Management's Discussion and Analysis

Fiscal Year 2004

Defense Threat Reduction Agency
Fort Belvoir, VA 22060-6201

DEFENSE THREAT REDUCTION AGENCY (DTRA)

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

FISCAL YEAR 2004

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Message from the Chief Financial Officer

DTRA
DEFENSE THREAT REDUCTION AGENCY

I am pleased to present the Defense Threat Reduction Agency (DTRA) Management's Discussion and Analysis (MD&A) for Fiscal Year 2004. This report summarizes the Agency's mission, organization, programmatic achievements, financial status, and business priorities for the past year.

DTRA is a proud organization performing a vital national security mission: reducing the threat of weapons of mass destruction. We are a defense combat support agency with more than 2,000 personnel coming from the military services, the Federal civil service, universities, non-governmental organizations, and corporate America.

We work around the world to pursue and accomplish our mission by taking threat reduction to the source, stopping the spread of weapons of mass destruction (WMD), securing and dismantling strategic offensive arms, taking the fight to the enemy, detecting WMD threats, protecting our nation against weapons of terror, and deterring WMD use.

Underlying DTRA's programmatic achievements is our commitment to organizational excellence and sound financial management. In FY 2004, for the third consecutive year, DTRA received an unqualified "clean" audit opinion on its financial statements. This is the best possible audit result and should provide confidence that the financial statements contain reliable information.

As required by Section 1116(e) of Title 31 of the U.S.C., I am pleased to report that the financial and performance information contained in this report is complete and reliable. I am also pleased to report that DTRA is in substantial compliance with the requirements contained in the Federal Managers' Financial Integrity Act (FMFIA) and Federal Financial Management Improvement Act (FFMIA). My assessment is based on the Independent Auditor's Report received on November 9, 2004.

It is our job here at DTRA to ensure that U.S. capabilities are the best in the world and that the returns to the American people who support these activities with their tax dollars meet their highest expectations. It is the dedication and commitment of an outstanding staff here at DTRA that makes all this possible.

Myron K. Kunka
Chief Financial Officer
November 10, 2004

1.0 Mission and Organization

The Defense Threat Reduction Agency (DTRA) was established on October 1, 1998 as part of the Defense Reform Initiative (DRI) to enable the Department of Defense (DoD) to deal more effectively with threats posed by nuclear, chemical, and biological weapons of mass destruction. The DTRA organization is a consolidation of the former On-Site Inspection Agency (OSIA), Defense Special Weapons Agency (DSWA), elements of the Offices of the Under Secretary of Defense for Policy (USD (P)), and the Assistant to the Secretary of Defense for Nuclear, Chemical and Biological Defense Programs, (ATSD (NCB)).

1.1 Mission

The mission of the Defense Threat Reduction Agency is to safeguard America's interests from weapons of mass destruction (chemical, biological, radiological, nuclear and high explosives) by controlling and reducing the threat, and by providing quality tools and services for the warfighter. The following strategic goals are identified in DTRA's Strategic Plan and provide the framework for accomplishing DTRA's mission.

- **Deter the use and reduce the impact of WMD** - The fundamental goal of deterring the use of WMD underpins the mission and activities of DTRA. DTRA pursues a multi-faceted approach, focusing on the U.S. nuclear force, support of missile defense programs and the science, technology, and demonstration of counter-proliferation capabilities. This also enhances our support to civil and military crisis and consequence management response capabilities.

- **Reduce the present threat** - DTRA looks to execute and expand treaty and non-treaty efforts to control, safeguard and eliminate existing weapon capabilities, and to foster efforts to evaluate and counter WMD threats from all potential adversaries.

- **Prepare for future threats** - DTRA strives to predict emerging WMD capabilities, evaluate threats from potential adversaries, and develop new technologies to assist the warfighter of the future by providing powerful tools to counter specific threats and to protect personnel, infrastructure, and mission critical systems.

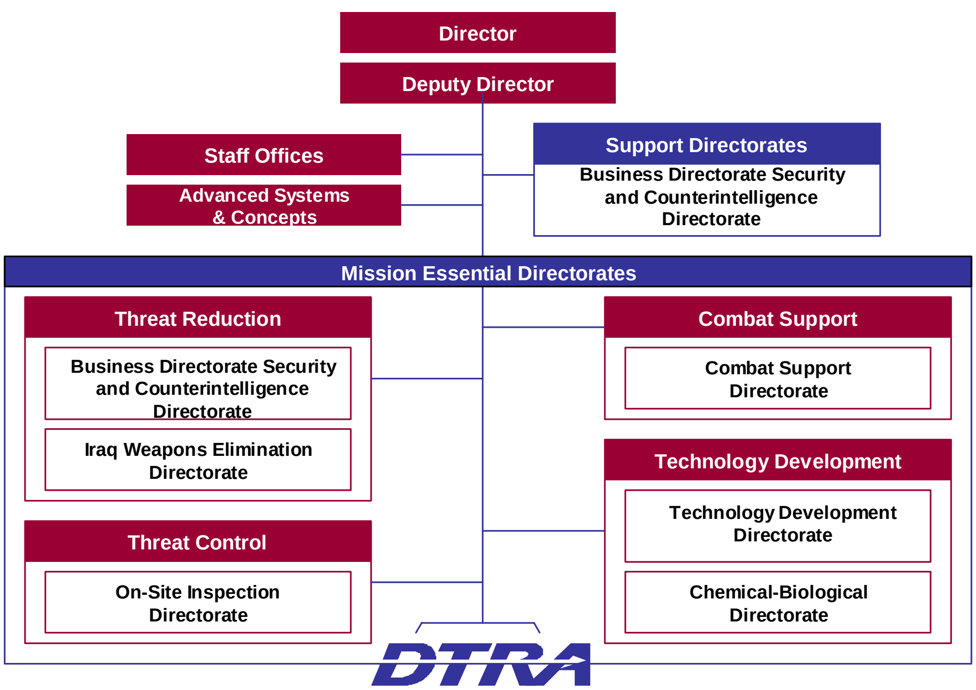
- **Conduct the right programs in the best manner** - DTRA is committed to being a good steward of the nation's resources. DTRA reviews its programs regularly, incorporates best business practices, optimizes current workforce distribution, and determines future needs, and builds beneficial relationships with DoD, U.S. Government, industry and international partners concerned with threat reduction.

- **Develop our people and enable them to succeed** - DTRA is committed to attracting and retaining a trained, satisfied and highly-motivated workforce. DTRA strives to clearly articulate its values and expected behaviors, encourage and reward excellence, and sustain high individual and organizational performance. Furthermore, DTRA endeavors to create an effective, healthy, safe, secure and accessible workplace.

1.2 Organization and Resources

To fulfill its mission and strategic goals, DTRA operates under the authority, direction, and control of the Under Secretary of Defense for Acquisition, Technology and Logistics (USD (AT&L)). DTRA is designated as a Defense Combat Support Agency for certain functions specified by the Secretary of Defense. Additionally, the Threat Reduction Advisory Committee (TRAC), which is composed of distinguished policy, scientific, and defense experts, was established to advise DTRA and other senior defense officials in identifying threats and emerging WMD challenges.

DTRA's staff offices and support directorates perform key infrastructure and support functions for the Agency. These offices provide advice and services in the areas of security, logistics, financial management, administration, personnel, equal opportunity, information technology (IT), and acquisition. There are five directorates that directly support DTRA's critical mission: On-Site Inspection Directorate (OS), Combat Support Directorate (CS), Technology Development Directorate (TD), Chemical-Biological Defense Directorate (CB), and Cooperative Threat Reduction Directorate (CT). The FY2004 DTRA organizational structure is depicted below.



Although the Chemical-Biological Defense Directorate is a part of DTRA, funding for the Chemical-Biological Defense Program is appropriated to OSD in a separate account and is not part of DTRA's direct Total Obligation Authority (TOA). As such, details of the Chemical-Biological Defense Program are not addressed in this report.

DTRA is supported by the Advanced Systems and Concepts Office (ASCO), which is fully engaged to develop and maintain an evolving analytical vision of necessary and sufficient capabilities to protect the U.S. and its allies from emerging WMD threats. ASCO analyzes future WMD threats, forecasts requirements, and integrates the results into the Agency's overall planning. It supports DTRA through projects that are designed to encourage alternative thinking, innovative strategies, and cross-cutting integrated approaches to WMD threats. ASCO integrates its work with the advice and recommendations of the TRAC.

On October 1, 2003, DTRA consolidated its business management functions into a single directorate. The Business Directorate consolidated the functions of the former Resource Management, Information Management, and Acquisition and Logistics Management Directorates. This consolidation is intended to promote business integration across the Agency and increase synergy between functions.

DTRA's FY 2004 total obligation authority is presented, by appropriation, below. DTRA's authorization is 1,022 civilian full-time equivalent (FTE) employees and 888 active duty military.

Appropriation	FY 2004 Budget Authority (Millions)
Operation and Maintenance	$318
RDT&E	390
Procurement	34
Military Construction	26
Former Soviet Union Threat Reduction	449
Total	$1,217

1.3 Location

DTRA continues to make progress towards its goal of achieving optimal organizational synergy, efficiency, and force protection by consolidating DTRA's National Capital Region (NCR) activities in one geographic location. The new Defense Threat Reduction Center, located at Fort Belvoir, is scheduled to be completed in October 2005 and occupied by January 2006. In addition to its NCR activities, DTRA maintains operations in Albuquerque, NM, San Francisco, CA and Mercury, NV.

DTRA also maintains world-wide operations in support of its global missions. Germany is home to the European Operations Division of the On-Site Inspection Directorate, and provides gateway support to American inspection teams transiting from the U.S. to points further east. DTRA mans and operates the Arms Control Implementation Units located in U.S. embassies in Kazakhstan, Russia and the Ukraine.

DTRA employees provide support for U.S. inspection, observation and portal monitoring teams through the former Soviet Union (FSU), as well as for the implementation of the Cooperative Threat Reduction program. Employees of DTRA's On-Site Inspection Directorate stationed in Japan assist U.S. inspection and observation teams traveling to Far East points of entry in the FSU. In recognition of DTRA's combat support mission, liaison personnel are located at appropriate sites to enhance responsiveness to the Combatant Commanders in meeting critical warfighting needs.

2.0 Performance Goals, Objectives, and Results

2.1 Strategies and Resources

The Agency receives strategic planning guidance from the National Military Strategy and other Departmental planning guidelines. Through its strategic planning process, DTRA ensures the products and services offered enhance DoD's capabilities to achieve national military objectives and operational requirements.

To accomplish the overall Agency mission within the organizational structure identified above, DTRA has identified four mission areas. While DTRA's directorates may focus on a particular function, there is a synergy between the directorates due to their particular expertise. Accordingly, resources have been allocated to support critical requirements across the combat support, technology development, threat control, and threat reduction mission areas.

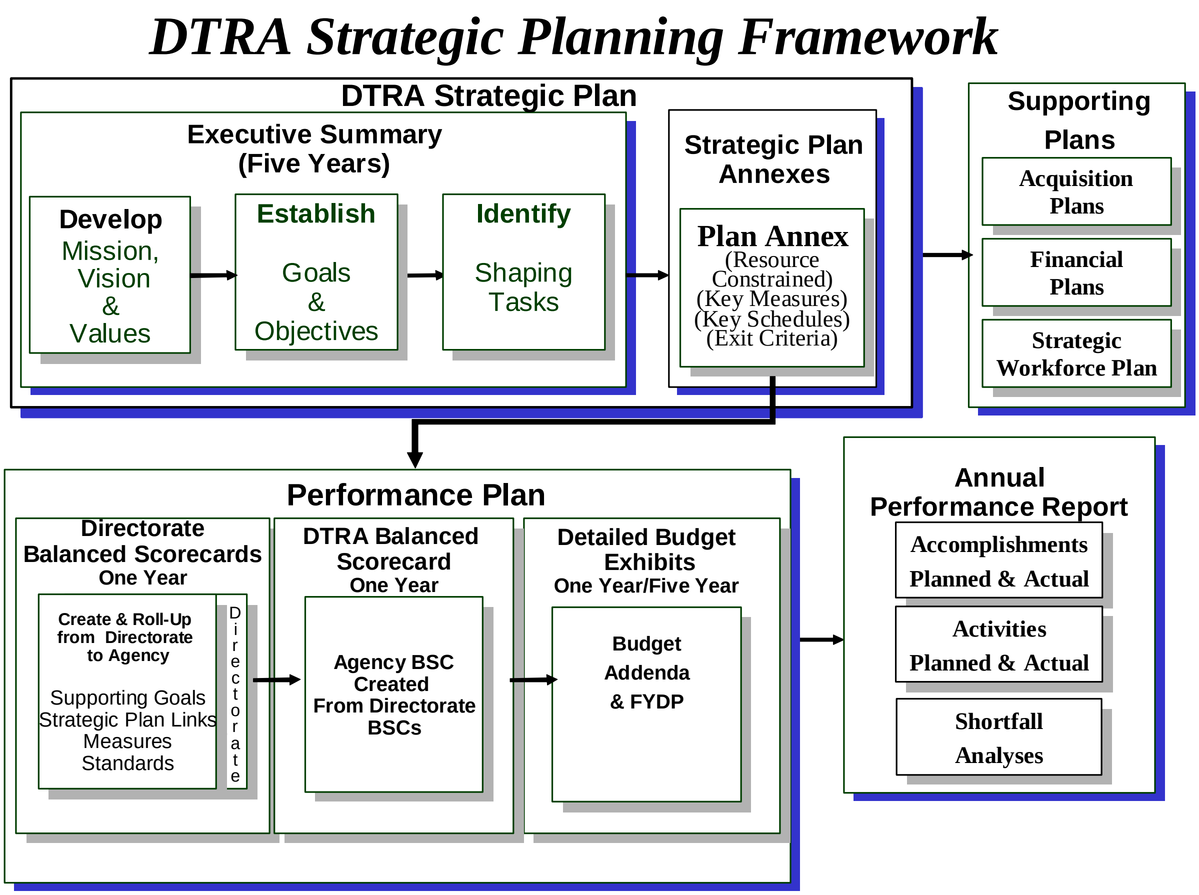
- **Combat Support** – DTRA provides combat support to the Joint Chiefs of Staff (JCS), the Joint Staff, the Combatant Commanders and the military services to deter, engage, and assess the threat and challenges posed to the United States, its forces, and its allies by WMD. This mission area is primarily the responsibility of DTRA's Chemical-Biological, Combat Support and Technology Development Directorates.

- **Technology Development** – DTRA develops, manages, coordinates and conducts research and development activities to enhance and enable WMD combat support, threat control and threat reduction. This mission area is primarily the responsibility of DTRA's Technology Development and Chemical-Biological Directorates.

- **Threat Control** – DTRA shapes, manages and implements arms control and other non-treaty efforts to control, safeguard and eliminate nuclear, biological, chemical, conventional, and other special weapons. This mission area is primarily the responsibility of DTRA's On-Site Inspection Directorate.

- **Threat Reduction** - DTRA provides assistance to eligible states of the FSU in order to dismantle WMD and to reduce the threat of WMD proliferation. This mission area is primarily the responsibility of the Cooperative Threat Reduction Directorate.

