inspector General (OIG) has combined elements of previously identified management challenges and added new challenges. Information technology management is now part of the larger issue of "Information Security and Privacy," logistics and homeland defense are now part of "Joint Warfighting and Readiness," and "Acquisition Processes and Contract Management" now include information technology acquisition. Additionally, with Base Realignment and Closure (BRAC) decisions

made, the challenge of Infrastructure and Environment was removed. However, implementation of those decisions will affect Department employees, so BRAC issues pertaining to personnel were merged with Human Capital. The challenge areas, summarized in the following pages, include:

- Acquisition Processes and Contract Management
- Financial Management
- Health Care
- Human Capital
- Information Security and Privacy
- Joint Warfighting and Readiness

Acquisition Processes and Contract Management

The Department's management challenge is to provide required materiel and services that are superior in performance, high in quality, sufficient in quantity, and reasonable in cost despite the ever increasing volume and complexity of purchases. Every acquisition dollar that is not prudently spent results in the unavailability of that dollar to fund the top priorities of the Secretary of Defense and wastes valuable taxpayer dollars.

Ensuring the appropriate size and experience level of the acquisition workforce in light of changing acquisition strategies and vehicles, prior downsizing, and an aging workforce, is a challenge.

Management is also challenged to make appropriate use of acquisition streamlining initiatives. Government quality assurance is more limited under commercial contracts. Before procuring against a commercial specification, the procurement community must be vigilant in deciding that the item will meet warfighter requirements as well as being a truly commercial item. The Department also continues to experience a variety of shortcomings in its approach to compliance with the DoD 5000 series of guidance and the Federal Acquisition Regulation in FY 2006. The OIG identified instances where Army acquisition officials misused appropriated funds by not complying with the DoD



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5000 series of guidance and the Federal Acquisition Regulation.

The Department also has significant challenges regarding purchases made through other agencies for the Department. Last year, the OIG found that Military Interdepartmental Purchase Requests used primarily in the fourth quarter of FY 2004 did not comply with the appropriations law and the Federal Acquisition Regulation for making purchases through other agencies. These purchases were valued at approximately \$406 million.

The Department has a goal to influence development of acquisition, planning, and innovation processes that will further the information assurance mission and support transformation of the force. One of the strategic objectives of the goal is to ensure that information assurance is integrated and sustained throughout the life cycle of Department programs. The objective states that Department business processes should include information assurance across the enterprise and conform to the Administration's "smart buy" concept. The Department is challenged to ensure that contracting for Information Technology (IT) includes information assurance and all contracting clauses required by the federal and Department regulations to safeguard our IT infrastructure.

Inspector General Assessment of Progress

The Department has made progress improving numerous acquisition processes. Despite progress, the increasing volume of acquisitions, the decrease in the number of acquisition personnel, and the numerous types of contracting vehicles and methods for accomplishing acquisition make this a long-term challenge. The Department management reacts positively after problems are identified; however, the sheer volume of contracting and the pressures on contracting officials to award procurements faster make the challenge of correcting the problems more difficult.

The Department needs to continue to vigilantly investigate allegations of corrupt acquisition, both criminally and administratively. Unfortunately, the works of a few to undermine the integrity of the acquisition process can set back the success of millions of acquisition actions within the Department. The Department also needs to strike a proper balance between reducing the time to award procurements and maintaining adequate controls to safeguard scarce resources. Use of acquisition streamlining initiatives such as buying commercial items makes sense, but buying unique major military systems as commercial items does not.

Financial Management

The Department faces financial management challenges that are complex, long-standing, and pervade virtually all of its business operations, thus affecting the ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting, and policy decisions. The Department's financial management problems are so significant that they constitute the single largest and most challenging impediment to the U.S. Government's ability to obtain an opinion on its consolidated financial statements. The weaknesses that affect the auditability of the financial statements also impact other Department programs and operations and contribute to waste, mismanagement, and inefficient use of Department resources.

The Government Accountability Office first identified Department financial management as a high-risk area in 1995, a designation that continues to date. Combined with the high-risk areas of business systems modernization (designated a high-risk area in 1995), and supply chain management (designated a high-risk area in 1990), these three areas directly affect the Department's ability to attain an unqualified audit opinion on its financial statements. In its March 3, 2006, Executive Branch Management Scorecard, OMB assessed the status of the



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Department's financial performance as "Red," or "Unsatisfactory."

The Department OIG previously identified and reported on several material control weaknesses that reflect some of the pervasive and long-standing financial management issues faced by the Department and prevent the Department from obtaining an unqualified opinion on its financial statements. These weaknesses also affect the safeguarding of assets and proper use of funds, thus impairing the prevention and identification of fraud, waste, and abuse, to include the following:

- Fund balance with Treasury
- Inventory
- Operating materials and supplies
- Property, plant, and equipment
- Government-furnished material and contractor-acquired material
- Environmental liabilities
- Financial management systems
- Intragovernmental eliminations
- Other accounting entries
- Statement of Net Cost
- Statement of Financing

The following elements and actions are essential to improving the Department's financial management:

- Create an environment that fully supports clean financial reporting. The financial managers need buy-in from senior management and personnel in the field offices in order to successfully implement the corrective action plans.
- Maintain a significant level of continued review to identify all of the material financial management and reporting deficiencies, internal control weaknesses, and quality of data issues.
- Develop corrective action plans that will adequately correct the deficiencies and result in financial reporting in accordance with generally accepted accounting principles.

- Implement the corrective action plans that address the system, control, reporting, or quality of data weakness.

Inspector General Assessment of Progress

One significant measure of the ongoing progress in the area of financial management would be the Department's ability to obtain unqualified audit opinions on its financial statements. The Department is far from reaching this milestone as demonstrated by the audit opinions received by the Department and its components on their FY 2005 and 2006 financial statements.

However, the Department's ongoing initiatives in the area of financial management improvement indicate that the Department management is responding to the significant and pervasive financial management issues and is positioning itself to leverage planned systems and business improvements to achieve sustainable and long-term solutions. The Department has made progress by establishing a framework to direct and hold managers accountable for the Department's financial improvement efforts. The framework, called the Financial Improvement and Audit Readiness (FIAR) improvement initiative, comprises a directorate that is responsible for centrally coordinating the initiative; a regularly updated, written plan with stated objectives and milestones; a defined process with protocols for making decisions; a tool for tracking progress; and oversight groups consisting of participants from across the Department to guide the decision making process.

The FIAR plan categorizes the financial management challenges faced by the Department into three broad categories: those that heavily depend on systems solutions; those that depend primarily on process solutions; and those that depend on both systems and process solutions. The FIAR plan focuses on the process solutions that Department financial managers identify, develop, and implement to correct financial reporting deficiencies or internal control weaknesses.



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The Department OIG has primarily focused its audit efforts on the FIAR improvement initiative. The Enterprise Transition Plan addresses systems solutions. The Department has made progress by establishing the Business Transformation Agency and developing the business enterprise architecture and the Enterprise Transition Plan.

The Department OIG considers the following Department financial management efforts to be successes:

- implementation of integrated organizational structures and processes to address financial management improvement,
- assignment of accountability to Department managers,
- Department improvement initiatives at the entity and line item level, and
- self-assessment of controls over financial reporting related to OMB Circular A-123, Management's Responsibility for Internal Control.

