November 15, 2005

Fiscal Year 2005

Department of Defense

Performance and Accountability Report

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Message from the Acting Deputy Secretary of Defense

November 15, 2005

The Department of Defense's Performance and Accountability Report represents an important opportunity to inform the American public of the challenges and accomplishments faced by the Department during the past year.

I am proud of the millions of men and women in uniform and the thousands of civilians who support them. Together, they defend the United States by deterring and defeating aggression and coercion in critical regions. Across the globe, they stand united with our allies to preserve and promote freedom in the face of threats from terrorists and unfriendly regimes.

Internally, the Department continues to improve its financial management and internal controls through its Business Management Modernization Program, the Financial Improvement and Audit Readiness initiative, and other initiatives. These initiatives and our corrective action plans and schedules are discussed in greater detail throughout this report.

While our report contains the most accurate and complete financial and performance information available to us, limitations as a result of systemic weaknesses with financial management systems and business operations continue to impair the financial information. Our auditors have determined that our financial statements in their entirety are not auditable. We have noted throughout this report where information is either unavailable or incomplete.

The Department remains committed to effective internal controls, full compliance with established guidelines and standards, and proper stewardship of the resources entrusted to the Department. In 2005, we resolved 22 of our 46 material weaknesses in internal controls and reported 10 new material weaknesses. With the exception of the remaining weaknesses we are addressing, the Department has reasonable assurance that its management controls are effective and I am confident that we can fulfill our mission responsibilities.

The Department of Defense continues to transform itself into a more agile organization able to meet the challenges of the 21st century. The Department must continue to improve its financial accountability, shift resources from the bureaucracy to the warfighter, and improve the quality of life of our armed forces—and is committed to do so.

Gordon England

Overview: How to Use This Report

The Department of Defense (DoD) fiscal year (FY) 2005 Performance and Accountability Report provides the American people, the President, Congress, other Federal departments and agencies, and DoD military members, civilians, and contractors with an overview of DoD's:

- Mission, goals, accomplishments, and challenges;
- Financial and audit results, and
- Resource management and accountability.

The Report covers the 12-month period ending September 30, 2005 and is comprised of the following five parts:

Part 1: Management's Discussion and Analysis

Management's Discussion and Analysis is a high-level overview of DoD performance and financial information for FY 2005. It describes DoD's performance management model and highlights the Department's FY 2005 annual performance goals and results (detailed in Part 2). Part 1 also provides financial highlights for FY 2005 (detailed in Part 3) and a summary of the Department's status on meeting the President's Management Agenda objectives. Part 1 concludes with a discussion of the Department's compliance with legal and regulatory requirements and DoD's progress on eliminating the high risk areas identified by the U.S. Government Accountability Office.

Part 2: Performance Information

Performance Information presents the Department's strategic plan, strategic objectives, strategic goals, performance goals, and annual performance results for FY 2005.

Part 3: Financial Information

Financial Information comprises the Department's principal financial statements, notes to the statements, consolidating and combining statements, and other required information for FY 2005. This section includes a message from the Chief Financial Officer, as well as the DoD Inspector General Auditor's Report with opinion on the FY 2005 financial statements.

Part 4: Inspector General's Summary of Management Challenges

Inspector General's Summary of Management Challenges presents a summary, prepared by the DoD Inspector General, of the most serious management challenges facing the Department, as well as DoD management's response.

Appendixes

Appendixes include a glossary of acronyms used in this report and a list of Internet links for further information.

We welcome your feedback regarding the content of this report. To comment or request copies of the Report, please email us at DoDPAR@osd.mil, or write to:

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

You may also view this document at www.dod.mil/comptroller/par.

DoD in Review

As recently as 2001, the Department of Defense was still arranged to fight the wars of the century just past. The Soviet Empire was gone, but our American military was still preparing to fight it. The most likely enemies of the future lacked large armies, navies, and air forces, but we were still arranged to defend against the conventional armies, navies, and the last century. In short, we had won the wars of the past, but were not yet prepared for the unconventional challenges of the future.

In 2001, President George W. Bush charged the Department of Defense with a new mission: to transform both the military and the Pentagon bureaucracy to meet the threats and challenges of the 21st century.

Looking back across the last four years, an extraordinary amount of change has taken place, across the entire U.S. defense establishment. Without a doubt, the status quo has been challenged, and a new architecture of American defense not only envisioned, but planned, developed, constructed and, in many ways, employed.

Some of the change was driven by external events, most notably, the global war on terror. Much was undertaken as a result of the Department's own internal analysis of what was required to prepare the U.S. military and the Department for the future.

Together, they represent possibly one of the most significant periods of accomplishment in the history of the Department of Defense.

While transformation began well before the attacks on America on September 11, 2001, and continues today, the global war on terror is perhaps the best lens through which to view all that has been achieved since January 2001.

First and foremost, al Qaeda, the global terrorist network responsible for the September 11 attacks, has been scattered, its assets seized in more than 160 countries around the world, its financial network exposed and thwarted, its home base and host regime in Afghanistan destroyed, its network fractured, and three quarters of its top leadership killed or captured.

Terrorists and terrorist cells continue to be disrupted or destroyed on a daily basis, and well over 10,000 individuals and enemy combatants have been brought under U.S. control. While Osama bin Laden is still alive, he is a fugitive, hunted by an international coalition, with just a fraction of his earlier ability to plan and perpetrate terrorism on a scale previously possible.

Operation Enduring Freedom, the first battle in the first war of the 21st century, ended in the liberation of 25 million people in Afghanistan, the establishment of an interim representative government and, on October 9, 2004, the first free and open election in five millennia of that country's recorded history.

In Iraq, Operation Iraqi Freedom liberated some 27 million people from an excessively brutal and repressive regime which maintained its grip on power through the worst type of corruption and torture, including the massive slaughter of its own people. It also eliminated a decades-old state sponsor and facilitator of terrorism whose drive to develop or acquire weapons of mass destruction threatened the region and the world.

Today, Saddam Hussein, and many of the leaders of the regime that carried out his orders, are in prison and awaiting trial, and his sons – the next generation of despicable dictators – are dead. On January 30, 2005, thousands of courageous Iraqi leaders stood for election, and millions of Iraqi citizens went to the polls despite direct threats of death and violence, some walking more than 20 miles to exercise their new-found freedom.

Throughout operations in both Afghanistan and Iraq, the U.S. military has adapted quickly to the changing conditions of combat, learned the lessons of current battles, and incorporated them into its techniques, tactics, and procedures.
In Operation Enduring Freedom, the keys to victory were flexibility, speed of deployment and employment, overcoming restricted access to regional bases, integration of ground and air power, and the increased use of precision weapons.

In Operation Iraqi Freedom, the lessons learned in Afghanistan continue to be refined with a focus on advanced joint and combined operations, the importance of intelligence, the need for precision in such a cluttered battle space, and how best to train, equip, and employ Iraqi forces in defense of their country.

While Afghanistan and Iraq remain the central fronts in the war on terror, they are not the only places where freedom is being defended against the forces of terror. Across the globe, the United States is working with like-minded states to combat the threat posed by the spread of weapons of mass destruction and, in particular, to prevent terrorists from acquiring such weapons.

U.S. Special Forces persist in the search for high-value targets, finding and striking them where they are, and new technologies are constantly being developed to counter everything from improvised explosive devices to the enemy's use of the Internet to communicate and execute operational command and control.

At home, the Global War on Terror gave new impetus and urgency to transformation efforts already well underway, and a new determination to remake the U.S. military into a more agile, efficient, and expeditionary force, ready to meet the unconventional challenges of a new an uncertain time.

Four years ago, U.S. forces were still organized, trained and equipped for the Cold War, ready to face large armies, navies and air forces from mostly static positions. Today, smaller, more agile units take the fight to the enemy.

Where once millions of tons of bombs leveled entire cities, today smart bombs and real-time targeting destroy strongholds while limiting civilian casualties and collateral damage.

Similarly, Cold War programs and weapons systems were canceled or significantly modified, lighter, faster systems added, as well as new technological advancements such as unmanned vehicles, laser communications, and new satellites for advanced command and control. Recently, a restructured Missile Defense Program fielded a limited operating capability to defend the continental United States against rogue attack.

New strategic partnerships have been established with the nations of Central and South Asia, as well as with non-traditional partners such as Pakistan. Going forward, the location of U.S. forces abroad will reflect these and other realities of the post-Cold War world.

The Department played a major role in humanitarian relief for natural disasters. Hurricanes Katrina and Rita wreaked catastrophic damage on New Orleans and the Gulf Coast, as well as Florida. DoD provided troops to support relief operations through air, sea, and ground operations. The tsunami that struck Southeast Asia after Christmas inflicted extensive damage. The Department is providing assistance to the governments of Indonesia, Sri Lanka, Thailand, and other affected nations as they deal with the effects of the tsunami. U.S. military operations are in support of overall U.S. Government assistance efforts, and are being conducted in coordination with international organizations, non-governmental organizations, and other nations.

Organizationally, the Department stood up needed new organizations and trimmed back in less functional areas. A new Under Secretary for Intelligence was created, as well as new Assistant Secretaries for Homeland Defense and Networks and Information Integration.

A new National Security Personnel System will allow needed flexibility in managing a 21st century workforce, and a new Base Realignment and Closure process is underway to shed unneeded infrastructure and allocate resources to more appropriate needs.

Many aspects of the Department's basic program, budget, and acquisition processes have been modernized, streamlined and consolidated. A two-year budget cycle has been instituted, and the acquisition process streamlined. Procurement safeguards have been strengthened to preclude duplication among the Military Services. Intrinsic to this process was the establishment early on of the Senior Level Review Group, which consists of the Secretary, Deputy Secretary, Chairman and Vice Chairman of the Joint Chiefs of Staff, Under Secretaries, Service Secretaries, and Service Chiefs of Staff.

Until this group was created, the Military Services used to build budgets separately and often competed with one another for programs and funding. Today, this group brings top planners together, to generate common concepts of operations and programs for the military, which also strengthens joint and combined warfighting operations on the battlefield.

Looking ahead, many challenges remain

In Afghanistan, we must ensure that Taliban remnants and the possibility of terrorism that stems from drug trafficking do not slow the progress that is clearly underway. In Iraq, a functional Iraqi military and police must be established to secure the environment, defeat the insurgency, and give the new government every chance to succeed as a functioning democracy. Another challenge will be to focus appropriately on intelligence, working closely with other government agencies to ensure that our warfighters have what they need to prevail in the global war on terror. This will require improving all aspects of our ability to collect, analyze, disseminate, integrate and share intelligence to both the battlefield and the boardroom.

Most importantly, we must strike the right balance between the capabilities needed for the war on terror and capabilities needed to manage emerging military competition in other areas.

We must hedge against the emergence of a major military competitor in the decades ahead through the right levels of research and development, as well as intelligent procurement of advanced warfighting and surveillance systems.

We must work with the Department of Homeland Security to ensure we are properly positioned to do our part in preventing, or contending with the aftermath of, a catastrophic attack on the homeland, particularly with regard to terrorism involving weapons of mass destruction.

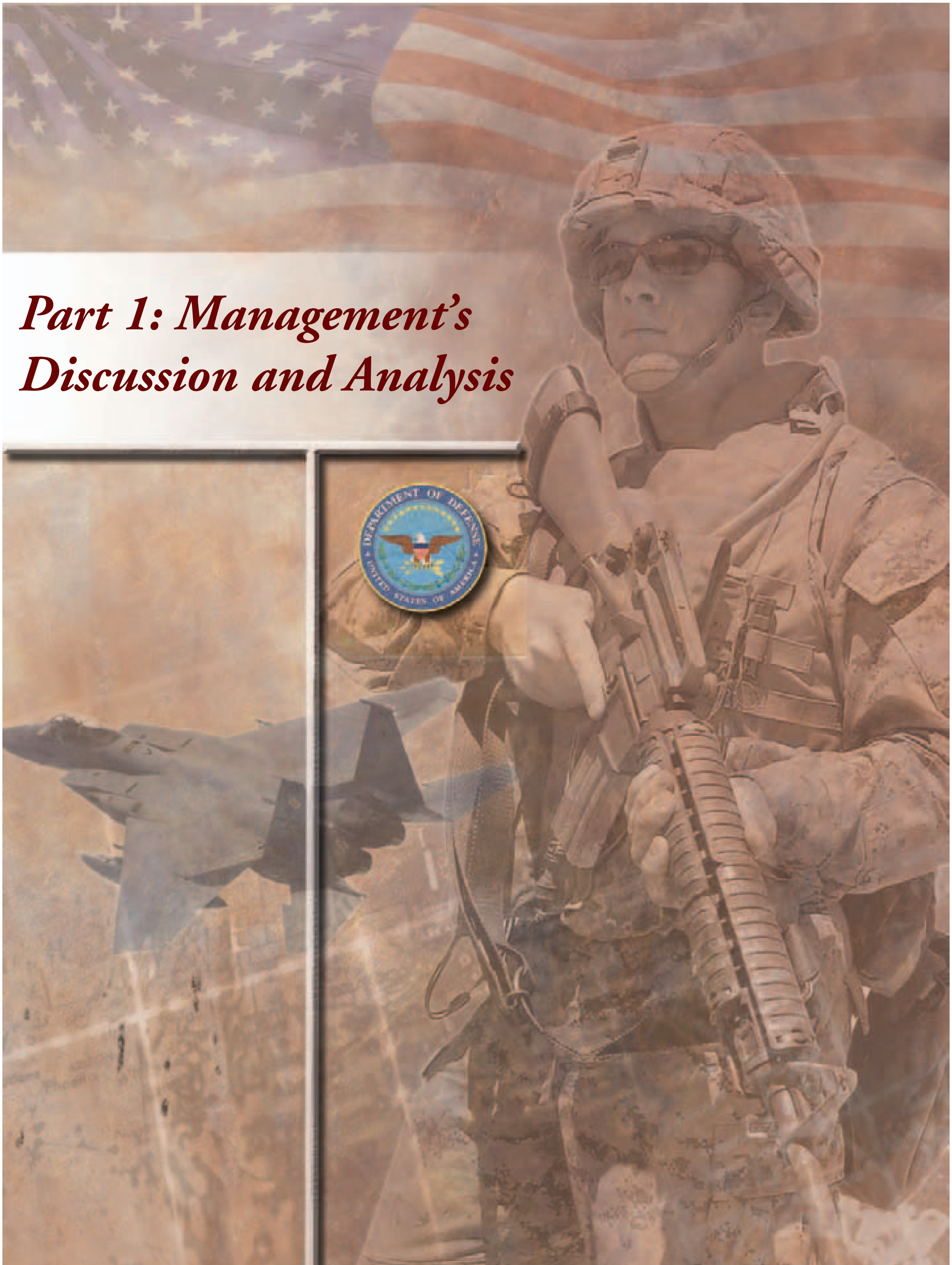
To take precision targeting to a new level, we must focus resources on persistent surveillance, using both manned and unmanned systems.

All of these, as well as other key issues such as potential changes in roles, missions, and organizations; needed changes in the law; pursuit of key enablers like space, information operations, surveillance systems, and special programs; changes to our strategic nuclear forces; new approaches for developing a 21st century civilian workforce; and improved business practices of the Department of Defense are being examined in depth.

We are cognizant of the responsibilities inherent in managing nearly 18 percent of the Federal budget and more than 3 percent of the Gross Domestic Product, and even more so of the precious resources loaned to us by a caring Nation – the 2.2 million active duty, Guard, and Reserve members of the U.S. Armed Forces, along with the civilian workforce.

The Department of Defense has initiated significant change and accomplished a great deal over the past four years and, with the continuing support of the Congress and, most importantly, the American people, we will continue to improve and accomplish our mission in the years to come.

Part 1: Management's Discussion and Analysis



How the Department Evolved

1775 - The Army, Navy, and Marine Corps were established in concurrence with the American Revolution.

1789 - The War Department was established and was the precursor to what is now the Department of Defense.

1798 - The Department of the Navy, and the U.S. Coast Guard, were founded.

1947 – Congress established a civilian, Cabinet-level Secretary of Defense. The Department of the Air Force was created, the War Department was converted to the Department of the Army, and the three military departments of the Army, Navy and Air Force were placed under the direct control of the first Secretary of Defense.

1949 - the national defense structure was consolidated further, creating what we now know as the Department of Defense, and withdrawing cabinet-level status for the three Military Department Secretaries.

Management's Discussion and Analysis

This part of the report provides an overview of the Department of Defense's financial and performance results for fiscal year (FY) 2005. Detailed performance information is presented in Part 2; detailed financial information is presented in Part 3.

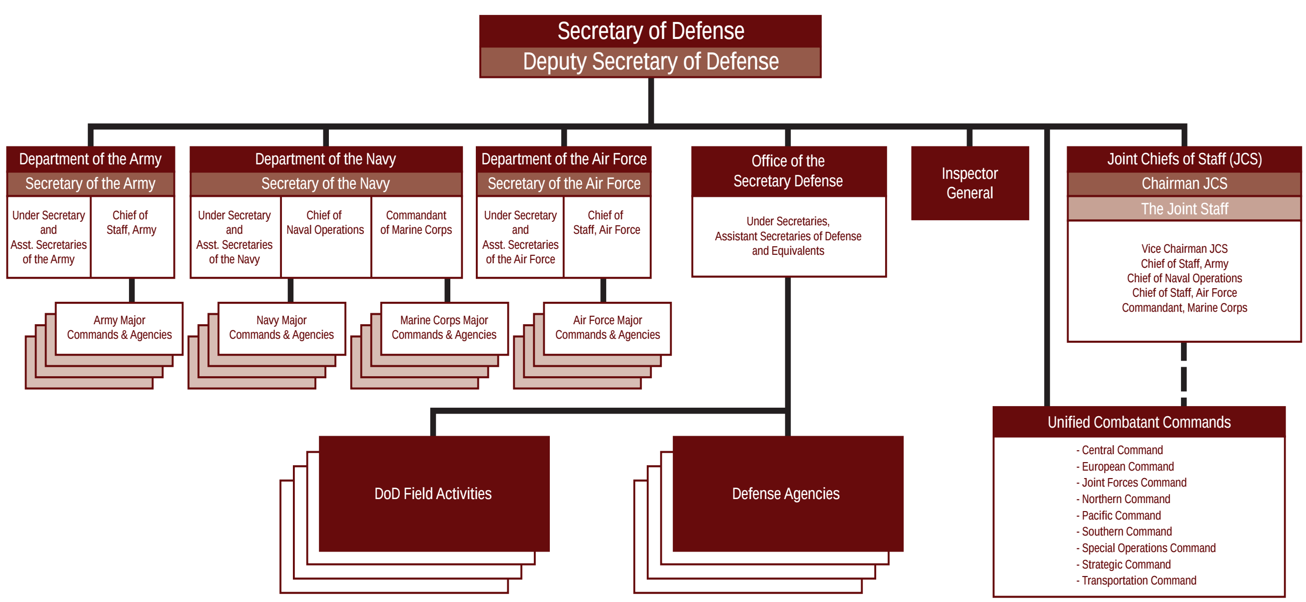
Mission, Organization, and Resources

Mission

The mission of the United States Armed Forces is to defend the United States; deter aggression and coercion forward in critical regions; swiftly defeat aggression in overlapping major conflicts while preserving for the President the option to call for a decisive victory in one of those conflicts, including the possibility of regime change or occupation; and conduct a limited number of smaller-scale contingency operations.

Organization

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



The Secretary and the Office of the Secretary

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

Military Departments

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

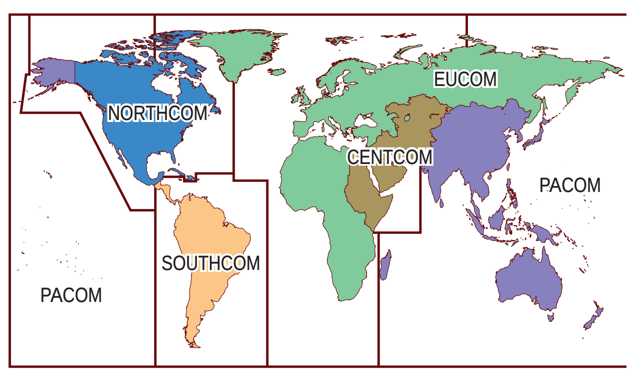
The Military Departments include Active duty, Reserve, and National Guard forces. Active duty forces are full-time duty military service members. The Reserves, when ordered to active duty by the Congress, support the active forces. They are an extension of the active duty personnel and perform similarly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

Chairman of the Joint Chiefs of Staff

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

Combatant Commands

The nine Combatant Commands are responsible for conducting the DoD missions around the world. The Army, Navy, Air Force, and Marine Corps supply forces to these Commands.



Five of these Commands have specific mission objectives for their geographic area of responsibility, as shown in the map above:

- U.S. European Command (EUCOM) is responsible for activities in Europe, Greenland, Russia, and most of Africa.
- U.S. Central Command (CENTCOM) is

responsible for the Middle East, eastern Africa, and several of the former Soviet republics. This Command is primarily responsible for conducting Operation Enduring Freedom in Afghanistan and Operation Iraqi Freedom.
- U.S. Pacific Command (PACOM) is responsible for China, Southeast Asia, Australia, and the Pacific Ocean.
- U.S. Southern Command (SOUTHCOM) is responsible for South America and the southern Caribbean.
- U.S. Northern Command (NORTHCOM) is responsible for North America and the northern Caribbean.

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

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

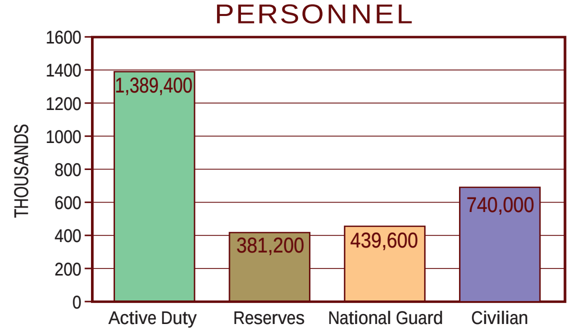
Defense Agencies and the DoD Field Activities

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

Resources

To provide Americans with the highest level of national security, the DoD employs nearly 1.4 million men and women in Active duty, more than 820,000 in the Reserve and National Guard, and approximately 740,000 civilians. Together, these men and women work daily to protect U.S. interests around the world.

MILITARY & CIVILIAN PERSONNEL

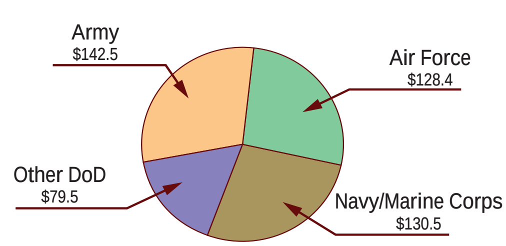


Source: *FY 2006 President's Budget and FY 2005 Emergency Supplemental Request*

The DoD's worldwide infrastructure includes nearly 600,000 buildings and structures in more than 6,000 locations on more than 30 million acres of land in 146 countries. To protect the security of the United States, the Department uses approximately 250,000 vehicles, 15,000 aircraft, 1,000 oceangoing vessels, and 550 public utility systems.

The Department's budget for FY 2005 was $480.9 billion[1]. The chart below shows how the budget was divided among the three Military Departments and the DoD Department-wide functions.

FY 2005 DoD BUDGET
($ in Billions)



[1] *Does not include Trust Fund or U.S. Army Corps of Engineers Civil Works appropriations.*

The DoD, the federal government's single largest agency, receives more than half the discretionary budget of the United States. Looking to a future in which budgets likely will remain tight and subject to greater scrutiny, and the tempo of day-to-day military operations will remain high, the cost-effectiveness of America's forces takes on increased importance.

The Department uses a variety of metrics to demonstrate accountability for the resources provided by the American people. This report highlights those metrics in the next two sections of Management's Discussion and Analysis, "Performance Objectives, Goals, and Results" and "Analysis of Financial Statements and Stewardship Information."

Performance Objectives, Goals, and Results

Key Performance information is summarized in this section; details are provided in Part 2 of this report.