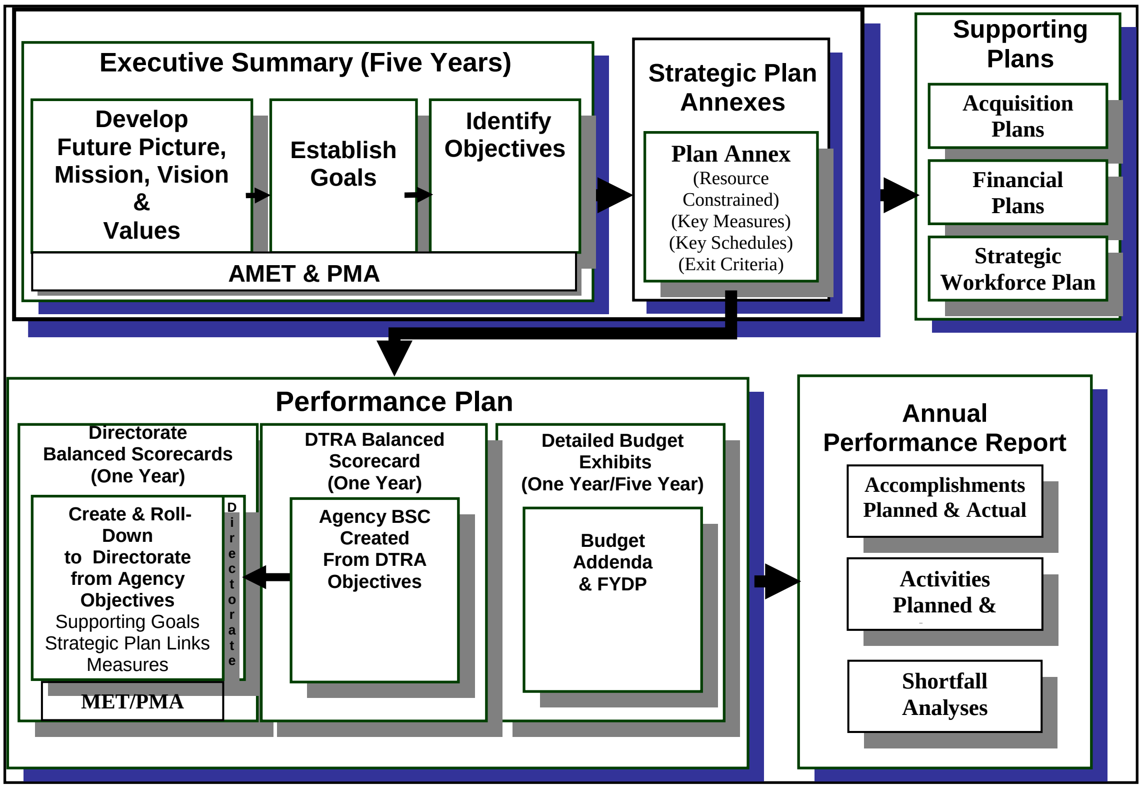
DTRA has developed and matured a carefully crafted strategic planning management framework, integrating Agency strategic planning and resource allocation efforts as required under the Government Performance and Results Act (GPRA). The Agency uses performance planning and measurement to ensure that the organization reaches its objectives and goals. In fiscal year 2004, DTRA used the strategic planning framework below.



During FY 2004, DTRA revised its management framework in order to achieve additional integration and reduce duplicative activities. In its next strategic plan, DTRA will develop a "Future Picture" of what the Agency will be in 10-15 years toward which to align and direct Agency resources and planning efforts. Another key aspect of this revision is to integrate shaping tasks, President's Management Agenda (PMA), Agency Mission Essential Task (AMET) List items (derived from the Joint Chiefs of Staff Uniform Joint Task List), internal mission essential tasks (METs), and other such reporting requirements into the annual DTRA and Directorate Balanced Scorecards. This will consolidate and standardize reporting.

The Agency evaluated its performance indicators to ensure they accurately reflect progress on issues, provide a good measurement of success, and focus on where the resources are spent. Also, to ensure alignment with its strategic plan, the annual DTRA scorecard will be more closely aligned with the Agency's strategic goals and objectives. A schematic depicting DTRA's revised strategic planning and performance measurement framework, which is to be phased in during FY 2005 is shown in the figure below.

DTRA Strategic Planning Framework 2005



2.2 Performance Assessments

Performance assessments continue to be an integral part of DTRA's strategic planning process. Beginning in FY 2002, DTRA implemented a comprehensive internal performance assessment process to identify and adopt meaningful, quantitative measures of progress and accomplishments. DTRA prepares and publishes annual performance plans for all mission areas using a Balanced Scorecard approach. These Balanced Scorecards further define the objectives of the strategic plan and measure progress using the following DoD Risk Management Perspectives:

Force Management Risk – Providing a trained and ready force.

Operational Risk – Ensuring DTRA is ready at all times to accomplish the mission.

Institutional Risk – Ensuring that Agency financial, acquisition, and resource management processes are streamlined and efficient.

Future Challenges Risk – Anticipating future threats and adjusting capabilities to maintain a military advantage.

These resource-constrained action plans are designed to clearly articulate what DTRA expects to accomplish with its planned resources, as well as how performance will be measured. During FY 2004, DTRA continued to mature its process for identification and tracking of meaningful performance metrics. By conducting quarterly performance and financial program reviews, DTRA's leadership can make any necessary course corrections to more effectively carry out its essential national security missions. The DTRA Leadership uses a color rating system to track performance and quickly identify areas that need attention. This system is shown below.

BSC Scoring Key	
(red)	Task cannot/will not be completed by due date.
(yellow)	Issues/problems possibly impacting ability to complete by due date.
(green)	Task on track to be completed by due date.
(blue)	Task completed successfully.

From an external validation perspective, two external DoD reviews – the Biennial Defense Review and the Combat Support Agency Review – provide an ongoing mechanism for continuing, independent assessment of DTRA's accomplishments.

2.3 Planned and Actual Performance

The following summaries of performance only include the programs funded within DTRA's direct TOA; therefore, the Chemical-Biological Defense Program is not included. In addition to this programmatic planned-actual performance information, Section 5.0 of this MD&A presents specific goals, actions, and accomplishments associated with DTRA's success in implementing President's Management Agenda (PMA) initiatives.

<u>Combat Support</u>

DTRA provides warfighting support to the Joint Chiefs of Staff, the Joint Staff, the Combatant Commands, and military services as they engage the threat and challenges posed to the United States, its forces and allies by WMD. DTRA supports the essential WMD response capabilities, functions, activities, and tasks necessary to sustain all elements of operating forces in theater at all levels of war. DTRA's combat support program provides operational and analytical support to DoD components and other U.S. and NATO organizations for nuclear and other WMD matters. DTRA conducts research, development, test and evaluation programs and provides technical support to DoD components and other organizations in areas related to WMD and other designated advanced weapons.

Combat Support activities include: Support to the Secretary of Defense, the Joint Chiefs of Staff, combatant commands, military departments, and DoD components for matters involving nuclear and designated special weapons. DTRA also provides direct technical support to the theater commands for forecasting potential hazards and planning for threats posed by recent activities to include support for contingency planning. Support is also provided to OSD for programs that provide oversight for DoD nuclear matters. Additional support is provided to the Joint Staff for stockpile tracking and accounting and by conducting nuclear surety inspections. Finally, the Defense Nuclear Weapons School provides training in nuclear and radiological hazards and response, and other WMD response techniques.

The significant balanced scorecard items tracked and met for this mission area include:

- Manage the strategic weapons stockpile.
- Coordinate nuclear surety.
- Safeguard national strategic capabilities.
- Coordinate force protection for strategic forces and means.
- Review operations plans.

Technology Development

DTRA's technology development efforts reduce WMD threats by conducting innovative research and development that support the Nation's counter proliferation, consequence management, arms control, and combating terrorism needs. DTRA delivers research and development products that provide operational support services that reduce threats posed by WMD. Within this program area, DTRA focuses on operational applications, system applications, nuclear technology, and test and technology support.

The significant balanced scorecard items tracked for this mission area include:

- Ensure that investments directly support Combat Commanders' requirements.
- Improve the quality and accuracy of financial management information.

These scorecard items were rated as green or blue.

On-Site Inspection

The United States seeks to reduce the threat from WMD in a number of ways, particularly through treaty and non-treaty efforts to control, safeguard, and eliminate existing weapons. As a focal point for implementing U.S. treaty inspection, escort, and monitoring activities, DTRA executes current arms control treaties and agreements and prepares for imminent or potential agreements. Moreover, through the implementation of both conventional and strategic arms control agreements, and experience gained from this activity, DTRA is increasingly involved in on-site activities in post-conflict stabilization operations.

As monitors for force withdrawals from regional trouble spots, DTRA inspectors provide to the United States Government (USG) first hand evidence that international commitments have been fulfilled. Through the verifiable reduction of the world's stockpiles of nuclear, chemical, and conventional weapons, as well as the training and equipping of law enforcement and border personnel in the former Soviet Union (FSU), Eastern Europe and the Baltic countries, U.S. security interests are directly enhanced by the DTRA mission.

The significant balanced scorecard items tracked and met for this mission area include the following:

- Accomplish inspection, escort and monitoring requirements for arms control treaties and agreements.
- Train inspector/escort personnel and conduct in-house inspector/escort certification/recertification tests.
- Provide required equipment for inspection/escort teams.
- Support Combatant Commander arms control readiness requirements.

These scorecard items were rated green.

Cooperative Threat Reduction

With legislation passed in 1991, Senators Nunn and Lugar established the Cooperative Threat Reduction (CTR) program to respond to the threat of proliferation of the FSU arsenal of nuclear and chemical weapons, and biological weapons materials and knowledge on the territories of several New Independent States (NIS). The CTR program provides assistance to eligible states of the FSU in order to dismantle WMD and to reduce the threat of WMD proliferation.

The program objectives are: to dismantle FSU WMD and associated infrastructure; to consolidate and secure FSU WMD and related technology and materials; to increase transparency and encourage higher standards of conduct; and to support defense and military cooperation with the objective of preventing proliferation. The CTR program continues to be a key element of U.S. and DoD national security strategy.

The significant balanced scorecard items tracked for this mission area include:

- Eliminate ICBMs, SLBMs, and nuclear-capable ASMs.
- Eliminate silos, mobile launchers, SSBN launch tubes and bombers.
- Construct a CW Destruction Facility.
- Eliminate FSU nuclear, CW and BW infrastructure at one site.

Various scorecard items were rated blue, green, yellow, and red. For items not rated green or blue, specific reasons have been noted in action plans and/or assumptions and constraints (which reflect areas outside of DTRA control).

2.4 Performance Trends

In fiscal year 2004, DTRA relied on the Balanced Scorecard concept and technique to collect measurable data and report accomplishments against specific targets (this business improvement initiative was started in FY 2002). DTRA is proud of its progress to date but recognizes the need for and value of additional historical performance data on which to base future DTRA performance trends.

Under the Balanced Scorecard and President's Management Agenda (PMA) scorecard processes now in place at DTRA, performance measurement information is maturing in order to consistently identify and report performance targets and progress in future MD&As. Additionally, as described in Section 5.0 of this MD&A, DTRA is making tangible progress in all PMA initiative areas.

3.0 Financial Overview

As of September 30, 2004, the financial condition of DTRA was sound, with sufficient funds to meet program needs, and adequate control of these funds in place to ensure effective financial management.

The FY 2004 financial statements, which were produced by the Defense Finance and Accounting Service (DFAS), do not include the Chemical/Biological Defense Program, which is separately reported in FY 2004. In addition, the FY 2003 financial statements have been restated to eliminate the amounts attributable to the Chemical/Biological Defense Program.

3.1 Assets

DTRA's total assets were approximately $2.146 billion as of September 30, 2004. This is a decrease of $29 million from September 30, 2003, and is mainly due to a decrease in Accounts Receivable, partially offset by an increase in Property, Plant and Equipment. The assets reported on DTRA's Balance Sheet are summarized in the table shown below.

Asset Summary (in thousands)	**FY 2004**	**FY 2003**
Fund Balance with Treasury	$2,042,532	$2,064,331
Accounts Receivable, Net	6,756	57,164
Property, Plant and Equipment	97,140	53,958
Other Assets	0	5
Total Assets	$2,146,428	$2,175,458

Fund Balance with Treasury represents DTRA's largest asset. The balance accounts for 95 percent of DTRA's total assets. The balance decreased approximately 1 percent between 2003 and 2004.

The value of Property, Plant and Equipment accounts for more than 4 percent of DTRA's total assets. The increase of $43 million is primarily due to an increase in Construction in Progress, representing progress in completing the new Defense Threat Reduction Center, and an increase in Internal Use Software, which was adjusted in May 2004 in response to an OSD memo requiring immediate implementation of policy regarding internal-use software.

For FY 2004 Accounts Receivable represents less than 1 percent of DTRA's total assets. The decrease from 2003 is partly attributable to a successful effort by DTRA to collect aged receivables. The remaining decrease is attributable to the following accounting procedural change in FY 2004: DTRA did not adjust its accounts receivable balance to the budgetary data provided by the Budget Execution and Reporting Division, whereas in FY 2003 DTRA's accounts receivable balance was adjusted to the budgetary data.

3.2 Liabilities

DTRA's liabilities were $138 million as of September 2004, an increase of 36 percent from the previous year. The increase is due to increases in Environmental Liabilities and Other Liabilities, partly offset by a decrease in Accounts Payable. The liabilities are summarized in the table below.

Liability Summary (in thousands)	**FY 2004**	**FY 2003**
Accounts Payable	$50,259	$75,948
Salaries and Other Employment-Related	2,040	2,052
Environmental Liabilities	71,508	1,536
Other Liabilities	14,289	8,606
Total Liabilities	$138,096	$88,142

The decrease in Accounts Payable is mainly due to a waiver from adjusting the intra-governmental Accounts Payable balance to the sellers' Accounts Receivable balances for 3rd and 4th Quarter 2004. DTRA did not have a waiver for the corresponding period in 2003.

The increase in Environmental Liabilities is for restoration activities at Johnson Atoll and cleanup at the Nevada Test Site. The $1.5 million reported in 2003 was for work at Johnson Atoll. The activity at the Nevada Test Site was begun in FY 2004.

The increases in Other Liabilities is partly due to increases in various payroll costs and to increases in Advances From Others for deposits received from Federal and non-Federal customers for work yet to be performed.

3.3 Net Position

The Agency's Net Position at the end of Fiscal Year 2004 was $2.0 billion. Net Position is the sum of the Unexpended Appropriations and Cumulative Results of Operations at the end of 2004.

Unexpended Appropriations represent amounts of authority, which are unobligated and have not been rescinded or withdrawn, and amounts obligated for which legal liabilities for payments have been incurred. There was no material change in Unexpended Appropriations between 2003 and 2004.

Cumulative Results of Operations represents the difference, since inception of an activity, between expenses and losses and financing sources, including appropriations, revenue and gains. DTRA's FY 2004 Cumulative Results of Operations was $2.99 million, versus $27.1 million in 2003. The $24 million decrease is mainly due to an increase in future environmental liability of $66 million, coupled with an additional depreciation expense of $2.8 million, offset by a decrease in resources used to finance the acquisition of assets of $46 million.

