



Section 3



Other Accompanying Information

The Pentagon Memorial



One hundred eighty four lives were lost in a single moment at the Pentagon. *One hundred eighty four individuals forever linked through the horrific events that unfolded on September 11, 2001.*

Thousands of others lost their lives and suffered injury that day while millions wept. *That day was simply incomprehensible. It jolted us into a different world, a tragic reality that just did not seem real.*

We claim this ground in remembrance of the events of September 11, 2001. To honor the 184 people whose lives were lost, their families, and all those who sacrifice that we may live in freedom.

We will never forget.

Section 3: Other Accompanying Information

Inspector General’s Summary of Management and Performance Challenges and Management’s Response to Auditor Challenges

The Inspector General (IG) has determined that five of the six management and performance challenges identified in FY 2006 continue to be challenges for FY 2007. Human capital has been removed as a separate challenge area and has been incorporated into the remaining challenge

areas due to its fundamental relationship with virtually all other facets of management. The following are the five management and performance challenges identified by the IG for FY 2007:

1. Financial Management
2. Acquisition Processes and Contract Management
3. Joint Warfighting and Readiness
4. Information Assurance, Security and Privacy
5. Health Care

The table below outlines these challenges and includes both the IG’s and Department of Defense (DoD) management’s assessments of the Department’s progress in addressing the issues. Columns A and B were prepared by the Inspector General; Column C was prepared by the Department.

1. Financial Management		
A. IG Summary of the Challenge	B. IG Assessment of Progress	C. Management’s Response
<p>The Department faces financial management challenges that are complex, long-standing, and pervade virtually all its business operations. The challenges affect DoD’s ability to provide reliable, timely, and useful financial and managerial data needed to support operating, budgeting, and policy decisions. The DoD’s financial management problems are so significant that they constitute the single largest and most challenging impediment to the U.S. Government’s ability to obtain an opinion on its consolidated financial statements. The weaknesses that affect the auditability of the financial statements also impact other DoD programs and operations and contribute to waste, mismanagement, and inefficient use of DoD resources.</p> <p>The Government Accountability Office identified DoD financial management as a high-risk area in 1995, a designation that continues to date. This designation, together with the high-risk areas of business systems modernization (designated in 1995), and supply chain management (designated in 1990) directly affect the Department’s ability to attain an unqualified audit opinion on its financial statements. In its June 30, 2007, Executive Branch Management Scorecard, the Office of Management and Budget assessed the status of the Department’s financial performance as “Red,” or “Unsatisfactory.”</p> <p>The IG previously had identified and reported on several material control weaknesses that reflect some of the pervasive and long-standing financial management issues faced by DoD and which directly impact the Department’s ability to obtain an unqualified opinion on its financial statements. These weaknesses, which also affect the safeguarding of assets and proper use of funds and impair the prevention and identification of fraud, waste, and abuse, include the following:</p> <ul style="list-style-type: none"> • Fund balance with Treasury • Inventory • Operating materials and supplies 	<p>One significant measure of the ongoing progress in the area of financial management would be the Department’s ability to obtain an unqualified audit opinion on its financial statements. The DoD is far from reaching this milestone as demonstrated by the audit opinions received by the Department and its Components on their FY 2006 financial statements. However, the Department’s ongoing initiatives in the area of financial management improvement indicate that DoD management is responding to the significant and pervasive financial management issues and is positioning itself to leverage planned systems and business improvements to achieve sustainable and long-term solutions. The Financial Improvement and Audit Readiness (FIAR) Directorate is responsible for centrally coordinating the FIAR initiative; regularly updating a written plan with stated objectives and milestones; defining a process with protocols for making decisions; tracking progress; and providing guidance for the decision-making process through oversight groups consisting of participants from across DoD.</p> <p>The FIAR Plan categorizes the financial management challenges faced by the Department into three broad categories; those that depend on:</p> <ol style="list-style-type: none"> 1. systems solutions, 2. process solutions, and 3. both systems and process solutions. <p>The FIAR plan focuses on the process solutions that DoD financial managers identify, develop, and implement to correct financial reporting deficiencies or internal control weaknesses. The IG has focused its audit efforts primarily on the FIAR improvement initiative.</p> <p>The IG considers the following DoD financial management efforts to be limited successes:</p> <ul style="list-style-type: none"> • Implementation of integrated organizational structures and processes to address financial management improvement. • Assignment of accountability to DoD managers. • DoD improvement initiatives at the entity and line-item level. 	<p>The Department is pleased to see the recognition on the part of the DoDIG regarding financial improvements being made across the DoD. We concur that the financial management area is a large challenge and we have comprehensive plans that highlight improvements on the path forward. Our financial management challenges are both pervasive and well documented.</p> <p>The Department’s roadmap for financial improvements is its Financial Improvement and Audit Readiness (FIAR) initiative. The FIAR Plan is our guide for comprehensively improving financial management and preparing for audit. It identifies critical activities for improving internal controls, resolving auditor identified weaknesses, optimizing fiscal stewardship, and achieving audit readiness. The Plan addresses action taken to correct both auditor identified material weaknesses along with internal management control weaknesses. Milestones are established to monitor progress and to ensure that required actions are completed and the Department is on schedule to achieve auditability.</p> <p>We also concur that the Department has made substantive progress in “establishing a culture and ingrained structure” and will continue our commitment to the on-going evolution of the Department’s business processes and organizational structure.</p> <p>Based on the efforts achieved with the FIAR Plan, the Office of Management and Budget continues to rate the Department “green” for progress in Improving Financial Performance under the President’s Management Agenda. The FIAR Plan is closely integrated with the Department’s Enterprise Transition Plan, which guides the Department’s business transformation effort to modernize processes, systems, and information flows to support 21st century national security requirements. The links below connect to these plans and provide details about the Department’s goals and accomplishments.</p>

1. Financial Management		
A. IG Summary of the Challenge	B. IG Assessment of Progress	C. Management's Response
<ul style="list-style-type: none"> Property, plant, and equipment Government-furnished material and contractor-acquired material Environmental liabilities Financial management systems Intragovernmental eliminations Other accounting entries Statement of Net Cost Statement of Financing (see note 21) Accounts Payable Accounts Receivable <p>The following elements and actions are key to improving the Department's financial management:</p> <ul style="list-style-type: none"> Create an environment that fully supports clean financial reporting. The financial managers need buy-in from senior management and personnel in the field offices in order to successfully implement the corrective action plans. Maintain a significant level of continued review to identify all of the material financial management and reporting deficiencies, internal control weaknesses, and quality of data issues. Develop corrective action plans that will adequately correct the deficiencies and result in financial reporting in accordance with generally accepted accounting principles. Implement the corrective action plans that address the system, control, reporting, or quality of data weakness. <p>Additionally, an overall shortage of qualified auditors and accountants has hindered progress on the challenges outlined above. Continual turnover of qualified staff who conduct audits at DoD Agencies and independent public accounting firms, and also turnover of qualified accounting staff to support financial functions and audits, has surfaced as a formidable obstacle to the effective and efficient execution of those audits. The Department needs improved recruiting and retention practices as well as robust training and continuity of operations planning to alleviate the problem.</p>	<p>Although the IG anticipates that DoD will need to make refinements in these areas, the IG considers these to be the critical steps for establishing a culture and ingrained structure that will enable DoD managers to identify internal control weaknesses and plan effectively for resolution of those weaknesses. The culture and structure also will hold DoD managers accountable for improving internal controls over financial reporting. Further, these steps should result in a financial management structure that can provide accurate, relevant, and timely financial management information for decision making.</p> <p>We fully support the Department's goal to implement internal controls that will result in sustained improvements in its ability to produce timely, reliable, and complete financial management information. To that end, DoD needs to continue the development of comprehensive, integrated plans that will lead to improved systems and internal control. We recognize that there are many variables affecting the execution of DoD improvement initiatives, such as specific Components' ability to make corrective actions and meet the projected milestones.</p> <p>For example, the U.S. Army Corps of Engineers is making progress by working to fix the majority of the property, plant, and equipment beginning balances; and the Office of the Under Secretary of Defense (Comptroller) is tracking progress through weekly updates from the U.S. Army Corps of Engineers and DoD IG personnel. The IG will continue to provide input to the DoD managers on these initiatives as requested, or as part of the IG's advisory role on the DoD committees that support these initiatives. However, the qualified staffing shortage will remain a concern for the foreseeable future until it is more adequately addressed.</p>	<p>FIAR Plan - http://www.defenselink.mil/comptroller/FIAR/documents/FIAR_Plan_Sept_2007.pdf</p> <p>Enterprise Transition Plan - http://www.defenselink.mil/dbt/products/2007_BEA_ETP/etp/ETP.html</p>