How the DoD Assesses Performance

The DoD is committed to effective resource stewardship and has implemented numerous performance and financial measures to help meet that commitment. To demonstrate tangible benefits to the American public and to carefully monitor its own performance, the Department uses the performance management model depicted in the diagram below. Each component of the model is described below.

Mission. Explains why the DoD exists, tells what it does, and describes how it does it.

Strategic Objectives. High-level, broad actions through which the Department carries out the military, national security, and defense strategies.

Strategic Goals. The Department's strategic goals center on balancing risk in four key risk management framework areas.

Performance Goals. The desired outcomes the Department plans to achieve to attain its strategic goals. The Department has 16 performance goals, four for each strategic goal.

Performance Measures. A series of indicators, expressed in qualitative, quantitative, or other tangible terms that the Department uses to indicate whether current performance achieves the performance goals.

Performance Targets. Expressions of desired performance levels or specific desired results targeted for a given fiscal year. Achievement of targets defines success. Where possible, targets are expressed in quantifiable terms.

The fiscal year (FY) 2005 Performance and Accountability Report chronicles the Department's achievements toward meeting its FY 2005 performance goals and targets.

Defense Strategy and Strategic Planning

As directed in the 2002 National Security Strategy, the Department is implementing the President's commitment "to build a safer, better world that favors human freedom, democracy, and free enterprise." The 2005 National Defense Strategy outlines DoD's approach to dealing with challenges it will likely confront, not just those it is currently best prepared to meet. The intent is to create favorable security conditions around the world and to continue transforming how the Department thinks about security, formulates strategic objectives, and adapts to achieve success. The 2005 National Defense Strategy emphasizes the importance of influencing events before challenges become more dangerous and less manageable.

To guide the Department's activities in support of the broader effort to create conditions conducive to a secure international system—as the President's National Security Strategy states, a balance of power that favors freedom—the Department established four strategic objectives. These strategic objectives serve as links between defense activities and those of other government agencies in pursuit of national security goals.

Secure the United States from direct attack. The Department will give top priority to dissuading, deterring, and defeating those who seek to harm the U.S. directly, especially violent extremists with weapons of mass destruction.
Secure strategic access and retain global freedom of action. The Department will promote the security, prosperity, and freedom of action of the U.S. and its partners by securing access to key regions, lines of communication, and the global commons.

Strengthen alliances and partnerships. The Department will assist in expanding the community of nations that share principles and interests with the U.S. and help these partners increase their capacity to defend themselves and collectively meet challenges in the Nation's interest.

Establish favorable security conditions. The Department will create conditions conducive to a favorable international system by honoring the security commitments and working with others to bring about a common appreciation of threats; a broad, secure and lasting peace; and the steps required to protect against these threats.

The Department is focusing efforts on four key actions that enable accomplishment of these strategic objectives.

One action is to assure allies and friends. Throughout the Cold War, U.S. military presence and activities abroad upheld America's commitment to its international partners. The U.S. shared risks by contributing to their physical defense. Now, given new challenges, the DoD aims to assure a growing and more diverse community of partners of that same commitment. Another action is to dissuade potential adversaries. Would-be opponents will seek to offset U.S. military advantages. In response, the Department will work to limit their strategic options and dissuade them from adopting threatening capabilities, methods, and ambitions, particularly by sustaining and developing key U.S. advantages. A third action to accomplish the Department's strategic objectives is to deter aggression and counter coercion. During the Cold War, deterrence was based necessarily on the threat of a major response after suffering an attack. Today, there are many scenarios where the U.S. is not willing to accept the huge consequences of an attack before responding. Therefore, current deterrence policy places increasing emphasis on preventing and protecting against attacks. This requires maintaining rapidly deployable military forces and, when necessary, demonstrating the will to resolve conflicts decisively on favorable terms. Lastly, when deterrence fails or efforts short of military action do not forestall gathering threats, the U.S will employ military power, together with other instruments of national power, as necessary, to defeat adversaries. At the direction of the President, the Department will defeat adversaries in a manner that establishes conditions conducive to a secure peace.

The strategic circumstances of the 21st century are far different today from those of the Cold War. However, as described in the 2005 National Defense Strategy, America remains vulnerable to security challenges in this age of uncertainty. America has learned that an unrivaled capacity to respond to traditional challenges is no longer sufficient. The consequences of even a single catastrophic attack, for example, are unthinkable. Therefore, the U.S. must confront challenges earlier and more comprehensively, before they are allowed to mature. The Department must plan with surprise in mind.

To contend with a world of uncertainty and surprise, the Department shifted its strategic planning from the "threat-based" model that guided DoD thinking in the past to a "capabilities-based" model for the future. Capabilities-based planning focuses more on how adversaries may challenge the U.S. rather than on who those adversaries might be or where conflict may occur. Under the threat-based model, planners looked at a threat posed, for example, by the former Soviet Union, and fashioned a force to fit it. Under a capabilities-based model, planners examine the capabilities that exist to threaten the U.S., such as chemical, biological, nuclear, or cyber-space capabilities, and fashion a response to contend with those capabilities regardless of where they might originate. This new approach focuses the Department on the growing range of capabilities and methods it must possess to contend with an uncertain future. Operating within fiscal constraints, this new approach enables the Secretary of Defense and Combatant Commanders to balance risk across traditional, irregular, disruptive, and catastrophic challenges.

As such, Cold War programs and weapons systems have been canceled or significantly modified, and lighter, faster systems have been added, as well as new technological advancements such as unmanned vehicles, laser communications, and new satellites for advanced command and control. All are tied together by the concept of net-centric warfare and truly joint/combined operations – absolute necessities for contending with the diverse and ever changing set of security challenges facing the U.S.

Experience in the war on terrorism has also underscored the need for a changed defense establishment—one postured both for extended conflict and continuous transformation. The U.S. is in a long-term struggle against persistent, adaptive adversaries, and must transform to prevail. Transformation is not only about technology. It is also about changing perspective in thinking about challenges and opportunities facing the Nation, adapting the defense establishment to that new perspective, and refocusing capabilities to meet future challenges. Therefore, the Department will continually adapt how it approaches and confronts challenges, conducts business, and works with others.

This demands an adaptive strategy, predicated on creating and seizing opportunities and contending with challenges through an active, layered defense of the Nation and its interests. The U.S. will seize the strategic initiative in all areas of defense activity—assuring, dissuading, deterring, and defeating. The U.S. must also defeat the most dangerous challenges early and at a safe distance, before they are allowed to mature. Such preventive actions include security cooperation, forward deterrence, humanitarian assistance, peace operations, and non-proliferation initiatives. The concept of active, layered defense includes international partners. Thus, among the key goals of the National Security Strategy is to work with other nations to resolve regional crises and conflicts.

Managing risk is a central element of the defense strategy. It involves balancing the demands of the present against preparations for the future consistent with the Department's strategic objectives and forms the basis for the strategic goals. The Quadrennial Defense Review is the Department's vehicle for risk assessment. The Quadrennial Defense Review is a comprehensive examination of the national defense strategy, force structure, force modernization, infrastructure, budget plan, and other elements of the defense program and policies of the U.S. It allows the Secretary to consider the full range of risks associated with resources and operations and manage explicit tradeoffs across the Department.

The risk framework comprises force management risk, operational risk, institutional risk, and future challenges risk:

1) Force management risks are those associated with managing military forces fulfilling the missions described in the 2005 National Defense Strategy. The primary concern is the ability to recruit, retain, train, and equip a ready force and sustain that readiness.

2) Operational risks are those associated with the current force executing the strategy successfully within acceptable human, material, financial, and strategic costs.

3) Institutional risks are those associated with the capacity of new command, management, and business practices.

4) Future challenges risks are those associated with the Department's capacity to execute future missions successfully against an array of prospective future challengers.

These four dimensions of risk cannot be assessed and managed independently. Choices in one area affect choices in others. The Secretary makes deliberate choices that balance across and within the four risk areas.

The 2005 National Defense Strategy builds upon the Department's last Quadrennial Defense Review and culminating Report in 2001. Since the 2001 Quadrennial Defense Review Report was released, events have confirmed the importance of assuring our allies and friends, dissuading potential adversaries, deterring aggression and coercion, and defeating adversaries. America is a Nation at war, and the war on terrorism has exposed new challenges, but also unprecedented strategic opportunities to work at home and with our international partners to create conditions favorable to a secure international order. The Department's 2005 Quadrennial Defense Review is now underway, is incorporating these new challenges and is discussed in the last section of Part 1, titled "Looking Forward: Challenges for 2006 and Beyond."

Annual Performance Plan

The Secretary's Annual Defense Report serves as the Department's annual performance plan. The Annual Defense Report incorporates the strategic objectives and goals of Quadrennial Defense Review Report, as refined by the National Security, Defense, and Military Strategies.

The annual performance plan identifies four performance goals for each strategic goal, which are then further defined and measured by 71 corresponding metrics (measures and targets). These performance goals or dimensions of risk cannot be assessed and managed independently because choices in one area affect choices in others. The Department's guiding principle for managing risk is to deliberate choices that balance across and within the four risk areas.

Strategic Goal 1: Balancing Force Management Risk. Specific performance goals include:

- 1.1 Ensure Sustainable Military Tempo and Maintain Workforce Satisfaction.
- 1.2 Maintain a Quality Workforce.
- 1.3 Maintain Reasonable Force Costs.
- 1.4 Shape the Force of the Future.

Strategic Goal 2: Balancing Operational Risk. Specific performance goals include:

- 2.1 Maintain Force Readiness (Are Our Forces Currently Ready?).

2.2 Ensure Superior Capabilities Exist to Succeed (Are Our Forces Postured to Succeed?).
2.3 Align Forces Consistent with Strategic Priorities (Are Our Forces Employed Consistently With Our Strategic Priorities?).
2.4 Transition Forces Rapidly to Meet New Threats (Do We Have the Right Forces Available?).

Strategic Goal 3: Balancing Institutional Risk. Specific performance goals include:

3.1 Improve the Readiness and Quality of Key Facilities.
3.2 Manage Overhead and Indirect Costs.
3.3 Realign Support to the Warfighter.
3.4 Streamline the Decision Process, Improve Financial Management, and Drive Acquisition Excellence.

Strategic Goal 4: Balancing Future Challenges Risk. Specific performance goals include:

4.1 Define and Develop Transformational Capabilities.
4.2 Define Skills and Competencies for the Future.
4.3 Develop More Effective Organizations.
4.4 Drive Innovative Joint Operations.

The Annual Defense Report and more information on each of the strategic and performance goals and the corresponding 71 metrics can be found at http://www.defenselink.mil/execsec/adr2004/index.html.

Performance Assessment for FY 2005

During FY 2005, the DoD effectively accomplished its mission. On the international front, the Department faced challenges with the fierceness of the insurgencies in Afghanistan and Iraq, the deterioration of the relationship with Iran, and the mobilization of relief efforts following the tsunami in Asia. Closer to home, the DoD led efforts to provide relief for Hurricane Katrina and Hurricane Rita victims, and completed its Base Closure and Realignment recommendations to further transform the Department and optimize resources to support the warfighter.

The following paragraphs summarize the Department's performance results for the past fiscal year, and describe progress in achieving the results needed to meet the goals in each of the risk areas identified by the Annual Performance Plan.

Strategic Goal 1: Balancing Force Management Risk – recruit, retain, train, and equip a ready force and sustain readiness.

The Department continued its efforts to maintain a quality workforce satisfied with its quality of life, while making the best use of every dollar invested in the workforce and shaping the DoD workforce for the future. Thirty-seven metrics measure progress toward the four performance goals under Balancing Force Management Risk. Some of these metrics still are under development or just beginning to collect information, so meaningful, quantitative data is not yet available. In general, the preliminary steps required to establish these metrics were completed according to schedule in FY 2005.

Success stories in Force Management include two metrics where performance exceeded the goals by a wide margin. First, Active Component Enlisted Recruiting Quality (Metric 1.2.7) measures recruits' educational levels and scores on standardized aptitude tests taken by all military applicants. Working with the National Academy of Sciences, the DoD established benchmarks to support this metric that are highly accurate indicators of a recruit's success in the military. As an example, the DoD aimed to fill, at a minimum, 90 percent of its available recruitment slots with individuals that have earned a high school diploma; as of the end of third quarter FY 2005, 94 percent of recruits had earned a high school diploma.

Second, Military Personnel Costs—Enlisted Pay Gap (Metric 1.3.7) tracks the percentage of the pay gap between military and civilian pay that has been closed. Experience shows that when military is significantly less than the 70th percentile, as compared to civilian pay, recruiting and retention problems may arise. The DoD has established annual targets to close the gap at a rate of 25 percent annually until the gap is eliminated. The DoD exceeded its annual target for FY 2005 by closing the gap 54 percent over the previous year through an average pay increase, an average basic allowance increase for housing, and an increase in the basic allowance for subsistence. Overall, 88 percent of the enlisted pay gap has been closed.

The Department came close to meeting its performance goals for some of the metrics. "Came close" is defined as estimated to be within a few percentage points of the target, yet still within range to be considered acceptable performance. For example, Satisfaction with Access to Medical Care (Metric 1.1.5) measures individuals' satisfaction with access to appointments in TRICARE Prime, which is the Military Health Care System's equivalent of a health maintenance organization. Health care is a quality of life issue that affects recruitment, retention, and ultimately job satisfaction in any profession. The DoD's target was a satisfaction rate of 84 percent or higher; as of third quarter, the rate was 81.2 percent. The Department came up short on this goal due to a larger percentage of medical appointments for Active duty personnel, who tend to be younger and have higher expectations. Steps taken to improve the score in the future include using more contract physicians to improve appointment availability.

Some metrics showed mixed results; i.e., some Military Departments met or exceeded targets while others fell short. For example, Reserve Component Enlisted Recruiting Quantity (Metric 1.2.10) tracks the number of new Reserve recruits against targets designed to maintain required strengths after factoring in normal attrition, promotions, etc. Overall, as of the end of the third quarter, the DoD fell short and reached only 77,375 or 83 percent of its goal of recruiting slightly more than 93,000 reservists. The Marine Corps and the Air Force Reserves, however, met their targets. The Army National Guard and Army Reserve fell short of their targets and are not expected to achieve their goals for the year. Enhanced recruiting and retention incentives are helping to attract new Reservists.

Finally, some goals were not met due to a variety of factors. For instance, Critical Skill Recruit Needs (Metric 1.2.4) tracks the ability of the Services to recruit for Active duty individuals that fit one or more criteria, e.g., possess skills crucial to combat readiness or meet high entrance standards. The FY 2005 target was to fill all critical skills at 95 percent or more. The results, as of the third quarter, showed that one-third (22 of 67) of the designated critical skills did not meet that threshold. In particular, the Army reported notable declines in a significant majority of critical skills. These shortcomings are attributed to a more challenging recruiting environment, which the Department is addressing through various recruiting and retention incentives and bonuses.

Strategic Goal 2: Balancing Operational Risk – achieve and maintain operational superiority.

Prior to 2001, the DoD measured operational risk almost exclusively in terms of the ability of the Armed Forces to wage two major wars simultaneously in Northeast Asia and Southwest Asia. In 2001, the Department adopted a capabilities-based approach that reflects the fact that the DoD cannot be certain which nation, combination of nations, or non-state actor will pose threats to vital U.S. interests decades from now. This new approach more realistically captures the demands facing the armed forces by focusing more on how an adversary might fight rather than on the identity of the adversary or where a war might occur. It requires identifying capabilities that U.S. military forces will need to deter and defeat adversaries who will rely on surprise, deception, and non-traditional styles of warfare to achieve their objectives.

Nine metrics measure the progress toward the four Balancing Operational Risk performance goals. These metrics are under development and progress is measured by adherence to specific milestones. Quantitative data will not be available until after FY 2005. Metric examples include:

- Adaptive Planning (Metric 2.1.1). This metric will ensure the capability to produce plans that are more timely, adaptive, and responsive to the current security environment, providing relevant options to the President and the Secretary of Defense. In FY 2005, the DoD began applying adaptive planning concepts into contingency planning guidance and several warplans.

- Global Force Management (Metric 2.2.1). This metric develops an integrated force assignment, apportionment, and allocation methodology. It provides comprehensive insight into U.S. forces available worldwide, and accounts for ongoing operations and constantly changing unit availability. The Secretary approved the guidance for the program in May 2005. The DoD also chartered five Global Force Management Boards led by Joint Staff study teams.

- Joint Concepts (Metric 2.3.1). This metric guides the transformation of the joint force so that it is prepared to operate successfully 8-20 years in the future. In simple terms, the joint force will eliminate military "stovepipes" by seamlessly combining the armed forces' capabilities necessary to address a situation or event. In FY 2005, the Joint Staff developed and the Secretary approved four joint operation concepts.

- Operational Availability (Metric 2.4.1). This metric ensures integrated data and management systems to assess the percentage of forces ready for specific joint tasks to address diverse requirements. These systems will enable DoD to develop the ability to rapidly transition forces to post-hostility operations, and identify and deter threats to the U.S., while standing ready to assist civil authorities in mitigating the consequences of a terrorist attack or other catastrophic event. In FY 2005, the DoD updated and used analytic baselines, a set of common scenarios and data, to assess mobility and air refueling capabilities.

Strategic Goal 3: Balancing Institutional Risk – align the organization and its resources to support the warfighter.

As the Department transforms its military capabilities to meet changing threats, it also must transform its institutions to ensure that its people can focus their immense talents on defending America, and that they have the resources, information, and freedom to perform. This means changing the way the Department conducts its daily business, because the current organizational arrangements, processes, and systems are draining scarce resources from training, infrastructure, operations, and housing.

This area has four performance goals to improve institutional management that focus on improving readiness and quality of facilities, timeliness of support, and financial management; streamlining processes; and reducing administrative costs. Fourteen metrics track achievements in this area. For example, Reduce Percentage of DoD Budget Spent on Infrastructure (Metric 3.2.1), is used to measure the trend in resources toward less infrastructure and more mission programs. The DoD's target, set in FY 2004, is 41 percent; for FY 2005, the projected percentage is 42 percent – slightly higher than the annual performance target.

The DoD also measures Customer Wait Time (Metric 3.3.1). The purpose of this metric is to measure customer wait time in filling orders for military equipment materials, and spare and repair parts. The targeted turnaround time in filling customer orders was 15 days; the DoD average wait time as of the third quarter was 21 days due to heavy demands of Operation Iraqi Freedom.

Strategic Goal 4: Balancing Future Challenges Risk – execute future missions successfully against an array of prospective challengers.

While many elements of America's existing military force will continue to contribute to the DoD's capabilities, the DoD needs to develop new, leading-edge capabilities to meet the challenges of tomorrow. The Department needs to rapidly convert innovative warfighting concepts from prototypes into fielded capabilities. It needs to define the skills required for the future and plan to recruit, train, and retain talented individuals who have those special abilities. Finally, the DoD must continue to experiment with new warfare concepts, enhance its intelligence-gathering capabilities, and maintain its science and technology strengths.

This strategic goal has four performance goals, which include 11 metrics. Most of these metrics are under development and progress is measured by adherence to specific milestones. Quantitative data will not be available until after FY 2005. Examples of these metrics include:

- Deny Enemy Advantages and Exploit Weaknesses (Metric 4.1.1). This metric focuses on specific steps necessary to establish strategic outcomes and efficiency measures to gauge the effectiveness of America's intelligence activities and the DoD's training and associated program structures. Many domestic, international, and organizational variables contribute to the success of the overall program. The task of developing enduring outcome goals and measures involves a significant amount of developmental research and analysis. In FY 2005, the DoD initiated a polygraph program and began conducting polygraph examinations on translators and other personnel prior to their arrival at Guantanamo Bay.

- Attract, Recruit, Retain, and Reward High Quality People from Government, Industry, and Academia (Metric 4.2.1). This metric measures the DoD's success in bringing to its intelligence community people with broad and varied experiences who are agile problem solvers and can operate in an environment that changes as the threat changes. A key first step in FY 2005 was to establish a common human resources system for the DoD intelligence community.

- Enhance Homeland Defense and Consequence Management (Metric 4.3.1). This metric required the development of a comprehensive, Defense-wide Strategy for Homeland Defense and Civil Support, which was issued in June 2005. This strategy incorporates an integrated threat assessment and addresses force structure, technology, and resource implications. It includes implementation actions that will be reported in the FY 2006 Performance and Accountability Report.

- Maintain Balanced and Focused Science and Technology (Metric 4.4.2). This metric is designed to ensure a balanced and focused investment by funding basic research, applied research, and advanced technology development. The DoD established percentage goals for each category; as of the end of FY 2005, the balance between the funding levels was close enough to be viewed as meeting the goal.

Analysis of Financial Statements and Stewardship Information

This section summarizes key financial information; Part 3, Financial Information, provides more details.

Supporting the Department's warfighting mission is critical to defending the Nation's security. Among other things, success hinges on sound and reliable financial management. "Clean" or unqualified audits are one element of success. Overall success will be achieved when the DoD has accounted for all monies expended past and present, eliminated redundancies, revealed and corrected errors, and directed the savings from this effort toward improving the mission-readiness of those who serve this country.

The DoD continues to improve financial management by overhauling the Department's business and financial management processes and systems. This represents a major management challenge that goes far beyond financial accounting. The Secretary and his senior leaders are committed to changing the Department's business culture, thus improving the Department's combat support infrastructure. The DoD has three primary mechanisms in place to achieve these goals: the Business Management Modernization Program (BMMP), the Financial Improvement and Audit Readiness (FIAR) Plan, and the Under Secretary of Defense (Comptroller) Strategic Plan (FY 2005 - 2009).

Business Management Modernization Program

In 2001, the Department established this program as the foundation to transform the DoD business operations. Its approach targets essential business capabilities and functions, and creates integrated and executable plans to achieve business and financial transformation. One of its early achievements was the establishment of a Business Enterprise Architecture, a guide for investments in the DoD organization, operations, and systems as they relate to or affect business operations. The architecture plays a critical role in transformation by establishing clear links among systems/initiatives, business capabilities, Business Enterprise Priorities, and core business missions. Business systems development consists of setting priorities based on warfighting needs and financial accountability, assigning programs to provide the capabilities of those priorities, refining the architecture and transition plans to support those particular decisions, funding the approved programs, and then implementing the transformation. The architecture evolves and matures as the Department defines its priorities, identifies emerging viable programs, and institutes Department-wide standards.

In 2005, the Department developed an Enterprise Transition Plan, which provides an iterative, modular, and tiered approach to enable a manageable transformation. The plan highlights the business capabilities that the DoD needs to support warfighter requirements, identifies the known systems and non-systems solution to achieve business transformation, and identifies the resources for implementing those solutions. The Enterprise Transition Plan provides key milestones to mark the path to transformation and measure progress along that path.

Additionally, the Department implemented the concept of tiered accountability whereby systems or initiatives that affect Department-wide capabilities, or meet specific investment thresholds, are managed and reviewed as part of the DoD-wide portfolio. Business systems and initiatives not meeting those criteria are delegated to the DoD components for management and review.

The Defense Business Systems Management Committee chaired by the Acting Deputy Secretary of Defense defines the Business Enterprise Priorities based on desired outcomes—those areas where transformed business operations will improve warfighter support, reduce costs, and improve regulatory compliance. In FY 2005, the Committee approved six Business Enterprise Priorities and 43 initiatives to achieve them. One of those priorities, the Financial Visibility Priority, focuses on achieving enhanced end-to-end financial information flow and visibility that will benefit the warfighter while continuously improving financial transparency and reducing systems complexity. The Department defined six core financial capabilities in support of the Financial Visibility Priority, including:

- Forecast, plan, program, and budget;
- Manage financial assets and liabilities;
- Funds allocation, collection, disbursement, and control;
- Manage General Ledger;
- Managerial accounting; and
- Financial reporting.

The DoD established performance measures to monitor and guide activities that will lead to the full development and maintenance of those financial capabilities. The FY 2005 accomplishments include developing a Standard Financial Information Structure (SFIS) and initiating a Program/Budget Framework.