4.0 Management Controls and Compliance with Laws and Regulations

4.1 Compliance with Laws and Regulations

DTRA has worked aggressively to comply with laws made by Congress to ensure that the Federal Government provides the best possible service to the American people. Among these laws are:

- Chief Financial Officers Act of 1990
- Government Performance and Results Act of 1993
- Federal Financial Management Improvement Act of 1996
- Improper Payments Information Act of 2002
- Prompt Payment Act of 1982
- Federal Managers' Financial Integrity Act of 1982

Chief Financial Officers Act

The Chief Financial Officers Act (CFO Act) requires Federal agencies to prepare auditable annual financial statements. Since 2001 DTRA's financial statements have been audited by an independent audit firm. For FY 2001 the audit firm audited the balance sheet only and rendered an unqualified opinion on the balance sheet. Since FY 2002, all financial statements have been audited, and DTRA has consistently received an unqualified opinion on its statements.

Government Performance and Results Act

The Government Performance and Results Act of 1993 requires a recurring cycle of performance reporting for Federal agencies. This cycle involves five-year strategic plans, annual performance plans, and annual performance reports. DTRA now uses the Balanced Scorecard approach to evaluate and report performance results.

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 requires Federal agencies to report on their compliance with Federal financial management system requirements, Federal accounting standards, and the U.S. Government Standard General Ledger. For FY 2004, DTRA's financial systems were not substantially compliant with FFMIA. Pending final DoD decisions regarding the implementation of a Business Management Modernization Program application, DTRA continues to build and sustain financial and accounting crosswalks to support integrated Agency systems reporting.

Improper Payments Information Act

The Improper Payments Information Act of 2002 requires an annual review of Agency programs and activities that may be susceptible to significant improper payments. During FY 2004, DTRA's improper payments were less than 1 percent of its total payments – that is, 0.4 percent ($2.3 million) out of $558 million. In addition, the improper payments were recovered.

Prompt Payment Act

The Prompt Payment Act of 1982, as amended, provides Government-wide guidelines for establishing due dates on commercial invoices and provides for interest payment on invoices paid late. During FY 2004, DTRA effectively used electronic fund transfers to minimize the number of late payments.

Federal Managers' Financial Integrity Act

The Federal Managers' Financial Integrity Act (FMFIA) requires Federal agencies to assess the effectiveness of management, administrative and accounting controls, and of financial management systems. Using self-assessments as the basis, this Act requires Agency heads to provide an annual statement of assurance on the effectiveness of the management controls and to include material weaknesses found in management controls that warrant reporting to a higher level. DTRA regularly monitors and aggressively works to improve the management control effectiveness of its operations, programs and financial systems. DTRA's 2004 Annual Statement of Assurance was submitted to the Secretary of Defense on September 27, 2004. The assurance statement is based on information gathered from various sources including managers' personal knowledge of day-to-day operations and existing controls, management program reviews, and other management-initiated evaluations.

4.2 Systemic Weaknesses

A systemic weakness is defined as a material weakness that affects management controls across organizational and program lines and usually affects multiple DoD components. Five systemic weaknesses identified by the Office of the Secretary of Defense (OSD) were addressed in DTRA's 2004 Annual Statement of Assurance.

1. *DTRA lacks an integrated financial management system*. Status: DTRA is actively participating in a joint effort to develop and procure a new business/financial system that will serve the needs of all Defense agencies.

2. *DTRA is not able to fully account for all software in use throughout the Agency, thus leaving it vulnerable to computer software piracy*. Status: A desktop management system has been installed on DTRA's primary unclassified network and is being used to remotely install various software security patches. DTRA is also in the process of upgrading the operating system and office automation software for the desktop systems. DTRA has established a baseline of all software purchased.

3. *DTRA faces a challenge in estimating environmental liability*. Status: An appropriate distribution of environmental costs between the test range users and the test range owners does not yet exist. Although the process needs improvement, DTRA has implemented procedures and methodologies to consistently estimate, budget and report for identified environmental restoration sites, in compliance with Federal, state and other regulatory requirements.

4. *DoD hiring is adversely affected because personnel security investigations are backlogged*. Status: DTRA mitigates this weakness through constant monitoring of open investigations with weekly status checks and the use of a direct liaison to resolve unnecessary hiring delays.

5. *DoD acquisition oversight is not always adequate when contracting for DoD services*. Status: DTRA has implemented policies and procedures to ensure that there is adequate oversight of all contractual actions to include requirements for services.

4.3 Material Weaknesses

A material weakness is defined as a weakness in management controls that warrant reporting to a higher level. In FY 2004, DTRA reported one new material weakness and three material weaknesses still outstanding from prior years. Four previously-identified weaknesses were corrected in fiscal 2004.

4.3.1 *ONE* Material Weakness Identified During the Current Period

A - Material Weakness (identified in current period)	First Reported	Targeted Correction Date	Appropriation
Inadequate Training Program for CTR Project Managers	FY 2004	3rd Quarter FY 2005	FSU Threat Reduction PE 0901515BR

Description of the Issue - During FY 2004, management identified a shortfall in the knowledge, skills and abilities among existing staff in the Cooperative Threat Reduction Directorate Project. This resulted in inconsistent, uncoordinated, and in some cases, inadequate approaches to satisfying the U.S. commitment to provide CTR assistance to the various states of the Former Soviet Union (FSU).

Progress to Date - The DTRA CT Administrative and Advisory Services support contractor delivered a proposal to develop a CTR-specific program management training course designed to target all program and project management personnel who participate in the planning, oversight or execution of CTR projects.

4.3.2 *THREE* Uncorrected Weaknesses Identified During Prior Periods

A - Material Weakness (uncorrected, identified in prior periods)	First Reported	Original Correction Date	New Correction Date	Appropriation
Combating Computer Software Piracy	FY 1999	4th Quarter FY 2004	2nd Quarter FY 2005	Procurement PE 0305898BR

Description of the Issue - DTRA is not currently able to account for all of the software in use throughout the Agency due to different record-keeping methods of legacy agencies and the lack of an automated desktop management system.

Reason for Change in Date - Completion of the final validation action was projected for 4th Quarter FY 2004. However, continued challenges with the implementation of the desktop management software as well as challenges encountered in the early stages of the desktop operating system upgrade contributed to the need for an extended deadline.

Progress to Date - A desktop management system has been installed on DTRA's primary unclassified network and is being used to remotely install various software security patches. DTRA is also in the process of upgrading the operating system and office automation software for the desktop systems. DTRA personnel have reviewed all available software purchase-order documentation and established a baseline of all software purchased.

DTRA is also negotiating an Enterprise Software License Agreement with Microsoft ©. This agreement will enable the Agency to consolidate many existing software licensing agreements, further reducing the risk of piracy.

B - Material Weakness **(uncorrected, identified in prior periods)**	**First Reported**	**Original Correction Date**	**New Correction Date**	**Appropriation**
Financial Management Systems	FY 2002	1st Quarter FY 2005	4th Quarter FY 2007	O&M Dev/ Procurement

Description of the Issue - DTRA lacks an integrated business/financial management system capable of providing complete, reliable, consistent, and timely information to include auditable financial statements.

Reason for Change in Date - Draft Management Information Decision (MID 920) prohibits Components from initiating steps to procure a new Core Financial System until Proof of Concept is complete for the two approved Component systems. Estimated completion date for Proof of Concept is 4th Qtr 2006.

Progress to Date - DTRA is actively participating in a joint effort to develop and procure a new business/financial system that will serve the needs of all Defense agencies through the BMMP's Finance and Accounting and Strategic Planning and Budgeting Domains.

C - Material Weakness **(uncorrected, identified in prior periods)**	**First Reported**	**Original Correction Date**	**New Correction Date**	**Appropriation**
Russian Federation Failure to Honor Commitments	FY 2002	4th Quarter FY 2003	3rd Quarter FY 2005	FSU Threat Reduction PE 0901515BR

Description of the Issue - The Russian Federation has declared that it no longer requires a Heptyl (rocket fuel) Conversion Plant. DTRA had worked closely with Russia to build this facility according to the stated needs. In January 2003 Russia notified the United States that the facility was no longer needed for its intended purpose and that Heptyl would be used for commercial space launch purposes. This issue was further addressed in subsequent

DoD IG audits on the Solid Rocket Motor Disposition Facility and on CTR construction projects.

Reason for Change in Date - While significant progress has been made, some of the objective milestones previously identified still require action.

Progress to Date - The Russian Federation has signed the amendments to Nuclear Weapons Storage Security (NWSS)/Nuclear Weapons Transportation Security (NWTS) Implementing Agreements as well as the Chemical Weapons Elimination Agreement. Successful semi-annual Executive Review sessions were held July 2004 and the intrusive Audit and Examination of Inter-Modal Tank Containers is underway at this writing. DTRA has reached an agreement with the Russian Federation that a Joint Requirements Implementation Plan may not be required for the NWSS/NWTS Programs. Strategic risks previously documented are now being identified on a project-specific basis as part of project Milestone Decision Reviews and in monthly and quarterly project status reports. To the extent practical, DTRA will work with other DoD agencies and with the Russian Federation to ensure that Russia's delivery of a practical plan for nerve agent elimination is completed by June 30, 2005.

4.3.3 *FOUR* Material Weaknesses Corrected During the Current Period

A - Material Weakness (corrected during current period)	**First Reported**	**Date Corrected**	**Appropriation**
Inadequate Internal Controls for Contract Documentation	FY 2004	FY 2004	FSU Threat Reduction PE 090151BR

Description of the Issue - During the period August 2003 through May 2004, the DoD Inspector General conducted an audit of contracts awarded in support of the CTR Program and found a lack of internal controls to ensure contract documentation accurately reflects accounting and appropriations data; that decisions concerning price reasonableness were well documented; and that sufficient justification exists for contract vehicle types.

Resolution of the Issue - DTRA has put in place internal controls to verify that accounting and appropriations data on contract actions is correct. DTRA has also strengthened its internal control program with the Directorate by placing oversight responsibility via the creation of a Senior Business Officer (SBO). DTRA will continue to stress the importance and use of information contained in the relevant guidelines.

B - Material Weakness (corrected during current period)	**First Reported**	**Original Correction Date**	**Actual Correction Date**	**Appropriation**
Scrap Proceeds	FY 2001	FY 2003	4th Quarter FY 2004	FSU Threat Reduction PE 0901515BR

Description of the Issue - The DoD IG reported that OSD could reduce U.S. costs and increase the cooperative nature of the CTR program by requesting that Russia use the proceeds from the sale of Heptyl for CTR Program purposes.

Resolution of the Issue - In June 2004 an agreement was reached with the Russian Aviation Space Agency (RASA) on the administrative arrangements for the Audit and Examination (A&E) of submarine dismantlement scrap revenues. Beginning in March 2005, and annually thereafter, the RASA will report to the U.S. all revenues generated from the sale of scrap materials. Furthermore, beginning in 2005 and annually thereafter, A&Es of the scrap proceed records will be conducted.

C - Material Weakness (corrected during current period)	**First Reported**	**Original Correction Date**	**Actual Correction Date**	**Appropriation**
Continuity of Operations Planning	FY 2002	1st Quarter FY 2004	2nd Quarter FY 2004	N/A

Description of the Issue - All DoD Components were required to establish Continuity of Operations Plans (COOPs) to ensure that mission essential functions continue effectively and without interruption. DTRA's plan was in draft form.

Resolution of the Issue - The final version of DTRA's COOP was signed December 15, 2003.

D - Material Weakness (corrected during current period)	**First Reported**	**Original Correction Date**	**Actual Correction Date**	**Appropriation**
Lack of Written Requirements or Strategic Guidance from OSD	FY 2003	FY 2004	3rd Quarter FY 2004	FSU Threat Reduction PE 0901515BR

Description of the Issue - The CTR program guidance and oversight function within the AT&L chain was discontinued in 1998. Subsequently, all OSD guidance and oversight was provided piecemeal. In past years, the lack of documented strategic guidance led to several execution problems.

Resolution of the Issue - OSD ISP, NCB, and the Directorate Administration and Management staffs have agreed with the DoD IG recommendation to revise their respective charters to update roles and responsibilities for CTR program guidance and oversight.

5.0 President's Management Agenda

DTRA has adopted a working habit and attitude of continuous process improvement and innovation in management techniques. The President's Management Agenda includes five Government-wide initiatives intended to improve the quality of its performance and delivery of services to the public: (1) Competitive Sourcing, (2) Improved Financial Performance, (3) Budget and Performance Integration, (4) Expanded Electronic Government, and (5) Strategic Management of Human Capital.

DTRA has taken steps leading to improvements in all five PMA initiatives, and has integrated these actions into the Agency's broader goals of continuous improvements under the Balanced Scorecard technique. It understands and has made the Administration's strategy for improving the management and performance of government an integral part of its business operations, performance measurement processes, and capabilities. DTRA has addressed each of the five initiatives with an approach to maximize our value to the public.

5.1 Competitive Sourcing

DTRA has successfully controlled its operating costs by maximizing the use of competitively awarded service contracts consistent with Federal Acquisition Regulations, the FAIR Act, and OMB Circular A-76. DTRA competitively contracts for technical services, information technology support, certain editing and publishing services, mailroom and general labor services, cleaning and building maintenance services, audit and financial services, and security services. Beginning in FY 2005, DTRA plans to study 120 positions, at a rate of 30 positions per year, for possible competitive sourcing. DTRA will continue to evaluate competitive alternatives and efficient service contracting options to maximize efficiency and minimize cost.

5.2 Improved Financial Performance

For the third straight year, DTRA received an unqualified opinion on its audited financial statements – a significant and unique accomplishment. The achievement of the "clean" audit opinion is the primary measure of success and criteria for OMB's "GREEN" standing within this PMA initiative. DTRA continues to improve upon its long-standing record of prudent fiscal management and cost control by continuing to monitor key financial management performance indicators and implement efficiency, control, and effectiveness improvements. A key aspect to this improvement is the development and maintenance of metrics related to significant financial functions in the office. The monthly metrics report now has more than 20 indicators. The metrics provide us early warning of issues that may be audit risks and also, at a more micro level, of functional areas that need improvement.

5.3 Budget and Performance Integration

In FY 2004, DTRA continued to work toward budget and performance integration, as well as use of this integrated data for management decision making. DTRA managers and executives analyze quarterly updates to the Agency Balanced Scorecard and conduct quarterly program reviews to address financial program execution information. DTRA also links performance appraisal plans for key senior leaders to the Balanced Scorecard organizational results. This technique was piloted in the Business Directorate starting in FY 2003 and continues to be expanded in FY 2004.

5.4 Expanded e-Government

DTRA considers e-Government goals during the initiation phase of every major IT project and in DTRA's entire investment review process. In recent years, DTRA has committed significant resources to e-Government modernization initiatives. DTRA is working closely with the DoD Business management Modernization Program (BMMP) to develop and implement a new, integrated technology solution for the Department. At the end of FY 2003, DTRA prepared its first IT-300 addressing administrative infrastructure systems per OSD guidance. DTRA also continues to enhance its Clinger-Cohen compliant IT Capital Planning and Investment Control Process to review and analyze technology initiatives and return-on-investment (ROI) benefits to the Agency.

In addition, 94 percent of current DTRA systems are certified and accredited for security controls – security reviews will continue toward the DTRA goal of 100 percent secured. Finally, DTRA is analyzing alternatives and initiatives to integrate E-Gov into DTRA's business environment. DTRA recognizes the importance of leveraging new technologies to create a modern IT delivery system that is architecture-based to better communicate across directorates, mission and support areas, and external stakeholders.