2. Acquisition Processes and Contract Management		
A. IG Summary of the Challenge	B. IG Assessment of Progress	C. Management's Response
<p>The Department continues to experience the management challenge to provide required materiel and services that are superior in performance, high in quality, sufficient in quantity, and within the timeframes needed by the warfighter while balancing the cost concerns for the taxpayer. With the war, the volume and complexity of purchases have increased to provide the additional support needed by the warfighter. The DoD spending in FY 2007 (with supplementals) will exceed \$600 billion, which is more than double the spending from FY 2000. This, in turn, has led to efforts to increase the speed of the procurements to meet urgent warfighter needs. Some of these efforts have resulted in less than prudent contracting practices. Every acquisition dollar that is not prudently spent results in the unavailability of that dollar to fund other top priorities of the Secretary of Defense and wastes valuable taxpayer dollars.</p>	<p>The Department has made progress in improving acquisition processes. Despite this progress, the increasing volume of acquisitions, the decrease in the number of acquisition personnel, and the numerous types of contracting vehicles and methods for accomplishing acquisition make this a long-term challenge. The Department has worked closely with the IG and other agencies to develop solutions to make interagency contracting work better. The DoD also has demonstrated a strong commitment to hold contracting officers accountable for following the regulations and the law. However, the sheer number of contracting actions and the pressures on contracting officials to award procurements faster make the challenge of correcting the problem more difficult. These same issues are compounded when contracting for and in hostile environments such as Southwest Asia and the aftermath of tragedies such as Hurricane Katrina.</p>	<p>No Response</p>

2. Acquisition Processes and Contract Management		
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<p>While the problems encountered in the contracting process are not unique to the wartime environment, the risk of critical gaps in the contracting process increases during contingency operations. The challenge in a wartime environment is to mitigate these gaps. Gaps occurred when:</p> <ul style="list-style-type: none"> • user requirements were not met, • funds were not spent appropriately and unaccounted for, • goods and services were not properly accounted for, • delivery of goods and services were not made properly, • individuals involved in the acquisition process lacked integrity, and • adequate documentation was not retained or prepared. <p>The DoD acquisition workforce has not kept pace with the increasing demand for technical expertise, compounding the risk of critical gaps. Ensuring the appropriate size and experience level of the acquisition workforce in light of changing acquisition strategies and vehicles, prior downsizing, and an aging workforce, is a challenge. A recent congressional proposal calls for the transfer of 600 General Services Administration contracting officers to assist the Department in meeting its contracting needs. Management also is challenged to make appropriate use of acquisition streamlining initiatives. Government quality assurance and pricing options are more limited under commercial contracts. Therefore, the procurement community must continue to closely monitor whether we are receiving the real benefits of the commercial marketplace including market-based pricing and products and services that meet warfighter requirements.</p> <p>The Department also continued to experience a variety of shortcomings in its approach to compliance with the DoD acquisition guidance and the Federal Acquisition Regulation in FY 2007. The IG identified instances where acquisition officials made decisions to proceed with key milestones without sufficient documentation to support those decisions. In other cases, warfighter requirements were not adequately justified. In one case, acquisition officials prematurely released the presolicitation notice for the competition of a 5.56-mm carbine before they performed other essential requirements to determine that a new competition was warranted or contacted the current contractor to determine whether the contractor would lower its unit prices.</p> <p>The Department continues to experience significant challenges regarding purchases made through other agencies for the Department. Last year, the Inspector General continued to find a variety of problems with interagency orders. One significant recurring issue was the failure to allow all contractors the fair opportunity to compete for awards on multiple award contracts. Also, Military Interdepartmental Purchase Requests did not comply with the appropriations law and the Federal Acquisition Regulation for making purchases through other agencies.</p>	<p>The Department needs to continue to be vigilant about allegations of corrupt acquisition, especially with the volume and speed of acquisitions in support of Operation Iraqi Freedom and Operation Enduring Freedom. In support of this mission, the Defense Criminal Investigative Service, as a member of the Department of Justice National Procurement Fraud Task Force Training Committee, assisted in the development of the Procurement Fraud Investigation Training Program, which has been made available to all Defense criminal investigative organizations through the Federal Law Enforcement Training Center.</p> <p>Furthermore, the National Defense Authorization Act of FY 2007 directed the Department of Defense to convene a panel of senior leaders representing a cross-section of the Department. The panel's mission is to conduct a Department-wide review of vulnerabilities to fraud, waste, and abuse in contracting integrity, to recommend corrective actions, and to report the panel's findings and actions to the Congress by December 31, 2007. The report will be the first of three annual reports issued by the panel. The panel has developed subcommittees that will evaluate issues related to the challenge areas noted above. The creation of this panel is a positive step toward addressing and managing these challenges.</p>	<p>No Response</p>

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<p>With the war effort, it was sometimes quicker and easier for contracting officers to go to known sources without ensuring that Federal Acquisition Regulation guidelines on exceptions from competition were met before making these awards. We found instances where sole source actions were not properly justified. The challenge remains to ensure that adequate market research is performed before contracts are awarded, thereby allowing capable contractors to compete for the large volume of procurements.</p> <p>A final challenge with the decline in the acquisition workforce is to provide adequate surveillance over cost-type service contracts. These contracts provide no incentive for contractors to control costs so adequate surveillance by the Department is especially important to make sure that we get the quality of services that we should expect while also best serving the taxpayer.</p>		No Response

3. Joint Warfighting and Readiness		
A. IG Summary of the Challenge	B. IG Assessment of Progress	C. Management's Response
<p>The challenge of Joint Warfighting and Readiness is to provide the right force, the right personnel, and the right equipment and supplies in the right place, at the right time, and in the right quantity, across the full range of military operations. This challenge is compounded by the strain on resources as a result of Operation Iraqi Freedom and Operation Enduring Freedom. Furthermore, this challenge encompasses the need for the Services and allies to be interoperable, communicate with each other effectively, share data when necessary, and train together when possible. To meet this challenge, the Department is continuously transforming.</p> <p>While U.S. forces continue to operate around the world, changes are underway to better align the resources of the Department to benefit the warfighters, wherever they are. Those changes have taken a variety of forms, not the least of which is the improvement of the tools used to fight the enemies of the United States. The fight against terrorism, as well as the ongoing Operations Enduring Freedom and Iraqi Freedom continue to test the limits of the Department and its ability to successfully defend the United States. But those have been shared battles, with each Service shouldering its portion of the load. For example, the IG's investigative component, the Defense Criminal Investigative Service, has worked effectively with the Army's Criminal Investigation Command, Federal Bureau of Investigation, and the Special Inspector General for Iraq Reconstruction, by assigning two special agents to Iraq and two special agents to Kuwait on 6-month rotating details. These agents specifically will address allegations related to bribery, kickbacks, contracting irregularities, and other matters that involve procurement fraud and public corruption that impact joint warfighting capabilities. In addition, in June 2007 the DoD IG established a field office in Afghanistan to conduct audits of contracts, funds management, and other accountability-related issues in support of Operation Enduring Freedom.</p>	<p>The Department is making progress on the issue of Joint Warfighting and Readiness, but that progress must be monitored to ensure that it continues. Changes in the location and numbers of bases in the European and Pacific theaters and the continued operations in Southwest Asia have brought to light numerous challenges facing commanders. The DoD has taken steps to align materials pre-positioned in the European theater with the new basing structure for that Command. Our review of the management of pre-positioned munitions in the European theater showed that DoD had taken positive steps to reduce the amount of munitions stored in the European theater while still meeting requirements. The ability to equip in-lieu-of forces, as well as those forces performing nontraditional missions was highlighted by our work in the U.S. Central Command area of responsibility. Our audit of force structure changes in the U.S. Pacific Command highlighted the need for continued vigilance as DoD realigns forces to meet commitments in that theater.</p> <p>Transformational changes in the Army structure and warfighting policies have had an effect on the ability to provide weapons for the entire Army. Transformation to a modular force also has had an effect on making sure small arms get out to the warfighter; however, the Army continues to be responsive in efforts to forecast requirements for small arms. During our review of the availability of small arms for meeting current operational requirements, we concluded that the Army equipped its deployed forces in support of Operation Iraqi Freedom with the small arms necessary to meet Combatant Commanders' requirements. However, before deployment, some units were not fully equipped with the types of small arms required to do their assigned mission, so they had to obtain those small arms from other sources, such as nondeployed units. This happened because the current mission requirements warrant different types of small arms not reflected in a unit's Modified Table of Organization and equipment.</p>	<p>Joint warfighting capabilities and readiness remains a major focus of the Department. At the strategic level, considerable effort is expended to ensure our current and emerging joint warfighting capabilities and basing strategy support our strategic and operational needs, and the changes in the European theater cited by the IG are one example of that effort. As the Department realigns forces to better respond to today's environment, forward positioned munitions are continuously evaluated to ensure requirements are met and excess munitions are retrograde to CONUS depots. However, current operations in OIF/OEF continue to be the major effort and place significant strain on the force. The Department is committed to ensuring forces deploying to OIF/OEF have the personnel, equipment and training necessary to meet operational needs. To do so, the non-deployed force has seen a decrease in readiness as some of their equipment and personnel are re-allocated to fully man/equip deploying units for their theater assigned missions. Additionally, these manning and equipment shortfalls can result in decreased training for non-deployed units. Moreover, some units are trained to new missions to relieve the stress on certain heavily demanded segments of the force (ex: military police). These in-lieu-of (ILO) units must be trained, and often receive new equipment, for this new mission before deploying to OIF/OEF. But to reiterate, great effort is expended to ensure all deploying units are manned, equipped and trained to meet the operational needs identified by the gaining combatant commander. As OIF/OEF operations continue, the Department is addressing the resources needed to reset and reconstitute the force. As the IG noted, considerable reset funds are expended today, and additional resources will be necessary in the coming years to repair or replace damaged or worn out equipment. Furthermore, as the Department works diligently to ensure success in OIF/OEF, we remain vigilant of other global areas</p>