Although the Department OIG anticipates that Department will need to make refinements in these areas, the Department OIG considers these to be critical steps in establishing a culture and ingrained structure that will (1) enable Department managers to identify internal control weaknesses, (2) effectively plan for resolution of those weaknesses, and (3) hold Department managers accountable for improving internal controls over financial reporting. Further, these steps should result in a financial management structure that can provide accurate, relevant, and timely financial management information for decision making.

We fully support the Department's goal to implement internal controls that will result in sustained improvements in its ability to produce timely, reliable, and complete financial management information. To that end, the Department needs to continue to develop comprehensive, integrated plans that will lead to improved systems and internal control. We recognize

that there are many variables affecting the execution of the Department improvement initiatives, such as the ability of specific Components' to make corrective actions and meet the projected milestones. The Department OIG will continue to provide input to the Department managers on these initiatives as requested, or as part of the Department OIG advisory role on the Department committees that support these initiatives.

Health Care

The Department Military Health System must provide quality care for approximately 9.2 million eligible beneficiaries within fiscal constraints while facing growth pressures, legislative, imperatives and inflation that make cost control difficult in both the public and private sectors. The Department challenge is magnified because the Military Health System's primary mission is to provide health support for the full range of military operations. Part of the challenge in delivering health care is combating fraud. As of June 30, 2006, health care fraud constituted 8 percent of the 1,595 Defense Criminal Investigative Service's open cases.

A major challenge to the Department is sufficient oversight of the growing cost of health care for military members. The increased frequency and duration of military deployment further stresses the Military Health System in both the Active and Reserve components. The Department's budget for health care costs was \$38.4 billion in 2006, including \$20.4 billion in the Defense Health Program appropriation, \$6.9 billion in the Military Departments' military personnel appropriations, \$0.3 billion for military construction, and \$10.8 billion for contributions to the Department's Medicare-Eligible Retiree Health Care Fund to cover future costs of health care for Medicare-Eligible retirees, retiree family members, and survivors. The Department's challenge is how to oversee the growing cost of health care for military members.

A challenge related to medical readiness remains the completion of a Medical Readiness Review (MRR)



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being overseen by a steering group co-chaired by the Under Secretary of Defense for Personnel and Readiness and the Director, Program Analysis and Evaluation. The MRR continues to identify medical readiness and personnel management capabilities required by the National Security Strategy and related transformation of war fighting. Readiness of the medical staff and units includes ensuring that medical staff can perform at all echelons of operation and that units have the right mix of skills, equipment sets, logistics support, and evacuation and support capabilities. As with most Department functions, the Military Health System continues to face the challenges of increased joint operations.

The FY 2004 National Defense Authorization Act authorized temporary provisions to expand TRICARE health and dental coverage for Reserve Component members and families. The FY 2005 National Defense Authorization Act permanently extended the benefits for Reserve Component members and their family members. The challenge of keeping reservists medically ready to deploy continues because of the frequency and duration of Reserve deployments.

Inspector General Assessment of Progress

The Department's Military Health System has been moving forward on improving health care while attempting to control costs. It has made significant progress in implementing new TRICARE contracts. TRICARE transitioned from 12 regions and 7 contracts in the United States to 3 regions and 3 contracts. The contracts provide incentives for customer satisfaction and include the managed care support contractors as partners in support of medical readiness. Some issues still exist as the Military Health System enters its third year with the new contracts. Lessons learned are being developed that will be used to improve the next set of contracts.

The Department continues to pursue the implementation of federal ceiling prices for pharmaceuticals. The issue is in litigation with

industry because some companies in the industry have challenged the government's legal right to control prices by establishing ceilings. Resolution of this issue could allow the Military Health System to realize millions of dollars of savings annually in pharmacy costs dispensed in the retail venue. Also, in an attempt to sustain medical benefits and costs, the Military Health System proposed modifications to beneficiary costs. The status of the proposal is in question and currently being reviewed in Congress.

The Medical Readiness Review continues. Four working groups are addressing: medical readiness capabilities, casualty estimation, capability metrics, and medical resources. The review has completed significant portions of its review of military resource requirements. Because of the dynamics of troop deployments and other factors, the review continues to operate as conditions warrant. A tentative completion date is December 2006. The focus of the Medical Readiness Review was expanded to address operational tempo issues, the Military Health System role in the Global War on Terror, and national disaster response.

Although the challenge of medically preparing reservists and guardsmen for deployment still exists, the Military Health System has tools available to commanders to screen deployers both pre-deployment and post-deployment, and to assist the deployed reservists' and guardsmen's family members. The Department also has a deployment-based medical service contract (FEDS-HEAL) to assist units with screening, dental services, immunizations, needed medical appointments, and administrative support.

Human Capital

The challenge in the area of human capital is multifaceted. The Department must ensure that its Total Force, which includes Active Component, Reserve Component, civilians, and contractors, is:



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- Appropriately sized,
- Maintaining a balanced level of skills to support core defense capabilities,
- Motivated,
- Held to high standards of integrity,
- Capable of functioning in an integrated work environment, and
- Capable of handling the emerging technologies and threats.

The Department’s challenge in human capital includes implementing the National Security Personnel System (NSPS) and minimizing disruption from Base Realignment and Closure (BRAC).

The Department’s challenges also involve issues such as the continuing and growing backlog of security clearances and correcting past deficiencies in the Defense Security Service handling and processing of security clearances. The security clearance backlog directly affects the placement of both Department and contractor personnel in needed positions.

The Department also faces a challenge in meeting its goal to reduce preventable accidents. Accidents not only reduce readiness through lost man-hours and the unavailability of personnel but are estimated to cost the Department approximately \$25 billion a year. In May 2003, the Secretary of Defense challenged senior leaders within the Department to reduce in 2 years the accident mishap rate by 50 percent. In March 2004, the Secretary challenged Department managers to reduce accidents 75 percent by 2008. The challenge for the Department is to make safety an institutional value. Responsibility for environment, safety, and health policy is dispersed throughout the Department.

Inspector General Assessment of Progress

The Department issued a new Personnel and Readiness Strategic Plan in April 2006 that focuses on developing the right mix of people and skills across the Total Force. The plan is a critical piece in

the Department’s efforts to meet their personnel and readiness goals.

The Department is phasing in the NSPS, the system designed to change how the Department hires, pays, promotes, disciplines, and fires its civilian workforce to make practices more in line with personnel practices in the private sector. The Department has conducted meetings with employees, unions, and other affected parties and has formed working groups to identify and develop options and alternatives for NSPS. The Department has adjusted its implementation schedule to better effect the changes needed for the program. It has developed communications to target groups within the Department and methodologies to gauge effectiveness.

The Department has required business plans to implement the Base Realignment and Closure (BRAC) recommendations, but the extent of the loss of human capital skills is pending on the progress and effectiveness of the implementation. Employees may leave or retire instead of moving to a new location or face the uncertainty of being downsized. Many of the BRAC recommendations will be implemented in years 2008 through 2011 which further increases the level of uncertainty. It is too early in the implementation phase to determine the extent of loss of specialized and general skills and whether the Department adequately planned for this loss.