5.5 Strategic Management of Human Capital

DTRA continues to make progress on implementation of the President's Management Agenda human capital initiative. DTRA's efforts in this area are based on building a workforce of the future, recruiting new, skilled workers, and actively working to retain people with essential technical capabilities. This also means implementing extensive training and development programs to equip DTRA employees with the skills they will need to meet future challenges.

DTRA has established an HR review process in the Annual Program Review cycle for reviewing long-term requirements. It has prepared a Strategic Workforce Plan (SWP) baseline document which links HR strategies to current and emerging Agency missions and goals. During the year, DTRA convened a Human Resources Management Committee (HRMC) as needed to discuss HR activities, priorities, and requirements.

DTRA's Human Resource and Equal Opportunity staff members meet frequently to design and coordinate strategic workforce initiatives to recognize greater emphasis on performance and accountability. DTRA has multiple outreach programs and tools to promote underrepresented audiences, such as programs to advertise in diversity publications and websites and participates in virtual/in-person job fairs.

6.0 The Road Ahead – Future Challenges

DTRA's mission and role continues to evolve and expand. Its responsibilities and operations span and are affected by many different military, political, and technological factors. Undoubtedly the future will continue to present significant external challenges to DTRA and DTRA will continue to respond by maintaining its ability to perform its mission. Factors that may affect DTRA include:

- Contingencies at home and abroad
- DoD budget constraints and changing priorities
- Increased inspection and security demands worldwide
- Evolving terrorist threats and activities
- Increased communications and technology requirements
- Globalization involving broader treaty obligations and multi-national agreements

DTRA understands this global and technical environment and has proven time and again prior to and since September 11, 2001, that it is committed to effective, responsive programs and activities that meet the challenges of the future and make the world safer.

In the near future, DTRA hopes to procure and implement a new core financial management system. The new system will provide the basis for greatly increased functionality and timeliness and efficiency in the production of financial information, including compliant financial statements, cost accounting and performance management information.

The new core financial system will also provide the basis for implementing a cost accounting system. The advancements in financial systems will provide the basis for DTRA to support its performance measurement plans with systems for accumulating information on actual performance. Performance data will also be linked to the full cost of accomplishment. DTRA will be able to report the full cost of activities, develop cost information over a span of years and provide data for better decision making.

7.0 Limitations of Financial Statements

In accordance with OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, we are disclosing the following limitations of DTRA's FY2004 financial statements.

DTRA's financial statements have been prepared to report the financial position and results of operations of DTRA, pursuant to the requirements of 31 U.S.C. 3515(b). While the financial statements have been prepared from the books and records of DTRA in accordance with generally accepted accounting principles (GAAP) for federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. At this time, the Agency is unable to implement all elements of the standards due to financial management systems limitations. DoD is in the process of implementing system improvements to address those limitations. The financial statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Defense Threat Reduction Agency

Management's Discussion and Analysis (MD&A)

Fiscal Year 2004

Annual
Financial Statements

Fiscal Year 2004

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TAB A

MANAGEMENT DISCUSSION AND ANALYSIS

TAB B

PRINCIPAL STATEMENTS

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATED BALANCE SHEET
As of September 30, 2004 and 2003
(Amounts In Thousands)

		2004 Consolidated		2003 Consolidated
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)	$	2,042,532	$	2,064,331
Accounts Receivable (Note 4)		6,756		54,322
Total Intragovernmental Assets		2,049,288		2,118,653
Accounts Receivable (Note 4)		-		2,842
General Property, Plant and Equipment (Note 6)		97,140		53,958
Other Assets (Note 5)		-		5
TOTAL ASSETS		2,146,428		2,175,458
LIABILITIES (Note 7)				
Intragovernmental:				
Accounts Payable (Note 8)		622		22,836
Other Liabilities (Note 7 and Note 10)		2,224		1,368
Total Intragovernmental Liabilities		2,846		24,204
Accounts Payable (Note 8)		49,637		53,112
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 12)		2,040		2,052
Environmental Liabilities (Note 9)		71,508		1,536
Other Liabilities (Note 7 and Note 10)		12,065		7,238
TOTAL LIABILITIES		138,096		88,142
Commitments and Contingencies (Note 11)				
NET POSITION				
Unexpended Appropriations (Note 13)		2,005,345		2,060,250
Cumulative Results of Operations		2,987		27,066
TOTAL NET POSITION		2,008,332		2,087,316
TOTAL LIABILITIES AND NET POSITION	$	2,146,428	$	2,175,458

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATED STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	2004 Consolidated	**2003 Consolidated**
Program Costs		
Intragovernmental Gross Costs	$ 94,092	$ 62,264
(Less: Intragovernmental Earned Revenue)	(23,574)	(16,079)
Intragovernmental Net Costs	70,518	46,185
Gross Costs With the Public	1,301,793	1,131,239
(Less: Earned Revenue From the Public)	365	1
Net Costs With the Public	1,302,158	1,131,240
Total Net Cost	1,372,676	1,177,425
Cost Not Assigned to Programs	-	-
(Less:Earned Revenue Not Attributable to Programs)	-	-
Net Cost of Operations	$ 1,372,676	$ 1,177,425

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	2004 Consolidated	2003 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 27,066	$ (1,160,988)
Prior period adjustments (+/-)	-	-
Beginning Balances, as adjusted	27,066	(1,160,988)
Budgetary Financing Sources:		
Appropriations used	1,272,119	2,153,167
Other budgetary financing sources (+/-)	(1,460)	207,033
Other Financing Sources	-	-
Imputed financing from costs absorbed by others	77,938	5,279
Total Financing Sources	1,348,597	2,365,479
Net Cost of Operations (+/-)	1,372,676	1,177,425
Ending Balances	2,987	27,066
UNEXPENDED APPROPRIATIONS		
Beginning Balances	2,060,249	2,943,139
Prior period adjustments (+/-)	-	-
Beginning Balances, as adjusted	2,060,249	2,943,139
Budgetary Financing Sources:		
Appropriations received	1,244,349	1,318,496
Appropriations transferred-in/out (+/-)	(10,508)	(24,463)
Other adjustments (rescissions, etc) (+/-)	(16,626)	(23,755)
Appropriations used	(1,272,119)	(2,153,167)
Other Financing Sources	-	-
Total Financing Sources	(54,904)	(882,889)
Net Cost of Operations (+/-)		
Ending Balances	$ 2,005,345	$ 2,060,250

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

		2004 Combined		2003 Combined
BUDGETARY FINANCING ACCOUNTS				
BUDGETARY RESOURCES				
Budget Authority:				
Appropriations received	$	1,244,349	$	1,318,496
Net transfers (+/-)		(10,208)		45,161
Unobligated balance:				
Beginning of period		637,337		541,310
Net transfers, actual (+/-)		(300)		(69,624)
Spending authority from offsetting collections:				
Earned				
Collected		39,742		9,316
Receivable from Federal sources		(16,533)		6,034
Change in unfilled customer orders				
Advance received		(2,214)		-
Without advance from Federal sources		(7,576)		13,637
Subtotal		13,419		28,987
Recoveries of prior year obligations		72,645		58,896
Temporarily not available pursuant to Public Law		-		-
Permanently not available		(16,522)		(23,744)
Total Budgetary Resources	$	1,940,720	$	1,899,482

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	2004 Combined	2003 Combined
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 1,460,439	$ 1,228,315
Reimbursable	14,480	33,829
Subtotal	1,474,919	1,262,144
Unobligated balance:		
Apportioned	388,669	611,077
Exempt from apportionment	-	-
Other available	1	1
Unobligated Balances Not Available	77,131	26,260
Total, Status of Budgetary Resources	1,940,720	1,899,482
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	1,436,816	1,408,275
Obligated Balance transferred, net (+/-)	-	-
Obligated Balance, Net - end of period:		
Accounts receivable	(39,508)	(56,041)
Unfilled customer order from Federal sources	(29,856)	(37,432)
Undelivered orders	1,576,186	1,464,119
Accounts payable	71,095	66,171
Outlays:		
Disbursements	1,285,283	1,155,036
Collections	(37,529)	(9,316)
Subtotal	1,247,754	1,145,720
Less: Offsetting receipts	-	-
Net Outlays	$ 1,247,754	$ 1,145,720

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINED STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	2004 Combined	2003 Combined
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 1,474,919	$ 1,262,144
Less: Spending authority from offsetting collections and recoveries (-)	(86,064)	(87,883)
Obligations net of offsetting collections and recoveries	1,388,855	1,174,261
Less: Offsetting receipts (-)	-	-
Net obligations	1,388,855	1,174,261
Other Resources		
Imputed financing from costs absorbed by others	77,938	5,279
Net other resources used to finance activities	77,938	5,279
Total resources used to finance activities	1,466,793	1,179,540
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 (-)	(112,096)	(33,161)
Unfilled Customer Orders	(9,790)	13,637
Resources that fund expenses recognized in prior periods	(2,202)	(1,861)
Budgetary offsetting collections and receipts that do not affect net cost of operations	-	-
Resources that finance the acquisition of assets	(46,118)	(6,365)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Total resources used to finance items not part of the net cost of operations	(170,206)	(27,750)
Total resources used to finance the net cost of operations	$ 1,296,587	$ 1,151,790

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINED STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	2004 Combined	2003 Combined
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	$ 7,161	$ -
Increase in environmental and disposal liability	65,977	-
Other (+/-)	87	(34)
Total components of Net Cost of Operations that will require or generate resources in future periods	73,225	(34)
Components not Requiring or Generating Resources:		
Depreciation and amortization	2,840	(3,841)
Revaluation of assets or liabilities (+/-)	-	20,660
Other (+/-)	24	8,850
Total components of Net Cost of Operations that will not require or generate resources	2,864	25,669
Total components of net cost of operations that will not require or generate resources in the current period	76,089	25,635
Net Cost of Operations	$ 1,372,676	$ 1,177,425

The accompanying notes are an integral part of these statements.

TAB C

NOTES TO THE PRINCIPAL STATEMENTS

ORGANIZATION

The Defense Threat Reduction Agency (DTRA) was established in 1998 bringing together the organizational elements within the Department of Defense (DoD) that were involved in reducing the global threats from weapons of mass deduction. The creation of DTRA consolidated three activities: the On-Site Inspection Agency (OSIA), the Defense Special Weapons Agency (DSWA), and the Defense Technology Security Administration (DTSA). DTRA's first fiscal year of operations was 1999. The accompanying financial statements report on the activity and positions of these combined organizational units for fiscal year 2004.

On December 18, 2003, the OSD Comptroller ordered that the Chemical and Biological Defense Program (CBDP) would have financial statements separate from DTRAs. Beginning with the first quarter of the fiscal year 2004, DFAS is reporting separate financial statements for DTRA and CBDP. The accompanying financial statements report on DTRA.

MISSION

The DTRA's mission is to reduce the threat to the United States and its allies from nuclear, biological, chemical (NBC), conventional and special weapons through the execution of technological security activities, cooperative threat reduction (CTR) programs, arms control treaty monitoring and on-site inspection, force protection, NBC defense, and counter proliferation (CP); to support the United States nuclear deterrent; and to provide technical support on weapons of mass destruction (WMD) matters to the DoD Components.

NOTES TO PRINCIPAL FINANCIAL STATEMENTS

Note 1.	Significant Accounting Policies

Basis of Presentation

The accompanying financial statements have been prepared to report the financial position and results of operations of the Defense Threat Reduction Agency (DTRA), as required by the Chief Financial Officers (CFO) Act of 1990, expanded by the Government Management Reform Act (GMRA) of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the DTRA in accordance with the "Department of Defense Financial Management Regulation" ("DoDFMR"), Office of Management and Budget (OMB) Bulletin No. 01-09, "Form and Content of Agency Financial Statements" and to the extent possible Federal generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the DTRA is responsible except that information relative to classified assets, programs, and operations has been excluded from the statement or otherwise aggregated and reported in such a manner that it is no longer classified. The DTRA's financial statements are in addition to the financial reports also prepared by the DTRA pursuant to OMB directives that are used to monitor and control the DTRA's use of budgetary resources.

The DTRA is unable to fully implement all elements of Federal GAAP and OMB Bulletin No. 01-09 due to limitations of its financial management processes and systems, including nonfinancial feeder systems and processes. DTRA is able to remedy most of these deficiencies through end-of-year adjustments and accruals. The elements that are uncorrected are not material to the financial statements. The FASAB intends that application of its standards be limited to items that are material. The DTRA continues to implement process and system improvements addressing the limitations of its financial and nonfinancial feeder systems. A more detailed explanation of these financial statement elements is provided in the applicable notes.

Appropriations and Funds

The DTRA's appropriations and funds are in the general fund account. This account is used to fund and report how the resources have been used in the course of executing the DTRA's mission.

General funds are used for financial transactions arising under congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and construction accounts.

Basis of Accounting

The DTRA identifies programs based upon the major appropriation groups provided by Congress and generally records transactions on a budgetary basis and not an accrual accounting basis as is required by Federal GAAP. For FY 2004, the DTRA's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the DTRA's financial and non-financial feeder systems and processes were designed and implemented prior to the issuance of Federal GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as is required by Federal GAAP. The DTRA has undertaken efforts to determine the actions required to bring its financial and non-financial feeder systems and processes into compliance with all elements Federal GAAP. Until such time as all of the DTRA's financial and non-financial feeder systems and processes are updated to collect and report financial information as required by Federal GAAP, the DTRA's financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from non-financial feeder systems, and adjusted for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities. In all material respects, the financial statements are presented on the accrual basis of accounting as required.

On December 21, 2001, the Office of Management and Budget published a memorandum for chief financial officers and inspector generals entitled, "Future External Reporting Changes." Driven primarily by the President's Management Agenda, the memorandum's goal is to enhance financial performance as a result of improving timeliness, reliability and usefulness of information. The memo requires agencies to submit quarterly unaudited financial statements 21 days following the end of each quarter. The unprecedented and historic milestone commenced with the quarter ending March 31, 2004.

Revenues and Other Financing Sources

Financing sources for general funds are provided primarily through congressional appropriations that are received on both an annual and a multiyear basis. When authorized, these appropriations are supplemented by revenues generated by sales of goods or services through a reimbursable order process. The DTRA recognizes revenue as a result of costs incurred or services performed on behalf of other federal agencies and the public. Revenue is recognized when earned under the reimbursable order process.

The DTRA does not include non-monetary support provided by U.S. Allies for common defense and mutual security in its list of other financing sources that appears in the Statement of Financing. The U.S. has agreements with foreign countries that include both direct or indirect sharing of costs that each country incurs in support of the same general purpose. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port. DoD is reviewing these types of financing and cost reductions in order to establish accounting policies and procedures to identify what, if any, of these costs are appropriate for disclosure in the financial statements in accordance with generally accepted accounting principles. Recognition of support provided by host nations would affect both financing sources and recognition of expenses.

Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the DTRA’s financial and non-financial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, and environmental liabilities. Expenditures for capital and other long-term assets are not recognized as expenses in the DTRA's operations until depreciated in the case of Property, Plant and Equipment (PP&E) or consumed in the case of Operating Materials and Supplies (OM&S). Net increases or decreases in unexpended appropriations are recognized as a change in the net position. Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made.

Accounting for Intra-governmental Activities

The DTRA, as an agency of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the DTRA as though the agency was a stand-alone entity.