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	<p>The Army continues to address small arms sustainment and modernization that should close future shortage gaps.</p> <p>Ongoing reviews cover issues such as the Army's reset program for equipment to determine the effectiveness of the technical inspection process for those units that are completing their tour in support of Operation Iraqi Freedom.</p> <p>Since FY 2002, the Army has allocated approximately \$38.6 billion for equipment reset, with the Army receiving \$17.1 billion in FY 2007 Global War on Terror supplemental funding. Another ongoing review is addressing whether U.S. ground forces supporting Operation Iraqi Freedom are receiving training necessary to meet operational requirements.</p> <p>Specifically, we will determine whether requirements reflect the training necessary in the area of operation and verify whether the ground forces are receiving the required training, as well as evaluate whether the training is meeting the needs of ground forces supporting Operation Iraqi Freedom. Additionally, we have an ongoing review evaluating the transformation of the U.S. global defense posture in the U.S. European Command.</p>	<p>of concern, and regularly assess our preparedness to respond to contingencies/event elsewhere.</p>
<p>The Global War on Terror will continue to be a long and difficult war affecting the entire global community. It will require firm commitment and cooperation of U.S. allies and coalition partners, as well as international organizations, domestic state governments, and the private sector. The demands placed on the Armed Forces the past few years have been extensive, but our military is unwavering in its focus on, resolve, and dedication to peace and freedom. With the Congress' continued strong support, the military will continue to effectively combat terrorism, counter the proliferation of weapons of mass destruction, help Iraq and Afghanistan build a stable and secure future, improve joint warfighting capabilities, and transform the Armed Forces to meet future threats.</p>	<p>The Department has made great strides toward addressing the challenge of defending our homeland. The Department has taken positive steps toward enhancing its ability to promote a greater understanding and cooperation among all DoD Components that are combating weapons of mass destruction. Also, the Department has made significant improvements in its controls over transfers of militarily sensitive technology to countries of concern during the past 6 years. Further, the Department has developed numerous policies, plans, and procedures for deterring, intercepting, and defeating threats to the U.S. homeland.</p> <p>However, terrorists and countries of concern are relentless in their pursuit to strike our cities, our citizens, and our interests abroad. Therefore, the Department must maintain its vigilance, as the traditional vanguard of America's security, in addressing the dynamic and ever-changing challenges of defending our homeland.</p>	<p>While DoD has "taken positive steps toward enhancing its ability to promote a greater understanding and cooperation among all DoD Components that are Combating Weapons of Mass Destruction", there is still more to be done. The Department needs to ensure it is effectively organized and staffed to oversee CWMD programs; the lack of a single portfolio manager for CWMD programs significantly hampers the Department's ability to allocate investments across the eight WMD mission areas. Furthermore, to realize national goals in CWMD, DoD will need increased investment in WMD detection, WMD forensics and attribution, and WMD consequence management.</p>
<p>The Department's available resources are finite and require constant monitoring of our abilities and of the world situation to enable the Department to successfully operate on a global scale. The continued operations in Iraq and Afghanistan require a significant commitment of forces. Meanwhile, the advances by the People's Republic of China in modernizing its armed forces and the possibility of nuclear weapons in North Korea and Iran also require constant monitoring. The combination of these various factors continues to challenge the Department.</p>		<p>The Department regularly assesses readiness to meet the demands of the national military strategy. This includes an assessment of our ability to conduct current operations as well as other, simultaneous scenarios. While OIF/OEF does put significant stress on our forces, leadership is routinely advised of situations being monitored globally, and our readiness to respond elsewhere, if needed.</p>

3. Joint Warfighting and Readiness		
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<p>Additionally, the Department is being asked to take on other roles that require different tactics, techniques, and procedures than warfighting operations, often at the same time. In November 2005, the Deputy Secretary of Defense issued DoD Directive 3000.05, which established that stability operations are a core U.S. Military mission to be given priority comparable to combat operations and to be "... explicitly addressed and integrated across all DoD activities including doctrine, organizations, training, education, exercises, materiel, leadership, personnel, facilities, and planning."</p> <p>A National Security Presidential Directive and the National Defense Authorization Act for FY 2006 recognize DoD's role in reconstruction and stabilization efforts. In fact, some of the work being done in Southwest Asia can be considered part of these activities. These programs support Global War on Terror and other national interest areas. The DoD often takes on efforts in these areas, even though they might not be the agency or organization with primary responsibility – because they can. A number of challenges in this area exist. The doctrine must be developed and the difference between reconstruction and stability and warfighting missions must be clearly articulated while at the same time recognizing that the two might be conducted simultaneously. Building and rebuilding the DoD institutions and organizations and developing meaningful doctrine may require significant investment, including the need for the DoD training schools and educational system to address two different missions with different tactics, techniques, and procedures, that more than likely will be executed at the same time and place.</p>		<p>Since the issuance of DoD Directive 3000.5 and NSPD 44, the Department has either led, participated in or supported change initiatives required to conduct stability, security, transition and reconstruction operations. These initiatives have included seeking new Congressional Authorities, launching a new Combatant Command with inherently unique interagency command structure, participating in an interagency crisis planning initiative, assisting in publishing guidelines for military and Non-governmental Humanitarian Organizations (NGHO's) relationships, increasing billet sharing among the department and interagency and creating a department sponsored Consortium for Complex Operations (CCO). Undertaking these initiatives simultaneously has made analytical assessment of any one activity a challenge. That said, the broad front on which the department has engaged SSTR challenges illustrates the commitment to improving the department's capability and capacity to conduct SSTR. The following assessment is provided in the broader categories of SSTR improvements:</p> <p>Authorities. The department has sought and will continue to seek congressional support to build on our force's ability to assist and train partners in the WWar on Terror, build our interagency partner capacity through the development of a Civilian Response Corps (CRC), and expanding the capability of the Commander's Emergency Response Program (CERP).</p> <p>Planning. The department is experimenting with organizational structures in the Combatant Commands in effort to improve interagency communication and integration in campaign planning. These experiments include placing interagency officials in the command organization at the Africa Command headquarters and creating an interagency directorate at Southern Command. The department also participated in the first table top planning exercise using the Interagency Management System (IMS) sponsored by the Department of State. The IMS is designed to respond to complex crises and operations that have been identified as national priorities.</p> <p>Training and Education. The department is becoming more coordinated, integrated and standardized. Though not necessarily the model for all future SSTR missions, the Provincial Reconstruction Teams (PRTs) deployed to Iraq and Afghanistan are prepared in an integrated and coordinated environment. The Department's CCO when operational in the Spring 2008, will serve as a training and education hub to facilitate interagency education sharing.</p> <p>Doctrine. The department has issued a Joint Operational Concept (JOC) for SSTR operations. This is the first step in developing codified doctrine for force wide adaptation. Joint and Service exercises are incorporating SSTR into planning and execution to test and evaluate the JOC. Capabilities Based Assessments (CBAs) are under consideration which will inform force structure requirements in both the general purpose as well as the special operations forces. SSTR assessment will by the nature of the operations which occur during all phases of a campaign, including pre-hostilities, will be iterative and ongoing.</p>