The SFIS standardizes Department-wide financial information supported by the U.S. Standard General Ledger and marks a major step in achieving the financial management capabilities listed above. The DoD incorporated SFIS, a DoD-wide data structure that supports the Department's budget, cost/performance management, and external reporting requirements, into its Business Enterprise Architecture. As a common business language, SFIS provides the means to track and audit transaction-level financial information, thus enabling financial statement auditability consistent with the Federal Financial Management Improvement Act.

The Program/Budget Framework initiative provides a foundation for a new Program/Budget data structure using a common language, enabling senior-level DoD decision makers to weigh options and resource constraints across a spectrum of challenges. The Framework will help link the Department's strategic plans, programs, and budgets to accounting and performance data.

Financial Improvement and Audit Readiness Plan

Recognizing the need for a comprehensive, integrated financial improvement plan to orchestrate the financial improvement efforts of the DoD components, ensure integration and leverage of BMMP solutions, and provide the roadmap to verification of improvements through audit, the Department initiated an effort to develop, manage and execute a FIAR Plan. This plan complements the BMMP's Enterprise Transition Plan by integrating the Financial Visibility Priority discussed above with component-level FIAR Plans. The FIAR Plan is focused on, but not limited to, the Department's near-term objectives in four major areas: Military Equipment, Medicare Eligible Retiree Health Care Fund, Real Property, and Environmental Liabilities. These areas comprise some of the most significant balance sheet categories; improving these areas will greatly enhance the Department's financial auditability.

Major DoD components have prepared a FIAR Plan that delineates specific steps to meet a prescribed set of business rules for achieving financial improvement that is verified by audit. Issued by the DoD Chief Financial Officer in FY 2004, these business rules, or phases as they are sometimes called, are Discovery and Correction, Validation, Assertion, Assessment, and Audit. These business rules force the components to consider all pertinent factors when determining tasks and solutions, yet provide the flexibility to account for unique circumstances and environments. Although the estimated end dates for corrective action and completion of all phases vary, the process, business philosophy, and critical factors are uniform across the Department. Over time, the FIAR Plan will enable the DoD to cost-effectively generate reliable financial data and forecast accurate budget expenditures and needs.

Under Secretary of Defense (Comptroller) Strategic Plan (FY 2005 - 2009)

The mission of the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer is to ensure that the Department's budget and financial expenditures support the national security objectives of the United States. This mission highlights proper stewardship and business management of taxpayer dollars in support of the Department. The strategic plan establishes executive-level performance goals and tracks results; designates key performance outcomes, measures, and indicators; and assigns responsibility for metrics to individual component levels within the Department. Budget and financial indicators monitor and guide financial management reform and target resources to areas where the DoD needs better stewardship of financial resources.

Financial Improvement Progress and Results

To date, the Department-wide financial statements have received a disclaimer of opinion from the auditors, which means that the financial information displayed in the statements is in such poor condition that the auditors are unable to express an opinion. The auditors have noted 11 specific financial statement weaknesses, which the Department has been working to resolve through various initiatives. These weaknesses and the Department's mechanisms in place to address them, as well as the Department's progress are discussed below. Overall, the DoD's inability to obtain an unqualified or "clean" opinion on its financial statements is due to inadequate systems and business processes.

Financial Statement Weakness	Description	Primary Corrective Action Mechanism	Status	Target Completion Date
Financial Management Systems	The DoD systemic deficiencies in financial management systems and business processes result in the inability to collect and report financial and performance information that is accurate, reliable, and timely.	BMMP	Implementation of the DoD BMMP Enterprise Transition Plan and the BMMP Business Enterprise Architecture containing financial management elements, including the SFIS, will resolve this material weakness.	FY 2015
Intra-governmental Eliminations	The inability to reconcile most intragovernmental transactions results in adjustments that cannot be fully supported.	BMMP	Under the BMMP Financial Visibility initiative "Intragovernmental Transactions," DoD will develop standardized, consolidated and integrated processes and system components.	FY 2015
Accounting Entries	The DoD continues to enter material amounts of unsupported accounting entries.	BMMP	Resolving this material weakness requires the implementation of the BMMP Enterprise Transition Plan and the BMMP Business Enterprise Architecture solutions, including the SFIS, Business Enterprise Information Services, and Intragovernmental Transactions initiatives. Additionally, deployment of modern accounting systems capable of using the SFIS is required. Resolution of this material weakness will be achieved incrementally as the BMMP solutions and systems are implemented.	FY 2015

Financial Statement Weakness	Description	Primary Corrective Action Mechanism	Status	Target Completion Date
Fund Balance with Treasury	The Department has been unable to fully reconcile its records to those of the U.S. Treasury.	FIAR Plan	The Department strengthened internal controls for disbursements through reconciliation training and metric tracking to more accurately record disbursements. The Department obtained the necessary legislation to clear, and did clear, old unreconcilable suspense accounts and check issue differences totaling $609 million through FY 2005. The Department has a multi-phase program underway to enhance system functionality for improving expenditure reconciliation and reporting.	FY 2009 (Army and Air Force plan to have ready for audit in FY2006)
Environmental Liabilities	Guidance and audit trails are insufficient. The inventory of ranges and operational activities (landfills, open burning pits, etc.) is incomplete.	FIAR Plan	The Department issued guidance for closed sites in October 2002. The Department plans to issue financial guidance for ongoing operational activities by December 2005. Inventories of operational and non-operational ranges are complete. Additional review and validation are needed to ensure audit trails are sufficient.	FY 2010
General Property, Plant, and Equipment (PP&E)	The cost and depreciation of the DoD General PP&E is not reliably reported due to: (1) a new accounting requirement that went into effect in FY 2003 that classifies military equipment as General PP&E (such costs were previously expensed), (2) a lack of supporting documentation for General PP&E which were purchased many years ago, and (3) most legacy property and logistics systems are not integrated with acquisition and financial systems and were not designed to capture the acquisition cost, cost of modifications and upgrades, or calculate depreciation.	FIAR Plan	The Department implemented guidance and training to improve property accountability and provide better financial reporting. The Department has completed 95 percent of Army and Navy initial military equipment valuations and 100 percent of Air Force valuations. The Department plans to complete valuations of all known military equipment programs by December 2005. The military equipment baseline will be updated to a single base year in FY 2006. The Department began development of a system that will facilitate the update and maintenance of baseline values. The system will be deployed as a pilot by December 2005 and will be fully operational by the end of September 2006. At that time, the DoD will have established its military equipment baseline.	FY 2011
Government Property and Material in the Possession of Contractors	The cost of DoD property and material in the possession of contractors is not reliably reported due to a lack of an integrated reporting methodology.	FIAR Plan	The Department is developing policy and processes to help correct this weakness. The Office of Management and Budget will soon release new policy that will bring property in the possession of contractors up to leading industry standards and help the Department correct this weakness. To improve accountability, accuracy, and reliability, the DoD is creating an on-line government property system to be used jointly by government and industry for recording property in the possession of contractors. Initial data loads will take place in 2006.	FY 2011
Inventory	The existing inventory valuation at most activities is not reported in accordance with generally accepted accounting principles.	FIAR Plan	The Department issued a change in policy in FY 2001 to begin valuing inventory at moving-average-cost to comply with historical cost valuation requirements. In FY 2004, a DoD workgroup began to assess major logistics and financial systems—current and future—to determine the adequacy for producing historically-based valuations. Based on these efforts, the Department will issue a baselining requirements policy in FY 2006.	DoD components will complete plans by 12/31/05
Operating Materials and Supplies	The Department's systems were designed to expense materials when purchased rather than when consumed.	FIAR Plan	The DoD workgroup addressed issues pertaining to the capitalization of Operating Materials and Supplies versus expensing. The Department currently is reviewing its policies for potential update.	DoD components will complete plans by 12/31/05

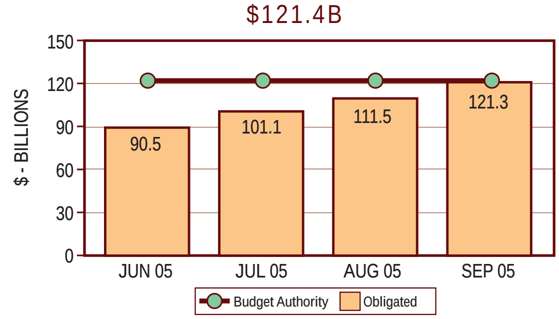
Financial Statement Weakness	Description	Primary Corrective Action Mechanism	Status	Target Completion Date
Statement of Net Cost	The Statement of Net Cost is not presented by programs that align with major goals and outputs described in the DoD's strategic and performance plans required by the Government Performance and Results Act. Revenues and expenses are reported by appropriation categories because financial processes and systems do not collect costs in line with performance measures.	BMMP	Resolving this material weakness requires the implementation of the BMMP Enterprise Transition Plan and the BMMP Business Enterprise Architecture solutions including the SFIS, Business Enterprise Information Services, and Intragovernmental Transactions initiatives. Additionally, deployment of modern accounting systems capable of using the SFIS is required. Resolution of this material weakness will be achieved incrementally as the BMMP solutions and systems are implemented.	FY 2015
Statement of Financing	The DoD cannot reconcile budgetary obligations to net cost without making unsupported adjustments.	BMMP	Resolving this material weakness requires the implementation of the BMMP Enterprise Transition Plan and the BMMP Business Enterprise Architecture solutions including the SFIS, Business Enterprise Information Services, and Intragovernmental Transactions initiatives. Additionally, deployment of modern accounting systems capable of using the SFIS is required. Resolution of this material weakness will be achieved incrementally as the BMMP solutions and systems are implemented.	FY 2015

The following are several of the budget and financial indicators that we monitor to help us guide financial management reform and target resources to areas where we need to drive better stewardship of financial resources.

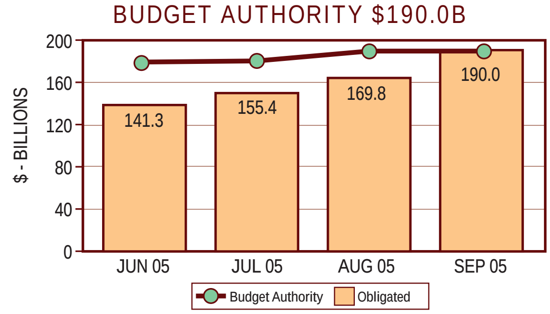
Execution of Military Personnel and Operation and Maintenance Appropriations

The Department executed 99.9 percent of its Military Personnel Appropriations by the end of September 2005 and 100 percent of its Operation and Maintenance Appropriations for the Military Departments. The Department uses the metric below to compare each appropriation's annual budget authority with the Service projected annual obligations to fund the full requirement. The Department's goal is to ensure projected obligations remain between 98 and 100 percent of budget authority for the fiscal yearend.

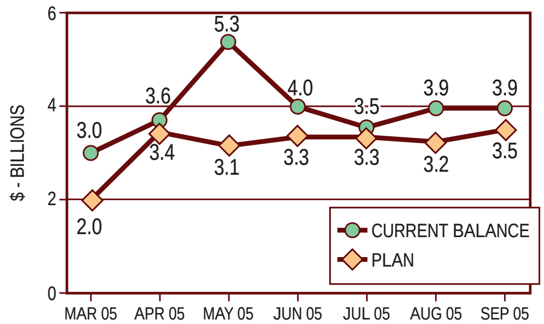
TOTAL MILITARY PERSONNEL APPROPRIATIONS BUDGET AUTHORITY $121.4B



OPERATION & MAINTENANCE APPROPRIATIONS MILITARY DEPARTMENTS BUDGET AUTHORITY $190.0B

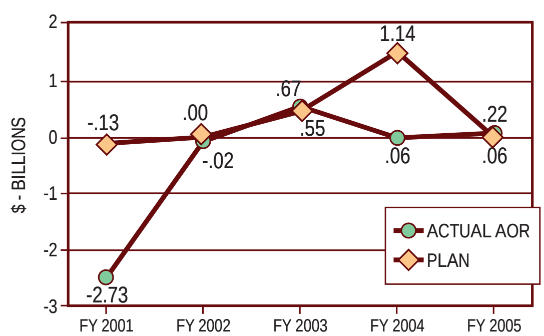


Defense Working Capital Fund Cash Management with U.S. Treasury



The management of cash within the Defense Working Capital Fund is defined as the ability to maintain sufficient liquidity to meet current obligations and accurately forecast cash requirements. The Department transferred $2.1 billion to the Operation and Maintenance appropriation this fiscal year. Transfers give the Fund the ability to maintain sufficient liquidity to service current obligations and accurately forecast cash requirements. Higher fuel costs and inventory replacement have severely reduced cash in FY 2005 and will severely reduce cash in FYs 2006 and 2007. Additional supplemental funding of $1.4 billion was required to offset the fuel loss in FY 2005.

Defense Working Capital Fund Accumulated Operating Results



The Accumulated Operating Results (AOR) reflects the cumulative operating gain or loss since inception for each industrial type business area. This indicator displays the variance between the phased plan for AOR provided in the budget and the actual AOR reported in the monthly financial statement.
The Department anticipates completing FY 2005 ahead of plan due to increased revenue from workload related to contingency operations. Improved performance at the Depot Maintenance activities, Defense Information Systems Agency, and Defense Logistics Agency Distribution Depots are the primary drivers for AOR growth over plan. Rate adjustments in the budget years ahead will bring AOR closer to zero. Improved AOR from FY 2001 to FY 2002 was the result of corrections of prior year accounting data.

Late Payments of Commercial Invoices

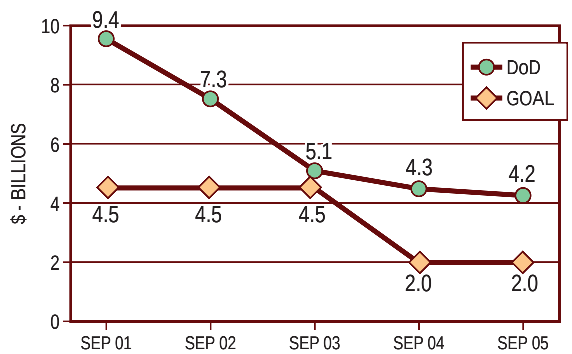
The Prompt Pay Act requires that invoices be paid on time. This indicator highlights the degree to which the DoD is able to reduce its untimely commercial payments. The Department met its FY 2005 goal to reduce late payments to a level not to exceed 2 percent of total commercial invoices. Improving this indicator reduces cost to the Department and improves its relationship with suppliers. The Department reduced late payments by 46 percent from FY 2004. Attention to this indicator has driven overdue payments to contractors down by 66 percent since FY 2001.

Delinquent Accounts Receivable

This Accounts Receivable indicator highlights the amount owed to the Government by an individual, organization, public entity, foreign entity, or any other entity (including Federal entities), to satisfy a debt or claim. Delinquent receivables are broken down into two types: public and intragovernmental. For FY 2005, the Department did not meet its goal to reduce these receivables by 75 percent from the FY 2003 baseline of $4.7 billion. The majority of public delinquencies are not under the Department's control. For September 2005, $3.7 billion of the

$4.6 billion of total public delinquencies were at Treasury or in litigation at the Department of Justice. For September 2005, the amount of receivables owed to the Department from other federal agencies was $261 million.

The DoD Travel Card Program Individually Billed Accounts Delinquency Rates



The indicator measures the percent of the DoD employee travel card balances outstanding for more than 61 days. Reducing outstanding balances helps increase rebates to the Department. The delinquency rate for individual travel accounts declined 55 percent since FY 2001.

Overview of Financial Statement Results

The DoD's financial management environment is complex and diverse. Its FY 2005 financial statements included $1.3 trillion in assets, $1.9 trillion in liabilities, and $635 billion in Net Cost of Operations. In FY 2005, DoD prepared and obtained an audit opinion on the Department-wide financial statements and nine major reporting components that comprise the Department-wide financial statements. The major reporting components include the Military Retirement Fund, the Medicare Eligible Retiree Health Care Fund, the U.S. Army Corps of Engineers, and the general funds and working capital funds for the Army, Air Force, and Navy.

Of those, only the Military Retirement Fund received an unqualified audit opinion, meaning that the financial statements are presented fairly, in all material respects. The liabilities of the Military Retirement Fund account for 47 percent of the Department-wide liabilities.

The Medicare Eligible Retiree Health Care Fund, which accounts for 5 percent of the DoD's assets and 28 percent of its liabilities, received a qualified opinion, which means that except for certain conditions, the financial statements meet the standards for an unqualified opinion as described above.

The DoD also prepares statements for many of the smaller entities within the Department that are then rolled up into the overall consolidated financial statement and identified as "Other Defense Organizations." Some of these smaller entities are subject to audit each year. Four organizations within this group achieved unqualified audit opinions again in FY 2005: the Defense Finance and Accounting Service, the Defense Contract Audit Agency, the Defense Commissary Agency, and the Defense Threat Reduction Agency. In addition, at the DoD-wide level, the Department received favorable audit results on three financial statement items in FY 2005: (1) Investments, (2) Federal Employees' Compensation Act Liabilities, and (3) Appropriations Received.

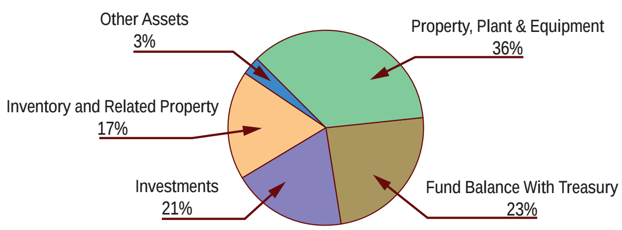
As a result of these financial improvements and audit successes, 21 percent of DoD's assets and 47 percent of its liabilities received favorable audit results in FY 2005. DoD's financial statements for FY 2005 are presented in their entirety in Part 3, Financial Information. A summary of results is provided below.

Assets

Assets are resources owned or managed by DoD that are available to provide future economic benefits.

The Consolidated Balance Sheet shows that DoD assets as of September 30, 2005, were $1.3 trillion, an increase of $58.4 billion from FY 2004. A summary analysis is provided below.

TYPES OF ASSETS



The DoD's Fund Balance with Treasury at September 30, 2005 of $290.7 billion is essentially unchanged from FY 2005. The Fund Balance with Treasury is the equivalent of DoD's "checkbook" balance or aggregate amount of funds deposited in Treasury available to make authorized expenditures or pay liabilities.

Investments increased by $32.5 billion primarily due to contributions and interest exceeding benefits paid by the Military Retirement Fund and the Medicare Eligible Retiree Health Care Fund for retired military members and their dependents.

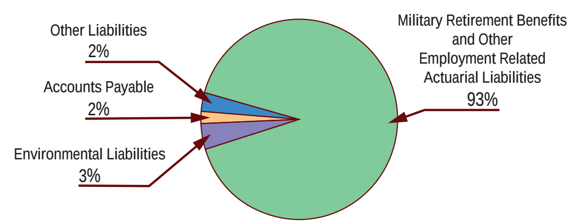
Plant, Property, and Equipment increased by $19.8 billion due primarily to DoD's ongoing efforts to identify and capitalize military equipment.

Asset Type	FY 05	FY 04	Change
Property, Plant, & Equipment	$460.7B	$440.9B	+$19.8B
Fund Balance w/Treasury	$290.7B	$289.6B	+$1.1B
Investments	$264.0B	$231.5B	+$32.5B
Inventory & Related Property	$222.6B	$220.5B	+$2.1B
Remaining Assets	$36.2B	$33.3B	+$2.9B
Total	$1,274.2B	$1,215.8B	+$58.4B

Liabilities

Liabilities are amounts owed by the DoD that will require payments from current or future assets. The Consolidated Balance Sheet shows that DoD liabilities as of September 30, 2005, were $1.9 trillion, an increase of $163.2 billion (10 percent) from FY 2004.

TYPES OF LIABILITIES



Military Retirement Benefits and Other Employment Related Actuarial Liabilities increased $166.4 billion (11 percent), due in part to a significant increase in death benefits and life insurance for service members killed in combat. Also contributing to the increase is the significant number of military retirees and their family members who are taking greater advantage of military health facilities in recent years, and relying less on private sector health insurance. With civilian benefits eroding due to the high cost of health care, more and more veterans and their families are finding their TRICARE health benefit a better value. This phenomenon has required the adjustment of actuarial factors used to calculate the expected long-term costs of the TRICARE benefit.

Environmental Liabilities increased by $660.5 million primarily due to improving the Department's inventory of environmental sites and the accuracy of environmental liability estimates.

Liability Type	FY 05	FY 04	Change
Military Retirement Benefits and Other Employment Related Actuarial Liabilities	$1,736.1B	$1,569.7B	+$166.4B
Environmental Liabilities	$65.0B	$64.4B	+$0.6B
Accounts Payable	$30.6B	$30.2B	+$0.4B
Other Liabilities	$41.7B	$45.8B	-$4.1B
Total	$1,873.4B	$1,710.1B	+163.3B

Costs

The Consolidated Statement of Net Cost shows that the net cost of operations for the Department of Defense for FY 2005 was $634.9 billion, an increase of $29.5 billion (5 percent) from FY 2004. The principal reason for this increase continues to be military operations in Iraq and Afghanistan, as indicated by the table below, which reflects that costs to pay, operate, maintain, supply, and transport forces increased by $87.2 billion. Though liabilities associated with military retiree benefits increased significantly as discussed above, the table below reflects that total military retirement costs decreased from FY 2004 by $31.6 billion. This is due to the recognition of concurrent receipt benefits in FY 2004, which resulted in significant additional costs in FY 2004, and far exceeded the additional benefits recognized in FY 2005. The Consolidating Statement of Net Cost in Part 3, Financial Information, provides a more detailed breakout of the Department's costs.

Program Type	FY 05	FY 04	Change
Military Personnel	$122.5B	$112.3B	+$10.2B
Operation & Maintenance	$264.1B	$187.1B	+$77.0B
Procurement	$62.0B	$79.2B	-$17.2B
Research, Development, Test & Evaluation	$61.9B	$56.8B	+$5.1B
Military Retirement	$121.8B	$153.5B	-$31.7B
Other Programs	$2.6B	$16.5B	-$14.1B
Total	$634.9B	$605.4B	+$29.5B

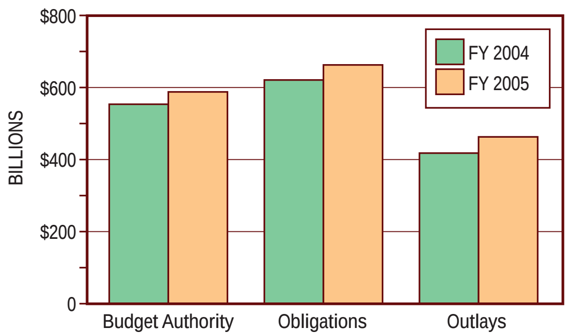
Budget Authority

Budget Authority is the authority provided by law to incur financial obligations that will result in outlays—payment for the amounts of orders placed, contracts and grants awarded, services received and similar transactions during a given period. Specific forms of budget authority requested by the Department include:

- Appropriations Received from Congress provide authority to incur obligations and to make payments from Treasury for specified purposes.
- Borrowing Authority from Congress to authorize the DoD to incur obligations and make payments to liquidate the obligations of funds borrowed from Treasury or directly from the public.
- Contract Authority from Congress permits obligations to be incurred in advance of appropriations or receipts with payments made only when a subsequent appropriation or offsetting collection is received.
- Appropriation Transfers from other funded agencies permit the DoD to incur obligations and make payments.

The Combined Statement of Budgetary Resources shows that the amount of budget authority the Department had for FY 2005 was $661.5 billion. This is a $45.2 billion (7 percent) increase from FY 2004. Increased funding to fight the global war on terror precipitated this increase and the corresponding increases to both obligations and outlays, which are discussed below.

STATEMENT OF
BUDGETARY RESOURCES



Obligations

An obligation is a binding agreement that will result in outlays, immediately or in the future. Budgetary resources must be available before obligations can be incurred legally. The Combined Statement of Budgetary Resources shows that obligations made during FY 2005 were $777.5 billion, an increase of $56.8 billion (8 percent) from FY 2004.