The Department has taken some steps to address identified problems within the personnel security clearance program. However, longstanding issues must be resolved to make any meaningful progress in reducing the backlog and ensuring a more effective and efficient end-to-end security clearance process. Resolution of these systemic problems should contribute to a more fiscally sound program.

Reducing preventable accidents remains a challenge for the Department. The Department did not achieve the Secretary’s goal of reducing accidents by 50 percent. The Defense Safety Oversight Council was



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established to facilitate oversight of the Department's efforts to achieve the Secretary's goal. The council is working to determine which indicators should be tracked and how to collect such data and is exploring leading (pre-accident) rather than lagging (post-accident) indicators. The Under Secretary of Defense for Personnel and Readiness has issued guidance that includes using safety management and results in performance plans and appraisals.

Information Security and Privacy

Ensuring that a robust information security program is in place is still a challenge to the Department. Such a program includes periodic risk assessments; security awareness training; security policies, procedures, and practices, as well as tests of their effectiveness; and procedures for addressing deficiencies and for detecting, reporting, and responding to security incidents.

The Department has developed five priorities for information assurance: protecting information, defending systems and networks, providing situational awareness, improving information assurance capabilities, and creating a professional information assurance workforce. However, there is no action plan to assess the effectiveness of these initiatives.

The Department also faces the challenge of ensuring that privacy protections are not compromised by advances in technology.

One of the major challenges identified last year was implementation of the Health Insurance Portability and Accountability Act. Challenges continue for protecting sensitive personal and medical information as the Department and health care industry move toward electronic health care records.

Inspector General Assessment of Progress

The Department has made little progress during the course of FY 2006 in improving its information

security posture. Unresolved issues are now exacerbated by the recent losses of privacy data by various federal agencies, including components of the Department, and the dearth of clear Department policy from the Assistant Secretary of Defense (Networks & Information Integration) regarding protection of privacy data.

The Department also has made little progress during the course of FY 2006 in improving its information assurance posture and has not addressed key policy issues pertaining to that posture. Although the Deputy Secretary of Defense assured the Director of the Office of Management and Budget on November 8, 2005, that the Department would resolve such issues as the applicability of National Institute of Standards and Technology standards and guidelines to the Department, the lack of a standard definition of "system" for reporting purposes, and the lack of an adequate Department inventory of information systems, little or no progress has been made.

The Department continues to make progress implementing the Health Insurance Portability and Accountability Act. Ongoing efforts throughout the federal government to better use encryption capabilities will assist in lessening this challenge. The Administrative Simplification Enforcement final rule, effective March 2006, covers civil penalties for violations of administrative simplification provisions of the Act.

Joint Warfighting and Readiness

The challenge in the area of Joint Warfighting and Readiness is to provide the right force, the right personnel, the right equipment, and supplies in the right place, at the right time, and in the right quantity, across the full range of military operations. To meet this challenge, the Department is continuously transforming.

While U.S. forces continue to operate around the world, changes are underway to better align the



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resources of the Department to benefit the warfighters, wherever they are located. Those changes have taken a variety of forms, not the least of which is the improvement of the tools used to fight the enemies of the United States. The fight against terrorism, as well as the ongoing Operations Enduring Freedom and Iraqi Freedom, continue to test the limits of the Department and its ability to successfully defend the United States. But those have been shared battles, with each Service shouldering its portion of the load.

The Global War on Terror will continue to be a long and difficult war affecting the entire global community. It will require firm commitment and cooperation of U.S. allies and coalition partners, as well as international organizations, domestic state governments, and the private sector. The demands placed on the U.S. forces the past few years have been extensive, but our military is unwavering in its focus, resolve, and dedication to peace and freedom. With Congress's continued strong support, the military will continue to effectively combat terrorism, counter the proliferation of weapons of mass destruction, help Iraq and Afghanistan build a stable and secure future, improve joint warfighting capabilities, and transform the Force to meet future threats.

The Department's available resources are finite and require constant monitoring of our abilities and of the world situation to enable the Department to successfully operate on a global scale. The continued operations in Afghanistan and Iraq require a significant commitment of forces. Meanwhile, the advances by the Peoples Republic of China in modernizing its armed forces and the possibility of nuclear weapons in North Korea and Iran also require constant monitoring. The combination of these various factors continues to challenge the Department.

Transformation of logistics capabilities poses a significant challenge to the Department. The Department's transformed logistics capabilities must support future joint forces that are fully integrated, expeditionary, networked, decentralized, adaptable,

capable of decision superiority, and increasingly lethal. In addition, transformed logistics capabilities must support future joint force operations that are continuous and distributed across the full range of military operations.

Supply chain management is a challenge for the Department. The Government Accountability Office (GAO) identified supply chain management as a High-Risk Area because of weaknesses uncovered in key aspects, such as distribution, inventory management, and asset visibility. The GAO has reported on numerous problems associated with supply chain management, such as shortages of items caused by inaccurate or inadequately funded war reserve requirements and the Department's lack of visibility and control over the supplies and spare parts it owns.

Inspector General Assessment of Progress

The Department continues to make progress in the area of Joint Warfighting and Readiness. However, there is still much to do. The drawdown and reorganization of forces in the European and Pacific theaters will add to the ability of the armed forces to readily respond to situations as required. Although the Department is taking positive actions to increase its warfighting ability and readiness posture, opportunities for improvement will continue to exist.

The Department has made progress toward meeting its goal of transforming logistics through numerous initiatives. The Department and the military services have issued policy and procedures to implement performance-based logistics. However, that progress is tempered by the sheer magnitude of logistics operations that will continue to make it a long-term challenge.

The Department has taken actions to improve the supply chain management, such as assigning new organizational responsibilities for distribution, developing a logistics transformation strategy, and implementing other specific process improvements.



However, the Department must be vigilant in ensuring that the strategy for logistics transformation is continuously reevaluated and that new initiatives and systems are adequately funded and effectively implemented.

Government Accountability Office High-Risk Areas

Since 1990, the Government Accountability Office has periodically reported on government operations that it has designated as high risk. Its audits and evaluations identify federal programs and operations that, in some cases, are high risk due to their greater vulnerabilities to fraud, waste, abuse, and mismanagement. In its latest report, the Government Accountability Office designated 26 high-risk areas. Eight involved Department of Defense programs and operations; five involved the Department as well as other federal agencies. The Department-related high-risk areas are listed below.

Department of Defense:

- Approach to Business Transformation
- Business Systems Modernization
- Personnel Security Clearance Program
- Support Infrastructure Management
- Financial Management
- Supply Chain Management (formerly Inventory Management)
- Weapon Systems Acquisition
- Contract Management

Department of Defense and Other Federal Agencies:

- Strategic Human Capital Management
- Managing Federal Real Property
- Protecting the Federal Government's Information Systems and the Nation's Critical Infrastructures
- Establishing Appropriate and Effective Information-Sharing Mechanisms to Improve Homeland Security
- Management of Interagency Contracting

Management's Response to Auditor Challenges

In general, the Department concurs with the concerns identified by the Inspector General in his Summary of Management and Performance Challenges and the issues presented in the Government Accountability Office's High Risk List. The Department is taking progressive steps to evaluate weaknesses across the Department in systems, processes and internal controls. The Department established comprehensive plans, presented throughout this report, that describe the steps necessary to improve these areas of concern within the Department. Without question, the path forward to implement solutions will be challenging, expensive, and require much time. However, the Department has made a good start and has made substantial progress in many areas. The support of the Congress and the Department's many stakeholders, as well as the efforts of individuals and organizations across the entire Department, have contributed to the development of these plans and the progress made in implementing solutions.