3. Joint Warfighting and Readiness		
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<p>Transformation of logistics capabilities poses a significant challenge to the Department. The Department's transformed logistics capabilities must support future joint forces that are fully integrated, expeditionary, networked, decentralized, adaptable, capable of decision superiority, and increasingly lethal. Additionally, transformed logistics capabilities must support future joint force operations that are continuous and distributed across the full range of military operations. Supply chain management is a challenge for the Department. The Government Accountability Office identified supply chain management as a high-risk area because of weaknesses uncovered in key aspects, such as distribution, inventory management, and asset visibility. It has reported on numerous problems associated with supply chain management such as shortages of items caused by inaccurate or inadequately funded war reserve requirements and DoD's lack of visibility and control over the supplies and spare parts it owns.</p>	<p>The Department has made progress toward meeting its goal of transforming logistics through numerous initiatives. However, that progress is tempered by the sheer magnitude of logistics operations that will continue to make it a long-term challenge. To this goal, the Inspector General has evaluated such areas as inventory management, which remains a challenge within the Department. The Defense Logistics Agency successfully has managed selected items in its own inventory by providing a stable industrial base through a program entitled "Warstopper." These items, critical to the Services' mission, are needed to meet wartime surge requirements, but their peacetime requirements are not sufficient to maintain an industrial capability. Among the items included as warstopper items were nerve agent antidote auto-injectors; chemical protective over-garments and gloves; meals ready-to-eat; tray pack rations; combat boots, including cold weather boots; and barrier materials. The program provides an increased industrial capacity to provide surge and sustainment of selected warstopper items. However, the program also included items that did not fully meet its criteria, resulting in the use of scarce warstopper funds for non-program projects at the expense of higher priority projects. While DoD officials established business rules, defined goals for measuring customer wait time, and reported customer wait time metrics from 2001 to 2005, the metrics did not allow DoD officials to effectively measure the link between customer wait time and operational availability of equipment. Consequently, officials do not know how the customer wait time for high priority items will affect operational readiness.</p>	<p>The DoD supply chain is undergoing a significant transformation. Joint and Service logistics capabilities must support a joint force that is fully integrated, expeditionary, networked, decentralized, and adaptable. Without a coordinated and holistic approach, progress towards transforming the DoD Supply Chain will continue to be tempered by the sheer magnitude of logistics operations. Services must strive to fully integrate and synchronize the DoD Supply Chain by achieving unity of effort, JLE-wide visibility, and rapid/precise response to better generate and sustain joint readiness. The Services are engaged in numerous transformation efforts to enhance and better coordinate their efforts such as BRAC, Air Force eLog-21, Marine Corps MLI, USTRANSCOM Distribution Process Owner, OSD and Joint Staff's DoD Joint Supply Chain Architecture efforts.</p>
<p>The Department also faces a challenge in meeting its goal to reduce preventable accidents. Accidents not only reduce readiness through lost man-hours and the unavailability of personnel but are estimated to cost the Department approximately \$25 billion a year, not to mention the human suffering that is the most regrettable consequence of accidents. In March 2004, the Secretary challenged Department managers to reduce accidents 75 percent by 2008. In May 2007, the Secretary recommitted to the 75 percent accident reduction target and stated a goal of zero preventable accidents. The challenge for the Department is to make safety an institutional value. Responsibility for environment, safety, and health policy is dispersed throughout the Department.</p>	<p>Reducing preventable accidents remains a challenge for the Department. Based on current trends, the Department is unlikely to achieve the Secretary's target of reducing accidents by 75 percent. The Defense Safety Oversight Council, established in June 2003 to facilitate oversight of the Department's efforts to achieve the Secretary's goal, has established eight task forces to address near-term issues and produce rapid results. The council is encouraging Service participation and partially funding Department-wide adoption of the Voluntary Protection Program, an Occupational Health and Safety Administration-developed program designed to stress prevention activities.</p>	<p>The Department continues to strive towards reducing accidents and meet the SecDef 75% mishap reduction goals from the baseline of 2002. The Defense Safety Oversight Council (DSOC) monitors mishap metrics on a regular basis with specific focus on: civilian lost day rates, private motor vehicle (PMV) accident fatality rates, military injury case rates and aviation Class A rates. To date, the Department has shown improvements in all areas with the exception of military injuries, which show a 20% increase. This increase may be attributable to improved reporting procedures and DSOC routinely re-validates the data. Civilian lost day rates have shown a 29% reduction, PMV 20%, and aviation Class A with a 25% reduction. The Department has seen these improvements in mishap rates despite the increased exposure to risk due to increased training, deployments, and OPTEMPO in inherently dangerous environments. Further improvements may be gained through continued leadership commitment, coordinated efforts between the DSOC and the functional organizations, and investments in safety technologies and safety training.</p>

4. Information Assurance, Security and Privacy		
A. IG Summary of the Challenge	B. IG Assessment of Progress	C. Management's Response
<p>Ensuring that a robust information assurance and security program is in place is still a challenge to the Department. Such a program includes periodic risk assessments; security awareness training; security policies, procedures, and practices, as well as tests of their effectiveness; procedures for addressing deficiencies and for detecting, reporting, and responding to security incidents and privacy data breaches; and ensuring the continuity of operations.</p> <p>The Department also faces the challenge of ensuring that privacy protections are not compromised by advances in technology. One of the major challenges identified last year was protection of DoD information in the hands of contractors and the appropriate response to data breaches involving both privacy protected data, such as personally-identifiable information, and sensitive but unclassified information, such as contractor proprietary information.</p>	<p>The Department made little improvement during the course of FY 2007 in its information assurance and security posture. Unresolved issues now are exacerbated by the recent losses of privacy and sensitive but unclassified data, and the lack of clear DoD policy regarding protection of such data and the reporting of incidents regarding its compromise. Of particular concern is protection of DoD information in the hands of contractors, to include all members of the Defense Industrial Base (DIB). The Department has recognized these challenges and initiated cooperative efforts with the Directors of National Intelligence and the National Institute of Standards and Technology. These efforts establish a common set of information security controls, risk management framework, and security certification and accreditation process that can meet the needs of federal agencies managing and operating both national security and non-national security systems. Additionally, it has initiated outreach efforts to members of the Defense Industrial Base to improve identification of and response to instances of data breaches pertaining to DoD information in the hands of contractors. These efforts should be expanded and accelerated.</p>	<p>The Department has moved aggressively to address DIB information assurance (IA) vulnerabilities. Beginning in April 2007, DoD working groups developed a strategy to address DIB IA that was presented to the Deputy Secretary of Defense (DSD) in July.</p> <p>At DSD direction, DoD reached out to industry under the DIB sector coordinating committee of the Critical Infrastructure Partnership Advisory Council (CIPAC) and has developed a concept of operations for threat information sharing, incident reporting and response and damage assessments. In addition, the CIPAC DIB working groups have developed an IA standard built on guidance published by the National Institute of Standards and Technology. This DoD/industry effort is working under an aggressive schedule to implement changes needed to address IA in the DIB.</p> <p>The Department also is publishing updated guidance that explicitly addresses certification and accreditation of information systems operated by contractors on behalf of the Department, as required by the Federal Information Security Management Act of 2002. Additionally, in July 2007 the Department issued a policy memorandum requiring that all unclassified DoD information not cleared for public release that is stored on mobile computing devices (e.g., laptops) or removable storage media (e.g., thumb drives) be encrypted. The policy applies to supporting contractors as well as DoD organizations.</p> <p>In May 2007, DoD revised and reissued the DoD Directive and Regulation, both entitled DoD Privacy Program. In those documents specific requirements were established to ensure the protection of personally identifiable information (PII) throughout the DoD including applicability to contractors. The regulation described specific reporting requirements to agency heads, the Defense Privacy Office and the US-Computer Emergency Response Team at the Department of Homeland Security. The requirement to notify individuals of the loss, theft or compromise previously directed by a DEPSECDEF Memo dated July 15, 2005 was incorporated into the regulation and included a sample notification letter.</p> <p>In May 2007, OMB issued a memorandum "Safeguarding Against and Responding to Breaches of Personally Identifiable Information" requiring establishment of new policies to address safety and security measures to instill safeguards to prevent a breach. While DoD has adopted policies in many of the areas addressed, new requirements were established to augment, and thereby strengthen current agency policies.</p> <p>The OMB Memo included new requirements to inform and train persons with access to PII. New training policies include specific focused training to managers as well as others in the workforce as a prerequisite to system/network access, and annual refresher training followed by signed certification of awareness by individuals.</p> <p>Agencies were directed to review and reduce the volume of PII. DoD components were required to establish plans for the systematic review of holdings of PII to determine that such holdings are accurate,</p>

