FISCAL YEAR 2008
AGENCY FINANCIAL REPORT

Department of Defense

November 17, 2008

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MESSAGE FROM THE DEPUTY SECRETARY OF DEFENSE

DEPUTY SECRETARY OF DEFENSE
1010 DEFENSE PENTAGON
WASHINGTON, DC 20301-1010

November 17, 2008

At the end of each fiscal year, the Department of Defense (DoD) provides an accounting to the American people for the funds appropriated by act of Congress and signed into law by the President during the previous budget cycle.

The Agency Financial Report (AFR) is a concise and easy-to-understand summary of DoD's use of those tax dollars to maintain and modernize America's defenses – including expenditures to pay, train, equip, and supply the men and women who wear the nation's uniform, and to cover the costs of the Global War on Terror and other military operations. In Fiscal Year 2008, the Department's accomplishments included these highlights:

- In Iraq, the "Surge" strategy succeeded in destroying terrorist networks and restoring stability. The Iraqi economy is growing and a democratic society is developing in the heart of the Middle East.
- In Afghanistan, U.S. forces continued to work with local and North Atlantic Treaty Organization (NATO) troops to secure the country against Taliban extremists.
- In the Horn of Africa, the Philippines, Latin America and elsewhere, U.S. forces worked with our allies and partners to prevent the rise of radical extremists.
- U.S. Service members also safeguarded the nation against terrorist attack, helped to secure America's borders, and responded to natural disasters at home and abroad.

The AFR contains details about these and other achievements. It also includes important information on the Department's progress in improving financial management. We take our responsibility in this area very seriously, and we continually strive to ensure that DoD financial management is equal to the trust the public has placed in us. We have made measurable progress in the past year.

This report supports the Defense Department's participation in the Office of Management and Budget pilot financial reporting initiative for all federal agencies and contains the most complete financial information available.

Overview

The Department of Defense (DoD) Fiscal Year (FY) 2008 Agency Financial Report (AFR) provides the President, Congress, other federal departments and agencies, and the American public an overview of the Department's financial condition. This report compares to the private sector's annual report to stockholders.

The Department is producing the AFR as an alternative to the consolidated Performance and Accountability Report (PAR) under the Office of Management and Budget (OMB) Pilot Program for Alternative Approaches to Performance and Accountability Reporting. This approach is intended to improve performance reporting by presenting it in a more accessible and informative format, and provide more complete performance information given the additional time to collect actual year-end performance data.

The pilot consists of three required components:

Agency Financial Report: The AFR consists of the Deputy Secretary of Defense Message, Management's Discussion and Analysis, Financial Statements and Notes, the Audit Report, Major Management Challenges, and Other Accompanying Information.

Annual Performance Report: The FY 2008 Annual Performance Report (APR) will be available by the due date of January 15, 2009. The APR is required by the Government Performance and Results Act (GPRA) and contains details of the Department's performance and progress in achieving its strategic goals.

Citizen's Report: The Citizen's Report will be available by the due date of January 15, 2009. The Citizen's Report is a 25 page summary of the Department's mission, key goals, budget allocation, and progress on key performance goals linking to the strategic goals.

Additionally, the FY 2010 Annual Performance Plan (APP) will be included with our Congressional Budget Justification (CBJ). GPRA requires an APP that links the general goals and objectives to the strategic plans and performance goals. The CBJ includes the APR and APP with detailed descriptions of the Department's activities and proposals at the program, project, and activity level.

These reports and information on related topics are available on the DoD Comptroller Web site. (See Appendix B.)

Year In Review

Since September 11, 2001, the primary mission of the Department of Defense and America's Armed Forces has been to confront and defeat the threat posed by radical Islamic fundamentalism to the Nation and the world, and to work with our allies and partners to prevail in the ongoing struggle against global terrorism.

In Iraq, the buildup of U.S. forces known as the "Surge" and the leadership of U.S. Army General David Petraeus have contributed to increased success over coalition enemies. Overall, violence was significantly reduced; 13 of Iraq's 18 provinces, including Anbar province, were turned over to Iraqi control, and incremental but significant political progress has been achieved.

As a result of this success, and Iraq's increased capacity to provide for its own security, the five Army brigade combat teams, two Marine battalions, and one Marine expeditionary unit sent to Iraq as part of the Surge, have already returned to the United States. A Marine battalion stationed in Anbar

U.S. Marines from Foxtrot Company, 2nd Battalion, 7th Marine Regiment communicate with their command operation center during a raid on a Taliban headquarters in Afghanistan. *DoD photo by Sgt. Freddy G. Cantu August 2008* province will return in November, and from September 2008 through January 2009, another 3,400 noncombat forces—including aviation personnel, explosive ordnance teams, combat and construction engineers, military police, and logistics support teams—will be withdrawn. By February 2009, another 8,000 U.S. forces will return from Iraq without being replaced.

In addition, many of Iraq's neighbors, including Bahrain, Jordan, Kuwait, and the United Arab Emirates, have shown an increasing willingness to engage with and help stabilize Iraq.

In Afghanistan, U.S. and Coalition forces continued to work to counter a revived extremist insurgency. U.S. forces in Afghanistan increased from fewer than 21,000 two years ago to nearly 31,000 in 2008. Coalition forces also increased from about 20,000 to 31,000. Meanwhile, in addition to some 75,000 Afghan National Police, the Afghan National Army is now more than 65,000 strong and still growing.

In 2008, the international community also increased resources devoted to non-military efforts, pledging more than $20 billion in assistance to Afghanistan at the Paris Donors' Conference in June.

While the situations in Iraq and Afghanistan are still fragile, the forces of freedom made great strides over the forces of fear in 2008.

As always, the Department is cognizant of the responsibilities inherent in managing nearly 18 percent of the Federal budget and over 3 percent of the gross domestic product, and even more so of the precious resources loaned to us by a caring Nation—including the nearly 3 million active duty, guard, and reserve members of the U.S. Armed Forces, and the civilian workforce. With the support of Congress and, most importantly, the American people, DoD will continue to accomplish its mission in the years to come.

The Sections of the AFR

The Department of Defense Agency Financial Report 2008 covers the 12-month period ending September 30, 2008, in the following sections:

Management's Discussion and Analysis: Includes executive-level information on the Department's mission, organization, key strategic goals and objectives, analysis of financial statements, systems, controls, legal compliance, and other challenges facing DoD.

Financial Information: Includes a Message from the Chief Financial Officer, the DoD Inspector General Auditor's Report and opinion, the Department's principal financial statements and notes, required supplementary stewardship information, and required supplementary information.

Other Accompanying Information: Includes the Inspector General's Summary of Management and Performance Challenges and Management's Responses, Summary of the Financial Statement Audit and Management Assurances, and Improper Payment Information Act Reporting Details.

Appendixes include a glossary and a list of Internet links for more detailed information about topics discussed in this report.

We welcome your feedback regarding the content of this report. To comment or to request copies of the report, please e-mail us at DoDAFR@osd.mil, or write to:

U.S. Department of Defense
Office of the Under Secretary of Defense (OUSD) (Comptroller)
1100 Defense Pentagon
Washington, DC 20301-1100

This document also is available at:
http://www.defenselink.mil/comptroller/afr

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Section 1: Management's Discussion and Analysis

MISSION AND ORGANIZATIONAL STRUCTURE

Mission

The mission of the United States Armed Forces is to:

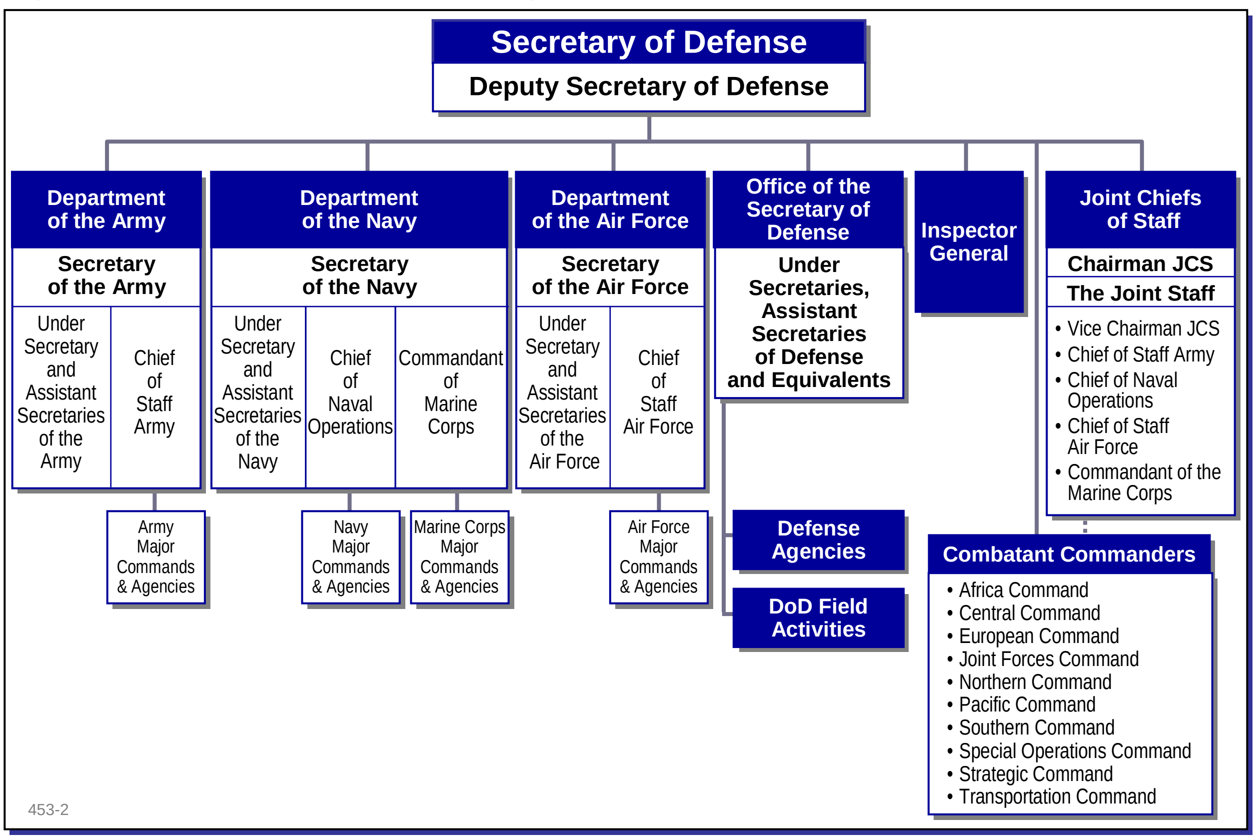
- Defend the United States.
- Deter aggression and coercion in critical regions.
- Swiftly defeat aggression in overlapping major conflicts while preserving for the President the option to call for a decisive victory in one of those conflicts, including the possibility of regime change or occupation.
- Conduct a limited number of smaller-scale contingency operations.

Organization

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

Figure 1-1 shows how the Department is structured.

Figure 1-1. Department of Defense Organizational Structure



The Secretary of Defense and the Office of the Secretary

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

Military Departments

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

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

U.S. service members exit a C-130 Hercules aircraft at Ali Air Base in Iraq. The aircraft transports personnel and cargo throughout the theater.

U.S. Air Force photo by Tech. Sgt. Sabrina Johnson May 2008

Chairman of the Joint Chiefs of Staff

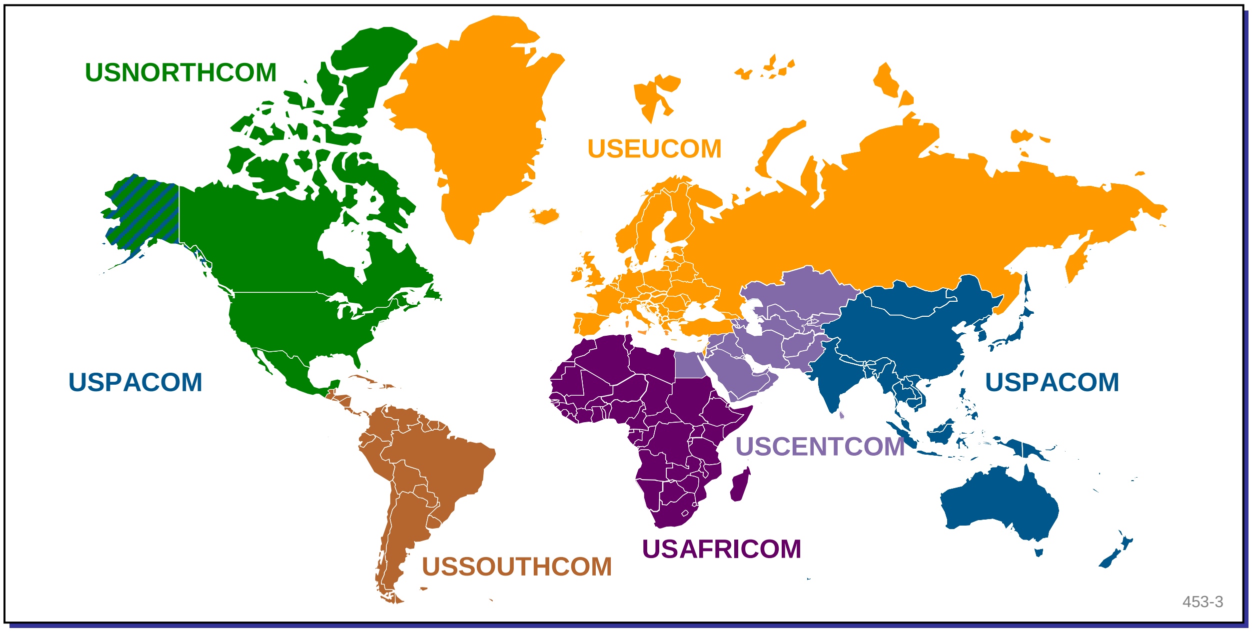
The Chairman of the Joint Chiefs of Staff is the principal military advisor to the President, the National Security Council, and the Secretary of Defense. The Chairman assists the President and the Secretary in providing for the strategic direction of the Armed Forces, including operations conducted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

Combatant Commands

The 10 Combatant Commands are responsible for conducting DoD missions around the world (Figure 1-2). The Army, Navy, Air Force, and Marine Corps supply forces to these Commands.

The 10th Combatant Command, U.S. Africa Command (USAFRICOM), officially established in October 2008, assumed responsibility from three existing Combatant Commands to cover all of Africa, with the exception of Egypt. The focuses of USAFRICOM's missions are diplomatic, economic, and humanitarian aid, aimed at prevention of conflict, rather than at military intervention.

Figure 1-2. Geographic Combatant Commands



Six of these Commands have specific mission objectives for their geographic areas of responsibility:

- U.S. European Command (USEUCOM) is responsible for activities in Europe, Greenland, and Russia.
- U.S. Central Command (USCENTCOM) is responsible for the Middle East, several of the former Soviet republics, and Egypt. This Command is primarily responsible for conducting Operation Enduring Freedom in Afghanistan and Operation Iraqi Freedom.
- U.S. Pacific Command (USPACOM) is responsible for Northeast, South, and Southeast Asia, as well as Oceania.
- U.S. Southern Command (USSOUTHCOM) is responsible for Central and South America, and the Caribbean.
- U.S. Northern Command (USNORTHCOM) is responsible for North America, including Canada and Mexico.
- U.S. Africa Command (USAFRICOM) is responsible for all of Africa, with the exception of Egypt.

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

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

Elementary school children in Damerdjog, pose for U.S. Marines with the 8th Provisional Security Company deployed to Camp Lemonier, Djibouti, conduct a civil affairs visit to their school.

U.S. Air Force photo by Staff Sgt. Samuel Rogers – September 2008

Defense Agencies and Defense Field Activities

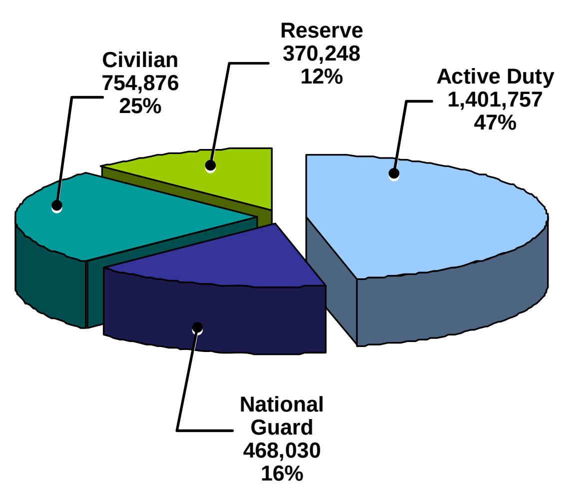
Defense Agencies and DoD Field Activities provide support services commonly used throughout the Department. For example, the Defense Finance and Accounting Service provides accounting services, contractor and vendor payments, and payroll services; and the Defense Logistics Agency provides logistics support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

Resources

Nearly half of the Department's workforce comprises men and women on active duty. To provide Americans with the highest level of national security, the Department employs 1,401,757 men and women on active duty, and 838,278 in the Reserve and National Guard, and 754,876 civilians (Figure 1-3).

The Department's worldwide infrastructure includes nearly 545,000 facilities (buildings, structures, and utilities) located at more than 5,400 sites around the world, on more than 29 million acres. To protect the security of the United States, the Department uses approximately 11,532 aircraft, and 639 ships.

Figure 1-3. Staffing for FY 2008



As of September 30, 2008

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ANALYSIS OF FINANCIAL STATEMENTS

Financial Analysis

The Department's financial statements are presented in Section 2: Financial Information. Preparing these statements is part of the Department's goal to improve financial management and provide information to assess performance and allocate resources. The Department's management is responsible for the integrity of the financial information presented in these financial statements.

The financial statements have been prepared to report the financial position and results of operations. These statements were prepared from the books and records of the Department in accordance with U.S. generally accepted accounting principles (USGAAP) to the extent possible, the Office of Management and Budget (OMB) Circular No. A-136, "Financial Reporting Requirements," and the "DoD Financial Management Regulation."

For FY 2008, 5 of the 33 reporting entities are projected to receive unqualified audit opinions. Additionally, Medicare-Eligible Retiree Health Care Fund and U.S. Army Corps of Engineers are projected to receive a qualified opinion in FY 2008. The Components are listed in Figure 1-4. At the Departmentwide level, favorable reviews were received for the fourth consecutive year on three financial statement line items in FY 2008: (1) Investments, (2) Federal Employees' Compensation Act Liabilities, and (3) Appropriations Received.

Budgetary Resources. The Statement of Budgetary Resources presents total resources of $1.1 trillion that was available to the Department during FY 2008 and the

Figure 1-4. Projected Audit Opinions

DoD Reporting Entity	Audit Opinions
Defense Commissary Agency	Unqualified
Defense Contract Audit Agency	Unqualified
Defense Finance and Accounting Service	Unqualified
Military Retirement Fund	Unqualified
Office of the Inspector General	Unqualified
Medicare-Eligible Retiree Health Care Fund	Qualified
U.S. Army Corps of Engineers	Qualified (1)

(1) Out-of-cycle audit opinion

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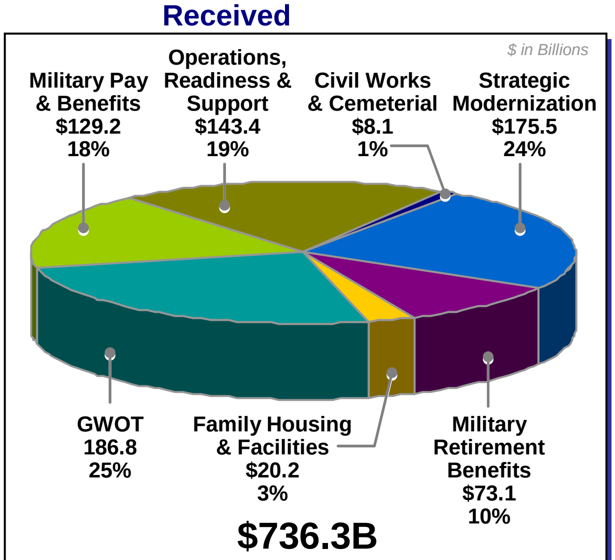
status at the end of the period. It presents the relationship between budget authority and outlays, and reconciles obligations to total outlays.

The Department's total resources primarily consist of carried forward budget authority of $112.0 billion for unfilled commitments from FY 2007 and received additional appropriations of $736.4 billion in FY 2008 to support the Global War on Terror (GWOT), train and equip our warfighters, and ensure broad national security priorities are met. Figure 1-5 displays appropriations received by program.

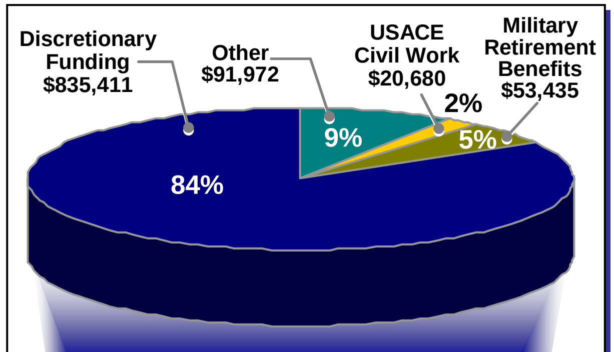
Most ($1.0 trillion or 91%) of the total budgetary resources for FY 2008 were spent or reserved for specific purposes. The remaining resources relate to receipt of multi-year appropriations and supplemental funding that were received late in the fiscal year with insufficient time to fully obligate and outlay. The Department's total FY 2008 obligations incurred are in support of present and future initiatives such as establishing the Africa Command (AFRICOM), building partnership capacity with foreign partners, realigning the ballistic missile defense sites in Europe, and strengthening cyberspace security. Obligations incurred presented in Figure 1-6 are shown separate between mandatory and discretionary funding.

Figure 1-5. FY 2008 Appropriations Received



Amounts include DoD direct appropriations and funds appropriated for military retiree health and pension benefits.

Figure 1-6. FY 2008 Obligations Incurred

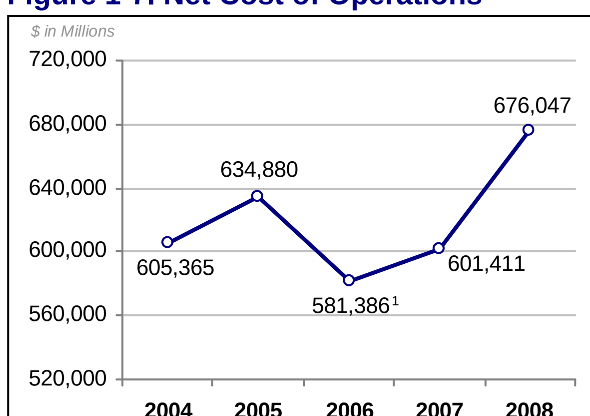


Discretionary Funding	
Military Pay & Benefits	145,550
Family Housing & Facilities	19,859
Operations, Readiness & Support	427,001
Strategic Modernization	243,001
Total	**835,411**

Net Cost of Operations. The Statement of Net Cost presents the net cost of operations which represents the difference between the costs incurred less earned revenue. This is essentially equivalent to outlays displayed on the Statement of Budgetary Resources less capitalized asset purchases plus accrued liabilities and accounts payable. Differences between budgetary resources and net cost generally arise from timing of cost recognition.

The majority of funding used to cover cost is received through congressional appropriations and reimbursement for the provision of goods or services to other federal agencies. The Department's net cost of operations during FY 2008 totaled $676.0 billion. This represents an increase of $74.6 billion, or 12 percent from last year (Figure 1-7).

Figure 1-7. Net Cost of Operations



¹ *Security Assistance Program is not included*

The Military Retirement Benefits accounted for the majority of the FY 2008 increase in cost. This increase is due largely to the growth in actuarial liabilities that resulted from a reduction in the interest rate assumption that affects the value of investments available to pay benefits.

Also contributing to the increase in net cost are the operation and maintenance costs for base operations support related to troop readiness and increased requirements of GWOT.

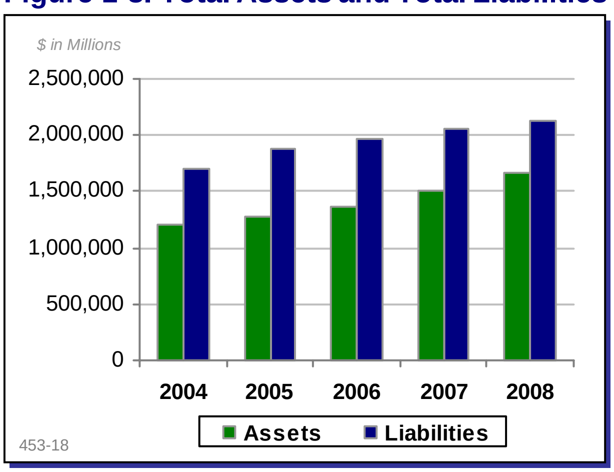
Balance Sheet. The consolidated Balance Sheet presents a status of our financial condition as of September 30, 2008, and displays assets, liabilities and the resulting net position. Figure 1-8 displays asset and liability trends with the difference depicting the Department's net position.

Assets of $1.7 trillion represent amounts that the Department owns and manages. Assets increased $185.9 billion at the end of FY 2008, or 13 percent. This increase is largely attributable to increases in Fund Balance with Treasury (FBWT), Investments, and Military Equipment.

The increase in Fund Balance with Treasury was due to a $73.8 billion increase in appropriated funds primarily in support of the GWOT. The Department was given these appropriations late in the fiscal year with insufficient time to fully obligate and outlay.

The net increase in investments of $60.8 billion is related to expected normal growth to cover unfunded portions of future military retirement and health benefits. Funds not needed to pay current benefits are held in separate trust and special funds and invested in U.S. Treasury securities.

Figure 1-8. Total Assets and Total Liabilities



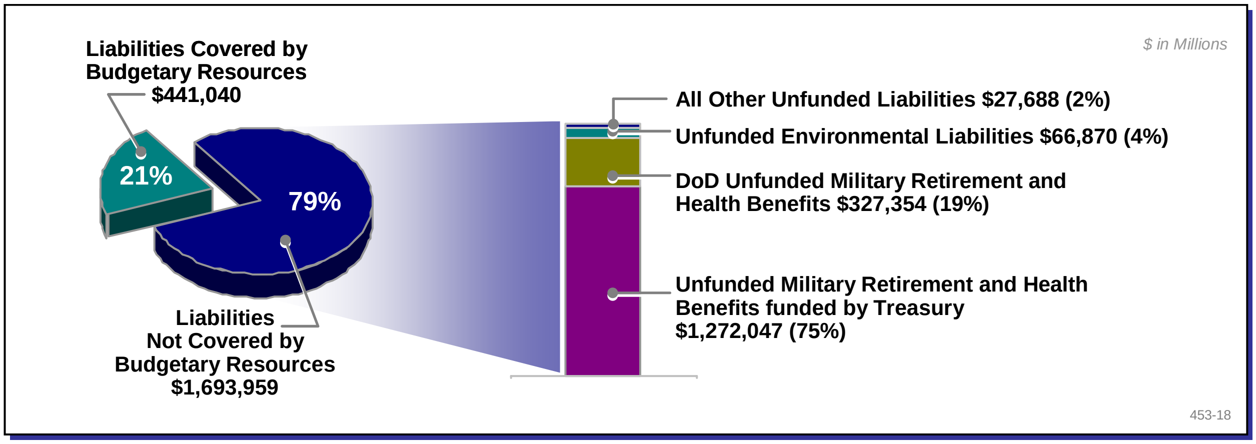
Military Equipment increased $34.0 billion reflecting the receipt of combat vehicles such as Mine Resistant Ambush Protected (MRAP) vehicles, tanks, personnel carriers, other armored vehicles, and trucks, as well as ships and F-22 and C-17 aircraft.

In contrast, the Department has significant unfunded liabilities consisting primarily of actuarial liabilities related to military retirement pension and health care benefits. While the liability presents the Department with a negative financial position, the majority of the unfunded portion will come from annual appropriations outside the Department's budget. The FY 2008 actuarial liability estimate totaled $2.0 trillion of which $1.3 trillion will come from the U.S. Treasury to cover liabilities existing at inception of the programs. Approximately $378.9 billion is currently covered with invested U.S. Treasury securities. Due to the significant growth in liability in recent years, the Board of Actuaries accelerated the liquidation of the initial unfunded liabilities by reducing the amortization period thus increasing the annual contribution amounts from the U.S. Treasury. Figure 1-9 identifies the unfunded portions of liabilities requiring future resources.

Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Department of Defense, pursuant to the requirements of 31 U.S.C. 3515(b). The statements are prepared from accounting records of the Department in accordance with OMB Circular No. A-136 and, to the extent possible, U.S. generally accepted accounting principles (USGAAP). The statements, in addition to the financial reports, are used to monitor and control budgetary resources, which are prepared from the same records. The statements should be read with the realization

Figure 1-9. Unfunded Liabilities



that they are for a Component of the U.S. Government, a sovereign entity.

The Deputy Secretary of Defense has made financial management improvement and business transformation a priority. He chairs the Defense Business Systems Management Committee, chartered to oversee business transformation, and requires Component heads to demonstrate specific involvement and responsibility by signing their quarterly financial statements. The comprehensive Financial Improvement and Audit Readiness Plan and the Business Transformation Agency's Enterprise Transition Plan drive these improvements.

Financial Improvement and Audit Readiness

The Department initiated the Financial Improvement and Audit Readiness (FIAR) Plan in 2005 to set the course for improving both financial information and audit readiness. The FIAR Plan has three primary goals:

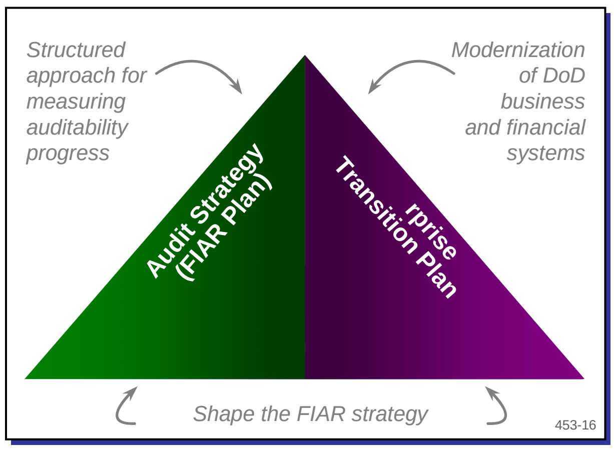
- Improve decision making by providing relevant, accurate, reliable, and timely financial information.
- Sustain improvements through a process of annual assessments and internal control.
- Achieve unqualified audit opinions on DoD annual financial statements.

The first FIAR Plan identified financial management improvement priorities, established standard business rules for financial management improvement efforts, and aligned itself with other business transformation efforts (Figure 1-10). This approach has not changed, although the framework upon which the Department structures, plans, and monitors financial management improvement efforts is today more complete. The FIAR Plan structures improvement efforts into incremental and prioritized areas (such as the U.S. Marine Corps). The OUSD(C) plays an active role in overseeing, managing, and monitoring Component improvement efforts through the FIAR Plan.

The Department has made significant progress in achieving the FIAR goals as evidenced by:

- $1.4 trillion, or 37 percent of $3.8 trillion, of the Department's assets and liabilities has received an unqualified audit opinion,

Figure 1-10. Three Pronged Strategy For Transformation



- The TRICARE Management Activity Contract Resource Management organization's $247 billion (7 percent) in assets and liabilities have been validated as audit ready,
- Favorable audit opinions on five reporting entities' FY 2008 financial statements,
- Favorable reviews on three DoD financial statement line items, and
- Audit readiness at the Defense Information Systems Agency, whose FY 2007 financial statements are presently under audit.

In addition, to the above achievements, the Navy, Air Force and Defense Logistics Agency have asserted audit readiness and are sustaining it until their entire financial statements are ready for audit.

Business Transformation Agency

The Department of Defense is fully engaged in business transformation efforts to modernize its processes, systems, and information flows to support 21st century national security requirements. To help guide this undertaking, the Department established the Defense Business Transformation Agency (BTA) and released its first Business Enterprise Architecture (BEA) and Enterprise Transition Plan (ETP) in 2005. Over the past 3 years, the Department has made significant progress, not only in the improvements to business capabilities, but also in the fundamental ways in which it thinks about business operations and the methods to achieve transformation.

Business Enterprise Architecture

The Business Enterprise Architecture (BEA) guides Defense business transformation by providing a common reference for target systems and initiatives. The BEA blueprints business transformation and includes activities, processes, data standards, business rules, system functionality, and technical standards. Six business enterprise priorities define the scope and allow the BEA to evolve in a controlled and consistent fashion:

- Personnel visibility
- Acquisition visibility
- Common supplier engagement
- Materiel visibility
- Real property accountability
- Financial visibility

Enterprise Transition Plan

The Enterprise Transition Plan is the Department's comprehensive plan for implementing the business enterprise architecture. The Department issues a new ETP each September and reports progress each March. The FY 2008 ETP, like the preceding plans, contains milestones and measures for the programs and initiatives that support achievement of the business enterprise priorities. The ETP describes the Department's system initiatives and status of Enterprise Resource Planning (ERP) and other system implementations throughout the Army, Navy, Air Force, and Defense Agencies. This year's ETP also contains performance measures for achieving the business capabilities and their supporting operational activities. This set of performance measures permits the opportunity to baseline performance growth. The Enterprise Transition Plan has become part of the business operations culture of DoD, and is the framework that integrates capabilities across the Department.

Members of Defense Logistics Agency s (DLA) Defense Distribution Deployable Center prepare to load tarps into trucks at FEMA s Hurricane Ike disaster relief staging area on Fort Sam Houston, Texas.
DoD photo by SPC Sean Harp September 2008

PERFORMANCE OBJECTIVES, GOALS, AND RESULTS

DoD Key Performance Outcomes

The President's Management Agenda (PMA) Budget and Performance Integration Initiative, subsequently renamed Performance Improvement Initiative (PII), is focused on re-emphasizing and implementing all statutory provisions of the Government Performance and Results Act (GPRA) of 1993. The PII calls for a Government that is results-oriented, and guided by performance, not process. Since the first quarter of FY 2003, the Department has maintained a "yellow," or satisfactory, rating for overall status of this initiative.

DoD Performance Budget Hierarchy

The Department's performance budget hierarchy is depicted in Figure 1-11. This hierarchy indicates that every level of DoD is accountable for measuring performance and delivering results at multiple tiers of the organization. The DoD investments in systems and other initiatives are aggregated to support strategic objectives at the enterprise-level.

The DoD strategic objectives and performance targets (measures and milestones) are subject to annual refinement based on changes in missions and priorities. Such changes reflect the evolutionary nature of DoD's performance budget and the Department's ensuing efforts to link resource allocation to identifiable and measurable strategic outcomes.

DoD Strategic Plan

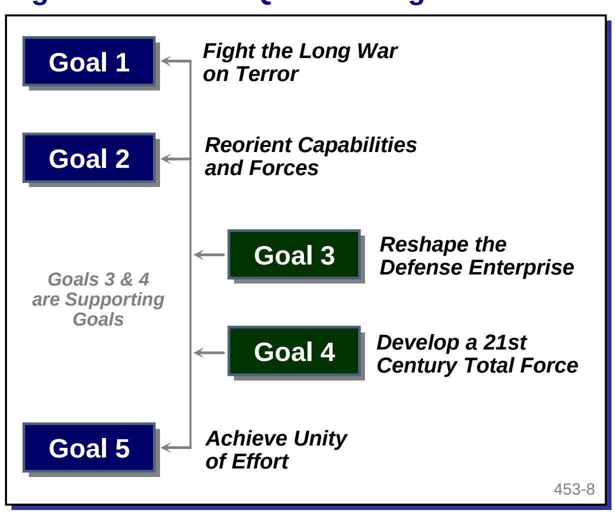
The Quadrennial Defense Review (QDR) constitutes DoD's strategic plan. On February 3, 2006, the Department unveiled its most recent QDR, charting the way ahead for the next 20 years. The QDR report acknowledges that the Department has been and is transforming along a continuum that shifts emphasis from the 20th century to the 21st century. The 2006 QDR was founded on the National Military Strategy, published in May 2004, and the National Defense Strategy, published in March 2005.

Figure 1-11. Department of Defense Performance Budget Hierarchy

The QDR acknowledges that everything done in the Department must contribute to joint warfighting capability. Its purpose is to provide the U.S. with strong, sound, and effective warfighting capabilities.

The 2006 QDR was the first contemporary defense review to coincide with an ongoing major conflict. Consequently, (Figure 1-12) Strategic Goal 1 focuses on the ongoing

Figure 1-12. 2006 QDR Strategic Goals



major conflict and extended stabilization campaigns in Iraq and Afghanistan. At the same time, the 2006 QDR recognized that the Department needed to recast its view of future warfare through the lens of a long duration and globally-distributed conflict. Therefore, Strategic Goal 2 focuses on reorienting the Armed Forces to deter and defend against transnational terrorists around the world. Strategic Goal 5 recognizes that DoD cannot meet today's complex challenges alone. This goal recognizes integrated security cooperation and strategic communication as additional tool sets the Combatant Commanders may use to fight wars. Together, these three goals encompass the Department's warfighting missions. Strategic Goals 3 and 4 focus on developing a Total Force and reshaping the defense infrastructure, respectively, in ways that better support the warfighter. These supporting goals enable accomplishment of the Department's primary goals, Strategic Goals 1, 2, and 5.

FY 2008 Performance Plan

The Department also established a task force and Senior Review Group (SRG) in January 2007 to develop a limited number of strategic objectives and performance targets at the joint- or enterprise-level. The task force and SRG included representatives from each OSD Principal Staff, the Joint Staff, and the Military Departments. As a result of their efforts, 17 supporting strategic objectives and 51 enterprise-level performance targets were developed for FY 2008.

FY 2008 Key Performance Outcomes:

The following tables show key, unclassified strategic objectives and performance measures, and targeted results for FY 2008. The tables are organized by QDR Strategic Goal, and Strategic Objective. Performance Measures are also provided for each strategic objective and are numbered respectively.

The DoD expects to meet or exceed most of its key outcomes for FY 2008. Actual year-end results for these same key outcomes will be addressed in the Department's FY 2008 Citizen's Report.

Strategic Goal 1: Fight the Long War on Terror

Since 2001, the Department has been engaged in developing the forces and capabilities of Iraq and Afghanistan in fighting the long war on terror. Two key outcomes focused on training Iraqi and Afghan Security Forces and were identified as primary indicators for transitioning the security of these two nations to the Iraqi and Afghan governments. By the end of FY 2008, the Department expects to have trained 529,000 Iraqi Security Forces (ISF) and 152,000 Afghan National Security Forces (ANSF).

STRATEGIC GOAL 1: FIGHT THE LONG WAR ON TERROR				
Strategic Objective 1.1:	**Conduct a large-scale, potentially long-duration irregular warfare campaign that includes counterinsurgency, security stability, transition, and reconstruction operations.**			
Performance Measures	**Strategic Plan Long-term Performance Targets**	**Annual Performance Targets/Results**		
		FY 2007 Target	FY 2007 Results	FY 2008 Target
1.1-1a: Cumulative number of Iraqi Security Forces (ISF) trained.	1.1-1a: By FY 2009, DoD will train 588,000 Iraqi Security Forces (ISF).	365,000	439,700	529,000
1.1-1b: Cumulative number of Afghan National Security Forces (ANSF) trained.	1.1-1b: By FY 2009, DoD will train 162,000 Afghan National Security Forces (ANSF).	112,000	124,700	152,000

Strategic Goal 2: Reorient Capabilities and Forces

Four key performance outcomes are most reflective of the Department's goal to reorient its capabilities and forces. Two outcomes reflect new DoD capabilities that have been established to assist in mitigating attacks on the U.S. personnel, facilities, and key assets. Two other outcomes focus on converting Army force structure to modular designs, as primary indicators for the most significant transformation of the Army in a generation.

STRATEGIC GOAL 2: REORIENT CAPABILITIES AND FORCES				
Strategic Objective 2.1:	**Deter or defeat direct attacks to the U.S. homeland and its territories and contribute toward the nation's response to the management of Weapons of Mass Destruction (WMD) or catastrophic event; Improve ability to respond to Chemical, Biological, Radiological, Nuclear, and Explosive (CBRNE) attacks and improve the capability of interagency partners to contribute to our nation's security.**			
Performance Measures	**Strategic Plan Long-term Performance Targets**	**Annual Performance Targets/Results**		
		FY 2007 Target	FY 2007 Results	FY 2008 Target
2.1-1: Number of National Guard Weapons of Mass Destruction –Civil Support Teams (WMD-CSTs) certified.	2.1-1: By FY 2007, 55 National Guard Weapons of Mass Destruction-Civil Support Teams (WMD-CSTs) will be certified.	55	55	55
2.1-2: Number of National Guard Chemical, Biological, Radiological, Nuclear, and High-Yield Explosive (CBRNE) Enhanced Response Force Packages (CERFPs) trained.	2.1-2: By FY 2008, 17 National Guard Chemical, Biological, Radiological, Nuclear, and High-Yield Explosive (CBRNE) Enhanced Response Force Packages (CERFPs) will be trained for WMD or other catastrophic responses.	12	12	17
Strategic Objective 2.2:	**Deter and defend against transnational terrorists attacks and globally distributed aggressors and shape the choices of countries at strategic crossroads, while postured for a second, nearly simultaneous campaign.**			
2.2-4a: Number of Army Brigades Combat Teams (BCTs) converted to a modular design and available to meet military operational demands.	2.2-4a: By FY 2013, 76 modular Army Brigade Combat Teams (BCTs) will be available to meet military operational demands.	35	35	38
2.2-4b: Number of Army Multi-functional and Functional Support (MFF) brigades converted to a modular design and available to meet military operational demands.	2.2-4b: By FY 2013, 227 modular Army Multi-functional and Functional Support (MFF) brigades will be available to meet military operational demands.	144	144	187

Strategic Goal 3: Reshape the Defense Enterprise

Five key performance outcomes are identified as representative samples of the Department's reshaping goal. The first outcome, average customer wait time, has been used by the DoD logistics community to improve joint warfighting support. The second key outcome under this goal reflects a reduction in the number of inadequate military family housing units in the continental United States in order to improve the quality of life for service members and their families. The third and fourth outcomes demonstrate an increase in DoD's financial audit readiness—a significant step in improving financial stewardship to the American taxpayer. The final performance outcome shows how the Department's inventory of information technology systems are faring against information assurance standards.