Outlays

An outlay is a payment to liquidate an obligation (other than the repayment of debt principal). Outlays generally are equal to cash disbursements, but also are recorded for cash-equivalent transactions, such as the subsidy cost of direct loans and loan guarantees, and interest accrued on issues of public debt. Outlays are the measure of government spending. The Combined Statement of Budgetary Resources shows that outlays made during FY 2005 were $563.9 billion, an increase of $42.8 billion (8 percent) from FY 2004.

President's Management Agenda

The President's Management Agenda, announced in the summer of 2001, is an aggressive strategy for improving the management of the federal government. The Department has made significant progress toward achieving the goals of the President's Management Agenda. Each quarter, federal departments and agencies receive "stoplight" grades of green, yellow, or red from the Office of Management and Budget on both their current status and progress toward meeting the standards for success established for each area. A green score indicates success, yellow denotes mixed results, and red represents failure. The results for all agencies are reported on the Executive Branch Management Scorecard, which is available at http://www.results.gov. This website includes detailed information about the President's Management Agenda.

The Agenda currently focuses on five key federal government-wide management areas and two program initiatives:

- Electronic Government (e-Gov),
- Strategic Management of Human Capital,
- Improved Financial Performance,
- Budget and Performance Integration,
- Competitive Sourcing,
- Real Property Management Initiative, and
- Eliminating Improper Payments Initiative.

In addition, the President's Management Agenda includes several agency-specific initiatives, two of which apply to DoD:

- Coordination of Department of Veterans Affairs (VA) and DoD and
- Privatization of Military Housing.

As of September 30, 2005, the Department's grades were mixed:

Executive Branch Management Scorecard Results for DoD (September 30, 2005)

Government-Wide Program Initiatives	Status Score	Progress Score
Electronic Government (e-Gov)	Red	Red
Strategic Management of Human Capital	Yellow	Green
Improved Financial Performance	Red	Yellow
Budget & Performance Integration	Yellow	Green
Competitive Sourcing	Red	Red
Real Property Management Initiative	Red	Green
Eliminating Improper Payments Initiative	Yellow	Green
DoD-Specific Initiatives		
Coordination of VA and DoD Programs and Systems	Yellow*	Yellow*
Privatization of Military Housing	Green	Green

** Scores as of June 30, 2005*

Following is a brief description of each initiative and efforts the Department has undertaken thus far toward successful implementation of the President's Management Agenda.

Electronic Government

<u>Goal:</u> *To ensure that the DoD's multi-billion dollar annual investment in information technology (IT) is well spent.*

The DoD is working to ensure that all major IT investments are justified with strong business cases; all projects are completed within 10 percent of cost, schedule, and performance goals; and IT systems are secured properly and data is protected appropriately. The Department is taking an active role in several initiatives, including the government-wide SmartBUY, Integrated Acquisition Environment, and Grants.gov, as well as the DoD initiatives involving the Defense Travel System and education and training.

SmartBUY

The DoD participated actively in the government-wide SmartBUY team, which negotiated three "co-branded" software products on behalf of the entire federal government. These agreements enable federal agencies to obtain discounts and improved terms and conditions, and even better discount terms and conditions on large orders and enterprise licenses.

Integrated Acquisition Environment

The DoD leads government-wide implementation of the Integrated Acquisition Environment, which is a portfolio of systems and initiatives that support procurement and procurement-related processes. This ongoing implementation supports both federal and the DoD goals of strategic and cost-effective acquisition and delivery of the best possible goods and services to the warfighter, as well as unification and simplification of the acquisition business environment to support delivery. A key accomplishment includes adapting existing the DoD programs for government-wide use as a part of the portfolio. The federal versions of the DoD's Central Contractor Registry, the DoD Technical Data Solution, and Past Performance Information Retrieval System are all federal award-winning programs under the Integrated Acquisition Environment mantel. This simplifies the way the government does business, as well as the way industry interacts with government.

Grants.gov

The Department has been influential in shaping the policy related to the electronic processing of government grants. Earlier this year, the DoD succeeded in adding language to the electronic grant application to better reflect the legal effect of individuals or organizations submitting a grant application electronically through Grants.gov. The DoD components are posting solicitations that may result in assistance agreements at Grants.gov. Use of Grants.gov and the standard solicitation announcement provide greater insight into the DoD's programs and funding and have the potential to expand the Department's research base by making program information more widely available.

Defense Travel System

The DoD Defense Travel System was developed separately from the General Services Administration's eTravel Service. It is more expansive in scale, scope, and functionality than the eTravel Service, which is being implemented in non-Defense agencies. The DoD and the General Services Administration collaborate closely on a wide range of federal travel issues, seeking common solutions where appropriate. The Defense Travel System represents a whole new way of doing business for government and the DoD must ensure that promises and goals envisioned are achievable. Specifically, the Department will assess whether it is delivering increased efficiencies, improved services, and achieving cost savings as promised. In doing so, the DoD will study carefully the several reports and evaluations of the system before taking any action.

Education and Training Initiatives

The DoD established a new Organizational Transformation Certificate program at the Information Resources Management College in June 2005. The program focuses on developing leaders who can anticipate and implement the transformational changes required to establish a net-centric environment that serves the citizen, warfighter, and the business mission equally well. Students may specialize in Electronic Government, National Security, Domestic Preparedness, or the Business of Government. This program replaces the current eGovernment Leadership Certificate program.

The College also inaugurated a new Enterprise Architecture Certificate program in January 2005. This program is organized around the seven core competencies for enterprise architecture established by the federal Chief Information Officers' Council, and builds on architectures & infrastructures, one of the 11 Chief Information Officer core competencies. The program includes a choice of classes concentrating on either the DoD or federal architectures as well as a final practicum course where students will apply their learning to solve real-world enterprise architecture challenges.

The DoD continues to expand the information technology and information assurance education opportunities available through the DoD's Information Assurance Scholarship program. One hundred and fifty students have participated in this program, with 65 graduated to date. The Department continues to enhance the flexibility of the program to meet emerging needs by adding part-time master's degree programs, authorizing enlisted participation at the Naval Postgraduate School, and increasing the number of partnership arrangements with civilian Centers of Academic Excellence.

Strategic Management of Human Capital

<u>**Goal:**</u> *To ensure that the Department's civilian workforce is high-performing, capable, agile, and well trained. This includes moving toward a mission-focused, performance-based human resources management system that provides flexibility while taking care of the DoD's civilian employees.*

The Department has several initiatives underway to meet this goal:

National Security Personnel System

The Department, with assistance from the Office of Personnel Management, designed the National Security Personnel System (NSPS), a modernized, performance-based civilian personnel system. This system, an essential element of the Department's overall transformation, will provide a more flexible means of managing the DoD's civilian workforce while preserving employee rights and protections. Civilians are critical to accomplishing the Department's mission. The NSPS not only will benefit the Department; it will provide the DoD employees with opportunities for greater control of their careers and advancement.

The DoD published a proposed regulation that outlined the fundamental features of the system in the February 14, 2005 Federal Register. More than 58,000 comments were received from employees, employee representatives, interest groups, elected officials, and the public. The Department reviewed and analyzed these comments and plans to issue the final regulations for Congressional notification and publication in the Federal Register by the end of 2005. After the regulations are published, the DoD will begin training its workforce and implementing the flexibilities afforded by NSPS.

Senior Executive Service Appraisal System

In addition to NSPS, the DoD is institutionalizing a performance-based culture at all levels. The Department developed a pay-for-performance strategy for Senior Executive Service members and equivalent senior executives. The design of the system grew out of the Department's experience with performance-based pay strategies at its personnel demonstration projects. The Office of Personnel Management approved the DoD Executive and Senior Professional Pay and Performance System in April 2005. Under this system, individual performance will be a basis for pay decisions and recognition of individual performance and contribution to the DoD's mission. The Department sent a request for provisional certification to the Office of Personnel Management in June 2005 and received a response in late August 2005. While DoD did very well overall, the Office of Personnel Management recommended improvement in translating and cascading performance requirements into more refined expectations, particularly in terms of achieving results. With only a few weeks remaining in the FY 2005 performance cycle, the DoD elected not to revise senior employees' performance plans. The Department will seek provisional certification by the end of 2005 for the FY 2006 performance cycle.

Critical Skills and Competencies

The correct mix of skills and competencies is critical to mission completion. Monitoring the fill rate of core and critical support occupations is one aspect of assessing skill gaps that the Department undertakes quarterly. Assessing competency gaps is another important element. The Department is approaching this from two directions: (1) convening study groups to focus on specific competencies required in core, critical occupations across the Department and (2) by recurring reviews of metrics that identify competency gaps in the workforce. The DoD recently initiated a project to identify the fundamental competencies and expertise needed by general/flag officers, senior executives, and senior noncommissioned officers serving in joint positions to identify gaps between required and available competencies and to develop proposals to close the gaps.

The Department also chartered a working group to examine the core DoD competencies associated with the development and progression in career fields. Competency identification will create a foundation for applications and investment in such areas as recruitment, selection, performance management, training and development, and strategic workforce shaping. The alignment of core competencies with mission requirements will result in a more flexible, agile, and mission-focused civilian workforce.

The Department continues to perform thorough reviews of historical and projected loss and turnover rates for these mission-critical occupations quarterly. In light of findings from these reviews, the Department received approval for direct-hire authority for severe shortages in forensic biologist positions at the U.S. Army Criminal Investigation Laboratory and certain accountant positions, and successfully sought special pay rates for law enforcement occupations.

Workforce Restructuring

The Department of Defense Workforce Restructuring Plan and Human Resources Strategic Plan performance measures are valuable tools that enable effective monitoring of the Department's ability to meet current and future human capital needs and accomplish the Administration's objectives. All components continue to support the plan's initiatives in the following areas:

- Major Headquarters Reductions,
- Planned Reorganizations,
- Reduction in the Number of Managers and Supervisors,
- Projected Outsourcing Efforts, and
- Reengineered or Streamlined Processes Resulting in Efficiencies or Savings.

The DoD issued policy regarding the use of Voluntary Separation Incentive Pay (buyout) allocations to the components for FY 2005. Quarterly monitoring of usage indicates clearly that the DoD is applying buyout and early retirement authorities judiciously to shape the force as necessary.

The Department's Priority Placement Program is the primary vehicle for placing employees who have been affected adversely by workforce reductions, transfer of functions, and the Base Realignment and Closure process. The Department established the Base Realignment and Closure 2005 Working Group (consisting of members from the DoD components and Defense Agencies) to assess private sector transition assistance programs, evaluate the best practices/lessons learned from previous Base Realignment and Closure rounds, and recommend applicable Departmental guidance, publications, and services in advance of the 2005 process. The Department developed an on-line "tool kit" to help employees understand the process and become familiar with the programs and benefits available to them. The website provides information on various placement programs, separation incentives, transition benefits, frequently asked questions concerning a wide range of pertinent issues, links to the DoD component Base Realignment and Closure websites, and offers up-to-date information on Base Realignment and Closure developments. Additionally, Internet-based distance learning modules were developed to provide cost-effective training to reach all human resources specialists involved with reduction-in-force and placement activities.

Accountability

The Human Capital Accountability and Evaluation initiative launched during the fourth quarter will design, develop, and implement a Human Capital Accountability System to provide centralized management and oversight of human capital assessment and accountability efforts across the DoD. The effort will result in a common framework for identifying issues and comprehensive strategies to improve performance. This program is being developed in close cooperation with the Office of Personnel Management and will align with its framework. Implementation of the program is planned for FY 2006.

Improved Financial Performance

Goal: *To ensure transparency over the DoD's finances by having timely and reliable financial information available on a regular, recurring basis and using that information to make informed decisions about the DoD or program management. Transparency means knowing the costs and results of government programs and operations and being able to judge the best return on investment for the American people. Demonstrating fiscal accountability and achieving unqualified financial statements are good first steps. Ultimately, agency leadership will use this more accurate, precise, and timely financial information in day-to-day management.*

The Department has several initiatives underway to improve its financial performance: the Business Management Modernization Program, the Financial Improvement and Audit Readiness Plan, and the Under Secretary of Defense (Comptroller) Strategic Plan. These initiatives are discussed earlier in this report.

Budget and Performance Integration

Goal: *To improve program results and to ensure that performance is routinely considered in funding and management decisions.*

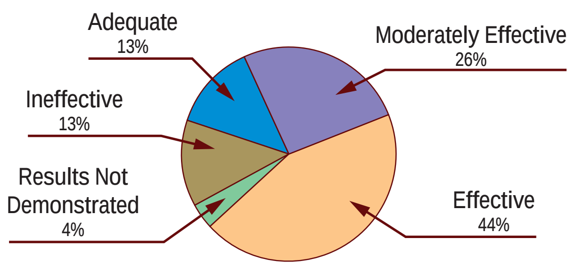
During FY 2005, the Department developed and defended its FY 2006 budget, which requested $419.3 billion in the DoD discretionary budget authority for FY 2006. The budget supports priorities established by Secretary Rumsfeld to fulfill the President's pledges to defeat global terrorism, restructure America's armed forces and global defense posture, develop and field advanced warfighting capabilities, and take good care of the DoD's people. To develop the FY 2006 budget, the Department continued to implement a new Planning, Programming, Budgeting, and Execution process and developed the DoD's first full 2-year budget. This process increases the effectiveness of the Department's resource allocation process by linking performance results to programming and budgeting decisions and placing additional emphasis on program execution. The Department addressed the marginal costs of achieving goals during the development of its FY 2006 President's Budget by considering alternatives that made performance trade-off decisions more focused and useful.

The Department developed and submitted the FY 2005 Emergency Wartime Supplemental Request for funds to finance continuing military operations in Iraq and Afghanistan. The request was formulated, in large part, by calculating the costs—based on current cost and performance data—for specific performance elements (e.g., the deployment of specific units to specific locations) and estimating the associated operational tempo.

The Department also met the goal of using the Program Assessment Rating Tool (PART) to assess programs representing 60 percent of its resources in the FY 2006 President's Budget. The PART provides a systematic and consistent approach to rating programs across the federal government. The PART process analyzes whether a program has a clear definition of success, uses strong management practices, and produces results.

The Office of Management and Budget provided favorable ratings to most DoD PART programs. Of the 23 DoD programs assessed using the PART through the FY 2006 President's Budget, the Office of Management and Budget rated 19 (83 percent) as Adequate or better. Examples of programs include Air Force Aircraft Depot Maintenance, Communications Infrastructure, and Navy Ship Operations. The Missile Defense Program improved the previous year's Results Not Demonstrated rating to a Moderately Effective rating. The following chart provides a breakout of the overall ratings for the DoD PART programs.

DoD PROGRAMS
BY PART RATING CATEGORY



Competitive Sourcing

<u>Goal:</u> *To help agencies become more results-oriented and effective through public-private competition in accordance with Office of Management and Budget Circular A-76, "Performance of Commercial Activities," and efficiency alternatives to the A-76 process.*

The Department uses the A-76 process only when it makes military and economic sense to do so. Competition is a driving force enabling organizations to improve quality, reduce cost, and provide rapid delivery of better products and services. The DoD continues to use the process of public-private competition to obtain services clearly identified as commercial, thereby improving support to the warfighter and increasing readiness.

The alternatives to A-76 also produce significant efficiencies and are focused primarily on military to civilian conversions, high performing organizations in accordance with section 337 of the National Defense Authorization Act of 2004 (Public Law 108-136), and privatization initiatives.

A-76 competitions have produced significant savings for the DoD. From FY 2000 to the present, the Department expects to produce savings of nearly $10 billion through the periods of performance regardless of who ultimately wins the competition.

The DoD is committed to providing all responsible officials with the training required to meet their new and expanded duties required to successfully execute the Department's A-76 competitive sourcing program. Courses are being developed by the Defense Acquisition University to ensure the training is timely, effective, and consistent across the Department. Prior to competing a function, the government defines its requirements with both the in-house and contractor workforces independently determining how they will perform the function. When the decision favors contract performance, the contractor normally hires much of the existing workforce, thus reinforcing the competitive process and ensuring that the DoD has the right person for the job.

The DoD's web-based data information system provides the Department with real time daily updates on the status of A-76 initiatives with a special module to track the status of military to civilian conversions. The Department maintains oversight of the relatively small number of other types of competitive sourcing initiatives by tracking status periodically.

Ultimately, the success of competitive sourcing and achievement of true savings will be realized by addressing the cultural hurdles and embracing the reengineered work processes, funding and integrating the new technology tools with the existing systems, and ensuring a complete and seamless integration.

Real Property Management Initiative

<u>Goal:</u> *To help the DoD efficiently manage the nearly $100 billion in real property it owns. The Federal Real Property Council developed standards for how federal agencies should initiate improvements to property management, to include timely and accurate inventory data and performance measures in evaluating property acquisition, maintenance, and disposal decisions.*

The Department has developed and implemented a comprehensive plan to improve real property management to ensure that the right assets are available when and where needed with the capabilities necessary to support the warfighter. Accurately capturing the real property inventory, and continuing to refine performance measures that monitor how well the DoD sustains, restores, and modernizes its facilities are integral steps in accomplishing that goal. The Department's plan to monitor progress, identify and correct deficiencies, and address overall management of its real property includes:

- Increased visibility of the assets under management through improved real property inventories.
- Application of requirements models based on accurate and auditable commercial benchmarks and tied directly to the existing and forecasted assets.
- Standardization of performance targets across the Department through improved planning guidance.
- Implementation of mechanisms for continuous tracking of performance through the programming and budgeting cycle.
- Controlling the size of the Defense footprint through incentives and robust demolition and disposal programs, including Base Realignment and Closure 2005.
- An up-to-date asset management plan including goals and timelines, linked to and consistent with higher order plans and priorities.
- Achieving full sustainment funding levels to prevent waste through deterioration and loss of service life.
- Reaching a recapitalization rate that matches the expected service life of the assets under management to prevent loss of effectiveness through obsolescence.

To improve asset accountability, the Department developed a real property unique identification concept. All assets have a DoD-wide unique identifier, allowing management and financial systems to better track environmental, operational, and financial data to real property. This concept is being reviewed by industry and other federal agencies for use outside of the DoD.

Eliminating Improper Payments Initiative

<u>Goal:</u> *To strengthen financial management controls to better detect and prevent improper payments, thus enabling the DoD to better ensure the taxpayer dollar is put to the use the Congress intended.*

The Department makes more than $500 billion in payments to individuals and a variety of other entities each year. An improper payment occurs when the funds go to the wrong recipient, the recipient receives the incorrect amount of funds, or the recipient receives payment for an ineligible service. Improper payments also include duplicate payments and payments for products and services not received. The Department maintains a vigorous review process to identify and prevent duplicate vendor payments and make sure program dollars are spent as intended. This review process includes pre and post payment reviews, continual enhancements to commercial payment systems to detect potential erroneous payments prior to disbursement, post-payment reviews of commercial payments within 180 days of disbursement, and continual review by Office of Inspector General of purchase and travel card payments. The DoD's efforts to eliminate improper payments are described in the Analysis of Systems, Legal Compliance, and Controls section of this report and in greater detail in Part 3, Financial Information.

Coordination of Department of Veterans Affairs and DoD Programs and Systems

<u>Goal:</u> *This initiative seeks to ensure a seamless transition from active duty to veteran status, continuity of care,*

greater accuracy in forecasting patient population, and increased sharing of services to reduce costs and improve the quality of care.

Both the DoD and the Department of Veterans Affairs (VA) operate comprehensive medical care systems programs for Active duty military members and veterans. The DoD and VA continue to work together in a wide variety of areas to find efficiencies and improve health care to their beneficiaries. The Joint Executive Council and its subordinate Health Executive Council and Benefits Executive Council are pursuing opportunities to share health care resources between the two Departments and updating the Joint Strategic Plan for FY 2006. The plan includes goals, objectives, and performance metrics in the following areas:

- Leadership, commitment, and accountability,
- High quality health care,
- Seamless coordination of benefits,
- Integrated information sharing,
- Efficiency of operations, and
- Joint contingency/readiness capabilities.

As part of the integrated information sharing goal, the Departments have created the Federal Health Information Exchange to support the transfer of electronic health information from the DoD to VA at the point of a Service member's separation. VA clinicians and claims adjudicators use this information, which includes patient demographics, lab results, radiology reports, outpatient pharmacy data, allergy information, discharge summaries, consultation reports, and the DoD's standard ambulatory data records for specific health encounters. As of June 2005, the DoD had transferred medical records for more than 3 million unique patients to the exchange repository. More than 1.4 million of these patients—nearly half—have approached VA for care or claim determination. VA queries the exchange repository more than 2,500 times per week.

Privatization of Military Housing

Goal: This initiative seeks to eliminate inadequate family housing and increase the quality of life for Service members and their families.

DoD received "green" scores for both status and progress on this initiative. Leveraging the DoD's resources with private sector capital revitalizes inadequate housing faster and at a lower lifecycle cost to the taxpayer than traditional construction. Since the end of 2000, the DoD has privatized almost 111,600 housing units, and plans to privatize a cumulative total of more than 185,000 units by the end of 2007. The DoD tracks its progress in four categories: (1) elimination of inadequate housing units, (2) privatization of housing inventory, (3) average housing costs covered for Service members living in non-governmental housing, and (4) satisfaction of Service members who choose to live in revitalized private housing.

Analysis of Systems, Legal Compliance, and Controls

Systems

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 requires federal agencies to conform to the U.S. Government Standard General Ledger, comply with all applicable federal accounting standards, establish financial management systems that meet government-wide standards and requirements, and support full disclosure of federal financial data, including the costs of federal programs and activities.

The Department's Inspector General and the audit agencies in the Military Services have provided comprehensive reporting on the Department's failure to comply with the Act's requirements. The DoD's inability to comply materially with the Act primarily is the result of structural problems related to legacy accounting systems that do not accurately account for both budgetary and proprietary activities. Quite simply, the Department does not have the systems and accounting structures in place to achieve compliance.

To remedy these challenges, the Department of Defense is placing an unprecedented emphasis on reforming the Department's financial management systems and accounting structures. Primarily through the Business Management Modernization Program, the Department is identifying the business capabilities, standards, and solutions at the DoD-wide enterprise-level that support compliance. However, substantial compliance cannot be achieved completely until improved accounting systems and underlying accounting structures are in place to support proper accounting for both proprietary and budgetary activities.

As previously discussed, a major step toward achieving compliance is the development of a Department-wide Standard Financial Information Structure supported by a U.S. Government Standard General Ledger. This structure was incorporated in the DoD Business Enterprise Architecture and serves as a common business language that facilitates tracking and traceability of financial information at the transaction level. Improving visibility of financial information at the transaction level enhances financial statement auditability consistent with the Act.

Legal Compliance

In addition to establishing and maintaining effective controls throughout the Department, each year the DoD works aggressively to ensure that its programs and operations comply with laws to ensure that the federal government provides the best possible service to the American people.

Chief Financial Officers Act

The Chief Financial Officers Act of 1990 requires federal agencies to prepare auditable annual financial statements. An overview of the DoD's financial statement activity is included in the prior section on Analysis of Financial Statements and Stewardship Information; a detailed presentation of the statements and the auditor's report appear in Part 3, Financial Information.

As noted earlier, the DoD received a disclaimer of opinion from its auditors. The Department developed the Financial Improvement and Audit Readiness Plan to serve as a roadmap for financial improvement and plots the Department's course for accurate and reliable financial data that results in a clean financial audit. The plan's comprehensive strategy supports continual and integrated improvements, while its agility allows each DoD component to realistically identify goals, progress, and necessary actions. The Financial Improvement and Audit Readiness Plan's framework and boundaries ensure that the DoD's financial improvement efforts are consistent operationally.

To minimize the funds spent on audits until the financial statements are ready for audit, the Department implemented a rigorous five-phase process in FY 2004. Phase one requires entities to identify and correct deficiencies in financial reporting. In phase two, management validates that the deficiencies were corrected. After validation, in phase three, management asserts to the auditors that the information is reliable, and documents the basis for that assertion. In phase four, the auditors perform an assessment to determine audit readiness. If the information is ready, the auditors will perform a full audit in phase five.

Government Performance and Results Act

The DoD's activities under the Government Performance and Results Act of 1993 are highlighted in the prior section on Performance Objectives, Goals, and Results; detailed performance information is provided in Part 2, Performance Information.