4. Information Assurance, Security and Privacy		
A. IG Summary of the Challenge	B. IG Assessment of Progress	C. Management's Response
		<p>relevant, timely, and complete, and to reduce them. Agencies were directed to review and reduce the volume of PII. DoD components were required to establish plans for the systematic review of holdings of PII to determine that such holdings are accurate, relevant, timely, and complete, and to reduce them to the minimum necessary. Also included was direction to reduce the use of the Social Security number when found to be unnecessary. Plans for addressing these reviews were incorporated in the annual reporting requirement of the Federal Information Security Management Act for 2007 and are ongoing.</p> <p>The DoD established and published new privacy policy for compliance by the DoD Components with the OMB Memo in a September 21, 2007 Memo signed by the Director of Administration and Management. The new policies are applicable to all DoD personnel including contractors and business partners.</p> <p>The DoD has taken constructive steps through the development of new policies and reporting requirements to safeguard PII in its possession to prevent loss, theft or compromise. With these new policy initiatives and increased individual and organization awareness, safeguarding and protection of PII and other sensitive information to prevent loss, theft or compromise will continue to improve.</p>

5. Health Care		
A. IG Summary of the Challenge	B. IG Assessment of Progress	C. Management's Response
<p>The DoD Military Health System must provide quality care for approximately 9.1 million eligible beneficiaries within fiscal parameters while facing growth pressures, legislative imperatives, and inflation that make cost control difficult in both the public and private sectors. The DoD challenge is magnified because the Military Health System's primary mission is to provide health care support for the full range of military operations. Part of the challenge in delivering health care is combating fraud. Health care fraud is among the top five categories of criminal investigations; currently representing approximately 8 percent of the open cases of the Defense Criminal Investigative Service. A major challenge to the Department is sufficient oversight of the growing cost of health care for its beneficiaries. The increased frequency and duration of military deployment further stresses the Military Health System in both the Active and Reserve Components. The DoD budget for health care costs was approximately \$40 billion in 2007, including \$21.9 billion in the Defense Health Program appropriation, \$6.5 billion in the Military Departments' military personnel appropriations, \$0.4 billion for military construction, and \$11.2 billion for contributions to the DoD Medicare-Eligible Retiree Health Care Fund to cover future costs of health care for Medicare-eligible retirees, retiree family members, and survivors. Increasing health care benefits provides additional pressure to manage and contain costs. The Department is scheduled to transition to the next generation of TRICARE contracts during FY 2008.</p>	<p>The DoD Military Health System has been moving forward on improving health care while attempting to control costs. The Military Health System has made progress in implementing new TRICARE contracts. The current contracts provide incentives for customer satisfaction and include the managed care support contractors as partners in support of medical readiness. The Military Health System continues to work with the contractors to refine the contracts with the ultimate goal of improving readiness and the quality of care. Lessons learned are being used to implement the next set of contracts, with formal acquisition scheduled to commence this fall when the request for proposals will be issued. It appears unlikely that DoD will obtain authority on the use of federal ceiling prices for pharmaceuticals in the near future, a process that would allow the Military Health System to realize millions of dollars in savings annually in pharmacy costs. However, DoD is making headway in economizing on pharmacy costs by implementing use of generic drugs and promoting use of the TRICARE Mail Order Pharmacy system.</p> <p>The Medical Readiness Review has been completed. It was created to assess the baseline medical capabilities required to support the warfighter during peacetime and to assess the surge capabilities required for wartime. The Review evaluated medical personnel currently available, the cost of those personnel, and strategies necessary to supply those capabilities. It also reviewed wartime medical force requirements and compared those requirements to the current force structure, looking for gaps and redundancies. The Review recommended aligning medical support with the growing movement</p>	

5. Health Care		
A. IG Summary of the Challenge	B. IG Assessment of Progress	C. Management's Response
<p>The Department's challenge is how to oversee the growing cost of health care for military members and to effectively transition to the next generation of TRICARE contracts.</p> <p>Maintaining medical readiness continues to be a challenge. Readiness of the medical staff and units includes ensuring that medical staff can perform at all echelons of operation and that the units have the right mix of skills, equipment sets, logistics support, and evacuation and support capabilities. The challenge of keeping reservists medically ready to deploy continues because of the frequency and duration of Reserve deployments. In addition, transitioning wounded, ill, or injured Service members to post-deployment care will continue to grow as a challenge while the Global War on Terror, Operation Iraqi Freedom, and Operation Enduring Freedom continue.</p> <p>As with most Department functions, the Military Health System continues to face the challenges of increased joint operations. For example, the number of wounded warriors associated with Southwest Asia and other such conflicts significantly impacts the health care resources within the Department and can result in such issues as the conditions that were raised at Walter Reed Army Medical Center. And another related challenge to medical readiness are the issues inherent in providing efficient processes for post-deployment health care and benefits to severely injured and ill Service members. The Department needs to improve the medical care and benefits transition program to achieve a streamlined, transparent process as wounded warriors move from the DoD system to the Department of Veterans Affairs' system.</p> <p>Information assurance relating to sensitive medical information continues to be a challenge in the health care community. Episodes of potential exposure of electronic patient information during the year demonstrate the challenge to maintain security and privacy. Also, expanding automation efforts, including the transition from paper to electronic patient records, increases the exposure of sensitive patient information to inadvertent or intentional compromise. Maintaining information operations that ensure the protection and privacy of data will continue to grow as a challenge.</p>	<p>toward joint capabilities and recommended improving the medical planning process. The policies, techniques, and tools developed during the Review are now being imbedded within the system to determine future optimal force structure in a constantly changing threat environment. The DoD continually will reassess the results of the Review against the ever changing and expanding medical missions facing the Department at war and in support of homeland security contingency planning.</p> <p>Disparities in the transition of health care and benefits are easily identified, yet actionable solutions are difficult to implement and streamline. On a positive note, DoD's response to Traumatic Brain Injury and mental disorders, such as Post Traumatic Stress Disorder, is improving significantly—but much effort still is required to help Traumatic Brain Injury patients.</p> <p>The Department established the Force Health Protection Quality Assurance Program to ensure that the health of Service members, as well as applicable DoD civilian and contractor personnel, is monitored, protected, sustained, and improved effectively across the full range of military activities and operations. Although the Military Health System has tools available for commanders to screen those pre-deployed, deployed, and post-deployed, and to assist the deployed reservists' and guardsmen's family members, the challenge of preparing reservists and guardsmen medically for deployment will go on as the Global War on Terror, Operation Iraqi Freedom, and Operation Enduring Freedom continue.</p> <p>Recent reports in the press on problems associated with post-deployment transition to care for wounded Service members has resulted in many reviews internal and external to the DoD including the President's Commission on Care for America's Returning Wounded Warriors. The President's Commission made several recommendations focusing on ways to better serve the multiple needs of injured service members and their families; better support the wounded warriors in their recovery and return to military duty or their communities; and simplify the delivery of medical care and disability programs. In addition, the Congress provided \$300 million for research and \$600 million for care of trauma and serious injuries, including traumatic and other brain injuries. Implementing the recommendations resulting from the reviews will be core to the Department's business this coming year.</p> <p>The DoD continues to progress in sharing electronic medical records with the Department of Veterans Affairs. Under the auspices of the American Health Information Community, the DoD and the Department of Veterans Affairs are partnering on building a Joint Inpatient Record to complement existing outpatient records systems.</p>	
<p>Implementing recommendations resulting from the 2005 Base Realignment and Closure process will continue to be a challenge for the near future. In addition to improving the readiness and cost efficiency associated with realigning base structure, a primary objective of the process was to examine and implement opportunities for greater joint activity among the Military Departments.</p>	<p>The Military Health System is facing a major challenge in overseeing the implementation of the 2005 Base Realignment and Closure recommendations and has begun the multi-year transition and acquisition process of improving capability and access to care in two major and several minor markets. Realignment recommendations for the National Capital Area and San Antonio regional markets are examples of DoD's efforts to exploit joint medical opportunities as they transition to new facilities.</p> <p>Additionally, the Military Health System is ready to</p>	<p>Consistent with BRAC law and the 2005 Quadrennial Defense Review (QDR) Medical Roadmap, DEPSECDEF has established a Joint Task Force to (1) ensure the effective and efficient delivery of world-class military healthcare within the NCR Tricare Sub-region (JOA) using all available military healthcare resources within this JOA, and (2) oversee the consolidation and realignment of military healthcare within the JOA in accordance with the BRAC.</p>

5. Health Care		
A. IG Summary of the Challenge	B. IG Assessment of Progress	C. Management's Response
	embark on a change in governance. The Department completed various studies of a unified medical command. Using those studies and recommendations made by the Defense Business Board, the Department decided on an incremental approach to increasing joint governance. The Department is exploring the opportunities provided by the 2005 Base Realignment and Closure recommendations as well as establishing a joint medical education and training center. In addition, the Department also is looking into bringing support functions such as finance, logistics, information technology, facilities, human capital management, and medical research and development under joint governance in a combined headquarters. These functions would serve as corporate assets and the Military Health System could potentially enhance medical readiness while gaining efficiency and economy of scale.	