Improper Payments Information Act Reporting Details

As discussed in Section 1: Management's Discussion and Analysis, the Department conducted a review of the improper payments per the Office of Management and Budget guidance.

Risk Assessment

The Department reviewed all of its programs and activities and determined that six programs/activities were susceptible to improper payments: Military Retirement, Travel Pay, Military Health Benefits, Military Pay, Civilian Pay, and Commercial Pay. These programs represent approximately 86 percent of the Department's total payments. The Department of Defense performed risk assessments for each of these programs/activities that addressed the strength



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of the internal controls in place to prevent improper payments (such as prepayment reviews), system weaknesses identified internally or by outside audit activities, voluntary returns of overpayments by vendors, etc. The subsequent paragraphs summarize the process and results of these assessment surveys. There are two other types of payment programs/activities that the Department did not conduct surveys for and as a result are not discussed below, intragovernmental payments (approximately \$75 billion in fiscal year (FY) 2005) and payments for afloat and deployed forces (approximately \$600 thousand in FY 2005). The Department is developing a program to cover these remaining program/activity payments.

Statistical Sampling

Military Retirement. During FY 2006, the Department continued the process, implemented in FY 2004, of monthly random reviews of confirmed deceased retiree accounts, in addition to monthly random reviews from the overall population of retired and annuitant pay accounts. Both of these sampling plans are designed to produce annual estimates of improper payments, with probability of 95 percent and sample precision of plus or minus 2.5 percent.

A monthly sample of accounts is selected from the population of confirmed deceased accounts. Each account is audited to determine if the member was overpaid after the member's death. Statistics collected from the review include the number of accounts reviewed, number with overpayments, dollar amount of the overpayment, amount of correct pay (what the payment should have been), and the dollar amount collected back from the member's account/estate within the first 60 days after notification. These sample statistics are projected to the population of deceased retirees to then determine an improper payment rate population estimate for deceased accounts.

Population estimates from the deceased account reviews are then added to any improper payments

identified through other than retired pay random or special audits, to determine an overall improper payments population estimate for retired pay.

Travel Pay. The Department performs monthly random post-payment reviews of travel records settled through the Defense Travel System and Integrated Automated Travel System. These reviews satisfy requirements of Certifying Officers Legislation and ensure payments are legal, accurate, and have supporting documentation. These random reviews are designed to produce annual estimates of improper payments, with probability of 95 percent and sample precision of plus or minus 2.5 percent, at the Military Service component level (Army, Navy, Air Force, and Marine Corps).

For travel payments made by the U. S. Army Corps of Engineers, all temporary duty and permanent change of station travel vouchers greater than or equal to \$2,500 are subject to a post audit review. A sample composed of every 366th temporary duty travel voucher less than \$2,500 is also reviewed. These reviews are designed to produce annual estimates of improper payments, with probability of 95 percent and sample precision plus or minus 2 percent.

Military Health Benefits. To determine the statistically valid estimate of the annual amount of improper payments, the Department uses the following sampling methodology to pull TRICARE (i.e., triple option health benefit plan available for military families) encounter data records for the annual target health care cost audits of the managed care support services contracts.

For each contract option period, a statistically valid sample of claims with care end dates within the specified option period is selected for payment error auditing. Variable sampling, using stratified sampling with optimum allocation, is used to calculate the sample size for the payment errors. The sample size is designed to produce annual estimates of improper payments, with probability of 90 percent and sample precision plus or minus 1 percent.



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Claims with a cost less than \$100 are not sampled (except for Medicare dual eligibility claims). One sample category includes all claims \$100,000 and more. Claims with a cost of greater than \$100 but less than \$100,000 are broken down into 12 sample categories. A formula is applied to calculate the sample size for each sample category. If the sample category universe count is less than 30, all the claims in that category are audited. The percentage of overpayments for the sample is applied to all the payments to determine the improper payment amounts.

Military Pay. The Department uses a stratified sampling plan designed to produce annual estimates of improper payments at the Military Service component level (annual target sample of 1,800 or 150 accounts monthly per component). The annual sample provides improper payment estimates with 95 percent probability and sampling precision of plus or minus 2.5 percent, at the Service Component level (Army, Navy, Air Force, and Marine Corps).

The Department reviews monthly randomly selected military pay accounts and their associated entitlements and deductions for accuracy. The root cause and detail of the improper payments are documented for correction and follow-up actions. The sample rate is multiplied by the total net pay of the population to determine an estimated improper payment dollar value. Any improper payments identified through means other than the random review are summarized and added to the population estimate (from the random review) to determine an overall population improper payment estimate for military pay.

The FY 2006 improper payments rate for military pay was substantially lower than the FY 2005 rate. Because this large difference is primarily attributed to fewer sampled accounts having high dollar rate erroneous payments, the Department is performing a comprehensive analysis, comparing the types and dollar values of errors from FY 2005 to FY 2006.

Civilian Pay. The Department uses a stratified sampling plan for civilian pay, similar to that used for military pay. The sampling plan is designed to produce annual estimates of improper payments at the Service component level (annual target sample of 1,800 or 150 accounts monthly per component). The annual sample provides improper payment estimates with 95 percent probability and sampling precision of plus or minus 2.5 percent, at the Service Component level (Army, Navy, Air Force, Marine Corps, and Defense Agencies).

The Department reviews monthly randomly selected civilian pay accounts for accuracy. The root cause and detail of the improper payments are documented for correction and follow-up actions. The sample rate is multiplied by the total net pay of the population to determine an estimated improper payment dollar value. Any improper payments identified through means other than the random review are summarized and added to the population estimate (from the random review) to determine an overall population improper payment estimate for civilian pay.

Commercial Pay. The Department uses a stratified sampling plan designed to produce estimates of improper payments at the program (entitlement system) level. These sample results are compared with the Department's database used to track and resolve commercial pay improper payments to develop annual improper payment estimates with 95 percent probability and sampling precision of plus or minus 2.5 percent.

For commercial pay payments made by the U. S. Army Corps of Engineers, a random sample is selected from all commercial payments. The sample size is based on the estimated minimum (374,400) commercial payments expected to be processed in a year. This sample provides annual improper payment estimates with 95 percent probability and sampling precision of plus or minus 2 percent.



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Corrective Action Plans

Military Retirement. The improper payments rate for the military retirement is projected to remain nearly the same from FY 2005 (\$49.3 million or .1381 percent) to FY 2006 (\$48.8 million or .137 percent). The majority of the improper payments are made to deceased retirees (approximately \$48.5 million). Random reviews from FY 2006 indicate 95 percent of the overpaid dollars to deceased retirees is recovered within the first 60 days after notification. To reduce the initial improper payment primarily caused by the delay in death notification to the paying office by family members, the Department has substantially improved its internal processing methods and is using data mining techniques with the Social Security Administration. This process allows the Department to receive death notice information through an automated system and helps prevent improper payments by the pay system.