Inspector General Act Amendments

The Inspector General Act of 1978, as amended, requires an explanation for all audit reports with recommendations open for more than 1 year. As of September 30, 2005, the Department had 214 audit reports open for more than 1 year, with potential monetary benefits of $7.1 billion. The Department closed out and implemented recommendations from 94 audit reports in FY 2005 with claimed monetary benefits of $444 million.

Improper Payments Information Act

The Improper Payments Information Act of 2002, as implemented by the Office of Management and Budget, requires federal agencies to review annually all programs and activities and identify those that may be susceptible to significant erroneous payments.

The DoD's FY 2005 survey did not identify any programs or activities where payments met the Office of Management and Budget's criteria for "significant" erroneous payments. During this survey, however, the DoD found military pay susceptible to significant risk for erroneous payments. In accordance with Office of Management and Budget guidance, the DoD calculated a statistically valid estimate of military pay erroneous payments and implemented a plan to reduce the amount of erroneous payments. The DoD reports to both the President and the Congress its progress in reducing erroneous payments. The Department also reports again this fiscal year on military health benefits and military retirement, two programs previously identified by the Office of Management and Budget as susceptible to significant erroneous payments. Reviews of these programs produced the following results.

Military Health Benefits. Numerous prepayment and postpayment controls are built into the military health benefits' claims processing system to minimize improper payments. One control, the claims edit system, "rebundles" services that the provider should have billed under a single code. Procedure "unbundling" occurs when the provider uses two or more procedure codes to describe a service for which a single comprehensive code exists that accurately describes all services performed. This is an inflationary practice and contributes to excessive health care costs.

An example of this practice is "unbundling" charges that should be included in a global surgical package. Some surgical codes represent an all-inclusive charge to include certain types of anesthesia, pre-op visits, post-op care in the recovery room, and typical follow-up visits after discharge for a 90-day period. Physicians who perform the entire global package should bill for their services with the single comprehensive surgical code. "Unbundling" occurs when a physician bills separately for services included in this global package. For example:

Code	Procedure	Cost
	Unbundle Billing:	
30520	Repair of nasal septum	$547.60
00160	Anesthesia, nose/sinus	246.60
99214	Preop visit	64.25
99231	Subsequent hospital visit	37.03
	Final Unbundle Billing Cost	$895.48
	vs.	
	Bundle Billing:	
30520	Global surgical package	$547.60
	Final Unbundle Billing Cost	$547.60
	OVERCHARGE	$347.88

In FY 2004, the DoD realized a cost avoidance of $110.7 million because of these rebundling edits. Anticipating that this trend will continue, the Department projects approximately a 10 percent increase in the cost avoidance for FY 2005.

Another control that helps to ensure the accurate payment of claims and appropriate expenditure of taxpayer dollars is the prepayment review required under the contracts. Contractors use this strategy to prevent payment for questionable billing practices. Prepayment review allows for a closer examination of the services rendered and may require the provider to submit medical documentation to support the services billed. In calendar year 2004, prepayment review resulted in a cost savings of $7.3 million.

The Department also requires each contractor to have a fraudulent claims investigation or anti-fraud unit to identify and investigate any pattern of suspicious or potential fraudulent billings. Artificial intelligence software is a contract requirement to facilitate data mining to identify questionable billing practices. In calendar year 2004, the Department received $6 million in fraud judgments and identified another $2.29 million for administrative recovery.

For FY 2005, the Department projected $150.0 million of improper payments (underpayments and overpayments) for the military health benefits purchased care program. This represents an error rate of approximately 2 percent of the $7.5 billion in military health benefits program payments made during FY 2005.

For many years prior to passage of the Improper Payments Information Act in 2002, the Department had in place performance standards for claims processing. Under the existing managed care support contracts, the DoD has a zero tolerance for unallowable costs. If the contractor pays a claim that is not allowable, the Department will not reimburse the contractor. In addition, contractors face a financial disincentive. In addition to placing the contractors at risk for unallowable costs, this contractual design provides a built-in incentive for the contractors to continually perfect their claims processing system, up to the point where financial costs outweigh the benefits.

<u>**Military Retirement.**</u> The Department conducts various types of prepayment and postpayment reviews for military retirement payments. Payments to deceased retirees pose the highest risk for improper payments. A review of confirmed payments to deceased retirees in FY 2005 indicated that the DoD had recovered 96 percent of the amount overpaid within 60 days.

For FY 2005, the Department projected $49.3 million of improper payments for this program, with most of that amount ($46.7 million) going to deceased retirees. This represents an error rate of 0.1381 percent of the $35.6 billion in military retirement payments.

<u>**Military Pay.**</u> Several sources identify improper payments for military pay. The Department performs monthly random reviews by Military Service, identifies pay system discrepancies, and conducts special audits or reviews. Monthly reviews are stratified by military pay account, which include the Active and Reserve components of the Military Departments and Army National Guard and the Air National Guard. The sampling plan produces estimates with a 95 percent probability and sample estimate precision of plus or minus 2.5 percent. For the first 10 months of FY 2005, the DoD reviewed 8,530 military pay accounts using the sampling plan criteria. Based on the sample results and discrepancies identified, the Department estimated $432 million in improper payments for military pay in FY 2005. This represents 0.63 percent of the total net pay of more than $66.8 billion.

For further reporting details about the Improper Payments Information Act, see Part 3, Financial Information.

Controls (Management Assurances)

The Federal Managers' Financial Integrity Act of 1982 requires federal agencies to assess the effectiveness of internal controls for program, operational, and administrative areas as well as accounting and financial management. Internal 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.

Using self-assessments as the basis, this Act requires agency heads to provide an annual statement of assurance on the effectiveness of the internal controls and to include material weaknesses found in internal controls that warrant reporting to a higher level. The Department's FY 2005 Annual Statement of Assurance is provided in the Acting Deputy Secretary's Message at the front of this report. The Department is also asserting that all DoD components have reported to the Secretary of Defense their individual statements of assurance over internal controls, except for the National Reconnaissance Office, which is reporting to the Director of National Intelligence beginning this fiscal year. Material weaknesses previously reported to the Secretary of Defense by the National Reconnaissance Office are being transferred to the Director of National Intelligence.

Maintaining integrity and accountability in programs and operations:

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

In FY 2005, the Department took numerous steps to improve the Department-wide training, awareness, communication, and emphasis for forthright reporting and prompt resolution of weaknesses. Early in the calendar year, the Department conducted a Department-wide conference attended by more than 120 representatives from the Department's 33 components. The main topic introduced was the broad strategy for implementing the Office of Management and Budget Circular A-123, "Management's Responsibility for Internal Control" Appendix A, which prescribes a statement of assurance on the effectiveness of internal controls over financial reporting. Also discussed at the conference was the DoD scorecard which is used to measure important elements of the Defense component feeder statements. These feeder statements help build the DoD Annual Statement of Assurance. The categories scored are the timeliness of the feeder statements, accuracy and completeness, evidence of effective program execution and training to ensure robust assessments of the internal controls, and prompt resolution of previously reported weaknesses. The scorecard (as shown in Table VI) has already improved the timeliness of component feeder statements. Since instituted, the timeliness has improved from 48 percent on time in FY 2003 to 97 percent on time in FY 2005.

The Department classifies management control weaknesses into three categories:

1. **Section 2 Systemic Weaknesses:** Weaknesses materially affecting management controls across organizational and program lines and usually affecting multiple DoD components.

2. **Section 2 Material Weaknesses:** Weaknesses materially affecting management controls that warrant reporting to a higher level and usually affect a single DoD component.

3. **Section 4 System Nonconformance Weaknesses:** System nonconformance with the principles, standards, or related requirements prescribed by the Comptroller General.

The prompt resolution of weaknesses became a leadership focus area in FY 2004 and, as a result of the scorecard and the quarterly tracking on the progress of corrective actions, the Department has dramatically reduced the number of Federal Managers' Financial Integrity Act (FMFIA) weaknesses in FY 2005.

Recognizing that training is essential for understanding how to establish and continuously assess the effectiveness of internal controls, the Department presented training briefings to 8 of the 33 Defense components in FY 2005. In addition, the Department conducted training at the American Society of Military Comptrollers national training session, introducing the Department of Defense overall strategy for implementing the Office of Management and Budget Circular No. A-123, Appendix A. This training was audio-taped and is now available on-line as course instruction for the Certified Defense Financial Manager certification.

The Department uses periodic management-conducted assessments as the basis for the Annual Statement of Assurance and reports internal control weaknesses relating to Sections 2 and 4 of the Federal Managers' Financial Integrity Act. Section 2 requires "internal accounting and administrative controls that reasonably ensure costs comply with applicable laws, assets are safeguarded, and revenue and expenses are recorded and accounted for properly." Section 4 requires that "accounting systems conform to principles, standards or related requirements prescribed by the Comptroller General."

In FYs 2002 through 2005, the Department reported one Section 4 system nonconformance weakness that encompasses the entire DoD financial system noncompliance with control requirements. The Department also considers the DoD financial systems' noncompliance as a Section 2 systemic weakness which affects multiple DoD components. In addition, the auditors have identified the DoD financial systems as a material weakness under the requirement of the Chief Financial Officers Act.

The following six tables list the weaknesses grouped differently as Section 2 (corrected, transferred, or ongoing, financial, and non-financial) and Section 4 (ongoing only).

Tables Ia and Ib

Section 2 Corrected Financial and Non-Financial Material Weaknesses list 22 corrected during this fiscal year.

Table II

Section 2 Material Weaknesses Transferred to Non-Defense Agency lists one material weakness that was transferred to the Director of National Intelligence.

FMFIA Weaknesses		Beginning FY05	New FY05	Resolved FY05	Transferred FY05	Ending FY05
Section 2 -Systemic	Financial	5	0	0	0	5
	Non-Financial	4	2	0	0	6
Subtotal		9	2	0	0	11
Section 2 - Material	Financial	12	4	8	0	8
	Non-Financial	25	4	14	1	14
Subtotal		37	8	22	0	22
Section 2 Total		46	10	22	1	33
Section 4 - System Nonconformance		1	0	0	0	1
TOTAL FMFIA WEAKNESSES		47	10	22	1	34

Table III

Section 2 Systemic Weaknesses – Ongoing lists the nine systemic weaknesses that remained open at the end of FY 2004, plus two additional weaknesses that were identified in FY 2005.

Tables IVa and IVb

Section 2 Financial and Non-Financial Material Weaknesses – Ongoing list the 22 ongoing material weaknesses. Eight are financial issues of which four are being newly reported. Fourteen are related to non-financial issues of which four were newly identified this fiscal year. For these material weaknesses, a sample of the corrective actions was selected for reporting. The status dates for FYs 2004 and 2005 are listed to show progress in completing the weakness as planned.

Table V

Section 4 System Nonconformance Weaknesses – Ongoing lists the one ongoing Section 4 system nonconformance material weakness.

Since FY 2003, the Department has scored the annual statements of assurance provided by the DoD components. The results for each of the components for FY 2005 scoring have been included in **Table VI, Scorecard Results for FY 2005.**

TABLE 1a. Section 2 Corrected Financial Material Weaknesses

Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
1. Estimation of accrued liabilities, when goods and services are provided, is not always properly monitored due to inadequate controls recording undelivered orders. (Defense Finance and Accounting Service)	- Revised and published the estimation policy in the DoD financial management guide.	1st QTR 2005	Completed
	- Developed adequate procedures and controls for the DoD Business Enterprise Architecture.	1st QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 2003	*Correction Target Date: 4th Qtr, FY 2005 Completed*		
2. Suspense account balances with Treasury trial balances are not fully resolved and reconciled. (Defense Finance and Accounting Service)	- Legislation passed to allow DoD to write-off aged suspense accounts to help reduce the balances to zero.	Completed	Completed
	- Began write-offs.	Completed	Completed
	- Implemented courses of action to reduce account activity to an acceptable level, thus improving the reconciliation process.	4th QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 1997	*Correction Target Date: 4th Qtr, FY 2005 Completed*		
3. Appropriation balances in the accounting records do not always balance with the Treasury's balances and transaction level reconciliations are not always performed. (Defense Finance and Accounting Service)	- Updated procedures on how to reconcile the DoD balances with Treasury Balances.	Completed	Completed
	- Conducted the first Department-wide conference highlighting business rules.	Completed	Completed
	- Expanded systems solutions for Treasury reporting.	4th QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 1999	*Correction Target Date: 4th Qtr, FY 2005 Completed*		

TABLE 1a. Section 2 Corrected Financial Material Weaknesses			
Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
4.Telecommunication invoices are not always certified and obligations are not pre-validated prior to payment. (Defense Finance and Accounting Service)	- Began summary certification process for the Defense Information Telcommunications.	Completed	Completed
	- Received from the Defense Information Telecommunications leadership a formal decision on how to account for the receipt of telecommunication services.	1st QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 2001	*Correction Target Date: 4th Qtr, FY 2005 Completed*		
5. Inadequate controls have caused payments to be made to deceased retirees which were not reclaimed in an effective or timely manner. (Defense Finance and Accounting Service)	- Standardized the procedures for suspending retirement payments when Department suspects the retiree has died.	Completed	Completed
	- Improved documentation of procedures.	Completed	Completed
	- Trained customer service representatives to differentiate between accounts suspended due to death rather than for other reasons.	1st QTR 2005	Completed
	- Automated processes for using existing records to determine if payment should be made.	3rd QTR 2005	Completed
	- Validated that the weakness was corrected.	3rd QTR 2005	Completed
First Reported: FY 2004	*Correction Target Date: 3rd Qtr, FY 2005 Completed*		
6. Inadequate data being provided to the Services for budget planning results in the appearance of over-obligation on the financial statements. (Defense Finance and Accounting Service)	- A team was established from all the Services to work in concert with finance for a viable solution to the varied problems.	Completed	Completed
	- Began implementing forward compatible pay.	2nd QTR 2005	Completed
	- Validated that the weakness was corrected.	3rd QTR 2005	Completed
First Reported: FY 2004	*Correction Target Date: 3rd Qtr, FY 2005 Completed*		
7. Adequate controls are not in place to ensure that "fast payment purchases" are received in Department of the Navy vendor pay offices. (Defense Finance and Accounting Service)	- Established control mechanisms to confirm receipt of payment data.	Completed	Completed
	- Developed and distributed standard operating procedures.	Completed	Completed
	- Initiated system change requirements to automatically compare receipt data in the supply system to payment data.	Completed	Completed
	- Weakness has been downgraded from a material weakness to significant deficiency.	3rd QTR 2005	Completed
First Reported: FY 2004	*Correction Target Date: 3rd Qtr, FY 2005 Completed*		
8. Contract pay services are non-compliant with Certifying Officer's Legislation because some invoices are not individually reviewed and certified prior to payment. (Defense Finance and Accounting Service)	- Implemented a daily validation process that compares invoice data to payment data.	Completed	Completed
	- Modified the contract pay certification process.	2nd QTR 2005	Completed
	- Pursued data mining techniques to enhance and automate the comparison of invoices to payments.	2nd QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 2004	*Correction Target Date: 4th Qtr, FY 2005 Completed*		

TABLE 1b. Section 2 Corrected Non-Financial Material Weaknesses			
Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
9. Procedures are not always adequate to ensure that the prices paid for contracts are reasonable. (Defense Logistics Agency)	- Conducted reviews to ensure proper documentation of "price-reasonableness."	Completed	Completed
	- Conducted a management review to assess performance.	1st QTR 2005	Completed
	- Validated that the weakness was corrected.	2nd QTR 2005	Completed
First Reported: FY 2001	*Correction Target Date: 2nd Qtr, FY 2005 Completed*		
10. Payments for fuel charges incurred as part of the DoD Fleet Card have been delinquent. (Defense Logistics Agency)	- Established an integrated process team for oversight of program management.	Completed	Completed
	- Established periodic audit procedures. Developed a plan to ensure oversight responsibilities are adequate.	1st QTR 2005	Completed
	- Established and implemented a formal training program for program coordinators and end-users.	1st QTR 2005	Completed
	- Validated that the weakness was corrected.	1st QTR 2005	Completed
First Reported: FY 2002	*Correction Target Date: 1st Qtr, FY 2005 Completed*		
11. Controls for assessing which employees can receive mass transit benefits are not always adequate. (Defense Logistics Agency)	- Obtained Union agreement on mass transit benefits.	Completed	Completed
	- Validated parking decals. Certified employee participation against the Department of Transportation database.	1st QTR 2005	Completed
	- Validated that the weakness was corrected.	1st QTR 2005	Completed
First Reported: FY 2003	*Correction Target Date: 1st Qtr, FY 2005 Completed*		
12. Existing controls did not ensure that incidents of sexual assault among the cadet population were prevented or reported. (Department of the Air Force)	- Completed 138 of 165 corrective actions. Incorporated training to improve the gender climate.	Completed	Completed
	- Implemented remaining action items.	1st QTR 2005	Completed
	- Conducted unit compliance inspections to review institutional response to sexual assault and compliance within the instructions.	2nd QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 2003	*Correction Target Date: 4th Qtr, FY 2005 Completed*		
13. Controls over management of spare parts were not always adequate to meet the war fighter mission. (Department of the Air Force)	- Sponsored an integrated process team and performed an analysis to determine the correct number of stock level days that should be used in spares' computation. Revised the Department of Air Force guidance.	Completed	Completed
	- Initiated a management plan to enhance spare parts support and identify systematic supply shortfalls.	Completed	Completed
	- Determined the total spares parts requirement for FY 2004 Program Objective Memorandum.	Completed	Completed
	- Revised the requirements computation systems to provide more accurate consumption patterns.	Completed	Completed
	- Included the total spare parts requirement in the FY 2004 Program Objective Memorandum submission.	Completed	Completed
	- Compared the projected spare part requirements to actual and determined effectiveness of forecasting tools and other corrective actions.	4th QTR 2005	Completed
	- Validated that the weakness was corrected.	4th QTR 2005	Completed
First Reported: FY 1999	*Correction Target Date: 4th Qtr, FY 2005 Completed*		

TABLE 1b. Section 2 Corrected Non-Financial Material Weaknesses			
Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
14. Better controls over efforts to provide safe areas surrounding air installations are needed to minimize public exposure from the hazards of aircraft operations. (Department of the Air Force)	- Raised awareness of air hazards around aircraft operations. Developed the Department of Air Force multi-Service training.	Completed	Completed
	- Re-evaluated the Air Installation Compatible Use Zone Program.	2nd QTR 2006	Completed
	- Validated that the weakness was corrected.	4th QTR 2006	Completed
First Reported: FY 2000	*Correction Target Date: 4th Qtr, FY 2006 Completed*		
15. Processes for reporting the readiness for going to war are not always accurate and consistent. (Department of the Navy)	- Discontinued the use of estimates to compile data, using only actual enrollees or graduates.	Completed	Completed
	- Revised training and readiness reporting procedures to ensure accuracy and consistency.	Completed	Completed
	- Developed an installation readiness assessment system to support and sustain forces.	3rd QTR 2005	Completed
	- Weakness has been downgraded from a material weakness to a significant deficiency.	4th QTR 2005	Completed
First Reported: FY 2002	*Correction Target Date: 4th Qtr, FY 2005 Completed*		
16. Some procedures for projecting training requirements have not been adequate, causing inefficient use of training resources and lost operational work years. (Department of the Navy)	- Automated the instructor requirements.	Completed	Completed
	- Used computer software to develop more effective and efficient delivery techniques to provide instruction.	Completed	Completed
	- Transitioned to a curriculum module within the Training Information Management System, which will enable quantitative tracking and analysis.	4th QTR 2006	Completed
	- Weakness has been downgraded from a material weakness to a significant deficiency.	1st QTR 2007	Completed
First Reported: FY 1999	*Correction Target Date: 1st Qtr, FY 2007 Completed*		
17. Better management of Active and Reserve recruiting functions is needed to maintain a ready force. (Department of the Navy)	- Ensured that the recruiter and classifier errors are corrected or waived in a timely and efficient manner.	Completed	Completed
	- Validated the corrective measures using an on-site verification.	1st QTR 2005	Completed
	- Validated that the weakness was corrected.	1st QTR 2005	Completed
First Reported: FY 2001	*Correction Target Date: 1st Qtr, FY 2005 Completed*		
18. Policies and procedures were not always adequate for processing other non-recurring requirement transactions. (Defense Logistics Agency)	- Reviewed current policies and procedures.	Completed	Completed
	- Published policy and procedures guidance.	Completed	Completed
	- Completed validation of policy and procedures and published final policy.	2nd QTR 2005	Completed
	- Validated that the weakness was corrected.	2nd QTR 2005	Completed
First Reported: FY 2004	*Correction Target Date: 2nd Qtr, FY 2005 Completed*		

TABLE 1b. Section 2 Corrected Non-Financial Material Weaknesses			
Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
19. Inadequate training has caused inconsistent, uncoordinated, and sometimes inadequate approaches to satisfying the United States' commitment to provide foreign countries adequate assistance with Cooperative Threat Reduction. (Defense Threat Reduction Agency)	- Developed a program management training course.	Completed	Completed
	- Held two pilot training sessions for module 1, which addressed planning and documentation for milestone decision authority review and approval.	Completed	Completed
	- Held module 1 training session.	1st QTR 2005	Completed
	- Held pilot training session for module 2, which addressed contract and project execution, control and close-out.	2nd QTR 2005	Completed
	- Held module 2 training session.	2nd QTR 2005	Completed
First Reported: FY 2004	- Validated that the weakness was corrected. *Correction Target Date: 3rd Qtr, FY 2005 Completed*	3rd QTR 2005	Completed
20. Inadequate controls to ensure that secondary item repair costs were properly budgeted. (Department of the Air Force)	- Developed instructions addressing responsibilities for validating sources of repair used in preparing budgets.	Completed	Completed
	- Published revised secondary item repair costs instructions.	2nd QTR 2005	Completed
	- Incorporated new procedures in automated budget processes to support budget development.	3rd QTR 2005	Completed
First Reported: FY 2004	- Validated that the weakness was corrected. *Correction Target Date: 4th Qtr, FY 2005 Completed*	4th QTR 2005	Completed
21. Controls were not always adequate to ensure accountability of automated data processing equipment. (United States Pacific Command)	- Disciplinary actions initiated to correct personnel performance issues.	Completed	Completed
	- Appointed custodians to assist in managing and tracking equipment.	Completed	Completed
	- Performed 100% wall-to-wall inventory.	4th QTR 2005	Completed
First Reported: FY 2004	- Validated that the weakness was corrected. *Correction Target Date: 4th Qtr, FY 2005 Completed*	4th QTR 2005	Completed
22. Manpower challenges impact the mission accomplishment of military intelligence operations. (Under Secretary of Defense (Intelligence))	- Identified manpower requirements.	Completed	Completed
	- Developed documentation for manpower requirements.	Completed	Completed
	- Validated manpower data to correct weakness.	2nd QTR 2005	Completed
First Reported: FY 2004	- Validated that the weakness was corrected. *Correction Target Date: 2nd Qtr, FY 2005 Completed*	2nd QTR 2005	Completed

Table II. Section 2 Material Weaknesses Transferred to Non-Defense Agency
Lack of sufficient controls to ensure regulation compliance, information management, and records management. (National Reconnaissance Office)

Table III. Section 2 Systemic Weaknesses – Ongoing	
Title	**1. Department of Defense Financial Management Systems and Processes**
Description of Issue	The Department of Defense financial and business management systems and processes are costly to maintain and operate, not fully integrated, and do not provide information that is reliable, timely, and accurate.
Progress to Date	A. Completed Milestones: • Created a portfolio management approach to review information technology investments. • Incorporated the enterprise business process model into the Business Enterprise Architecture release 2.1. • Established integrated goals, objectives, measures, and targets. • Initiated a single Department-wide information technology registry to track all business systems. • Established five core business mission areas: financial management, human resources management, weapon system lifecycle management, real property and installation lifecycle management, and materiel supply and service management. These were business areas which worked together to unify the Department's business transformation efforts. • Established six initial business enterprise priorities: financial visibility; acquisition program visibility; materiel transaction visibility; personnel visibility; real property accountability; and common supplier engagement to guide the initial direction of transformation activities. • Defined six core financial capabilities in support of the financial visibility priorities, and established performance measures to monitor and guide activities that lead to the full development and maintenance of those capabilities. The six capabilities are: forecast, plan, program and budget; manage financial assets and liabilities; managerial accounting; funds allocation, funds collection, funds control, and funds disbursement; manage general ledger; and financial reporting. • Identified five initiatives to support the financial visibility priorities: Standard Financial Information Structure; business enterprise information services; defense cash accountability system; intragovernmental transaction system; and the program budget framework. • Chartered the Defense Business System Management Committee to oversee transformation in the five core business mission areas. • Established the Defense Financial Management Investment Review Board as the authoritative body to review and approve all investment priorities for all Defense business systems under the Under Secretary of Defense (Comptroller) purview. The Financial Management Investment Review Board will enhance the Department's ability to comply with the National Defense Authorization Act of FY 2005 to ensure the review all business system investments annually and certify the compliance of business system modernizations over $1,000,000.
	B. Planned Milestones for FY 2006 and beyond: • Publish version 3.0 of the Business Enterprise Architecture, which will include the elements of Phase 1 of the Standard Financial Information Structure. • Publish the Department of Defense Enterprise Transition Plan which will reflect the Department's goals, objectives, and implementation strategies and create an integrated picture of the Department's business transformation. • Update the Enterprise Transition Plan and Financial Improvement and Audit Readiness Plan every 6 months to ensure the Department of Defense components have the most up to date guidance available. • Update and publish versions 3.1 and 4.0 of the business enterprise architecture and integrate it with the Enterprise Transition Plan. • Integrate Phase 1 of the Standard Financial Information Structure into the business enterprise information services to create a shared business intelligence environment. The business enterprise information services will include a corporate general ledger where legacy accounting systems transactions (that have been cross-walked to the Standard Financial Information Structure) can be recorded. The financial management transformation team will work closely with the targeted accounting systems to ensure a common understanding and implementation of the Phase 1 elements of the Standard Financial Information Structure. • Implement Phase 2 of the Standard Financial Information Structure into the framework for a Statement of Net Cost. Phase 2 will define segments of responsibility and links to support the consolidation of financial statements, and provide a corporate level view of major operations segments of responsibility. • Align and integrate the program budget framework initiative with Phases I and II of the Standard Financial Information Structure to create a direct link between the Department's plans, programs, and budgets with execution and performance data. • Align the financial visibility performance measures to the Office of the Under Secretary of Defense (Comptroller) strategic plan goals and measures. *Correction Target Date: 4th Quarter, FY 2015*
Title	**2. Management of Information Technology and Assurance**
Description of Issue	The Department of Defense information systems are potentially vulnerable to an information warfare attack. In addition, this issue has also been reported as a "significant deficiency" under the reporting requirements of the Federal Information Security Management Act.
Progress to Date	A. Completed Milestones: • Expanded the authority of the United States Strategic Command to include network operations and information assurance. • Completed and updated the Department of Defense policies addressing public key infrastructure and enterprise-wide certification requirements for information assurance / technology professionals.