STRATEGIC GOAL 3: RESHAPE THE DEFENSE ENTERPRISE				
Strategic Objective 3.3:	**Implement improved logistics operations to support joint warfighting priorities.**			
Performance Measures	**Strategic Plan Long-term Performance Targets**	**Annual Performance Targets/Results**		
		FY 2007 Target	FY 2007 Results	FY 2008 Target
3.3-1: Average customer wait time.	3.3-1: Beginning in FY 2007, DoD will reduce average customer wait time to 15 days.	15	17	15
Strategic Objective 3-4:	**Maintain capable, efficient, and cost-effective installations to support the DoD workforce.**			
3.4-4a: Number of inadequate family housing units in CONUS.	3.4-4a: By FY 2009, DoD will eliminate all inadequate family housing in the continental United States (CONUS).	0	13,242	2,959
Strategic Objective 3.5:	**Improve financial management and budget and performance integration to support strategic decisions and provide financial stewardship to the taxpayer.**			
3.5-1a: Percent of audit-ready assets.	3.5-1a: By 2017, DoD will demonstrate that 100 percent of assets have achieved audit readiness.	18%	15%	23%
3.5-1b: Percent of audit-ready liabilities.	3.5-1b: By 2017, DoD will demonstrate that 100 percent of liabilities have achieved audit readiness.	49%	50%	51%
Strategic Objective 3.6:	**Make information available on a network that people depend on and trust.**			
3.6-2: Percent of applicable information technology (IT) and National Security Systems (NSS) programs that are FISMA-compliant.	3.6-2: By FY 2013, 95 percent of applicable information technology (IT) and National Security Systems (NSS) programs in the IT Repository will be FISMA-compliant.	90% or >	87.1%	90% or >

Strategic Goal 4: Develop a 21st Century Total Force

Four key performance outcomes are focused on sustaining the capacity of the All-Volunteer Force to prevail in the Global War on Terror. Two outcomes assess DoD active and reserve component end-strength at levels not less than those prescribed by the Secretary of Defense for mission accomplishment. A third outcome measures how well the Military Health Service identifies significant medical conditions that would affect the availability of Service members to deploy. This goal's final key outcome measures the Department's ability to support the Combatant Commanders across the full spectrum of operations by providing combat units trained in joint warfighting doctrine.

STRATEGIC GOAL 4: DEVELOP A 21ST CENTURY TOTAL FORCE				
Strategic Objective 4.1:	**Ensure an "All Volunteer" military force is available to meet the steady-state and surge activities of the DoD.**			
Performance Measures	**Strategic Plan Long-term Performance Targets**	**Annual Performance Targets/Results**		
		FY 2007 Target	FY 2007 Results	FY 2008 Target
4.1-1a: Percent variance in Active component end strength.	4.1-1a: For each fiscal year, the DoD Active component end strength must not be less than (NLT) and not to exceed (NTE) three percent above the SECDEF prescribed end strength for that fiscal year.	NLT authorized /NTE +3% above SECDEF prescribed end strength	+.9% above SECDEF prescribed end strength	NLT authorized/ NTE +3% above SECDEF prescribed end strength
4.1-1b: Percent variance in Reserve component end strength.	4.1-1b: For each fiscal year, the DoD Reserve component end strength will not vary by more than two percent from the SECDEF prescribed end strength for that fiscal year.	+/-2% from SECDEF prescribed end strength	-1.7% below SECDEF prescribed end strength	+/-2% from SECDEF prescribed end strength
4.1-2: Percent of deployable Armed Forces without any deployment- limiting medical condition.	4.1-2: By FY 2010, DoD will sustain the percent of deployable Armed Forces without any deployment-limiting medical condition to equal to or greater than 92 percent.	>87% of deployable Armed Forces	85% of deployable Armed Forces	>90% of deployable Armed Forces
Strategic Objective 4.4:	**Improve workforce skills to meet mission requirements.**			
4.4-2: Percent of deployed combat units receiving joint training in Joint National Training Center (JNTC) - accredited programs prior to arriving in theater.	4.4-2: By FY 2012, 80 percent of deployed combat units will participate in joint training at JNTC-accredited programs prior to arriving in theater.	Not available	70% of units trained	72% or greater of units trained

Strategic Goal 5: Achieve Unity of Effort

This goal focuses on building the capacity of international partners in fighting the Global War on Terror by improving access to equipment, technology, and training. A single key outcome provides for an increase in the number of various technological and security reviews of goods and services proposed for transfer to international partners.

STRATEGIC GOAL 5: ACHIEVE UNITY OF EFFORT				
Strategic Objective 5.1:	**Build capacity of international partners in fighting the war on terror.**			
Performance Measures	**Strategic Plan Long-term Performance Targets**	**Annual Performance Targets/Results**		
		FY 2007 Target	FY 2007 Results	FY 2008 Target
5.1-1: Annual number of Technology Security Actions (TSAs) processed.	5.1-1: Beginning in FY 2007, DoD will increase the number of reviews of relevant technologies involving transfers to international partners by two percent per year.	102,059	116,017	118,337

ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

Management Assurances

The Department's management is committed to addressing DoD weaknesses, as identified in evaluations and assessments of its management systems, controls, and processes. The DoD's overall goal is to improve its operations by focusing on ensuring effective internal controls, systems conformance with federal requirements, and the ability to produce accurate, timely, and reliable financial and performance data for reporting.

Federal Managers' Financial Integrity Act

The Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires agencies to establish internal controls and financial systems that ensure the integrity and protection of federal programs and operations. In addition, FMFIA requires the head of each agency to provide an annual assurance statement outlining what the agency has done to meet this requirement, including details of remaining material weaknesses. OMB Circular A-123, "Management's Responsibility for Internal Control" provides specific requirements to agencies for conducting management's assessments of internal controls. For FMFIA reporting results, see Section 3: Other Accompanying Information.

ANNUAL ASSURANCE STATEMENT

DEPUTY SECRETARY OF DEFENSE
1010 DEFENSE PENTAGON
WASHINGTON, DC 20301-1010

November 17, 2008

The Department of Defense's (DoD) leadership is committed to establishing and maintaining effective internal management controls and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). The Department aggressively reduced material weaknesses by 85 percent—from 116 material weaknesses in Fiscal Year 2001 to 17 in Fiscal Year 2008 and we continue to work towards zero weaknesses. By instituting a senior-level review, the Department is attempting to accelerate the correction and eliminate remaining material weaknesses. Details of these material weaknesses are available in Section 3, Other Accompanying Information.

As part of a Department-wide evaluation and assessment of internal management controls, the DoD provides qualified reasonable assurance that objectives of the FMFIA over non-financial operations have been achieved. The Department conducted its assessment on the effectiveness of internal controls over financial reporting, according to the Office of Management and Budget's Circular No. A-123, Appendix A, *Management's Responsibility for Internal Control.* This evaluation determined that, while measurable progress is being made, as of June 30, 2008, the Department cannot provide reasonable assurance that internal management controls over financial reporting are effective. As of the date of this report, the Department's financial systems are not in substantial compliance with the Federal Financial Management Improvement Act.

The Department continues to achieve positive results by:

- Increasing awareness on the importance of establishing and maintaining effective internal management controls through the "*Check It*" campaign challenge.
- Emphasizing internal management control program responsibility, and providing training throughout DoD to include deployed troops.
- Ensuring senior management attention to internal management controls.
- Focusing on responsible planning to resolve financial reporting and systems weaknesses through the Department's Financial Improvement and Audit Readiness and Enterprise Transition Plans.

Gordon England

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act (FFMIA) requires certain federal agencies, including DoD, to report on conformance with Federal Financial Management System Requirements, Federal Accounting Standards, and the U.S. Standard General Ledger at the transaction level.

The Department's Inspector General and the audit agencies within the Military Services have reported on the Department's noncompliance with the Act's requirements. The Department's non-compliance is largely due to the legacy financial management systems in use by the Department's Components. These systems, for the most part, do not comply with the wide range of requirements for systems compliance and, therefore, do not provide the necessary assurances to rely on information contained either in the core financial system or in the mixed systems that provide source transactional information. The Business Enterprise Architecture is the Department's blueprint providing the business rules and controls for complying with the Act's requirements. The Financial Improvement and Audit Readiness Plan and the Enterprise Transition Plan provide the approach and plan for reaching unqualified audit opinions and FFMIA compliance.

Improper Payments Information Act Reporting

The Improper Payments Information Act (IPIA) of 2002, as implemented by OMB Circular A-123, Appendix C, "Requirements for Effective Measurement and Remediation of Improper Payments," requires federal agencies to review their programs and activities, and identify those susceptible to significant improper payments. The National Defense Authorization Act (PL 107-107) established the requirement for government agencies to carry out cost-effective programs for identifying and recovering overpayments made to contractors, also known as "recovery auditing." The OMB established specific

Shiite pilgrims walk across Sarafiyah Bridge on their way to the Kadhamiyah shrine in Baghdad, Iraq. The bridge was destroyed last year by insurgents and reopened to traffic in early 2008

DoD photo by Staff Sgt. Lorie Jewell, U.S. Army July 2008

reporting requirements for agencies with programs that possess a significant risk of improper payments and for reporting on the results of recovery auditing activities. For FY 2008 IPIA reporting results, see Section 3: Other Accompanying Information.

OTHER MANAGEMENT INFORMATION, INITIATIVES, AND ISSUES

Looking Forward: Challenges for 2008 and Beyond

The 2006 Quadrennial Defense Review (QDR) provided new direction for accelerating the transformation of the Department to focus more on the needs of Combatant Commanders and to better develop joint capabilities rather than individual, parallel programs. The QDR was designed to serve as a catalyst to spur the Department's continuing adaptation and reorientation to a joint force that is more agile, more rapidly deployable, and more capable against the wider range of threats.

The essence of capabilities-based planning is to identify capabilities that adversaries could employ and capabilities that could be available to the United States, then evaluate their interaction, rather than over-optimize the joint force for a limited set of threat scenarios.

The goal is to manage the Department increasingly through the use of joint capability portfolios. Doing so should improve the Department's ability to meet the needs of the President and Combatant Commanders.

Moving toward a more "demand-driven" approach reduces program redundancy, improves joint interoperability, and streamlines acquisition and budgeting processes. The Department is continuing to shift from stovepiped vertical programs to more transparent and horizontally-integrated programs. Just as the U.S. forces operate jointly, DoD recognized that horizontal integration must become an organizing principle for the Department's investment and enterprisewide functions. These reforms will not occur overnight, and care must be taken not to weaken what works effectively during the transition to a more cross-cutting approach. However, the complex strategic environment of the 21st century demands greater integration of forces, organizations and processes, and closer synchronization of actions.

Aligning Authority and Accountability through Joint Capability Portfolios

Most of the Department's resources are provided through the Military Services. This arrangement can lead to both gaps and redundancies within capability areas as each Service attempts to supply a complete warfighting package rather than organize to depend on capabilities provided by other Military Departments. To optimize capabilities for the joint warfighter, the Department is working to reorient its processes around joint capability portfolios. In the acquisition realm, the Department has already instituted several joint capability reviews. These reviews look across major force programs to assess needed investments in specific capability portfolio areas, such as integrated air and missile defense, land attack weapons and electronic warfare.

The QDR used such a portfolio approach to evaluate surveillance capabilities. The Department began by accounting for all of its current and planned surveillance capabilities and programs. This included a transparent review of capabilities at all levels of classification. Viewing capabilities across the entire portfolio of assets enabled decision-makers to make informed choices about how to reallocate resources among previously stovepiped programs, to deliver needed capabilities to the joint force more rapidly and efficiently.

The Department is building on these initial efforts to integrate tasks, people, relationships, technologies, and associated resources more effectively across the Department's many activities. By shifting the focus from Service-specific programs to joint capabilities, the Department should be better positioned to understand the implications of investment and resource trade-offs among competing priorities. As a first step, the Department will manage four capability areas using a capability portfolio concept: Joint Command and Control, Joint Net-Centric Operations, Joint Logistics, and Battlespace Awareness. As lessons are learned, the Department will expand this approach to other capability areas.

Summary

Reshaping the Defense enterprise is a difficult task. The structures and processes developed over the past half-century were forged during the Cold War and are strengthened by success. However, the strategic landscape of the 21st century demands excellence across a broader set of national security challenges. With change comes turmoil, and achieving a desired vision requires determination and perseverance within the Department and, more importantly, in cooperation with Congress. As the Department emphasizes agility, flexibility, responsiveness, and effectiveness in the operational forces, the Department's organizations, processes, and practices must change to embody these characteristics and maximize support to the joint warfighter and the Commander in Chief.

Section 2: Financial Information

MESSAGE FROM THE ACTING CHIEF FINANCIAL OFFICER

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

November 17, 2008

The Department of Defense fiscal year (FY) 2008 Agency Financial Report highlights the Department's financial position and significant accomplishments in financial management. This report reflects our support to the DoD's warfighters as we strive to maximize the value of every dollar spent on their behalf.

In FY 2008, the Department focused its efforts on resolving material weaknesses and strengthening internal controls. By the end of FY 2008, DoD reduced management-identified internal control weaknesses from 116 to 17, an 85 percent improvement.

Stronger internal controls have reduced opportunities for waste, fraud, and abuse and increased efficiencies in several processes. By strengthening our internal controls, the Department has achieved positive results with the achievement of unqualified audit opinions for some agencies. To date, five DoD entities have earned unqualified opinions. These organizations account for $1.3 trillion – one third -- of Department assets and liabilities.

Today, the Department's fiscal information provides a more complete depiction of DoD's financial health than in previous years. This progress will continue because the Department has strategically invested in its workforce and financial systems and has a detailed plan to achieve optimal financial results. The Department's audit strategy is described in the Defense Financial Improvement and Audit Readiness (FIAR) Plan.

I wish to thank the financial management community throughout the Department. The accomplishments reflected in this report are a result of their extraordinary dedication to our mission. We are improving our financial stewardship to the taxpayers and warfighters who expect and deserve nothing less. Together we will tackle our ambitious agenda for the future.

Douglas A. Brook
Acting Under Secretary of Defense
(Comptroller)/DoD Chief Financial Officer

INDEPENDENT AUDITOR'S REPORT

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

November 12, 2008

MEMORANDUM FOR ACTING UNDER SECRETARY OF DEFENSE (COMPTROLLER)/DOD CHIEF FINANCIAL OFFICER

SUBJECT: Independent Auditor's Report on the Department of Defense FY 2008 and FY 2007 Basic Financial Statements (Report No. D-2009-021)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying DoD Agency-Wide Consolidated Balance Sheet as of September 30, 2008 and 2007, and the Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and related notes for the fiscal years then ended. The financial statements are the responsibility of DoD management. DoD is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the DoD Agency-Wide FY 2008 and FY 2007 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

Disclaimer of Opinion on the Financial Statements

The Acting Under Secretary of Defense (Comptroller)/DoD Chief Financial Officer acknowledged to us that the DoD Agency-Wide FY 2008 and FY 2007 Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (GAAP), and that DoD financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2008. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Accordingly, we did not perform auditing procedures required by U.S. Government auditing standards and Office of Management and Budget (OMB) Bulletin 07-04, "Audit Requirements for Federal Financial Statements," as amended,[1] to determine whether material amounts on the financial statements were fairly presented. Prior audits have identified, and DoD has also acknowledged, the long-standing material internal control weaknesses

[1] OMB Memorandum M-08-24, Technical Amendments to OMB Bulletin 07-04, "Audit Requirements for Federal Financial Statements," August 25, 2008.

identified in the Summary of Internal Control. These pervasive material weaknesses may affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the basic financial statements.[2] Therefore, we are unable to express, and we do not express, an opinion on the basic financial statements. Additionally, the purpose of the audit was not to express an opinion on Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information presented with the basic financial statements. Accordingly, we express no opinion on that information.

As discussed in Notes 6 and 25 to the basic financial statements, DoD restated the FY 2007 balance in Non-Federal Other Assets by $1.3 billion. DoD had incorrectly reported contract financing payments as expenses rather than assets in its FY 2007 financial statements because of legacy system deficiencies. This error affected the following accounts: Other Assets, Expenses, Unexpended Appropriations, Cumulative Results of Operations, and Net Position. These accounts affected various amounts reported on the following financial statements: Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position.

As discussed in Notes 20 and 25 to the basic financial statements, on September 30, 2007, DoD incorrectly reported disbursements of $1.3 billion in military pay that were actually paid on October 1, 2007. This resulted in an overstatement of FY 2007 outlays and an understatement of FY 2008 outlays. This error affected the following accounts: Delivered Orders-Obligations Paid, Delivered Orders-Obligations Unpaid, Accounts Payable, and Fund Balance with Treasury. These accounts affected various amounts reported on the Balance Sheet and the Statement of Budgetary Resources.

As discussed in Note 25, DoD changed its financial report presentation to separately report the Executive Office of the President activity not resulting from allocation transfers. The FY 2007 DoD financial statements included certain programs of the Executive Office of the President. However, revised guidance from OMB declared that these programs should be reported separately from the DoD financial statements. In addition, based on the OMB Circular A-136, "Financial Reporting Requirements," it was determined that only Executive Office of the President activity resulting from allocation transfers should be reported on the DoD financial statements. This change in reporting affected the following accounts: Total Assets ($36.8 billion), Total Liabilities ($33.2 billion), Net Cost of Operations ($19.7 billion), Net Position ($3.6 billion), and Total Budgetary Resources ($53.1 billion). These accounts affected various amounts reported on the following financial statements: Balance Sheet, Statement of Net Cost, Statement of Net Position, and Statement of Budgetary Resources.

[2] The annual financial statements include the basic financial statements, Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

Summary of Internal Control

In planning our work, we considered DoD internal control over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control.

Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified significant deficiencies, all of which are material, continued to exist in the following areas:

- **Financial Management Systems**
- **Fund Balance with Treasury**
- **Accounts Receivable**
- **Inventory**
- **Operating Materials and Supplies**
- **General Property, Plant, and Equipment**
- **Government-Furnished Material and Contractor-Acquired Material**
- **Accounts Payable**
- **Environmental Liabilities**
- **Statement of Net Cost**
- **Intragovernmental Eliminations**
- **Other Accounting Entries**
- **Reconciliation of Net Cost of Operations to Budget**

We did not identify any additional material weaknesses for FY 2008.

A material weakness is a significant deficiency, or a combination of significant deficiencies, resulting in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.[3]

[3] The term "remote" is defined as when the chance of a future event or events occurring is slight. Therefore, the likelihood of an event is "more than remote" when it is at least reasonably possible.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

A significant deficiency is a control deficiency, or a combination of control deficiencies, adversely affecting the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP. Significant deficiencies result in more than a remote likelihood that a misstatement of an entity's financial statements that is more than inconsequential will not be prevented or detected. The following significant deficiency continued to exist:

- **Contingent Legal Liabilities**

Internal control work that we conducted as part of our prior audits would not necessarily disclose all significant deficiencies. The Attachment offers additional details on significant deficiencies, most of which we consider to be material internal control weaknesses.

DoD reported all of the above weaknesses in its 2008 Statement of Assurance.

Summary of Compliance with Laws and Regulations

We limited our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting because management acknowledged that instances of noncompliance identified in prior audits continued to exist. The Acting Under Secretary of Defense (Comptroller)/DoD Chief Financial Officer acknowledged to us that DoD financial management systems do not substantially comply with Federal financial management system requirements, GAAP, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether DoD complied with all applicable laws and regulations related to financial reporting. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. See the Attachment for additional details on compliance with laws and regulations.

Management's Responsibilities

Management is responsible for:

- preparing the financial statements in conformity with GAAP;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met; and
- complying with applicable laws and regulations.

We provided a draft of this report to the Acting Under Secretary of Defense (Comptroller)/DoD Chief Financial Officer, who provided technical comments, which have been incorporated as appropriate. DoD officials expressed their continuing commitment to address the problems this report outlines.

Patricia A. Marsh

Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

Attachment:
As stated

Report on Internal Control and
Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing and maintaining effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; that the requirements of applicable laws and regulations are met; and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses and significant deficiencies that could adversely affect the DoD financial management operations.

Previously Identified Material Weaknesses. Management acknowledged that previously identified significant deficiencies, all of which are material, continued to exist in the following areas.

Financial Management Systems. Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," requires financial management system controls that are adequate to ensure that transactions: comply with budgetary and financial laws and other requirements; are consistent with the purposes authorized; and are recorded in accordance with Federal accounting standards. Statement of Federal Financial Accounting Concepts No. 1 also requires financial management system controls to ensure that assets are properly safeguarded to deter fraud, waste, and abuse; and that performance measurement information is adequately supported. The Acting Under Secretary of Defense (Comptroller)/ DoD Chief Financial Officer acknowledged that DoD financial management and feeder systems do not substantially comply with Federal financial management system requirements. DoD financial management and feeder systems were not designed to adequately support various material amounts on the financial statements. These deficiencies in financial management and feeder systems, as well as inadequate DoD business processes, prevent the DoD from collecting and reporting financial and performance information that is accurate, reliable, and timely.

Fund Balance with Treasury. Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities;" the U.S. Treasury Manual; and DoD Financial Management Regulation, 7000.14-R, require DoD to resolve financial and accounting inconsistencies to accurately report Fund Balance with Treasury. However, inconsistencies continue to exist related to in-transit disbursements, unmatched disbursements, negative unliquidated obligations, unreconciled differences in suspense accounts, and unreconciled differences between U.S. Treasury records and DoD accounting records. For example, the Air Force General Fund does not receive transaction-level data from other Components processing collection and disbursement data on its behalf. Therefore, there is no assurance that the Air Force can reconcile its reported balance of Fund Balance with Treasury to the balance the Treasury maintains.

Attachment

Accounts Receivable. According to Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," a receivable should be recognized when a Federal entity establishes a claim to cash or other assets against other entities, based on either legal provisions, or goods or services provided. DoD acknowledged that it is unable to accurately record, report, collect, and reconcile Intragovernmental Accounts Receivable, as well as accounts receivable due from the public. DoD identified Accounts Receivable as a material weakness based on its FY 2008 assessment of internal control over financial reporting, as required by OMB Circular A-123, Appendix A. Also, our Independent Auditor's reports on internal control for the FY 2008 Navy General and Working Capital Funds, Army General Fund, and the U.S. Army Corps of Engineers, Civil Works, revealed Accounts Receivable to be a material weakness. These Components' accounts represented approximately 58 percent of the DoD Agency-Wide combined Accounts Receivable balance as of September 30, 2008.

Inventory. Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," requires DoD to use the historical cost, the latest acquisition cost (adjusted for holding gains and losses), or the moving average cost for valuing inventory. However, DoD acknowledged that the existing inventory value for most activities is not reported in accordance with GAAP, and the Department's legacy systems do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standards No. 3. Also, DoD does not distinguish between Inventory Held for Sale and Inventory Held in Reserve for Future Sale, as required by Statement of Federal Financial Accounting Standards No. 3.

Operating Materials and Supplies. Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," states that Operating Materials and Supplies must be expensed when the items are consumed. DoD has acknowledged that significant amounts of Operating Materials and Supplies were expensed when purchased, instead of when consumed. In addition, DoD cannot accurately report the value of operating materials and supplies, which causes the potential for a misstatement in financial reporting.

General Property, Plant, and Equipment. Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," requires DoD to record General Property, Plant, and Equipment at acquisition cost; capitalize improvement costs; and recognize depreciation expense. However, the cost and depreciation of the DoD General Property, Plant, and Equipment are not reliably reported because of: (1) an accounting requirement that classified military equipment as General Property, Plant, and Equipment (such costs were previously expensed); (2) a lack of supporting documentation for aged General Property, Plant, and Equipment items; and (3) a failure to integrate most legacy property and logistics systems with acquisition and financial systems. Also, DoD property and logistics systems were not designed to capture acquisition cost and the cost of modifications and upgrades, or to calculate depreciation. DoD has acknowledged that it does not currently meet GAAP for the financial reporting of personal property and that documentation for personal property is neither accurate nor reliable. In addition, DoD does not have adequate internal controls in place to provide reasonable assurance that real property assets are identified and properly reported in its financial reports. DoD has also acknowledged that its inability to accurately report the value of military equipment increases the risk that the financial statements are materially misstated.

Government-Furnished Material and Contractor-Acquired Material. Statement of Federal Financial Accounting Standards No. 11, "Amendments to Accounting for Property, Plant, and Equipment," requires that property and equipment in the possession of a contractor for use in accomplishing a contract be considered Government property. Such property should be accounted for based on the nature of the item, regardless of who has possession. DoD has acknowledged that it is unable to comply with these requirements for Government-Furnished Material and Contractor-Acquired Material. As a result, the value of DoD property and material in the possession of contractors is not reliably reported.

Accounts Payable. According to Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government," a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future. DoD acknowledged that it does not meet accounting standards for the financial reporting of public accounts payable. DoD cannot support its Accounts Payable balances because it lacks standard procedures for recording, reporting, and reconciling the amounts among the financial, accounting, and reporting systems. DoD identified Accounts Payable as a material weakness based on its FY 2008 assessment of internal control over financial reporting, as required by OMB Circular A-123, Appendix A. Additionally, our Independent Auditor's reports on Internal Control for the FY 2008 Army General and Working Capital Funds; Navy General and Working Capital Funds; and the U.S. Army Corps of Engineers, Civil Works, identified Accounts Payable as a material weakness. These Components represented more than 55 percent of the DoD Agency-Wide combined Accounts Payable balance as of September 30, 2008.

Environmental Liabilities. DoD has acknowledged that its internal control for reporting environmental liabilities does not provide reasonable assurance that clean-up costs for all of its ongoing, inactive, closed, and disposal operations are identified, consistently estimated, and appropriately reported. In addition, guidance and audit trails for estimating environmental liabilities are insufficient, and the inventory of ranges and operational activities is incomplete. DoD has also acknowledged uncertainty regarding the accounting estimates used to calculate the reported Environmental Liabilities.

Statement of Net Cost. Statement of Federal Financial Accounting Standards Concepts No. 2, "Entity and Display," requires the Statement of Net Cost to provide an explanation of the net costs of each organization and each program. In addition, the Statement of Net Cost should provide gross and net cost information that can be related to the amounts of outputs and outcomes for the programs and organizations. DoD acknowledged the following deficiencies related to the Statement of Net Cost.

- The amounts presented for the General Funds may not report actual accrued costs.

- Although Working Capital Funds are generally recorded on an accrual basis, as required by GAAP, the systems do not always capture actual costs in a timely manner.

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- The Statement of Net Cost is not presented by program, in alignment with major goals and outputs described in DoD strategic and performance plans, as required by the Government Performance and Results Act.

- Revenues and expenses are reported by appropriation category because financial processes and systems do not collect costs according to performance measures.

Intragovernmental Eliminations. DoD disclosed that it cannot accurately identify most of its intragovernmental transactions by customer because DoD systems do not track the buyer and seller data needed to match related transactions. In addition, the Department is unable to fully reconcile intragovernmental transactions with all Federal partners. DoD acknowledged that its inability to reconcile most intragovernmental transactions results in adjustments that cannot be fully supported.

Other Accounting Entries. DoD acknowledged that it continues to enter material amounts of unsupported accounting entries. For example, Defense Finance and Accounting Service (DFAS), Indianapolis Operations recorded $595.8 billion in unsupported accounting entries to prepare the FY 2008 Army General Fund Financial Statements.

Reconciliation of Net Cost of Operations to Budget. Statement of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources," requires a reconciliation of proprietary and budgetary information to assist users in understanding the relationship between the net cost of operations and the budgetary resources obligated by the entity during the period. DoD acknowledged that it is unable to reconcile budgetary obligations to net costs without making unsupported adjustments. Specifically, budgetary data do not agree with proprietary expenses and capitalized assets. DoD made unsupported adjustments of $7 billion (absolute value) to reconcile obligations to the Statement of Net Cost.

Previously Identified Significant Deficiencies. As part of our financial-related audits, we noted the following significant deficiency, which continued to exist.

Contingent Legal Liabilities. Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government," as amended by Statement of Federal Financial Accounting Standards No. 12, "Recognition of Contingent Liabilities Arising from Litigation," requires contingent legal liabilities to be disclosed if there is at least a reasonable possibility that a loss may be incurred. We noted that significant deficiencies continued to exist regarding the DoD process for reporting contingent legal liabilities. Specific examples include the following.

- DoD excluded from its legal representation letters at least 94 pending cases, with a total claim amount of $4.3 billion, that individually did not meet the DoD Agency-Wide reporting threshold but in the aggregate exceeded this threshold.

- The legal representation letters from the DoD Office of General Counsel showed that DoD General Counsel was unable to express an opinion on the likely outcome of 45 (totaling $2.6 trillion) of 55 pending legal actions.

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These financial management deficiencies may cause inaccurate management information. As a result, DoD management decisions based in whole or in part on this information may be adversely affected. Financial information reported by DoD may also contain misstatements resulting from these deficiencies.

Compliance with Laws and Regulations

Management is responsible for complying with existing laws and regulations related to financial reporting. We limited our work to determine compliance with selected provisions of the applicable laws and regulations because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether DoD was in compliance with selected provisions of all applicable laws and regulations related to financial reporting. Our objective was not to, and we do not, express an opinion on overall compliance with applicable laws and regulations.

Federal Financial Management Improvement Act of 1996. The Federal Financial Management Improvement Act of 1996 requires DoD to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. The Federal Financial Management Improvement Act also requires DoD to develop a remediation plan when its financial management systems do not comply with Federal financial management systems requirements. The remediation plan is to include remedies, resources required, and milestones. For FY 2008, DoD did not fully comply with the Federal Financial Management Improvement Act of 1996. DoD acknowledged that many of its critical financial management and feeder systems did not substantially comply with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2008.

Government Performance and Results Act. Congress enacted the Government Performance and Results Act of 1993 (GPRA) to establish strategic planning and performance measurement in the Federal Government. Strategic plans, annual performance plans, and annual program performance reports represent the main elements of GPRA. DoD did not fully comply with the requirements of GPRA and subsequent implementation guidance in OMB Circular A-11, "Preparation, Submission, and Execution of the Budget." Specifically, DoD did not have a compliant strategic plan for FY 2008 because DoD designated the Quadrennial Defense Review report (which was prepared to fulfill the specific legislative requirements for a Quadrennial Defense Review) as its strategic plan, without consideration of other requirements specified in GPRA. As a result, the DoD budget and performance report for FY 2008 did not comply with the requirements of GPRA and OMB Circular A-11.

Antideficiency Act. Section 1341, title 31, United States Code (31 U.S.C. 1341) limits DoD and its agents to making or authorizing only expenditures or obligations that do not exceed the available appropriations or funds. Additionally, DoD or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. According to 31 U.S.C. 1351, if an officer or employee of an executive agency violates the Antideficiency Act (ADA), the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken. During FY 2008, DoD reported 14 cases of violation of the ADA. Therefore, DoD did not comply with the ADA, 31 U.S.C. 1341, and 31 U.S.C. 1351.

DoD internal guidance limits the time from the start of the investigation to reporting of ADA violations to 12 months. Our review of DoD ADA investigations of potential violations shows that DoD did not process the 14 ADA violation cases within 12 months.

Prompt Payment Act. According to the Prompt Payment Act (PPA), the payment date for an invoice is the date payment is due under the contract or 30 days after a proper invoice is received, if a specific payment date is not established by the contract. The PPA also states that an agency must make payments no earlier than 7 days prior to the payment due date unless the agency head or designee has determined (on a case-by-case basis) that earlier payment is necessary. The PPA also requires DoD to maintain an internal control environment in accordance with OMB Circular A-123, "Management's Responsibility for Internal Control," December 21, 2004. In prior audit reports, we identified internal control weaknesses within the DFAS Columbus Mechanization of Contract Administration Service (contractor payment system) that resulted in incorrect payments of interest to contractors. If controls governing compliance with PPA are not corrected, DFAS Columbus could continue to pay a significant number of interest payments incorrectly and violate the provisions of the PPA.

Improper Payments Information Act. DoD does not fully comply with the requirements of the Improper Payments Information Act of 2002, Public Law 107-300, and subsequent OMB guidance. Specifically, DoD was still in the process of developing procedures to implement OMB's August 2006 guidance that requires additional documentation related to the identification of improper payments. The new OMB guidance requires that when an agency is unable to discern whether a payment is proper because of insufficient documentation, the payment must be considered an error. In addition, DoD efforts to manage recovery audit contracts have been largely unsuccessful. The DoD needs to disseminate existing guidance to improve contracting for recovery audits and adhere to that guidance in reporting recovered funds.

In November 2006, to facilitate DoD compliance with OMB guidance, the Office of the Acting Under Secretary of Defense (Comptroller)/DoD Chief Financial Officer established a DoD Project Officer for Improper Payments and Recovery Auditing. The Project Officer reviews DoD statistical methodologies and processes to verify that its reporting is accurate, complete, and meets or exceeds OMB requirements. In May 2007, DoD held its first Defense Improper Payments Information Act Conference to facilitate identifying and reporting improper payments in the Department.

Audit Disclosures

The Acting Under Secretary of Defense (Comptroller)/DoD Chief Financial Officer acknowledged to us on April 7, 2008, that the DoD financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the financial statements, and previously identified material weaknesses continue to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: the Federal Credit Reform Act of 1990, the Pay and Allowance System for Civilian Employees, and the Provisions Governing Claims of the United States Government (including provisions of the Debt Collection Improvement Act of 1996).

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance with laws and regulations, because previous audit reports contained recommendations for corrective actions or because audit projects currently in progress will include appropriate recommendations.

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PRINCIPAL FINANCIAL STATEMENTS AND NOTES

The financial statements of the Department include four principal statements listed in Figure 2-1.

The statements, presented in Section 2, Financial Information, reflect the aggregate financial posture of the Department and include both the proprietary (federal accounting standards) and budgetary resources of the Department. The Department's financial management environment is large and complex, includes an asset base of $1.7 trillion, and more than 3 million military and civilian employees on installations in every state and around the world.

Figure 2-1. Four Principal Financial Statements

Statement	What Information It Provides
Balance Sheet	Reflects the Department's financial position as of the statement date (September 30, 2008). The assets are the amount of future economic benefits owned or managed by the Department. The liabilities are amounts owed by the Department. The net position is the difference between the assets and liabilities.
Statement of Net Cost	Shows separately the components of the net cost of the Department's operations for the period. Net cost is equal to the gross cost incurred by the Department less any exchange revenue earned from its activities.
Statement of Changes in Net Position	Presents the sum of the cumulative results of operations since inception and unexpended appropriations provided to the Department that remain unused at the end of the fiscal year. The statement focuses on how the net cost of operations is financed. The resulting financial position represents the difference between assets and liabilities as shown on the consolidated balance sheet.
Statement of Budgetary Resources	Provides information about how budgetary resources were made available as well as their status at the end of the period. It is the only financial statement exclusively derived from the Department's budgetary general ledger in accordance with budgetary accounting rules.

Department of Defense Consolidated Balance Sheet
Agency Wide

Dollars in Millions

	2008 Consolidated	Restated 2007 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 468,396.9	$ 396,530.7
Investments (Note 4)	394,508.5	333,711.0
Accounts Receivable (Note 5)	1,326.2	1,412.9
Other Assets (Note 6)	1,282.9	1,212.5
Total Intragovernmental Assets	**$ 865,514.5**	**$ 732,867.1**
Cash and Other Monetary Assets (Note 7)	2,804.8	2,591.1
Accounts Receivable, Net (Note 5)	7,784.5	7,451.4
Loans Receivable (Note 8)	236.0	212.2
Inventory and Related Property, Net (Note 9)	236,027.7	224,948.7
General Property, Plant and Equipment, Net (Note 10)	514,876.3	474,530.5
Investments (Note 4)	1,861.5	1,412.3
Other Assets (Note 6)	29,005.0	28,166.9
Stewardship Property, Plant & Equipment (Note 10)		
TOTAL ASSETS	**$ 1,658,110.3**	**$ 1,472,180.2**
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	1,687.4	1,911.5
Debt (Note 13)	262.6	307.0
Other Liabilities (Note 15)	11,709.8	11,420.8
Total Intragovernmental Liabilities	**$ 13,659.8**	**$ 13,639.3**
Accounts Payable (Note 12)	32,095.2	28,695.5
Military Retirement and Other Federal Employment Benefits (Note 17)	1,984,605.4	1,874,679.5
Environmental and Disposal Liabilities (Note 14)	70,505.9	72,489.9
Loan Guarantee Liability (Note 8)	24.5	25.0
Other Liabilities (Note 15)	34,107.6	29,286.4
Commitments & Contingencies (Note 16)		
TOTAL LIABILITIES	**$ 2,134,998.4**	**$ 2,018,815.6**
NET POSITION		
Unexpended Appropriations - Earmarked Funds (Note 23)	4.9	8.1
Unexpended Appropriations - Other Funds	446,864.3	378,190.7
Cumulative Results of Operations - Earmarked Funds	(1,345,925.0)	(1,280,107.2)
Cumulative Results of Operations - Other Funds	422,167.7	355,273.0
TOTAL NET POSITION	**$ (476,888.1)**	**$ (546,635.4)**
TOTAL LIABILITIES AND NET POSITION	**$ 1,658,110.3**	**$ 1,472,180.2**

The accompanying notes are an integral part of these financial statements.

Department of Defense Consolidated Statement of Net Cost
Agency Wide

Dollars in Millions

	2008 Consolidated	Restated 2007 Consolidated
Program Costs		
Gross Costs	$ 732,319.4	$ 646,987.0
(Less: Earned Revenue)	(56,272.5)	(45,575.6)
Net Program Costs	**$ 676,046.9**	**$ 601,411.4**
Net Cost of Operations	**$ 676,046.9**	**$ 601,411.4**

The accompanying notes are an integral part of these financial statements.

Department of Defense Consolidated Statement of Changes in Net Position
Agency Wide

Dollars in Millions

For Periods ended September 30, 2008 and 2007	2008 Earmarked Funds	2008 All Other Funds	2008 Eliminations	2008 Consolidated	Restated 2007 Earmarked Funds	Restated 2007 All Other Funds	Restated 2007 Eliminations	Restated 2007 Consolidated
Cumulative Results Of Operations								
Beginning Balances	$ (1,211,821.2)	$ 285,681.6	$ 0	$ (926,139.6)	$ (1,206,769.4)	$ 306,618.6	$ 0	$ (900,150.8)
Adjustments:								
Changes in accounting principles	0	0	0	0	0	(4,230.9)	0	(4,230.9)
Corrections of errors	0	1,305.4	0	1,305.4	0	0	0	0
Beginning balances, as adjusted	**$ (1,211,821..2)**	**$ 286,987.0**	**$ 0**	**$ (924,834.2)**	**$ (1,206,769.4)**	**$ 302,387.7**	**$ 0**	**$ (904,381.7)**
Budgetary Financing Sources:								
Appropriations used	3.2	662,422.0	0	662,425.2	3.3	581,262.3	0	581,265.6
Nonexchange revenue	3,634.8	84.6	0	3,719.4	3,076.9	19.5	0	3,096.4
Donations and forfeitures of cash and cash equivalents	34.1	0	0	34.1	63.8	0	0	63.8
Transfers(in/out without reimbursement)	(718.6)	877.6	0	159.0	200.2	(78.4)	0	121.8
	0	(1.0)	0	(1.0)	0	0	0	0
Other Financing Sources (Non-Exchange)								
Donations and forfeitures of property	0	1.5	0	1.5	0	13.8	0	13.8
Transfers(in/out without reimbursement)	(436.1)	384.9	0	(51.2)	243.3	(230.5)	0	12.8
Imputed financing	0	16,098.1	11,923.2	4,174.9	0	14,813.4	10,392.1	4,421.3
	(12.1)	6,674.0	0	6,661.9	(21.8)	(8,014.8)	0	(8,036.6)
Total Financing Sources	**$ 2,505.3**	**$ 686,541.7**	**$ 11,923.2**	**$ 677,123.8**	**$ 3,565.7**	**$ 587,785.3**	**$ 10,392.1**	**$ 580,958.9**
Net Cost of Operations	50,377.1	637,593.0	11,923.2	676,046.9	8,617.5	603,186.0	10,392.1	601,411.4
Net Change	**$ (47,871.8)**	**$ 48,948.7**	**$ 0**	**$ 1,076.9**	**$**	**$ (15,400.7)**	**$ 0**	**$ (20,452.5)**
Cumulative Results of Operations	**$ (1,259,693.0)**	**$ 335,935.7**	**$ 0**	**$ (923,757.3)**	**$ (1,211,821.2)**	**$ 286,987.0**	**$ 0**	**$ (924,834.2)**
Unexpended Appropriations								
Beginning Balances	8.1	378,190.7	0	378,198.8	11.4	307,698.0	0	307,709.4
Adjustments:								
Changes in accounting principles	0	0	0	0	0	3,745.5	0	3,745.5
Beginning balances, as adjusted	**$ 8.1**	**$ 378,190.7**	**$ 0**	**$ 378,198.8**	**$ 11.4**	**$ 311,443.5**	**$ 0**	**$ 311,454.9**
Budgetary Financing Sources:								
Appropriations received	0	742,587.3	0	742,587.3	0	653,684.9	0	653,684.9
Appropriations transferred (in/out)	0	(434.4)	0	(434.4)	0	(190.2)	0	(190.2)
Other adjustments	0	(11,057.3)	0	(11,057.3)	0	(5,485.2)	0	(5,485.2)
Appropriations used	(3.2)	(662,422.0)	0	(662,425.2)	(3.3)	(581,262.3)	0	(581,265.6)
Total Budgetary Financing Sources	**$ (3.2)**	**$ 68,673.6**	**$ 0**	**$ 68,670.4**	**$ (3.3)**	**$ 66,747.2**	**$ 0**	**$ 66,743.9**
Unexpended Appropriations	**$ 4.9**	**$ [illegible]**	**$ 0**	**$ [illegible]**	**$ 8.1**	**$ [illegible]**	**$ 0**	**$ [illegible]**
Net Position	**$ (1,259,688.1)**	**$ 782,800.0**	**$ 0**	**$ (476,888.1)**	**$ (1,211,813.1)**	**$ 665,177.7**	**$ 0**	**$ (546,635.4)**

The accompanying notes are an integral part of these financial statements.