The DTRA's proportionate share of public debt and related expenses of the federal government are not included. Debt issued by the federal government and the related costs are not apportioned to federal agencies. The DTRA's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through budget appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the Department of the Treasury does not allocate such interest costs to the benefiting agencies.

The DTRA's civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement Systems (FERS), while the military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security as do certain CSRS employees. The DTRA funds a portion of the civilian pensions. Reporting civilian pension under CSRS and FERS retirement systems is the responsibility of the Office of Personnel Management (OPM). The DTRA recognizes an imputed expense for the portion of civilian employee pensions and other retirement benefits funded by the OPM in the Statement of Net Cost and recognized corresponding imputed revenue from the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

To prepare reliable financial statements, transactions occurring between entities within the DoD or between two or more federal agencies must be eliminated. Under the provisions of the DoD Financial Management Regulation, Volume 6B, Chapter 13, the DTRA obtained a waiver for 3rd and 4th Quarter, FY 2004, whereby, the seller side revenues and receivables of other components were adjusted to agree with the DTRA's expenses and payables (buyer-side). In addition, other component's buyer side payables, expenses and advances were adjusted to agree with the DTRA's accounts receivables, revenues and advances (seller-side) for 3rd and 4th Quarter, FY 2004 as outlined in the DoD Financial Management Regulation. For comparative purposes, the DTRA did not have a waiver for eliminations for 3rd and 4th Quarter, FY 2003. Finally, the DTRA implemented the policies and procedures contained in the Intragovernmental Eliminations Task Force's "Intragovernmental Fiduciary Transactions Accounting Guide" for reconciling intragovernmental transactions pertaining to investments in federal securities, borrowings from Treasury and the Federal Financing Bank, Federal Employee Compensation Act transactions with the Department of Labor, and benefit program transactions with the OPM.

Transactions with Foreign Governments and International Organizations

Each year, the DoD Components dispense articles and services to foreign governments and international organizations, primarily under the provisions of the Arms Export Control Act of 1976. Under the provisions of the Act, the DoD has authority to sell defense articles and services to foreign countries, generally at no profit or loss to the U.S. Government. Customers may be required to make payments in advance.

Funds with the U.S. Treasury

The DTRA'S financial resources are maintained in U.S. Treasury accounts. The majority of cash collections, disbursements, and adjustments are processed at the DTRA. The remaining disbursements, collections, and adjustments are processed at the Defense Finance and Accounting Service (DFAS) and Military Services and the U. S. Army Corps of Engineers (USACE) disbursing stations, as well as the Department of State financial service centers. Each disbursing station prepares monthly reports, which provide information to the U.S. Treasury on check issues, interagency transfers and deposits.

In addition, the DFAS centers and the USACE Finance Center submit reports to Treasury, by appropriation, on interagency transfers, collections received and disbursements issued. The Department of the Treasury then records this information to the appropriation Fund Balance with Treasury (FBWT) account maintained in the Treasury's system.

Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The Department does not recognize an allowance for estimated uncollectible amounts from another federal agency. Claims against another federal agency are to be resolved between the agencies. Material disclosures are provided at Note 4.

General Property, Plant and Equipment

General property, plant, and equipment (PP&E) assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of $100,000. Also, improvement costs over the DoD capitalization threshold of $100,000 for General PP&E should be capitalized. The Department contracted with two certified public accounting (CPA) firms to obtain an independent assessment of the validity of the General PP&E capitalization threshold. At the conclusion of the studies, both CPA firms recommended that the Department retain its current capitalization threshold of $100,000. All General PP&E, other than land, is depreciated on a straight-line basis.

When it is in the best interest of the government, the DTRA provides to contractors government property necessary to complete contract work. Such property is either owned or leased by the DTRA, or purchased directly by the contractor for the government based on contract terms. When the value of contractor procured General PP&E exceeds the DoD capitalization threshold, such PP&E should be included in the value of General PP&E reported on the DTRA's Balance Sheet. The Department recently completed a study that indicates that the value of General PP&E above the DoD capitalization threshold and not older than the DoD Standard Recovery Periods for depreciation, and that is presently in the possession of contractors, is not material to the Department's financial statements. Regardless, the Department is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the DTRA currently reports only government property in the possession of contractors that exceeds the DoD capitalization threshold.

To bring the DTRA into fuller compliance with federal accounting standards, the Department has issued new property accountability and reporting regulations that require the DoD Components to maintain, in DoD Component property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards.

Material disclosures are provided at Note 6.

Advances and Prepayments

Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as an asset on the Balance Sheet. Advances and prepayments are recognized as expenditures and expenses when the related goods and services are received.

Other Assets

The DTRA 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 DTRA provides financing payments. One type of financing payment that the DTRA makes, for real property, is based upon a percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in progress and are reported on the General PP&E line and in Note 6, General PP&E, Net.

In addition, based on the provision of the Federal Acquisition Regulations, the DTRA makes financing payments under fixed price contracts that are not based on a percentage of completion. DoD has completed a review of all applicable federal accounting standards; applicable public laws on contract financing; Federal Acquisition Regulation Parts 32, 49, and 52; and the OMB guidance in 5 Code of Federal Regulations Part 1315, "Prompt Payment." DoD concluded that SFFAS No. 1 does not fully or adequately addresses the subject of progress payment accounting and is considering what further action is appropriate.

Contingencies and Other Liabilities

The SFFAS No. 5, “Accounting for Liabilities of the Federal Government,” defines a contingency as an existing condition situation, or set of circumstances that involves an uncertainty as to possible gain or loss to the DTRA. The uncertainty will be resolved when one or more future events occur or fail to occur. A contingency is recognized as a liability when a past event or exchange transaction has occurred, a future loss is probable, and the amount of loss can be reasonably estimated. Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but when there is at least a reasonable possibility that a loss or additional loss will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments.

The DTRA loss contingencies could arise as a result of pending or threatened litigation, property or environmental damages, and contract disputes.

Accrued Leave

Civilian annual leave is accrued as earned and the accrued amounts are reduced as leave is taken. The balances for annual leave at the end of the quarterly reporting period reflect current pay rates for the leave that is earned but not taken. Sick and other types of non-vested leave are expensed as taken.

Net Position

Net Position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent amounts of authority, which are unobligated and have not been rescinded or withdrawn, and amounts obligated for which legal liabilities for payments have been incurred.

Cumulative results of operations represent the difference, since inception of an activity, between expenses and losses and financing sources including appropriations, revenue, and gains. Beginning with FY 1998, this included the cumulative amount of DTRA donations and transfers of assets in and out without reimbursement.

Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other facilities, which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. DoD capital assets overseas are purchased with appropriated funds; however, title to land and improvements are retained by the host country. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. These fixed assets are subject to loss in the event treaties are not renewed or other agreements are not reached which allow for the continued use by the DoD. Therefore, in the event treaties or other agreements are terminated whereby use of the foreign bases is no longer allowed, losses will be recorded for the value of any non-retrievable capital assets after negotiations between the U.S. and the host country have been concluded to determine the amount to be paid the U.S. for such capital investments.

Comparative Data

In FY 2001, the Defense Threat Reduction Agency began presenting the current and previous year's financial data for comparative purposes. This data is presented in the financial statements, as well as in the notes to the principal statements. The Financial Statements and accompanying Notes to the Financial Statements report the financial position and results of operations for the FY 2004.

Unexpended Obligations

The DTRA records obligations for goods and services that have been ordered but not yet received. No liability for payment has been established in the financial statements because goods/services have yet to be delivered.

Note 2.	Nonentity Assets

As of September 30 (Amounts In Thousands)	2004	2003
Intra-governmental Assets		
Accounts Receivable	$ 239	$ 4
Total Intra-governmental Assets	239	4
Non-Federal Assets		
Accounts Receivable	-	1,249
Total Non-Federal Assets	-	1,249
Total Non-Entity Assets	239	1,253
Total Entity Assets	2,146,189	2,174,205
Total Assets	$ 2,146,428	$ 2,175,458

Definition

Asset accounts are categorized as either entity or nonentity. Entity accounts consist of resources that the agency has the authority to use, or when management is legally obligated to use funds to meet entity obligations. Non-entity accounts are assets that are held by an entity, but are not available for use in the operations of the entity.

Composition of Non-Entity Assets

Intragovernmental Assets	(In Thousands)
Line 1.C. Accounts Receivable	$239

The Defense Special Weapons Agency reclassified accounts receivable from entity to non-entity at year-end. The outstanding accounts receivables are in canceling appropriation and were re-established as a non-entity asset. Entity assets reclassified as non-entity assets (collections) would go to the Treasury of the United States instead of to the Defense Threat Reduction Agency. DTRA believes these receivables will be collected in the 1st quarter of FY 2005.

Note 3. Fund Balance with Treasury

As of September 30 (Amounts In Thousands)	2004	2003
Fund Balances		
Appropriated Funds	$ 2,040,379	$ 2,064,331
Other Fund Types	2,153	-
Total Fund Balances	2,042,532	2,064,331
Fund Balances Per Treasury Versus Agency		
Fund Balance per Treasury	-	-
Fund Balance per DTRA	2,042,532	2,064,331
Reconciling Amount	$ (2,042,532)	$ (2,064,331)

Definition

Currently, the Department of Treasury reports fund balances at the appropriation basic symbol level. The Other Defense Organizations (ODO) general funds Treasury Index 97 funds are allotted at limit level. This precludes compliance by the ODO general fund reporting entities, specifically the Defense Threat Reduction Agency (DTRA), from providing the Fund Balance per Treasury amounts.

Note 4.	Accounts Receivable

As of September 30 (Amounts In Thousands)	2004			2003
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
Intra-governmental Receivables	$ 6,756	N/A	$ 6,756	$ 54,322
Non-Federal Receivables (From the Public)	-	-	-	2,842
Total Accounts Receivable	$ 6,756	$ -	$ 6,756	$ 57,164

Disclosure on Accounts Receivable Procedural Change

In FY 2004, DTRA did not adjust its accounts receivable balance to the budgetary data provided by the Budget Execution and Reporting Division, whereas in FY 2003 DTRA's accounts receivable balance was adjusted to the budgetary data.

Allowance Method

The DTRA has analyzed the non-federal accounts receivable, and based on historical data has determined that all non-federal accounts receivable are collectible. Therefore, an allowance for doubtful accounts will not be established for the DTRA.

Allocation of Undistributed Collections

The policy of the Department of Defense (DoD) is to allocate supported undistributed collections between federal and non-federal categories based on the percentage of federal and non-federal accounts receivable.

Receivables over 180 Days

	(In Thousands)
Public	
	$ 0
Intragovernmental:	
Due within DoD	$ 1,943
Debt Outside DoD	0
Total Intragovernmental	$ 1,943

Note 5. Other Assets

As of September 30 (Amounts In Thousands)	2004	2003
Intra-governmental Other Assets:		
Advances and Prepayments	$ -	$ -
Other Assets	-	-
Total Intra-governmental Other Assets	-	-
Non-Federal Other Assets:		
Outstanding Contract Financing Payments	-	-
Other Assets (With the Public)	-	5
Total Non-Federal Other Assets	-	5
Total Other Assets:	$ -	$ 5

Note 6. General PP&E, Net

As of September 30	2004					2003
(Amounts In Thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	FY Book Value Net
Major Asset Classes:						
Software	S/L	2-5 Or 10	13,745	-	13,745	-
General Equipment	S/L	5 or 10	50,455	(16,664)	33,791	35,750
Construction-						
-in-Progress	N/A	N/A	49,604	N/A	49,604	18,208
Total General PP&E			$ 113,804	$ (16,664)	$ 97,140	$ 53,958

Relevant Information for Comprehension

The value of the DTRA's general property, plant and equipment (PP&E) personal property (Major Asset Class of Equipment) includes all of the general PP&E in the possession of contractors above Department of Defense (DoD) capitalization threshold. The net book value (NBV) of such property, in relation to the total general PP&E NBV for the DoD government-wide financial statements, is immaterial. In accordance with an Office of Management and Budget approved strategy, the General Accounting Office and the DoD Inspector General, the Department is developing new policies and a contractor reporting process to capture general PP&E information for future reporting purposes for compliance with generally accepted accounting standards.

The DTRA recognizes that inclusion in the Major Asset Class of property-in-the-hands-of-the-contractor, is contrary to DoD directives. However, the decision to include such property was based on an audit recommendation from the independent audit firm retained by the DTRA. The audit firm made its recommendation based on the Statement of Federal Financial Accounting Standards (SFFAS 6 Chapter 2) and stated concepts of the Federal Accounting Standards Advisory Board (FASAB).

Property in Hands of Contractors

	In Thousands
Acquisition Value	$ 41,060
Depreciation	(10,867)
Net Book Value	$ 30,193

Disclosure Regarding Internal Use Software

In FY 04, DTRA recognized Internal Use Software totaling $13,745 thousand as a capital asset. This change in accounting procedure was directed by a Department of Defense memorandum dated May 14, 2004, which required that treatment begin in the third quarter of FY 2004.

Note 7.	Liabilities Not Covered by Budgetary Resources

As of September 30 (Amounts In Thousands)	2004	2003
Intra-governmental Liabilities		
Accounts Payable	$ (157)	$ -
Other	693	455
Total Intra-governmental Liabilities	536	455
Non-Federal Liabilities		
Accounts Payable	721	-
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	2,040	2,052
Environmental Liabilities	65,977	-
Other Liabilities	6,441	5,941
Total Non-Federal Liabilities	75,179	7,993
Total Liabilities Not Covered by Budgetary Resources	75,715	8,448
Total Liabilities Covered by Budgetary Resources	62,381	79,694
Total Liabilities	$ 138,096	$ 88,142

Definitions

Liabilities Not Covered by Budgetary Resources. Liabilities that are not considered covered by realized budgetary resources as of the Balance Sheet date. Budgetary resources encompass the following:

New budget authority.
Spending authority from offsetting collections (credited to an appropriation or fund account).
Recoveries of unexpired budget authority through downward adjustments of prior-year obligations.
Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior-year balances during the year.
Borrowing authority or permanent indefinite appropriations, which have been enacted and signed into law as of the Balance Sheet date, provided that the resources may be apportioned by the Office of Management and Budget (OMB) without further action by Congress or without a contingency first having to be met.

Liabilities Covered by Budgetary Resources. Liabilities incurred by the reporting entity, which are covered by realized budget resources as of the Balance Sheet date. Budgetary resources encompass not only new budget authority, but also other resources available to cover liabilities for specified purposes in a given year. Available budgetary resources include the following:

New Budget Authority.
Spending authority from offsetting collections (credited to an appropriation or fund account).
Recoveries of unexpired budget authority through downward adjustments of prior-year obligations.
Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year.
Borrowing authority or permanent indefinite appropriations, which have been enacted and signed into law as of the Balance Sheet date, provided that the resources may be apportioned by the OMB without further action by the Congress or without a contingency first having to be met.

Note 8.	**Accounts Payable**

As of September 30	2004			2003
(Amounts In Thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
Intra-governmental Payables	$ 622	N/A	$ 622	$ 22,836
Non-Federal Payables (to the Public)	49,637	-	49,637	53,112
Total	$ 50,259	$ -	$ 50,259	$ 75,948

Definitions:

Intragovernmental Payables. Intragovernmental accounts payable consists of amounts owed to other federal agencies for goods or services ordered and received, but not yet paid. Interest, penalties and administrative fees are not applicable to intragovernmental payables. Non-federal payables (to the public) are payments to non-federal government entities.