Summary of Financial Statement Audit and Management Assurances

The Federal Managers' Financial Integrity Act (FMFIA) requires Federal agencies to assess the effectiveness of internal management controls for program, operational, and administrative areas as well as accounting and financial management. Internal management controls are the organization, policies, and procedures that are considered the tools that help program and financial managers achieve results and safeguard the integrity of their programs. The program strengthens integrity and accountability within programs and operations, and:

- Is critical for good government
- Demonstrates responsible stewardship over assets and resources
- Promotes high-quality, responsible leadership
- Enhances the sound delivery of services to customers
- Maximizes desired program outcomes.

The Department conducts its assessments of the internal management controls under a formalized program conducted throughout the Department to include forward-deployed units such as the Multi-National Forces - Iraq. Using assessments according to the Office of Management and Budget Circular A-123, "Management's Responsibility for Internal Control," as the basis, the Department prepared the FY 2007 Annual Statement of Assurance (presented in the Management's Discussion and Analysis section of this report). The Department asserts that all Components have reported to the Secretary their individual statements of assurance over internal control.

The Department's internal control program is divided into two main processes:

1. The overall statement of assurance that covers the effectiveness of internal management controls for all functions and processes except for the financial reporting.
2. The statement of assurance over financial reporting which covers the effectiveness of internal management controls as prescribed by Appendix A of Circular A-123.

The Department has 34 entities required to report including (3) Military Departments, (9) Combatant Commands, (1) Joint Staff, (1) Office of the Secretary of Defense, (1) Office of the Inspector General, (18) Defense Agencies, and (1) Department Financial Reporting Senior Assessment Team. Components are required to conduct a robust programmatic approach to establishing and assessing internal management controls for the overall operations with the Component heads annually providing assurance to the Secretary of Defense. Only specified Components are also required to include financial reporting assurance. The Department uses these feeder statements as the basis for the Department's Statement of Assurance. The Department has dramatically reduced the number of outstanding material weaknesses since fiscal year 2001, by 84 percent from 116 material weaknesses to 19 in fiscal year 2007. The percentage of material weaknesses resolved rose from 21% in fiscal year 2006 to 34 percent in fiscal year 2007.

The Department reports several types of weaknesses. Table 1 shows the material weaknesses in financial statement reporting as identified by the Department of Defense Inspector General, who audits the annual financial statements. Table 2 shows management self-identified material weaknesses. Table 2a identifies financial reporting weaknesses, Table 2b identifies overall material weaknesses, and Table 2c identifies system nonconformances identified by the Department through its internal control process.

Details about each weakness are presented in expanded tables available at <http://www.defenselink.mil/comptroller/afr/fy2007/fy07afrsection3fmfia.pdf>. Table 2d summarizes the Department's compliance with the Federal Financial Management Improvement Act of 1996.

The Department-identified weaknesses fall into three categories:

- Section 2 Financial Reporting Material Weaknesses:** Financial reporting material weaknesses are identified as materially affecting the Department's financial reporting identified under the oversight of the DoD Senior Assessment Team during the limited assessment of internal controls over financial reporting. The Department is using an incremental approach in complying with OMB Circular A-123, Appendix A. In fiscal year 2007, the assessments conducted include: fund balance with Treasury, investments, accounts receivable, inventory and operating materials and supplies, real property, military equipment, accounts payable, Federal Employees' Compensation Act Liabilities, environmental liabilities, Medicare-eligible Retiree Health Care Liabilities, and appropriations received.
- Section 2 Overall Operations Material Weaknesses:** Overall operations material weaknesses materially affect internal management controls usually affecting multiple Department Components for all functions except financial reporting weaknesses unless those financial weaknesses were identified through assessments which were not under the oversight of the

Department's Senior Assessment Team. At this time, only one material weakness, general personal property, is functionally part of the financial reporting, but it is included in the overall material weakness category because the assessment did not fall under the oversight of the Senior Assessment Team.

- Section 4 System Nonconformance Material Weaknesses:** System nonconformance material weaknesses are identified as systems that nonconform with Government-wide requirements such as the Federal Financial Management Improvement Act as prescribed by OMB Circular A-127, "Financial Management Systems." The Department is reporting one weakness that covers the entire pervasive problems identified with system nonconformance.

DoD Reportable Conditions are weaknesses identified as materially affecting only one Department Component unless the weakness is so pervasive that it is deemed material to the Department as a whole. Reportable conditions, as prescribed in the OMB Circular A-123, are not reported in the Statement of Assurance, but are tracked internally for correction. The Department is reporting five material weaknesses in overall operations as being reassessed to reportable conditions in fiscal year 2007.

The tables below summarize the results of the fiscal year 2007 financial statement audit and the results of management's assessments of the Department's internal control process. Links in tables 2b, 2c, and 2d will take you to specific details on each weakness.

Table 1. Summary of Financial Statement Audit

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

¹ In accordance with OMB guidance, the Statement of Financing is a note to the financial statements, Reference Note 21.

Table 2. Summary of Management Assurances

Table 2a. Summary of Management Assurances							
Effectiveness of Internal Control over Financial Reporting (FMFIA Section 2)							
Statement of Assurance	No Assurance						
Material Weaknesses (information deemed necessary for clarification)	Ref Table 1	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
1) Valuation of Property Plant and Equipment -Military Equipment	11	1					1
2) Real Property Assets	11	1					1
3) Environmental Liabilities	3	1					1
4) Health Care		1					1
5) Fund Balance with Treasury (includes reported problems with unsupported accounting entries)	10 & 2	1					1
6) Accounts Receivable	13		1				1
7) Inventory Valuation	12		1				1
8) Operating Materials and Supplies	6		1				1
9) Accounts Payable (includes reported problems with eliminations)	1 & 5		1				1
Total Financial Reporting Material Weaknesses		5	4	0	0	0	9

Table 2b. Summary of Management Assurances							
Effectiveness of Internal Control over Overall Operations (FMFIA Section 2)							
Statement of Assurance	Qualified						
Overall Material Weaknesses (information deemed necessary for clarification)	Ref Table 1	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
1) Ending Balance Adjustments at Defense Finance and Accounting Service		1		1			0
2) Accounts Receivable Noncompliance at Defense Finance and Accounting Service		1		1			0
3) Foreign Military Sales Authority (consolidated into Overall Operations Material Weakness #19)		1			1		0
4) Unsupported Adjustments at Defense Logistics Agency (consolidated into Financial Reporting Material Weakness #9)		1			1		0
5) Joint Training Exercises		1		1			0
6) Pharmaceuticals		1		1			0
7) Engineering Plan		1		1			0
8) Civilian Premium Payment		1		1			0
9) Information Technology Capital Implementation		1		1			0
10) Systems Acquisition Program (consolidated into Overall Operations Material Weakness #27)		1			1		0
11) Status of Funds (reassessed as a DoD Reportable Condition)		1				1	0
12) Planning Program (reassessed as a DoD Reportable Condition)		1				1	0
13) Force Readiness		1		1			0
14) Program Inefficiencies		1		1			0
15) Inaccurate Accountability of Equity (reassessed as a DoD Reportable Condition)		1				1	0

Table 2b. Summary of Management Assurances							
Effectiveness of Internal Control over Overall Operations (FMFIA Section 2)							
Statement of Assurance	Qualified						
Overall Material Weaknesses (information deemed necessary for clarification)	Ref Table 1	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
16) Lack of Policy (reassessed as a DoD Reportable Condition)		1				1	0
17) Foreign Military Sales Export Controls		1		1			0
18) Foreign Language Inadequacies (reassessed as a DoD Reportable Condition)		1				1	0
19) Department of Defense Financial Management Systems and Processes (includes reported problems with unsupported accounting entries, reconciliation of net costs of operations to budget, and unauditible financial statements)	2,7,8, & 9	1					1
20) Management of Information Technology and Assurance		1					1
21) Personal Property (General Personal Property which includes reported problems with the cost of DoD property and material in the possession of contractors)	11 & 4	1					1
22) Personnel Security Investigations		1					1
23) Real Property Infrastructure		1					1
24) Government Card Program		1					1
25) Inventory Valuation (reassessed and moved to DoD Financial Reporting Material Weakness # 7)		1				1	0
26) Non-Department of Defense Contracts		1		1			0
27) Contracting		1					1
28) Procurement Reporting		1		1			0
29) Accounts Payable (reassessed and moved to DoD Financial Reporting Material Weakness # 9)		1				1	0
30) Procurement Data			1				1
31) Interagency Acquisition and Potential Anti-Deficiency Act Violations			1				1
Total Material Weaknesses for Overall Operations		29	2	12	3	7	9

Table 2c. Summary of Management Assurances							
Conformance with Financial Management System Requirements (FMFIA Section 4)							
Statement of Assurance	No Assurance						
Material Weaknesses (information deemed necessary for clarification)	Ref Table 1	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
1) Department of Defense Financial Management Systems and Processes (includes reported problems with unsupported accounting entries, reconciliation of net costs of operations to budget, and unauditible financial statements)	2,7,8, & 9	1					1
Total System Conformance Material Weaknesses		1	0	0	0	0	1
Total FMFIA Weaknesses		35	6	12	3	7	19

	Agency	Auditor
Overall Substantial Compliance	No	No
1. System Requirements	No	No
2. Accounting Standards	No	No
3. U.S. Standard General Ledger at Transaction Level	No	No

✓CHECK IT

The Department of Defense leadership is keenly aware and actively involved in helping its managers and employees understand that effective internal management controls are important to getting the job done right. The Department reminds its personnel that the Defense mission cannot be accomplished by the warfighters alone; everyone has a job to do, and every job is important. Internal management controls help ensure that what should happen does happen on a daily basis, but first internal management controls must be in place, effective and used. To help draw the attention of the approximately 2.9 million employees in more than 140 countries, the Deputy Secretary of Defense kicked off an awareness campaign known as, the Check It Campaign. The slogan states, “Check It. What gets checked, gets done.”