Department of Defense Combined Statement Of Budgetary Resources Agency Wide *Dollars in Millions*	Budgetary Financing Accounts		Nonbudgetary Financing Accounts	
	2008 Combined	Restated 2007 Combined	2008 Combined	Restated 2007 Combined
Budgetary Resources				
Unobligated balance, brought forward, October 1	$ 111,980.6	$ 85,778.0	$ 25.5	$ 31.5
Recoveries of prior year unpaid obligations	49,744.1	44,862.5	0	0
Budget authority				
Appropriation	859,403.8	741,888.3	0	0
Borrowing authority	0	0	130	371.4
Contract authority	78,927.8	68,668.0	0	0
Spending authority from offsetting collections				
Earned:				
Collected	174,493.0	164,627.1	53.9	13.6
Change in receivables from federal sources	791.8	(1,277.6)	0	0
Change in unfilled customer orders:				
Advance received	753.2	448.9	0	0
Without advance from federal sources	5,679.1	5,994.0	12.6	53.5
Expenditure transfers from trust funds	766	0	0	0
Subtotal	**$ 1,120,814.7**	**$ 980,348.7**	**$ 196.5**	**$ 438.5**
Nonexpenditure transfers, net, anticipated and actual	(264.1)	(111.3)	0	0
Temporarily not available pursuant to Public Law	(59,949.4)	(33,819.5)	0	0
Permanently not available	(85,156.8)	(74,763.9)	(27.6)	(1.8)
Total Budgetary Resources	**$ 1,137,169.1**	**$ 1,002,294.5**	**$ 194.4**	**$ 468.2**
Status of Budgetary Resources				
Obligations incurred:				
Direct	811,662.0	719,463.4	168.1	442.7
Reimbursable	189,837.4	170,850.3	0	0
Subtotal	**$ 1,001,499.4**	**$ 890,313.7**	**$ 168.1**	**$ 442.7**
Unobligated balance:				
Apportioned	120,047.8	98,585.7	0.3	0.2
Exempt from apportionment	1,060.7	1,050.5	0	0
Subtotal	**$ 121,108.5**	**$ 99,636.2**	**$ 0.3**	**$ 0.2**
Unobligated balance not available	14,561.2	12,344.6	26.0	25.3
Total status of budgetary resources	**$ 1,137,169.1**	**$ 1,002,294.5**	**$ 194.4**	**$ 468.2**

The accompanying notes are an integral part of these financial statements.

Department of Defense Combined Statement of Budgetary Resources Agency Wide *Dollars in Millions*	Budgetary Financing Accounts		Nonbudgetary Financing Accounts	
	2008 Combined	Restated 2007 Combined	2008 Combined	Restated 2007 Combined
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	372,558.6	321,809.1	768.0	378.5
Less: Uncollected customer payments from federal sources, brought forward, October 1	(60,131.3)	(55,414.9)	(130.4)	(76.9)
Total unpaid obligated balance	**$ 312,427.3**	**$ 266,394.2**	**$ 637.6**	**$ 301.6**
Obligations incurred net	1,001,499.4	890,313.7	168.1	442.7
Less: Gross outlays	(892,195.4)	(794,701.2)	(63.2)	(53.1)
Less: Recoveries of prior year unpaid obligations, actual	(49,744.1)	(44,862.5)	0	0
Change in uncollected customer payments from federal sources	(6,470.9)	(4,716.4)	(12.6)	(53.5)
Obligated balance, net, end of period				
Unpaid obligations	432,118.5	372,559.1	872.9	768.1
Less: Uncollected customer payments (+/-) from federal sources	(66,602.2)	(60,131.3	(143.0)	(130.4)
Total, unpaid obligated balance, net, end of period	**$ 365,516.3**	**$ 312,427.8**	**$ 729.9**	**$ 637.7**
Net Outlays				
Net Outlays:				
Gross outlays	892,195.4	794,701.2	63.2	53.1
Less: Offsetting collections	(176,012.2)	(165,076.0)	(53.9)	(13.6)
Less: Distributed offsetting receipts	(70,247.6)	(48,272.0)	0	0
Net Outlays	**$ 645,935.6**	**$ 581,353.2**	**$ 9.3**	**$ 39.5**

The accompanying notes are an integral part of these financial statements.

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense, as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the Department in accordance with, and to the extent possible, U.S. generally accepted accounting principles (USGAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB), OMB Circular No. A-136, "Financial Reporting Requirements," and the "DoD Financial Management Regulation." The accompanying financial statements account for all resources for which the Department is responsible unless otherwise noted. Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is not discernable.

The Department is unable to fully implement all elements of USGAAP and OMB Circular No. A-136 due to limitations of financial and nonfinancial management processes and systems that support the financial statements. The Department derives reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistics systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with USGAAP. The Department continues to implement process and system improvements addressing these limitations.

The Office of Management and Budget requires financial statements of the following Department reporting activities to undergo audits: Army General Fund, Army Working Capital Fund, Navy General Fund, Navy Working Capital Fund, Air Force General Fund, Air Force Working Capital Fund, Military Retirement Fund, and U.S. Army Corps of Engineers (Civil Works).

In addition, the Department requires the Medicare-Eligible Retiree Health Care Fund, Marine Corps General and Working Capital Funds, and the following Defense Agencies to prepare internal stand-alone auditable financial statements: Defense Logistics Agency, Defense Finance and Accounting Service, Defense Information Systems Agency, Defense Contract Audit Agency, Defense Commissary Agency, Defense Security Service, Defense Threat Reduction Agency, Defense Advanced Research Projects Agency, Chemical and Biological Defense Program, Missile Defense Agency, Services Medical Activity, TRICARE Management Activity, and U.S. Special Operations Command.

The Department has 13 auditor-identified material weaknesses: (1) Accounts Payable, (2) Accounting Entries, (3) Environmental Liabilities, (4) Government Property and Materiel in Possession of Contractors, (5) Intragovernmental Eliminations, (6) Operating Materiel and Supplies, (7) Reconciliation of Net Cost of Operations to Budget (formerly Statement of Financing), (8) Statement of Net Cost, (9) Financial Management Systems, (10) Fund Balance with Treasury, (11) General Property, Plant, and Equipment, (12) Inventory, and (13) Accounts Receivable. Refer to Section 3: Other Accompanying Information for additional details relative to the Department's challenges and recognized weaknesses.

1.B. Mission of the Reporting Entity

The Department of Defense was established by the National Security Act of 1947. The Department provides the military forces needed to deter war and protect the security of our country. Since the creation of America's first army in 1775, the Department and predecessor organizations have evolved into a global presence with a worldwide infrastructure dedicated to defending the United States by deterring and defeating aggression and coercion in critical regions.

The Department of Defense includes the Military Departments and the Defense Agencies. The Military Departments consist of the Army, the Navy (of which the Marine Corps is a component), and the Air Force. The Defense Agencies provide support services commonly used throughout the Department.

1.C. Appropriations and Funds

The Department receives appropriations and funds as general, working capital (revolving), trust, special, and deposit funds. The Department uses these appropriations and funds to execute missions and subsequently report on resource usage.

General Funds are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and military construction.

Working Capital Funds (WCF) received funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. The corpus finances operations and transactions that flow through the fund. The WCF resources the goods and services sold to customers on a reimbursable basis and maintains the corpus. Reimbursable receipts fund future operations and generally are available in their entirety for use without further congressional action. At various times, Congress provides additional appropriations to supplement the WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute. Special fund accounts are used to record government receipts reserved for a specific purpose. Certain trust and special funds may be designated as earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. The Department is required to separately account for and report on the receipt, use and retention of revenues and other financing sources for earmarked funds.

Deposit funds are used to record amounts held temporarily until paid to the appropriate government or public entity. They are not Department funds, and as such, are not available for the Department's operations. The Department is acting as an agent or custodian for funds awaiting distribution.

The Department is a party to allocation transfers with other federal entities as a transferring (parent) or receiving (child) entity. Allocation transfers are an entities' legal delegation of authority to obligate budget authority and outlay funds to another entity. Generally, all financial activity related to allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity. Exceptions to this general rule apply to specific funds for which OMB has directed that all activity be reported in the financial statements of the child entity. These exceptions include U.S. Treasury-Managed Trust Funds, Executive Office of the President (EOP), and all other funds specifically designated by OMB. Based on an agreement with OMB, funds for Security Assistance programs are reported separately from the Department's financial statements and notes beginning in the 3rd Quarter, FY 2008.

The Department receives allocation transfers from the following agencies: Departments of Agriculture, Interior, Energy, and Transportation; the Appalachian Regional Commission; and the Federal Highway Administration.

Additionally, the Department receives allocation transfers from certain funds meeting the OMB exception and all related activity is included in the Department's financial statements. The exceptions reported by the Department include South Dakota Terrestrial Wildlife Habitat Restoration, Inland Waterways and Harbor Maintenance, and the EOP other than funds executed by Defense Security Cooperation Agency (DSCA) for Security Assistance.

As the parent, the Department allocates funds to the Departments of Transportation and Agriculture, and reports related activity in these financial statements.

1.D. Basis of Accounting

For FY 2008, the Department's financial management systems are unable to meet all full accrual accounting requirements. Many of the Department's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of USGAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by USGAAP. Most of the Department's financial and nonfinancial legacy systems were designed to record information on a budgetary basis.

The Department is determining the actions required to bring financial and nonfinancial feeder systems and processes into compliance with USGAAP. One such action is the current revision of accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). Until all Department financial and nonfinancial feeder systems and processes are able to collect and report financial information as required by USGAAP, the Department's financial data will be derived from budgetary transactions (obligations, disbursements, and collections), from nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, and environmental liabilities.

1.E. Revenues and Other Financing Sources

The Department receives congressional appropriations as financing sources for general funds that expire annually, on a multiyear basis, or do not expire. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The Department recognizes revenue as a result of costs incurred for goods and services provided to other federal agencies and the public. Full-cost pricing is the Department's standard policy for services provided as required by OMB Circular A-25, "User Charges." The Department recognizes revenue when earned within the constraints of its current system capabilities. In some instances, revenue is recognized when bills are issued.

Depot Maintenance and Ordnance WCF activities recognize revenue according to the percentage of completion method. Supply Management WCF activities recognize revenue from the sale of inventory items.

The Department does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and Note 21, “Reconciliation of Net Cost of Operations to Budget.” The U.S. has cost sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

1.F. Recognition of Expenses

For financial reporting purposes, the Department's policy requires the recognition of operating expenses in the period incurred. Current financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis. Estimates are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. In the case of Operating Materiel and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to transition to the consumption method for recognizing OM&S expenses. Under the consumption method, OM&S would be reported in expenses when consumed. Due to system limitations, in some instances expenditures for capital and other long-term assets may be recognized as operating expenses. The Department continues to implement process and system improvements to address these limitations.

1.G. Accounting for Intragovernmental Activities

Accounting standards require that an entity eliminates intraentity activity and balances from consolidated financial statements in order to prevent overstatement for business with itself. However, the Department cannot accurately identify intragovernmental transactions by customer because the Department's systems do not track buyer and seller data at the transaction level. Generally, seller entities within the Department provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal Department accounting offices. In most cases, the buyer-side records are adjusted to agree with the Department's seller-side balances and are then eliminated. The volume of intragovernmental transactions is so large that reconciliations cannot be accomplished effectively. The Department is developing long-term system improvements to ensure accurate intragovernmental information, including developing sufficient up-front edits and controls, eliminating the need for reconciliations.

The U.S. Treasury's "Federal Intragovernmental Transactions Accounting Policies Guide" and Treasury Financial Manual Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government," provide guidance for reporting and reconciling intragovernmental balances. While the Department is unable to fully reconcile intragovernmental transactions with all federal agencies, the Department is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management.

The Department's proportionate share of public debt and related expenses of the Federal government is not included. The Federal government does not apportion debt and related costs to federal agencies. The Department's financial statements do not report any public debt, interest, or source of public financing, whether from issuance of debt or tax revenues. Generally, financing for the construction of the Department's facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the U.S. Treasury does not allocate such costs to the Department.

1.H. Transactions with Foreign Governments and International Organizations

Each year, the Department sells defense articles and services to foreign governments and international organizations under the provisions of the Arms Export Control Act of 1976. Under the provisions of this Act, the Department has authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to the Federal government. Payment in U.S. dollars is required in advance.

1.I. Funds with the U.S. Treasury

The Department's monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of Defense Finance and Accounting Service, the Military Departments, the U.S. Army Corps of Engineers, and the Department of State's financial service centers process the majority of the Department's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports to the U.S. Treasury of checks issued, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS sites and USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. On a monthly basis, the Department's FBWT is adjusted to agree with the U.S. Treasury's accounts.

1.J. Foreign Currency

Cash is the total of cash resources under the control of the Department, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and nonpurchased foreign currencies held in foreign currency fund accounts. Foreign currency is valued using the U.S. Treasury prevailing rate of exchange.

The majority of cash and all foreign currency is classified as "nonentity" and is restricted. Amounts reported consist primarily of cash and foreign currency held by disbursing officers to carry out their paying, collecting, and foreign currency accommodation exchange missions. Cash seized during Operation Iraqi Freedom is restricted to assist the Iraqi people and support the restoration of Iraq.

The Department conducts a significant portion of operations overseas. Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations: operation and maintenance, military personnel, military construction, family housing operation and maintenance, and family housing construction. The gains and losses are calculated as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The Department does not separately identify foreign currency fluctuation transactions.

1.K. Accounts Receivable

Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. Allowances for uncollectible accounts due from the public are based upon an analysis of collection experience by fund type. The Department does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual at http://www.fms.treas.gov/tfm/vol1/07-03.pdf.

1.L. Direct Loans and Loan Guarantees

The Department operates a direct loan and loan guarantee program authorized by the National Defense Authorization Act for FY 1996 (Public Law (PL) 104-106, Section 2801). The Act includes a series of authorities that allow the Department to work with the private sector to renovate military housing. The Department's goals are to obtain private capital to leverage government dollars, make efficient use of limited resources, and use a variety of private sector approaches to build and renovate military housing faster and at a lower cost to the American taxpayers.

The Act also provides the Department with a variety of authorities to obtain private sector financing and expertise to improve military housing. The Department uses these authorities individually or in combination. They include guarantees (both loan and rental), conveyance/leasing of existing property and facilities, differential lease payments, investments (both limited partnerships and stock/bond ownership), and direct loans.

The National Defense Authorization Act for FY 2005 (PL 108-375, Section 2805) provided permanent authorities to the Military Housing Privatization Initiative (MHPI).

The Department operates the Armament Retooling and Manufacturing Support Initiative under Title 10 United States Code 4551-4555. This loan guarantee program is designed to encourage commercial use of inactive government facilities. The revenue generated from property rental offsets the cost of maintaining these facilities.

The Department administers the Foreign Military Financing program on behalf of the EOP. This program is authorized by sections 23 and 24 of the Arms Export Control Act of 1976, as amended, PL 90-629, as amended, and section 503(a). This program provides loans to help countries purchase U.S. produced weapons, defense equipment, services, or military training. The direct loans and loan guarantees related to Foreign Military Sales are not included in these financial statements as of the 3rd Quarter, FY 2008, per the Department's agreement with OMB.

The Federal Credit Reform Act of 1990 governs all amended direct loan obligations and loan guarantee commitments made after FY 1991.

1.M. Inventories and Related Property

The Department values approximately 65 percent of resale inventory using the moving average cost method. An additional 15 percent (fuel inventory) is reported using the first-in-first-out method. The Department reports the remaining 20 percent of resale inventories at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (PL 104-208). The Department is continuing to transition the balance of the inventories to the moving average cost method through the use of new inventory systems. Most transitioned balances were not baselined to auditable historical cost and remain noncompliant with SFFAS No. 3.

The Department manages only military or government-specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment. Items commonly used in and available from the commercial sector are not managed in the Department's materiel management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The Department holds materiel based on military need and support for contingencies. The Department does not attempt to account separately for "inventory held for sale" and "inventory held in reserve for future sale" based on SFFAS No. 3 definitions, unless otherwise noted.

Related property includes OM&S and stockpile materiel. OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the Department uses the purchase method. Under this method, materiel and supplies are expensed when purchased. During FY 2008, the Department expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for the Department and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

The Department determined that the recurring high dollar-value of OM&S in need of repair is material to the financial statements and requires a separate reporting category. Many high-dollar items, such as aircraft engines, are categorized as OM&S rather than military equipment.

The Department recognizes condemned materiel as "excess, obsolete, and unserviceable." The cost of disposal is greater than the potential scrap value, therefore, the net value of condemned materiel is zero. Potentially redistributable materiel, classified in previous years as "excess, obsolete, and unserviceable," is included in the "held for use" or "held for repair" categories.

Inventory available and purchased for resale includes consumable spare and repair parts, and repairable items owned and managed by the Department. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make it suitable for sale. Often, it is more economical to repair these items rather than to procure them. The Department often relies on weapon systems and machinery no longer in production. As a result, the Department supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Work in process balances include: (1) costs related to the production or servicing of items, including direct material, labor, and applied overhead; (2) the value of finished products or completed services that are yet to be placed in service; and (3) munitions in production and depot maintenance work with associated costs incurred in the delivery of maintenance services.

1.N. Investments in U.S. Treasury Securities

The Department reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized over the term of the investments using the effective interest rate method or another method that yields similar results. The Department's intent is to hold investments to maturity unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities.

The Department invests in nonmarketable market-based U.S. Treasury securities. These securities are issued by the Treasury's Bureau of Public Debt to federal agencies. They are not traded on any securities exchange but mirror the prices of particular U.S. Treasury securities traded in the government securities market.

The Department's net investments are held by various trust and special funds. These funds include the Military Retirement Fund; Medicare-Eligible Retiree Health Care Fund; Other Defense Organizations General Fund trust and special funds; donations (gift funds); and the United States Army Corps of Engineers (USACE) South Dakota Terrestrial Habitat Restoration, Inland Waterways, and Harbor Maintenance Trust Fund accounts.

Other investments represent joint ventures with private developers constructing or improving military housing on behalf of the Department under the authority of the MHPI, authorized by PL 104-106, Section 2801. These investments do not require market value disclosure. The Department's potential losses on these ventures are limited to the amounts invested.

1.O. General Property, Plant and Equipment

The Department uses the estimated historical cost for valuing military equipment. The Department identified the universe of military equipment by accumulating information relating to program funding and associated military equipment, equipment useful life, program acquisitions, and disposals to establish a baseline. The military equipment baseline is updated using expenditure, acquisition, and disposal information.

The Department's General Property, Plant, and Equipment (General (PP&E)) capitalization threshold is $100 thousand except for real property, which is $20 thousand. The Department has not fully implemented the threshold for real property. Therefore, the Department is primarily using the capitalization threshold of $100 thousand for General PP&E and most real property.

With the exception of USACE Civil Works and WCF, General PP&E assets are capitalized at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the Department's capitalization threshold. The Department also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed the Department's capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The Department depreciates all General PP&E, other than land, on a straight-line basis.

The WCF capitalizes all General PP&E used in the performance of the mission, whether or not the assets meet the definition of any other General PP&E category.

The USACE Civil Works General PP&E is capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and the acquisition cost exceeds $25 thousand. The exception is buildings and structures related to hydropower projects which are capitalized regardless of cost.

When it is in the best interest of the government, the Department provides government property to contractors to complete contract work. The Department either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E meets or exceeds the Department's capitalization threshold, federal accounting standards require that it be reported on the Department's Balance Sheet.

The Department developed policy and a reporting process for contractors with government furnished equipment that provides appropriate General PP&E information for financial statement reporting. The Department requires that entities maintain, in their property systems, information on all property furnished to contractors. These actions are structured to capture and report the information necessary for compliance with federal accounting standards.

1.P. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, the Department's policy is to record advances or prepayments in accordance with USGAAP. As such, payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The Department's policy is to expense and/or properly classify assets when the related goods and services are received. The Department has not fully implemented this policy primarily due to system limitations.

1.Q. Leases

Lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), and the value equals or exceeds the current capitalization threshold, the Department records the applicable asset as though purchased, with an offsetting liability, and depreciates it. The Department records the asset and liability at the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The Department, as the lessee, receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risks of ownership. Payments for operating leases are expensed over the lease term as they become payable.

Office space and leases entered into by the Department in support of contingency operations are the largest component of operating leases based on costs gathered from existing leases, General Services Administration bills, and interservice support agreements. Future year projections use the consumer price index.

1.R. Other Assets

Other assets include those assets, such as military and civil service employee pay advances, travel advances, and certain contract financing payments that are not reported elsewhere on the Department's Balance Sheet.

The Department conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the Department may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulation, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the government. Contract financing payment clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on cost, and interim payments under certain cost reimbursement contracts. It is the Department's policy to record certain contract financing payments as other assets.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion. The Defense Federal Acquisition Regulation Supplement authorizes progress payments based on a percentage or stage of completion only for construction of real property, shipbuilding and ship conversion, alteration, or repair. Progress payments for real property and ships are reported as construction-in-progress.

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The Department recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist, but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The Department's risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as aircraft, ship and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for the Department's assets. This type of liability has two components: nonenvironmental and environmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Based on the Department's policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of the Federal Government," nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. The Department recognizes nonenvironmental disposal liabilities for military equipment nuclear-powered assets when placed into service. These amounts are not easily distinguishable and are developed in conjunction with environmental disposal costs.

1.T. Accrued Leave

The Department reports liabilities for military leave and accrued compensatory and annual leave for civilians. Sick leave for civilians is expensed when taken. The liability is based on current pay rates.

1.U. Net Position

Net position consists of unexpended appropriations and cumulative results of operations.

Unexpended appropriations represents amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative results of operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. Beginning with FY 1998, cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

1.V. Treaties for Use of Foreign Bases

The Department has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The Department purchases capital assets overseas with appropriated funds, however, the host country retains title to the land and capital improvements. Treaty terms generally allow the Department continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, use of the foreign bases is prohibited and losses are recorded for the value of any nonretrievable capital assets. The settlement due to the U.S. or host nation is negotiated and takes into account the value of capital investments and may be offset by the cost of environmental cleanup.

1.W. Comparative Data

The Department's financial statements and notes are presented on a comparative basis.

1.X. Unexpended Obligations

The Department obligates funds to provide goods and services for outstanding orders not yet delivered. Unless title has passed, the financial statements do not reflect a liability for the payment of goods and services not yet delivered. Unexpended obligations includes both obligations for which goods and services have been delivered (title passed) and a liability recognized, and obligations for which no delivery has occurred and no liability recognized. The balance of unexpended obligations appears immediately before net outlays in the Statement of Budgetary Resources, and is referred to as "Total, unpaid obligated balances, net, end of period."

1.Y. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury.

Supported disbursements and collections are evidenced by collaborating documentation. Unsupported disbursements and collections do not have supporting documentation for the transaction and most likely would not meet audit scrutiny.

The Department's policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported, undistributed disbursements are recorded in accounts payable. Unsupported, undistributed collections are recorded in other liabilities.

Note 2. Nonentity Assets

Nonentity Assets				Dollars in Millions
As of September 30		2008		Restated 2007
Intragovernmental Assets				
Fund Balance with Treasury	$	1,170.2	$	1,399.5
Accounts Receivable		0.1		0.9
Total Intragovernmental Assets	**$**	**1,170.3**	**$**	**1,400.4**
Nonfederal Assets				
Cash and Other Monetary Assets	$	2,681.8	$	2,442.7
Accounts Receivable		5,054.6		5,144.9
Other Assets		183.4		186.0
Total Nonfederal Assets	**$**	**7,919.8**	**$**	**7,773.6**
Total Nonentity Assets	**$**	**9,090.1**	**$**	**9,174.0**
Total Entity Assets		**1,649,020.2**		**1,463,006.2**
Total Assets	**$**	**1,658,110.3**	**$**	**1,472,180.2**

Nonentity assets are assets for which the Department maintains stewardship accountability and reporting responsibility but are not available for the Department's normal operations.

Intragovernmental Fund Balance with Treasury (FBWT) consists of deposit funds, seized Iraqi cash, and the Development Fund for Iraq (DFI). Deposit funds are generally used to record amounts held temporarily until paid to the appropriate party. Humanitarian relief and reconstruction deposit funds are funds held for expenditures on behalf of the Iraqi people. Seized Iraqi cash is former Iraqi regime monies confiscated by coalition forces and restricted for support of the Iraqi people. The DFI consists of proceeds from Iraqi oil sales, repatriated assets from the United States and other nations, and deposits from unencumbered oil-for-food proceeds. DFI funds are restricted for Iraqi infrastructure and other Iraqi support needs.

Nonfederal Cash and Other Monetary Assets primarily consists of cash held by Disbursing Officers to carry out payment, collection, and foreign currency accommodation exchange missions.

Nonfederal Accounts Receivable consists of amounts due for canceled year appropriations; and interest, fines and penalties due on debt. Generally, the Department cannot use the collections and must distribute them to the U.S. Treasury. The Department has specific statutory authority to retain collections from certain canceled year accounts receivable as entity assets.

Nonfederal Other Assets primarily consists of an Advance Payment Pool Agreement with a nonprofit educational institution to finance research and development projects.

Note 3. Fund Balance with Treasury

Fund Balance with Treasury As of September 30	2008		Restated 2007	
Dollars in Millions				
Fund Balance				
Appropriated Funds	$	455,876.7	$	382,107.3
Revolving Funds		8,978.8		11,021.1
Trust Funds		1,818.5		1,019.0
Special Funds		436.4		396.5
Other Fund Types		1,286.5		1,986.8
Total Fund Balance	**$**	**468,396.9**	**$**	**396,530.7**
Fund Balance Per Treasury Versus Agency				
Fund Balance per Treasury	$	473,736.8	$	399,862.9
Fund Balance per Agency		468,396.9		396,530.7
Reconciling Amount	**$**	**5,339.9**	**$**	**3,332.2**

The Department restated the FY 2007 balance in appropriated funds by $1.3 billion. On September 30, 2007, the military payroll due for disbursement on October 1st was processed one day early. The payroll was not actually paid to the soldiers until October 1st even though it appeared as disbursed in the Department's system. Since the processing of the payroll and the actual outlays for the payroll crossed over two fiscal years, the outlays in both fiscals years were incorrectly stated (overstated in FY 2007 and understated in FY 2008) and required correction. The restated amount of $1.3 billion impacted the Balance Sheet and Statement of Budgetary Resources.

Other Fund Types primarily consist of deposit funds, receipt accounts, clearing accounts, and Development Fund for Iraq.

The Department shows a reconciling net difference of $5.3 billion with the U.S. Treasury. This includes $5.1 billion in canceled appropriations, $268.4 million in unavailable receipt accounts, and ($29.2) million in allocation transfers.

Status of Fund Balance with Treasury As of September 30	2008		Restated 2007	
Dollars in Millions				
Unobligated Balances				
Appropriated Funds	$	121,096.4	$	99,165.6
Revolving Funds		401,136.6		338,321.9
Obligated Balance not yet Disbursed		432,553.3		373,327.3
Nonbudgetary FBWT		1,060.8		1,359.6
NonFBWT Budgetary Accounts		(487,450.2)		(415,643.7)
Total Fund Balance	**$**	**468,396.9**	**$**	**396,530.7**

The Status of Fund Balance with Treasury is the reconciliation between budgetary and proprietary accounts at Treasury. It consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursement against current or future obligations.

Unobligated Balance is classified as available or unavailable and represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. The unavailable balance consists primarily of funds invested in U.S. Treasury securities that are temporarily precluded from obligation by law. Certain unobligated balances are restricted for future use and are not apportioned for current use. Unobligated balances for trust fund accounts are restricted for use by the public law that established the funds.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods and services not received, and those received but not paid.

Nonbudgetary FBWT includes accounts that do not have budgetary authority, such as deposit funds, receipt accounts, clearing accounts, and nonentity FBWT.

NonFBWT Budgetary Accounts reduces the Status of FBWT and consists of investments in U.S. Treasury securities, unfilled customer orders without advance, contract and borrowing authority, and receivables.

Note 4. Investments and Related Interest

Investments and Related Interest					*Dollars in Millions*
	2008				
As of September 30	**Cost**	**Amortization Method**	**Amortized (Premium) / Discount**	**Investments, Net**	**Market Value Disclosure**
Intragovernmental Securities					
Nonmarketable, Market-Based					
Military Retirement Fund	$ 255,722.1	See Below	$ (5,423.8)	$ 250,298.3	$ 240,912.7
Medicare-Eligible Retiree Health Care Fund	135,483.4	See Below	(2,683.7)	132,799.7	127,002.4
US Army Corps of Engineers	4,790.4	See Below	(26.0)	4,764.4	4,909.9
Other Funds	2,382.0	See Below	(19.6)	2,362.4	2,391.2
Total Nonmarketable, Market-Based	**$ 398,377.9**		**$ (8,153.1)**	**$ 390,224.8**	**$ 375,216.2**
Accrued Interest	4,283.7			4,283.7	4,283.7
Total Intragovernmental Securities	**$ 402,661.6**		**$ (8,153.1)**	**$ 394,508.5**	**$ 379,499.9**
Other Investments					
Total Other Investments	**$ 1,861.5**		**$ 0.0**	**$ 1,861.5**	**N/A**
Amortization Method Used: Effective Interest					

Investments and Related Interest					Dollars in Millions
	2007				
As of September 30	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
Intragovernmental Securities					
Nonmarketable, Market-Based					
Military Retirement Fund	$ 222,030.5	See Below	$ (6,666.2)	$ 215,364.3	$ 212,242.6
Medicare-Eligible Retiree Health Care Fund	110,206.3	See Below	(1,762.9)	108,443.4	106,692.8
US Army Corps of Engineers	4,058.5	See Below	(44.1)	4,014.4	4,043.1
Other Funds	2,039.0	See Below	(11.5)	2,027.5	2,040.2
Total Nonmarketable, Market-Based	**$ 338,334.3**		**$ (8,484.7)**	**$ 329,849.6**	**$ 325,018.7**
Accrued Interest	3,861.4			3,861.4	3,861.4
Total Intragovernmental Securities	**$ 342,195.7**		**$ (8,484.7)**	**$ 333,711.0**	**$ 328,880.1**
Other Investments					
Total Other Investments	**$ 1,412.3**		**$ 0.0**	**$ 1,412.3**	**N/A**

Amortization Method Used: Effective Interest

Most of the Department's earmarked funds are invested in non-marketable, market-based securities that fluctuate in tandem with the current selling price of the equivalent marketable security on the open market. These securities are purchased with the intent to hold until maturity, thus balances are not adjusted to market value.

The Federal government does not set aside assets to pay future benefits and expenditures associated with earmarked funds. The cash generated from earmarked funds is deposited in the U.S. Treasury, which uses the cash for general government purposes. The U.S. Treasury securities are issued to the earmarked funds as evidence of earmarked fund receipts and are an asset to the Department and a liability to the U.S. Treasury. Because the Department of Defense and the U.S. Treasury are both part of the Federal government, these assets and liabilities offset each other from the standpoint of the Federal government as a whole. Therefore, they do not represent an asset or a liability in the U.S. Governmentwide financial statements.

The U.S. Treasury securities provide the Department with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the Department requires redemption of these securities, the Federal government finances the securities out of accumulated cash balances by raising taxes or other receipts, borrowing from the public or repaying less debt, or curtailing other expenditures. The Federal government uses the same method to finance all other expenditures.

Other Funds primarily consists of $1.7 billion in investments of the DoD Education Benefits Trust Fund and $511.6 million in investments of the Voluntary Separation Incentive Trust Fund.

Note 5. Accounts Receivable

Accounts Receivable				Dollars in Millions
	2008			Restated 2007
As of September 30	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
Intragovernmental Receivables	$ 1,326.2	N/A	$ 1,326.2	$ 1,412.9
Nonfederal Receivables (From the Public)	8,170.8	(386.3)	7,784.5	7,451.4
Total Accounts Receivable	**$ 9,497.0**	**$ (386.3)**	**$ 9,110.7**	**$ 8,864.3**

Accounts receivable represent the Department's claim for payment from other entities. The Department only recognizes an allowance for uncollectible amounts from the public. Claims with other federal agencies are resolved in accordance with the Intragovernmental Business Rules.

Note 6. Other Assets

Other Assets		Dollars in Millions
As of September 30	2008	Restated 2007
Intragovernmental Other Assets		
Advances and Prepayments	$ 1,158.0	$ 1,087.6
Other Assets	124.9	124.9
Total Intragovernmental Other Assets	**$ 1,282.9**	**$ 1,212.5**
Nonfederal Other Assets		
Outstanding Contract Financing Payments	27,312.1	26,152.0
Advances and Prepayments	1,282.8	1,549.6
Other Assets (With the Public)	410.1	465.3
Total Nonfederal Other Assets	**$ 29,005.0**	**$ 28,166.9**
Total Other Assets	**$ 30,287.9**	**$ 29,379.4**

The Department restated the FY 2007 balance in Nonfederal Other Assets by $1.3 billion. The Department incorrectly reported $1.3 billion of contract financing payments as expenses rather than assets in FY 2007. Refer to Note 25, Restatements, for additional details.

Intragovernmental Other Assets represents the Department's right to approximately 6 million barrels of crude oil held by the Department of Energy.

The balance of outstanding contract financing payments includes $25.9 billion in contract financing payments and an additional $1.4 billion in estimated future payments to the contractor upon delivery and government acceptance of a satisfactory product.

Contract terms and conditions for certain types of contract financing payments convey rights to the Department that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy. However, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Federal government. The Federal government does not have the right to take the work, except as provided for in contract clauses related to termination or acceptance, and the Department is not obligated to make payment to the contractor until delivery and acceptance.

The balance in Other Assets (With the Public) includes $183.1 million for an Advance Payment Pool Agreement with nonprofit institutions and $182 million for inventory returned to vendors pending credit.

Note 7. Cash and Other Monetary Assets

Cash and Other Monetary Assets		*Dollars in Millions*
As of September 30	2008	Restated 2007
Cash	$ 1,421.3	$ 1,470.1
Foreign Currency	1,383.5	1,121.0
Total Cash, Foreign Currency, and Other Monetary Assets	**$ 2,804.8**	**$ 2,591.1**

Cash (except for $123.1 million in undeposited collections) and Foreign Currency represent nonentity assets, and are restricted and unavailable for use in the Department's mission.

Note 8. Direct Loan and Loan Guarantees

Direct Loan and Loan Guarantee Programs

The Department operates the following direct loan and loan guarantee programs:

- Military Housing Privatization Initiative (MHPI).
- Armament Retooling and Manufacturing Support Initiative (ARMS).

The Federal Credit Reform Act of 1990 governs all amended direct loan obligations and loan guarantee commitments made after FY 1991.

Direct loans are reported at the net present value of the following projected cash flows:

- Loan disbursements.
- Repayments of principal.
- Payments of interest and other payments over the life of the loan after adjusting for estimated defaults, prepayments, fees, penalties, and other recoveries.

Loan guarantee liabilities are reported at their net present value. The cost of loan guarantees is the net present value of the following estimated projected cash flows:

- Payments by the Department to cover defaults and delinquencies, interest subsidies, or other payments; offset by
- Payments to the Department including origination and other fees, penalties, and recoveries.

Military Housing Privatization Initiative

The MHPI includes both direct loan and loan guarantee programs. The loan guarantee program is authorized by the National Defense Authorization Act for FY 1996 (PL 104-106, Section 2801) and includes a series of authorities that allow the Department to work with the private sector to renovate and build military family housing. The MHPI accelerates the construction of new housing, built to market standards, and leverages private sector capital. The Department provides protection to the private sector partner against specific risks, such as base closure or member deployment. One of the goals of the Department is to obtain private sector capital to leverage government dollars. The Department provides protection to the private sector partner against specific risks, such as base closure or member deployment.

Armament Retooling and Manufacturing Support Initiative

The ARMS Initiative, authorized by Title 10 United States Code 4551-4555, is a loan guarantee program designed to encourage commercial use of the Army's inactive ammunition plants through incentives for businesses willing to locate to a government ammunition production facility. The production capacity of these facilities is greater than current military requirements, however, this capacity may be needed by the military in the future. Revenues from property rentals are used to help offset the overhead costs for the operation, maintenance, and environmental cleanup at the facilities.

In an effort to preclude any additional loan liability, the Army instituted an ARMS loan guarantee moratorium in FY 2004. The Army continues to operate under the moratorium and does not anticipate new loans.

Summary of Direct Loans and Loan Guarantees				*Dollars in Millions*
As of September 30, 2008 and 2007		2008		Restated 2007
Loans Receivable				
Direct Loans:				
Military Housing Privatization Initiative	$	236.0	$	212.1
Total Direct Loans	**$**	**236.0**	**$**	**212.1**
Defaulted Loan Guarantees:				
Armament Retooling & Manufacturing Support Initiative		0.0		0.1
Total Default Loan Guarantees	**$**	**0.0**	**$**	**0.1**
Total Loans Receivable	**$**	**236.0**	**$**	**212.2**

Summary of Direct Loans and Loan Guarantees				*Dollars in Millions*
As of September 30, 2008 and 2007		2008		Restated 2007
Loan Guarantee Liability				
Military Housing Privatization Initiative	$	22.2	$	24.7
Armament Retooling & Manufacturing Support Initiative		2.3		0.3
Total Loan Guarantee Liability	**$**	**24.5**	**$**	**25.0**

Direct Loans Obligated		Dollars in Millions
As of September 30, 2008 and 2007	**2008**	**Restated 2007**
Direct Loans Obligated After FY 1991 (Present Value Method):		
Military Housing Privatization Initiative		
Loans Receivable Gross	$ 339.6	$ 308.0
Allowance for Subsidy Cost (Present Value)	(103.6)	(95.9)
Value of Assets Related to Direct Loans	236.0	212.1
Total Direct Loans Receivable	**$ 236.0**	**$ 212.1**

Loans receivable, net, or value of assets related to loans, is not the same as the proceeds the Department would expect to receive from selling the loans.

Total Amount of Direct Loans Disbursed		Dollars in Millions
As of September 30, 2008 and 2007	**2008**	**Restated 2007**
Direct Loan Programs		
Military Housing Privatization Initiative	$ 31.7	$ 11.9
Total Direct Loans Disbursed	**$ 31.7**	**$ 11.9**

Subsidy Expense for Direct Loan by Program

As of September 30, 2008 and 2007 — *Dollars in Millions*

2008	Interest Differential	Defaults	Fees	Other	Total
New Direct Loans Disbursed:					
Military Housing Privatization Initiative	$ 12.6	$ 3.0	$ 0.0	$ 0.0	$ 15.6
2007 Restated	Interest Differential	Defaults	Fees	Other	Total
New Direct Loans Disbursed:					
Military Housing Privatization Initiative	$ 2.1	$ 1.3	$ 0.0	$ 0.0	$ 3.4

Subsidy Expense for Direct Loan by Program

As of September 30, 2008 and 2007 — *Dollars in Millions*

2008	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.0	$ (0.8)	$ (2.2)	$ (3.0)	$ (3.0)
2007 Restated	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.0	$ (7.3)	$ (8.2)	$ (15.5)	$ (15.5)
	2008	**Restated 2007**			
Total Direct Loan Subsidy Expense:					
Military Housing Privatization Initiative	$ 12.6	$ (12.1)			

Subsidy Rate for Direct Loans by Program

Dollars in Millions

As of September 30, 2008 and 2007	Interest Differential	Defaults	Fees and other Collections	Other	Total
Budget Subsidy Rates for Direct Loans					
Military Housing Privatization Initiative	25.25%	18.25%	0.00%	0.00%	43.50%

Subsidy rates pertain to the loan agreements contracted during the current fiscal year. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans disbursed in the current year could result from disbursement of loans from both current and prior year loan agreements. The subsidy expense reported in the current year also includes reestimates.

Schedule for Reconciling Subsidy Cost Allowance Balances for Post FY1991 Direct Loans

Dollars in Millions

As of September 30, 2008 and 2007	2008	Restated 2007
Beginning Balance, Changes, and Ending Balance:		
Beginning Balance of the Subsidy Cost Allowance	**$ 95.9**	**$ 104.6**
Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component		
Interest Rate Differential Costs	12.6	2.1
Default Costs (Net of Recoveries)	3.0	1.3
Total of the above Subsidy Expense Components	**$ 15.6**	**$ 3.4**

Schedule for Reconciling Subsidy Cost Allowance Balances for Post FY1991 Direct Loans

Dollars in Millions

As of September 30, 2008	2008		Restated 2007	
Adjustments				
Subsidy Allowance Amortization		(4.9)		(3.6)
Other		0.0		7.0
Total of the above Adjustment Components	**$**	**(4.9)**	**$**	**3.4**
Ending Balance of the Subsidy Cost Allowance before Reestimate	**$**	**106.6**	**$**	**111.4**
Add or Subtract Subsidy Reestimate by Component				
Interest Rate Reestimate		(0.8)		(7.3)
Technical/Default Reestimate		(2.2)		(8.2)
Total of the above Reestimate Components		**(3.0)**		**(15.5)**
Ending Balance of the Subsidy Cost Allowance	**$**	**103.6**	**$**	**95.9**

Defaulted Guaranteed Loans

Dollars in Millions

As of September 30, 2008	2008		2007	
Defaulted Guaranteed Loans from Post-FY 1991 Guarantees (Present Value Method):				
Armament Retooling & Manufacturing Support Initiative				
Defaulted Guaranteed Loans Receivable, Gross	$	15.1	$	14.4
Allowance for Subsidy Cost (Present Value)		(15.1)		(14.3)
Total Value of Assets Related to Defaulted Guaranteed Loans Receivable	**$**	**0.0**	**$**	**0.1**

Guaranteed Loans Outstanding

Dollars in Millions

As of September 30, 2008	Outstanding Principal of Guaranteed Loans, Face Value		Amount of Outstanding Principal Guaranteed	
Guaranteed Loans Outstanding				
Military Housing Privatization Initiative	$	499.1	$	499.1
Armament Retooling & Manufacturing Support Initiative		3.1		2.6
Total Guaranteed Loans Outstanding	**$**	**502.2**	**$**	**501.7**

Liabilities for Loan Guarantees		Dollars in Millions
As of September 30, 2008 and 2007	**2008**	**2007**
Liabilities for Loan Guarantee from Post FY 1991 (Present Value):		
Military Housing Privatization Initiative	$ 22.2	$ 24.7
Armament Retooling & Manufacturing Support Initiative	2.3	0.3
Total Loan Guarantee Liability	**$ 24.5**	**$ 25.0**

Subsidy Expense for Loan Guarantees by Program					*Dollars in Millions*
As of September 30, 2008 and 2007					
2008	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
Modifications and Reestimate:					
Military Housing Privatization Initiative	$ 0.0	$ (0.9)	$ (2.9)	$ (3.8)	$ (3.8)
Armament Retooling & Manufacturing Support Initiative	0.0	0.4	1.7	2.1	2.1
Total	**$ 0.0**	**$ (0.5)**	**$ (1.2)**	**$ (1.7)**	**$ (1.7)**
2007	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
Modifications and Reestimate:					
Military Housing Privatization Initiative	$ 0.0	$ 0.0	$ (0.2)	$ (0.2)	$ (0.2)
Armament Retooling & Manufacturing Support Initiative	0.0	2.1	(1.1)	1.0	1.0
Total	**$ 0.0**	**$ 2.1**	**$ (1.3)**	**$ 0.8**	**$ 0.8**

	2008	2007
Total Loan Guarantee Subsidy Expense:		
Military Housing Privatization Initiative	$ (3.8)	$ (0.2)
Armament Retooling & Manufacturing Support Initiative	2.1	1.0
Total	**$ (1.7)**	**$ 0.8**

There are no new loan guarantees in FY 2008.