Table III. Section 2 Systemic Weaknesses – Ongoing	
Progress to Date (continued)	A. Completed Milestones (continued): • Developed an automated security certification and accreditation process for information systems. Began the expansion to more robust web-based design using shared information and services that deliver improved functionality by interconnecting data transactions into a common database. • Awarded the Department of Defense-wide enterprise license for an information assurance vulnerability scanning tool. • Coordinated for comments the revised Department of Defense security certification and accreditation policy and process to improve compliance and to provide an enterprise management capability. • Incorporated a revised security certification and accreditation process, including vulnerability management into the enterprise mission assurance support system and began piloting this process in selected Defense components. • Developed and coordinated for comments the information assurance training, certification, and workforce management manual. The manual provides essential details necessary to track information assurance personnel through the personnel management systems. • Awarded the Department of Defense-wide enterprise license for an automated information assurance vulnerability "patching" tool and completed evaluating the "wrapper" capability that helps prevent malicious modification of operating systems by viruses. • Developed an on-line knowledge service that provides detailed guidelines, standards and collaboration tools for security certification and accreditation. • In the Federal Information Security Management Act report, dated March 2005, reported 84 percent of Department of Defense systems certified and accredited. • Approved Increment 1.0 of the information assurance element of the Global Information Grid architecture, which for the first time provides a comprehensive architectural basis for developing and providing information assurance within the Department.
	B. Planned Milestones for FY 2006: • Issue policy establishing a comprehensive process to develop and implement plans and milestones to manage and correct identified security performance weaknesses, and direct Department of Defense components to appropriately report all security weaknesses identified in annual reviews or audits. • Issue guidance on information assurance training and certification standards. • Award Department of Defense-wide enterprise license for operating system "wrapper" capability. • Continue modular development and deployment of additional services to support core information assurance processes, e.g., investment, resource management, workforce management, and information assurance management tools. • Expand the information assurance element of the Global Information Grid architecture. • Provide information assurance management tools as a core enterprise service. • Achieve 100 percent security certification and accreditation for the Department of Defense systems. • Complete the Defense Civilian Personnel Data System detailed information assurance workforce database updates. Incorporate changes to the military personnel databases to support the information assurance workforce management program.
	C. Planned Milestones for Beyond FY 2006: • Continue developing the information assurance element of the Global Information Grid architecture and deploy the information assurance capabilities. • Continue to identify and track information assurance personnel in the civilian and military personnel systems. • Provide the United States Strategic Command a real time situational awareness of the Department of Defense information assurance posture. *Correction Target Date: 3rd Quarter, FY 2007*
Title	3. Environmental Liabilities
Description of Issue	The Department of Defense has not developed the policies, procedures, and methodologies needed to ensure that cleanup costs for all of its ongoing and inactive or closed operations are identified, consistently estimated, and appropriately reported. Site inventories and cost methodologies to identify budget requirements and financial liabilities continue to need improvement.
Progress to Date	A. Completed Milestones: • Provided guidance to accomplish an initial operational range inventory. • Reported the operational range inventory to Congress in February of FY 2004. • Completed a real property inventory business process reengineering and presented the concept for Department of Defense-wide review. • Revised the Financial Management Regulation for liability recognition and reporting for operational ranges and munitions response areas. • Published the directive entitled "Sustainment of Ranges and Operating Areas," that requires reporting of environmental remediation liabilities.

Table III. Section 2 Systemic Weaknesses – Ongoing	
Progress to Date (continued)	A. Completed Milestones (continued): • Issued planning guidance that requires the assessment of environmental condition of the operational ranges. • Completed the final inventory of munitions sites (other than operational ranges) and made this information available to the public in accordance with Congressional direction. This inventory is updated and reported annually to Congress. • Developed and issued an interim change to the regulations that requires the reconciliation of real property and environmental site records. • Developed and coordinated guidance to enable Department of Defense components to recognize, document, and report environmental liabilities other than those included in the Defense Environmental Restoration Program. • Developed and coordinated the guidance on how to conduct operational range assessments. • Developed and coordinated the guidance on how to report and forecast real property inventory.
	B. Planned Milestones for FY 2006: • Complete the policy changes. • Closure of final recommendations in the Government Accountability Office report. *Correction Target Date: 1st Quarter, FY 2006* *(Management within the Office of the Secretary of Defense for Acquisition, Technology and Logistics responsible for reporting this systemic weakness provided this information. However, the DoD components reporting similar weaknesses show corrective actions extending past the correction target date to FY 2007. Therefore, the corrective actions and correction target date will be reviewed and the impact assessed.)*
Title	**4. Personnel Security Investigations Program**
Description of Issue	The Department of Defense hiring is adversely affected because personnel security investigations are backlogged.
Progress to Date	A. Completed Milestones: • Signed an interagency agreement with the Office of Personnel Management to allow the Defense Security Service to use the Office of Personnel Management computer system for tracking and controlling the Department of Defense personnel security investigations and case processing. • Realigned 200 overhead positions in the Defense Security Service to investigator positions, redesigned the organizational structure, closed offices that lacked sufficient work, and deployed "tiger teams" to conduct overseas investigations. Reduced the number of pending cases in the case control management system from over 400,000 to less than 57,000. • Reinforced quality reviews of contractor work. Issued to the contractors cure letters for failing to meet agreed upon timelines. Took back a number of investigations from the contractors. • Transferred the security investigations function to the Office of Personnel Management in February 2005. The Department made final payments to contractors and terminated all contracts associated with this function. • Notified that the Office of Personnel Management has contracted with five investigative service providers to address the need for more investigators in order to improve the processing time of investigations. • Implemented the Joint Personnel Adjudication System for submitting and tracking all investigative requests. The verification and validation module achieved initial operating capability in May 2005. Beginning in July 2005, investigations for Defense contract personnel were submitted to the Office of Personnel Management through the Joint Personnel Adjudication System.
	B. Planned Milestones for FY 2006: • The Office of Personnel Management indicates that 90 percent of investigations submitted in FY 2006 will be completed within the timelines established by the Intelligence Reform and Terrorism Prevention Act of 2004 and that there will be no open investigations over a year old. *Correction Target Date: 4th Quarter, FY 2006*
Title	**5. Real Property Infrastructure**
Description of Issue	The Department has not adequately managed the real property infrastructure to halt the deterioration or obsolescence of facilities on military installations.
Progress to Date	A. Completed Milestones: • Conducted a comprehensive review of planned facilities sustainment programs, resulting in an increase of $85 million in funding for FY 2005..

Table III. Section 2 Systemic Weaknesses – Ongoing	
Progress to Date (continued)	A. Completed Milestones (continued): • Preserved the previously approved corporate facilities sustainment rate at 95 percent of benchmarks in FY 2005 • Improved funding to support an overall facilities recapitalization rate of 136 years, down from a funded rate of 149 years in FY 2003. • Issued updated strategic planning guidance to the Defense components addressing sustainment and recapitalization goals. • Initiated new efforts to model the operation costs for facilities and forecast requirements. • Published an updated Defense Installations Strategic Plan, expanding the focus to include environment and installation services, and directed the Defense components to prepare implementation plans. • Initiated a second survey of demolition and disposal requirements for obsolete and excess assets. • Completed a study of facility restoration requirements, which updated the target date for restoring adequate readiness conditions. • Accepted a reduction in funding for facilities recapitalization, which resulted in a slight increase in the overall recapitalization rate to 110 years in FY 2006, up slightly from 104 years in FY 2005. This risk is taken in view of upcoming restationing and Base Realignment and Closure actions that will decrease the size of the Department's inventory and increase the investment in recapitalization. • Refined and updated the unit costs for sustainment and construction of facilities, with emphasis on utility systems. • Completed a model that predicts the average annual cost required to modernize and refurbish facilities on an ongoing basis. • Corrected a deficiency in the methodology used to score facilities sustainment funding that had produced inaccuracies due to contingency-related costs. • Completed a model to improve the accuracy of forecasting costs associated with operating facilities. • Completed an assessment of demolition and disposal requirements for obsolete and excess assets. • Initiated actions to improve the accuracy of the facilities recapitalization metric. • Initiated efforts to report the condition of facilities in the Defense Readiness Reporting System. • Expanded metrics to include family housing and industrial facilities.
	B. Planned Milestones for FY 2006 and beyond: • Complete a standard reporting procedure for facility conditions in the real property inventory. • Deploy a model that predicts the requirements for facility-related services, utilities, and leasing. • Deploy a model that predicts the average annual cost required to modernize and refurbish facilities on an ongoing basis. • Implement new corporate procedures for demolition and disposal of facilities that will more accurately capture the net effect of eliminating excess and obsolete facilities. • Begin reporting installation and facility data in order to fully capture the impact of facility capabilities on mission readiness. • Integrate military family housing and industrial facilities into the facility's metrics. *Correction Target Date: 1st Quarter, FY 2008*
Title	6. Government Card Program Management
Description of Issue	Instances of misuse, abuse, and fraud in respect to purchase and travel card use, and centrally billed accounts have been attributed to inadequate Department of Defense emphasis on proper use of the cards, poorly enforced controls, and lax oversight.
Progress to Date	<u>Purchase Card Program:</u> A. Completed Milestones: • Cancelled unnecessary cards and tailored spending limits to historical buying patterns. • Established methods to ensure cards are collected from departing civilians and service members. • Developed and issued a comprehensive purchase card concept of operations. • Completed the initial field tests of a centralized data mining tool to detect fraudulent, wasteful, and abusive card transactions. • Implemented new disciplinary guidelines specifically targeted to card misuse. Aggressively pursued prosecution of known fraud cases. • Increased awareness concerning the usage of purchase cards through training forums. Developed and enhanced training materials. • Issued omnibus charge card guidebook, including governing laws, regulations, and more salient business rules for purchase, travel, fleet, and air cards. • Implemented use of on-line statement review, approval, and certification. • Issued directive on purchase card roles and responsibilities.
	B. Planned Milestones for FY 2006: • Implement initial operating capability of authorization and data mining capabilities.

Table III. Section 2 Systemic Weaknesses – Ongoing	
Progress to Date	<u>Travel Card Program</u> A. Completed Milestones • Updated Joint Federal Travel Regulation and Joint Travel Regulation specifically prohibiting commercial travel offices from issuing premium class tickets without proper approval. • Issued guidance directing Defense components to modify contracts with commercial travel offices so that performance standards direct them not to issue airline tickets for premium class travel unless the traveler's orders identify that premium class travel is authorized. • Issued policy for all travelers to return unused paper and electronic tickets to their travel offices. • Issued policy to commercial travel offices to cancel unused tickets 30 days after the date of the last leg of the itinerary and to initiate refund actions. • Issued policy directing a contract modification with commercial travel offices that automatically cancels unused tickets 30 days after the date of the last leg of the itinerary and provides reports of unused airline tickets. • Issued policy to develop processes and procedures that minimize the potential for commercial travel offices to issue airline tickets under fraudulent circumstances. • Instituted a monthly review of travel card metrics. • Implemented mandatory split disbursement for military personnel and initiated bargaining for civilian employees. • Published disciplinary guidelines for both military and civilian personnel and modified systems to record and report instances of disciplinary actions taken. • Closed 161,000 unused accounts in FY 2004, and approximately 600,000 in FY 2002 and FY 2003. • Closed 3,900 accounts after reviewing the separation or retirement lists. • Collected approximately $48 million through salary offset. • Issued exemptions from mandatory use of the government travel charge card for travel related to deployments. • Instituted a monthly review of charges made on merchant codes that are supposed to be blocked from authorization. • Implemented a management initiative decision to require higher approval authorities for premium travel and to strengthen management controls. • Implemented a data mining pilot program with the Bank of America and Visa Corporation to flag and review high-risk transactions. • Published a standard training program. • Developed and issued additional guidelines for management of centrally-billed accounts. • Implemented the premium class travel task force recommendations regarding policies for the Department. • Developed a method for preventing or identifying centrally-billed travel tickets claimed for reimbursement on an individual's travel voucher.
	B. Planned Milestones for FY 2006: • Depending on the results of the Defense Travel System assessment, Office of the Under Secretary of Defense for Personnel and Readiness will determine whether to complete the deployment in FY 2006. • Continue to enhance the Defense Travel System to provide visibility of charges and establish additional controls. • Perform audits of travel claims to ensure compliance with new regulatory and policy guidelines on unused tickets and improper payments. • Continue to monitor travel card performance through monthly metric reviews. *Correction Target Date: 4th Quarter, FY 2006*
Title	**7. Valuation of Plant, Property, and Equipment on Financial Reports**
Description of Issue	The Department of Defense is unable to accurately report the value of property, plant, and equipment on its financial statements.
Progress to Date	A. Completed Milestones: • Established offices and groups of personnel to develop baseline valuations for property, plant, and equipment. • Received financial improvement and executing plans from components. • Established recurring reviews of Department of Defense components' progress against plans. • Issued new guidance for internal use software financial management policy. The Military Departments have established working groups to address the valuation and accountability of internal use software and have begun formulating a universe of programs to be valued. • Initiated discussions with the Marine Corps to develop and implement a pilot program to value personal property items meeting capitalization criteria. • Directed the Defense Commissary Agency and the Military Departments to reconcile property under the Department's "preponderance of use" policy. The Department has begun a similar initiative with the Defense Agencies. • Reviewed and developed procedures in accounting for real property inventory assets. • Reviewed the capitalization threshold methodology for real property.

Table III. Section 2 Systemic Weaknesses – Ongoing	
Progress to Date (continued)	A. Completed Milestones (continued): • Established metrics that report on the status of the reconciliation of the "preponderance of use" policy, documentation of inventory, and construction in process. • Developed and issued the military equipment valuation business rules (reviewed by the Government Accountability Office and approved by the Deputy Chief Financial Officer) and updated the regulations. • Established initial valuations based on actual data; 95 percent of identified military equipment will be valued. • Developed a functional requirement for the first increment of a transaction based valuation system for military equipment. • Reconciled 40 percent of property for other Defense Agencies under "the preponderance of use" policy.
	B. Planned Milestones for FY 2006: • Provide the Military Departments with baseline valuations for military equipment, a process and corresponding business rules for valuation, and a tool to maintain these baseline valuations. This will allow them to begin the assertion process for general property, plant, and equipment. • Publish the Federal Acquisition Regulation rule on property in the hands of contractors. • Reconciling the remaining 60 percent of property for other Defense Agencies under the "preponderance of use" policy. • Complete the baseline valuation for military equipment. • Implement Increment 1, full operational capability of the Capital Asset Management System-Military Equipment.
	C. Follow on Actions (after completion of Increment 1): • Reconcile construction in progress, inventory and associated documentation. • Implement Increment 2, initial operational capability of the Capital Asset Management System-Military Equipment. *Correction Target Date: 4th Quarter, FY 2006* *(Management within the Office of the Secretary of Defense for Acquisition, Technology and Logistics responsible for reporting this systemic weakness provided this information. However, the DoD components reporting similar weaknesses show corrective actions extending past the correction target date to FY 2008. Therefore, the corrective actions and correction target date will be reviewed and the impact assessed.)*
Title	8. Valuation of Inventory on Financial Reports
Description of Issue	The valuation of inventory is not always correctly reported.
Progress to Date	A. Completed Milestones: • Convened an inventory working group charged with developing a baseline for inventory valuation, establishing methodologies for valuing inventory, and testing the existence and completeness assertions. • Updated the policy on unique identification of assets. • Established an operating materials and supplies group, which is developing a methodology for baseline valuation. • Developed methodologies for valuing inventory; identified systems that are compliant with and could sustain moving average cost inventory valuations; and developed timelines and approaches to completing baselines for all systems to include testing existence and completeness assertions. • Worked with the Federal Accounting Standards Advisory Board to interpret and apply standards to the Department's processes. • Issued a final "unique identification and valuation" rule. • Published policy governing the application of passive radio frequency identification in the Federal Register for public comments. • Completed a methodology for baseline valuation based on the working group findings and recommendations. • Issued new and revised policies as a result of the working group findings and recommendations.
	B. Planned Milestones for FY 2006 • Extend "unique identification and valuation" rule to legacy items. • Publish policy governing application of identification tags to remaining commodities and locations. • Institute baseline inventory systems and implement processes to sustain them. *Correction Target Date: 3rd Quarter, FY 2006* *(Management within the Office of the Secretary of Defense for Acquisition, Technology and Logistics responsible for reporting this systemic weakness provided this information. However, DoD components reporting similar weaknesses show corrective actions extending past the corrective target date to FY 2011. Therefore, the correction actions and correction target date will be reviewed and the impact assessed.)*

Table III. Section 2 Systemic Weaknesses – Ongoing	
Title	9. Improper Use of Non-Department of Defense Contracting Vehicles
Description of Issue	Non-Department of Defense contracting vehicles have been used improperly to procure services or supplies.
Progress to Date	A. Completed Milestones • Commenced collaboration with the General Services Administration on the "Get It Right" Campaign. • Created a new policy which establishes internal review procedures for any procurement of services or supplies greater than the simplified acquisition threshold when using non-Department of Defense contract vehicles. • Conducted site visits to multiple assisting agencies. • Issued Department of Defense guidance. • Tasked the Office of the Secretary of Defense, Military Departments, and Defense Agencies to perform compliance reviews and report results. • Developed training programs with the Defense Acquisition University and General Services Administration. • Issued policy memorandum. • Issued interim rules in the Defense Federal Acquisition Regulation. • Conducted outreach programs with assisting civilian agencies. • Commenced workforce training.
	B. Planned Milestones for FY 2006: • Commence reporting on the use of non-Department of Defense contracts from assisting civilian agencies. • Complete compliance review conducted by the Office of the Secretary of Defense, Military Departments, and Defense Agencies regarding proper implementation of policy in using non Department of Defense contracts. *Correction Target Date: 2nd Quarter, FY 2006*
Title	10. Department of Defense Contracting for Services
Description of Issue	The Office of Inspector General, Department of Defense, and the Government Accountability Office have identified deficiencies in the policy for, and the execution of, procurement for services. (Newly reported: FY 2005)
Progress to Date	A. Planned Milestones for FY 2006: • Ensure Army reviews all logistic civil augmentation program contract orders to ensure that they are within scope and that they are being completed in a timely manner. • Ensure the Military Departments and Defense Agencies have adequate policies dealing with the appointment and training of contracting office representatives. • Provide guidance to the Military Departments and Defense Agencies regarding procedures for and use of waivers to competitive requirements. • Revise the policy on the proper use of other agencies' contracts to include guidance on conducting surveillance of services procured from other agencies' contracts. • Ensure the Military Departments' and Defense Agencies' service contract review processes and associated data collection procedures provide adequate visibility over contract surveillance.
	B. Planned Milestones for Beyond FY 2006: • Ensure that all personnel who develop statements of work receive performance-based service acquisition training. *Correction Target Date: 2nd Quarter, FY 2007*

Table III. Section 2 Systemic Weaknesses – Ongoing	
Title	11. Federal Procurement Data Reporting
Description of Issue	The new Federal Procurement Data System is not fully functional causing inaccurate procurement reporting data and increased costs required for continued maintenance of legacy systems. (Newly reported: FY 2005)
Progress to Date	A. Completed Milestones: • Established a joint Federal Procurement Data System–Next Generation migration team in 2003. • Identified outstanding requirements to the General Services Administration, necessary to transition to the new system. • Held regular weekly meetings with the General Services Administration throughout FYs 2004 and 2005 to provide detailed explanation of the outstanding requirements and to answer questions. • Provided on-site support with subject matter experts to the General Services Administration throughout FYs 2004 and 2005. • Certified contract-writing systems that directly report to the new system.
	B. Planned Milestones for FY 2006: • Certify that all FY 2005 data has been appropriately submitted to the new Federal Procurement Data System–Next Generation. • Complete testing to ensure that data from FYs 1997-2004 has been correctly migrated to the new system, which will be done by the General Services Administration in conjunction with the Defense Management Data Center. • Receive certification from the General Services Administration that the Federal Procurement Data System–Next Generation has attained full operating capability. • Complete migration from the current reporting environment to the Federal Procurement Data System–Next Generation.
	C. Follow on actions: • Certify that all FY 2006 data has been submitted to Federal Procurement Data System–Next Generation. • Decommission feeder systems. *Correction Target Date: 2nd Quarter, FY 2006*

Table IVa. Section 2 Financial Material Weaknesses - Ongoing			
Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
1. Adequate documentation does not always exist to support adjustments used to reconcile general ledger data to budgetary data. (Defense Finance & Accounting Service)	- Built crosswalks from the legacy line of accounting to the standard fiscal code to the Defense Departmental Reporting System-Budgetary.	Completed	Completed
	- Implemented and validated a crosswalk process to map transactions to the appropriate general ledger accounts.	Completed	Completed
	- Activated the Defense Departmental Reporting System-Budgetary.	2nd QTR 05	Completed
First Reported: FY 2003	- Validate that the weakness is corrected. *Revised Correction Target Date: 2nd Qtr, FY 2006*	2nd QTR 05	2nd QTR 06
2. Policy for recording, reporting, collecting and reconciling accounts receivable from public and government sources is not always followed. (Defense Finance & Accounting Service)	- Monitored monthly and performed quarterly reconciliation.	Completed	Completed
	- Conduct random review of compliance to policy and procedures.	4th QTR 05	2nd QTR 06
	- Publish standard accounts receivable operating procedures for Department.	2nd QTR 05	4th QTR 06
First Reported: FY 2003	- Provide assertion that accounts receivables are ready for audit and validate that the weakness is corrected. *Revised Correction Target Date: 2nd Qtr, FY 2007*	3rd QTR 06	2nd QTR 07