Details about the campaign may be found at http://www.defenselink.mil/comptroller/micp/03_check_it_campaign/index.html

Improper Payments Information Act Reporting

The Improper Payments Information Act (IPIA) of 2002, as implemented by the OMB Circular A-123, Appendix C, “Requirements for Effective Measurement and Remediation of Improper Payments,” requires federal agencies to review all programs and activities annually and identify those that may be susceptible to significant erroneous payments. The Department’s FY 2007 review did not identify any programs or activities at risk of significant erroneous payments in accordance with OMB criteria (programs with erroneous payments exceeding both \$10 million and 2.5% of program payments). However, based on the large volume of transactions or high dollar amounts, the following five programs are reportable in FY 2007: (1) Military Health Benefits, (2) Military Pay, (3) Civilian Pay, (4) Military Retirement, and (5) Travel Pay. Improper payment estimates for these programs are presented in the table below. Additionally, Commercial Pay information is included in Section V, Recovery Audit.

FY 2007 Estimated Improper Payments
(dollars in millions)

Program	Estimated \$	Estimated %
Military Health Benefits	\$ 156	2.00 %
Military Pay	\$ 370	0.51 %
Civilian Pay	\$ 75	0.26 %
Military Retirement	\$ 49	0.13 %
Travel Pay	\$ 44	1.00 %

I. Risk Assessment

The Department’s risk assessments for each of the programs identified above addressed the effectiveness of internal

controls in place to prevent improper payments (such as prepayment reviews) as well system weaknesses identified internally or by outside audit activities. While the Department’s improper payment percentages are extremely low, numerous pre- and post-payment controls further minimize and eliminate improper payments. The following paragraphs summarize the processes in place and the results of survey assessment reviews.

II. Statistical Sampling Process

The Department uses random sampling methods designed to meet or exceed the OMB requirement of annual estimates of improper payments with a 90% confidence interval (plus or minus 2.5%). Details on these sampling processes can be found at <http://www.defenselink.mil/comptroller/afr/fy2007/FY07AFRSection3IPIA.pdf>.

III. Corrective Action Plans

(1) Military Health Benefits. The Department’s contracts have had payment performance standards for military health benefit claims processing in place for many years. Overpayments found in the audit process are projected to the audit universe, and the managed care support contractor is liable for the total amount. This contractual design, combined with numerous prepayment and post-payment controls which effectively minimize improper payments, helps to ensure the Government is not at risk for improper payments in military health benefit payments. Additional discussion of these controls can be found at <http://www.defenselink.mil/comptroller/afr/fy2007/FY07AFRSection3IPIA.pdf>.

(2) Military Pay. Reviews of military pay accounts for FY 2007 resulted in projected improper payments of an estimated \$292 million (.4% of approximately \$73 billion in total military net pay). The majority (approximately \$271 million) are attributable to the Reserve and Guard Components, due to inaccurate and untimely reporting of entitlement data to the automated pay system. The two most significant reporting discrepancies involve leave accountability (Lump Sum Leave payments) and Basic Allowance for Housing. A special review and subsequent data extract of Active Duty in-service collections performed at the recommendation of the IG revealed approximately \$78 million in additional improper payments. Therefore, the total improper payment estimate for military pay, including Active Duty collections and adjusting sample results to preclude over-estimation, is approximately \$370 million (.51%) of net pay.

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

(3) Civilian Pay. Reviews indicate improper payments have decreased in civilian pay over recent years; however, efforts to identify and reduce actions contributing to net pay errors continue. For FY 2007, civilian pay account reviews project an estimated \$7.1 million (.02%) in annual improper payments out of approximately \$29 billion in net pay to civilian employees. However, based on findings from the special review of military pay collections, a similar review was conducted for civilian pay accounts. This special review and subsequent data extract of civilian in-service collections revealed approximately \$68 million in additional improper payments. Therefore, the total improper payment estimate for civilian pay, including collections and adjusting sample results as needed to prevent over-estimation, is approximately \$75 million (.26%) of net pay. The improper payments that resulted in collection actions are primarily attributed to untimely and inaccurate reporting of time and attendance, personnel actions, and pay allowances. The Pay and Personnel Council serves as a forum to address civilian pay problem areas and seek methods to mitigate risks and reduce improper payments. Civilian pay metrics and corresponding accuracy and timeliness goals have been developed at the Component level and serve as a baseline for corrective action plans.

(4) Military Retirement. Payments to deceased retirees continue to be the highest risk for improper payments in military retired pay. Based on FY 2007 reviews, the Department projected approximately \$49 million in improper payments for this program, with almost the entire amount paid to deceased retirees. This represents an overpayment rate of .13% of the estimated \$37 billion in annual military retirement payments. In certain situations, payment to deceased retirees is unavoidable due to payment cycle dates and the fact that notifying a payroll activity is not likely to be the first action for next-of-kin at the time of a retiree's passing. A review of confirmed payments to deceased retirees in FY 2007 indicated that the Department recovered 93% of the overpayment amounts within 60 days, demonstrating the effectiveness of controls within the retired pay system once a retiree's death confirmation is received and processed for final disposition.

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

(5) Travel Pay. The Department performs monthly random post-pay reviews of the Defense Travel System (DTS) and regularly reports the results to management. Reports address accuracy rate trends, over- and underpayment dollar amounts, reasons for errors, and recommendations for corrective actions to alleviate similar errors in the future. Results from reviews of trip records performed during FY 2007 revealed an estimated \$22 million (.91%) in improper payments out of a travel settlement population value of \$2.4 billion in DTS disbursements.

The Air Force's reviews of Reserve Travel System (RTS) vouchers for FY 2007 resulted in an estimate of \$19 million (1.6%) in improper payments out of \$1.2 billion in total payments for the year. Erroneous payments identified in RTS are sent to the appropriate Air Force bases for corrective actions (including collections or supplemental payments). The Air Force bases confirm corrections are completed. Also, a report of commonly identified errors is sent to all Air Force bases as a training tool. In the future, the Air Force plans to process all vouchers through DTS.

The other Active Duty Components (Army, Navy, and Marine Corps) primarily use the Integrated Automated Travel System (IATS) for travel payments not processed through DTS. Army payments are centrally processed through IATS with the exception of two offices that process a limited amount of travel payments. In FY 2007, Army IATS payments were reviewed against DTS payments to identify any duplicate payments between the two systems. The Department is implementing a sampling and review process for Army IATS in FY 2008 that meets the improper payment reporting requirements. Additionally, the Department is working with Navy and Marine Corps to ensure an adequate sampling and review process is developed and implemented in FY 2008 for their travel payments processed outside DTS. It is worth noting, however, that DTS implementation recently has been expanding exponentially throughout the Department. As DTS functionality expands, Components will continue transitioning away from the legacy systems.

Reviews of travel payment vouchers settled outside DTS for the U.S. Army Corps of Engineers (USACE) in FY 2007 resulted in approximately \$770 thousand (.5%) in improper payments out of approximately \$166 million in annual payments. The majority of these improper payments are due to traveler input errors and the failure of approving officials to properly review the voucher prior to payment. During FY 2007, all travel approving officials completed certification training. Additionally, the audit function will be consolidated at the USACE Finance Center in FY 2008. This should ensure greater consistency and accuracy in the audit of temporary duty travel vouchers.

IV. Program Improper Payment Reporting

The following table summarizes the Department’s improper payment reduction outlook and total program outlays (payments) from FY 2006 through FY 2010.