Schedule for Reconciling Loan Guarantee Liability Balances for Post-FY 1991 Loan Guarantees		Dollars in Millions
As of September 30, 2008	**2008**	**2007**
Beginning Balance, Changes, and Ending Balance:		
Beginning Balance of the Loan Guarantee Liability	**$ 25.0**	**$ 36.8**
Adjustments		
Foreclosed Property and Loans Acquired	0.7	2.3
Claim Payments to Lenders	(0.8)	(15.3)
Interest Accumulation on the Liability Balance	1.3	0.6
Other	0.0	(0.2)
Total of the above Adjustments	**$ 1.2**	**$ (12.6)**
Ending Balance of the Loan Guarantee Liability before Reestimates	**$ 26.2**	**$ 24.2**
Add or Subtract Subsidy Reestimates by Component		
Interest Rate Reestimate	(0.5)	2.1
Technical/Default Reestimate	(1.2)	(1.3)
Total of the above Reestimate Components	**$ (1.7)**	**$ 0.8**
Ending Balance of the Loan Guarantee Liability	**$ 24.5**	**$ 25.0**

Administrative Expenses

Administrative Expenses are limited to separately identified expenses for administrating pre-FY 1992 and post-FY 1991 direct loans and loan guarantee programs. The Department does not maintain a separate program to capture the expenses related to direct loans and loan guarantees for MHPI. Administrative expenses for ARMS represent a fee paid to U.S. Department of Agriculture, Rural Business Cooperative.

Note 9. Inventory and Related Property

Inventory and Related Property		Dollars in Millions
As of September 30	**2008**	**2007**
Inventory, Net	$ 86,600.1	$ 84,191.0
Operating Materiel & Supplies, Net	148,663.6	139,871.2
Stockpile Materiel, Net	764.0	886.5
Total Inventory and Related Property	**$ 236,027.7**	**$ 224,948.7**

Inventory, Net					Dollars in Millions
	2008			2007	Valuation Method
As of September 30	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	
Inventory Categories					
Available and Purchased for Resale	$ 101,121.2	$ (30,735.0)	$ 70,386.2	$ 61,080.7	LAC,MAC
Held for Repair	25,684.0	(10,195.2)	15,488.8	22,473.9	LAC,MAC
Excess, Obsolete, and Unserviceable	7,761.3	(7,761.3)	0.0	0.0	NRV
Raw Materiel	103.5	0.0	103.5	100.1	MAC,SP,LAC
Work in Process	621.6	0.0	621.6	536.3	AC
Total Inventory, Net	**$ 135,291.6**	**$ (48,691.5)**	**$ 86,600.1**	**$ 84,191.0**	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses
SP = Standard Price
AC = Actual Cost
NRV = Net Realizable Value
MAC = Moving Average Cost

Restrictions

There are few restrictions on the use, sale, or disposition of inventory. However, some restrictions do exist, and they include the following:

- War reserve materiel valued at $2.3 billion;
- Commissary items valued at $386.4 million held for purchase by authorized patrons; and
- Dispositions pending litigation or negotiation valued at $5.4 million.

There are no known restrictions on inventory disposition as related to environmental or other liabilities.

General Composition of Inventory

Inventory includes spare and repair parts, clothing and textiles, and fuels held for sale by the Defense Working Capital Funds. Inventory is tangible personal property that is:

- Held for sale, or held for repair and eventual sale;
- In the process of production for sale; or
- To be consumed in the production of goods for sale or in the provision of service for a fee.

The Department assigns inventory items to a category based upon the type and condition of the asset.

Operating Materiel and Supplies, Net					Dollars in Millions
	2008			2007	Valuation Method
As of September 30	OM&S, Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	
OM&S Categories					
Held for Use	$ 131,648.7	$ (0.0)	$ 131,648.7	$ 123,958.0	SP, LAC, MAC
Held for Repair	18,374.0	(1,359.1)	17,014.9	15,913.2	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	3,598.6	(3,598.6)	0.0	0.0	NRV
Total OM&S	**$ 153,621.3**	**$ (4,957.7)**	**$ 148,663.6**	**$ 139,871.2**	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses
SP = Standard Price
NRV = Net Realizable Value
MAC = Moving Average Cost

Restrictions

Some munitions included in Operating Materiel and Supplies (OM&S) are restricted due to condition. Restricted munitions are considered obsolete or unserviceable when they cannot be expected to meet performance requirements. Obsolete and unserviceable OM&S may be used in emergency combat situations in which no other suitable munitions are immediately available.

General Composition of OM&S

The OM&S includes spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally-managed aircraft engines held for consumption. The Department assigns OM&S items into a category based upon the type and condition of the asset.

Stockpile Materiel, Net					Dollars in Millions
	2008			2007	Valuation Method
As of September 30	Stockpile, Materiel Amount	Allowance for Gains (Losses)	Stockpile Materiel, Net	Stockpile Materiel, Net	
Stockpile Material Categories					
Held for Sale	$ 734.6	$ 0.0	$ 734.6	$ 857.2	AC, LCM
Held in Reserve for Future Sale	29.4	0.0	29.4	29.3	AC, LCM
Total Stockpile Material	**$ 764.0**	**$ 0.0**	**$ 764.0**	**$ 886.5**	

Legend for Valuation Methods:

AC = Actual Cost
LCM = Lower of Cost or Market

Restrictions

Materiel held by the National Defense Stockpile (NDS) is restricted until relieved by Congressional action and made available for sale on the open market. Stockpile materiel may not be disposed except for: (1) necessary upgrading, refining, or processing; (2) necessary rotation to prevent deterioration; (3) determination as excess with potential financial loss if retained; or (4) authorization by law.

Since 1994, the NDS has voluntarily suspended mercury sales. The suspension was in response to concerns raised by the U.S. Environmental Protection Agency regarding the accumulation of mercury in the global environment. The Requirements Report to Congress proposes additional restrictions on the use of beryllium metal and quartz.

Before selling any materiel, Congress must enact specific enabling legislation (e.g., the National Defense Authorization Act). When authorized to offer materiel for sale, NDS removes the materiel from Materiel Held in Reserve and reclassifies these items as Materiel Held for Sale. The estimated market price of the stockpile materiel held for sale as of 4th Quarter, FY 2008, is $1.6 billion.

General Composition of Stockpile Materiel

The Department holds strategic and critical stockpile materiel due to statutory requirements for use in national defense, conservation, or national emergencies.

Note 10. General PP&E, Net

General PP&E, Net — *Dollars in Millions*

As of September 30	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
Major Asset Classes						
Land	N/A	N/A	$ 10,522.3	N/A	$ 10,522.3	$ 10,509.6
Buildings, Structures, and Facilities	S/L	20 or 40	180,196.7	(105,262.3)	74,934.4	71,844.0
Leasehold Improvements	S/L	Lease term	587.1	(391.5)	195.6	228.4
Software	S/L	2-5 or 10	8,894.9	(5,529.0)	3,365.9	3,512.3
General Equipment	S/L	5 or 10	75,324.1	(52,835.1)	22,489.0	22,094.3
Military Equipment	S/L	Various	714,246.2	(333,900.0)	380,346.2	346,321.2
Assets Under Capital Lease1	S/L	Lease term	953.5	(536.0)	417.5	481.3
Construction-in-Progress	N/A	N/A	22,548.9	N/A	22,548.9	19,480.5
Other			57.7	(1.2)	56.5	58.9
Total General PP&E			**$ 1,013,331.4**	**$ (498,455.1)**	**$514,876.3**	**$474,530.5**

[1] *Note 15 for additional information on Capital Leases*
Legend for Valuation Methods: S/L = Straight Line N/A = Not Applicable

Heritage Assets and Stewardship Land

The Federal Accounting Standards Advisory Board's SFFAS No. 29, "Heritage Assets and Stewardship Land," requires note disclosures for these types of assets. The Department's policy is to preserve its heritage assets, which are items of historical, cultural, educational, or artistic importance.

Heritage assets within the Department consist of buildings and structures, archeological sites, and museum collections. The Department defines these as:

- Buildings and Structures. Buildings and structures that are listed on, or eligible for listing on, the National Register of Historic Places, including Multi-Use Heritage Assets.
- Archeological Sites. Sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Register of Historic Places in accordance with Section 110 National Historical Preservation Act.
- Museum Collection Items. Items which are unique for one or more of the following reasons: historical or natural significance; cultural, educational, or artistic importance; or significant technical or architectural characteristics.

The Department holds the following quantities of heritage assets at September 30, 2008.

Categories	Measure Quantity	As of 9/30/08
Buildings and Structures	Each	22,108
Archeological Sites	Site	27,158
Museum Collection Items (Objects, not including fine art)	Each	117,196
Museum Collection Items (Objects, fine art)	Each	10,550

In FY 2008, the Department acquired 111 fine art objects and 4,009 other museum collection items through donation.

The Department's Stewardship Land consists mainly of mission-essential land acquired by donation or devise. Stewardship Land data for FY 2008 is not yet available due to limitations of the Department's financial and nonfinancial management processes and systems that feed into the financial statements. The Department held the following acres of land as of September 30, 2007.

Facility Code	Predominant Land Use Categories	As of 9/30/07 *(Acres in Thousands)*
9110	Government Owned Land	8,068.8
9111	State Owned Land (Stewardship Land)	142.0
9120	Withdrawn Public Land (Stewardship Land)	16,137.5
9130	Licensed and Permitted Land	2,818.8
9140	Public Land (Stewardship Land)	705.7
9210	Land Easement	496.1
9220	In-leased Land	819.9
9230	Foreign Land	613.7
	Grand Total	**29,802.5**
	Total – All Other Lands	**12,817.3**
	Total – Stewardship Lands	**16,985.2**

The mission of the Department is to provide the military forces necessary to deter war and protect the security of the United States. In that mission, the Department, with minor exceptions, uses most of the buildings and stewardship land in its daily activities and includes the buildings on the Balance Sheet as multi-use heritage assets (capitalized and depreciated).

Other Disclosures

The Department has use of overseas land, buildings, and other facilities obtained through international treaties and agreements negotiated by the Department of State. Treaty covenants restrict the Department's use and disposal of real property (land and buildings) located outside the United States.

The Department does not have the acquisition value for all General PP&E and uses several cost methodologies to provide General PP&E values for financial statement reporting purposes.

Other primarily consists of assets awaiting disposal and the projected FY 2009 forest product sales.

Assets Under Capital Lease		Dollars in Millions
As of September 30	**2008**	**2007**
Entity as Lessee, Assets Under Capital Lease		
Land and Buildings	$ 654.9	$ 719.5
Equipment	298.6	263.2
Accumulated Amortization	(536.0)	(501.4)
Total Capital Leases	**$ 417.5**	**$ 481.3**

Note 11. Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources		Dollars in Millions
As of September 30	**2008**	**Restated 2007**
Intragovernmental Liabilities		
Accounts Payable	$ 0.7	$ 3.3
Debt	12.1	12.7
Other	9,751.2	6,986.1
Total Intragovernmental Liabilities	**$ 9,764.0**	**$ 7,002.1**
Nonfederal Liabilities		
Accounts Payable	670.4	461.8
Military Retirement and Other Federal Employment Benefits	1,599,400.6	1,547,796.2
Environmental Liabilities	66,870.0	68,718.8
Other Liabilities	17,253.7	13,904.4
Total Nonfederal Liabilities	**$ 1,684,194.7**	**$ 1,630,881.2**
Total Liabilities Not Covered by Budgetary Resources	**$ 1,693,958.7**	**$ 1,637,883.3**
Total Liabilities Covered by Budgetary Resources	**$ 441,039.7**	**$ 380,932.3**
Total Liabilities	**$ 2,134,998.4**	**$ 2,018,815.6**

Liabilities Not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources can be provided.

Intragovernmental Accounts Payable and Nonfederal Accounts Payable primarily represent liabilities in canceled appropriations that, if paid, will be disbursed using funds current in the year of disbursement.

Debt consists primarily of borrowing from the U.S. Treasury for capital improvements to the Washington Aqueduct Project. Arlington County and Falls Church, Virginia, will complete reimbursement to the Department by 2023.

Intragovernmental Liabilities Other primarily consists of $8.0 billion in custodial liabilities for nonentity assets. The amounts collected cannot be used by the Department and must be returned to the U.S. Treasury. Intragovernmental Liabilities Other also includes $1.4 billion in unfunded Federal Employees Compensation Act liabilities not due during FY 2008.

Military Retirement and Other Federal Employment Benefits consists of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities primarily consists of $903.8 billion in pension liabilities and $686.2 billion in health benefit liabilities. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Environmental Liabilities represents the Department's liability for existing and anticipated environmental cleanup and disposal.

Nonfederal Liabilities Other primarily consists of $8.9 billion in unfunded annual leave, $5.2 billion in contingent liabilities, and $2.0 billion in expected expenditures for disposal of conventional munitions.

Note 12. Accounts Payable

Accounts Payable *As of September 30*	*Dollars in Millions*			
	2008			**Restated 2007**
	Accounts Payable	**Interest, Penalties, and Administrative Fees**	**Total**	**Total**
Intragovernmental Payables	$ 1,687.4	N/A	$ 1,687.4	$ 1,911.5
Nonfederal Payables (To the Public)	32,094.0	1.2	32,095.2	28,695.5
Total Accounts Payable	**$ 33,781.4**	**$ 1.2**	**$ 33,782.6**	**$ 30,607.0**

Accounts Payable include amounts owed to federal and nonfederal entities for goods and services received by the Department. The Department's systems do not track intragovernmental transactions by customer at the transaction level. Therefore, buyer-side balances are adjusted to agree with internal seller-side accounts receivable. Accounts Payable was adjusted by reclassifying amounts between federal and nonfederal entities. Intradepartmental reciprocal balances were then eliminated.

In FY 2007, the Department recognized accounts payable balances of the Mechanization of Contract Administration Services system at gross value without reduction for partial and progress payments and non-accounts payable records, thus overstating nonfederal accounts payable. The overstated balance for FY 2007 was undeterminable due to system limitations, therefore, no correction was made. The FY 2008 ending balance is properly reported net of partial and progress payments and non-accounts payable records of $923.9 million.

Note 13. Debt

Debt					Dollars in Millions
	2008			Restated 2007	
As of September 30	Beginning Balance	Net Borrowing	Ending Balance	Net Borrowing	Ending Balance
Agency Debt (Intragovernmental)					
Debt to the Treasury	$ 236.3	$ 9.4	$ 245.7	$ 27.4	$ 236.3
Debt to the Federal Financing Bank	70.7	(53.8)	16.9	(102.5)	70.7
Total Debt	**$ 307.0**	**$ (44.4)**	**$ 262.6**	**$ (75.1)**	**$ 307.0**

The Department's debt consists of interest and principal payments due to the U.S. Treasury and the Federal Financing Bank. The Department borrows funds for the Washington Aqueduct Project, the U.S. Navy Afloat Prepositioning Force Program, the Military Housing Privatization Initiative, and the Armament Retooling and Manufacturing Support Program.

The Department must pay the debt on direct loans if borrowers (e.g. county or city governments, ship owners, or housing builders) default. For loan guarantees, the Department must pay the amount of outstanding principal guaranteed.

Note 14. Environmental Liabilities and Disposal Liabilities

Environmental Liabilities and Disposal Liabilities				Dollars in Millions
	2008			2007
As of September 30	Current Liability	Noncurrent Liability	Total	Total
Environmental Liabilities–Nonfederal				
Accrued Environmental Restoration Liabilities				
Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 1,184.2	$ 7,689.3	$ 8,873.5	$ 9,137.8
Active Installations—Military Munitions Response Program (MMRP)	117.3	4,917.8	5,035.1	5,404.7
Formerly Used Defense Sites-IRP & BD/DR	169.0	3,064.2	3,233.2	3,814.0
Formerly Used Defense Sites--MMRP	100.9	14,758.1	14,859.0	14,696.8
Other Accrued Environmental Liabilities—Non-BRAC				
Environmental Corrective Action	89.2	723.6	812.8	918.4
Environmental Closure Requirements	25.6	1,842.5	1,868.1	1,024.8
Environmental Response at Operational Ranges	19.3	185.4	204.7	209.6
Asbestos	7.1	421.5	428.6	0.0
Non-Military Equipment	1.6	87.6	89.2	0.0
Other	43.7	1,074.5	1,118.2	742.9

Environmental Liabilities and Disposal Liabilities				*Dollars in Millions*
	2008			**2007**
As of September 30	**Current Liability**	**Noncurrent Liability**	**Total**	**Total**
Base Realignment and Closure Installations				
Installation Restoration Program	657.1	3,115.5	3,772.6	3,952.2
Military Munitions Response Program	73.7	1,001.3	1,075.0	1,028.7
Environmental Corrective Action / Closure Requirements	30.5	342.3	372.8	163.3
Environmental Disposal for Military Equipment / Weapons Programs				
Nuclear Powered Military Equipment / Spent Nuclear Fuel	164.2	12,091.5	12,255.7	12,883.0
Non-Nuclear Powered Military Equipment	0.2	38.9	39.1	0.0
Other National Defense Weapons Systems	1.5	195.9	197.4	205.1
Chemical Weapons Disposal Program				
Chemical Agents and Munitions Destruction (CAMD)	1,242.6	9,394.1	10,636.7	18,308.6
CAMD Assembled Chemical Weapons Assessment (ACWA)	509.3	5,124.9	5,634.2	0.0
Total Environmental Liabilities	**$ 4,437.0**	**$ 66,068.9**	**$ 70,505.9**	**$ 72,489.9**

The above note schedule was recategorized in FY 2008 for clarity.

Other Accrued Environmental Liabilities, Non-BRAC, Other primarily consists of remediation related to Formerly Utilized Sites Remedial Action Program (FUSRAP). The USACE is responsible for FUSRAP, which remediates radiological contamination from the Department of Energy's U.S. Atomic Energy and Weapons Program.

Environmental Disclosures		*Dollars in Millions*
As of September 30	**2008**	**2007**
Intragovernmental Liabilities		
The unrecognized portion of the estimated total cleanup costs associated with general property, plant, and equipment.	$ 1,953.9	$ 1,589.1
Changes in total cleanup costs due to changes in laws, regulations, and/or technology.	223.3	(12.7)
Portion of the changes in estimated costs due to changes in laws and technology that is related to prior periods.	(35.0)	(4.4)

The table provides additional environmental disclosures required by SFFAS No. 5, "Accounting for Liabilities of the Federal Government." Not all Components of the Department are able to compile the necessary information for the disclosures above, thus the amounts reported may not accurately reflect the Department's total unrecognized costs associated with general plant, property, and equipment; and cleanup costs associated with changes in laws, regulations and technology. The Department is implementing procedures to address these deficiencies.

Other Disclosures

Types of Environmental Liabilities and Disposal Liabilities Identified

The Department has cleanup requirements for DERP sites at active installations, BRAC installations, Formerly Used Defense Sites, sites at active installations that are not covered by DERP, weapons systems programs, and chemical weapons disposal programs. The weapons systems programs consist of chemical weapons disposal, nuclear-powered aircraft carriers, nuclear-powered submarines, and other nuclear ships. All cleanup is done in coordination with regulatory agencies, other responsible parties, and current property owners.

Applicable Laws and Regulations for Cleanup Requirements

The Department is required to clean up contamination resulting from past waste disposal practices, leaks, spills, and other past activity that created a public health or environmental risk. The Department accomplishes this effort in coordination with regulatory agencies and, if applicable, other responsible parties and current property owners. The Department is also required to recognize closure and post-closure costs for its General PP&E and environmental corrective action costs for current operations. Each of the Department's major reporting entities is responsible for tracking and reporting all required environmental information related to environmental restoration costs, other accrued environmental costs, disposal costs of weapons systems, and environmental costs related to BRAC actions that have taken place.

The Department follows the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and the Superfund Amendment and Reauthorization Act to clean up DERP-eligible contamination. Contamination cleanup that is not eligible for DERP is performed in accordance with the Resource Conservation and Recovery Act (RCRA) or other applicable federal or state laws. The CERCLA and RCRA require the Department to clean up contamination in coordination with regulatory agencies, current owners of property damaged by the Department, and third parties that have a partial responsibility for the environmental restoration. Failure to comply with agreements and legal mandates puts the Department at risk of incurring fines and penalties.

The cleanup requirements for nuclear-powered aircraft carriers, submarines, and other nuclear ships are based on laws that affect the Department's conduct of environmental policy and regulations. The Atomic Energy Act of 1954, as amended, assures the proper management of source, special nuclear, and byproduct materiel. As in all cases with nuclear power, the Department coordinates actions with the Department of Energy. The Nuclear Waste Policy Act of 1982 requires all owners and generators of high-level nuclear waste and spent nuclear fuel to pay their respective shares of the full cost of the program. Finally, the Low-Level Radioactive Waste Policy Amendments Act of 1986 provides for the safe and efficient management of low-level radioactive waste.

The Chemical Weapons Disposal Program is based on FY 1986 National Defense Authorization Act (PL 99-145, as amended) that directed the Department to destroy the unitary chemical stockpile in accordance with the requirements of the Chemical Weapons Convention Treaty. The Army, as Executive Agent within the Department, provides policy, direction, and oversight for both the Chemical Stockpile Program and the Nonstockpile Chemical Materiel Project. As such, the Army is responsible for the safe and economical disposal of the U.S. stockpile of lethal and incapacitating chemical warfare agents and munitions.

Methods for Assigning Total Cleanup Costs to Current Operating Periods

The Department uses engineering estimates and independently validates models to estimate environmental costs. The models are contained within the Remedial Action Cost Engineering Requirements and the Normalization of Data System. The Department validates the models in accordance with DoD Instruction 5000.61 and primarily uses the models to estimate the liabilities based on data received during a preliminary assessment and initial site investigation. The Department primarily uses engineering estimates after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project.

Once the environmental cost estimates are complete, the Department complies with accounting standards to assign costs to current operating periods. The Department has already expensed the costs for cleanup associated with General PP&E placed into service before October 1, 1997, unless the costs are intended to be recovered through user charges. If the costs are to be recovered through user charges, the Department expenses cleanup costs associated with that portion of the asset life that has passed since the General PP&E was placed into service. The Department systematically recognizes the remaining cost over the remaining life of the asset.

For General PP&E placed into service after September 30, 1997, the Department expenses associated environmental costs systematically over the life of the asset using two methods: physical capacity for operating landfills, and life expectancy in years for all other assets. The Department expenses the full cost to clean up contamination for Stewardship PP&E at the time the asset is placed into service.

Nature of Estimates and the Disclosure of Information Regarding Possible Changes Due to Inflation, Deflation, Technology, or Applicable Laws and Regulations

The Department had changes in estimates resulting from overlooked or previously unknown contaminants, reestimation based on different assumptions, and lessons learned. Environmental liabilities may change in the future due to changes in laws and regulation, changes in agreements with regulatory agencies, and advances in technology.

Uncertainty Regarding the Accounting Estimates Used to Calculate the Reported Environmental Liabilities

The environmental liabilities for the Department are based on accounting estimates, which require certain judgments and assumptions that are reasonable based upon information available at the time the estimates are calculated. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. Liabilities can be further affected if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

The Army has a liability to take environmental restoration and corrective action for buried chemical munitions and agents, however, it is unable to estimate at this time because the extent of the buried chemical munitions and agents is unknown. The Department is also unable to provide a complete estimate for FUSRAP. The Department has ongoing studies and will update its estimate as additional liabilities are identified. In addition, not all Components of the Department recognize environmental liabilities associated with General PP&E due to process and system limitations.

The Department is in the process of determining the extent of the liabilities at installations that are realigning or closing as a result of BRAC requirements, in particular those liabilities associated with unexploded ordnance on training ranges. In addition, the Department has the potential to incur costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. The Department is unable to provide a reasonable estimate at this time because the extent of required restoration is unknown.

Note 15. Other Liabilities

Other Liabilities				*Dollars in Millions*
	2008			Restated 2007
As of September 30	Current Liability	Noncurrent Liability	Total	Total
Intragovernmental				
Advances from Others	$ 736.9	$ 0.0	$ 736.9	$ 308.9
Deposit Funds and Suspense Account Liabilities	829.2	0.0	829.2	1,181.6
Disbursing Officer Cash	2,856.0	0.0	2,856.0	2,619.7
Judgment Fund Liabilities	167.7	0.1	167.8	167.5
FECA Reimbursement to the Department of Labor	548.0	847.1	1,395.1	1,387.6
Custodial Liabilities	3,513.8	1,619.4	5,133.2	5,236.6
Employer Contribution and Payroll Taxes Payable	377.7	0.0	377.7	281.8
Other Liabilities	213.9	0.0	213.9	237.1
Total Intragovernmental Other Liabilities	**$ 9,243.2**	**$ 2,466.6**	**$ 11,709.8**	**$ 11,402.8**
Nonfederal				
Accrued Funded Payroll and Benefits	8,143.1	0.0	8,143.1	7,478.9
Advances from Others	3,144.4	0.0	3,144.4	2,426.3
Deposit Funds and Suspense Accounts	325.2	0.0	325.2	59.9
Nonenvironmental Disposal Liabilities				
Military Equipment (Nonnuclear)	7.7	244.5	252.2	271.2
Excess/Obsolete Structures	116.2	616.6	732.8	663.0
Conventional Munitions Disposal	0.0	2,043.0	2,043.0	1,284.1
Accrued Unfunded Annual Leave	9,025.9	0.0	9,025.9	8,708.1
Capital Lease Liability	3.8	142.5	146.3	183.5
Contract Holdbacks	558.9	11.3	570.2	812.9
Employer Contribution and Payroll Taxes Payable	1,844.1	0.0	1,844.1	1,565.9
Contingent Liabilities	1,216.5	5,968.0	7,184.5	5,050.6
Other Liabilities	695.4	0.5	695.9	782.0
Total Nonfederal Other Liabilities	**$ 25,081.2**	**$ 9,026.4**	**$ 34,107.6**	**$ 29,286.4**
Total Other Liabilities	**$ 34,324.4**	**$ 11,493.0**	**$ 45,817.4**	**$ 40,707.2**

The Department restated the FY 2007 balance in accrued funded payroll and benefits by $1.3 billion. On September 30, 2007, the military payroll due for disbursement on October 1st was processed one day early. The payroll was not actually paid to the soldiers until October 1st even though it appeared as disbursed in the Department's system. Since the processing of the payroll and the actual outlays for the payroll crossed over two fiscal years, the outlays in both fiscals years were incorrectly stated (overstated in FY 2007 and understated in FY 2008) and required correction. The restated amount of $1.3 billion impacted the Balance Sheet and Statement of Budgetary Resources.

Intragovernmental Other Liabilities primarily consists of unemployment compensation liabilities.

Contingent Liabilities includes $1.4 billion in estimated future contract financing payments. In accordance with contract terms, specific rights to the contractors' work vests with the Federal government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as rights of ownership. The Department is under no obligation to pay contractors for amounts greater than the amounts authorized in contracts until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of potential future payments are estimable, the Department has recognized a contingent liability for estimated future payments that are conditional pending delivery and government acceptance.

Nonfederal Other Liabilities primarily consists of accrued estimates for repairs and cargo expenses.

Capital Lease Liability *Dollars in Millions*

	2008 — Asset Category				2007
As of September 30	Land and Buildings	Equipment	Other	Total	Total
Future Payments Due					
2008	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 50.9
2009	43.9	1.5	0.0	45.4	45.4
2010	43.9	0.0	0.0	43.9	43.9
2011	41.3	0.0	0.0	41.3	41.3
2012	15.5	0.0	0.0	15.5	15.5
2013	11.1	0.0	0.0	11.1	0.0
After 5 Years	17.3	0.0	0.0	17.3	28.6
Total Future Lease Payments Due	**$ 173.0**	**$ 1.5**	**$ 0.0**	**$ 174.5**	**$ 225.6**
Less: Imputed Interest Executory Costs	28.2	0.0	0.0	28.2	42.1
Net Capital Lease Liability	**$ 144.8**	**$ 1.5**	**$ 0.0**	**$ 146.3**	**$ 183.5**
Capital Lease Liabilities Covered by Budgetary Resources				**123.9**	**150.8**
Capital Lease Liabilities Not Covered by Budgetary Resources				**22.4**	**32.7**

Note 16. Commitments and Contingencies

Legal Contingencies

The Department is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests. The Department has accrued contingent liabilities for legal actions where the Office of General Counsel (OGC) considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The Department records Judgment Fund liabilities in Note 12, Accounts Payable, and in Note 15, Other Liabilities.

In FY 2008, the Department reported 55 legal actions with individual claims greater than the Department's FY 2008 materiality threshold of $114.4 million. The total of these 55 actions is approximately $2.6 trillion. Of this amount, the OGC determined that claims totaling approximately $21.9 billion are classified "reasonably possible," $13.4 billion are classified "remote," and $2.5 trillion are classified "unable to determine the probability of loss." The Department also had a number of potential claims that individually did not meet the Department's materiality threshold but did meet the individual Components' thresholds. These claims are disclosed in the Components' financial statements.

Other Commitments and Contingencies

Undelivered orders for open (unfilled or unreconciled) contracts citing cancelled appropriations, for which the Department may incur a contractual commitment for payment, total $978.3 million.

The Department is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of expenditures. Currently, the Department has limited automated system processes by which it captures or assesses these potential contingent liabilities, therefore, the amounts reported may not fairly present the Department's contingent liabilities.

Contingencies considered both measurable and probable have been recognized as liabilities. Refer to Note 15, Other Liabilities, for further details.

Note 17. Military Retirement and Other Federal Employment Benefits

Military Retirement and Other Federal Employment Benefits *Dollars in Millions*

As of September 30	2008				Restated 2007
	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities	Liabilities
Pension and Health Actuarial Benefits					
Military Retirement Pensions	$ 1,150,748.8	5.75	$ (246,956.7)	$ 903,792.1	$ 1,025,320.6
Military Retirement Health Benefits	317,967.9	5.75	0.0	317,967.9	317,332.8
Military Medicare-Eligible Retiree Benefits	500,195.7	5.75	(131,941.1)	368,254.6	516,479.2
Total Pension and Health Actuarial Benefits	**$ 1,968,912.4**		**$ (378,897.8)**	**$ 1,590,014.6**	**$ 1,859,132.6**

Military Retirement and Other Federal Employment Benefits					Dollars in Millions
	2008				Restated 2007
As of September 30	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities	Liabilities
Other Actuarial Benefits					
FECA	6,862.2	4.4	0.0	6,862.2	6,830.1
Voluntary Separation Incentive Programs	1,146.0	4.5	(501.5)	644.5	1,250.5
DoD Education Benefits Fund	1,959.2	4.5	(1,817.3)	141.9	1,858.2
Total Other Actuarial Benefits	**$ 9,967.4**		**$ (2,318.8)**	**$ 7,648.6**	**$ 9,938.8**
Other Federal Employment Benefits	**$ 5,725.6**		**$ (3,988.2)**	**$ 1,737.4**	**$ 5,608.1**
Total Military Retirement and Other Federal Employment Benefits	**$ 1,984,605.4**		**$ (385,204.8)**	**$ 1,599,400.6**	**$ 1,874,679.5**

Actuarial Cost Method Used: Aggregate Entry-Age Method
Assumptions: See Below
Market Value of Investments in Market-based and Marketable Securities: $374.5 billion

Military Retirement Pensions

The Military Retirement Fund (MRF) is a defined benefit plan authorized by PL 98-94 to provide funds used to pay annuities and pensions to retired military personnel and their survivors. The Department of Defense Retirement Board of Actuaries approves the long-term economic assumptions for inflation, salary, and interest. The actuaries calculate the actuarial liabilities annually using economic assumptions and actual experience (e.g., mortality and retirement rates). Due to reporting deadlines, the current year actuarial present value of projected plan benefits rolls forward from the prior year's valuation results. The actuaries used the following assumptions to calculate the FY 2008 roll-forward amount:

Military Retirement Pensions	Inflation	Salary	Interest
Fiscal Year 2008	2.3% (actual)	3.5% (actual)	5.75%
Fiscal Year 2009	6.2% (estimated)	3.9% (estimated)	5.75%
Long Term	3.0%	3.75%	5.75%

Historically, the initial unfunded liability of the program was amortized over a 50-year period. Effective FY 2008, the initial unfunded liability will be paid over a 42-year period to ensure the annual payments cover the interest on the unfunded actuarial liablity, with the last payment expected to be made October 1, 2025. All subsequent gains and losses experienced are amortized over a 30-year period.

Change in MRF Actuarial Liability		Dollars in Billions
Actuarial Liability as of September 30, 2007	$	1,025.3
Expected Normal Cost for FY 2008		18.9
Plan Amendment Liability		8.1
Assumption Change Liability		60.1
Expected Benefit Payments for FY 2008		(45.7)
Interest Cost for FY 2008		60.7
Actuarial (gains)/losses due to changes in trend assumptions		23.3
Actuarial Liability as of September 30, 2008	**$**	**1,150.7**
Change in Actuarial Liability	**$**	**125.4**

Actuarial Cost Method Used: Aggregate Entry-Age Normal Method
Market Value of Investments in Market-Based and Marketable Securities: $243.7
Assumed Interest Rate: 5.75%

Military Retirement Health Benefits (MRHB)

The MRHB are post-retirement benefits the Department provides to non-Medicare-eligible military retirees and other eligible beneficiaries through private sector health care providers and Department Medical Treatment Facilities. The actuaries calculate the actuarial liabilities annually using assumptions and actual experience. For the FY 2008 actuarial liability calculation, the actuaries used the following assumptions:

Military Retirement Health Benefits (MRHB) Medical Trend	FY 2007 – FY 2008	Ultimate Rate FY 2032
Medicare Inpatient (Direct Care)	5.65%	6.25%
Medicare Outpatient (Direct Care)	3.33%	6.25%
Medicare Prescriptions (Direct Care)	3.00%	6.25%
Medicare Inpatient (Purchased Care)	6.65%	6.25%
Medicare Outpatient (Purchased Care)	4.33%	6.25%
Medicare Prescriptions (Purchased Care)	8.55%	6.25%
Non-Medicare Inpatient (Direct Care)	4.00%	6.25%
Non-Medicare Outpatient (Direct Care)	4.00%	6.25%
Non-Medicare Prescriptions (Direct Care)	4.00%	6.25%
Non-Medicare Inpatient (Purchased Care)	5.34%	6.25%
Non-Medicare Outpatient (Purchased Care)	10.45%	6.25%
Non-Medicare Prescriptions (Purchased Care)	7.43%	6.25%
U.S. Family Health Plan (USFHP) (Purchased Care)	10.00%	6.25%

Change in MHRB Actuarial Liability	Dollars in Billions	
Actuarial Liability as of September 30, 2007 (Department preMedicare + all Uniformed Services Medicare cost-benefit effect)	$	317.3
Expected Normal Cost for FY 2008		10.5
Expected Benefit Payments for FY 2008		(10.2)
Interest Cost for FY 2008		19.4
Actuarial (gains)/losses due to other factors		(4.8)
Actuarial (gains)/losses due to changes in trend assumptions		(14.2)
Actuarial Liability as of September 30, 2008 (Department preMedicare + all Uniformed Services Medicare cost-benefit effect)	**$**	**318.0**
Change in Actuarial Liability	**$**	**0.7**
Actuarial Cost Method Used: Aggregate Entry-Age Normal Method *Assumed Interest Rate: 5.75%*		

Medicare-Eligible Retiree Health Care Fund (MERHCF) Benefits

In accordance with PL 106-398, MERHCF accumulates funds to finance the health care program liabilities of Medicare-eligible retirees for all the Uniformed Services and specific Medicare-eligible beneficiaries. The DoD MERHCF Board of Actuaries approves the long-term assumptions for medical trends and interest. The actuaries calculate the actuarial liabilities annually using actual experience (e.g., mortality and retirement rates, direct care costs, purchased care). Due to reporting deadlines, the current year actuarial present value of projected plan benefits rolls forward from the prior year's results. The actuaries used the following assumptions to calculate the FY 2008 roll-forward amount:

Medicare-Eligible Retiree Health Care Fund (MERHCF) Benefits — Medical Trend	FY 2007 – FY 2008	Ultimate Rate FY 2032
Medicare Inpatient (Direct Care)	5.65%	6.25%
Medicare Inpatient (Purchased Care)	6.65%	6.25%
Medicare Outpatient (Direct Care)	3.33%	6.25%
Medicare Outpatient (Purchased Care)	4.33%	6.25%
Medicare Prescriptions (Direct Care)	3.00%	6.25%
Medicare Prescriptions (Purchased Care)	8.55%	6.25%
USFHP (Purchased Care)	10.00%	6.25%

Change in MERHCF Actuarial Liability	Dollars in Billions	
Actuarial Liability as of September 30, 2007 (all Uniformed Services Medicare)	$	516.5
Expected Normal Cost for FY 2008		10.1
Expected Benefit Payments for FY 2008		(8.5)
Interest Cost for FY 2008		31.3
Actuarial (gains)/losses due to other factors		(5.3)
Actuarial (gains)/losses due to changes in trend assumptions		(43.9)
Actuarial Liability as of September 30, 2008 (all Uniformed Services Medicare)	**$**	**500.2**
Change in Actuarial Liability	**$**	**(16.3)**
Actuarial Cost Method Used: Aggregate Entry-Age Normal Method *Market Value of Investments in Market-Based and Marketable Securities: $128.5 billion* *Assumed Interest Rate: 5.75%*		

The MERHCF liability includes Medicare liabilities for all Uniformed Services. The $500.2 billion liability includes $489.0 billion for the Department, $10.0 billion for the Coast Guard, $1.1 billion for the Public Health Service and $71.0 million for National Oceanic and Atmospheric Association (NOAA). The FY 2008 contributions from each of the Uniformed Services were $11.2 billion from the Department, $272.1 million from the Coast Guard, $36.6 million from the Public Health Service, and $1.8 million from NOAA.

Federal Employees Compensation Act (FECA)

The Department of Labor (DOL) annually determines the liability for future workers' compensation benefits, which includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred-but-not-reported claims. The liability is determined using historical benefit payment patterns related to a specific incurred period to predict the final payment related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year U.S. Treasury notes and bonds. A 4.37 percent interest rate was assumed for year one and 4.77 percent was assumed for year two and thereafter.

The DOL calculates this liability using wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIM). The actual rates for these factors for charge back year (CBY) 2008 were also used to adjust the methodology's historical payments to current year constant dollars. The compensation COLAs and CPIMs used in the projections for various charge back years were as follows:

Federal Employees — Compensation Act (FECA)		
CBY	**COLA**	**CPIM**
2008	3.03%	4.71%
2009	3.87%	4.01%
2010	2.73%	3.86%
2011	2.20%	3.87%
2012	2.23%	3.93%
2013+	2.30%	3.93%

The model's resulting projections were analyzed by DOL to ensure the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model of economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses (the medical component in particular) in CBY 2008 (by injury cohort) to the average pattern observed during the prior three charge back years, and (4) a comparison of the estimated liability per case in the 2008 projection to the average pattern for the projections for the most recent three years.

Voluntary Separation Incentive (VSI) Program

PL 102-190 established the VSI Program to reduce the number of military personnel on active duty. The VSI Board of Actuaries approved the assumed annual interest rate of 4.5 percent used to calculate the actuarial liability. Since the VSI Program is no longer offered, the actuarial liability calculated annually is expected to continue to decrease with benefit outlays and increase with interest cost. Market Value of Investments in Market-based and Marketable Securities: $545.0 million

DoD Education Benefits Fund (EBF)

PL 98-525 established the EBF program to recruit and retain military members and aid in the readjustment of military members to civilian life. The actuaries calculate the actuarial liability annually based on the assumed interest rate of 4.5 percent that was approved by the EBF Board of Actuaries. Market Value of Investments in Market-based and Marketable Securities: $1.8 billion

Other Federal Employment Benefits

Other Federal Employment Benefits primarily consists of accrued pensions and annuities, and an estimated liability for incurred-but-not-reported medical claims not processed prior to fiscal year end.

Note 18. General Disclosures Related to the Statement of Net Cost

General Disclosures Related to the Statement of Net Cost		*Dollars in Millions*
As of September 30	**2008**	**Restated 2007**
Intragovernmental Costs	$ 26,771.0	$ 27,060.9
Public Costs	705,548.4	619,926.1
Total Costs	**$ 732,319.4**	**$ 646,987.0**
Intragovernmental Earned Revenue	(29,652.6)	(20,450.0)
Public Earned Revenue	(26,619.9)	(25,125.6)
Total Earned Revenue	**$ (56,272.5)**	**$ (45,575.6)**
Net Cost of Operations	**$ 676,046.9**	**$ 601,411.4**

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Federal government supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The Department's current processes and systems do not capture and report accumulated costs for major programs based upon performance measures as required by the Government Performance and Results Act. The Department is reviewing available data and developing a cost reporting methodology as required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government."

Intragovernmental costs and revenues represent transactions made between two reporting entities within the Federal government. Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

The Department's systems do not track intragovernmental transactions by customer at the transaction level. Buyer-side expenses are adjusted to agree with internal seller-side revenues. Expenses are generally adjusted by reclassifying amounts between federal and nonfederal expenses. Intradepartmental reciprocal balances are then eliminated.