Note 9.	Environmental Liabilities and Disposal Liabilities

As of September 30	2004			2003
(Amounts In Thousands)	Current Liability	Noncurrent Liability	Total	Total
Environmental Liabilities – Non Federal				
Accrued Environmental Restoration (DERP funded) Costs:				
Active Installations--Environmental Restoration (ER)	$ 188	$ 9,895	$ 10,083	$ -
Other Accrued Environmental Costs (Non-DERP funds)				
Active Installations--Environmental Corrective Action	5,343	56,082	61,425	
Other	-	-	-	1,536
Total Environmental Liabilities:	$ 5,531	$ 65,977	$ 71,508	$ 1,536

Information Related to Environmental Liabilities

Composition of Other Liabilities

Other Accrued Environmental Costs - Non-DERP is comprised of non-federal current liabilities and non-federal noncurrent liabilities.

General Disclosures

The correct reporting of DERP costs required the movement of costs previously reported on Line B.4. Non-DERP-other for FY 2003 to Line A.1. Accrued environmental restoration (DERP funded) costs for 1st Quarter, FY 2004. This liability is for funded environmental restoration activities at Johnston Atoll, which was completed prior to year-end FY 2004.

The source of clean-up cost requirements (e.g. applicable laws and regulations) includes the Code of Federal Regulations, CFR 10, 40, 29, and 49 and the NTS Federal Facilities Agreement and Consent Order, which addresses environmental restoration under the legal authorities of the Comprehensive Environmental Response Compensation and Liability Act, the Resource Conservation and Recovery Act, the Federal Water Pollution Control Act, and various Nevada State Laws. Clean-up costs are for the NTS site.

The current liability is based on FY 2003 and FY 2004 funding that has been placed on contract through the Department of Energy - National Nuclear Security Administration (NNSA) at the NTS. This liability includes the fee charged by the NNSA at the NTS to contract this effort. The estimated costs are based on engineering estimates prepared by DTRA staff at NTS.

Note 10. Other Liabilities

As of September 30	2004			2003
(Amounts In Thousands)	Current Liability	Noncurrent Liability	Total	Total
Intra-governmental:				
Advances from Others	$ 508	$ -	$ 508	$ -
FECA Reimbursement to the Department of Labor	-	454	454	455
Other Liabilities	1,262	-	1,262	913
Total Intra-governmental Other Liabilities	1,770	454	2,224	1,368
Non-Federal:				
Accrued Funded Payroll and Benefits	2,526	-	2,526	1,738
Advances from Others	2,189	-	2,189	(4,911)
Deposit Funds and Suspense Accounts	-	-	-	85
Accounts Payable-Cancelled Appropriations	-	-	-	25
Accrued Unfunded Annual Leave	6,442	-	6,442	5,916
Other Liabilities	908	-	908	4,385
Total Non-Federal Other Liabilities	12,065	-	12,065	7,238
Total Other Liabilities:	$ 13,835	$ 454	$ 14,289	$ 8,606

Note 11.	Commitments and Contingencies

DTRA is a party in various administrative proceedings, legal actions, and claims brought by and against it. In the opinion of management and legal counsel, the ultimate resolution of these proceedings, actions, and claims will not materially affect DTRA's financial position or results of operations

DTRA General Counsel identified one known claim, litigation, and assessment of $10 million or more made against DTRA by Die Casters International, Inc. The plaintiff's complaint was filed in the United States Court of Federal Claims on July 6, 2004. Plaintiff is seeking approximately $110 million on theories of breach of contract and a taking under the Fifth Amendment of the Constitution of the United States. The Government intends to contest this claim vigorously. DTRA's General Counsel is unable to express an opinion concerning the likely outcome of this case.

Note 12.	Military Retirement Benefits and Other Employment Related Actuarial Liabilities

As of September 30	2004				2003
(Amounts In Thousands)	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
Other:					
FECA	$ 2,040		$ -	$ 2,040	$ 2,052
Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$ 2,040		$ -	$ 2,040	$ 2,052

The reporting of military retirement benefits and military retirement health benefits are reported separately by the Military Retirement Fund (MRF). The applicable portion of the military retirement benefits actuarial liability for the Defense Threat Reduction Agency (DTRA) is reported on the financial statements of the MRF.

Reporting liability pertaining to Federal Employees Compensation Act (FECA): The DTRA's actuarial liability for employees' compensation benefits is developed by the Department of Labor and provided to the DTRA at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the Office of Management and Budget's official economic assumptions for

10-year Treasury notes and bonds. Cost of living adjustments and medical inflation factors are also applied to the calculation of projected future benefits.

Note 13.	Unexpended Appropriations

As of September 30		2004		2003
(Amounts In Thousands)				
Unexpended Appropriations:				
A. Unobligated, Available	$	388,669	$	611,077
B. Unobligated, Unavailable		77,132		26,261
C. Unexpended Obligations		1,539,544		1,422,912
D. Total Unexpended Appropriations	$	2,005,345	$	2,060,250

Definitions

Unexpended appropriations are the amount of budget authority remaining for disbursements against current or future obligations.

Unobligated balances represent the cumulative amount of budgetary authority that has not been set aside to cover outstanding commitments and obligations. Unobligated balances are classified as available or unavailable. Unobligated balances associated with appropriations expiring at fiscal year-end remain available only for final obligation adjustments until the account is closed.

Unexpended obligations represent funds that have been committed for goods that have not been received or services that have not been performed.

Information Related to Unexpended Appropriations

Unexpended obligations reported as a component of unexpended appropriations include undelivered orders - unpaid and undelivered orders – paid only for direct appropriated funds. This amount is distinct from Line 12, Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but Not Yet Provided on the Statement of Financing (SOF). This line on the SOF includes the change in unexpended obligations against budget authority from all sources during the fiscal year.

Note 14.A	General Disclosures Related to the Statement of Net Cost

Statement of Net Cost

The Consolidated Statement of Net Cost (SoNC) in the federal government is unique because its principles are driven on understanding the net cost of programs and/or organizations that the federal government supports through appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

Reporting Entities

The DTRA records transactions on both accrual and budgetary basis in accordance with federal generally accepted accounting principles. Under the accrual basis, exchange revenues are recognized when earned and expenses are recognized when incurred. Budgetary accounting facilitates an entity's compliance with legal constraints and controls over the use of federal funds. The Defense Finance & Accounting Service captures and compiles the information presented in the SoNC based on disbursements and collection transactions, as well as integrating appropriate data from non-financial feeder systems and adjustments made to record accruals for items such as payroll expenses and expenditure transactions processed by others without the required pre-validation approval from the DTRA.

Note 14.B.	**Imputed Expenses**

As of September 30 (Amounts In Thousands)	2004	2003
Civilian (e.g.,CSRS/FERS) Retirement	$ 2,733	$ 2,738
Civilian Health	2,911	2,529
Civilian Life Insurance	14	12
Military Salaries	37,893	-
Military Benefits	34,387	-
Total Imputed Expenses	$ 77,938	$ 5,279

Relevant Information for Comprehension

The civilian employee imputed expense cost factors are provided by the Office of Personnel Management (OPM) to the Office of the Under Secretary of Defense (Personnel and Readiness (OUSD (P&R)) and to the Defense Finance and Accounting Service (DFAS). The DFAS provides civilian employees' base salary and number of employees electing health benefits by reporting entity to OUSD (P&R). The OUSD (P&R) computes and validates the imputed expenses for civilian employee retirement and other civilian and military retirement benefits, and provides to reporting components for inclusion in the audited financial statements. The imputed expense amount in this note should equal the imputed financing amount in Note 15.

In FY 2003, Military Salaries and Benefits of $74,085 thousand were disclosed in Note 13. In FY 2004, in accordance with SFFAS No. 4, Military Salaries and Benefits of $72,280 thousand were recorded in the accounting system.

Note 14.C.	Stewardship Assets

Stewardship assets include heritage assets, stewardship land, non-federal physical property, and investments in Research and Development. The current-year costs of acquiring, constructing, improving, reconstructing or renovating stewardship assets are included in the Statement of Net Cost. Material annual investment amounts related to stewardship assets are provided in the Required Supplemental Stewardship Information section of this financial statement.

Note 14.D.	Intra-governmental Revenue and Expense

Intragovernmental Revenue

The DTRA accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. The Department of Defense (DoD) intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that such reconciliations cannot be accomplished with the existing or foreseeable resources.

Note 15.	Disclosures Related to the Statement of Changes in Net Position

As of September 30 (Amounts In Thousands)	Cumulative Results of Operations 2004	Unexpended Appropriations 2004	Cumulative Results of Operations 2003	Unexpended Appropriations 2003
Imputed Financing:				
Civilian CSRS/FERS Retirement	$ 2,733	$ -	$ 2,738	$ -
Civilian Health	2,911	-	2,529	-
Civilian Life Insurance	14	-	12	-
Military Salaries	37,893	-	-	-
Military Benefits	34,387	-	-	-
Total Imputed Financing	$ 77,938	$ -	$ 5,279	$ -

Definitions

Imputed Financing

The amounts remitted to Office of Personnel Management (OPM) and for employees covered by Civil Service Retirement System (CSRS). Federal Employee Retirement System (FERS), Federal Employees Health Benefits Program (FEHB) and the Federal Employee Group Life Insurance Program (FEGLI) do not fully cover the Government's cost to provide these benefits. An imputed cost is recognized as the difference between the Government's cost of providing these benefits to the employees and contributions made by and for them. The OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for computation of imputed financing cost. The DFAS provides the costs to Office of the Under Secretary of Defense ((Personnel and Readiness) (OUSD (P&R)) for validation. The reporting components receive approved imputed costs for inclusion in their financial statements.

In FY 2003, Military Salaries and Benefits of $74,085 thousand were disclosed in Note 13. In FY 2004, in accordance with SFFAS No. 4, Military Salaries and Benefits of $72,280 thousand were recorded in the accounting system.

Note 16.	Disclosures Related to the Statement of Budgetary Resources

As of September 30 (Amounts In Thousands)	2004	2003
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 1,576,186	$ 1,464,119
Available Borrowing and Contract Authority at the End of the Period	$ -	$ -

Apportionment Categories for Obligations Incurred

As of September 30 (Amounts In Thousands)	Report on Budget Execution	Statement of Budgetary Resources
Direct Obligations, Category A	$ 1,508,622	$ 1,460,439
Reimbursable Obligations	14,480	14,480
Total Obligations	$ 1,523,102	$ 1,474,919

The difference of $48,183 thousand in direct obligations is primarily attributable to an audit adjustment of $47,903 thousand associated with undelivered orders.

Apportionment Categories

The Office of Management and Budget Bulletin No. 01-09, section 9.27, specifically requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B and exempt from apportionment. This disclosure should agree with the aggregate of the related information as included in each reporting entity's Report on Budget Execution (Standard Form 133) and lines 8A and 8B in the Statement of Budgetary Resources (SBR).

Undelivered Orders

Undelivered Orders presented in the SBR includes Undelivered Orders-Unpaid for both direct and reimbursable funds.

Spending Authority from Offsetting Collections

Adjustments in funds that are temporarily not available pursuant to Public Law, and those that are permanently not available (included in the Adjustments line in the SBR), are not included in the Spending Authority from Offsetting Collections and Adjustments line in the SBR, or the Spending Authority for Offsetting Collections and Adjustments line in the Statement of Financing.

Note 17.	**Disclosures Related to the Statement of Financing**

The objective of the Statement of Financing is to reconcile the difference between budgetary obligations and the net cost of operations reported. It is presented as combined or combining statements rather than consolidated statements due to intragovernmental transactions not being eliminated. Due to the Defense Threat Reduction Agency's financial system limitations, budgetary data is not in agreement with proprietary expenses and capitalized assets. Differences between budgetary and proprietary data are a previously identified deficiency.

TAB D

SUPPORTING CONSOLIDATING/COMBINING STATEMENTS

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATING BALANCE SHEET
As of September 30, 2004 and 2003
(Amounts In Thousands)

	Defense Threat Reduction Agency	Defense Technology Security Administration	On Site Inspection Agency	Defense Special Weapons Agency
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)	$ 1,815,801	$ 3	$ (6)	$ 226,734
Accounts Receivable (Note 4)	6,530	-	(1)	227
Total Intragovernmental Assets	1,822,331	3	(7)	226,961
Accounts Receivable (Note 4)	-	-	-	-
General Property, Plant and Equipment (Note 6)	96,916	-	220	4
Other Assets (Note 5)	-	-	-	-
TOTAL ASSETS	$ 1,919,247	$ 3	$ 213	$ 226,965

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATING BALANCE SHEET
As of September 30, 2004 and 2003
(Amounts In Thousands)

	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)	$ 2,042,532	$ -	$ 2,042,532	$ 2,064,331
Accounts Receivable (Note 4)	6,756	-	6,756	54,322
Total Intragovernmental Assets	2,049,288	-	2,049,288	2,118,653
Accounts Receivable (Note 4)	-	-	-	2,842
General Property, Plant and Equipment (Note 6)	97,140	-	97,140	53,958
Other Assets (Note 5)	-	-	-	5
TOTAL ASSETS	$ 2,146,428	$ -	$ 2,146,428	$ 2,175,458

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATING BALANCE SHEET
As of September 30, 2004 and 2003
(Amounts In Thousands)

	Defense Threat Reduction Agency	Defense Technology Security Administration	On Site Inspection Agency	Defense Special Weapons Agency
LIABILITIES (Note 7)				
Intragovernmental:				
Accounts Payable (Note 8)	$ 775	$ -	$ -	$ (153)
Other Liabilities (Note 7 and Note 10)	1,922	-	76	226
Total Intragovernmental Liabilities	2,697	-	76	73
Accounts Payable (Note 8)	48,257	-	-	1,380
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 12)	1,830	-	210	-
Environmental Liabilities (Note 9)	71,508	-	-	-
Other Liabilities (Note 7 and Note 10)	12,065	-	-	-
TOTAL LIABILITIES	136,357	-	286	1,453
NET POSITION				
Unexpended Appropriations (Note 13)	1,778,517	3	(5)	226,830
Cumulative Results of Operations	4,373	-	(68)	(1,318)
TOTAL NET POSITION	1,782,890	3	(73)	225,512
TOTAL LIABILITIES AND NET POSITION	$ 1,919,247	$ 3	$ 213	$ 226,965

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATING BALANCE SHEET
As of September 30, 2004 and 2003
(Amounts In Thousands)

	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
LIABILITIES (Note 11)				
Intragovernmental:				
Accounts Payable (Note 8)	$ 622	$ -	$ 622	$ 22,836
Other Liabilities (Note 7 and Note 10)	2,224	-	2,224	1,368
Total Intragovernmental Liabilities	2,846	-	2,846	24,204
Accounts Payable (Note 8)	49,637	-	49,637	53,112
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 12)	2,040	-	2,040	2,052
Environmental Liabilities (Note 9)	71,508	-	71,508	1,536
Other Liabilities (Note 7 and Note 10)	12,065	-	12,065	7,238
TOTAL LIABILITIES	138,096	-	138,096	88,142
NET POSITION				
Unexpended Appropriations (Note 13)	2,005,345	-	2,005,345	2,060,250
Cumulative Results of Operations	2,987	-	2,987	27,066
TOTAL NET POSITION	2,008,332	-	2,008,332	2,087,316
TOTAL LIABILITIES AND NET POSITION	$ 2,146,428	$ -	$ 2,146,428	$ 2,175,458