Table IVa. Section 2 Financial Material Weaknesses - Ongoing			
Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
3. Instances where an ineffective process prevents ensuring that disbursements and collections by service providers are properly recorded. (Defense Intelligence Agency)	- Established adequate staffing.	-	Completed
	- Establish a baseline for reconciliation.	-	4th QTR 06
	- Reconcile the Fund Balance with Treasury account.	-	1st QTR 07
First Reported: FY 2005	- Validate that the weakness is corrected. *Correction Target Date: 4th Qtr, FY 2007*	-	4th QTR 07
4. Accounts Payable were not always accurately recorded in a timely manner. (Department of the Navy)	- Defined scope and created plan to correct problem.	-	Completed
	- Conduct training.	-	1st QTR 06
	- Collect requirements to modify the workflow process.	-	2nd QTR 06
	- Modify the workflow and systems to accurately record accounts payable.	-	1st QTR 07
	- Ensure that corrective actions are working.	-	3rd QTR 07
	- Assert that the account is ready to audit.	-	1st QTR 08
First Reported: FY 2005	- Conduct audit to validate that the weakness is corrected. *Correction Target Date: 2nd Qtr, FY 2008*	-	2nd QTR 08
5. There are instances where unsupported adjustments are being made to the general ledger accounts. (Defense Logistics Agency)	Launched agency-wide effort to properly establish codes and correctly use them.	-	Completed
	Review procedures to maintain supporting documentation.	-	1st QTR 06
	Implement procedures to perform reconciliation.	-	1st QTR 06
First Reported: FY 2005	Validate that the weakness is corrected. *Correction Target Date: 4th Qtr, FY 2006*	-	4th QTR 06
6. The Fund Balance with Treasury accounts for the Defense Agencies and Navy cannot always be accurately reconciled. (Defense Finance and Accounting Service)	- Develop a plan and milestones that address controls, reconciliation, and assertion that the accounts are ready to audit.	-	1st QTR 06
	- Implement full operational capability of financial system.	-	2nd QTR 06
	- Reconcile disbursements.	-	3rd QTR 06
	- Modify business procedures to eliminate incorrect subheads on transactions.	-	4th QTR 06
	- Perform validation of identified actions for selected Defense Agencies.	-	1st QTR 07
First Reported: FY 2005	- Validate that the weakness is corrected. *Correction Target Date: 3rd Qtr, FY 2007*	-	3rd QTR 07
7. Accounts receivable and accounts payable need to be actively managed and reduced to acceptable levels. (Defense Logistics Agency)	- Issued standard guidance and procedures for managing accounts receivables and payables.	Completed	Completed
	- Collected, wrote-off, or closed-out supportable and valid account receivables over 2 years old except for certain categories.	Completed	Completed
	- Implemented a plan to liquidate valid over aged accounts payable and write-off invalid payables.	1st QTR 05	Completed
First Reported: FY 2002	- Validate that the weakness is corrected. *Revised Correction Target Date: 1st Qtr, FY 2006*	4th QTR 05	1st QTR 06

Table IVa. Section 2 Financial Material Weaknesses - Ongoing			
Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
8. The accounts payable do not always accurately reflect the liabilities associated with the actual receipt of goods and services in the appropriate time period. (Defense Finance & Accounting Service)	- Reviewed current business practices.	Completed	Completed
	- Established a plan of action.	1st QTR 05	Completed
	- Implement metrics to measure magnitude of problem and impact of corrective actions.	2nd QTR 05	2nd QTR 06
	- Validate that the weakness is corrected.	2nd QTR 06	1st QTR 07
First Reported: FY 2004	*Revised Correction Target Date: 1st Qtr, FY 2007*		

Table IVb. Section 2 Non-Financial Material Weaknesses - Ongoing			
Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
9. Contractors are not always appropriately identifying themselves according to the Federal Acquisition Regulation. (National Defense University)	- Developed remedial training for contractors.	-	Completed
	- Standardized e-mail procedures for contractors.	-	Completed
	- Proper identification is established.	-	2nd QTR 06
	Validate that the weakness is corrected.	-	2nd QTR 06
First Reported: FY 2005	*Correction Target Date: 2nd Qtr, FY 2006*		
10. Inadequate controls to effectively manage pharmaceuticals. (Department of the Air Force)	- Issued policy.	-	Completed
	- Implemented system modifications to alert medical personnel of inappropriate procurement sources and to track backorder status.	-	2nd QTR 06
	- Publish procedures to manage procurement of pharmaceuticals.	-	3rd QTR 06
	- Validate that the weakness is corrected.	-	3rd QTR 07
First Reported: FY 2005	*Correction Target Date: 3rd Qtr, FY 2007*		
11. There are instances where planning for periods of crisis has not been fully developed. (Office of the Under Secretary of Defense (Counter-Intelligence Field Activity))	- Develop and implement a plan.	-	2nd QTR 06
	- Conduct training.	-	2nd QTR 06
	- Validate that the weakness is corrected.	-	2nd QTR 06
First Reported: FY 2005	*Correction Target Date: 2nd Qtr, FY 2006*		
12. The skill sets to support critical missions are currently inadequate. (Office of the Under Secretary of Defense (Intelligence))	- Identified the requirement for manpower.	-	Completed
	- Develop supporting documentation.	-	Completed
	- Obtain senior level approval.	-	3rd QTR 06
	- Validate that the weakness is corrected.	-	4th QTR 06
First Reported: FY 2005	*Correction Target Date: 4th Qtr, FY 2006*		

Table IVb. Section 2 Non-Financial Material Weaknesses - Ongoing			
Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
13. DoD's capital investment process for information technology does not confirm that the best investments are selected, that they deliver expected benefits, or that the final product or service delivers what DoD expects. (Defense Information Systems Agency)	- Completed the inventory of the enterprise information technology hardware and established a mechanism to maintain it.	Completed	Completed
	- Publish a capital planning and investment guide that incorporates the portfolio management, enterprise architecture requirements, and information management.	2nd QTR 05	1st QTR 06
First Reported: FY 2002	- Validate that the weakness is corrected. *Revised Correction Target Date: 1st Qtr, FY 2006*	3rd QTR 05	1st QTR 06
14. The Russian Federation failed to honor commitments associated with the Cooperative Threat Reduction Program. (Defense Threat Reduction Agency)	- The Russian Federation signed the amendments for storage security, weapons transportation security, and chemical weapon elimination.	Completed	Completed
	- Work with the Russian Federation to ensure plans are prepared for further reduction of nerve agents.	3rd QTR 05	1st QTR 06
First Reported: FY 2002	- Validate that the weakness is corrected. *Revised Correction Target Date: 1st Qtr, FY 2006*	3rd QTR 05	1st QTR 06
15. DoD has not established guidance or effective controls for processing line of duty and incapacitation pay, which adversely affects reservists who attempt to receive benefits after their duty obligation is met. (Department of the Army)	- Developed policies and procedures.	Completed	Completed
	- Conducted legal review of the regulation changes.	1st QTR 05	Completed
	- Published the regulatory guidance.	2nd QTR 05	Completed
First Reported: FY 2002	- Conduct audit review to validate the effectiveness of corrective actions. *Revised Corrected Target Date: 1st Qtr, FY 2006*	4th QTR 05	1st QTR 06
16. Current processes for managing workload, linking workload to dollars required, or predicting future manpower requirements have not been established. (Department of the Army)	- Validated the missions. Refined the linkage between operating and generating forces.	Completed	Completed
	- Analyzed workload for peacetime and wartime. Linked the workload to the operating force.	2nd QTR 05	Completed
	- Ensured that there is accurate documentation to validate the manpower requirements in the official record called the "Table of Distribution and Allowances."	4th QTR 05	Completed
	- Issued a change to the regulation on the approval authority for manpower requirement determinations.	4th QTR 05	Completed
First Reported: FY 1997	- Audit review to validate that the weakness is corrected. *Revised Correction Target Date: 1st Qtr, FY 2006*	4th QTR 05	1st QTR 06
17. Automated management tools are needed to ensure accountability of Reserve component personnel from home station to duty station and back home. (Department of the Army)	- Modified the global command and control system to allow data entry at all the mobilization stations.	Completed	Completed
	- Corrected the mobilized unit identification codes.	1st QTR 05	Completed
	- Corrected any disconnects between mobilization orders and the data entry.	2nd QTR 05	Completed
	- Interfaced between the global command and control system and the mobilization deployment integration system to obtain the on-hand data.	2nd QTR 06	Completed
First Reported: FY 2003	- Validate that the weakness is corrected. *Correction Target Date: 4th Qtr, FY 2006*	4th QTR 06	4th QTR 06

Table IVb. Section 2 Non-Financial Material Weaknesses - Ongoing			
Non-Financial Material Weaknesses	Major Corrective Action(s) A sample of the actions is presented.	Status Date as Reported in FY04	Status Date as Reported in FY05
18. Lack of clearly defined strategies or implementation plans has caused program inefficiencies for both the Chemical Demilitarization and the Nuclear Weapons Physical Security Programs. (Office of the Under Secretary of Defense for Acquisition, Technology and Logistics)	- Developed draft strategies and implement risk management plans.	1st QTR 05	Completed
	- Submitted draft strategies and plans for review and approval.	1st QTR 05	Completed
	- Completed actions required for a clearly defined strategies and implementation plans.	2nd QTR 05	Completed
	- Submit final transition plan to leadership.	2nd QTR 05	2nd QTR 06
	- Validate that the weakness is corrected.	2nd QTR 05	2nd QTR 06
First Reported: FY 2004	*Revised Corrected Target Date: 2nd Qtr, FY 2006*		
19. Inadequate controls have caused instances of inaccurate accountability for equipment sold to foreign countries. (Defense Security Cooperation Agency)	- Set record keeping standards.	Completed	Completed
	- Developed checklists for validation.	Completed	Completed
	- Deployed automated application and conducted assessment visits.	4th QTR 05	Completed
	- Conduct final assessment visits and validate that the weakness is corrected.	4th QTR 06	4th QTR 06
First Reported: FY 2004	*Correction Target Date: 4th Qtr, FY 2006*		
20. Lack of policy and clear delineation of organizations and responsibilities puts the organization at risk for security violations, duplication of efforts, delays in program activities, and confusion over requirements. (Defense Security Cooperation Agency)	- Reviewed and coordinated changes to regulations.	3rd QTR 05	Completed
	- Publish handbook.	2nd QTR 06	2nd QTR 06
	- Validate that the weakness is corrected.	2nd QTR 06	2nd QTR 06
First Reported: FY 2004	*Correction Target Date: 2nd Qtr, FY 2006*		
21. Controls were not always adequate over exported Defense articles from initial shipment point to receipt by foreign customers. (Defense Security Cooperation Agency)	- Actively participated with interagency working groups.	Completed	Completed
	- Issue detailed documentation requirements and policy.	4th QTR 05	2nd QTR 06
	- Confirmation that the Bureau of Customs and Border Protection receives adequate information on shipments.	1st QTR 05	3rd QTR 06
	- Issue policy decision on freight tracking system.	4th QTR 05	4th QTR 06
	- Validate that the weakness is corrected.	4th QTR 06	4th QTR 06
First Reported: FY 2004	*Correction Target Date: 4th Qtr, FY 2006*		
22. Adequate policies to mandate the appropriate proficiency in foreign languages are necessary to more adequately support the global war on terror. (Office of the Under Secretary of Defense (Personnel and Readiness)	- Obtained approval of a transformation roadmap.	1st QTR 05	Completed
	- Publish revised DoD Directive.	2nd QTR 05	Completed
	- Publish DoD Instruction.	3rd QTR 06	3rd QTR 06
	- Validate that the weakness is corrected.	4th QTR 06	4th QTR 06
First Reported: FY 2004	*Corrected Target Date: 4th Qtr, FY 2006*		

Table V. Section 4 System Nonconformance Weaknesses - Ongoing	
Description of Issue	The Department of Defense financial and business management systems and processes are costly to maintain and operate, not fully integrated, and do not provide information that is reliable, timely, and accurate.
Progress to Date	See Table III, number 1 above, for progress explanation.

Table VI. Scorecard Results for FY 2005

Agency	Rating Categories					Scoring		
	Timely	Format	Program Execution	Training	Material Weakness Reporting	FY05 Color Score	FY05 Over-all Score	Change from FY04 Overall Score
Defense Logistics Agency	Green	Blue	Blue	Blue	White	Blue	3.2	1.6
Department of Air Force	Green	Blue	Blue	Blue	White	Blue	3.2	0.4
Department of Navy	Green	Blue	Blue	Blue	White	Blue	3.2	1.4
Defense Finance and Accounting Service	Green	Blue	Blue	Green	White	Blue	3.0	1.6
Defense Commissary Agency	Blue	Blue	Blue	Blue	Green	Green	2.8	0.2
Defense Intelligence Agency	Blue	Blue	Blue	Blue	Green	Green	2.8	0.4
Pentagon Force Protection Agency	Blue	Blue	Blue	Blue	Green	Green	2.8	0.4
United States Special Operations Command	Blue	Blue	Blue	Blue	Green	Green	2.8	0.2
National Defense University	Blue	Green	Blue	Blue	Green	Green	2.6	0.8
National Security Agency	Green	Blue	Blue	Blue	Green	Green	2.6	0.0
Office of Secretary of Defense (OSD Principal Staff and DoD Field Activities)	Green	Blue	Blue	Blue	Green	Green	2.6	-0.2
United States Pacific Command	Blue	Green	Green	Green	Purple	Green	2.6	1.6
United States Strategic Command	Blue	Green	Blue	Blue	Green	Green	2.6	0.4
Defense Information Systems Agency	Green	Green	Blue	Blue	Green	Green	2.4	0.6
Defense Security Cooperation Agency	Blue	Amber	Green	Green	Purple	Green	2.4	1.0
Joint Staff	Green	Blue	Green	Blue	Green	Green	2.4	0.0
Missile Defense Agency	Green	Green	Blue	Blue	Green	Green	2.4	0.0
National Geo-Spatial Intelligence Agency	Blue	Green	Blue	Green	Green	Green	2.4	0.4
Office of the Secretary of Defense, Inspector General	Blue	Green	Blue	Green	Green	Green	2.4	1.0
United States Southern Command	Blue	Green	Green	Blue	Green	Green	2.4	0.2
United States Transportation Command	Green	Green	Blue	Blue	Green	Green	2.4	0.6
Defense Advanced Research Projects Agency	Blue	Blue	Green	Green	Amber	Green	2.2	0.0
Defense Contract Audit Agency	Blue	Green	Green	Green	Green	Green	2.2	0.4
Uniformed Service University of the Health Sci-ences	Blue	Green	Green	Green	Green	Green	2.2	0.4
Defense Contract Management Agency	Blue	Green	Green	Green	Amber	Green	2.0	0.8
Defense Threat Reduction Agency	Green	Green	Green	Green	Green	Green	2.0	0.6
United States Central Command	Green	Green	Green	Green	Green	Green	2.0	1.6
United States Joint Forces Command	Blue	Green	Green	Green	Amber	Green	2.0	1.0
United States Northern Command	Green	Green	Green	Green	Green	Green	2.0	0.6
Defense Security Service	Green	Amber	Green	Red	White	Amber	1.8	1.0
United States European Command	Green	Green	Green	Amber	Green	Amber	1.8	1.6
Department of Army	Red	Green	Amber	Blue	Red	Red	0.8	-0.4
Maximum Possible Scores	3 (Blue)	3 (Blue)	3 (Blue)	3 (Blue)	5 (White)	Blue	3.4	

Possible Scores per Category: White = 5, Purple = 4, Blue = 3, Green = 2, Amber = 1, and Red = -1

U.S. Government Accountability Office High-Risk Areas

Since 1990, the U.S. Government Accountability Office (GAO) has periodically reported on government operations that it has designated as high risk. GAO's high-risk status reports are provided at the start of each new Congress. GAO's audits and evaluations identify federal programs and operations that, in some cases, are high risk due to their greater vulnerabilities to fraud, waste, abuse, and mismanagement. Increasingly, GAO also is identifying high-risk areas to focus on the need for broad-based transformations to address major economy, efficiency, or effectiveness challenges.

In its latest report, GAO designated 26 high-risk areas. Eight cited DoD programs and operations specifically; five involved the DoD as well as other federal agencies. The DoD-related high-risk areas are listed below; the year that the area was first added to the list is noted in parentheses.

DoD-Specific:
- DoD Approach to Business Transformation (2005).*
- DoD Business Systems Modernization (1995).
- DoD Personnel Security Clearance Program (2005).
- DoD Support Infrastructure Management (1997).
- DoD Financial Management (1995).
- DoD Supply Chain Management (formerly Inventory Management) (1990).
- DoD Weapon Systems Acquisition (1990).
- DoD Contract Management (1992).

DoD Involved:
- Strategic Human Capital Management (2001).*
- Managing Federal Real Property (2003).*
- Protecting the Federal Government's Information Systems and the Nation's Critical Infrastructures (1997).
- Establishing Appropriate and Effective Information-Sharing Mechanisms to Improve Homeland Security (2005).
- Management of Interagency Contracting (2005).

(*) GAO noted that legislation is likely to be necessary, as a supplement to actions by the executive branch, to effectively address this high-risk area.

Emerging Areas

In addition to specific areas designated as high risk, GAO identified other important broad-based challenges facing the government that are serious and merit continuing close attention. GAO noted specifically that the DoD is in the process of transforming its force capabilities and business processes and commented that it had reported on limitations in the DoD's strategic planning and budgeting, including the use of overly optimistic assumptions in estimating funding needs, often resulting in a mismatch between programs and budgets.

The DoD's Efforts to Resolve GAO High-Risk Areas

In general, the DoD agrees with GAO's assessment of the high-risk areas facing the Department. These challenges are long-standing problems that defy quick fixes. The DoD has plans in place to resolve these problems areas, but recognizes that it will take time and resources to address the problems inherent in the Department. The DoD is pleased to note that GAO has acknowledged the Department's progress. The DoD Inspector General's list of management challenges, presented in Part 4 of this report, echoes most of the GAO high-risk designations. The President's Management Agenda also addresses many of the areas identified by

GAO and the Inspector General as opportunities for improvement. The DoD's response to the challenges it faces are presented throughout this report.

Looking Forward: Challenges for 2006 and Beyond

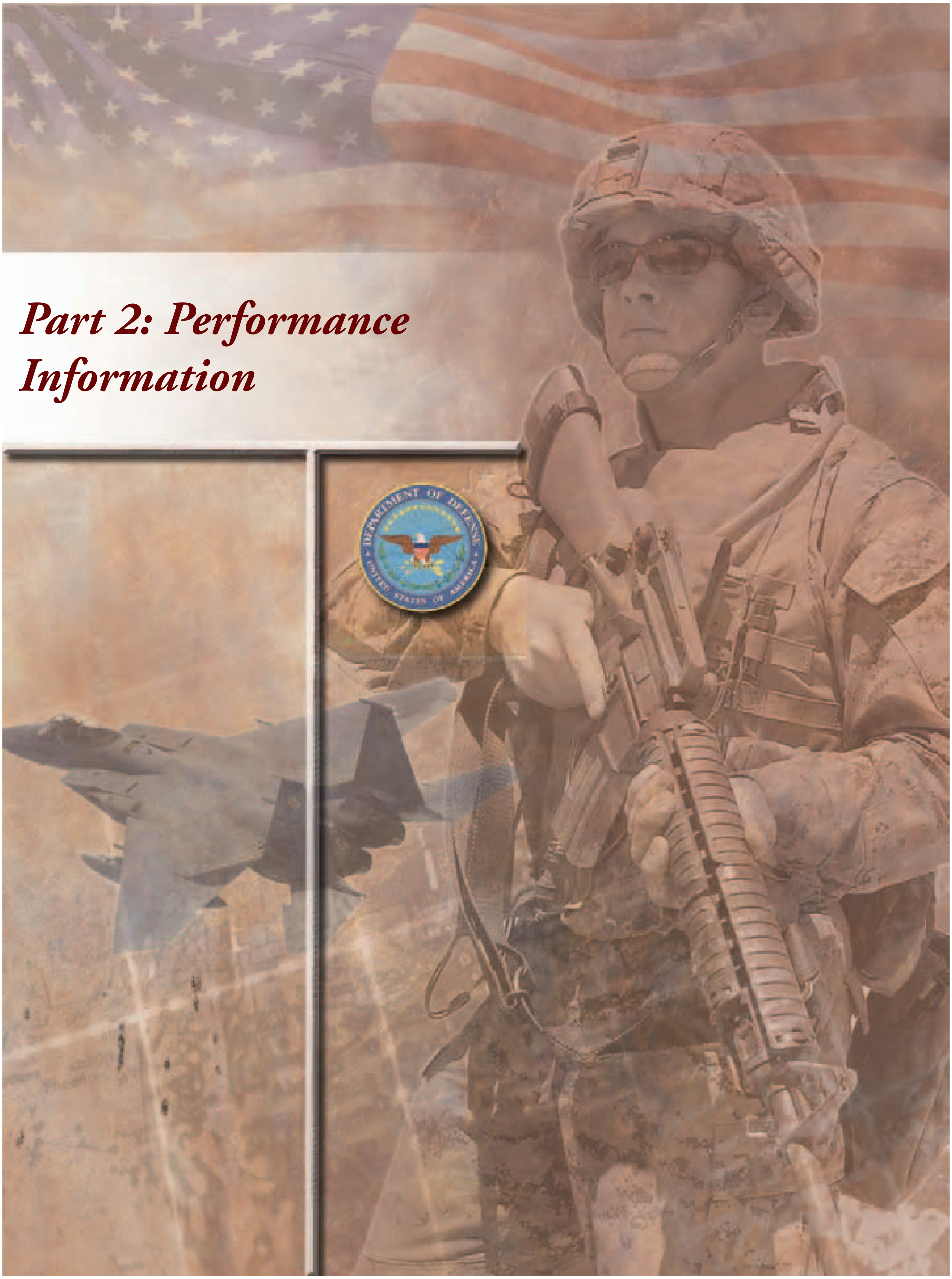
The "Defense Strategy and Strategic Planning" section mentioned the 2005 Quadrennial Defense Review process, which is now underway, and will incorporate the National Defense, National Military, and National Security Strategies. Past Quadrennial Defense Reviews focused on the proper "size" of the force; for 2005, the Department is first determining the right mix of capabilities for the 21st century and then considering the capabilities the Nation needs without prejudging to how these capabilities should be resourced, or even whether they belong in the DoD. The 2005 Quadrennial Defense Review will operationalize the new National Defense Strategy and shape the future force with a 20-year outlook by linking strategy to defense resources and encompassing four areas that drive capabilities development and force planning:

- Building partnerships to defeat terrorist extremist networks,
- Defending the homeland in depth,
- Shaping the choices of countries at strategic crossroads, and
- Preventing the acquisition or use of weapons of mass destruction by hostile state or non-state actors.

The 2005 Quadrennial Defense Review process is also looking at all aspects of the DoD, not just programs and force size: the right mix of capabilities; enablers like logistics, space, and ISR (intelligence, surveillance, and reconnaissance); roles, missions, and organizations; manning and balancing the force; business practices and processes; and DoD authorities.

The 2005 Quadrennial Defense Review recognizes that the United States is a Nation at war and is building upon lessons learned from recent and ongoing operations in Iraq and Afghanistan. Senior DoD leaders are guiding and participating in all aspects of the review to avoid "stovepiping" of issues and resource priorities. This Quadrennial Defense Review includes ideas from other government agencies, industry, allies, and partners. The DoD is consulting closely with Congress throughout the process. A theme crosscutting Quadrennial Defense Review issues is how America might help allies and partners develop their capacities to confront common security challenges. Experience in the war on terrorism has underscored the need for a changed defense establishment—one postured both for extended conflict and continuous transformation. This demands an adaptive strategy, predicated on creating and seizing opportunities and contending with challenges through an active, layered defense of the Nation and its interests.