The SNC presents information based on budgetary obligation, disbursement, and collection transactions, as well as data from nonfinancial feeder systems. Amounts are adjusted for accruals such as payroll expenses, accounts payable, and environmental liabilities. The General Fund data is generally derived from budgetary transactions (obligations, disbursements, and collections), data from nonfinancial feeder systems, and accruals made for major items. While Working Capital Funds generally record transactions on an accrual basis, the systems do not always capture actual costs in a timely manner.

Imputed costs totaling $4.2 billion equal imputed financing. The imputed costs are included within Gross Costs.

The majority of the Department's accounting systems do not capture information relative to heritage assets separately and distinctly from normal operations. However, the Department was able to identify $31.4 thousand in FY 2008 costs for acquiring, constructing, improving, reconstructing or renovating heritage assets.

The Department recognized a prior period adjustment of $1.3 billion and restated net cost of operations. During FY 2007, the Department incorrectly reported $1.3 billion of contract financing payments as expenses rather than assets. Refer to Note 25, Restatements, for additional details.

Note 19. Disclosures Related to the Statement of Changes in Net Position

The Department recognized a prior period adjustment, which impacted the Statement of Changes in Net Position. During FY 2007, the Department incorrectly recognized $1.3 billion of contract financing payments as expenses rather than assets. The prior period adjustment reduced the net cost of operations by $1.3 billion, and increased the cumulative results of operations by the same amount. The resulting impact is as if the contract financing payments had been properly capitalized and not expensed in FY 2007. Refer to Note 25, Restatements, for further details.

Other Financing Sources, Other consists primarily of adjustments to reconcile budgetary and proprietary trial balances. Due to financial system limitations, the Department adjusts for these unreconciled differences. In the SCNP, offsetting balances for intradepartmental activity between Earmarked Funds and All Other Funds are reported on the same lines. The Eliminations column contains all appropriate elimination entries, which net to zero within each respective line, except for intraentity imputed financing costs.

Earmarked Cumulative Results of Operations ending balance on the SCNP does not agree with the Earmarked Cumulative Results reported on the Balance Sheet because the cumulative results on the Balance Sheet are presented net of eliminations.

The Appropriations Received on the SCNP do not match the Appropriations on the Statement of Budgetary Resources due to trust fund appropriations and special fund receipts. The difference of $116.8 billion is primarily related to the Military Retirement Fund and the Medicare-Eligible Retiree Health Care Fund appropriations. In order to preserve visibility with the President's Budget, these appropriations are effectively reported twice on the SBR; they are reported once by the Military Departments and Defense Agencies as appropriated and once by the individual trust funds as receipts. Refer to Note 20, Disclosures Related to the Statement of Budgetary Resources, for further details.

Note 20. Disclosures Related to the Statement of Budgetary Resources

Disclosures Related to the Statement of Budgetary Resources		Dollars in Millions
As of September 30, 2008	**2008**	**Restated 2007**
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period.	$ 407,362.0	$ 349,757.7

Restatements and adjustments to beginning balance of budgetary resources

The Department restated the balance in gross outlays by $1.3 billion to correct a timing difference. On September 30, 2007, the military payroll due for disbursement on October 1st was processed one day early. The payroll was not actually paid to the soldiers until October 1st even though it appeared as disbursed in the Department's system. Since the processing of the payroll and the actual outlays for the payroll crossed over two fiscal years, the outlays in both fiscals years were incorrectly stated (overstated in FY 2007 and understated in FY 2008) and required correction. The restated amount of $1.3 billion impacted the Balance Sheet and Statement of Budgetary Resources.

Also, in FY 2007 the Department presented a combined report of the DoD financial statements and the financial statements of certain programs of the Executive Office of the President (EOP). In FY 2008, it was determined that DoD would report on EOP programs administered by DoD separately from the DoD financial statements. This change in reporting resulted in a restatement of the Department's prior year balances. Refer to Note 25, Restatements, for further details.

Reconciliation Differences

Appropriations Received on the Statement of Budgetary Resources (SBR) exceeds Appropriations Received on the Statement of Changes in Net Position by $116.8 billion. This difference represents trust and special fund receipts reported as exchange revenue on the Statement of Net Cost and included in appropriations on the SBR. In accordance with Office of Management and Budget guidance, $90.0 billion of General Fund appropriations received by the Department are also recognized on the SBR as appropriations received for trust and special funds.

The Statement of Budgetary Resources comparative column (FY 2007) includes $83.4 million more in budget authority than reported in the actual FY 2007 column of the President's Budget for FY 2009. The difference is primarily due to the Treasury's amortized payments for the unfunded actuarial liabilities of the Medicare-Eligible Retiree Health Care Fund and the Military Retirement Fund. The President's Budget does not include these payments. Also, the payments are reported twice in the Department's SBR as described above.

The Statement of Budgetary Resources comparative column (FY 2007) also includes $634 million less in obligations than reported in the actual FY 2007 column of the President's Budget for FY 2009. The Department of the Navy corrected the understatement of obligations in FY 2007 prior to completion of input for the President's Budget, however, the SBR was not corrected until FY 2008. This correction also created a difference in available funds.

Permanent Indefinite Appropriations

The Department of Defense received the following permanent indefinite appropriations:

- Department of the Army General Gift Fund (10 USC 2601(b)(1))
- Department of the Navy General Gift Fund (10 USC 2601(b)(2))
- Department of the Air Force General Gift Fund (10 USC 2601 (b)(3))
- Foreign National Employees Separation Pay Account, Defense (10 USC 1581)
- United States Naval Academy Gift and Museum Fund (10 USC 6973-4)
- Ship Stores Profits, Navy (10 USC 7220, 31 USC 1321)
- Midshipmen's Store (10 USC 6971B)
- Burdensharing Contributions Account (10 USC 2350j)
- Forest Program (10 USC 2665)
- DoD Base Closure Account (10 USC 2687)
- Medicare-Eligible Retiree Health Care Fund (MERHCF) (10 USC 1111)
- Military Retirement Fund (MRF) (10 USC 1461)
- Education Benefits Fund (10 USC 2006)
- Host Nation Support for U.S. Relocation Activities (10 USC 2350k)
- National Defense Sealift Fund (10 USC 2218)
- Environmental Restoration, Navy (10 USC 2702)
- Hydraulic Mining Debris Reservoir (33 USC 683)
- Maintenance and Operation of Dams and Other Improvements of Navigable Waters (16 USC 810(a))
- Payments to States (33 USC 701c-3)
- Wildlife Conservation (16 USC 670-670(f))
- Ainsworth Bequest (31 USC 1321)
- DoD Family Housing Improvement Fund (10 USC 2883 (a))
- DoD Military Unaccompanied Housing Improvement Fund (10 USC 2883 (a))
- Voluntary Separation Incentive Fund (10 USC 1175(h))
- Rivers & Harbors Contributed Funds (33 USC 560, 701h)

The above permanent indefinite appropriations cover a wide variety of purposes to help the Department accomplish its missions. These purposes include: (1) military retirees health care benefits, retirement and survivor pay, and education benefits for veterans; (2) environmental, coastal, and wildlife habitat restoration, and water resources maintenance; (3) costs associated with the closure or realignment of military installations; (4) relocation of armed forces to a host nation; (5) separation payments for foreign nationals; (6) the construction, purchase, alteration, and conversion of sealift vessels; and (7) upkeep of libraries and museums.

Apportionment Categories for Obligations incurred

The Department reported the following amounts of direct obligations: (1) $604.2 billion in category A; (2) $161.9 billion in category B; and (3) $45.7 billion in exempt from apportionment. The Department reported the following amounts of reimbursable obligations: (1) $38.6 billion in category A; (2) $151.1 billion in category B; and (3) $141.0 million in exempt from apportionment. Category A relates to appropriations for a specific period of time (e.g., Military Personnel appropriation), and category B relates to appropriations for a specific project (e.g., Military Construction appropriation).

Legal Arrangements Affecting the Use of Unobligated Balances

A portion of the Department's unobligated balances represent trust fund receipts collected in the current fiscal year that exceed the amount needed to pay benefits or other valid obligations. These receipts are temporarily precluded from obligation by law due to a benefit formula or other limitation. The receipts, however, are assets of the funds and are available for obligation as needed in the future. The Department operates within the constraints of fiscal law and has no additional legal arrangements affecting the use of unobligated balances.

Other Disclosures

Effective FY 2007, OMB Circular No. A-136 "Financial Reporting Requirements" required entities to report programs administered on behalf of the Executive Office of the President. Based upon additional guidance from OMB, effective 3rd Quarter, FY 2008, the Department reports the Foreign Military Sales program separately from the basic financial statements. The effect reduced Obligated Balances Brought Forward by $65.0 billion, Unobligated Balances Brought Forward by $43.9 million, Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period by $2.3 billion, and Available Borrowing and Contract Authority at the End of the Period by $32.2 billion.

The President's budget for FY 2010 has not yet been published. The budget is expected to be published in February 2009, and will be available at:

http://www.defenselink.mil/comptroller/defbudget.

The SBR includes intraentity transactions because the statements are presented as combined.

The Department utilizes borrowing authority for the Military Housing Privatization Initiative and the Armament Retooling and Manufacturing Support Initiative. Borrowing authority is used in accordance with OMB Circular A-129, "Managing Federal Credit Programs."

The Department received additional funding of $190.5 billion to cover obligations incurred above baseline operations primarily in support of the Global War on Terror and disaster relief.

Note 21. Reconciliation of Net Cost of Operations to Budget

Reconciliation of Net Cost of Operations to Budget				*Dollars in Millions*
As of September 30, 2008 and 2007		**2008**		**Restated 2007**
Resources Used to Finance Activities				
Budgetary Resources Obligated:				
Obligations incurred	$	1,001,667.5	$	890,756.4
Less: Spending authority from offsetting collections and recoveries (-)		(232,293.7)		(214,722.0)
Obligations net of offsetting collections and recoveries	**$**	**769,373.8**	**$**	**676,034.4**
Less: Offsetting receipts (-)		(70,247.6)		(48,272.0)
Net Budgetary Resources Obligated	**$**	**699,126.2**	**$**	**627,762.4**
Other Resources:				
Donations and forfeitures of property		1.5		13.8
Transfers in/out without reimbursement (+/-)		(51.2)		12.8
Imputed financing from costs absorbed by others		4,174.9		4,421.3
Other (+/-)		6,661.9		(8,036.6)
Net other resources used to finance activities	**$**	**10,787.1**	**$**	**(3,588.7)**
Total resources used to finance activities	**$**	**709,913.3**	**$**	**624,173.7**
Resources Used to Finance Items not Part of the Net Cost of Operations				
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:				
Undelivered Orders (-)		(57,575.7)		(51,370.2)
Unfilled Customer Orders		6,444.9		6,496.4
Resources that fund expenses recognized in prior Periods (-)		(29,958.6)		(34,595.5)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations		2,562.6		1,976.2
Resources that finance the acquisition of assets (-)		(139,518.3)		(92,336.0)

Reconciliation of Net Cost of Operations to Budget *As of September 30, 2008 and 2007* (*Dollars in Millions*)	2008	Restated 2007
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	(10.0)	(10.0)
Other (+/-)	(5,306.6)	8,010.1
Total resources used to finance items not part of the Net Cost of Operations	**$ (223,361.7)**	**$ (161,829.0)**
Total resources used to finance the Net Cost of Operations	**$ 486,551.6**	**$ 462,344.7**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	646.0	1,866.1
Increase in environmental and disposal liability	1,813.2	2,615.0
Upward/Downward reestimates of credit subsidy expense (+/-)	(1.7)	(4.1)
Increase in exchange revenue receivable from the public (-)	(24.7)	(23.3)
Other (+/-)	139,220.3	91,873.1
Total components of Net Cost of Operations that will Require or Generate Resources in future periods	**$ 141,653.1**	**$ 96,326.8**
Components not Requiring or Generating Resources:		
Depreciation and amortization	37,690.3	27,287.0
Revaluation of assets or liabilities (+/-)	8,154.5	6,073.3
Other (+/-)		
Trust Fund Exchange Revenue	(46,429.9)	(39,246.6)
Cost of Goods Sold	64,716.5	56,125.0
Operating Material and Supplies Used	25,695.8	30,590.5
Other	(41,985.0)	(38,089.3)
Total Components of Net Cost of Operations that will not Require or Generate Resources	**$ 47,842.2**	**$ 42,739.9**
Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	**$ 189,495.3**	**$ 139,066.7**
Net Cost of Operations	**$ 676,046.9**	**$ 601,411.4**

Due to the Department's financial system limitations, budgetary data do not agree with proprietary expenses and capitalized assets. The difference between budgetary and proprietary data is a previously identified deficiency. The following adjustments (absolute value) were made to balance the Reconciliation of Net Cost of Operations to the Statement of Net Cost:

	(*Amounts in millions*)
Resources that Finance the Acquisition of Assets	$4,258.8
Revaluation of Assets or Liabilities	2,530.0
Total Amount	$6,788.8

The following Reconciliation of Net Cost of Operations to Budget lines are presented as combined instead of consolidated due to intraagency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

Other Resources, Other and Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations, Other primarily consist of nonexchange gains and losses necessary to reconcile the proprietary and budgetary accounts and losses on disposition of assets. Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations, Other also consists of $1.3 billion in prior period adjustments to correct costs expensed that should have been capitalized as other assets in FY 2007. Refer to Note 25, Restatements, for further details.

Components Requiring or Generating Resources in Future Period, Other primarily consists of future funded expenses for the current year change in actuarial liabilities of $135.3 billion. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional disclosures.

Components not Requiring or Generating Resources, Other primarily consists of other expenses not requiring budgetary resources, cost capitalization offsets, and applied overhead.

Note 22. Disclosures Related to Incidental Custodial Collections

The Department collected $4.3 million of incidental custodial revenues generated primarily from the collection of fines, penalties, and forfeitures. These funds are not available for use by the Department. At the end of each fiscal year, the accounts are closed and the balances rendered to the U.S. Treasury.

Note 23. Earmarked Funds

Earmarked Funds					Dollars in Millions
	2008				
As of September 30	Military Retirement Fund	Medicare Eligible Retiree Health Care Fund	Other Earmarked Funds	Eliminations	Total
Balance Sheet					
Assets					
Fund balance with Treasury	$ 17.5	$ 5.0	$ 2,237.7	$ 0.0	$ 2,260.2
Investments	253,046.7	134,291.6	7,170.2	0.0	394,508.5
Accounts and Interest Receivable	24.5	12.5	551.2	(5.8)	582.4
Other Assets	0.0	0.0	1,999.5	0.0	1,999.5
Total Assets	**$ 253,088.7**	**$ 134,309.1**	**$ 11,958.6**	**$ (5.8)**	**$ 399,350.6**
Liabilities and Net Position					
Military Retirement Benefits and Other Federal Employment Benefits	1,154,108.1	500,819.2	3,105.3	0.0	1,658,032.6
Other Liabilities	1.8	199.8	810.3	(85.7)	926.2
Total Liabilities	**$1,154,109.9**	**$ 501,019.0**	**$ 3,915.6**	**$ (85.7)**	**$1,658,958.8**
Unexpended Appropriations	0.0	0.0	4.9	0.0	4.9
Cumulative Results of Operations	(901,021.2)	(366,709.9)	8,038.1	(86,232.0)	(1,345,925.0)
Total Liabilities and Net Position	**$ 253,088.7**	**$ 134,309.1**	**$ 11,958.6**	**$ (86,317.7)**	**$ 313,038.7**
Statement of Net Cost					
Program Costs	171,077.5	(8,429.7)	2,252.9	(2,524.3)	162,376.4
Less Earned Revenue	(80,659.5)	(32,657.2)	(1,206.9)	89,991.0	(24,532.6)
Net Program Costs	90,418.0	(41,086.9)	1,046.0	87,466.7	137,843.8
Net Cost of Operations	**$ 90,418.0**	**$ (41,086.9)**	**$ 1,046.0**	**$ 87,466.7**	**$ 137,843.8**
Statement of Changes in Net Position					
Net Position Beginning of the Period	(810,603.2)	(407,796.8)	6,586.9	0.0	(1,211,813.1)
Net Cost of Operations	90,418.0	(41,086.9)	1,046.0	87,466.7	137,843.8
Budgetary Financing Sources	0.0	0.0	2,950.3	1,229.6	4,179.9
Other Financing Sources	0.0	0.0	(448.2)	5.1	(443.1)
Change in Net Position	**$ (90,418.0)**	**$ 41,086.9**	**$ 1,456.1**	**$ (86,232.0)**	**$ (134,107.0)**
Net Position End of Period	**$ (901,021.2)**	**$ (366,709.9)**	**$ 8,043.0**	**$ (86,232.0)**	**$(1,345,920.1)**

Earmarked Funds

Dollars in Millions

As of September 30	2007				
	Military Retirement Fund	**Medicare Eligible Retiree Health Care Fund**	**Other Earmarked Funds**	**Eliminations**	**Total**
Balance Sheet					
Assets					
Fund balance with Treasury	$ 20.4	$ 5.0	$ 1,961.4	$ 0.0	$ 1,986.8
Investments	218,085.0	109,549.1	6,076.8	0.0	333,710.9
Accounts and Interest Receivable	143.1	10.3	515.2	(151.8)	516.8
Other Assets	0.0	0.0	2,214.8	0.0	2,214.8
Total Assets	**$ 218,248.5**	**$ 109,564.4**	**$ 10,768.2**	**$ (151.8)**	**$ 338,429.3**
Liabilities and Net Position					
Military Retirement Benefits and Other Federal Employment Benefits	1,028,850.7	517,104.6	3,108.7	0.0	1,549,064.0
Other Liabilities	1.0	256.6	1,072.6	(133.8)	1,196.4
Total Liabilities	**$1,028,851.7**	**$ 517,361.2**	**$ 4,181.3**	**$ (133.8)**	**$1,550,260.4**
Unexpended Appropriations	0.0	0.0	8.1	0.0	8.1
Cumulative Results of Operations	(810,603.2)	(407,796.8)	6,578.8	(68,286.0)	(1,280,107.2)
Total Liabilities and Net Position	**$ 218,248.5**	**$ 109,564.4**	**$ 10,768.2**	**$ (68,419.8)**	**$ 270,161.3**
Statement of Net Cost					
Program Costs	105,253.0	(13,945.8)	3,175.1	(2,542.8)	91,939.5
Less Earned Revenue	(53,311.2)	(31,539.3)	(1,014.3)	70,427.7	(15,437.1)
Net Program Costs	51,941.8	(45,485.1)	2,160.8	67,884.9	76,502.4
Net Cost of Operations	**$ 51,941.8**	**$ (45,485.1)**	**$ 2,160.8**	**$ 67,884.9**	**$ 76,502.4**
Statement of Changes in Net Position					
Net Position Beginning of the Period	(758,661.4)	(453,467.9)	5,371.4	0.0	(1,206,757.9)
Net Cost of Operations	51,941.8	(45,485.1)	2,160.8	67,884.9	76,502.4
Budgetary Financing Sources	0.0	186.0	3,154.8	(414.2)	2,926.6
Other Financing Sources	0.0	0.0	221.5	13.1	234.6
Change in Net Position	**$ (51,941.8)**	**$ 45,671.1**	**$ 1,215.5**	**$ (68,286.0)**	**$ (73,341.2)**
Net Position End of Period	**$ (810,603.2)**	**$ (407,796.8)**	**$ 6,586.9**	**$ (68,286.0)**	**$(1,280,099.1)**

Abnormal Balances

The abnormal balance of $8.4 billion in program costs for the Medicare-Eligible Retiree Health Care Fund (MERHCF) is due to a $16.3 billion decrease in MERHCF actuarial liability, which was updated September 30, 2008. This decrease was caused by changes in the actuarial assumptions, new assumptions, experience, and assumed discount rate. This decrease is offset by $7.9 billion in normal benefit expenses.

Other Disclosures

The Statement of Federal Financial Accounting Standards (SFFAS) No. 27, "Identifying and Reporting Earmarked Funds," requires the disclosure of Earmarked Funds separate from All Other Funds on the Statement of Changes in Net Position (SCNP) and Balance Sheet. Funds must meet three criteria to be classified as earmarked: (1) a statute committing use of specifically-identified revenues for designated purposes, (2) explicit authority to retain the revenues, and (3) a requirement to account and report on the revenues. The Department's earmarked funds are either special or trust funds and use both receipt and expenditure accounts to report activity to the U.S. Treasury. There have been no changes in legislation that significantly changed the purposes of the funds.

The Total column is shown as consolidated and relates only to Earmarked Funds. The Eliminations column includes eliminations associated with Earmarked Funds and excludes the offsetting eliminations from All Other Funds. This exclusion causes assets to not equal liabilities and net position in the note. However, the amounts in the Total column equal the amounts reported for Earmarked Funds on the Balance Sheet.

The SFFAS No. 27 requires the presentation of gross amounts of Earmarked Funds separate from All Other (nonearmarked) Funds. Cumulative Results of Operations ending balances for Earmarked Funds on the SCNP do not agree with the Cumulative Results of Operations for Earmarked Funds reported on the Balance Sheet because the Cumulative Results of Operations on the Balance Sheet are presented net of eliminations, whereas the SCNP presents Cumulative Results of Operations gross.

Military Retirement Fund, 10 United States Code (USC) 1461. The MRF accumulates funds in order to finance, on an actuarially sound basis, the liabilities of the Department's military retirement and survivor benefit programs. Financing sources for the MRF are interest earnings on Fund assets, monthly Department contributions, and annual contributions from the U.S. Treasury. The monthly Department contributions are calculated as a percentage of basic pay. The contribution from the U.S. Treasury represents the amortization of the unfunded liability for service performed prior to October 1, 1984, plus the amortization of actuarial gains and losses that have arisen since then. The U.S. Treasury annual contribution also includes the normal cost amount for the concurrent receipt provisions of the FY 2004 National Defense Authorization Act.

Medicare-Eligible Retiree Health Care Fund, 10 USC 1111. The MERHCF accumulates funds to finance, on an actuarially sound basis, liabilities of the Department and the uniformed services health care programs for qualified Medicare-eligible beneficiaries. Financing sources for MERHCF are provided primarily through an annual actuarial liability payment from the U.S. Treasury, annual contributions from each Uniformed Service (Army, Navy, Air Force, Marine Corps, U.S. Coast Guard, National Oceanic and Atmospheric Administration, and U.S. Public Health Service) and interest earned from the Fund's investments.

Other Earmarked Funds

Special Recreation Use Fees, 16 USC 4061-6a note. The United States Army Corps of Engineers (USACE) is granted the authority to charge and collect fair and equitable Special Recreation Use Fees at campgrounds located at lakes or reservoirs that are under the jurisdiction of USACE. Types of allowable fees include daily use fees, admission fees, recreational fees, annual pass fees, and other permit type fees. The receipts are used for the operation and maintenance of the recreational sites.

Hydraulic Mining in California, Debris, 33 USC 683. Operators of hydraulic mines through which debris flows in part or in whole to a body restrained by a dam or other work erected by the California Debris Commission are required to pay an annual tax as determined by the Commission. Taxes imposed under this code are collected and expended under the supervision of USACE and the direction of the Department of the Army. The funds are used for repayment of funds advanced by the Federal government or other agencies for construction, restraining works, settling reservoirs, and maintenance.

Payments to States, Flood Control Act of 1954, 33 USC 701c-3. Seventy-five percent of all funds received and deposited from the leasing of lands acquired by the United States for flood control, navigation, and allied purposes (including the development of hydroelectric power) are returned to the state in which the property is located. USACE collects lease receipts into a receipt account. Funds are appropriated for the amount of receipts the following fiscal year. The funds may be expended by the states for the benefit of public schools and public roads of the counties in which such property is situated, or for defraying any of the expenses of county government.

Maintenance and Operation of Dams and Other Improvements of Navigable Waters, 16 USC 803(f) and 810. When a reservoir or other improvement is constructed by the U.S., the Federal Energy Regulatory Commission (FERC) assesses charges against licensees directly benefited. The statute requires all proceeds from any Indian reservation be placed to the credit of the Indians of the reservation. All other charges arising from licenses, except those charges established by the FERC for administrative reimbursement, are paid to the U.S. Treasury and allocated for specific uses. The Army is allocated 50 percent of charges from all licenses, except licenses for the occupancy and use of public lands and national forests. These funds are deposited in a special fund and used for maintenance, operation, and improvement of dams and other navigation structures that are owned by the United States, or in construction, maintenance, or operation of headwater, or other improvements to navigable waters of the United States.

Fund for NonFederal Use of Disposal Facilities (for dredged material), 33 USC 2326. Any dredged material disposal facility under the jurisdiction of, or managed by, the Secretary of the Army may be used by a nonfederal interest if the Secretary determines that such use will not reduce the availability of the facility for project purposes. Fees may be imposed to recover capital, operation, and maintenance costs associated with such use. Any monies received through collection of fees under this law shall be available to, and used by, the Secretary of the Army for the operation and maintenance of the disposal facility from which the fees were collected.

South Dakota Terrestrial Wildlife Habitat Restoration Trust Fund, Public Law 106-53 Sec. 603. Yearly transfers are made from the General Fund of the U.S. Treasury to the Trust Fund for investment purposes. Investment activity is managed by the Bureau of the Public Debt (BPD). The BPD purchases and redeems nonmarketable market-based securities. Investments include one-day certificates, bonds, and notes. When the fund reaches the aggregate amount of $108 million, withdrawals may be made by USACE for payment to the State of South Dakota. The state uses the payments to fund annually-scheduled work for wildlife habitat restoration.

Coastal Wetlands Restoration Trust Fund and Coastal Wetlands Planning, Protection, and Restoration Act, 16 USC 3951-3956. USACE (along with the Environmental Protection Agency, and the Fish and Wildlife Service) is granted the authority to work with the State of Louisiana to develop, review, evaluate, and approve a plan to achieve a goal of "no net loss of wetlands" in coastal Louisiana. USACE is also responsible for allocating funds among the named task force members. Federal contributions are established at 75 percent of project costs or 85 percent if the state has an approved Coastal Wetlands Conservation Plan.

Rivers and Harbors Contributed and Advance Funds, 33 USC 701h, 702f, and 703. Whenever any state or political subdivision offers to advance funds for a flood control project duly adopted and authorized by law, the Secretary of the Army may, in his discretion, receive such funds and expend them in the immediate prosecution of such work. The funding may be used to construct, improve, and maintain levees, water outlets, flood control, debris removal, rectification and enlargement of river channels, etc. in the course of flood control and river and harbor maintenance.

Inland Waterways Trust Fund, 26 USC 9506. This law made the Inland Waterways Trust Fund available for USACE expenditures for navigation, construction, and rehabilitation projects on inland waterways. Collections for excise taxes from the public are made into the Trust Fund. The collections are invested and investment activity is managed by the BPD. The BPD purchases and redeems nonmarketable market-based securities. Investments include one-day certificates, bonds, and notes.

Harbor Maintenance Trust Fund, 26 USC 9505. The USACE Civil Works mission is funded by the Energy and Water Development Appropriations Act. The Water Resources Development Act of 1986 covers a portion of USACE operations and maintenance costs for deep draft navigation. The Harbor Maintenance Trust Fund is available for making expenditures to carry out the functions specified in the Act and for the payment of all expenses of administration incurred by the U.S. Treasury, USACE, and the Department of Commerce. Collections are made into the Trust Fund from taxes collected from imports, domestics, passengers, and foreign trade. The collections are invested and investment activity is managed by the Bureau of Public Debt.

Foreign National Employees Separation Pay Account Trust Fund, 10 USC 1581. This fund makes payments from amounts obligated by the Secretary of Defense that remain unexpended for separation pay for foreign national employees of the Department. The foreign national employees' separation pay funded by Foreign Military Sales administrative funds is maintained as a separate fund.

Defense Commissary Agency Surcharge Trust Fund, 10 USC 2685. This fund was established as the repository for the surcharge on sales of commissary goods paid for by authorized patrons to finance certain operating expenses and capital purchases of the Commissary System, which are precluded by law from being paid with appropriated funds. Most Surcharge revenue is generated by the 5 percent surcharge applied to each sale. These funds may be used to pay for commissary store-related information technology investments, to purchase commissary equipment, to finance advance design modifications to prior year projects, for both minor and major construction projects, and to maintain and repair commissary facilities and equipment.

Education Benefit Fund, 10 USC 2006. This fund was established to finance, on an actuarially sound basis, the liabilities of the Department's education benefit programs for current and former active duty, guard, and reserve members of the armed forces, and members of the Coast Guard. Financing sources for the Education Benefit Fund are interest earnings on Fund assets and monthly Department contributions.

Voluntary Separation Incentive Fund, 10 USC 1175. This fund was established to finance, on an actuarially sound basis, the liabilities of the Department's incentive program for early separation from military service. Financing sources for the Voluntary Separation Incentive Fund are interest earnings on Fund assets and annual Department contributions.

Military Housing Privatization Initiative, Public Law 104-106, Section 2801. The Military Housing Privatization Initiative (MHPI) includes both direct loan and loan guarantee programs, is authorized by the National Defense Authorization Act for FY 1996, and includes a series of authorities that allow the Department to work with the private sector to renovate and build military family housing. The MHPI accelerates the construction of new housing built to market standard and leverages private sector capital with government dollars. The Department provides protection to the private sector partner against specific risks, such as base closure or member deployment.

Armament Retooling and Manufacturing Support Initiative, 10 USC 4551-4555. The Armament Retooling and Manufacturing Support Initiative is a loan guarantee program designed to incentivize commercial use of the Army's inactive ammunition plants for businesses willing to locate to a government ammunition production facility. The production capacity of these facilities is greater than current military requirements, however, this capacity may be needed in the future. Revenue from property rentals are used to pay for the operation, maintenance and environmental cleanup at the facilities.

Note 24. Other Disclosures

Other Disclosures				*Dollars in Millions*
	2008 — Asset Category			
As of September 30	**Land and Buildings**	**Equipment**	**Other**	**Total**
Entity as Lessee – Operating Leases				
Future Payments Due				
Fiscal Year 2009	$ 309.6	$ 38.5	$ 174.8	$ 522.9
Fiscal Year 2010	291.8	35.3	178.7	505.8
Fiscal Year 2011	274.2	36.0	186.2	496.4
Fiscal Year 2012	244.7	19.9	194.1	458.7
Fiscal Year 2013	223.2	5.3	126.0	354.5
After 5 Years	364.5	0.0	131.9	496.4
Total Future Lease Payments Due	**$ 1,708.0**	**$ 135.0**	**$ 991.7**	**$ 2,834.7**

Operating leases are leases that do not transfer all the benefits and risk of ownership of capital leases. Payments are charged as expenses over the lease term. Office space is the largest component of land and building leases. Other leases are generally one-year leases that are not building or equipment leases. Future year cost projections use the Consumer Price Index.

Subsequent Event

On October 16, 2008 the Cost of Living Adjustment index of 5.8% was issued for the benefits payments beginning January 1, 2009. The actuarial valuation model used to develop the actuarial liability included on the balance sheet used the 6.2% projected index at the time the liability was calculated. The Office of the Actuary estimates the impact of the reduction in the index caused an overstatement to the actuarial liability of $3.0 billion. This overstatement is included in the actuarial liability in the accompanying Balance Sheet and Statement of Net Cost at September 20, 2008.

Note 25. Restatements

During the reporting period, the Department identified material errors and report presentation changes. As a result, the Department made prior year changes in accordance with generally accepted accounting principles.

Corrections Due to Accounting Errors

As a result of ongoing audit readiness efforts, the Department discovered $1.3 billion of contract financing payments classified as expenses rather than assets due to legacy system deficiencies. This error impacted other assets, expenses, unexpended appropriations, cumulative results of operations, and net position. It impacted the Department's Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position. Refer to Note 6, Other Assets, for additional details and disclosures.

On September 30, 2007, the military payroll due for disbursement on October 1st was processed one day early. The payroll was not actually paid to the soldiers until October 1st even though it appeared as disbursed in the Department's system. Since the processing of the payroll and the actual outlays for the payroll crossed over two fiscal years, the outlays in both fiscals years were incorrectly stated (overstated in FY 2007 and understated in FY 2008) and required correction. The restated amount of $1.3 billion impacted the Balance Sheet and Statement of Budgetary Resources.

REPORT PRESENTATION CHANGE

At FY 2007, the Department presented a combined report of the DoD financial statements and the financial statements of certain programs of the Executive Office of the President (EOP). After consultation and guidance from the Office of Management and Budget (OMB), it was determined that DoD would report on EOP programs administered by DoD separately from the DoD financial statements. Based on the OMB Circular No. A-136 "Financial Reporting Requirements," it was further determined that only EOP activity resulting from allocation transfers should be reported within the DoD financial statements. As a result, DoD changed its financial report presentation to separately report the EOP reporting activity not resulting from allocation transfers. The DoD continues to report activity resulting from EOP allocation transfers within the DoD financial statements; and, effective FY 2008, reports other activity executed on behalf of EOP in a separate report. Refer to the Defense Security Cooperation Agency Unaudited Financial Statements available on the Comptroller Web site. (See Appendix B.)

Effect on Comparative Balances

The following chart reflects the cumulative effect on the Department's balances reported in the comparative period:

FY 2007 Balance Sheet		*Dollars in Billions*
Fund Balance with Treasury	$	(10.6)
Cash and Other Monetary Assets		(12.5)
Loans Receivable		(3.0)
Other Assets		(8.0)
Total Assets	**$**	**(34.1)**
Debt		(2.9)
Other Liabilities		(28.9)
Total Liabilities	**$**	**(31.8)**
Net Position	**$**	**(2.3)**

FY 2007 Statement of Net Cost		*Dollars in Billions*
Gross Costs		(21.1)
Less: Earned Revenue		0.1
Net Cost of Operations	**$**	**(21.0)**

FY 2007 Statement of Changes in Net Position		*Dollars in Billions*
Cumulative Results of Operations		
Budgetary Financing Sources:		
Appropriations used		(4.4)
Nonexchange revenue		(16.6)
Other Financing Sources:		
Transfers–in/out without reimbursement		.1
Total Financing Sources	**$**	**(20.9)**
Net cost of Operations	**$**	**(21.0)**
Net Change	**$**	**.1**
Unexpended Appropriations		
Beginning Balances	$	(1.8)
Budgetary Financing Sources:		
Appropriations Received		(5.0)
Appropriation used		4.4
Total Budgetary Financing Sources	**$**	**(.6)**
Unexpended Appropriations	**$**	**(2.4)**
Net Position	**$**	**(2.3)**

FY 2007 Statement of Budgetary Resources		*Dollars in Billions*
Comparative Year Effect for FY 2007		
Appropriation	$	(20.8)
Contract Authority		(48.0)
Spending authority from offsetting collections		
Earned		
Collected		(0.9)
Permanently Not Available		16.6
Total Budgetary Resources	**$**	**(53.1)**
Obligations		(53.1)
Total Status of Budgetary Resources	**$**	**(53.1)**
Gross Outlays		(20.3)
Less: Offsetting Collections		16.7
Net Outlays	**$**	**(3.6)**

The following chart reflects the cumulative effect on the Department's balances reported in the current period:

FY 2008 Statement of Changes in Net Position		*Dollars in Billions*
Beginning Balance Change for FY 2008		
Cumulative Results of Operations		
Beginning Balances	$	(1.3)

FY 2008 Statement of Budgetary Resources		*Dollars in Billions*
Beginning Balance Change for FY 2008		
Unpaid Obligations, Brought Forward	$	(63.8)

REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

Federal financial reporting requires DoD to report on its stewardship over certain resources that cannot be measured in traditional financial reports. These resources do not meet the criteria for assets and liabilities required to be reported in the financial statements but are important to understanding the operations and financial condition of DoD at the date of the financial statements and in subsequent periods.

The Department's stewardship investments comprise, and are measured in terms of, expense incurred for: 1) federally-financed but not federally-owned physical property (Nonfederal Physical Property); and 2) federally-financed research and development (Research and Development). Information on additional reporting requirements for Nonfederal Physical Property and Research and Development follows.

Nonfederal Physical Property

The Nonfederal Physical Property investments support the purchase, construction, or major renovation of physical property owned by state and local governments. In addition, Nonfederal Physical Property Investments include federally-owned physical property transferred to state and local governments.

The Department continued transitioning to a new methodology for reporting Nonfederal Physical Property during 2008. Investment values included in this report are based on Nonfederal Physical Property outlays (expenditures). Outlays are used because current Department accounting systems are unable to capture and summarize costs in accordance with federal accounting standards.

Investments in Research and Development

Investment values included in this report are based on Research and Development outlays (expenditures). Outlays are used because current Department accounting systems are unable to capture and summarize costs in accordance with federal accounting standards. The Department continues to improve its methodology for reporting this information. Research and Development (R&D) programs are classified in the following categories: Basic Research, Applied Research and Development. Therefore, the amounts reported in the Investments in R&D table show outlays from FY 2006 – FY 2008 for all DoD Components. The definition for each type of Research and Development Category and Subcategories are explained below.

Basic Research is the systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications, processes, or products in mind. Basic Research involves the gathering of a fuller knowledge or understanding of the subject under study. Major outputs are scientific studies and research papers.

Nonfederal Physical Property
Department of Defense Consolidated — Nonfederal Physical Property

Yearly Investments in State and Local Governments
For Fiscal Years 2008 through 2004
Dollars in Millions

Categories	2008	2007	FY 2006	FY 2005	FY 2004
Transferred Assets:					
National Defense Mission Related	$ 1,169.2	$ 1,051.0	$ 1,295.5	$ 1,394.7	$ 4,483.7
Funded Assets:					
National Defense Mission Related	19.6	2.8	8.5	8.3	18.3
Total	**$ 1,188.8**	**$ 1,053.8**	**$ 1,304.0**	**$ 1403.0**	**$ 4,502.0**

Applied Research is the systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met. It is the practical application of such knowledge or understanding for the purpose of meeting a recognized need. This research points toward specific military needs with a view toward developing and evaluating the feasibility and practicability of proposed solutions and determining their parameters. Major outputs are scientific studies, investigations, and research papers, hardware components, software codes, and limited construction of, or part of, a weapon system to include non-system-specific development efforts.

Development takes what has been discovered or learned from basic and applied research and uses it to establish technological feasibility, assessment of operability, and production capability. Development consists of the five stages defined in the Investments is R&D table.

Advanced Technology Development is the systematic use of the knowledge or understanding gained from research and directed toward proof of technological feasibility and assessment of operational and productibility rather than directed toward the development of hardware for service use. It employs demonstration activities intended to prove or test a technology or method.

Advanced Component Development and Prototypes evaluates integrated technologies in as realistic an operating environment as possible to assess the performance or cost reduction potential of advanced technology. Programs in this phase are generally system specific. Major outputs of Advanced Component Development and Prototypes are hardware and software components, or complete weapon systems, ready for operational and developmental testing and field use.

Investments in Research and Development (R&D)
Department of Defense Consolidated

Yearly Investments in Research and Development
For the Current and Four Preceding Fiscal Years — *Dollars in Millions*

Categories	2008	2007	FY 2006	FY 2005 (1)	FY 2004 (1)
Basic Research	**$ 1,526.4**	**$ 1,331.2**	**$ 1,086.8**	**$ 1,107.2**	**$ 1,037.7**
Applied Research	3,169.7	4,462.0	3,787.0	3,757.5	3,461.3
Development					
Advanced Technology Development	5,977.9	6,019.7	5,737.4	5,795.2	5,057.0
Advanced Component Development and Prototypes	15,410.6	14,109.6	11,906.9	12,793.3	10,944.6
System Development and Demonstration	18,052.9	16,737.8	13,209.8	12,253.1	10,834.8
Research, Development, Test and Evaluation Management Support	5,471.0	4,705.4	3,736.0	3,590.6	3,405.6
Operational Systems Development	20,246.7	13,535.1	5,509.8	5,334.6	5,134.1
Totals:	**$69,855.2**	**$60,900.8**	**$44,973.7**	**$44,631.5**	**$39,875.1**

(1) Total amount available for obligations

System Development and Demonstration concludes the program or project and prepares it for production. It consists primarily of preproduction efforts, such as logistics and repair studies. Major outputs are weapons systems finalized for complete operational and developmental testing.

Research, Development, Test, and Evaluation Management Support is support for installations and operations for general research and development use. This category includes costs associated with test ranges, military construction maintenance support for laboratories, operation and maintenance of test aircraft and ships, and studies and analyses in support of the Research and Development program.

Operational Systems Development is concerned with development projects in support of programs or upgrades still in engineering and manufacturing development, which have received approval for production, and for which production funds have been budgeted in subsequent fiscal years.

REQUIRED SUPPLEMENTARY INFORMATION

Heritage Assets

Heritage Assets

For Fiscal Year Ended September 30, 2008	2008				
	Measure Quantity	As of 10/1/2007	Additions	Deletions	As of 9/30/2008
Categories					
Buildings and Structures	Each	17,117	6,675	1,684	22,108
Archeological Sites	Each	27,955	1,411	2,208	27,158
Museum Collection Items (Objects, Not Including Fine Art)	Each	113,269	4,012	85	117,196
Museum Collection Items (Fine Art)	Each	10,446	206	102	10,550

Heritage Assets are items of historical, natural, and cultural, educational, or artistic significance (e.g. aesthetic) or items with significant architectural characteristics. Heritage Assets are expected to be preserved indefinitely. FY 2008 categories are as follows:

Buildings and Structures. Buildings and structures that are listed on, or eligible for listing on, the National Register of Historic Places, including Multi-Use Heritage Assets.

Archeological Sites. Sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Register of Historic Places.

Museums Collection Items. Items which are unique for one or more of the following reasons: historical or natural significance; cultural, educational or artistic importance; or significant technical or architectural characteristics. Museum collection items are divided into two subcategories: fine art and objects. Fine art includes paintings, sculptures, and other three-dimensional art. Objects are current use, excess, obsolete, or condemned materiel; war trophies; and personal property, such as uniforms, medals, or diaries, and military equipment.