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
Program Costs				
Defense Special Weapons Agency				
Intragovernmental Gross Costs	$ -	$ -	$ -	$ 9,930
(Less: Intragovernmental Earned Revenue)	(98)	-	(98)	(287)
Intragovernmental Net Costs	(98)	-	(98)	9,643
Gross Costs With the Public	11,076	-	11,076	(759)
(Less: Earned Revenue From the Public)	226	-	226	-
Net Costs With the Public	11,302	-	11,302	(759)
Total Net Cost	11,204	-	11,204	8,884
Defense Technology Security Administration				
Intragovernmental Gross Costs	-	-	-	-
(Less: Intragovernmental Earned Revenue)	-	-	-	-
Intragovernmental Net Costs	-	-	-	-
Gross Costs With the Public	-	-	-	48
(Less: Earned Revenue From the Public)	-	-	-	-
Net Costs With the Public	-	-	-	48
Total Net Cost	$ -	$ -	$ -	$ 48

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
Defense Threat Reduction Agency				
Intragovernmental Gross Costs	$ 94,075	$ -	$ 94,075	$ 52,250
(Less: Intragovernmental Earned Revenue)	(23,476)	-	(23,476)	(15,792)
Intragovernmental Net Costs	70,599	-	70,599	36,458
Gross Costs With the Public	1,290,602	-	1,290,602	1,129,714
(Less: Earned Revenue From the Public)	139	-	139	-
Net Costs With the Public	1,290,741	-	1,290,741	1,129,714
Total Net Cost	1,361,340	-	1,361,340	1,166,172
On Site Inspection Agency	-			
Intragovernmental Gross Costs	17	-	17	84
(Less: Intragovernmental Earned Revenue)	-	-	-	-
Intragovernmental Net Costs	17	-	17	84
Gross Costs With the Public	115	-	115	2,236
(Less: Earned Revenue From the Public)	-	-	-	1
Net Costs With the Public	115	-	115	2,237
Total Net Cost	$ 132	$ -	$ 132	$ 2,321

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
Total Program Costs				
Intragovernmental Gross Costs	$ 94,092	$ -	$ 94,092	$ 62,264
(Less: Intragovernmental Earned Revenue)	(23,574)	-	(23,574)	(16,079)
Intragovernmental Net Costs	70,518	-	70,518	46,185
Gross Costs With the Public	1,301,793	-	1,301,793	1,131,239
(Less: Earned Revenue From the Public)	365	-	365	1
Net Costs With the Public	1,302,158	-	1,302,158	1,131,240
Total Net Cost	1,372,676	-	1,372,676	1,177,425
Cost Not Assigned to Programs	-	-	-	-
(Less:Earned Revenue Not Attributable to Programs)	-	-	-	-
Net Cost of Operations	$ 1,372,676	$ -	$ 1,372,676	$ 1,177,425

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	Defense Threat Reduction Agency	Defense Technology Security Administration	On Site Inspection Agency	Defense Special Weapons Agency
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balances	$ 39,085	$ -	$ 61	$ (12,080)
Prior period adjustments (+/-)	-	-	-	-
Beginning Balances, as adjusted	39,085	-	61	(12,080)
Budgetary Financing Sources:				
Appropriations used	1,422,530	-	-	(150,411)
Other budgetary financing sources (+/-)	(173,841)	-	2	172,379
Other Financing Sources:				
Imputed financing from costs absorbed by others	77,938	-	-	-
Total Financing Sources	1,326,627	-	2	21,968
Net Cost of Operations (+/-)	1,361,340	-	132	11,204
Ending Balances	$ 4,372	$ -	$ (69)	$ (1,316)

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balances	$ 27,066	$ -	$ 27,066	$ (1,160,988)
Prior period adjustments (+/-)	-	-	-	-
Beginning Balances, as adjusted	27,066	-	27,066	(1,160,988)
Budgetary Financing Sources:				
Appropriations used	1,272,119	-	1,272,119	2,153,167
Other budgetary financing sources (+/-)	(1,460)	-	(1,460)	207,033
Other Financing Sources:				
Imputed financing from costs absorbed by others	77,938	-	77,938	5,279
Total Financing Sources	1,348,597	-	1,348,597	2,365,479
Net Cost of Operations (+/-)	1,372,676	-	1,372,676	1,177,425
Ending Balances	$ 2,987	$ -	$ 2,987	$ 27,066

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	Defense Threat Reduction Agency	Defense Technology Security Administration	On Site Inspection Agency	Defense Special Weapons Agency
UNEXPENDED APPROPRIATIONS				
Beginning Balances	$ 1,976,996	$ 8	$ 29	$ 83,216
Prior period adjustments (+/-)	-	-	-	-
Beginning Balances, as adjusted	1,976,996	8	29	83,216
Budgetary Financing Sources:				
Appropriations received	1,244,349	-	-	-
Appropriations transferred-in/out (+/-)	(10,508)	-	-	-
Other adjustments (rescissions, etc) (+/-)	(9,791)	(5)	(33)	(6,797)
Appropriations used	(1,422,530)	-	-	150,411
Other Financing Sources				
Total Financing Sources	(198,480)	(5)	(33)	143,614
Net Cost of Operations (+/-)				
Ending Balances	$ 1,778,516	$ 3	$ (4)	$ 226,830

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
UNEXPENDED APPROPRIATIONS				
Beginning Balances	$ 2,060,249	$ -	$ 2,060,249	$ 2,943,139
Prior period adjustments (+/-)				
Beginning Balances, as adjusted	2,060,249	-	2,060,249	2,943,139
Budgetary Financing Sources:				
Appropriations received	1,244,349	-	1,244,349	1,318,496
Appropriations transferred-in/out (+/-)	(10,508)	-	(10,508)	(24,463)
Other adjustments (rescissions, etc) (+/-)	(16,626)	-	(16,626)	(23,755)
Appropriations used	(1,272,119)	-	(1,272,119)	(2,153,167)
Other Financing Sources				
Total Financing Sources	(54,904)	-	(54,904)	(882,889)
Net Cost of Operations (+/-)				
Ending Balances	$ 2,005,345	$ -	$ 2,005,345	$ 2,060,250

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	Defense Threat Reduction Agency	Defense Technology Security Administration	On Site Inspection Agency	Defense Special Weapons Agency
BUDGETARY FINANCING ACCOUNTS				
BUDGETARY RESOURCES				
Budget Authority:				
Appropriations received	$ 1,244,349	$ -	$ -	$ -
Net transfers (+/-)	(10,208)	-	-	-
Unobligated balance:				
Beginning of period	602,579	3	9	34,746
Net transfers, actual (+/-)	(300)	-	-	-
Spending authority from offsetting collections:				
Collected	37,691	-	-	2,051
Receivable from Federal sources	(14,354)	-	-	(2,179)
Change in unfilled customer orders	-	-	-	-
Advance received	(2,214)	-	-	-
Without advance from Federal sources	(7,359)	-	-	(217)
Subtotal	13,764	-	-	(345)
Recoveries of prior year obligations	56,567	5	29	16,044
Permanently not available	(9,791)	(5)	(33)	(6,693)
Total Budgetary Resources	$ 1,896,960	$ 3	$ 5	$ 43,752

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	2004 Combined	2003 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 1,244,349	$ 1,318,496
Net transfers (+/-)	(10,208)	45,161
Unobligated balance:		
Beginning of period	637,337	541,310
Net transfers, actual (+/-)	(300)	(69,624)
Spending authority from offsetting collections:		
Collected	39,742	9,316
Receivable from Federal sources	(16,533)	6,034
Change in unfilled customer orders	-	-
Advance received	(2,214)	-
Without advance from Federal sources	(7,576)	13,637
Subtotal	13,419	28,987
Recoveries of prior year obligations	72,645	58,896
Permanently not available	(16,522)	(23,744)
Total Budgetary Resources	$ 1,940,720	$ 1,899,482

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

STATUS OF BUDGETARY RESOURCES	**Defense Threat Reduction Agency**	**Defense Technology Security Administration**	**On Site Inspection Agency**	**Defense Special Weapons Agency**
Obligations incurred:				
Direct	$ 1,452,637	$ -	$ -	$ 7,802
Reimbursable	14,480	-	-	-
Subtotal	1,467,117	-	-	7,802
Unobligated balance:				
Apportioned	362,493	-	-	26,176
Other available	-	-	-	1
Unobligated Balances Not Available	67,350	3	5	9,773
Total, Status of Budgetary Resources	1,896,960	3	5	43,752
Relationship of Obligations to Outlays:				
Obligated Balance, Net - beginning of period	1,228,829	5	29	207,953
Obligated Balance, Net - end of period:				
Accounts receivable	(39,508)	-	-	-
Unfilled customer order from Federal sources	(29,777)	-	-	(79)
Undelivered orders	1,385,107	-	(10)	191,089
Accounts payable	71,205	-	10	(120)
Outlays:				
Disbursements	1,274,065	-	-	11,218
Collections	(35,478)	-	-	(2,051)
Subtotal	1,238,587	-	-	9,167
Net Outlays	$ 1,238,587	$ -	$ -	$ 9,167

The accompanying notes are an integral part of these statements.

Department of Defense

Defense Threat Reduction Agency

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the periods ended September 30, 2004 and 2003

(Amounts In Thousands)

		2004 Combined		2003 Combined
STATUS OF BUDGETARY RESOURCES				
Obligations incurred:				
Direct	$	1,460,439	$	1,228,315
Reimbursable		14,480		33,829
Subtotal		1,474,919		1,262,144
Unobligated balance:				
Apportioned		388,669		611,077
Other available		1		1
Unobligated Balances Not Available		77,131		26,260
Total, Status of Budgetary Resources		1,940,720		1,899,482
Relationship of Obligations to Outlays:				
Obligated Balance, Net - beginning of period		1,436,816		1,408,275
Obligated Balance, Net - end of period:				
Accounts receivable		(39,508)		(56,041)
Unfilled customer order from Federal sources		(29,856)		(37,432)
Undelivered orders		1,576,186		1,464,119
Accounts payable		71,095		66,171
Outlays:				
Disbursements		1,285,283		1,155,036
Collections		(37,529)		(9,316)
Subtotal		1,247,754		1,145,720
Net Outlays	$	1,247,754	$	1,145,720

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINING STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	Defense Threat Reduction Agency	Defense Technology Security Administration	On Site Inspection Agency	Defense Special Weapons Agency
Resources Used to Finance Activities:				
Budgetary Resources Obligated				
Obligations incurred	$ 1,467,117	$ -	$ -	$ 7,802
Less: Spending authority from offsetting collections and recoveries (-)	(70,331)	(5)	(29)	(15,699)
Obligations net of offsetting collections and recoveries	1,396,786	(5)	(29)	(7,897)
Net obligations	1,396,786	(5)	(29)	(7,897)
Other Resources				
Imputed financing from costs absorbed by others	77,938	-	-	-
Net other resources used to finance activities	77,938	-	-	-
Total resources used to finance activities	1,474,724	(5)	(29)	(7,897)

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINING STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	2004 Combined	2003 Combined
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 1,474,919	$ 1,262,144
Less: Spending authority from offsetting collections and recoveries (-)	(86,064)	(87,883)
Obligations net of offsetting collections and recoveries	1,388,855	1,174,261
Net obligations	1,388,855	1,174,261
Other Resources		
Imputed financing from costs absorbed by others	77,938	5,279
Net other resources used to finance activities	77,938	5,279
Total resources used to finance activities	1,466,793	1,179,540

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINING STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	Defense Threat Reduction Agency	Defense Technology Security Administration	On Site Inspection Agency	Defense Special Weapons Agency
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 (-)	(131,529)	5	29	19,399
Unfilled Customer Orders	(9,573)	-	-	(217)
Resources that fund expenses recognized in prior periods do not affect net cost of operations	(2,021)	-	(5)	(176)
Resources that finance the acquisition of assets	(46,118)	-	-	-
Total resources used to finance items not part of the net cost of operations	(189,241)	5	24	19,006
Total resources used to finance the net cost of operations	1,285,483	-	(5)	11,109

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINING STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	2004 Combined	2003 Combined
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 (-)	(112,096)	(33,161)
Unfilled Customer Orders	(9,790)	13,637
Resources that fund expenses recognized in prior periods do not affect net cost of operations	(2,202)	(1,861)
Resources that finance the acquisition of assets	(46,118)	(6,365)
Total resources used to finance items not part of the net cost of operations	(170,206)	(27,750)
Total resources used to finance the net cost of operations	1,296,587	1,151,790

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINING STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	Defense Threat Reduction Agency	Defense Technology Security Administration	On Site Inspection Agency	Defense Special Weapons Agency
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	7,120	-	-	41
Increase in environmental and disposal liability	65,977	-	-	-
Other (+/-)	-	-	87	-
Total components of Net Cost of Operations that will require or generate resources in future periods	73,097	-	87	41
Components not Requiring or Generating Resources:				
Depreciation and amortization	2,760	-	45	35
Revaluation of assets or liabilities (+/-)	-	-	-	-
Other (+/-)	-	-	5	19
Total components of Net Cost of Operations that will not require or generate resources	2,760	-	50	54
Total components of net cost of operations that will not require or generate resources in the current period	75,857	-	137	95
Net Cost of Operations	1,361,340	-	132	11,204

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Threat Reduction Agency
COMBINING STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
(Amounts In Thousands)

	2004 Combined	2003 Combined
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	7,161	-
Increase in environmental and disposal liability	65,977	-
Other (+/-)	87	(34)
Total components of Net Cost of Operations that will require or generate resources in future periods	73,225	(34)
Components not Requiring or Generating Resources:		
Depreciation and amortization	2,840	(3,841)
Revaluation of assets or liabilities (+/-)	-	20,660
Other (+/-)	24	8,850
Total components of Net Cost of Operations that will not require or generate resources	2,864	25,669
Total components of net cost of operations that will not require or generate resources in the current period	76,089	25,635
Net Cost of Operations	1,372,676	1,177,425

The accompanying notes are an integral part of these statements.

TAB E

REQUIRED SUPPLEMENTAL STEWARDSHIP INFORMATION

Investments In Research and Development

Yearly Investment in Research and Development
For Fiscal Years (Preceding 4th Fiscal Year) through FY2004
(In Millions of Dollars)

(a) Categories		(b) FY00	© FY01	(d) FY02	(e) FY03	(f) FY04
1.	Basic Research	0.000	0.000	0.000	0.000	0.000
2.	Applied Research	2.453	4.212	58.452	182.453	91.738
3.	Development					
	Advanced Technology Development	0.850	2.202	33.656	74.895	17.354
	Demonstration and Validation	0.000	0.000	0.000	0.000	0.000
	Engineering and Manufacturing Development	0.000	0.000	0.000	0.000	0.000
	Research, Development, Test and Evaluation	0.005	0.000	0.316	3.770	1.608
	Management Support	0.000	0.000	0.000	0.000	0.000
	Operational Systems Development					
Total		**3.308**	**6.414**	**92.424**	**261.118**	**110.700**

Narrative Statement

See attached.

Applied Research examples:

Outcomes from the applied research are:

Radiation Hardened Microelectronics: DTRA developed and demonstrated several radiation hardened prototype technologies. These technologies provide radiation hardening for up to 0.25 microns and initiated development of hardening for 0.15 micron technology.