Travel Pay. The Defense Travel System contains numerous automated prepayment flags to alert travelers and approving officials of potential inconsistencies that could result in an improper payment. In addition, results of monthly random reviews of Defense Travel System trip records are summarized and presented to applicable Service component representatives and to Defense Travel System management personnel. These reports include number, dollar value, and reasons for errors discovered among the sampled claims, as well as recommendations to prevent similar errors on future travel records. Analysis indicates most errors are attributed to traveler input or authorizing official oversight. Training of both travelers and authorizing officials is one of the primary tools the Department uses to alleviate these types of discrepancies.

In FY 2006, over 783,000 trip records, with total settlement dollar value of \$823.6 million, were processed through the Defense Travel System. As of September 30, 2006, the Department randomly selected and reviewed 30,100 settled trip records with

a value exceeding \$32.6 million. Improper payments accounted for .968 percent of the tested sample, so projected improper payments in the population of settlements could approach \$7.97 million.

Military Health Benefits. The Department has had contracts with payment performance standards for military health benefit claims processing in place for many years. Under the existing managed care support contracts, the Department has a zero tolerance for unallowable costs. If the contractor pays a claim that is not allowable, the Department will not reimburse the contractor. In addition to placing the contractors at risk for unallowable costs, this contractual design provides a built-in incentive for contractors to continually perfect their claims processing system, up to the point where financial costs outweigh the benefits.

The Department currently audits statistically valid samples that over the years have consistently produced an error rate of less than the 2 percent standard contained in the TRICARE contracts. Improperly submitted claims by the provider community, as well as a minimal degree of human error that can be expected with handling a large volume of claims within the tight time parameters established through the prompt payment regulations, cause errors in health care claims processing. Based on the FY 2006 survey, the FY 2006 improper payments rate for the military health benefits is projected to be \$140.0 million or 2.0 percent.

Numerous prepayment and post-payment controls are built into the military health benefits' claims processing system to minimize improper payments. Every TRICARE claim is adjudicated against this system of checks and balances. The managed care support contractors are required to utilize specialized software containing specific auditing logic designed to ensure appropriate coding on professional service claims and eliminate overpayments. The software does not set coverage/benefit policy; it merely audits claims for appropriate code combinations. For calendar



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year 2005, the prepayment automated software used by managed care contractors accounted for approximately \$184 million in cost avoidance for the TRICARE program. The \$89 million increase over the calendar year 2004 savings of \$95 million can be attributed to the implementation of additional edits, as well as increased claims volume.

Another control is the prepayment review required under the TRICARE contracts. The contractors use this strategy to prevent payment for questionable billing practices. Prepayment review allows for a closer examination of the services rendered and may require the provider to submit medical documentation to support the services billed. In calendar year 2005, prepayment review resulted in a cost savings of \$14 million, almost double the \$7.3 million saved in calendar year 2004.

The Department also requires each contractor to have a fraudulent claims investigation or anti-fraud unit to identify and investigate any pattern of suspicious or potential fraudulent billings. In FY 2005, fraud judgments were ordered for \$5.9 million. In addition, the anti-fraud efforts resulted in identifying \$3.7 million in benefit dollars for administrative recoupment.

Military Pay. The projected FY 2006 improper payments rate for military pay of \$65.9 million (.091 percent) is a substantial decrease from the FY 2005 rate of \$432 million (.6254 percent). The FY 2006 decrease in estimated improper payments for military pay is primarily attributed to fewer randomly sampled accounts having confirmed high dollar value erroneous payments. The Department places substantial emphasis on the accuracy of military pay. Several sources identify improper payments for military pay. The Department performs monthly random reviews by Military Service, identifies pay system discrepancies, and conducts special audits or reviews. The Department has established several processes to ensure correctness of pay and thus prevent improper payments within the military pay systems. These

include both random and targeted pre-payroll (payday) reviews, and producing pay abnormality and inconsistent condition reports.

In the pre-payroll review process, the Department selects random individual pay accounts from the Military Services for review prior to mid-month and end-of-month payroll release. The goal is to identify any incorrect pay generated by a systems or procedural issue and correct it.

Pay abnormality reports are generated by the pay systems to identify accounts that are receiving pay at a rate of 225 percent or greater increase from their normal pay. It provides the normal pay amount, what is being paid on the current payday, and identifies the input creating the increase in pay. Each account on this list is reviewed in detail to ensure the pay is accurate based on some unique occurrence (e.g., payment of a new entitlement, payment of a one-time item, such as a bonus, etc.)

Inconsistent condition reports identify pay conditions within the pay system that should not exist (e.g., the member is receiving Basic Allowance for Housing at the “no dependents” rate but also is receiving cost of living allowance at the “with dependents” rate). The reports are sent to the appropriate input source for research and correction of the account.

Both system and operations managers are notified of any randomly reviewed pay accounts with over or under payments, as they are detected, from the post-payment review. Also, a monthly report is produced that illustrates monthly and year to date error trends and reasons for discrepancies that impact net pay.

To further reduce improper payments, the Department implemented a process in May 2006 to capture reconciliation rates for overpayments and underpayments identified among the sampled accounts. An interim reconciliation rate target of 93 percent was established for the 4th Quarter of FY 2006. A more definitive rate will be established



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for FY 2007 pending the confirmation and analysis of more comprehensive data on reconciliation of overpayments and underpayments among the sampled accounts to ensure accuracy of the Service member's pay.

The Department has also established a Military Pay Improvement Action Plan with five key milestones: Personnel and Pay Leadership and Process Improvement, Personnel and Pay Systems Integration, Interim Improvements to Antiquated Pay System, Active and Reserve Pay Accounts Integration, and Improving Responses to Legislative Changes. The Department appointed a project manager and the plan's implementation is monitored by management, such as the Military Services' Financial Managers, the Business Transformation Agency, and the Defense Finance and Accounting Service Military Pay Operations Directors.

Civilian Pay. The Department also places substantial emphasis on the correctness of civilian pay. The Department has established several processes to ensure accuracy of pay and thus prevent improper payments within the civilian pay system. These measures include targeted pre-payroll (payday) reviews that focus on high visibility areas and those where recent system changes have occurred that impact net pay. In addition, as is the case in military pay, both system and operations managers are notified of any randomly reviewed pay accounts with over or under payments, as they are detected, from the post-payment review. Also, a monthly report is produced that illustrates monthly and year-to-date error trends and reasons for discrepancies that impact net pay. Improper payments for civilian pay in FY 2006 are projected at \$62.8 million or .1231 percent.

To further reduce improper payments, the Department implemented a process in May 2006 to capture reconciliation rates for overpayments and underpayments identified among the sampled civilian pay accounts, similar to that for military pay. The Department intends to establish targets for

FY 2007, pending confirmation and analysis of more comprehensive data on reconciliation of overpayments and underpayments among the sampled accounts to ensure accuracy of civilian pay.