Stewardship Land

Stewardship Land *For Fiscal Year Ended September 30, 2007*					*(Acres in Thousands)*
Facility Code	**Facility Title**	**As of 10/1/2006**	**Additions**	**Deletions**	**As of 9/30/2007**
9110	Government Owned Land	7,925.0	144.0		8,069.0
9111	State Owned Land	141.5	0.5		142.0
9120	Withdrawn Public land	16,064.0	73.5		16,137.5
9130	Licensed and Permitted Land	4,095.3		(1,276.5)	2,818.8
9140	Public Land	701.9	3.8		705.7
9210	Land Easement	498.4		(2.2)	496.1
9220	In-leased Land	2,329.7		(1,509.8)	819.9
9230	Foreign Land	652.3		(38.6)	613.7
Grand Total					**29,802.5**
TOTAL - All Other Lands					**12,817.3**
				TOTAL – Stewardship Lands	**16,985.2**

Narrative Statement:
The fiscal year ended September 30, 2008 stewardship land data will not be available until December 15, 2008 due to limitations of the Department's financial and nonfinancial management processes and systems that feed into the financial statements.

Stewardship Land is land and land rights owned by the Department but not acquired for, or in connection with, items of General Property, Plant, and Equipment. All land provided to the Department from the public domain or at no cost, regardless of its use, is classified as Stewardship Land.

Stewardship Land is presented in context of all categories of DoD lands and reported in acres based on the predominant use of the land. The three categories of Stewardship Land held in public trust are: State-Owned Land, Withdrawn Public-Land, and Public Land.

Real Property Deferred Maintenance

Real Property Deferred Maintenance *For Fiscal Year Ended September 30, 2008*			*(Dollars in Millions)*
Property Type	**Current Fiscal Year (CFY)**		
	Plant Replacement Value	**Required Work (deferred maintenance)**	**Percentage**
Category 1	$555,787	$62,810	11%
Category 2	$52,190	$7,854	15%
Category 3	$37,913	$6,239	16%

The deferred maintenance amount is based upon facility Q-ratings found in the Department's real property inventory. Q-ratings represent work needed to bring a facility to a fully serviceable condition with no repair needs. The reported deferred maintenance is the difference between the facility Q rating and the target Q rating that represents the acceptable operating condition established by each Component within the Department. The percentage column reflects the percent of total plant replacement value for each category represented by deferred maintenance.

Facility Categories are as follows:

- Category 1: Buildings, Structures, and Utilities that are enduring and required to support an ongoing mission, including multi-use Heritage Assets.

- Category 2: Buildings, Structures, and Utilities that are excess to requirements or planned for replacement or disposal, including multi-use Heritage Assets.
- Category 3: Buildings, Structures, and Utilities that are Heritage Assets.

Military Equipment Deferred Maintenance

Depot maintenance requirements for military equipment are developed during the annual budget process. The table below shows the deferred unfunded requirements for the depot maintenance program. The Department Components' FY 2008 Budget Estimates contain detailed information on each program.

Military Equipment Deferred Maintenance
For Fiscal Year Ended September 30, 2008

Major Categories	*(Dollars in Millions)*
1. Aircraft	$762.0
2. Automotive Equipment	$1.0
3. Combat Vehicles	$266.0
4. Construction Equipment	$19.0
5. Electronics and Communications Systems	$456.2
6. Missiles	$215.6
7. Ships	$35.9
8. Ordnance Weapons and Munitions	$50.6
9. General Purpose Equipment	$48.0
10. All Other Items Not Identified to Above Categories	$1,339.6
Total	**$3,193.9**

Statement Of Disaggregated Budgetary Resources *For the Years Ended September 30, 2008 and 2007* *Dollars in Millions*	2008											
	Military Retirement Fund	**Medicare Eligible Retiree Health Care Fund**	**Research, Development, Test and Evaluation**	**Civil Works**	**Operation and Maintenance**	**Procurement**	**Military Personnel**	**Military Construction/ Family Housing**	**Working Capital Funds**	Other	**2008 Combined**	**2007 Combined**
Budgetary Resources												
Unobligated balance, brought forward, October 1	$ 0.0	$ 0.0	$ 13,823.8	$ 9,648.2	$ 9,812.4	$ 46,367.8	$ 882.8	$ 8,792.5	$ 6,813.9	$ 15,839.2	$ 111,980.6	$ 85,778.0
Recoveries of prior year unpaid obligations	0.0	0.0	4,325.7	580.1	19,430.7	11,862.6	8,289.8	1,051.1	2,228.2	1,975.9	49,744.1	85,778.0
Budget authority												
Appropriation	80,751.0	32,270.8	75,538.3	9,566.6	251,295.1	147,536.8	135,615.4	13,730.2	4,190.2	108,909.4	859,403.8	741,888.3
Borrowing authority	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contract authority	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	78,927.9	(0.1)	78,927.8	68,668.0
Spending authority from offsetting collections												
Earned												
Collected	0.0	0.0	9,631.0	9,841.0	25,972.4	3,160.0	1,029.5	5,716.6	117,605.6	1,536.9	174,493.0	164,627.1
Change in receivables from Federal sources	0.0	0.0	(82.1)	(195.3)	(38.0)	99.9	(43.2)	154.0	792.4	104.1	791.8	(1,277.6)
Change in unfilled customer orders												
Advance received	0.0	0.0	(195.9)	522.0	309.2	(70.5)	0.0	231.2	(94.9)	52.1	753.2	448.9
Without advance from Federal sources	0.0	0.0	(81.9)	1,477.1	1,186.9	749.9	(17.9)	1,837.7	529.8	(2.5)	5,679.1	5,994.0
Expenditure transfers from trust funds	0.0	0.0	0.0	766.0	0.0	0.0	0.0	0.0	0.0	0.0	766.0	0.0
Subtotal	80,751.0	32,270.8	84,809.4	21,977.4	278,725.6	151,476.1	136,583.8	21,669.7	201,951.0	110,599.9	1,120,814.7	980,348.7
Nonexpenditure transfers, net, anticipated and actual	0.0	0.0	1,480.2	182.8	6,025.2	16,731.0	1,011.4	(201.2)	(1,733.5)	(23,760.0)	(264.1)	(111.3)
Temporarily not available pursuant to Public Law	(35,102.2)	(24,484.9)	0.0	(10.0)	0.0	0.0	0.0	0.0	0.0	(352.3)	(59,949.4)	(33,819.5)
Permanently not available	0.0	0.0	(1,533.1)	(5.5)	(3,980.0)	(4,805.9)	(398.3)	(74.0)	(74,223.8)	(136.2)	(85,156.8)	(74,763.9)
Total Budgetary Resources	$ 45,648.8	$ 7,785.9	$ 102,906.0	$ 32,373.0	$ 310,013.9	$ 221,631.6	$ 146,369.5	$ 31,238.1	$ 135,035.8	$ 104,166.5	$ 1,137,169.1	$ 1,002,294.5

Status Of Budgetary Resources

For the Years Ended September 30, 2008 and 2007

Dollars in Millions

	2008											
	Military Retirement Fund	Medicare Eligible Retiree Health Care Fund	Research, Development, Test and Evaluation	Civil Works	Operation and Maintenance	Procurement	Military Personnel	Military Construction/ Family Housing	Working Capital Funds	Other	2008 Combined	2007 Combined
Obligations incurred:												
Direct	$ 45,648.8	$ 7,785.9	$ 76,279.6	$ 9,125.3	$ 271,478.9	$ 152,984.3	$ 144,550.1	$ 11,763.7	$ 1,378.6	$ 90,666.8	$ 811,662.0	$ 719,463.4
Reimbursable	0.0	0.0	10,121.4	11,555.0	27,906.2	3,616.2	999.9	8,095.2	126,238.1	1,305.4	189,837.4	170,850.3
Subtotal	45,648.8	7,785.9	86,401.0	20,680.3	299,385.1	156,600.5	145,550.0	19,858.9	127,616.7	91,972.2	1,001,499.4	890,313.7
Unobligated balance:												
Apportioned	0.0	0.0	15,194.3	10,694.6	2,310.8	63,641.3	58.7	11,098.8	7,370.1	9,679.2	120,047.8	98,585.7
Exempt from apportionment	0.0	0.0	0.0	998.1	0.0	0.0	0.0	0.0	44.4	18.2	1,060.7	1,050.5
Subtotal	0.0	0.0	15,194.3	11,692.7	2,310.8	63,641.3	58.7	11,098.8	7,414.5	9,697.4	121,108.5	99,636.2
Unobligated balance not available	0.0	0.0	1,310.7	0.0	8,318.0	1,389.8	760.8	280.4	4.6	2,496.9	14,561.2	12,344.6
Total status of budgetary resources	$ 45,648.8	$ 7,785.9	$ 102,906.0	$ 32,373.0	$ 310,013.9	$ 221,631.6	$ 146,369.5	$ 31,238.1	$ 135,035.8	$ 104,166.5	$1,137,169.1	$1,002,294.5
Change in Obligated Balance:												
Obligated balance, net												
Unpaid obligations, brought forward, October 1	$ 3,530.2	$ 368.8	$ 39,037.5	$ 6,045.6	$ 107,560.1	$ 120,652.8	$ 8,593.0	$ 16,502.9	$ 53,983.2	$ 16,284.5	$ 372,558.6	$ 321,809.1
Less: Uncollected customer payments from Federal sources, brought forward, October 1	0.0	0.0	(5,637.0)	(4,136.3)	(11,872.3)	(2,753.3)	(22.4)	(7,013.7)	(28,675.3)	(21.0)	(60,131.3)	(55,414.9)
Total unpaid obligated balance	$ 3,530.2	$ 368.8	$ 33,400.5	$ 1,909.3	$ 95,687.8	$ 117,899.5	$ 8,570.6	$ 9,489.2	$ 25,307.9	$ 16,263.5	$ 312,427.3	$ 266,394.2
Obligations incurred net	45,648.8	7,785.9	86,401.0	20,680.3	299,385.1	156,600.5	145,550.0	19,858.9	127,616.7	91,972.2	1,001,499.4	890,313.7
Less: Gross outlays	(45,819.7)	(7,914.6)	(80,805.9)	(16,752.9)	(265,407.4)	(117,023.7)	(137,194.5)	(13,762.9)	(120,950.5)	(86,563.3)	(892,195.4)	(794,701.2)
Obligated balance transferred, net												
Actual transfers, unpaid obligations (+/-)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Actual transfers, uncollected customer payments from Federal sources	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Unpaid obligated balance transferred, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Less: Recoveries of prior year unpaid obligations, actual	0.0	0.0	(4,325.7)	(580.1)	(19,430.7)	(11,862.6)	(8,289.8)	(1,051.1)	(2,228.2)	(1,975.9)	(49,744.1)	(44,862.5)
Change in uncollected customer payments from Federal sources	0.0	0.0	164.0	(1,281.8)	(1,148.9)	(849.8)	61.0	(1,991.7)	(1,322.2)	(101.5)	(6,470.9)	(4,716.4)
Obligated balance, net, end of period												
Unpaid obligations	3,359.3	240.1	40,306.9	9,392.9	122,107.1	148,367.0	8,658.7	21,547.8	58,421.2	19,717.5	432,118.5	372,559.1
Less: Uncollected customer payments (+/-) from Federal sources	0.0	0.0	(5,473.0)	(5,418.1)	(13,021.2)	(3,603.1)	38.6	(9,005.4)	(29,997.5)	(122.5)	(66,602.2)	(60,131.3)
Total, unpaid obligated balance, net, end of period	$ 3,359.3	$ 240.1	$ 34,833.9	$ 3,974.8	$ 109,085.9	$ 144,763.9	$ 8,697.3	$ 12,542.4	$ 28,423.7	$ 19,595.0	$ 365,516.3	$ 312,427.8
Net												
Net Outlays:												
Gross outlays	$ 45,819.7	$ 7,914.6	$ 80,805.9	$ 16,752.9	$ 265,407.4	$ 117,023.7	$ 137,194.5	$ 13,762.9	$ 120,950.5	$ 86,563.3	$ 892,195.4	$ 794,701.2
Less: Offsetting collections	0.0	0.0	(9,435.1)	(11,129.0)	(26,281.6)	(3,089.6)	(1,029.5)	(5,947.8)	(117,510.7)	(1,588.9)	(176,012.2)	(165,076.0)
Less: Distributed Offsetting receipts	(46,187.0)	(20,774.9)	0.0	(638.9)	0.0	0.0	0.0	0.0	0.0	(2,647.0)	(70,247.8)	(48,272.0)
Net Outlays	$ (367.3)	$ (12,860.3)	$ 71,370.8	$ 4,985.0	$ 239,125.8	$ 113,934.1	$ 136,165.0	$ 7,815.1	$ 3,439.8	$ 82,327.4	$ 645,935.4	$ 581,353.2

Combined Statement Of Budgetary Resources *For the Years Ended September 30, 2008 and 2007* *Dollars in Millions*	Budgetary			Non Budgetary		
	Other	2008 Combined	2007 Combined	Other	2008 Combined	2007 Combined
Budgetary Financing Accounts						
Budgetary Resources						
Unobligated balance, brought forward, October 1	$ 15,839.2	$ 111,980.6	$ 85,778.0	$ 25.5	$ 25.5	$ 31.5
Recoveries of prior year unpaid obligations	1,975.9	49,744.1	85,778.0	0.0	0.0	0.0
Budget authority						
Appropriation	108,909.4	859,403.8	741,888.3	0.0	0.0	0.0
Borrowing authority	0.0	0.0	0.0	130.0	130.0	371.4
Contract authority	(0.1)	78,927.8	68,668.0	0.0	0.0	0.0
Spending authority from offsetting collections						
Earned						
Collected	1,536.9	174,493.0	164,627.1	53.9	53.9	13.6
Change in receivables from Federal sources	104.1	791.8	(1,277.6)	0.0	0.0	0.0
Change in unfilled customer orders						
Advance received	52.1	753.2	448.9	0.0	0.0	0.0
Without advance from Federal sources	(2.5)	5,679.1	5,994.0	12.6	12.6	53.5
Expenditure transfers from trust funds	0.0	766.0	0.0	0.0	0.0	0.0
Subtotal	110,599.9	1,120,814.7	980,348.7	196.5	196.5	438.5
Nonexpenditure transfers, net, anticipated and actual	(23,760.0)	(264.1)	(111.3)	0.0	0.0	0.0
Temporarily not available pursuant to Public Law	(352.3)	(59,949.4)	(33,819.5)	0.0	0.0	0.0
Permanently not available	(136.2)	(85,156.8)	(74,763.9)	(27.6)	(27.6)	(1.8)
Total Budgetary Resources	$ 104,166.5	$ 1,137,169.1	$ 1,002,294.5	$ 194.4	$ 194.4	$ 468.2

Statement of Disaggregated Budgetary Resources *For the Years Ended September 30, 2008 and 2007* *Dollars in Millions*	Budgetary Other	Budgetary 2008 Combined	Budgetary 2007 Combined	Non Budgetary Other	Non Budgetary 2008 Combined	Non Budgetary 2007 Combined
Budgetary Financing Accounts						
Obligations incurred:						
Direct	$ 90,666.8	$ 811,662.0	$ 719,463.4	$ 168.1	$ 168.1	$ 442.7
Reimbursable	1,305.4	189,837.4	170,850.3	0.0	0.0	0.0
Subtotal	91,972.2	1,001,499.4	890,313.7	168.1	168.1	442.7
Unobligated balance:						
Apportioned	9,679.2	120,047.8	98,585.7	0.3	0.3	0.2
Exempt from apportionment	18.2	1,060.7	1,050.5	0.0	0.0	0.0
Subtotal	9,697.4	121,108.5	99,636.2	0.3	0.3	0.2
Unobligated balance not available	2,496.9	14,561.2	12,344.6	26.0	26.0	25.3
Total status of budgetary resources	104,166.5	1,137,169.1	1,002,294.5	194.4	194.4	468.2
Change in Obligated Balance:						
Obligated balance, net						
Unpaid obligations, brought forward, October 1	16,284.5	372,558.6	321,809.1	768.0	768.0	378.5
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(21.0)	(60,131.3)	(55,414.9)	(130.4)	(130.4)	(76.9)
Total unpaid obligated balance	16,263.5	312,427.3	266,394.2	637.6	637.6	301.6
Obligations incurred net	91,972.2	1,001,499.4	890,313.7	168.1	168.1	442.7
Less: Gross outlays	(86,563.3)	(892,195.4)	(794,701.2)	(63.2)	(63.2)	(53.1)
Obligated balance transferred, net						
Actual transfers, unpaid obligations (+/-)	0.0	0.0	0.0	0.0	0.0	0.0
Actual transfers, uncollected customer payments from Federal sources	0.0	0.0	0.0	0.0	0.0	0.0
Total Unpaid obligated balance transferred ,net	0.0	0.0	0.0	0.0	0.0	0.0
Less: Recoveries of prior year unpaid obligations, actual	(1,975.9)	(49,744.1)	(44,862.5)	0.0	0.0	0.0
Change in uncollected customer payments from Federal sources	(101.5)	(6,470.9)	(4,716.4)	(12.6)	(12.6)	(53.5)
Obligated balance, net, end of period						
Unpaid obligations	19,717.5	432,118.5	372,559.1	872.9	872.9	768.1
Less: Uncollected customer payments (+/-) from Federal sources	(122.5)	(66,602.2)	(60,131.3)	(143.0)	(143.0)	(130.4)
Total, unpaid obligated balance, net, end of period	19,595.0	365,516.3	312,427.8	729.9	729.9	637.7
Net						
Net Outlays:						
Gross outlays	86,563.3	892,195.4	794,701.2	63.2	63.2	53.1
Less: Offsetting collections	(1,588.9)	(176,012.2)	(165,076.0)	(53.9)	(53.9)	(13.6)
Less: Distributed Offsetting receipts	(2,647.0)	(70,247.8)	(48,272.0)	0.0	0.0	0.0
Net Outlays	$ 82,327.4	$ 645,935.4	$ 581,353.2	$ (9.3)	$ 9.3	$ 39.5

Section 3: Other Accompanying Information

This section contains the DoD Inspector General's summary of the most significant management and performance challenges facing the Department, and the Department's response to the Inspector General's assessment. This section also includes a summary of the financial statement audit and management assurances, as well as a detailed report of the Improper Payments Information Act of 2002.

The FY 2008 financial statements for programs of the Executive Office of the President (EOP) are included in the "Defense Security Cooperation Agency Unaudited Financial Statements and Notes" available on the DoD Comptroller Web site. (See Appendix B.) In FY 2007, DoD financial statements included certain programs of EOP. Revised guidance from the Office of Management and Budget (OMB) declared that these programs be reported separately from the DoD financial statements. All other activities resulting from EOP allocation transfers are reported within the DoD financial statements.

INSPECTOR GENERAL'S SUMMARY OF MANAGEMENT AND PERFORMANCE CHALLENGES, AND MANAGEMENT'S RESPONSE TO INSPECTOR GENERAL'S CHALLENGES

The Reports Consolidation Act of 2000 requires that the Agency Financial Report include a statement prepared by the Agency's Inspector General (IG) summarizing what the IG considers the most serious management and performance challenges facing the Agency and briefly assessing the progress in addressing those challenges. The DoD Inspector General identified the following seven management and performance challenges facing the Department of Defense for FY 2008:

1. Financial Management
2. Acquisition Processes and Contract Management
3. Joint Warfighting and Readiness
4. Information Assurance, Security, and Privacy
5. Health Care
6. Equipping and Training Iraqi and Afghan Security Forces
7. Nuclear Enterprise

The following table outlines these challenges and includes both the IG's and DoD management's assessments of the Department's progress in addressing these issues. Columns A and B were prepared by the IG; Column C was prepared by the Department.

1. FINANCIAL MANAGEMENT	
FINANCIAL STATEMENTS	A. IG Summary of Challenge
The Department continues to face financial management challenges that adversely affect DoD's ability to provide reliable, timely, and useful financial and managerial data needed to support operating, budgeting, and policy decisions. Since 1995, the Government Accountability Office has identified DoD's Financial Management as a high-risk area. The DoD's financial management problems are so significant, 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. In the FY 2007 audit opinion on DoD's consolidated financial statements, the IG reported the same 12 material internal control weaknesses as the previous year, and added one additional material weakness. These pervasive and longstanding financial management issues directly affect the Department's ability to obtain an unqualified opinion on its financial statements. These weaknesses affect the safeguarding of assets and proper use of funds, and impair the prevention and identification of fraud, waste, and abuse.	

FINANCIAL STATEMENTS	B. IG Assessment of Progress

One significant measure of the ongoing progress in the area of financial management would be the Department's ability to obtain an unqualified opinion on its financial statements. The U.S. Army Corps of Engineers received a qualified opinion on its FY 2007 financial statements. While some agencies maintained their audit opinions, other agencies had their audit opinions downgraded. Specifically, the Defense Commissary Agency, Defense Contract Audit Agency, Defense Finance and Accounting Service, Military Retirement Fund, and Defense Office of the Inspector General all continued to receive unqualified opinions while the Medicare-Eligible Health Care Fund continued to receive a qualified audit opinion. However, the Defense Threat Reduction Agency received a qualified opinion from an independent public accounting firm, which the IG would not endorse because the problems identified were pervasive, and a disclaimer of opinion was more appropriate under these circumstances. In addition, the Chemical and Biological Defense Program received a disclaimer of opinion.

Although DoD is far from reaching an unqualified opinion, the Department has demonstrated improvement.

FINANCIAL STATEMENTS	C. Management's Assessment

The Department appreciates the opportunity to address the improvements in financial management being made throughout DoD. Our financial management challenges are pervasive and well documented. The Department's goals are to correct its financial material weaknesses, improve financial information for decision-makers, and accomplish an unqualified audit opinion on the Department's consolidated financial statements. The Department's corrective action plan is provided in the Financial Improvement and Audit Readiness (FIAR) Plan, described in more detail in the next section.

Significant progress in improving financial statements and achieving unqualified opinions has been made. In FY 2007, seven reporting entities received an audit opinion on their financial statements:

- Defense Commissary Agency (Unqualified)
- Defense Contract Audit Agency (Unqualified)
- Defense Finance and Accounting Service (Unqualified)
- Military Retirement Fund (Unqualified)
- Office of the Inspector General (Unqualified)
- Medicare-Eligible Retiree Health Care Fund (Qualified)
- U.S. Army Corps of Engineers (Qualified)

For the fourth consecutive year, the Department has received favorable audit reviews on the following Departmentwide financial statement line items:

- Investments
- Federal Employees' Compensation Act Liabilities
- Appropriations Received

The Department is making substantial progress in achieving audit readiness. For example, USACE has been audited for the first time and received a qualified opinion. Audit readiness accomplishments in FY 2008 represent approximately $49 billion in assets and $241 billion in liabilities, as follows:

- USACE received a qualified audit opinion on its FY 2007 and FY 2006 financial statements. This represents $44.6 billion in assets and $4.4 billion in liabilities.
- An (Independent Public Auditor) IPA completed its examination of the TRICARE Management Activity's (TMA) Contract Resource Management (CRM) ($1.3 billion in assets and $236.0 billion in liabilities), and validated the TMA's assertion on audit readiness for the CRM Balance Sheet.
- The TMA recently submitted two segment assertion packages: 1) the CRM Statement of Net Cost ($8.9 billion), Statement of Changes in Net Position (-$232.9 billion), and Statement of Budgetary Resources ($11.8 billion); and 2) the Uniformed Services University of the Health Sciences (USUHS) Statement of Budgetary Resources ($160.3 million).
- The TMA recently awarded a contract for an IPA to perform an examination on the USUHS Balance Sheet ($151.6 million in assets and $10.3 million in liabilities), Statement of Net Cost ($158.3 million), and Statement of Changes in Net Position ($141.2 million).
- The Defense Information Systems Agency's (DISA) General and Working Fund Balance Sheets ($2.9 billion in assets and $1.1 billion in liabilities) are undergoing financial statement audit.

IMPROVING FINANCIAL STATEMENTS	A. IG Summary of Challenge

The following elements and actions continue to be key to improving the Department's financial management:

- Creating an environment that fully supports clean financial reporting. The financial managers need buy-in from senior management and personnel in the field offices to successfully implement the corrective action plans.
- Fully implementing and maintaining an effective internal review and monitoring process to identify all material financial management and reporting deficiencies, internal control weaknesses, and quality of data issues.
- Developing corrective action plans that will adequately correct the deficiencies and result in financial reporting in accordance with generally accepted accounting principles.
- Implementing corrective action plans that address the systems, control, reporting, or quality of data weakness.

IMPROVING FINANCIAL STATEMENTS	B. IG Assessment of Progress

The Department's ongoing initiatives in the area of financial management improvement indicate DoD 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. One initiative is the Financial Improvement and Audit Readiness (FIAR) Plan.

As discussed in the March 2008 update to the FIAR Plan, the Department has refined the FIAR Plan's audit strategy to validate and sustain financial improvements and audit readiness not across individual line items as previously done, but across segments of the business environment.

Also new to this FIAR plan update is a clearer focus on a comprehensive business process framework as defined in the Department's Business Enterprise Architecture. Implementation of the framework has begun across the following areas:

- Acquire to Retire for Military Equipment (obtain, manage, and dispose of accountable property and capital assets).
- Acquire to Retire for Real Property (obtain, manage, and dispose of accountable property and capital assets).
- Hire to Retire (plan for, hire, develop, assign, sustain, and separate personnel resources).
- Procure to Pay (obtain and pay for goods and services).

DoD is tracking and reporting through Progress and Status Reports on each of the completed, ongoing and planned improvements in these areas.

The IG considers the following DoD financial management efforts to be limited successes:

- Implementation of integrated organizational structures and processes to address financial management improvement.
- Assignment of accountability to DoD managers.
- DoD improvement initiatives at the entity and line item level.

Although the IG anticipates that DoD will need to make improvements in these areas, the IG considers these to be the critical steps for establishing a culture and ingrained structure that will enable DoD managers to identify internal control weaknesses and plan effectively for resolution of those weaknesses. This culture and structure also will hold DoD 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.

Additionally, an overall shortage of qualified auditors and accountants continues to hinder progress on the challenges outlined above. Continual turnover of qualified staff who conduct audits at DoD Agencies and independent public accounting firms, and also turnover of qualified accounting staff to support financial functions and audits, is a formidable obstacle to the effective and efficient execution of those audits. The Department needs improved recruiting and retention practices, as well as robust training and continuity of operations planning to alleviate the problem.

IMPROVING FINANCIAL STATEMENTS	C. Management's Assessment

The Department initiated the FIAR Plan in 2005 to accomplish three primary goals: 1) improve decision making by providing relevant, accurate, reliable, and timely financial information; 2) sustain improvements through a process of annual assessments and internal controls; and 3) achieve unqualified audit opinions on DoD annual financial statements. To accomplish these goals, DoD employs a strategy that unites financial management improvement with business transformation by integrating the FIAR Plan with the DoD Enterprise Transition Plan and Business Best Practices.

When the FIAR effort began, DoD had to first establish cross-functional "buy in" to the goal of achieving auditability and develop in its functional workforce a basic familiarity with audit requirements. As the functional communities better understood audit requirements, and the financial community embraced long-term change, the FIAR Plan approach was expanded to focus financial improvement efforts within the business processes (e.g., Acquire to Retire, Hire to Retire, Procure to Pay) that generate financial transactions.

The FIAR approach:

- Applies OMB Circular No. A-123, Appendix A, to confirm continued audit readiness.
- Requires Component-level Financial Improvement Plans detailing the tasks and timelines for remediating business process issues negatively impacting auditability.
- Structures improvement efforts and ensures consistency through the mandatory use of Business Rules.
- Drives incremental progress through prioritized improvement objectives and segments.
- Focuses improvement work on four essential elements of financial improvement (Policies, Processes & Controls,Systems & Data, and Audit Evidence).

The Department has taken steps to ensure FIAR progress continues and to increase accountability and oversight of the accuracy of its financial statements and the plans to improve them by requiring the Secretaries of the Military Departments to certify to their accuracy and to report FIAR progress quarterly to the Deputy Secretary of Defense.

The Department has been aggressively working to retain and hire highly qualified accountants and financial personnel, and is taking steps to improve the knowledge and competency of its financial community. During 2008, the Department, in partnership with the CFO Council, created the CFO Academy as part of the National Defense University.

Note: The FIAR Plan and Enterprise Transition Plan provide details about the Department's goals and accomplishments and are available on the DoD Comptroller Web site. (See Appendix B.)

2. Acquisition Processes and Contract Management

ACQUISITION WORKFORCE	A. IG Summary of Challenge

Since 1990 and 1992, respectively, Government Accounting Office (GAO) has designated DoD Weapon Systems Acquisition and Contract Management as high-risk areas. Acquisition initiatives that began in the 1990s led to reductions in acquisition oversight assets and when the spending trend dramatically reversed after September 11th, the Department was not able to quickly react to the need for more contract and oversight support. The emphasis on urgency to support the war effort, especially for contracting in an expeditionary environment, has only served to increase the challenges. In FY 2008, the Defense budget with war funding will approach $650 billion. This total is more than double the last DoD budget preceding September 11, 2001. Keeping pace with this spending would be a difficult proposition if acquisition and oversight assets were increasing at a proportional rate. But, from 1990 until the end of FY 1999, total personnel included in the DoD acquisition workforce decreased about 50 percent, from 460,516 to 230,556 personnel.

As of May 2008, there were approximately 25,000 contracting officers to handle over $315 billion in procurements of goods and services. Other organizations, such as the Defense Contract Management Agency, which is responsible for much of the administration and surveillance of DoD contracts, decreased its staff levels by similar amounts during the same time frame. Even within the Inspector General's office, we reported in our March 31, 2008, growth plan that our auditors are unable to keep pace with the ballooning Defense budget and this growth "leaves the Department increasingly more vulnerable to fraud, waste and abuse."

ACQUISITION WORKFORCE	B. IG Assessment of Progress

Progress in training and equipping more contract officials within DoD to handle the increased workload will take time. However, a number of initiatives are underway that are addressing the challenges, both within the Department and from proposed legislation, that should lead to improvement and better meet these challenges. A commission, headed by Dr. Jacques Gansler, evaluated the Army Expeditionary Contracting and recommended urgent reform. As a result, the U.S. Army Materiel Command activated the Army Contracting Command, which will oversee more than $85 billion in contracts annually and focus on maintaining and improving the Army's ability to respond globally in support of warfighters' needs.

ACQUISITION WORKFORCE	C. Management's Assessment

DoD had a number of acquisition excellence initiatives in process that addressed contracting and contract management issues prior to the Gansler Commission Report issued recommendations for improvements to Army Expeditionary Contracting. The DoD has integrated and aligned the appropriate recommendations from the Commission with the existing Departmentwide initiatives to ensure an integrated Departmentwide strategy for improving the acquisition workforce. The DoD Human Capital Strategic Plan will provide the necessary focus for these initiatives. The DoD Task Force for Contracting and Contract Management in Expeditionary Operations, created by the Under Secretary of Defense Acquisition, Technology and Logistics (USD(AT&L)) to evaluate the Commission recommendations, was integral in developing the long-term, enterprisewide solutions for contracting and contract management in expeditionary operations. They will continue to monitor the accomplishment of the various initiatives milestones over time, with oversight provided by the Senior Leaders Steering Committee established by the DUSD Acquisition and Technology (A&T).

DoD initiatives to improve contingency contracting that predate or are independent of the Commission recommendations include: The increase in staffing in Defense Procurement and Acquisition Policy (DPAP) dedicated specifically to contracting in expeditionary operations. The DPAP development of the first-ever Joint Contingency Contracting Handbook, which provides essential tools and training for contingency contracting officers, and will be updated yearly. Draft Expeditionary Contracting Policy has also been developed, which forms a foundation for the handbook; DPAP coordinated the internal review and staffing of legislative proposals to provide solutions in areas where DoD lacked the authority to respond to Commission recommendations regarding additional general officer billets, increases in the number of contracting personnel and incentives for civilian personnel to pre-volunteer for expeditionary operations, and prepositioning of waivers of small business, U.S. labor, Buy American, Berry Amendment, and Specialty Metals provisions. The DoD has also established a business system team to leverage existing resources and knowledge to quickly provide electronic solutions for in-theater problems experienced in requirements generation, contract writing, invoicing, and the use of the Government Purchase Card.

In addition to these initiatives, DoD has conducted a contracting competency assessment of all military and civilian members of the Departmentwide contracting workforce. Results of the contracting competency assessment will be finalized during the first quarter of FY 2009. These results will provide a complete inventory of competencies that exist in the Departmentwide contracting workforce, identify current and projected competency gaps, and support workforce development in ways best fitting the strengths and weaknesses of the workforce and the needs of the contracting mission. By using key data provided from the contracting workforce assessment and from the Components, and by linking this data to drive workforce planning solutions, the Departmentwide contracting community can better meet future requirements and respond to its stakeholders.

DoD's commitment to a long-range vision for improving the contracting and contract management process and the continued accomplishment of near-term initiatives should ensure both immediate and long-term improvements in contracting and contract management in expeditionary operations.

In response to the FY 2008 NDAA, the Department established the DoD Acquisition Workforce Development Fund, which will be used for the recruitment, training, and retention of acquisition personnel for DoD. The fund ensures DoD's acquisition workforce has the capacity, in both personnel and skills, to properly perform the acquisition mission, oversee contractor performance, and ensure the Department and taxpayer receives the best value for investment dollars.

MAJOR WEAPON ACQUISITION	A. IG Summary of Challenge

Challenges also continued with major acquisition programs. Many large weapons systems acquisitions are receiving Congressional scrutiny because of continued cost, schedule, and control problems. GAO reported between FY 2000 and FY 2007, the number of DoD major defense acquisition programs increased from 75 to 95, total planned commitments grew from $790 billion to $1.6 trillion, while the average schedule delay in delivering initial capabilities increased from 16 to 21 months.

MAJOR WEAPON ACQUISITION	B. IG Assessment of Progress

DoD also outlined a series of initiatives to the House Oversight Committee on acquisition improvements. Three recent studies produced 55 recommendations for improving acquisition processes. Of these, 48 have been fully or partially implemented. These initiatives include early and competitive prototyping, continuous improvement through use of process review tools, stability in program management tenure, use of capital funding and configuration steering boards, and a capital funding pilot program. Another proposed initiative to improve major acquisition programs would require all new efforts to move through a "material development decision" milestone and would shift the crucial Milestone B decision to later in the process.

DoD continues to make limited progress in controlling cost and schedule of major acquisition programs and will have to make critical decisions about which systems should continue or be cut based on competing resources. The DDG 1000 is one recent example of a major system that succumbed to cost and schedule pressures.

MAJOR WEAPON ACQUISITION	C. Management's Assessment

The Department is pursuing a number of key initiatives designed to enhance the effectiveness of the DoD acquisition business process, and, consequently, improve cost, schedule, and performance outcomes.

Examples follow:

On September 19, 2007, the USD(AT&L) issued a policy memo requiring pending and future programs to implement a competitive prototyping approach. The policy is intended to reduce risk, validate designs, improve cost estimates, evaluate manufacturing processes and refine requirements.

On July 30, 2007, the USD(AT&L) issued policy establishing Configuration Steering Boards (CSBs) for all current and future major defense acquisition programs. The purpose of a CSB is to review all requirements changes that have the potential to impact program cost and schedule; assess them; and accept, reject, or defer them to future increments of capability.

The USD(AT&L) and the Director, Operational Test and Evaluation issued a policy memorandum on December 22, 2007, emphasizing the integration of developmental and operational testing to maximize Test and Evaluation process efficiency.

These policies are being institutionalized via the ongoing update to DoD Acquisition Policy [DoDI 5000.02]. In addition, a number of new policies are being considered via the update. These include the requirement for a formal acquisition process entry point, the Materiel Development Decision, and the requirement for preliminary designs prior to Milestone B, system development.

CONTRACTING AND THE IMPACT ON DECISION MAKING	A. IG Summary of Challenge

Dealing with the decreasing acquisition workforce has created a myriad of other challenges.

The Department has increasingly relied on interagency contracting and use of contractors to fill the gap from the reduced acquisition and oversight workforce, bordering on inherently governmental functions, thereby potentially taking on decision-making roles. Key areas where use of contractor support has bordered on inherently government functions impacting decision making include: strategic planning within programs and organizations; acquisition planning for specific acquisitions; source selection assistance and source selection decision making; contract administration and surveillance; and contractor testing of systems and weapons in which they participate in the development.

Our recent audit coverage has found a number of problems with use of interagency contracting, including lack of competition, inadequate price reasonableness determinations, and insufficient surveillance. In addition, the use of contractors has raised concerns about contractor ethics requirements and conflicts of interest.

Distorted use of acquisition initiatives such as commercial item procurements to achieve speed and reduce oversight in procurements continues to challenge contracting officials and the oversight community. Use of commercial items is beneficial when there is an established market to allow contracting officials to use the marketplace to establish price reasonableness for the items we buy. It also reduces the need for Government quality assurance when the Department can rely on a well-established commercial quality assurance program. However, the broad definition of commercial items that includes items that are not commercial items, but are "of a type" or have not been in the marketplace, such as items offered to the public or items that will be available in time to meet the Government's needs, cause significant challenges to ensure reasonable prices and sufficient quality assurance practices.

CONTRACTING AND THE IMPACT ON DECISION MAKING	B. IG Assessment of Progress

The Under Secretary of Defense for Acquisition, Technology and Logistics, and the Under Secretary of Defense (Comptroller)/Chief Financial Officer (USD[C]/CFO) have taken a series of corrective actions to improve systemic problems that our audits disclosed on interagency contracting. Each Under Secretary issues policy memoranda to implement actions based on our recommendations, and the USD (C)/CFO formed a task force to review the potential Antideficiency Act Violations we reported.

In addition, Section 813 of the John Warner National Defense Authorization Act (NDAA) for FY 2007 directed the Department of Defense to establish a Panel on Contracting Integrity. The panel consisting of senior leaders is focused on eliminating areas of vulnerability in contracting that allow fraud, waste, and abuse. The committee has established subcommittees in the areas of sustained senior leadership, capable contracting workforce, adequate pricing, appropriate contracting approaches, and techniques, sufficient contract surveillance, contracting integrity in a contingent environment, procurement fraud indicators, and contractor employee conflicts of interest. Initially, the Panel has developed 21 recommendations and is working on actions to improve the contracting process.

House and Senate proposed bills also address defining inherently governmental functions, tightening requirements on conflict of interest by contractor personnel disclosures, increasing contractor accountability, and curbing commercial item authorities.

CONTRACTING AND THE IMPACT ON DECISION MAKING	C. Management's Assessment

The Department has issued several policies regarding the use of interagency acquisition. Included in the policy guidance were specific process requirements addressing identified deficiencies in the interagency acquisition process. These included:

- Eliminating the use of advance payments (March 1, 2007).
- Requiring contracting officer review of nonEconomy Act transactions in excess of $500,000 (October 16, 2006, and January 18, 2008).

In addition, the Department provided the following tools to the acquisition workforce in this area:

- Assisted the OMB Office of Federal Procurement Policy in the development and issuance of an Interagency Acquisition Guide, entitled "Improving the Management and Use of Interagency Acquisitions (June 8, 2008)."
- The Department developed and fielded a continuous learning module (February 1, 2008).

Additionally, in accordance with Section 811 of the 2006 National Defense Authorization Act, the Department took specific action to review each transaction in excess of $100,000 that was to be issued on behalf of DoD by the Department of the Interior's acquisition office in Herndon, Virginia. This limitation was subsequently rescinded, except for one minor exception.

The Panel continues to make good progress, with five implemented actions and more than half of the actions in coordination. Nine additional actions were identified on May 22, 2008. To date, the panel has implemented policies on senior contracting leadership positions and succession plans; coordinated contract policy execution review plans to address many issues noted in audits; leveraged other training to improve Army training in contingency contracting; issued a Contingency Contracting Training handbook; incorporated procurement fraud indicator training and Contracting Officer's Representative (COR) training in Contingency Contracting; developed a new DAU Contingency Contracting Class; and completed several measures to improve Competition Advocacy and Fair Opportunity. Three legislative proposals and one proposed DFARs clause are pending other actions, but the Panel fully expects to implement the other actions during this calendar year. Highlights will include DoD COR certification standards and a COR policy memorandum, significant documentation to improve the contracting workforce, an interagency acquisition policy memorandum, and a memorandum regarding separation of duties. The Panel will address tightening requirements on conflict of interest through the use of contractor personnel disclosures, increasing contractor accountability, and mitigating risks of personal services contracts.

3. JOINT WARFIGHTING AND READINESS

JOINT WARFIGHTING AND READINESS	A. IG Summary of Challenge

The challenge of Joint Warfighting and Readiness is to provide the right force, the right personnel, and 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. This challenge is compounded by the strain on resources as a result of Operation Iraqi Freedom and Operation Enduring Freedom. Furthermore, this challenge encompasses the need for the services and allies to be interoperable, communicate with each other effectively, share data when necessary, and train together when possible. It also, encompasses the need to ensure that basic services continue uninterrupted for the members of the armed forces and their families. The other management challenges encompass areas that support the ability of the United States to conduct joint warfighting and readiness issues. The synergy of those other management challenges will shape the United States' ability to achieve its national objectives through joint operations.

JOINT WARFIGHTING AND READINESS	B. IG Assessment of Progress

The Department is making progress on the issue of Joint Warfighting and Readiness, but that progress must be monitored to ensure it continues. The Department cannot afford to ignore new, and in some cases recurring, situations that will require its attention. For example, the ongoing efforts to relocate service members to Guam and other locations around the globe will enable the armed forces to better shape and focus their force structure in a way that will provide greater flexibility in responding to threats. However, some challenges facing the Department were evident during reviews pertaining to the reset of Army equipment returning from Operation Iraqi Freedom (OIF) and the training of DoD ground forces supporting OIF.

JOINT WARFIGHTING AND READINESS	C. Management's Assessment

The Department's main focus remains on achieving success in ongoing operations. To accomplish this, a number of initiatives over the past few years continue to reap dividends. Our Global Force Management (GFM) processes allow us to effectively meet current operational demands with mission-ready forces. Recognizing the current operational demands stresses particular skill sets, GFM processes aid us in identifying and then training in-lieu-of forces to great effect thereby mitigating the strain on the overall force. Also, the emerging Defense Readiness Reporting System will provide access to more comprehensive readiness data in greater detail, and promises to improve support to our operational decision-making capability. Furthermore, we know the Department recruits individuals but retains the family, therefore high priority is given to those services that support our soldiers, sailors, airmen, Marines and their families.