Consequence Assessment: DTRA developed a atmospheric hazard prediction model to estimate the effects from CBRN events. The Hazard Prediction and Assessment Capability (HPAC) code now models incidents involving industrial facilities and transportation assets. This capability allows for the full range of CBRN assessment. Additionally, the code now has a full urban transport and dispersion capability that accounts for the uniqueness found within a city. The urban capability was used operationally during the 2004 Athens Summer Olympics and the Democratic and Republican National Conventions.

Integrated Munitions Effects. DTRA developed a target-attack planning tool for existing theater-level planning capabilities to defeating or denying a wide variety of facilities and capabilities. This planning tool, the Integrated Munitions Effects Assessment (IMEA), integrates collateral effects predictive tools, Hazard Prediction and Assessment Capability (HPAC), for a variety of applications supporting Nuclear, Biological and Chemical (NBC) target attack planning to include NBC expulsion and dispersion resulting from attacks on WMD facilities as well as acts of terrorism and hostile use of WMD to provide targeting solutions using conventional weapons for a variety of structures and equipment. It includes a high-resolution weather prediction capability that provides timely data necessary for more detailed predictions. Upgrades to the initial IMEA capability include additional target types (including complex facilities), multiple weapon effects, additional platforms, more operator-friendly displays, more WMD material types, weather interfaces and sources, and more detailed weapon input parameters (such as angle of attack).

Hard Target Defeat: DTRA developed tunnel and hard target attack technologies. These technologies include development and testing of advanced energetic materials as well as employment tactics. New explosive mixtures in penetrating warheads optimized for use against tunnels and chemical and biological targets and non-energetic warhead fills were developed. DTRA investigated fundamental properties of thermobarics and continued development of high fidelity computational fluid dynamics models for their performance and lethality. Mission critical equipment and vulnerabilities for WMD production tunnel facilities were identified. Defeat technologies to model and predict the extent of multiple weapons penetration, tunnel damage, and advanced weapon performance were developed. DTRA developed tunnel aim point optimization models to increase the effectiveness of the planning tools developed for warfighter planners and improved weapon/target interaction models of tunnels and liners to nuclear ground shock environments. DTRA completed construction of tunnel portals and tunnel at the White Sands Missile Range and, using newly developed tactics, techniques, and procedures (TTPs), conducted operational tunnel defeat demonstrations against the tunnel portals using inventory and new standoff weapons. DTRA conducted demonstration of a massive ordnance bomb against a tunnel facility at Nevada Test Site.

Special Projects: DTRA developed underground target characterization technologies to enable the Combatant Commands and Intelligence Community (IC) to find, characterize and assess tunnels and hard targets. DTRA developed and validated a remote site geology characterization process. DTRA incorporated initial nuclear and conventional weapons effects analysis and initial network analysis functionality into the Underground Target Analysis System (UTAS) software and used the tool to support targeting and IC by conducting assessments of hostile facilities based on JCS and Combatant Commanders' priorities. Characterizations of targets include three-dimensional target models. DTRA analyzed Operation Iraqi Freedom Bomb Damage Assessment (BDA) data for ground truth comparison to characterizations and assessments delivered during operations. DTRA completed a functional defeat operational demonstration on the Command, Control, Communications, and Intelligence (C3I) tunnel complex at the Nevada Test Site.

Development examples:

Four outcomes from the development and application of Weapons of Mass Destruction (WMD) Defeat Technologies to meet Counterproliferation and special weapon effects challenges are:

Second Counterproliferation (CP2) Advanced Concept Technology Demonstration (ACTD): CP2 ACTD developed and demonstrated standoff attack capabilities against WMD facilities. Final operational demonstrations and military utility assessments for the Tactical Tomahawk Penetrator Variant and Chemical Combat Assessment System have been completed. Residual components will undergo an extended user evaluation through the first quarter of calendar year 2006.

Agent Defeat, Deny, Disrupt (AD3) Program: Development and demonstration of an improved capability to hold weapons of mass destruction (WMD) targets at risk using advanced technology to defeat chemical/biological (CB) agents, deny the adversary access to agent material/facilities, and disrupt the adversary's agent-related processes. Successfully designed and conducted reduced-scale tests to characterize biological plumes and improve test and measurement techniques. Analyzed potential high explosive (HE) /incendiary fills, bomb designs, and loading weights to attain design goal of at least 2-log reduction in collateral damage than current HE fills.

Improvised Explosive Device (IED): DTRA established an IED Cell to focus on developing solutions and integrating technologies to fill gaps in IED defeat, and to avoid duplication in materiel solutions. Members interface with Services, deployed/ deploying units, Combatant Commanders and Joint Staff. DTRA delivered IED technologies (equipment) includes blast and fragmentation protective equipment, IR spotting scopes, digital cameras, robot kits, IED exploitation equipment, laser range finders, cordless spot lights, thermal imaging scopes and Z Backscatter vans.

Special Operations Forces (SOF) Support: Development and demonstration of various technologies resulted in the improved ability to provide warfighting capabilities to the Special Operations Forces (SOF) to defeat WMD. Successfully completed the Boundary Step Advanced Concept Technology Demonstration (ACTD); fourteen of the sixteen technologies were accepted by USSOCOM, the user/sponsor. The military utility assessments are continuing.

TAB F

REQUIRED SUPPLEMENTAL INFORMATION

Department of Defense
Defense Threat Reduction Agency
As of September 30, 2004
(Amounts In Thousands)

DoD Intra-governmental Asset Balances	**Treasury Index:**	**Fund Balance with Treasury**	**Accounts Receivable**
Department of Agriculture	12		$ 93
Department of Commerce	13		143
Navy General Fund	17		114
Department of State	19		735
Department of the Treasury	20	2,042,532	52
Army General Fund	21		27
Central Intelligence Agency	56		117
Air Force General Fund	57		2,333
Homeland Security	70		481
Department of Health and Human Services	75		58
National Aeronautics and Space Administration	80		646
Department of Energy	89		271
Other Defense Organizations General Funds	97		1,652
Other Defense Organizations Working Capital Funds	97-4930		-
Air Force Working Capital Fund	97-4930.003		36
Totals		**$ 2,042,532**	**$ 6,758**

Department of Defense
Defense Threat Reduction Agency
As of September 30, 2004
(Amounts In Thousands)

DoD Intra-governmental entity liabilities	**Treasury Index:**	**Accounts Payable**	**Other**
The Judiciary	10		16
Department of Commerce	13		1
Department of Labor	16		454
Navy General Fund	17	2	2
Department of State	19		289
Department of the Treasury	20	1	
Army General Fund	21	29	
Office of Personnel Management	24		1,024
General Service Administration	47	2	
Central Intelligence Agency	56		-
Air Force General Fund	57	374	172
Environmental Protection Agency	68	61	
Department of Energy	89	118	
Other Defense Organizations General Funds	97	85	27
Other Defense Organizations Working Capital Funds	97-4930	-	
Navy Working Capital Fund	97-4930.002	104	
The General Fund of the Treasury	99	(157)	239
Totals		**$ 619**	**$ 2,224**

Department of Defense
Defense Threat Reduction Agency
As of September 30, 2004
(Amounts In Thousands)

DoD Intra-governmental revenue and related costs	**Treasury Index:**	**Earned Revenue**
Department of Agriculture	12	469
Department of Commerce	13	833
Navy General Fund	17	266
Department of State	19	3,824
Department of the Treasury	20	30
Army General Fund	21	363
Central Intelligence Agency	56	260
Air Force General Fund	57	7,800
Homeland Security	70	628
Department of Health and Human Services	75	385
National Aeronautics and Space Administration	80	658
Department of Energy	89	845
US Army Corps of Engineers	96	1
Other Defense Organizations General Funds	97	7,038
Other Defense Organizations Working Capital Funds	97-4930	106
Navy Working Capital Fund	97-4930.002	67
Totals		**23,573**

TAB G

AUDIT OPINION

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INDEPENDENT AUDITOR'S REPORT

To the Director, Defense Threat Reduction Agency:

We have audited the Defense Threat Reduction Agency's (DTRA) Consolidated Balance Sheet, Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources and Combined Statement of Financing (Principal Financial Statements) as of, and for the years ended, September 30, 2004 and 2003; we have examined internal control over financial reporting in place as of September 30, 2004; and we have examined compliance with laws and regulations.

In our opinion, DTRA's 2004 and 2003 Principal Financial Statements are presented fairly in all material respects.

We found:

- no material conflicts with DTRA's 2004 report on management controls prepared under the Federal Managers' Financial Integrity Act of 1982 (FMFIA),
- matters related to internal control over financial reporting that we considered to be material weaknesses and reportable conditions, and
- instances of noncompliance with selected provisions of applicable laws and regulations.

Each of these conclusions is discussed in more detail below. This report also discusses the scope of our work.

PRINCIPAL FINANCIAL STATEMENTS

In our opinion, DTRA's 2004 and 2003 Principal Financial Statements, including the notes thereto, present fairly, in all material respects, DTRA's financial position as of September 30, 2004 and 2003, and the net cost of operations, the changes in net position, the use of budgetary resources, and the use of financing resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

INTERNAL CONTROL

We considered DTRA's internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the Principal Financial Statements. Since DTRA's financial recording and reporting, including the issuance of financial statements, are performed to a significant extent by the Defense Finance and Accounting Service (DFAS), our consideration of internal control included those aspects of internal control of DFAS which were relevant to DTRA. We limited our internal control testing to those controls necessary to achieve the objectives described in the Office of Management and Budget's (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*. We did not test all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as those controls relevant to assuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

The objectives of internal control are to provide management with reasonable, but not absolute, assurance that the following objectives are met:

- transactions are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over assets;

- funds, property, and other assets are safeguarded against loss from unauthorized acquisition, use, or disposition;

- transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations that the Office of Management and Budget (OMB), Department of Defense (DoD) management, or the Inspector General have identified as being significant and for which compliance can be objectively measured and evaluated; and

- data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters of internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgement, could adversely affect DTRA's or DFAS' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts, which would be material in relation to the financial statements being audited or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We noted several matters that we considered to be material weaknesses, as defined above, involving DFAS' internal control, as it relates to processing financial data for DTRA, as follows:

- significant elements of the financial statements including, but not limited to, Fund Balance with Treasury, Accounts Payable, and Property, Plant and Equipment are developed from sources other than the general ledger; and

- entries are processed to force financial data to agree with various data sources and various components of the Principal Financial Statements.

We noted one matters that we considered to be a reportable condition, as defined above, involving DTRA's internal control, as follows:

- DTRA does not have contingency plans for its Centralized Accounting and Financial Resource Management System (CAFRMS), which is housed at DTRA's Telegraph Road facility, or for the feeder systems on its local area network (LAN), which is housed in DTRA's Fort Belvoir facility.

The above reportable condition was cited in our audit of the 2003 Principal Financial Statements.

We noted certain other issues related to internal control as implemented by DTRA that we have communicated to DTRA's management in a separate letter dated November 9, 2004.

COMPLIANCE WITH LAWS AND REGULATIONS

DTRA's management is responsible for complying with laws and regulations applicable to its operations. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of DTRA's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. Since DTRA's financial recording and reporting, including the issuance of financial statements, are performed by DFAS, we considered compliance with laws and regulations by DFAS that were relevant to DTRA. We limited our tests to these provisions, and we did not test compliance with all laws and regulations applicable to DTRA. The objective of our audit of the Principal Financial Statements, including our tests of compliance with selected provisions of applicable laws and regulations, was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Reportable instances of noncompliance are failures to follow requirements, or violations of prohibitions in statutes and regulations, that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements or that sensitivity warrants disclosure thereof.

The inadequacies of DFAS' internal control over financial reporting are a failure to comply with:

- the Budget and Accounting Procedures Act of 1950, which requires an accounting system that provides full disclosure of the results of financial operations, adequate financial information needed in the management of operations and formulation and execution of the budget, and effective control over income, expenditures, funds, property, and other assets;

- the Federal Managers' Financial Integrity Act of 1982, which requires implementation of internal accounting and administrative controls that provide reasonable assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation, and (3) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports to maintain accountability over the assets;

- the Chief Financial Officers Act of 1990, which requires the development and maintenance of an integrated accounting and financial management system that (1) complies with applicable accounting principles, standards and requirements, and internal control standards, (2) complies with such policies and requirements as may be prescribed by the Director, OMB, (3) complies with any other requirements applicable to such systems, and (4) provides for (i) complete, reliable, consistent, and timely information that is prepared on a uniform basis and that is responsive to the financial information needs of management, (ii) the development and reporting of cost information, (iii) the integration of accounting and budgeting information, and, (iv) the systematic measurement of performance; and

- OMB Circular A-127, *Financial Management Systems*, which requires agencies to establish and maintain an accounting system that provides for (1) complete disclosure of the financial results of the activities of the agency, (2) adequate financial information for agency management and for formulation and execution of the budget, and (3) effective control over revenue, expenditures, funds, property, and other assets.

In addition, the DoD OIG has identified the following reportable noncompliances with laws and regulations by DFAS which are relevant to DFAS' processing of financial data for DTRA:

- DoD financial management systems do not properly account for assets and liabilities in accordance with SFFAS No.1;

- DoD financial management systems do not account for accounts receivable and accounts payable in accordance with SFFAC No. 1; and

- DoD financial management systems do not implement the United States Standard General Ledger at the transaction level.

RESPONSIBILITIES AND METHODOLOGY

DTRA management has the responsibility for:

- preparing the Principal Financial Statements in conformity with accounting principles generally accepted in the United States of America;
- establishing and maintaining effective internal control; and
- complying with laws and regulations.

Our responsibility is to express an opinion on the Principal Financial Statements based on our audit. Auditing standards generally accepted in the United States of America require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Financial Statements are free of material misrepresentation and presented fairly in accordance with accounting principles generally accepted in the United States of America. We considered DTRA's and DFAS' internal control for the purpose of expressing our opinion on the Principal Financial Statements and not to provide an opinion on internal control. We are also responsible for testing compliance with selected provisions of applicable laws and regulations that may materially affect the financial statements.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the Principal Financial Statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the Principal Financial Statements;
- obtained an understanding of the internal control over financial reporting by obtaining an understanding of the relevant internal controls, determined whether internal controls had been placed ion operation, assessed control risk and performed tests of controls;
- obtained an understanding of internal control over performance measures, including obtaining an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether they had been placed in operation;
- tested, or obtained evidence of, compliance with selected provisions of laws and regulations that may have a direct and material effect the Principal Financial Statements;

- obtained written representations from management; and

- performed other procedures as we considered necessary in the circumstances.

Our audits were conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Bulletin 01-02. We believe that our audits provide a reasonable basis for our opinion.

The Management's Discussion and Analysis (MD&A), and Required Supplementary Information are not a required part of the Principal Financial Statements, but are supplementary information required by OMB Bulletin 01-09, *Form and Content of Agency Financial Statements* and DoD Financial Management Regulation 1700.14-R, Volume 6B, *Form and Content of the Department of Defense Audited Financial Statements*, and the Federal Accounting Advisory Standards Board. We have applied certain limited procedures which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

This report is intended for the information of DTRA management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Leonard G. Birnbaum and Company, LLP

Alexandria, Virginia
November 9, 2004