Commercial Pay. The Department uses various manual and automated prepayment initiatives to prevent commercial pay improper payments. Based on review of improper payment data, detection logic is continually reevaluated and adjusted to improve the detection and prevention of improper payments. In addition, manual review procedures are used for selected high dollar value payments. During FY 2006, the Department identified more than \$550 million in improper payments out of the approximately \$300 billion in commercial payments, which equates to an improper payment rate of .1830 percent.

In FY 2007, the Department will implement a Business Activity Monitoring service, employing the latest technology to increase the efficiency and effectiveness of improper payment detection efforts.

The Defense Finance and Accounting Service Internal Review Office also conducts periodic independent reviews of commercial payments to improve the Department's improper payment detection, correction, and prevention efforts. Since FY 2003, this office has identified \$212.4 million in improper payments of which \$197.4 million has been recouped by the Department.

The U.S. Army Corps of Engineers manages the Military Lease Program for all military services. When leased property is sold or leases are terminated without timely notifications to the appropriate contracting officer or real estate office, extra payments may be made after the sale or termination. When such errors are identified, the U.S. Army Corps of Engineers helps correct the error and reminds the Military Service of the importance of accurate and timely notifications.

The U.S. Army Corps of Engineers also manages the utility payments for the Department. When there is a



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merger or acquisition of utility companies, payments may be made before the U.S. Army Corps of Engineers is aware of changes to the payee information. To reduce the likelihood of these errors, the U.S. Army Corps of Engineers is monitoring for news of pending/new acquisitions and mergers of utility companies. Additionally, many major companies now notify the U.S. Army Corps of Engineers directly as well as the end user/customer. The U.S. Army Corps of Engineers has also developed queries of all relevant databases to help ensure records are modified promptly upon receipt of change notifications.

In all cases of improper payments, the U.S. Army Corps of Engineers reminds the parties involved of the importance of accurate payments to prevent improper payments and the associated liability. For clerical errors in data entry, the personnel are notified and provided with additional guidance to help prevent the error from recurring.

Improper Payment Reduction Outlook

The following table summarizes the Department's improper payment (IP) reduction outlook and total program outlays (payments) from FY 2005 through FY 2009.

Program	FY 2005			FY 2006			FY 2007			FY 2008 Estimated			FY 2009 Estimated		
	Outlays (\$ B)	IP (%)	IP (\$ M)	Outlays (\$ B)	IP (%)	IP (\$ M)	Outlays (\$ B)	IP (%)	IP (\$ M)	Outlays (\$ B)	IP (%)	IP (\$ M)	Outlays (\$ B)	IP (%)	IP (\$ M)
Military Retirement (Note 1)	\$35.7	.1381	\$49.3	\$35.6	.137	\$48.8	\$37.8	.1283	\$48.5	\$39.6	.1234	\$48.8	\$41.3	.1209	\$50.0
Military Health Benefits (Notes 2-5)	\$7.5	1.17	\$87.8	\$7.0	2.0	\$140.0	\$9.0	2.0	\$180.0	\$8.3	2.0	\$166.0	\$8.9	2.0	\$178.0
Military Pay (Notes 1, 6-7)	\$69.1	.6254	\$432.0	\$72.2	.091	\$65.9	\$60.3	.5019	\$302.7	\$63.0	.4676	\$294.6	\$64.4	.458	\$295.1

B - Billions, M - Millions

Note 1: Military retirement and military pay outlays are net amounts (e.g., net of Federal and state withholdings). To estimate net outlays for future years, the percentage of net to gross for FY 2006 is determined and multiplied by the gross outlays reported in the FY 2007 President's Budget submission.

Note 2: The final payment error rate for FY 2005 is 1.17 percent, which is less than the amount reported in the FY 2005 report and the contract performance standard of 2 percent.

Note 3: The FY 2005 outlays include all benefit dollars subjected to the audit process. The total was computed as \$7.5 billion as reflected in this chart. Fee for service claims are determined to be susceptible to improper payments as payment is made based upon an individual claim being submitted by a provider or beneficiary based on a certification that the services were provided as billed. The \$7.5 billion does not include contracts, such as the dental and the U.S. Family Health Plan contracts, whereby the contractor is 100 percent responsible for improper payments—there is no shared risk with the government. Administrative or change order costs are also not included as those costs do not fall into the definition of areas susceptible to improper payments.

Note 4: Pharmacy claims for FY 2005 and FY 2006 were not included in the audit process. The Department is developing a process for future use.

Note 5: The improper payment amount for FY 2005 is understated by a \$3.6 million contract overpayment that was not included in the audit contractor review. The overpayment is being evaluated for recoupment.

Note 6: The FY 2006 decrease in estimated improper payments for military pay is primarily attributed to fewer randomly sampled accounts having confirmed high dollar value erroneous payments. The Department is performing a comprehensive analysis, comparing the types and dollar values of errors from FY 2005 to FY 2006.

Note 7: The military pay outlays appear lower for FY 2007 through FY 2009 because emergency supplemental funding is not included.



Section 4: Other Accompanying Information

Improper Payment Auditing

The Department utilizes a number of different mechanisms to prevent, identify, and collect improper payments to include recovery and contract auditing.

Recovery Auditing. The Department maintains an extensive post-payment process for identifying improper payments. This process utilizes post-payment review techniques, performed both internally and by recovery auditing contractors paid from the proceeds actually recovered.

For agency-wide commercial payments, the overpayment amounts identified for recovery are primarily attributable to internal recovery audit efforts and recoveries identified by other means (including contract reconciliation and statistical sampling as well as contractor voluntary refunds). In addition to the overpayments, these efforts identified underpayments. Approximately \$307.6 million was disbursed to correct underpayments in prior years, and \$256.2 million was disbursed in the current year for identified underpayments. Around \$19.0 million remains in the recovery process or referred to a Department of Defense debt management office for collection.

For commercial payments contractor recovery auditing, the Department has recouped more than \$18 million in improper commercial payments since its inception in 1996. During FY 2006, the Navy conducted a pilot to determine the feasibility and scope of a Department-wide recovery audit for the Navy. Based on the results, the Navy plans to perform a recovery audit in FY 2007. The Department anticipates additional recovery auditing by contractors in FY 2007.

The Department utilizes contractors to perform the entitlement process related to health care claims. To ensure the integrity of the payments made, a different contractor performs post-payment reviews using statistical methods to quantify the amount of

improper payments. The improper payments estimate becomes an unallowable cost to the vendor making the payment. The Department also is utilizing a recovery audit contractor to recapture overpayments made to hospitals that failed to submit amended cost reports from calendar years 1992 through 1997. From October 2003 through July 2006, these reviews have realized over \$20.6 million in recoupments.