ALIGNMENT OF RESOURCES	A. IG Summary of Challenge

While U.S. forces continue to operate around the world, changes are underway to better align the resources of the Department to benefit the warfighters, wherever they are. 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 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 combination of these various factors continues to challenge the Department.

ALIGNMENT OF RESOURCES	B. IG Assessment of Progress

During our review of the Army's technical inspection process for the reset of unit equipment returning from OIF, we concluded that the process was generally effective. However, inconsistencies occurred among redeploying units in the conduct of technical inspections, the granting of exemptions from automatic reset induction, and the reporting of reset equipment. As a result, units returning from OIF in the coming years will not use a standard method for initiating repair or replacement. Items needing reset may be delayed in entering the national-level reset pool. Exempting equipment reduces availability and creates difficulties in the redistribution of equipment to higher priority units. Additionally, reset status reporting may not provide decision makers with complete and consistent information. The Army continues to address issues and risks regarding the reset of equipment.

ALIGNMENT OF RESOURCES	C. Management's Assessment

Reset is a critical component of joint force readiness. Understanding the health of our weapon systems and the effect resourcing has on that health can be enhanced by taking a view across the Services through logistics portfolio management. Capability area managers are beginning to assess resourcing strategies and risk mitigation across the enterprise to improve our understanding of the appropriate alignment of resources to maximize readiness.

TRANSFORMING THE ARMED SERVICES	A. IG Summary of Challenge

The demands placed on the Armed Forces over the past few years have been extensive, but our military is unwavering in its focus on, and resolve and dedication to, peace and freedom. With the Congress' 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 Armed Forces to meet future threats.

Pre-deployment training of individual Augmentees for mentoring missions in Afghanistan and Iraq calls for a new approach to provide specialized preparation for these nontraditional missions. Combined and coalition operations require improved coordination of training priorities with our Coalition or International Security Assistance Force (ISAF) partners.

TRANSFORMING THE ARMED SERVICES	B. IG Assessment of Progress

In the last 3 years, the Army has been transforming its traditionally division-centric force to a more flexible, agile force. Part of this transition has included a restructuring of the Operations Groups, specifically Observer/Controllers, at Army Maneuver Combat Training Centers. While Army Maneuver Combat Training Centers (MCTC) have successfully trained U.S. ground forces to deploy in support of OIF, future training of U.S. ground forces could be negatively impacted due to planned restructuring of Army MCTC Operations Groups. This is because current Army manning guidance will not support future changes to staffing of Observer/Controllers at Army MCTCs. As a result, U.S. ground forces training to deploy in support of OIF may not receive the most realistic training and may not receive feedback that could be critical to the success of their mission. The Army recognizes this risk and is currently reviewing the Active Component Manning Guidance.

The Services have incorporated 14 theater-specific areas into their pre-deployment and annual training requirements. In addition, the Services effectively collected information from a variety of sources and regularly updated pre-deployment training. As a result, the Services generally provided realistic, theater-inspired training for units deploying in support of OIF. However, predeployment training for logistics and medical mentoring missions in Afghanistan and Iraq has not received the appropriate attention from the Geographic Combatant Commander or the Services.

TRANSFORMING THE ARMED SERVICES	C. Management's Assessment
Our Armed forces continue to transform effectively to meet today's dynamic and volatile environment. Concurrent with transformation, the Services train and certify their forces prior to deployment to any contingency area. Despite changes in U.S. ground force combat structure, the Army's Maneuver Combat Training Centers (MCTC) have adapted well to meet the demand for maneuver units. However, training of specialized support units and security assistance mission units has been more challenging. To overcome these shortcomings, the MCTCs and other Service training centers are evolving to incorporate lessons learned from theater. Feedback obtained from all Services and the Combatant Commands is shared through the Joint Lessons Learned Information Systems (JLLIS). The Department continues to adapt its training transformation initiatives for the benefit of the Services and Joint Forces. The Joint Warfare Fighting Center (JWFC) of the Joint Forces Command (JFCOM) supports individual augmentees (IAs) with a number of distance learning courses available through the Joint Knowledge Development Distribution Capability (JKDDC). Additionally, JWFC assists combatant commanders in certifying Joint Task Force Headquarters (JTF) in emerging missions through the Joint National Training Capabilities (JNTC) and Joint Headquarters exercises. These efforts continue as we transform forces while adapting to the dynamic environment in which they fight.	
TRANSFORMING LOGISTIC CAPABILITIES	A. IG Summary of Challenge
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. Additionally, 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. Since 1990, GAO has identified supply chain management as a high-risk area because of weaknesses uncovered in key aspects, such as distribution, inventory management, and asset visibility. It 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 DoD's lack of visibility and control over the supplies and spare parts it owns.	
TRANSFORMING LOGISTIC CAPABILITIES	B. IG Assessment of Progress
The Department has made progress toward meeting its goal of transforming logistics through numerous initiatives. However, that progress is tempered by the sheer magnitude of logistics operations that will continue to make it a long-term challenge. The Assistant Secretary of the Army for Acquisition, Logistics, and Technology activated the Program Executive Office Soldier (PEO Soldier) in April 2002 to develop, acquire, field, and sustain everything the soldier wears, carries, and operates to increase combat effectiveness. The Army viewed the soldier as a system and began taking a more strategic approach to designing, producing, and fielding clothing and individual equipment. PEO Soldier requested and used emergency supplemental Operational and Maintenance funds in FY 2006 of $221 million and $177 million in FY 2007 to provide Rapid Fielding Initiative items to soldiers who did not and were not scheduled to deploy in support of contingency operations. Army Officials took these actions because its managers believed that Rapid Fielding Initiative items qualified for emergency supplemental funds. As a result, PEO Soldier used about $221 million in emergency supplemental funds during FY 2006 to provide RFI items to about 125,000 soldiers who had not deployed and were not scheduled to deploy in support of contingency operations. Additionally, PEO Soldier's records as of October 2006 showed that during the first 5 months of FY 2007 the Program Office planned to provide these items to about 100,000 soldiers who were not scheduled to deploy at a cost of about $177 million.	
TRANSFORMING LOGISTIC CAPABILITIES	C. Management's Assessment
The Department continues to improve supply chain management. In July 2005, the Department developed the DoD Supply Chain Management High Risk Improvement Plan, which was endorsed as a template for use by other high-risk area owners in developing their plans. The Department's goals are to ensure continuous improvement in the area of Supply Chain Management by implementing the DoD Supply Chain Management High Risk Improvement Plan initiatives; publishing a roadmap for use in developing future improvement recommendations; monitoring supply chain management improvement; and implementing Supply & Storage Base Realignment and Closure. The Department also continues to improve its management of the logistics process with many projects to improve asset visibility throughout the worldwide supply chain. For example, The Joint Supply Chain Architecture (JSCA) project crosses Service organizational and funding boundaries to improve supply chain effectiveness and efficiency. It employs an enterprisewide, end-to-end perspective to achieve or improve logistics readiness across DoD. The project outlines the Joint supply chain; develops supply chain terms of reference (lexicon); delivers supply chain process architecture using industry's Supply Chain Operations Reference (SCOR) Model; and develops supply chain metrics. Ultimately, the JSCA could realize improved readiness and cost savings.	

An example of a Logistics transformation initiative is the Defense Transportation Coordination Initiative (DTCI). The Department is implementing DTCI with a world class coordinator of transportation management services in the Continental United States. The DTCI incorporates best commercial practices to improve the reliability, predictability, and efficiency of DoD materiel movement. The Department anticipates cost avoidances estimated at $40 to 60 million beginning in FY 2009, as more sites implement DTCI.

4. INFORMATION ASSURANCE, SECURITY AND PRIVACY

RISK MANAGEMENT	A. IG Summary of Challenge

Ensuring that a robust risk management, security, and information assurance program is in place is a significant on-going challenge to the Department. Such a program includes periodic risk assessments; physical and information security awareness training; security policies, procedures, and practices, as well as tests of their effectiveness; procedures for addressing deficiencies and for detecting, reporting, and responding to security incidents and privacy data breaches; and ensuring the continuity of operations.

The Department also faces the challenge of ensuring that security and privacy protections are not compromised by advances in technology, while also taking advantage of those advances to enhance collaboration and sharing of time-sensitive information.

RISK MANAGEMENT	B. IG Assessment of Progress

The Department made little improvement during the course of FY 2008 in its information assurance and security posture. Previous issues have been exacerbated by ongoing losses of government data, to include privacy and sensitive but unclassified data, and the lack of clear DoD policy regarding protection of such data and the reporting of incidents regarding its compromise. Of particular concern is protection of DoD information in the hands of contractors, to include all members of the Defense Industrial Base, and other nonDoD entities such as foreign, state, local and tribal governmental entities.

RISK MANAGEMENT	C. Management's Assessment

The Department has made significant advances in FY 2008 to improve information assurance (IA) and security posture. These include:

- Expanding enterprise rollout of vulnerability scanning and remediation tools to reduce system and network vulnerabilities.
- Increasing enterprisewide deployment of the Host-Based Security System.
- Awarding an enterprise contract for an insider threat focused tool to permit detailed analysis of user activities.
- Establishing BPAs for data at rest encryption products to facilitate the protection of sensitive data, both through disk encryption and file encryption.
- Making progress in certifying 40 percent of the IA workforce by the end of 2008 to ensure the Department has personnel with proven knowledge in securing the systems.
- Completing the security redesign of the public facing internet firewalls to limit internet access into DoD networks.

The Department has recently issued policies specifically addressing the protection of sensitive data, including personally identifiable information (PII) and controlled unclassified information (CUI). Given the lag time between issuance of a DoD policy and evidence of quantifiable effects, the impact of these policies started to become apparent during FY 2008. Policies addressing the protection of sensitive data include:

- DoD Chief Information Officer (CIO) policy memorandum, "Guidance on Protecting Personally Identifiable Information," August 18, 2006.
- Secretary of Defense memorandum, "Information Security/Website Alert," August 6, 2006.
- DoD Senior Privacy Official policy memorandum, "Safeguarding Personally Identifiable Information," June 15, 2006.
- DoD CIO policy memorandum, "Encryption of Sensitive Unclassified Data at Rest on Mobile Computing Devices and Removable Storage Media," July 3, 2007.
- Numerous Security Technical Implementation Guides addressing insecure technologies and mitigation of vulnerabilities.

The OMB Memorandum M-06-19 and guidance at www.us-cert.gov requires agencies to report to the U.S. Computer Emergency Readiness Team (US CERT) within one hour of receiving the notification of PII loss. The Defense senior privacy official requires organizations to report within 24 hours to the DoD Component Privacy Office/Point of Contact (POC) and within 48 hours to the DoD Privacy Office.

The Department is also responding to the challenges of ensuring security and privacy protections by continuing to work closely with the commercial sector. We expect to evaluate and adopt for use sophisticated "controlled sharing" capabilities emerging from the commercial sector.

PROTECTING DOD INFORMATION	A. IG Summary of Challenge
One of the major challenges identified last year was protection of DoD information in the hands of contractors and the appropriate response to data breaches involving both privacy-protected data, such as personally-identifiable information, and sensitive but unclassified information, such as contractor proprietary information. This challenge continues and is amplified by challenges associated with continued critical inaccuracies in the DoD database used for oversight of the DoD information system inventory. Further, DoD has made very limited progress in developing a Homeland Security Presidential Directive-12 compliant Personal Identity Verification credential, thereby failing to take advantage of possible enhancements to the DoD physical and logical access security programs.	
PROTECTING DOD INFORMATION	B. IG Assessment of Progress
Longstanding issues impeding improved security of DoD operations have not been addressed. The Department continues to lack an accurate, authoritative data repository for information regarding DoD systems, and does not have a requirement for an inventory of systems containing DoD information operated by contractors and other nonDoD entities. This fundamental inadequacy renders nearly all metrics regarding DoD information security meaningless as there is no possibility of meaningful management oversight and verification of reported data. This inadequacy applies to all information assurance programs, as well as all privacy programs. Further, DoD has yet to develop a Homeland Security Presidential Directive-12 compliant Personal Identity Verification credential, thus failing to achieve the possible benefits of utilizing such a credential for logical and physical access envisioned by the 2004 Presidential Directive. In addition, internal controls over card stock for existing DoD identification credentials are inadequate.	
PROTECTING DOD INFORMATION	C. Management's Assessment
Contractor systems that are under DoD control, i.e., those operated on behalf of the Department, are treated the same as DoD-owned systems and are subject to all DoD IA policies and requirements. However, it is not feasible nor practical to require contractor systems that are not operating on behalf of the Department but may contain some DoD information because of a business relationship with the Department to comply with all DoD IA policies. By the IG's own estimate, there are some 46,000 such systems in the commercial sector. The Department does recognize a need for more definitive guidance in this challenging area and is in the final stages of formal coordination of a DoD CIO policy memorandum specifying steps that must be taken to ensure greater and more consistent protection of DoD information in the possession of contractors doing business with the Department. The Department is breaking new ground with this policy, as we know of no other government policy or guidance that addresses this issue. The Department is leading an extensive effort to implement automated application controls which prevent the introduction of inconsistent data into the DoD Information Technology Portfolio Repository (DITPR) and performs periodic scans of DITPR to ensure accuracy. Additional user guidance to clarify the business rules and simplify use has been developed. The annual FISMA Reporting Guidance also directs Components to include the total number of operational systems that are Contractor Owned and Contractor Operated (COCO) on behalf of DoD and Contractor Owned and Government (DoD) Operated (COGO). As a part of the overall IA compliance program, the Department has ongoing programs to assess and verify the accuracy and completeness of reports by the Components. As outlined in the OMB-approved DoD HSPD-12 Implementation Plans, OMB recognized that the Department's requirement to transition to HSPD-12 from an already deployed operational program is different from deploying a new system. Over 600,000 DoD Common Access Card (CAC) Personal Identity Verification (PIV) transitional credentials have been issued. These are in addition to the 3.5 million nonPIV cards that the Department uses daily to access unclassified networks, secure Web sites, and bases/installations around the world. This is the reason Federal Information Processing Standard (FIPS) 201 allows for a transitional card, as well as the reason OMB approved the DoD HSPD-12 Implementation Plan. The Department's plan is focused on minimizing any adverse effects to the Department's 3.5 million daily users and minimizing the disruption of services during and after the transition. The Department will conduct General Services Administration (GSA)-approved conformance testing by the end of calendar year 2008 as it migrates from PIV transitional implementation to PIV end-state.	

5. HEALTH CARE	
IMPROVED HEALTH CARE	A. IG Summary of Challenge
The DoD Military Health System must provide quality care for approximately 9.2 million eligible beneficiaries within fiscal parameters while facing growth pressures, legislative imperatives, and inflation that make cost control difficult in both the public and private sectors. The DoD's challenge is magnified because the Military Health System provides health care support for the full range of military operations. The increased frequency and duration of military deployment further stresses the Military Health System in both the Active and Reserve Components. Part of the challenge in delivering health care is combating fraud. Health care fraud is among the top 5 categories of criminal investigations; currently representing approximately 7 percent of the 1,646 open cases of the Defense Criminal Investigative Service.	
IMPROVED HEALTH CARE	B. IG Assessment of Progress
The DoD Military Health System has been moving forward on improving health care while attempting to control costs. Although the transition to the new TRICARE contracts has been delayed until FY 2009, the Military Health System has made progress in defining the requirements and issuing the request for proposal for the new TRICARE contracts. The current contracts provide incentives for customer satisfaction and include the managed care support contractors as partners in support of medical readiness. The Military Health System continues to work with the contractors to ensure performance under the contracts with the ultimate goal of improving readiness and the quality of care. Lessons learned from all prior solicitations, as well as senior Departmental leadership and industry comments, will be incorporated into the next set of TRICARE contracts.	
IMPROVED HEALTH CARE	C. Management's Assessment
TRICARE Management concurs with the IG's Summary of Challenge and Assessment of Progress.	
OVERSIGHT OF COSTS	A. IG Summary of Challenge
A major challenge to the Department is sufficient oversight of the growing cost of health care for its beneficiaries. During a recent hearing with the Senate Appropriations Subcommittee on Defense, the Secretary of Defense stated the cost of health care is a concern that must be controlled. The DoD budget for health care costs was approximately $42 billion in 2008, a 35 percent increase since FY 2005 ($31 billion). Congress provided an additional $1.4 billion via the Supplemental Appropriations Act of 2008. Increasing health care benefits provides additional pressure to manage and contain costs. One of the Department's challenges is to effectively transition to the next generation of TRICARE contracts.	
OVERSIGHT OF COSTS	B. IG Assessment of Progress
DoD obtained authority to use federal ceiling prices for pharmaceuticals, and is in the process of issuing a proposed rule. The DoD is also making headway in economizing on pharmacy costs by implementing use of generic drugs and promoting use of the TRICARE Mail Order Pharmacy system. Additionally, the MHS has adopted an approach to cost control that will simultaneously improve quality and reduce cost by focusing on the elimination of unnecessary care, test and procedures.	
OVERSIGHT OF COSTS	C. Management's Assessment
TRICARE Management concurs with the IG's Summary of Challenge and Assessment of Progress.	
MEDICAL READINESS	A. IG Summary of Challenge
The ability to support and develop the people in the Military Health System continues to be a challenge. Maintaining medical readiness of the medical staff and units includes ensuring that medical staff can perform at all echelons of operation, and that the units have the right mix of skills, equipment sets, logistics support, and evacuation and support capabilities. The challenge of keeping reservists medically ready to deploy continues because of the frequency and duration of Reserve deployments.	
MEDICAL READINESS	B. IG Assessment of Progress
The MHS Human Capital Strategic Plan for 2008 to 2013 has been published, and the Department established a Military Health System Human Capital Strategic Support Office. The Medical Readiness Review was completed and efforts are underway to institutionalize the analytic process for determining operational medical personnel needs. The Military Health System has continued to meet all mission requirements despite very high operational tempo. Data from the Joint Theater Trauma Registry reveal unprecedented outcomes, including died of wounds rates of 5 percent and the lowest ever disease nonbattle injury rates.	

MEDICAL READINESS	C. Management's Assessment
TRICARE Management concurs with the IG's Summary of Challenge and Assessment of Progress.	
TRANSITION OF CARE	A. IG Summary of Challenge
Strengthening medical care from accession through active service to rehabilitation and transition to VA care is a major challenge for the Department. The number of wounded warriors associated with Southwest Asia and other such conflicts significantly impact the health care resources within the Department, and can result in issues such as the conditions that were raised at Walter Reed Army Medical Center. Another related challenge to medical readiness is the issues inherent in providing efficient processes for post-deployment health care and benefits to severely injured and ill service members. Transitioning wounded, ill, or injured service members to post-deployment care will continue to grow as a challenge while the Global War on Terror, Operation Iraqi Freedom, and Operation Enduring Freedom continue. The Department needs to improve the medical care and benefits transition program to achieve a streamlined, transparent process as wounded warriors move from the DoD system to the Department of Veterans Affairs' system. Increased numbers of returning service members with mental health complaints, along with a shortage of uniformed and civilian mental health workers, will require examination of automated screening tools and improved diagnostics to provide earlier detection and intervention.	
TRANSITION OF CARE	B. IG Assessment of Progress
The revised MHS strategic plan recognizes continuum of care as a strategic priority. As stated last year, disparities in the transition of health care and benefits are easily identified, yet actionable solutions are difficult to implement and streamline. The opening of the Center for the Intrepid in San Antonio, Texas, in 2007 provides the MHS with a technologically advanced rehabilitation center for amputees and burn victims. In addition, DoD's response to Traumatic Brain Injury (TBI) and psychological health, including Post Traumatic Stress Disorder (PTSD), is showing promise with the creation of the Defense Centers of Excellence for Psychological Health and TBI. This year, the Department established the Senior Oversight Council (SOC) to ensure that all aspects of care, rehabilitation and reintegration for wounded warriors was accomplished. One focus of the SOC is to overhaul the disability processing system and implement improved case management for recovering warriors. The Armed Forces Health Surveillance Center was established to ensure tracking and ongoing surveillance of the health of service members would be accomplished in a joint manner and coordinated with Veterans Affairs.	
TRANSITION OF CARE	C. Management's Assessment
TRICARE Management concurs with the IG's Summary of Challenge and Assessment of Progress.	
SHARING OF INFORMATION	A. IG Summary of Challenge
Providing information to the right people so they can make more informed decisions continues to be a challenge in the health care community. Along with the benefits of expanding automation efforts comes the increased risk to security and privacy of information. The transition from paper to electronic patient records increases the exposure of sensitive patient information to inadvertent or intentional compromise. Maintaining information operations that ensure the protection and privacy of data will continue to grow as a challenge.	
SHARING OF INFORMATION	B. IG Assessment of Progress
The organizational goal to deliver information that aids in better decision-making was added to the Military Health System strategic plan. Specific milestones were established to implement a personal health record prototype, and to expand bidirectional sharing of health information between DoD and the Department of Veterans Affairs. In addition, a deadline was established to define the Military Health System strategic plan for implementing a paperless electronic health record. The DoD continues to progress in sharing electronic medical records with the Department of Veterans Affairs. The DoD and VA executive leadership initiated a joint assessment project to determine the best approach for sharing inpatient electronic health records. The final report on the assessment project recommends the Departments pursue a common-services approach, which will allow DoD and VA to build upon their already extensive information sharing capabilities. It also will set the stage for the appropriate level of interoperability with other government and private sector organizations.	
SHARING OF INFORMATION	C. Management's Assessment
TRICARE Management concurs with the IG's Summary of Challenge and Assessment of Progress.	

IMPLEMENTING BRAC	A. IG Summary of Challenge
Implementing recommendations resulting from the 2005 Base Realignment and Closure process will continue to be a challenge. In addition to improving the readiness and cost efficiency associated with realigning base structure, a primary objective of the process was to examine and implement opportunities for greater joint activity among the Military Departments. Recapitalization of the physical infrastructure is a challenge. Military treatment facilities are aging and in need of replacement.	
IMPLEMENTING BRAC	B. IG Assessment of Progress
The base realignment and closure process addresses part of the aging infrastructure, but to fully address the challenge, better standardized data on the condition of facilities is needed. The Military Health System has begun the multiyear transition and acquisition process of improving capability and access to care in two major and several minor markets. Groundbreaking for the new Walter Reed National Military Medical Center at Bethesda occurred July 3, 2008. Additionally, the Military Health System is following a roadmap for changes in governance that should result in increased unity of purpose and functional integration. The road map should yield improvements in quality, efficiency, and patient satisfaction consistent with the MHS Strategic Plan. Each of the elements of the plan should contribute to the achievement of stability and uniformity of healthcare processes and resource acquisition. By establishing more unity of command in each of the major markets, the market leaders should be able to distribute resources across hospitals and clinics within a market to meet the needs of the entire population of eligible beneficiaries. In addition, the increased span of control will enable improved continuity of care and coordination of safety and quality programs. In the National Capital Region, the Secretary of Defense established the Joint Task Force National Capital Region Medical to clarify command and control. Through the establishment of joint governance for the Joint Medical Education and Training Center, the MHS should improve the quality and consistency of training for all enlisted, contributing to a culture of jointness and interoperability. The combination of all medical research and development assets under joint governance should foster better coordination of research activities, eliminate redundant efforts, and focus resources on developing solutions for both the warfighter and the clinician. Co-locating of the headquarters functions of Health Affairs, the TRICARE Management Activity, the Army Medical Command, the Navy Bureau of Medicine and the Air Force Medical Service should enhance efforts to achieve unity of purpose for MHS policy, strategy, and financial programming and yield greater consistency across the Services in program execution.	
IMPLEMENTING BRAC	C. Management's Assessment
TRICARE Management concurs with the IG's Summary of Challenge and Assessment of Progress.	
HUMANITARIAN ASSISTANCE	A. IG Summary of Challenge
The Department's expanded role in providing humanitarian assistance and disaster relief to support U.S. strategic objectives and promote human dignity through better health will provide financial and organizational challenges. One of the first challenges will be developing plans and budgets to support the expanded role.	
HUMANITARIAN ASSISTANCE	B. IG Assessment of Progress
Building a bridge to peace through humanitarian assistance and disaster relief is a goal under the Military Health System strategic plan. The Summer 2008 Military Health System Strategic Plan recognizes many of these challenges and includes a set of performance metrics to measure mission success. This clearly defined roadmap is progress toward meeting the challenges.	
HUMANITARIAN ASSISTANCE	C. Management's Assessment
TRICARE Management concurs with the IG's Summary of Challenge and Assessment of Progress.	

6. EQUIPPING AND TRAINING IRAQI AND AFGHAN SECURITY FORCES

IRAQI SECURITY FORCES	A. IG Summary of Challenge

The Iraqi Security Forces (ISF) are comprised of the military and police forces. The Iraqi government continues to pursue significant expansions of ISF authorized end-strength, currently at 488,000 personnel with 445,500 on the payroll. This expansion will require addressing an already existing leadership shortage within the officer and noncommissioned officer ranks.

Coalition efforts to build the capability of the Iraqi Ministries of Defense (MoD) and Interior (MoI) and their respective forces continue to focus on four major areas: developing ministerial capability; improving the proficiency of military and police forces through the assistance of embedded advisors and partnership unit relationships; building the logistic, sustainment, and training capability of the MoD and MoI; and supporting the expansion of the army and police.

IRAQI SECURITY FORCES	B. IG Assessment of Progress

The existing Iraqi-run training centers continue to operate at full capacity to achieve ISF personnel goals.

Efforts are ongoing to build the capability of the security forces and the MoD and MoI to sustain themselves, without Coalition logistical support, and for the forces to be able to operate independently without the full range of Coalition combat enablers, such as: air and ground transport of troops, equipment, and supplies; tactical air support; communication (signal) capabilities; and artillery.

IRAQI SECURITY FORCES	C. Management's Assessment

As of July 31, 2008, the current Iraqi Security Force (ISF) overall assigned strength is approximately 588,000. One hundred fifty-nine Iraqi Army (IA) battalions are in the fight, and 105 of those are in the lead for operations. Twenty-eight more are in force-generation. Though the MoDs, leader-to-led ratios are improving, the shortage of key leaders in the ISF is a challenge that will take years to overcome. Officer training and development are improving, but much work remains. The four Military Academies are graduating enough cadets for the needs of the Iraqi Joint Forces, but facilities remain rudimentary and tactical training is limited. The NCO corps has grown in the last couple of years, but most significantly in the last year—mostly at the junior ranks. The Iraqis understand they need an NCO Corps and have developed an NCO education system, starting with corporals to sergeants to platoon sergeants. The top 10 percent of the graduates from basic training attend the corporal's course. From January 1 to July 31, 2008, the training base graduated 6,772 NCOs. Additionally, as of June 30, 2008, 13,077 total NCOs have entered the IA since June 2007; 8,362 of those NCOs have accessed since January 1, 2008. The NCO ranks are at almost 70 percent fill in the aggregate. Some measures to address this issue are occurring now such as the rehiring of former NCOs and officers into the ISF. From January 1 to May 30, 2008, the MoD successfully vetted 2,177 officers from the former regime and allowed them to "rejoin" the IA.

In all operations, the ISF continued to rely on Coalition enablers. Overall, the ISF continues to improve, but relies on Coalition forces (CF) for close air support, fire support, intelligence, surveillance and reconnaissance, logistics, sustainment and communications. The IA units must also improve in their ability to specify command relationships. Operations in Diyala and Amarah demonstrated a gradual improvement in the command and support relationships of attached brigades from other IA divisions.

Logistics unit development is progressing. By the end of 2008, the IA will grow one division headquarters, five brigade headquarters, eight infantry battalions, five additional location commands, two motor transport regiments, one general transport regiment, one logistics battalion, and an Army ammunition depot. Each of the additional logistics units will be dedicated to support specific IA divisions and each is essential for the IA to achieve self-sufficiency.

Dependency on CF to move supplies from the central depots will be reduced by accelerating the fielding of motor transport regiments. The IA has fielded ten motor transportation regiments and will field two additional transport regiments in 2008. The donation of a number of German transport trucks, and the purchase of medium and heavy cargo vehicles has accelerated the generation of a general transportation regiment, with projected Initial Operating Capability (IOC) by November 2008.

IRAQI NATIONAL ARMY	A. IG Summary of Challenge

The Iraqi Army continues to experience shortfalls in generating officer and noncommissioned officer personnel to meet the requirements of an expanding army, and the challenge of high attrition rates.

The Iraqi Army also continues to experience shortfalls in self-sustaining logistics. While the initiatives to develop the Iraqi Army logistics base are significant, success may be hampered by shortages in formally trained Iraqi logistics personnel and lack of information connectivity.

The Iraqis still have concerns about the responsiveness of Foreign Military Sales (FMS) to a country generating forces in the midst of ongoing combat operations and hostilities. On-the-ground U.S. commanders responsible for training, equipping, and supporting ISF have voices similar concerns.

IRAQI NATIONAL ARMY	B. IG Assessment of Progress
The Iraqi Army is taking several steps to mitigate leader shortage, such as actively recruiting prior service officers and noncommissioned officers, using mobile recruiting teams, and exploring accelerated promotions of personnel currently in the Army. However, it is unclear whether sufficient candidates can be recruited to offset increased force requirements. Multinational Security Transition Command-Iraq and Multinational Corps-Iraq are making significant strides in assisting the Iraqi Army to develop an Iraqi logistics sustainment base, but much work remains to be done. Through the efforts of the Iraqi Logistics Development Committee, specific logistics advisory, training, and partnering relationships have been established throughout Iraq to assist the Iraqi Army build its logistics system using an Iraqi model. Thirteen regional Iraqi logistics Location Commands are projected to be in full operation by the end of 2008. U.S. Logistics Management Advisory Teams will be assigned to each Location Command. In addition, U.S. Logistics Training and Assistance Teams, formed from in-country U.S. logistics sustainment brigades, are refocusing their efforts to provide more intense interaction with Iraqi Army units including the regional Location Commands to the line units, division and below. Development is underway of a robust FMS program to assist with Iraqi Government force expansion by procuring U.S. standard equipment. Progress has been made regarding MoD and MoI willingness to use the U.S. FMS system as a source of supply. However, the timeliness of equipment deliveries has not been satisfactory.	
IRAQI NATIONAL ARMY	C. Management's Assessment
The IA, as with the other services, remain understaffed in the officer and NCO ranks, but is taking steps to mitigate these challenges. MOD is developing a strong NCO Educational System that has produced nearly 14,000 NCOs including re-joining former army leaders from key courses. The MOD is also training former militia members mandated by the transition and reintegration program. The Government of Iraq (GOI) has also begun taking over control of the Sons of Iraq (SoI) program, intending to integrate 20% of the 100,000 SoI into the ISF. Once complete, the National Reconciliation Program will allow former soldiers the option to re-join the ISF, and should yield a moderate increase in the number of mid-grade officers and NCOs within the IA. The MOD is developing a national supply and distribution network, including location commands in support of each IA division with the Taji National Depot as the centerpiece. Accelerated fielding of the last motor transport regiments and the fielding of the general transportation regiment will reduce, but not eliminate ISF dependency on CF to move supplies. Since the advent of the FMS task force, the average time required to process FMS cases has improved significantly, and the delivery of equipment has improved substantially.	
IRAQI NATIONAL POLICE	A. IG Summary of Challenge
Because the training effort of the past four years has focused on generating policemen, and because of the time it takes to grow professional junior officers, there have been inadequate numbers of officer-rank police entering at junior levels. The resulting low officer manning has affected command and control, planning functions, street-level supervision, morale, retention, and ethical conduct.	
IRAQI NATIONAL POLICE	B. IG Assessment of Progress
Although progress has been made, some National Police units lack personnel, individual equipment, and reliable vehicles to conduct operations without Coalition support. The Iraqi Police Service and the National Police use various methods to acquire officers. Both of the police services are actively seeking to increase officers through four methods: a 3-year officer course, a 9-month officer course, a 6-month police commissioner's course, and a 3-week officer transition program for previously trained police officers. The police services have difficulty attracting officer candidates because they compete with the Iraqi Army for the same pool of personnel.	
IRAQI NATIONAL POLICE	C. Management's Assessment
Coalition advisors report continued improvement in the MoI's ability to perform key ministerial functions. Such functions include force management, personnel management, acquisition, training, logistics and sustainment, and the development and implementation of plans and policies. The MoI is improving its ability to provide life support (e.g., food, water, fuel, and most maintenance) for its forces. The Ministry has instituted a self-reliance policy. All life support, at both the Central Ministry and at the provincial level, is now contracted through the MoI contracting process. The MoI has expanded to a total of 18 training facilities. The Iraqi instructor cadre at the Baghdad Police College conducts all basic officer and enlisted recruit training and continues to increase the proportion of the specialized and advanced course loads. The Multi-National Security Transition Command–Iraq (MNSTC-I) advisors and international police advisors assist by providing advice, oversight, and quality control at all training institutions.	

The MoI training base is capable of training 67,170 enlisted police and 2,330 officers per year and operates at a total student capacity of 24,810 at any given time. For 2008, the MoI expects to train a total of approximately 42,235 basic policemen for the Iraqi Police Service (IPS), 14,435 for the National Police (NP), and 10,500 for the Department of Border Enforcement (DBE). With the MoI training base expansion plan through mid-2009, seat capacity will increase annual throughput to 117,100 enlisted and 5,472 officer seats.

Overcoming the MoI training backlog continues to be a significant challenge. In the past, deteriorating security conditions necessitated rapid MoI growth in basic security skills. This rapid expansion was accomplished through a truncated 80-hour training course, which provided police officers with basic operational skills; however, this course fell short of the full training requirement to be an effective police officer. As a result, the current IPS training backlog is approximately 88,000 personnel. The MoI's goal is to train all IPS personnel with the full 400-hour course, as the security situation and training capacity allows. MNSTC-I is working with the MoI to shorten duration of the full 400-hour course to 240-hours by extending the length of the training day and eliminating low priority training to reduce its training backlog to approximately 56,000 by July 2009.

As of July 31, 2008, there are 31 NP battalions in the fight, with 10 of them in the lead for security. Thirteen more are in force-generation.

The MoI is executing a four-phased plan to improve the professionalism of the NP, with all phases executed simultaneously. This has involved significant changes in senior leadership from division through battalion level to reduce sectarian behavior and achieve a balance of the sects representative of the makeup of Iraq. The MOI completed collective training for every brigade in the fall of 2007 and, situations permitting, these brigades undergo continuous sustainment training. Furthermore, leadership training conducted by the Carabinieri has been successful. The fourth class of Italian Carabinieri-led NATO Training Mission-Iraq (NTM-I) training concluded on June 21, 2008, with 422 graduates. The MNSTC-I and NTM-I are laying the foundation to double the throughput, accelerating professionalism of the NP. Finally, plans are in place to regionalize the NP by generating a third NP division. This will enable the NP to be regionally focused and postured to reinforce the IPS and allow the MOD to focus on external defense.

The MoI continues to receive large shipments of FMS purchases. Deliveries on a $96.3 million contract for ammunition and light weapons, brokered independently with China, demonstrate that the ministry is improving the capability to direct contract for goods.

ISF HEALTH CARE SYSTEM	A. IG Summary of Challenge

The Iraqi Security Forces depend on the development of supporting capability within the civilian sector for medical support.

Strong collaborative planning interactions are necessary between the Iraqi Ministries of Defense and Health for infrastructure development, training, and medical logistics, so sustainable, independent health care for the security forces can be developed.

ISF HEALTH CARE SYSTEM	B. IG Assessment of Progress

The partnerships between these Ministries for planning are just developing, and will need to be facilitated by Multinational Security Transition Command-Iraq and Multinational Forces-Iraq in order to be effective.

ISF HEALTH CARE SYSTEM	C. Management's Assessment

The Coalition Forces (CF) continue in their efforts to help the ISF design, recruit providers, train and provide initial medical infrastructure and medical supplies for the ISF to develop medical capability. These efforts include assisting MOI and MOD developing the capability to identify requirements, budget, commit, monitor and execute funds to procure medical equipment, supplies, and personnel; improving supply chain management to enhance the efficiency and effectiveness of the medical logistics system; and developing medical personnel training progression. CF are also supporting continued development of internal programs by the Ministries of Health and Higher Education to broaden ISF medical capability. FMS have included field hospitals, ambulances, mortuary vehicles, and medical supplies.

AFGHAN SECURITY FORCES	A. IG Summary of Challenge

The Afghan National Security Forces (ANSF) are comprised of the military and police forces. Their effectiveness is being tested by increased Taliban attacks, including in heretofore safe areas of the country.

Coalition efforts to build the capability of the Afghan Ministries of Defense (MoD) and Interior (MoI) and their respective forces continue to focus on four major areas: developing ministerial capability; improving the proficiency of military and police forces through the assistance of embedded advisors and partnership unit relationships; building the logistic, sustainment, medical, and training capability of the MoD and MoI; and supporting the expansion of the army and police, and their ability to operate on an independent basis.

The Afghan government continues to pursue significant expansion of the ANSF. The MoD has requested an increase in the end-strength of the Afghan National Army (ANA), in particular, to 134,000 – an increase that is favorably endorsed by the U.S. Government.

AFGHAN SECURITY FORCES	B. IG Assessment of Progress
The ANA as an institution is generally highly regarded by the populace, although only a minority of its units are yet capable of operating without significant Coalition support. Progress in building the capability effectiveness of the Afghan National Police (ANP), which is often viewed with mistrust, lags that of the ANA, arguably as much as several years.	

AFGHAN SECURITY FORCES	C. Management's Assessment
We agree with the IG's assessment of progress made by the ANSF. The ANA is one of the most trusted and respected institutions within Afghanistan. As of Sept 2008, the ANA has grown to a force size of approximately 67,000. Over the last year they have made great progress and since March 2008, 13 ANA units have reached Capability Milestone-1 which indicates they are fully operationally capable. The ANA is increasingly capable of taking a lead role in planning and conducting operations, which is another sign of increased capacity and capability. In September 2008, the Government of Afghanistan and the international community agreed to increase the end strength of the ANA to 134,000 personnel by 2014, thus allowing for increased combat support and capability. The decision to increase the size of the ANA is consistent with the Government of Afghanistan's and the International Community's goal that Afghan Security Forces are eventually able to assume security functions within Afghanistan. As stated, the ANP currently lags behind the ANA in development but much progress has been made. The ANP is at a force level of 77,000 and growing towards 82,000. 31 Districts have completed FDD training and, as of Sept 2008, and six of these districts were validated at Capability Milestone 1, indicating that district ANP forces were capable of independent operations. The Combined Security Transition Command-Afghanistan (CSTC-A) is also implementing a training program for Afghan Border Police (ABP) along the eastern Pakistan border. Focused Border Development (FBD) provides additional survivability and interdiction skills for ABP Companies who will partner with JTF-101 units once they complete the training. The FBD training begins in late October 2008.	

AFGHAN NATIONAL ARMY	A. IG Summary of Challenge
Developing an effective Afghan National Army (ANA) force is a significant challenge in the midst of a war. The Afghan Army logistics system within the ANA is progressing, but is in its infancy and continues to experience shortfalls in having a self-sustaining logistics capability. While the initiatives to develop the Afghan Army logistics base are significant, success may be hampered by shortages in formally trained Afghan logistics personnel and lack of information connectivity. In addition, one of the problems in establishing logistics sustainment within the Afghan Army has been the lack of a systems approach. The Afghans have been accustomed to working in stovepipes with little coordination. The result of this is that important nodes in the logistics system were lacking visibility of the Afghan Army logistics capability, and senior leaders were unable to make informed decisions about logistics requirements. U.S. commanders have noted that progress has been made in improving Foreign Military Sales (FMS) program responsiveness. However, successful execution of the $7.4 billion FMS program in Afghanistan requires support beyond the norm for rapid ANSF force generation, replacement of combat losses, and force modernization. Similar concerns have been voiced by U.S. commanders on the ground, responsible for training, equipping, and supporting the ANA.	

AFGHAN NATIONAL ARMY	B. IG Assessment of Progress
Progress has been made in developing a capable Afghan National Army, but significant work still needs to be done. A continually improving national logistics infrastructure exists and is already supporting the Afghan Army. A series of national and forward support depots currently provide the bulk of Afghan Army needs. Brigade-level logistics structures and systems continue to develop. However, there is a gap in the linkage from the brigade level to the national level. This gap will require development of a corps-level logistics structure that will be addressed with the increase of 10,000 ANA personnel beginning in 2009. Plans for 2009 lay the groundwork for making currently-contracted logistics an Afghan Army core responsibility. The MoD recently requested that Combined Security Transition Command-Afghanistan (CSTC-A) assist in the development of a systems approach to logistics. The CSTC-A conceived the Logistics Readiness Assessment Tool, which was to have been implemented in May 2008 as an initial effort to gain visibility over the Afghan Army logistics system.	