Improper Payment Reduction Outlook

Program	FY 2006			FY 2007			FY 2008 Estimated			FY 2009 Estimated			FY 2010 Estimated		
	Outlays (\$ B)	IP (%)	IP (\$ M)	Outlays (\$ B)	IP (%)	IP (\$ M)	Outlays (\$ B)	IP (%)	IP (\$ M)	Outlays (\$ B)	IP (%)	IP (\$ M)	Outlays (\$ B)	IP (%)	IP (\$ M)
Military Health Benefits (Notes 1-4)	\$8.7	0.96	\$83.5	\$7.8	2.0	\$156.0	\$8.9	2.0	\$178.0	\$9.4	2.0	\$188.0	\$8.9	2.0	\$178.0
Military Pay (Notes 5)	\$72.4	0.09	\$65.9	\$72.9	0.51	\$370.0	\$75.7	0.46	\$349.6	\$68.4	0.46	\$314.6	\$69.7	0.45	\$313.4
Civilian Pay (Notes 6-7)	\$33.2	0.05	\$16.7	\$29.2	0.26	\$74.6	\$29.7	0.25	\$73.8	\$30.8	0.24	\$73.0	\$31.8	0.23	\$72.3
Military Retirement	\$35.9	0.14	\$49.4	\$37.1	0.13	\$48.7	\$39.6	0.13	\$51.2	\$41.3	0.13	\$51.9	\$42.9	0.12	\$52.3
Travel Pay (Notes 8-9)	\$5.2	0.80	\$29.4	\$5.8	1.00	\$43.6	\$6.8	1.00	\$68.0	\$6.8	1.00	\$68.0	\$6.8	1.00	\$68.0

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

Accompanying table notes can be found at <http://www.defenselink.mil/comptroller/afr/fy2007/FY07AFRSection3IPIA.pdf>.

V. Recovery Auditing Reporting

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

Recovery Auditing. The Department maintains an extensive post-payment process for identifying improper payments. This process utilizes post-payment review techniques performed both internally and by recovery auditing contractors paid from the proceeds actually recovered. Agency-wide commercial payments result in a large volume of transactions and high dollar values, so DoD maintains vigilance to ensure payment accuracy, using various manual and automated prepayment initiatives to prevent over- and underpayments.

Commercial pay overpayments identified for recovery are attributable primarily to internal recovery audit efforts and other means (including contract reconciliation and statistical sampling). Selected high dollar value payments are reviewed manually, and periodic independent reviews of commercial payments improve improper payment detection, correction, and prevention efforts.

The Department's Mechanization of Contract Administration Services (MOCAS) system, used for contract payments, processed 59% of the \$320 billion in DFAS commercial pay disbursements for FY 2007. Reviews of this system accounted for 69% (\$232.8 million) of the total \$338.4 million in improper commercial payments identified by DFAS for FY 2007. Over half of this total was underpayments. The Department disbursed approximately \$174 million in FY 2007 and \$210 million in FY 2006 to correct the identified underpayments. For FY 2006 and FY 2007, MOCAS system reviews identified \$66.2 million

in improper overpayments, of which \$59.2 million has been recouped. The Department also recouped \$18.6 million in commercial overpayments through contract recovery audits since 1996.

In addition to the amounts identified through recovery efforts, voluntary refunds received in FY 2006 and FY 2007 accounted for approximately \$125 million in collections. The DFAS continues to work with the Defense Agencies to improve the unsolicited refund process through improved identification and classification of the root causes of improper payments and take appropriate preventative actions.

The Department also has utilized a recovery audit contractor to identify for recapture overpayments made to hospitals that failed to submit amended cost reports from calendar years 1992 through 1997. These reviews have helped to recoup almost \$23 million in overpayments.

The Department has recovered \$30 million (99.9%) of the overpayments identified by the USACE during FYs 2004 through 2007. These recoveries are a result of reviews of payments, as well as vendor voluntary refunds. The two programs with the most identified overpayments pertain to military leases and utility payments. The USACE manages the Military Lease Program for all military services. When leased property is sold or leases are terminated without timely notifications, extra payments may be made. The USACE helps correct the error and notifies the Military Service. The USACE also manages the utility payments for the Department. When there is a merger or acquisition of utility companies, payments may be made before USACE is aware of changes to the payee information. To reduce the likelihood of these errors, USACE monitors the news for pending/new acquisitions and mergers of utility companies.

Recovery Audit Activity (amounts in millions)	Departmental Recovery Audit Totals (Note 1)	DFAS Agency-wide Commercial Payments (Note 2)	Military Health Benefits Recovery Audit Contractor
Amount Subject to Review for FY 2007 Reporting	\$189,300	\$189,300	\$0
Actual Amount Reviewed and Reported (FY 2007)	\$189,300	\$189,300	\$0
Overpayment Amounts Identified for Recovery (FY 2007)	\$24.6	\$24.6	\$0
Amounts Recovered (FY 2007)	\$19.6	\$18.9	\$0.7
Overpayment Amounts Identified for Recovery (Prior Years)	\$65.9	\$41.6	\$16.1
Amounts Recovered (Prior Years)	\$69.6	\$40.6	\$20.8
Cumulative Amounts Identified for Recovery (FY 2007 and Prior)	\$90.5	\$66.2	\$16.1
Cumulative Amounts Recovered (FY 2007 and Prior)	\$89.2	\$59.5	\$21.5

Note 1: The Department recovery audit totals include \$8.2 million in prior year recoveries (\$6.3 million in FY 2004 and \$1.9 million in FY 2005) from a recovery audit contract that concluded in FY 2005.

Note 2: The \$189.3 billion represents the total dollar value of disbursements (payments) in the MOCAS system, which includes 59% of the dollars disbursed by DFAS for commercial pay. There were \$59.1 million in overpayments and \$173.7 million in underpayments reported for MOCAS. Underpayments are not subject to recovery action. In accordance with IG recommendations, the identified recoveries do not include voluntary repayments of overpayments from vendors (these amounts were included in reporting in prior years). Cumulative amounts reflect totals from FYs 2006 and 2007, since detailed information on collections by type (to exclude voluntary repayments) is not readily available for FY 2005 and prior.

Additionally, many major companies now notify the USACE and the customer directly. Queries of related USACE databases help ensure records are modified promptly upon receipt of change notifications.

The Department of the Navy, Office of the Chief Information Officer, conducted a pilot recovery audit in FY 2006 on a sample of Navy telecommunications invoices. The results of the pilot indicated that a full recovery audit initiative might deliver a number of benefits to the Navy and assist in the ongoing implementation of its Telecommunications Management and Action Plan. A recovery audit contractor began work in early calendar year 2007 to examine all local, long distance, and data-related telecommunications costs. The program currently remains in its initial stages and no funds yet have been recovered or identified as recoverable.

Contract Auditing. The Defense Contract Audit Agency (DCAA) routinely performs billing system audits at major contractors (e.g., contractors with a substantial amount of flexibly priced contracts and fixed price contracts) to determine the adequacy of the contractor's billing system internal controls and its compliance with those controls. This effort provides assurance to the Department that the contract payment billings are based on costs incurred and approved provisional billing rates. The DCAA also performs paid voucher reviews at major contractors and special purpose audits at contractor locations when an improper payment risk factor is identified and neither a billing system review nor a test of paid vouchers is planned.

VI. Accountability

Certifying officer legislation holds certifying and disbursing officers accountable for government funds. In accordance with Section 2773a of Title 10, United States Code, pecuniary liability attaches automatically when there is a fiscal irregularity, i.e., (1) a physical loss of cash, vouchers, negotiable instruments, or supporting documents, or

(2) an improper payment. Efforts to recover from a recipient must be undertaken in accordance with the debt collection procedures in Volume V, Chapters 29 and 30, of the DoD Financial Management Regulation.

VII. Infrastructure

The Department has the information and infrastructure needed to reduce improper payments in each of the improper payment program areas. The Department also is implementing a Business Activity Monitoring service which will employ the latest technology to increase the efficiency and effectiveness of improper payment detection efforts for commercial pay.

VIII. Barriers

The Department did not identify any program areas facing statutory or regulatory barriers limiting corrective actions.

IX. Additional Comments

The OMB requested the Department identify Iraq improper payment indicators. In support of this request, DFAS and the USACE have conducted additional reviews on payments for Iraq.

At the recommendation of the IG, DFAS initiated a review of in-service collections in FY 2007. Findings confirmed that these collections were related to initial improper payments. Therefore, special reviews of these populations are ongoing for military pay and civilian pay collections. Results of these new reviews are included in improper payments reporting.

Details about these special reviews can be found at <http://www.defenselink.mil/comptroller/afr/fy2007/FY07AFRSection3IPIA.pdf>.