	Recovery Audit Activity		
	Agency-wide Commercial Payments	Commercial Payments Recovery Auditing Contractor	Military Health Benefits Recovery Auditing Contractor
Amount Subject to Review for Current Year Reporting	\$299.4 billion	N/A	N/A
Actual Amount Reviewed and Reported	\$299.4 billion	N/A	N/A
Overpayment Amounts Identified for Recovery	\$170.0 million	N/A	\$25.3 million
Amounts Identified/ Actual Amount Reviewed	.0006%	N/A	N/A
Amounts recovered Current Year	\$133.3 million	N/A	\$4.6 million
Amounts recovered Prior Year(s)	\$138.3 million	\$18.6 million	\$16.0 million

Note: Because of timing differences, there is no direct relationship between recovery auditing efforts and actual recovery amounts (e.g., recovery audit effort may have been performed in a previous fiscal year on disbursements made in multiple fiscal years). As a result, the table is limited to the actual amounts recovered in FY 2006 and prior years.

Contract Auditing. The Defense Contract Audit Agency routinely performs billing system audits at major contractors (e.g., contractors with a substantial amount of flexibly priced contracts and fixed price contracts) to determine the adequacy of the contractor's billing system internal controls and its compliance with those controls. This effort provides assurance to the Department that the contract payment billings are based on costs incurred and approved



Section 4: Other Accompanying Information

provisional billing rates. The Defense Contract Audit Agency also performs paid voucher reviews at major contractors and special purpose audits at contractor locations when a risk factor for improper payments is identified and neither a billing system review nor a test of paid vouchers is planned.

Accountability

Certifying officer legislation currently in effect holds certifying and disbursing officers accountable for government funds. Pecuniary liability attaches automatically when there is a fiscal irregularity, i.e., (a) a physical loss of cash, vouchers, negotiable instruments, or supporting documents, or (b) an improper payment. Pecuniary liability for accountable officials attaches if a commander/director determines an improper payment was the result of the accountable official's negligence. For certifying officers and disbursing officers, there is a presumption of negligence and those individuals bear the burden of proof in establishing the absence of negligence, i.e., they must produce evidence to establish that there was no contributing fault or negligence on their part. A presumption of negligence does not apply to accountable officials. Efforts to recover from the recipient must be undertaken in accordance with the debt collection procedures in Volume 5, Chapters 29 and 30, of the Department's Financial Management Regulation.

In addition, the Department actively monitors performance metrics to further reduce improper payments. These metrics include all programs/activities the Department has identified as having a risk of improper payments (i.e., military retired, military health benefits, and military, civilian, travel, and commercial pay areas).

Information Systems

The Department has the information and infrastructure needed to reduce improper payments for five of the six major program/activity areas. For commercial

payments, as previously mentioned, the Department is currently in the process of procuring business activity monitoring services, which will employ the latest technology to increase the efficiency and effectiveness of improper payment detection efforts. The Department will prioritize the use of this capability first toward commercial payments and then to all payment areas.

Statutory or Regulatory Barriers

There are currently no statutory or regulatory barriers limiting the Department's corrective actions for five of the six major program/activity areas.

For military retirement, two barriers impede the agency's ability to take corrective actions in reducing improper payments: the Federal Acquisition Regulation and the Retired and Annuitant Pay service contract. In January 2002, the Defense Finance and Accounting Service awarded the Retired and Annuitant Pay service operations to a government contractor. Although most functions remain unchanged from when the government performed these functions, there are now contractual limits to the government's involvement in the day-to-day operations of Retired and Annuitant Pay. The Continuing Government Activity Office was formed to oversee the Retired and Annuitant Pay contract. To ensure the contractual requirements are followed, however, the government can no longer direct how the work is accomplished. To bring about an operational change, both the government and the contractor must agree on how to effect and fund the change. The Federal Acquisition Regulation requires any deviation from the current contract be accomplished via a contract modification.

Additional Comments

The Office of Management and Budget requested that the Department identify Iraq improper payment indicators. In support of this request, additional reviews are conducted on payments for Iraq by the



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Defense Finance and Accounting Service and the U. S. Army Corps of Engineers, as discussed below.

The Defense Finance and Accounting Service initiated a survey to identify military contracts and payments made from the Mechanization of Contract Administration Services entitlement system in support of Iraq reconstruction to determine if there were any improper payments made during the first three quarters of FY 2006. The intent of the first phase of the survey is to assess if payments made for Iraq Reconstruction contracts are at any greater risk of improper payments than other contract payments processed under the same system. A secondary review will encompass high visibility/high dollar value Iraq contract payments. The Defense Finance and Accounting Service is also pursuing lists of contracts for Coalition Support (military operations) requirements to enable the post-payment review of contracts paid from the Mechanization of Contract Administration Services. Future plans will be dependent upon the results of these initial reviews and system comparisons. Data is not currently available, as this comparative process is still underway. The Defense Finance and Accounting Service will report results of reviews after the end of the first quarter of FY 2007.

For the U. S. Army Corps of Engineers, a random sample of every 15th item from the population of monthly Iraqi payments greater than or equal to \$500,000 is selected for audit. The audit process includes: verifying Prompt Payment Act compliance; reviewing receiving report information to ensure payments were for goods/services actually received; reviewing vendor invoices and supporting documentation to ensure that correct vendors were paid the correct amounts; verifying vendors are not on the contractor indebtedness list; and reviewing appropriation expense coding for validity.

Although the Department has made significant progress toward preventing overall improper payments, identifying occurrences, and acting to alleviate similar future errors, the Department realizes

the importance of continuing this critical initiative. In an effort to identify and prevent improper payments before they occur, the Department recently procured a managed service that includes the latest “best in class” private industry Business Activity Monitoring processes coupled with a comprehensive Enterprise Risk Management Strategy Program. The combination of these two processes will allow the Department to (1) more accurately, efficiently, and effectively identify potential improper payments before they occur, and (2) integrate improper payment root cause analysis with existing internal management control program and audit “weaknesses” to assign inherent risks to better isolate areas for future improper payment prevention. Additional FY 2007 Department initiatives to facilitate identification and reporting of improper payments include: (1) periodic workgroup meetings of Military Service and Defense Agency representatives to establish guidelines and ensure consistent reporting and adherence to the Office of Management and Budget implementation guidelines for the Improper Payments Information Act and (2) increased emphasis on data mining or reviewing additional subsets of the pay system populations that are deemed as potentially at higher risk for improper payments.

Funds Managed by the Department for the Executive Office of the President

The Department manages the following funds for the Executive Office of the President:

- International Military Education and Training
- Foreign Military Financing Program Grants
- Military Debt Reduction Financing
- Special Defense Acquisition Fund
- Foreign Military Loan Liquidating Account
- Foreign Military Financing, Direct Loan Financing
- Foreign Military Sales Trust Fund

The consolidated FY 2006 financial statements below summarize the activities of these funds.