AFGHAN NATIONAL ARMY	C. Management's Assessment
As stated above, the ANA has made great progress over the past year. As the ANA grows to 134,000, it is increasingly improving in capability and in building logistics capacity While we agree with the need for more robust ANA logistics processes, it should be noted that Afghanistan poses unique issues in terms of implementing an integrated nation wide logistics system. Many areas within Afghanistan lack reliable power and communications capacity and do not allow for a networked logistics system. Additionally, the issue is made even more challenging because of low literacy rates among the populace and the lack of trained personnel with a logistics background. The DoD is focused on improving logistics within the ANA. One of the objectives of the CSTC-A Campaign Plan is to develop an efficient logistics system that is capable of acquiring and distributing resources to the ANA. The CSTC-A is developing a unified ANA logistics strategy which will ensure standardized logistics mentoring within the ANA. A robust Ministerial Development program is in place which focuses on building logistics capabilities within the MOD and the General Staff Headquarters.	
AFGHAN NATIONAL ARMY HEALTH CARE SYSTEM	A. IG Summary of Challenge
Development of medical support for the ANA depends on a strong collaborative relationship with the civilian Ministries of Public Health and Higher Education. ANA capacity development must therefore include commensurate strengthening of the authority and ability of these ministries to support the ANA.	
AFGHAN NATIONAL ARMY HEALTH CARE SYSTEM	B. IG Assessment of Progress
Little progress has been made in developing strong civil – military relationships within the medical community in Afghanistan, largely due to limited resources, and lack of a clear policy commitment with a corresponding multi-year strategic plan for training, mentoring, and infrastructure development.	
AFGHAN NATIONAL ARMY HEALTH CARE SYSTEM	C. Management's Assessment
The DoD has provided mentorship and training to improve the Afghan Army health care system through the CSTC-A Command Surgeon's office. We concur with the need to build better Civil-Military cooperation and to better collaborate with the Afghan Ministry of Public Health and other international players. The DoD has coordinated policies with NATO and other international partners as well as the Ministry of Public Health but the scope of this challenge is beyond DOD's ability to influence. Fully developing the Civil-Military relationship will require assistance from other U.S. Government agencies, and international partners, as well as the Government of the Islamic Republic of Afghan.	
AFGHAN NATIONAL POLICE	A. IG Summary of Challenge
The National Police are the face of the government to most Afghan people. Unfortunately, in the past, this has often been the face of corruption and unprofessionalism. The Afghan MoI and National Police logistics system continues to experience shortfalls in self-sustaining logistics. While the initiatives to develop the Afghan Police logistics base are significant, success may be hampered by shortages in formally trained Afghan logistics personnel. Logistics sustainment for the MoI and the Afghan Police significantly lags that of Afghan Army. Supplying regional, district, and provincial police units is a vastly different problem than providing support for an army corps, brigade, or battalion. The MoI is behind in establishing needed logistics policies and procedures and in obtaining the requisite training for their logistics personnel. The U.S. Police Mentoring Teams have been under-resourced for personnel, requiring CSTC-A to fill the gap by using U.S. military personnel who had previously been assigned to train the Afghan Army. The shortage of qualified logistics trainers for the Police Mentoring Teams is and has been a continuing problem in advancing the logistics capability of the Afghan Police.	
AFGHAN NATIONAL POLICE	B. IG Assessment of Progress
A program of focused district development has been created to break the cycle of corruption and provide Afghanistan a professional, well-led, and well-trained police force. The program involves an eight-week formal police training course and reflects a strategy of reforming the way policing is done at the district and community levels, and reinforcing the government's counterinsurgency capability at the interface with the populace. For the Afghan Police, logistics development is currently focused on verification and accountability. Regional, provincial, and district level gaps in Afghan Police logistics stem in part from still-developing MoI logistics policies and procedures and lack of logistics officer skills. The MoI is working to close these gaps through regional, provincial, and district level logistics officer training.	

AFGHAN NATIONAL POLICE	C. Management's Assessment

The ANP have made great progress over the last year as a result of the implementation of the Focused District Development (FDD) program. We concur with the comments made regarding the issues being addressed within the MoI.

The FDD has attempted to improve the logistic capabilities of ANP districts by ensuring equipment is properly issued and accounted for. The FDD training program that the district police attend also teaches ANP officers about logistics and equipment accountability. Logistics officers within police units are provided additional training in these areas.

The CSTC-A has a robust program that is focusing on ministerial-level logistics development within the MoI.

AFGHAN NATIONAL POLICE HEALTH CARE SYSTEM	A. IG Summary of Challenge

The Afghan Police do not have effective medical support. The general lack of Afghan Police resources and dispersed nature of much of the force in remote areas calls for an integrated health care approach between MoI and MoD and with the civilian Ministry of Public Health.

AFGHAN NATIONAL POLICE HEALTH CARE SYSTEM	B. IG Assessment of Progress

Although the Afghan Police do not have effective medical support, they are reluctant to integrate with the Afghan Army due to institutional mistrust.

Effective partnering with the Afghan Army and the civilian Ministry of Public Health is needed, but little progress has been made, largely due to limited resources and lack of a clear policy commitment on a way forward with a corresponding multi-year strategic plan for training, mentoring, and integration.

AFGHAN NATIONAL POLICE HEALTH CARE SYSTEM	C. Management's Assessment

The ANP has made progress in their health system and CSTC-A continues to mentor them in this area.

We agree that a coordinated ANSF health care system is desirable but as noted, we cannot accomplish this without support from the Afghan Government. The International Community and other areas of the U.S. Government outside of DoD will need to be involved in this effort as well.

7. NUCLEAR ENTERPRISE

A. IG Summary of Challenge	B. IG Assessment of Progress	C. Management's Assessment

DECLINE OF FOCUS ON THE NUCLEAR ENTERPRISE	A. IG Summary of Challenge

The Department faces complex and long standing nuclear enterprise management challenges that affect the Department's ability to provide public assurance that it can meet its nuclear operational and surety responsibilities. A recent Defense Science Board report stated that since the end of the Cold War, there has been a marked but gradual decline in the level and intensity of focus on the nuclear enterprise and the nuclear mission. When comparing the current level of focus to that of 1990, the aggregate change is dramatic. The decline is characterized by:

- Embedding nuclear mission forces in nonnuclear organizations.
- Markedly reducing levels of leadership whose daily focus is on nuclear enterprise.
- Generally devaluing the nuclear mission and those who perform the mission.

Numerous reports and studies issued over the past decade have documented the decline. From 1991 to 2008, the IG identified and reported on aspects of this decline in a series of classified audit reports related to the security of nuclear systems. Although specific report details are classified; the weaknesses identified in each of those reports are a direct result of the decline in emphasis of the nuclear enterprise and mission.

DECLINE OF FOCUS ON THE NUCLEAR ENTERPRISE	B. IG Assessment of Progress

The Department has begun to address and reverse the nuclear enterprise decline.

For example, in February 2008, the Air Force issued its report on the "Air Force Blue Ribbon Review of Nuclear Weapons Policies and Procedures." The report contained 36 observations and recommendations, as well as the following general conclusions:

- Air Force Nuclear Surety is sound but needs strengthening.
- Air Force focus on nuclear mission has diminished since 1991.
- Nuclear enterprise in the Air Force works, despite being fragmented.
- Declining Air Force nuclear experience has led to waning expertise.
- Air Force nuclear surety inspection programs need standardization.

The Air Force is in the process of implementing the report recommendations.

Other studies and task forces have been initiated as described below. However, it is critical that DoD leadership recognize the consequences of failure to ensure the security of its nuclear forces and to implement as quickly as possible, viable recommendations to stop and reverse the decline focus on the nuclear enterprise.

DECLINE OF FOCUS ON THE NUCLEAR ENTERPRISE	C. Management's Assessment

The Department agrees there has been a decline in the level and intensity of focus on the nuclear enterprise and the nuclear mission. The Department continues to address and reverse the nuclear enterprise decline. Actions to address the findings and recommendations from various reports and studies are overseen by the DoD Senior National Security Presidential Directive-28 Oversight Committee (Senior NOC), and the joint DoD/DOE Nuclear Weapons Council (NWC), both chaired by the USD(AT&L); as well as the Interagency Nuclear Command and Control System Committee of Principals (NCCS CoP), chaired by the Deputy Secretary of Defense. The Military Departments are aggressively implementing changes to organizational structure, processes, and procedures to improve the security of nuclear forces and senior leaders' focus on the nuclear mission.

INCIDENTS INDICATE SYSTEMIC PROBLEMS	A. IG Summary of Challenge

Over the past year, the Department experienced series of incidents that indicated significant problems with nuclear enterprise management. Failure to follow prescribed verification procedures resulted in nuclear warheads being inadvertently transferred from Minot AFB to Barksdale AFB. Sensitive missile components were erroneously shipped to Taiwan. The 2nd Bomb Wing at Barksdale AFB failed a nuclear surety inspection and had to be re-inspected to a satisfactory rating. The recent series of limited nuclear surety inspections conducted as a result of the Minot transfer incident exposed potential problems related to operational readiness.

INCIDENTS INDICATE SYSTEMIC PROBLEMS	B. IG Assessment of Progress

In response to the Minot transfer incident, the Secretary of the Air Force conducted a Commander-Directed Investigation of the incident, decertified a portion of the 5th Bomb Wing at Minot, and executed a series of limited nuclear surety inspections. However, the 5th Bomb Wing failed the May 2008 Defense Nuclear Surety Inspection and was re-inspected.

In response to a February 2008 request from the Under Secretary of Defense (Acquisition, Technology, and Logistics), the Defense Science Board Permanent Task Force issued its "Report on the Unauthorized Movement of Nuclear Weapons." The report identified the root and systemic causes of the Minot transfer incident and provided 12 recommendations to strengthen nuclear surety programs and practices. The Department is implementing the recommendations. Recently, the Under Secretary tasked the Defense Science Board to review the nuclear inspection regime and make recommendations for improvement.

In March 2008, the Secretary of Defense appointed Admiral Donald, USN, to conduct an investigation into the facts and circumstances surrounding the accountability for, and shipment of, sensitive missile components to Taiwan in 2006. The investigation concluded that the specific cause was the Air Force and Defense Logistic Agency's "sole reliance on, and lack of compliance with," existing supply system procedures to provide positive control of the components. The investigation identified 7 findings, and 3 systemic problems, and contained 13 recommendations for corrective action. The report makes clear that the problems and mistakes have their roots in decisions made over a period of at least 10 years.

INCIDENTS INDICATE SYSTEMIC PROBLEMS	C. Management's Assessment
The Department is applying the highest levels of accountability and control to the stewardship of nuclear weapons. The Department has reviewed and is enhancing logistics processes for the nuclear weapons enterprise that identifies, manages, and accounts for all nuclear weapons and sensitive nuclear weapons-related material. These improvements will be incorporated into DoD directives and Service/Agency-level policies. The USD(AT&L) staff will monitor processes through full implementation.	

KEYS TO IMPROVEMENT	A. IG Summary of Challenge
To reverse this trend, the Department needs to refocus on the nuclear enterprise. The following elements are key to improvement: • Create an environment that emphasizes the nuclear mission and that a reliable, safe, secure, and credible nuclear deterrent is essential to national security and is a high DoD priority. • Conduct detailed reviews and studies of all critical elements of the nuclear enterprise to identify key deficiencies and methods for improvement. • Develop corrective action plans that correct the deficiencies and provide adequate funding and leadership to ensure implementation. • Implement the corrective actions and conduct follow-up reviews to ensure that the action plans are correcting the deficiencies. As stated in the Defense Science Board report, the series of nuclear related incidents that occurred over the past year "can be a just-in-time rescue if lasting corrective actions are implemented now."	

KEYS TO IMPROVEMENT	B. IG Assessment of Progress
The Department initiated additional reviews to address critical aspects of the nuclear enterprise. In June 2008, the Secretary of Defense tasked the Under Secretary of Defense for Policy, in coordination with the Director of Administration and Management, to establish the Task Force on Nuclear Weapons Management as a subcommittee of the Defense Policy Board. The task force will have two phases. The first phase, to be completed within 60 days, will make recommendations on organizational, procedural, and policy matters involving the Air Force. The second phase, to be completed within 120 days, will examine management and oversight of nuclear weapons and related materials and systems across the entire Department. Additionally, the Secretary directed that a Nuclear Command and Control System Comprehensive Review (NCR) be conducted. This review will examine and make recommendations on the full range of nuclear command and control (NCCS) policies, procedures, responsibilities, functions, capabilities, management and oversight necessary to meet national and Department policy and guidance, and maintain the highest standards required for planning, directing, and controlling nuclear weapons, weapon systems, and associated operations. The Department will also be conducting a Nuclear Posture Review intended to examine the New Triad and its relationship to Defense policy goals, command and control planning and intelligence, and sizing of the nuclear force. We fully support these efforts and believe they are a necessary first step in reversing the decline. However, in the past, similar types of reviews were conducted that resulted in good, solid recommendations, which were never implemented. Fixing the problems will require commitment, effort, and resources. The IG will monitor the Department's progress in implementing the various report and study recommendations.	

KEYS TO IMPROVEMENT	C. Management's Assessment
The Department fully supports these efforts and agrees they are the first step in reversing the decline in the emphasis of the nuclear enterprise and mission. The Department's focus will be on determining and correcting the root and systemic causes of the decline. The Senior NOC, NWC, and NCCS CoP will continue to oversee actions to ensure the proper level of leadership, commitment, effort, and resources are applied to correct the problems and refocus the nuclear enterprise.	

SUMMARY OF MANAGEMENT ASSURANCES AND FINANCIAL STATEMENT AUDIT

CHECK IT
what gets checked
gets done

Department leadership is resolute in its determination to continuously establish and maintain effective internal management controls for all mission-essential processes. In June 2008, the Public Relations Society of America awarded the Department's Check It campaign its prestigious Silver Anvil Award for the best internal communications campaign. Check It, with the tagline "What gets checked, Gets done," reminds the workforce to double check their work and helps ensure effective internal management controls.

The Check It campaign also sponsors a competition to report best process improvements. In two rounds of competition, 40 improvements from 24 Components were submitted to the Deputy Secretary of Defense. Submissions reported a total of $3 billion worth of savings due to improving internal management controls.

U.S. Deputy Secretary of Defense Gordon England at the DoD Check It Campaign's Most Improved Process Ceremony. Secretary England recognizes DoD Components for the most improved processes totaling $3 billion worth of savings due to improving internal management controls through the Check It Campaign.

DoD photo – March 2008

DoD Managers' Internal Control Program

The Department conducts self-assessments of internal management controls throughout the Department in accordance with the Federal Managers' Financial Integrity Act (FMFIA), formally designated as the Department's Managers' Internal Control Program. These internal management controls are the checks and balances that assist program and financial managers to achieve results, and safeguard the integrity of the programs. As prescribed by OMB Circular No. A-123, the Department's internal management control program assesses both the effectiveness of nonfinancial functions and processes, and the management controls as prescribed by Appendix A for financial reporting. A description of each self-assessed category with weaknesses and the corresponding results follow:

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1. FMFIA Section 2 Financial Reporting Material Weaknesses.

The DoD is using a phased-in approach for the FMFIA Section 2 Financial Reporting, and the areas that were tested in the FY 2008 are listed below.

- Fund Balance with Treasury
- Investments
- Military Equipment
- Real Property
- Medicare-Eligible Retiree Health Care Fund
- Federal Employees Compensation Act Liabilities
- Environmental Liabilities
- Appropriations Received
- Accounts Receivable
- Inventory
- Accounts Payable
- Operating Materials and Supplies
- Other Assets
- Other Liabilities
- General Property and Equipment (Defense Organizations only)
- Compilation of financial reports
- Internal Use Software (Intelligence Community only)

Table 1a identifies the resulting weaknesses. The column entitled "Ref Table 2" crosswalks the reported FMFIA manager-identified weaknesses to similar auditor-identified weaknesses in Table 2.

Table 1a. Summary of Management Assurances

Effectiveness of Internal Control over Financial Reporting (FMFIA Section 2)							
Statement of Assurance	**No Assurance**						
Material Weaknesses *(information deemed necessary for clarification)*	**Ref Table 2**	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
1) Valuation of Property Plant and Equipment - Military Equipment	11	1					1
2) Real Property Assets	11	1					1
3) Environmental Liabilities	3	1					1
4) Health Care *(Medicare-Eligible Retiree Health Care Liability in military departments direct care operations)*		1					1
5) Fund Balance with Treasury	10	1					1
6) Accounts Receivable	13	1					1
7) Inventory Valuation	12	1					1

Table 1a. Summary of Management Assurances - continued							
Effectiveness of Internal Control over Financial Reporting (FMFIA Section 2)							
Statement of Assurance	**No Assurance**						
Material Weaknesses *(information deemed necessary for clarification)*	**Ref Table 2**	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
8) Operating Materials and Supplies	6	1					1
9) Accounts Payable	1	1					1
10) Personal Property -General Personal Property *(Includes reported problems with the cost of DoD property and materiel in the possession of contractors. Reassessed and moved from Overall Nonfinancial Operations #3 to DoD Financial Reporting Material Weakness #10)*	11 & 4		1				1
11) Financial Reporting Compilation *(Includes Statement of Net Cost, Statement of Budgetary Resources, Statement of Net Position, and Accounting Adjustments)*	2, 7, & 8		1				1
12) Financial Reporting of Intragovernmental Eliminations *(Includes Anti-Deficiency Act Violations)*	5		1				1
Total Financial Reporting Material Weaknesses		**9**	**3**	**0**	**0**	**0**	**12**

2. FMFIA Section 2 Overall (Nonfinancial) Operations Material Weaknesses. The Department's 34 Component heads follow a robust, programmatic approach to establish and assess internal management controls for their respective nonfinancial, mission-essential operations. Table 1b shows the resulting weaknesses for this assessment.

Table 1b. Summary of Management Assurances

Effectiveness of Internal Control over Overall (Nonfinancial) Operations (FMFIA Section 2)							
Statement of Assurance	**Qualified**						
Overall Material Weaknesses *(information deemed necessary for clarification)*	**Ref Table 2**	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
1) Department of Defense Financial Management Systems and Processes *(Reassessed as a consolidation into Conformance with Financial Management System Requirement FMFIA Section 4, Material Weakness #1, Table 1c.)*		1				1	
2) Management of Information Technology and Assurance		1					1
3) Personal Property *(Reassessed as new financial weakness #10, Table 1a.)*		1				1	
4) Personnel Security Investigations		1					1
5) Real Property Infrastructure		1		1			
6) Government Card Program		1		1			
7) Contracting		1					1
8) Procurement Data		1		1			
9) Interagency Acquisition and Potential Anti-Deficiency Act Violations		1		1			
10) Certain Audits Do Not Meet Professional Standards			1				1
Total Material Weaknesses for Overall Operations		**9**	**1**	**4**	**0**	**2**	**4**

3. FMFIA Section 4 Financial System Nonconformance Weaknesses: The Department considers financial system conformance with governmentwide requirements and reports one weakness that covers the wide range of pervasive problems identified during the assessment. Table 1c shows the resulting weakness.

Table 1c. Summary of Management Assurances							
Conformance with Financial Management System Requirements (FMFIA Section 4)							
Statement of Assurance	No Assurance						
System Nonconformance *(information deemed necessary for clarification)*	Ref Table 2	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
1) Department of Defense Financial Management Systems and Processes	9	1					1
Total System Conformance Material Weaknesses		**1**					**1**
Total FMFIA Weaknesses		**19**	**4**	**4**	**0**	**2**	**17**

Improvement Results

Since FY 2001, the Department has reduced the number of outstanding management-identified material weaknesses by 85 percent—from 116 material weaknesses to 17 (Figure 3-1). From FY 2003 to FY 2007, the total number decreased 59 percent, from 41 to 19. And in the last year, the Department further reduced the self-identified weaknesses from 19 to 17 by correcting four, reassessing two, and identifying four new weaknesses.

Financial Statement Audit

In addition to the management-identified weaknesses described in the categories above, the Department of Defense Inspector General identified material weaknesses in financial statement reporting as shown in Table 2.

Figure 3-1. Reducing Internal Management Control Weaknesses

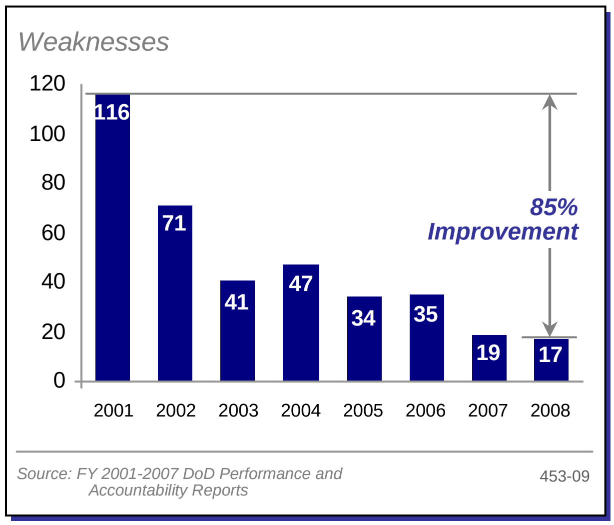

Table 2. Summary of Financial Statement Audit						
Audit Opinion			**Disclaimer**			
Restatement			**Yes**			
Material Weakness		**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
1	Accounts Payable	1				1
2	Accounting Entries	1				1
3	Environmental Liabilities	1				1
4	Government Property in Possession of Contractors	1				1
5	Intragovernmental Elimination	1				1
6	Operating Materiels and Supplies	1				1
7	Reconciliation of Net Cost of Operations to Budget	1				1
8	Statement of Net Cost	1				1
9	Financial Management Systems	1				1
10	Fund Balance with Treasury	1				1
11	General Property, Plant & Equipment	1				1
12	Inventory	1				1
13	Accounts Receivable	1				1
	Total Material Weaknesses	**13**	**0**	**0**	**0**	**13**

Compliance with Federal Financial Management Improvement Act

Table 3 shows the Department's compliance with the Federal Financial Management Improvement Act. The Department is committed to implementing the FIAR Plan and the ETP to achieve significant progress toward financial management improvement.

Table 3. Compliance with Federal Financial Management Improvement Act		
	Agency	**Auditor**
Overall Substantial Compliance	No	No
1. System Requirements	No	No
2. Accounting Standards	No	No
3. U.S. Standard General Ledger at Transaction Level	No	No

Good News Results

The Department has improved its financial management by focusing its efforts on fixing material weaknesses and strengthening internal controls. This approach has yielded positive results providing a more complete depiction of the Department's financial health and improved operational processes. The Department remains committed to transformational efforts to continue reducing material weaknesses.

IMPROPER PAYMENTS INFORMATION ACT REPORTING

The Improper Payments Information Act (IPIA) of 2002, as implemented by the OMB Circular No. A-123, Appendix C, "Requirements for Effective Measurement and Remediation of Improper Payments," requires federal agencies to review all programs and activities annually, and identify those that may be susceptible to significant erroneous payments. The Department strengthened financial management controls and improved processes used to detect and prevent improper payments. Eliminating improper payments ensures that taxpayer dollars are spent wisely and efficiently. The Department's FY 2008 review did not identify any programs at risk of significant erroneous payments in accordance with OMB criteria (programs with erroneous payments exceeding both $10 million and 2.5 percent of program payments). All DoD improper payment estimates for FY 2008 are at or below 2 percent for all programs. However, based on the large volume of transactions and/or high dollar amounts, DoD is required to report on all programs regardless of threshold criteria. The five programs are:

- Military Health Benefits
- Military Pay
- Civilian Pay
- Military Retirement
- Travel Pay

Improper payment estimates for these programs are presented in Figure 3-2. Commercial pay information is included in the Recovery Audit Reporting section of this report. Additional information regarding DoD's IPIA program and statistical sampling methodology is available on the Comptroller Web site. (See Appendix B.)

Risk Assessment

The Department's risk assessments for each of the programs identified above addressed the effectiveness of internal controls for preventing improper payments (such as prepayment reviews), and system weaknesses

Figure 3-2. FY 2008 Estimated Improper Payments

Program	Estimated $	Estimated %
Military Health Benefits	$ 178.0M	2.00 %
Military Pay	$ 434.6M	0.60 %
Civilian Pay	$ 73.9M	0.28 %
Military Retirement	$ 44.0M	0.12 %
Travel Pay	$103.0M	2.00 %

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identified internally or by outside audit activities. While the Department's improper payment percentages are low, numerous pre- and post-payment controls further minimize or eliminate improper payments. The following paragraphs summarize the processes in place and the results of survey assessment reviews.

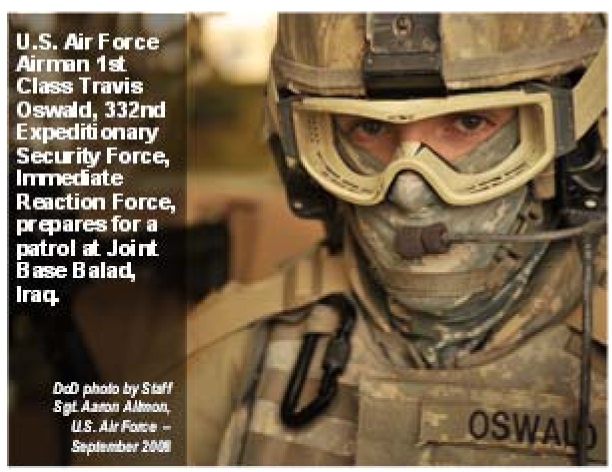
Statistical Sampling Process

The Department of Defense uses random sampling methods designed to meet or exceed the OMB requirement of annual estimates of improper payments with a 90 percent confidence interval (plus or minus 2.5 percent).

Corrective Action Plans

Military Health Benefits

The Department's contracts have had payment performance standards for military health benefit claims processing in place for many years. The estimate of 2 percent is based on the contract performance standard,



U.S. Air Force Airman 1st Class Travis Oswald, 332nd Expeditionary Security Force, Immediate Reaction Force, prepares for a patrol at Joint Base Balad, Iraq.

DoD photo by Staff Sgt Aaron Allmon, U.S. Air Force – September 2008 however, actual results have been consistently less than 2 percent. The FY 2007 results reflect an improper payment rate of 0.93 percent. Overpayments found in the annual audit process are projected to the audit universe, and the managed care support contractor is liable for the total amount. This contractual design, combined with numerous prepayment and post-payment controls, effectively minimizes improper payments and ensures the Government's risk for improper payments in military health benefits is minimized.

Military Pay

Reviews of military pay accounts for FY 2008 resulted in projected improper payments of an estimated $435 million (0.6 percent of approximately $72 billion in total military net pay). Most of these improper payments were due to inaccurate or untimely reporting of entitlement data to the automated pay system.

The Department has worked closely with the Active Duty Components to develop metrics and track timeliness and accuracy of pay entitlements. Senior leaders participate in quarterly Personnel and Pay Council meetings to discuss problem areas and seek solutions to mitigate discrepancies causing improper payments. This partnership with the Active Duty Components has improved pay entitlement timeliness and accuracy. The Department continues to develop Reserve and Guard performance metrics and goals to improve accuracy and timeliness, which should further reduce improper payments.

Civilian Pay

Reviews of civilian payments resulted in an improper payment estimate of $73.9 million (0.28% of approximately $26.4 billion). Efforts to identify and reduce actions contributing to net pay errors continue. Improper payments that resulted in collection actions are primarily attributed to untimely and inaccurate reporting of time and attendance (60 percent of total collections), and personnel actions and pay allowances (40 percent of total collections).

The Personnel and Pay Council continues to serve as a forum for senior leadership to address civilian pay problem areas and seek methods to mitigate risks and reduce improper payments. Civilian pay metrics, corresponding accuracy and timeliness goals, and corrective action plans have been developed at the component level.

Military Retirement

Payments to deceased retirees continue to be the highest risk for improper payments in military retired pay. Based on FY 2008 reviews, the Department projected approximately $44 million in improper payments for this program, with almost the entire amount paid to deceased retirees. This represents an overpayment rate of 0.12 percent of the estimated $36 billion in annual military retirement payments. In certain situations, payment to deceased retirees is unavoidable due to payment cycle dates and the fact that notifying a payroll activity is not likely to be the first action for next-of-kin at the time of a retiree's passing. A review of confirmed payments to deceased retirees in FY 2008 indicated that the Department recovered 96 percent of the overpayment amounts within 60 days, demonstrating the effectiveness of controls within the retired pay system once a retiree's death confirmation is received and processed for final disposition.

Secretary of Defense Robert M. Gates, left, presented then Chairman of the Joint Chiefs of Staff Marine Gen. Peter Pace with his certificate of retirement during an armed forces hail and farewell ceremony at Ft. Myer, Va. Pace retired after 40 years of active-duty military service.
DoD photo by Cherie A. Thurlby October 2007

The Department's control processes to prevent, identify, and reduce overpayments to deceased retirees include a series of periodic eligibility notifications, early detection data mining efforts, and partnerships with other Federal and state entities. The Department routinely compares retired and annuity payroll master file databases to Social Security Administration deceased records and periodically compares records with the Office of Personnel Management's deceased files. File comparisons are also conducted with the Department of Veterans Affairs' cemetery database and with individual states with sizable retiree and annuitant populations (e.g., Texas, California, and Florida). Retirees identified as deceased in these comparisons must validate their continued eligibility, or the accounts are suspended.

Travel Pay

The Department performs monthly random post-pay reviews of travel vouchers processed through the Defense Travel System (DTS) and the Windows Integrated Automated Travel System (WinIATS), as well as permanent change of station (PCS) vouchers, and regularly reports the results to management. Estimates of travel overpayments are projected based on random reviews of WinIATS temporary duty (TDY) and military PCS vouchers that were not included in last year's AFR. The Department implemented a sampling and review process for Army IATS in FY 2008 that meets the improper payment reporting requirements. Reports to management address accuracy rate trends, over- and underpayment dollar amounts, reasons for errors, and recommendations for corrective actions to alleviate similar errors in the future.

The DTS is targeted to be the single, online travel system used by the Department. Until DTS is fully implemented, Components will continue to use other travel systems, such as IATS and Reserve Travel System, to settle travel vouchers. Summary results for the Department during FY 2008 revealed an estimated $103 million (2 percent) in improper payments out of a total of $5.2 billion in travel voucher reimbursements.

Improper Payment Program Reporting

Figure 3-3 summarizes the Department's improper payment reduction outlook and total program outlays (payments) from FY 2007 through FY 2011. Detailed information regarding DoD's IPIA program and notes relating to Figure 3-3 are available on the Comptroller Web site. (See Appendix B.)

Figure 3-3. Improper Payment (IP) Reduction Outlook

	FY 2007			FY 2008			FY 2009 Estimated			FY 2010 Estimated			FY 2011 Estimated		
Program	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 Health Benefits	$ 9.5	0.93	$88.6	$ 8.9	2.00	$178.0	$10.8	2.00	$ 216	$ 10.5	2.00	$ 211	$ 10.8	2.00	$ 216
Military Pay	$72.9	0.57	$ 416.4	$ 72.1	0.60	$434.6	$68.4	0.53	$ 362.5	$ 69.7	0.52	$362.4	$ 71	0.51	$ 362.1
Civilian Pay	$29.6	0.25	$ 74.6	$ 26.4	0.28	$ 73.9	$31.3	0.24	$ 73	$ 32.3	0.23	$ 72.3	$ 32.3	0.22	$ 72.2
Military Retirement	$37.1	0.13	$48.7	$ 35.6	0.12	$ 44.0	$41.3	0.12	$ 51.4	$ 42.9	0.12	$ 54.2	$ 44.5	0.12	$ 52.3
Travel Pay	$ 5.8	1.00	$43.6	$ 5.2	2.00	$103.0	$ 8.6	0.95	$ 82.4	$ 8.5	0.90	$ 76.5	$ 8.3	0.88	$ 72.3

IP – Improper Payments, B – Billions, M – Millions

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Recovery Auditing Reporting

The Department uses a number of different mechanisms to prevent, identify, and collect improper payments, including recovery and contract auditing for all commercial payments.

Recovery Auditing

The Department maintains an extensive post-payment review process for identifying improper payments in the commercial pay arena. This process uses post-payment reviews performed both internally and by recovery auditing contractors paid from the recovered proceeds. Departmentwide commercial payments constitute a large volume of transactions with high dollar values, and DoD is vigilant about ensuring payment accuracy. In addition to the post-payment reviews, DoD also prevents over- and under-payments through various manual and automated prepayment initiatives.

Commercial pay overpayments identified for recovery result from internal recovery audit efforts and contract reconciliation. Selected high dollar value payments are reviewed manually, and periodic independent reviews of commercial payments improve improper payment detection, correction, and prevention efforts.

The Department's Mechanization of Contract Administration Services (MOCAS) system processed 57 percent of the $331 billion in DFAS commercial pay disbursements made in FY 2008. Reviews of this system accounted for 67 percent ($203.9 million) of the total $303.7 million in improper commercial payments identified by DFAS in FY 2008. Over two-thirds of this total represented underpayments (Figure 3-4).

Recovery Audit Activity Table

The $331.2 billion represents the total dollar value of disbursements (payments) in MOCAS and vendor pay systems. In accordance with IG recommendations, the recoveries identified do not include unsolicited refunds of overpayments from vendors. The DFAS successfully separated voluntary and involuntary refunds for FY 2008 reporting. Cumulative amounts reflect totals from FY 2006 and 2007 since detailed information on collections by type, excluding voluntary repayments, is not readily available prior to FY 2006. In addition to the success of DFAS, the Department is continuing to separate voluntary from involuntary refunds until all DoD Components achieve this capability. Components reported an additional $26.7 billion in commercial payments that were processed independently from DFAS in FY 2008. Recovery audit statistics for this amount includes voluntary refunds and, therefore, was excluded from the Recovery Audit Activity table. Additional recovery audit activity that includes voluntary refunds is available on the Comptroller Web site. (See Appendix B.)

Contract Auditing

The Defense Contract Audit Agency (DCAA) routinely performs billing system audits at major contractors to determine the adequacy of the contractor's billing system, internal controls, and compliance with those controls. Such audits assure the Department that the contract payment billings are based on costs incurred and on approved provisional billing rates. The DCAA also performs paid voucher reviews at major contractors, and special

Figure 3-4. Recovery Audit Activity

Recovery Audit Activity *(Amounts in millions)*	Departmental Recovery Audit Totals
Amount Subject to Review for FY 2008 Reporting	$331,192
Actual Amount Reviewed and Reported (FY 2008)	$331,192
Overpayment Amounts Identified for Recovery (FY 2008)	$53.3
Amounts Recovered (FY 2008)	$41.7
Overpayment Amounts Identified for Recovery (Prior Years)	$66.0
Amounts Recovered (Prior Years)	$60.0
Cumulative Amounts Identified for Recovery (FY 2008 and Prior)	$119.3
Cumulative Amounts Recovered (FY 2008 and Prior)	$101.7

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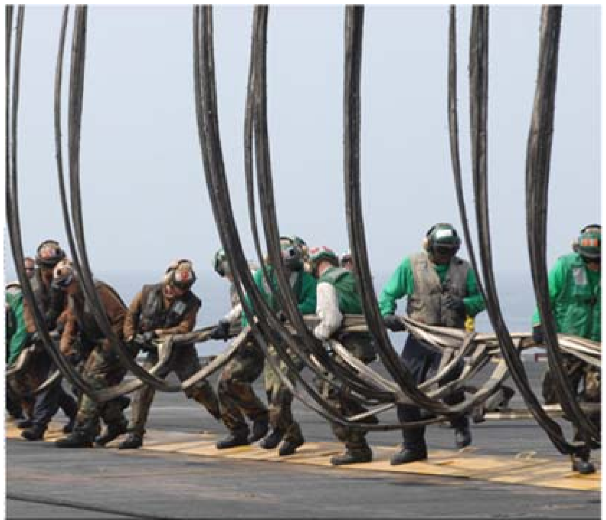

U.S. Sailors set the aircraft training barricade on the flight of the Nimitz-class aircraft carrier USS Ronald Reagan (CVN 76) while under way in the Gulf of Oman, during flight deck drills.

U.S. Navy photo by Specialist 3rd Class Chelsea Kennedy – September 2008

purpose audits at contractor locations, when an improper payment risk factor is identified and neither a billing system review nor a test of paid vouchers is planned.

Accountability

Certifying officer legislation holds certifying and disbursing officers accountable for government funds. In accordance with section 2773a of title 10, United States Code, pecuniary liability attaches automatically when there is a fiscal irregularity, i.e., 1) a physical loss of cash, vouchers, negotiable instruments, or supporting documents, or 2) an improper payment. Efforts to recover payments from a recipient must be undertaken in accordance with debt collection procedures in the DoD Financial Management Regulation.

Infrastructure

The Department has the information and infrastructure needed to reduce improper payments in each of the Improper Payment Program areas. The Department began implementing a Business Activity Monitoring (BAM) toolset in FY 2008, which will employ the latest technology to increase the efficiency and effectiveness of commercial pay improper payment detection and prevention procedures. The BAM toolset is expected to reach full functionality for improper payments in FY 2009.

Barriers

Military retirement is the only program area facing statutory or regulatory barriers limiting corrective actions. Barriers include the Retired and Annuitant Pay service contract and the Federal Acquisition Regulation.

In January 2002, DFAS awarded Retired and Annuitant Pay service operations to a contractor. Although most functions remained 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 this contract. 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 and modify the contract accordingly.

Appendixes

GLOSSARY OF TERMS

Acronym	Definition
AFB	Air Force Base
AFR	Agency Financial Report or Annual Financial Report
ANA	Afghan National Army
ANCOP	Afghan National Civil Order Police
ANP	Afghan National Policy
ANSF	The Afghan National Security Forces
A&T	Acquisition and Technology
AT&L	Acquisition, Technology, and Logistics
BAM	Business Activity Monitoring
BCT	Brigades Combat Team
BEA	Business Enterprise Architecture
BPA	Blanket Purchase Agreement
BTA	Business Transformation Agency
CAC	Common Access Card
CBRNE	Chemical, Biological, Radiological, Nuclear, and High-Yield Explosive
CBJ	Congressional Budget Justification
CERFP	Enhanced Response Force Package
CF	Coalition Forces
CFO	Chief Financial Officer
CM	Capability Milestone
COCO	Contractor Owned and Contractor Operated
COGO	Contractor Owned and Government (DoD) Operated
CONUS	Continental United States
COR	Contracting Officer's Representative
CRM	Contract Resource Management
CSB	Configuration Steering Board
CSTC-A	Combined Security Transition Command-Afghanistan
CUI	Controlled unclassified information
DBE	Department of Border Enforcement
DCAA	Defense Contract Audit Agency
DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DoD	Department of Defense
DOE	Department of Energy
DPAP	Defense Procurement Acquisition Policy
DTS	Defense Travel System
DUSD	Deputy Under Secretary of Defense
ETP	Enterprise Transition Plan
FDD	Focused District Development
FFMIA	Federal Financial Management

Acronym	Definition
	Improvement Act
FIAR	Financial Improvement and Audit Readiness
FIPS	Federal Information Processing Standard
FISMA	Federal Information Security Management Act
FMFIA	Federal Managers' Financial Integrity Act
FMS	U.S. Foreign Military Sales
FY	Fiscal Year
GAAP	Generally accepted accounting principles
GAO	General Accounting Office
GFM	Global Force Management
GPRA	Government Performance and Results Act
HSPD	Homeland Security Presidential Directive
IA	Iraqi Army
IA	Individual Augmentee
IATS	Integrated Automated Travel System
IG	Inspector General
IGT	Intragovernmental Transactions
IOC	Initial operational capability
IPA	Independent Public Accountant
IPA	International Police Advisor
IPIA	Improper Payment Information Act
ISAF	International Security Assistance Force
ISF	Iraqi Security Forces
ISR	Intelligence, surveillance, and reconnaissance
IT	Information Technology
IVAN	Intragovernmental Value-Added Network
JCS	Joint Chiefs of Staff
JFCOM	Joint Forces Command
JLLIS	Joint Lessons and Learned Information Systems
JKDDC	Joint Knowledgeable Development Distribution Capability
JNTC	Joint National Training Center
JSCA	Joint Supply Chain Architecture
JTF	Joint Task Force
JWFC	Joint Warfare Fighting Center
MCTC	Army Maneuver Combat Training Centers
MFF	Multi-Functional and Functional Support
MHS	Military Health System
MNSTC-1	Multinational Security Transition Command in Iraq

Acronym	Definition
MOCAS	Mechanization of Contract Administration Services
MoD	Ministry of Defense
MoI	Ministry of Interior
NATO	North Atlantic Treaty Organization
NCCS CoP	Interagency Nuclear Command and Control System Committee of Principals
NCO	Non-Commissioned Officer
NCR	Nuclear Command and Control System Comprehensive Review
NDAA	John Warner National Defense Authorization Act
NLT	Not less than
NP	Nonproliferation
NSS	National Security System
NTE	Not to exceed
NTM-I	NATO Training Mission – Iraq
NWC	Nuclear Weapons Council
OIF	Operation Iraqi Freedom
OMB	Office of Management and Budget
PCS	Permanent Change of Station
PEO Soldier	Program Execution Office Soldier
PII	Performance Improvement Initiative (formerly the PMA Budget and Performance Integration Initiative)
PII	Personally Identifiable Information
PIV	Personal Identity Verification
PMA	President's Management Agenda
PMT	Police Mentor Team
POC	Point of Contact
QDR	Quadrennial Defense Review
PTSD	Post Traumatic Stress Disorder

Acronym	Definition
RTS	Reserve Travel System
SCOR	Supply Chain Operations Reference
SecDef	Secretary of Defense
Senior NOC	DoD Senior National Security Presidential Directive-28 Oversight Committee
SRG	Senior Review Group
SOC	Senior Oversight Council
TBI	Traumatic Brain Injury
TDY	Temporary Duty
TMA	TRICARE Management Activity
TSA	Technology Security Action
USACE	U.S. Army Corps of Engineers
USAFRICOM	U.S. African Command
USCENTCOM	U.S. Central Command
US CERT	U.S. Computer Emergency Readiness Team
USD(AT&L)	Under Secretary of Defense for Acquisition, Technology, and Logistics
USD(C)	Under Secretary of Defense (Comptroller)
USEUCOM	U.S. European Command
USNORTHCOM	U.S. Northern Command
USPACOM	U.S. Pacific Command
USSOUTHCOM	U.S. Southern Command
USUHS	Uniformed Services University of the Health Sciences
WinIATS	Windows Integrated Automated Travel System
WMD	Weapon of Mass Destruction
WMD-CST	Weapons of Mass Destruction—Civil Support Team

USEFUL WEB SITES FOR RELEVANT INFORMATION

Web Address and Report Description
www.defenselink.mil • Main DoD Web site, and links to other DoD Web sites.
www.defenselink.mil/comptroller The DoD Comptroller Web site includes: • Agency Financial Report Provides the President, Congress, Federal departments and the American public with an overview of the Department's financial condition. This report is the annual centerpiece for reporting the Department's financial execution, plans, and accomplishments. • Annual Performance Plan Describes the Department's strategic goals and objectives, and the respective performance measures and targets that are used to assess progress. • Annual Performance Report Contains details of the Department's performance results and progress in achieving its strategic goals, and is required by the Government Performance and Results Act (GPRA). • Citizen's Report Summarizes the Department's mission, key goals, budget allocation, and progress on key performance goals linking to the strategic goals. • Congressional Budget Justification The Department of Defense's budget request to Congress. • Financial Improvement and Audit Readiness Plan Describes the Department's strategy for improving financial management and reports progress in achieving financial statement audit readiness.
www.defenselink.mil/dbt The DoD's Business Transformation Agency Web site includes: • Business Enterprise Architecture Blueprints DoD standard processes, data, data standards, business rules, operating requirements, and information exchanges for the Department's business and financial management activities. • Enterprise Transition Plan Sets the defense business systems modernization strategy and defines the target systems environment.
www.defenselink.mil/qdr/report/Report20060203.pdf • Quadrennial Defense Review Dated February 6, 2006, this is the Department's strategic plan.

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