Section 4: Other Accompanying Information

Unaudited

**Funds Appropriated to the President
Administered by the Department of Defense
Security Assistance**

BALANCE SHEET As of September 30, 2006 (\$ in Millions)	FY 2006
ASSETS	
Fund Balance With Treasury	\$ 2,604.6
Non-Entity Other	1,199.2
Accounts Receivable	14.4
Loans Receivable	<u>3,663.4</u>
Total Assets	\$ 7,481.6
LIABILITIES	
Debt	\$ 3,315.6
Other Liabilities	377.7
Accounts Payable	67.5
Military Retirement and Other Federal Employment Benefits	0.3
Other Liabilities	<u>1,834.4</u>
Total Liabilities	\$ 5,595.5
NET POSITION	
Unexpended Appropriations - Other Funds	1,823.1
Cumulative Results of Operations - Other Funds	<u>63.0</u>
Total Net Position	\$ <u>1,886.1</u>
Total Liabilities and Net Position	\$ <u><u>7,481.6</u></u>

STATEMENT OF NET COST For the Year Ended September 30, 2006 (\$ in Millions)	FY 2006
Program Costs:	
Gross Cost	\$ 5,321.0
Less: Earned Revenue	<u>(659.4)</u>
Net Program Costs	\$ <u>4,661.6</u>
Cost not Assigned to Programs	-
Less: Earned Revenues not Attributable to Programs	<u>-</u>
Net Cost of Operations	\$ <u><u>4,661.6</u></u>



Section 4: Other Accompanying Information

Unaudited

**Funds Appropriated to the President
Administered by the Department of Defense
Security Assistance**

STATEMENT OF BUDGETARY RESOURCES For the Year Ended September 30, 2006 (\$ in Millions)	Budgetary Financing Accounts	Non-Budgetary Credit Reform Financing Accounts
	_____	_____
Budgetary Resources		
Unobligated balance, brought forward, October 1	\$ 81.0	\$ 48.0
Recoveries of Prior Year unpaid obligations	10.4	-
Budget Authority		
Appropriations Received	\$ 4,601.7	\$ 16.0
Borrowing Authority	-	25.6
Contract Authority	373.0	-
Spending Authority from Offsetting Collections		
Earned	-	-
Collected	661.8	1,110.9
Change in Receivable from Federal Sources	-	-
Subtotal	\$ 5,636.5	\$ 1,152.5
Nonexpenditure transfers, net, anticipated and actual	26.0	-
Permanently Not Available	(254.3)	(1,083.0)
Total Budgetary Resources	\$ 5,499.6	\$ 117.5
Status of Budgetary Resources		
Obligations Incurred		
Direct	\$ 4,588.0	\$ 102.2
Reimbursable	199.8	-
Subtotal	\$ 4,787.8	\$ 102.2
Unobligated Balance		
Apportioned	1.3	0.7
Exempt from Apportionment	696.7	-
Subtotal	698.0	0.7
Unobligated Balances Not Available	13.8	14.6
Total Status of Budgetary Resources	\$ 5,499.6	\$ 117.5
Change in Obligated Balance:		
Obligated Balance, Net		
Unpaid obligations, brought forward, October 1	\$ 2,469.2	\$ 3,417.5
Less: Uncollected customer payments from Federal source, brought forward, October 1	-	-
Total unpaid obligated balance	2,469.2	3,417.5
Obligations incurred, net	4,787.8	102.2
Less: Gross outlays	(5,196.1)	(480.4)
Less: Recoveries of prior year unpaid obligations, actual	(10.4)	-
Obligated balance, net, end of period		
Unpaid obligations	2,050.5	3,039.3
Less: Uncollected customer payments from Federal Sources	-	-
Total, unpaid obligated balance, net, end of period	2,050.5	3,039.3
Net Outlays		
Gross outlays	5,196.1	480.4
Less: Offsetting collections	(661.8)	(1,110.9)
Less: Distributed Offsetting Receipts	-	-
Net Outlays	\$ 4,534.3	\$ (630.5)



Section 4: Other Accompanying Information

Unaudited

Funds Appropriated to the President
Administered by the Department of Defense
Security Assistance

STATEMENT OF CHANGES IN NET POSITION As of September 30, 2006 (\$ in Millions)	FY 2006	STATEMENT OF FINANCING For the Year Ended September 30, 2006 (\$ in Millions)	FY 2006
CUMULATIVE RESULTS OF OPERATIONS		Resources Used to Finance Activities:	
Beginning Balance	\$ 69.9	Budgetary Resources Obligated	
Prior Period Adjustments:		Obligations Incurred	\$ 4,890.1
Changes in accounting principles	-	Less: Spending Authority from Offsetting Collections and Recoveries	(1,783.1)
Corrections of errors	(1.2)	Obligations Net of Offsetting Collections and Recoveries	\$ 3,107.0
Beginning Balance, as adjusted	<u>\$ 68.7</u>	Less: Offsetting Receipts	-
Budgetary Financing Sources		Net Obligations	<u>\$ 3,107.0</u>
Appropriations Transferred in/out	\$ -	Other Resources	
Other Adjustments (rescissions, etc.)	-	Donations and Forfeitures of Property	\$ -
Appropriations Used	4,722.8	Transfers In/Out Without Reimbursement	(67.0)
Other Financing Sources:		Net Other Resources Used to Finance Activities	(67.0)
Donations and forfeitures of property	\$ -	Total Resources Used to Finance Activities	<u>\$ 3,040.0</u>
Transfers in/out Without Reimbursement	(66.9)	Resources Used to Finance Items not part of the Net Cost of Operations:	
Imputed financing from costs absorbed by others	-	Change in Budgetary Resources Obligated for Goods, Services, and Benefits ordered but not yet provided	
Other (+/-)	-	Undelivered Orders	\$ 523.4
Total Financing Sources	<u>\$ 4,655.9</u>	Resources that fund expenses recognized in Prior Periods	(26.6)
Net Cost of Operations	<u>\$ 4,661.6</u>	Budgetary Offsetting Collections and Receipts that do not affect Net Cost of Operations	1,572.5
Net Change	<u>\$ (5.7)</u>	Resources that Finance the Acquisition of Assets	(480.4)
CUMULATIVE RESULTS OF OPERATIONS	<u>\$ 63.0</u>	Other Resources or Adjustments to net Obligated that do not affect Net Cost of Operations	66.9
UNEXPENDED APPROPRIATIONS		Total Resources Used to Finance Items not part of the Net Cost of Operations	<u>\$ 1,655.8</u>
Beginning Balance	\$ 1,966.6	Total Resources Used to Finance the Net Cost of Operations	<u>\$ 4,695.8</u>
Prior Period Adjustments:		Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period	
Corrections of errors	(0.5)	Components Requiring or Generating Resources in Future Periods	
Beginning Balance, as adjusted	<u>\$ 1,966.1</u>	Upward/Downward Reestimates of Credit Subsidy Expense	\$ (33.8)
Budgetary Financing Sources		Total Components of Net Cost of Operations that will require or generate Resources in Future Periods	<u>\$ (33.8)</u>
Appropriation Received	\$ 4,601.7	Components Not Requiring or Generating Resources	
Appropriations Transferred in/out	25.9	Revaluation of Assets or Liabilities	\$ (0.4)
Other Adjustments (rescissions, etc.)	(47.8)	Other	-
Appropriations Used	(4,722.8)	Total Components of Net Cost of Operations that will not Require or Generate Resources	<u>\$ (0.4)</u>
Total Budgetary Financing Sources	<u>\$ (143.0)</u>	Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	<u>\$ (34.2)</u>
TOTAL UNEXPENDED APPROPRIATIONS	<u>\$ 1,823.1</u>	Net Cost of Operations	<u>\$ 4,661.6</u>
Net Position	<u>\$ 1,886.1</u>		