Part 2: Performance Information



Performance Information

This part of the report contains the annual program performance information required by the Government Performance and Results Act of 1993.

Overview

Part 1 of this report, Management's Discussion and Analysis, describes in detail the Department's strategic planning process and its methods for measuring performance. This part of the report explains each of the DoD's 71 metrics, summarizes the results for FY 2005, and presents for comparison prior year data in charts and tables as appropriate. In a few cases, FY 2004 results are presented because they are the latest available. Due to the volume of information, a full discussion of each metric, including the validation and verification procedures, can be found at http://www.dod.mil/comptroller/par.

Data Quality, Accuracy, and Reliability

The DoD is committed to providing clear and reliable data to those who use it for managing, decision making, and for oversight of the DoD programs. The Department also ensures, to the greatest extent possible, that the data are quantifiable and verifiable by putting in place internal management controls and by being responsive to the insights provided by the Department's Office of Inspector General, the U.S. Government Accountability Office, and others. Performance data for most quantifiable measures are generated as a by-product of the DoD's routine operations. Survey satisfaction data is produced from statistically valid surveys. Accuracy measures come from validated automated systems and are periodically reviewed and analyzed for accuracy. New metrics or metrics under development will be subject to the same data quality requirements once the metric is established.

In many cases, the data for FY 2005 are as of third quarter or incomplete due to lengthy reporting cycles. As a result, results are projected using partial year data. Incomplete data and projected results are noted for each metric as applicable. The FY 2006 Performance and Accountability Report will note any significant deviations from projected and actual results.

Performance Goals and Results

This section is organized by the four strategic goals as identified by risk area. Under each strategic goal are four performance goals, which are supported by one or more performance measures with targets. Each performance goal is explained and followed by a discussion of the performance measures and targets used to assess results.

Strategic Goal 1: Balancing Force Management Risk - recruit, retain, train, and equip a ready force and sustain readiness.

Performance Goal 1.1 - Ensure Sustainable Military Tempo and Maintain Workforce Satisfaction

Metric 1.1.1: PERSTEMPO Across Occupational Groups					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
The percentage of an occupational group that surpasses the PERSTEMPO day constraints	Services began tracking PERSTEMPO as directed by Congress	Published Interim Personnel Tempo Policy Guidance	• Validated and verified Service data • Considered global joint rotational policy	• Began tracking frequency and duration of PERSTEMPO trends • Work continued on metric development	• Metrics developed • Initial performance results to be posted to Departmental website during the first quarter FY 2006

[A] FY 2005 data are estimated as of the fourth quarter.

Metric Description

As directed by Congress, the Services started tracking and reporting individual time away from home (expressed in days), commonly referred to as personnel tempo (PERSTEMPO), on October 1, 2000. Each of the Services has developed or enhanced existing data collection systems to support the legislative requirements. They will report the number of days each member is deployed; particular emphasis and scrutiny will be placed on those 10 major occupational groups that have deployed 400 or more days out of the preceding 2 years. On October 8, 2001, the Department suspended certain PERSTEMPO management processes in accordance with the provisions of the national security waiver set forth in section 991(d) of Title 10, U.S. Code.

The metric being developed will incorporate a frequency and duration dimension to PERSTEMPO based on changes to the PERSTEMPO legislation in the FY 2004 National Defense Authorization Act. The metric will capture the percentage of an occupational group, as defined by the Defense Manpower Data Center occupational codes, that have exceeded the 400-day PERSTEMPO constraint within the last 730 days and/or the 191consecutive-day PERSTEMPO constraint, by Service and across the Department. This metric will provide valuable insight into the "high-deploying" skills and relate them to the high-deploying/low-density units, as appropriate

Performance Results for FY 2005

A contractor helped define and refine key performance indicators. Evaluation of the metrics using "live" data will be conducted into FY 2006. The Department completed development of the metric during second quarter FY 2005. Work continued throughout the remainder of the fiscal year to determine the best way to accumulate the data from the PERSTEMPO database and how best to display the information on the information delivery system website. DoD expects the data displays to be posted to the website during the first quarter FY 2006 for Departmental approval.

Metric 1.1.2: PERSTEMPO Standards Met					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
The percentage of Active and Reserve components (by Service) that has exceeded PERSTEMPO constraints.	Congressionally-directed PERSTEMPO reporting began	Published Interim Personnel Tempo Policy Guidance	• Validated and verified data • Considered global joint rotational policy	• Began tracking frequency and duration of PERSTEMPO trends • Work continued on metric development	• Developed metrics • Initial performance results to be posted to Departmental website during the first quarter FY 2006
[A] FY 2005 data are estimated as of the fourth quarter.					

Metric Description

On October 8, 2001, the Department suspended certain PERSTEMPO management processes in accordance with the provisions of the national security waiver set forth in section 991(d) of Title 10, U.S. Code. These included general/flag officer monitoring, approval of Service member PERSTEMPO days that may exceed certain thresholds, and payment of the high deployment per diem. However, Services were still required to report individual days away.

The metric being developed will incorporate a frequency and duration dimension to PERSTEMPO based on changes to the PERSTEMPO legislation in the FY 2004 National Defense Authorization Act. The metric will portray the percentage of the Service Active and Reserve components that exceed the 400-day PERSTEMPO constraint within the last 730 days and/or the 191-consecutive day PERSTEMPO constraint. This metric will provide valuable insight into the "high deploying" tendencies of various Service components. The "drill down" metric, PERSTEMPO Across Occupational Groups, (Metric 1.1.1) will measure those occupational groups that exceed the 400-day and/or the 191 consecutive-day constraint, and will provide further information on a Service's use of the distinctive skills of their personnel.

Performance Results for FY 2005

The DoD used a contractor to help define and refine key performance indicators. Evaluation of the metrics using "live" data will be conducted in FY 2006. The contractor completed its work in FY 2005. The Department completed development of the metric during second quarter FY 2005. Work continued throughout the remainder of the fiscal year to determine the best way to accumulate the data from the PERSTEMPO database and how best to display the information on the information delivery system website. The DoD expects the data displays to be posted to the website during the first quarter FY 2006 for Departmental approval.

Metric 1.1.3: Quality of Life Social Compact Improvement Index					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/Actual[A]
Trend data to monitor improvements in leading Quality of Life (QoL) indicators	No historical data; new metric		Developed framework for QoL index	Meet or exceed standard for eight functional areas/Four met or exceeded standards, two met or exceeded standards for some DoD components, one did not meet standards, and one metric is still under development [B]	Meet or exceed standard for eight functional areas[C] / Data not yet available

[A] FY 2005 data are not available until end of FY 2005. This is a new metric and it is a lagging indicator - 2005 actual data will not be available until the end of the fiscal year.
[B] Detailed FY 2004 actual and target data for each of the 21 programs that comprise the eight functional areas are provided at (website address).
[C] Detailed FY 2005 target data for each of the 21 programs that comprise the eight functional areas are provided at (website address).

Metric Description

The Quality of Life (QoL) Social Compact Improvement Index is one indicator in a three-pronged approach that combines a Community QoL Per Capita Cost (Metric 1.3.2) and Commitment to Military Life Index (Metric 1.1.4) to measure the health of QoL programs and services supporting military members and families. The Social Compact, a living document that outlines a 20-year strategy, requires continual review and revision to keep pace with the changing needs of the transforming military. While the Social Compact includes long-term, mid-term and short-term strategies, the index will focus on the short term. Current deployment and high operation tempo necessitate robust QoL support for troops and families. In an effort to mitigate force management risk in attracting and maintaining a quality workforce, the Department must transform QoL to keep pace with the American standard of living, changing demographics (two-thirds of military families live off the installation), and expectations of military members and their families.

The index links to the QoL programs and services included in the modernized Social Compact that recognize the reciprocal partnership that exists between DoD, the Service member, and his or her family. The index tracks improvement in QoL to ensure the Department underwrites support to families. The current index is comprised of eight major program areas, e.g., housing assignments, educational assistance, child care, etc. Functional areas and metrics will be added or eliminated as data mature and priorities change. Data will be cross-referenced with the Community QoL Per Capita Cost Metric and Commitment to Military Life Index to ensure QoL programs are provided to meet the unique needs of military members and their families.

Performance Results for FY 2005

This is the first full cycle of performance reporting for this metric since conversion from an activity to a metric. The data for the Social Compact index will not be available until the end of the fiscal year.

Metric 1.1.4: Commitment to Military Life Index					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Trend data to monitor results in key commitment areas that are predictors of retention and satisfaction	No historical data; new metric		• Reviewed corporate commitment literature • Developed commitment factors reflecting military environment and culture • Conducted focus groups to validate and expand commitment factors	• Fielded survey • Developed final commitment index for military service • Fielded commitment index in May 2004 survey of Guard and Reserve members • Commitment index included in the August 2004 Active duty survey	• Analyzed data from May 2004 survey of Guard and Reserve members • Analyzed data from August 2004 Active duty survey • Established baseline commitment data and correlations • Ongoing development of research methodology to link commitment and re-enlistment decisions
[A] The FY 2005 data are final as of fourth quarter.					

Metric Description

The Commitment to Military Life Index is one indicator in a three-pronged approach that combines a Community QoL Per Capita Cost Metric and QoL Social Compact Improvement Index to measure the health of QoL programs and services supporting military members and families. It is a new indicator that will track the factors that influence and predict commitment to military service for both Active duty members and spouses. This index is modeled after an approach used in corporate America to measure employee commitment. This performance measure responds to the National Security Presidential Directive–2 (February 2001), "Improving Quality of Life," and guidance from the Secretary of Defense to track QoL improvements and give priority to the implementation of QoL initiatives. Current deployment and high personnel tempo necessitate robust QoL support for troops and families. In an effort to mitigate force management risk and enhance workforce satisfaction, the Department must transform QoL to meet the needs of the changing demographics and expectations of military members and their families.

Retention is a critical problem in the military and commitment has been shown to be a primary predictor of retention decisions. Thus, this effort is directed at tracking a brief index of service member commitment to military service. A complementary index of spousal commitment to the military has been developed, thereby acknowledging the importance of both military and family factors in predicting commitment to the military.

The value of the index is to demonstrate the different fluctuations and factors of commitment over time. The commitment indexes contained in the Defense Manpower Data Center's Reserve Component Survey (May 2004) and Active Duty Survey (August 2004) provided initial baseline data for the commitment index. Frequent short surveys to a statistically valid DoD military population will be used to pulse the commitment of military members and spouses. The index will gain meaning as the factors influencing commitment are tracked at different points in time. The survey instrument will be reviewed and updated as needed and data will be cross-referenced with the QoL Social Compact Improvement Index and Community QoL Per Capita Cost Metric.

Ongoing Research

The DoD developed and validated metrics for tracking member commitment, and is in the process of doing the same for spousal commitment. Tracking commitment as a component of retention is important, but not sufficient to create informed interventions; the DoD needs to understand the underlying causes of commitment for members and spouses. This includes understanding the disruptions, policies, and practices which buffer negative events or foster positive ones, and determining how they affect the retention decision processes for Service members and their families. The DoD needs to validate the impact of commitment on decisions to re-enlist. Ongoing research must track, over time, how commitment develops and changes. It also must be connected to actual decisions to stay or leave the Service to verify the predictive validity of commitment. Ongoing research must also focus on the family so that DoD can learn how different events affect levels of commitment, and how re-enlistment decisions are negotiated. For example, baseline data collected from the May 2004 Reserve Status of Forces survey and the August 2004 Active duty survey showed that Active duty members who were married with children had the highest levels of commitment.

Performance Results for FY 2005

The DoD established preliminary baseline commitment data for Active duty, National Guard, and Reserve members and developed the spousal commitment index, which will be fielded during Fall 2005 in the Defense Manpower Data Center Survey of Military Spouses.

Metric 1.1.5: Saitsfaction with Access					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/Actual[A]
Satisfaction with access	81.8%	80.8%	83.0%	>84%/81.8%	>84%/81.2%
[A] The FY 2005 data are estimated as of the third quarter.					

Metric Description

Access always has been a significant factor in the overall satisfaction with medical care, and an area for focused improvement. The intent of this metric is to improve satisfaction with access to appointments for those individuals who have chosen to enroll in TRICARE Prime (similar to a health maintenance organization) within the Military Health System. This metric is based on a monthly customer satisfaction survey for those individuals who had an outpatient medical visit at a Military Treatment Facility (MTF) hospital or clinic during the previous month. Although there are a number of measures related to access, ease of making an appointment by phone is considered a key measure that has been tracked over the past few years. The metric is based on Question 10a of the customer satisfaction survey, which asks: How would you rate the (Clinic Name) on Ease of Making this Appointment by Phone?

The percentage of respondents (weighted by appropriate sampling weights) that answer "Good," "Very Good," or "Excellent" on a scale from "Poor" to "Excellent" is computed. The survey is fielded monthly. Reports are produced quarterly. Although information is available by Military Service branch, only an aggregate Military Health System score is shown above.

Performance Results for FY 2005

Each of the three Services experienced a decline in satisfaction with telephone access through the first three quarters of FY 2005. While two of the Services are down slightly, the third is down significantly. One reason for the decline is related to the survey population. For example, the survey shows that some of this decline is attributable to age differences, as older individuals tend to be more satisfied than younger individuals, and a larger percentage of the individuals being treated in the MTFs are now younger, Active duty personnel.

The greatest decline in performance has been experienced in Army MTFs with large troop populations. Because Active duty personnel generally score lower than other beneficiaries, and a larger percentage of the appointments are for Active duty personnel, there is a significant decrease in satisfaction with access. Not only is the system experiencing a shift in workload from retirees to Active duty, but the Active duty scores are also slightly lower this year than last. In fact, at some major troop locations, satisfaction scores are down as much as 10 percent.

For those locations where there have been problems with access, the DoD is using additional contract physicians to make more appointments available to returning Reservists. Based on the increased capacity at these MTFs, satisfaction with access should improve.

Metric 1.1.6: Overall Satisfaction With Appointment					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/Actual[A]
Satisfaction with appointment	88.5%	87.1%	88.4%	≥ 90%/87.6%	≥ 89%/87.8%
[A] The FY 2005 data are estimated as of the third quarter.					

Metric Description

This metric looks at beneficiaries' overall satisfaction with their outpatient medical appointments at a MTF hospital or clinic during the month. Overall satisfaction with the appointment is affected by numerous factors during the visit, including the experience in getting an appointment, the wait time at the appointment, the interaction with the provider, and interactions with the pharmacy or ancillary services. This metric is based on a monthly customer satisfaction survey for those individuals who had an outpatient medical visit at an MTF during the previous month. The metric is based on Question 12 of the customer satisfaction survey, which asks: All things considered, how satisfied were you with the (name of clinic) during this visit?

The percentage of respondents (weighted by appropriate sampling weights) who answer "Good," "Very Good," or "Excellent," on a scale from "Poor" to "Excellent," is computed. The survey is fielded monthly. There is a 55-day lag between the appointment date and the posting of data on the web-based reporting site due to the time required for fielding, collecting, and analyzing the data. Results are based on the summation of results for all surveys completed by patients during the year. Although information is available by Military Service branch, only an aggregate Military Health System score is shown above.

Performance Results for FY 2005

FY 2005 performance results were mixed across the Services. Two of the Services are just slightly below the goal for the year, and the other Service struggled during the first two quarters of FY 2005. During the third quarter, all three Services are at or above the goal of 89 percent satisfaction. This trend is expected to continue and the performance target should be achieved.

Metric 1.1.7: Satisfaction with Military Health Plan					
Metric	FY 2001 Actual[A]	FY 2002 Actual[B]	FY 2003 Actual	FY 2004 Target[C]/Actual[D]	FY 2005 Target[E]/Actual[F]
Percentage satisfied with military health plan	44.6%	46.5%	51.2%	≥ 56%/ 53%	≥ 57%/53%

[A] Surveys fielded in January, April, and July 2001.
[B] Surveys fielded in October 2001 and January, April, and July 2002.
[C] The FY 2004 initial goal was the same as the FY 2003 goal; however, after progress tracking during FY 2003, it was determined that the FY 2004 goal needed to be reset to a yearly goal that will match the Defense Health Program Performance plan for FY 2004. Accordingly, the goal changed from = civilian average to =56%, which represents closing the gap between the military health plan and civilian plans in 3 years. All future goals will be updated on an annual basis.
[D] FY 2004 is now complete and the actual performance represents a weighted average for the entire year, not the highest score during the year.
[E] The FY 2005 target has been adjusted to reflect the Defense Health Program Annual Performance plan goal (58% to 57%) and a change in the civilian benchmark (59% to 58%).
[F] The FY 2005 data are estimated as of second quarter.

Metric Description

A person's satisfaction with his or her health plan is a key indicator of the performance of the Military Health System in meeting its mission to provide health care to over eight million eligible beneficiaries. For this metric, the following survey item is used: We want to know your rating of all your experience with your health plan. Use any number from 0 to 10 where 0 is the worst health plan possible, and 10 is the best health plan possible. How would you rate your health plan now?

Satisfaction is measured as the percentage of respondents (weighted by appropriate sampling weights) who answer 8, 9, or 10. The survey, fielded quarterly, asks respondents questions about the plan during the prior year. Currently, the results for the year are based on the surveys fielded during the fiscal year, which means the results are actually based on the respondent's interactions with the health system during the prior fiscal year.

Performance Results for FY 2005

FY 2005 began with the initial rollout of the new Health Support Services Contracts and associated changes in claims processing and network development. Some problems occurred during this transition and beneficiaries voiced their displeasure when completing the survey. For example, claims processing dropped from approximately 99.9 percent of claims properly processed within 30 days, to a low of 80 percent (during a single month) for one of the claims processors. Additionally, a number of providers decided to leave the network when the rollout of new contracts occurred. With claims processing improving, and provider networks expanded to previous levels, satisfaction with plan results should improve for the rest of the year. For the first 2 months of this fiscal year, the metric is one percent above last year's performance at the same time.

Performance Goal 1.2 - Maintain a Quality Workforce

Metric 1.2.1: Active Component Enlisted Retention Goal					
Service	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual[A]	FY 2004 Target/Actual[A]	FY 2005 Target/Actual[A,B]
Army					
Initial	20,000	19,433	21,838	23,000/24,465	21,080/20,721
Mid-career	23,727	23,074	19,509	20,292/20,407	18,433/18,669
Career	21,255	15,700	12,804	12,808/13,574	10,436/13,730
Navy					
Initial	56.9%	58.7%	61.8%	56%/54.1%	53%/57.1%
Mid-career	68.2%	74.5%	76.7%	70%/70.2%	69%/66.2%
Career	85.0%	87.4%	87.9%	85%/86.9%	85%/85.6%
Marine Corps					
First term	6,144	6,050	6,001	5,990/6,011	4,462/5,888
Subsequent	5,900	7,258	5,815	5,628/7,729	3,809/5,520
Air Force					
First Term	56.1%	72.1%	60.5%	55%/63%	55%/47%
Mid-career	68.9%	78.3%	72.9%	75%/70%	75%/52%
Career	90.2%	94.6%	95.2%	95%/97%	95%/95%

[A] The Services are allowed (due to the National Emergency) to operate with the strength required to prosecute the global war on terror. Because of Operation Iraqi Freedom and Operation Enduring Freedom, the Services decided to operate at a higher level than they had planned at the beginning of the year. To get to this higher strength, they increased the retention goals. The Services use retention and recruiting as two levers they can adjust to hit the desired end strength. So, if recruiting is falling short, they increase retention goals. Similarly, if retention is falling short, they may choose to increase recruiting goals. In this case, they chose to adjust retention goals to operate at desired operational strength.

[B] FY 2005 data are final as of third quarter.

Definitions by years of service:

Army: Mid-career: 7 to 10; career: 10 to 20
Navy: Mid-career: 6 to 10; career 10 to 14
Air Force: Mid-career: 6 to 10; career 10 to 14

Metric Description

The Services determine their annual retention goals with latitude in how they establish their categories, goals within each category, and methods for tracking attainment of those goals. For that reason, three metrics are used: (1) number of people retained (used by the Army and Marine Corps), (2) percentage of eligible people retained (used by the Navy), and (3) average career length (used by the Air Force). The annual goals for these metric are dynamic and can change during the year of execution.

Performance Results for FY 2005

The Services are on course for a strong finish in FY 2005. Army reenlisted 63,507 soldiers toward a year-to-date target of 59,087 (107 percent). Army is on track to meet its annual goal. Air Force retention is sound, albeit below historical achievement as it seeks to reduce strength through voluntary separations in surplus skills. Like Army, Air Force is reducing stress by realigning military positions to war on terrorism needs (e.g., one in eight Air Force recruits this year will be trained as security forces). Navy has had strong reenlistment performance, and its attrition rates are at or near 15-year lows. Marine Corps continues to surpass its retention goals.

Metric 1.2.2: Active Component End Strength Meets or Exceeds the Fiscal Year Authorization But No More Than 2% Over the Fiscal Year Authorization (At the End of Each Quarter)					
Service	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Authorized/Actual	FY 2005 Authorized/Actual[A]
Army	480,801 (+0.2%)	486,542 (+1.4%)	499,301 (+4.0%)	482,400/499,543 (+3.6%)	502,400/489,971 (-2.5%)
Navy	377,810 (+1.4%)	383,108 (+1.9%)	382,235 (+1.7%)	373,800/373,197 (-0.2%)	365,900/363,858 (-0.6%)
Marine Corps	172,934 (+0.2%)	173,733 (+0.7%)	177,779 (+1.6%)	175,000/177,480 (+1.4%)	178,000/178,231 (+0.1%)
Air Force	353,571 (-1.0%)	368,251 (+2.6%)	375,062 (+4.4%)	359,300/376,616 (+4.8%)	359,700/358,705 (-0.3%)
[A] FY 2005 data are final as of the third quarter.					

Metric Description

Service end strength authorizations are set forth in the National Defense Authorization Act for the fiscal year. Services are required to budget and execute to that end strength. The Services' actual end strength for each quarter will be evaluated against the authorized strength for that fiscal year. By law (Section 115 of Title 10), the Service Secretaries may authorize operating up to two percent above the authorized end strength, and the Secretary of Defense may authorize the Services to operate up to three percent above their authorized end strength for that fiscal year, if determined to be in the national interest. Due of the ongoing global war on terror, the Secretary waived the Title 10 strength constraints. A recent change in law added a quarterly measure and requires that the Secretary, within the DoD's budgetary documentation for the fiscal year, report the strength levels of each DoD component for each of the first three quarters of the fiscal year, and the maximum allowable variance from those prescribed strengths.

Performance Results for FY 2005

The Nation continued to operate in a state of National Emergency by Reason of Certain Terrorist Threats in FY 2005. Consequently, the end strength requirements were waived. In addition, the Army and Marine Corps were granted authorized end strength increases during FY 2005. The Army's authorization was increased by 20,000; while the Marine Corps was increased by 3,000. The Marine Corps reached its new authorization by the end of the third quarter; while the Army struggled and lost ground as the year progressed. While Army had a successful retention program, it had a challenging recruiting year and probably will miss its authorized strength for the fiscal year. Air Force ended FY 2004 almost five percent above its fiscal year authorization and set about reducing strength levels and shaping the force in FY 2005. Air Force is a little below its authorized strength in the third quarter but will have no trouble meeting the FY 2005 year-end requirement. Navy had a 7,900 reduction in authorized strength from FY 2004 to FY 2005; its force-shaping plans enabled Navy to reduce strength gradually. Although the Navy ended the third quarter slightly below its authorized strength, it will meet its authorization at the end of the fiscal year.

Metric 1.2.3: Reserve Component Selected Reserve End Strength Within 2% of the Fiscal Year Authorization (at the End of Each Quarter)

Reserve Component	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Authorized/Actual	FY 2005 Authorized/Actual[B]
Army National Guard	351, 829 (+0.4%)	351,078 (+0.3%)	351,089[A] (+0.3%)	350,000/342,918 (-2.0%)	350,000/330,312 (-5.6%)
Army Reserve	205,628 (+0.2%)	206,682 (+0.8%)	211,890 (+3.4%)	205,000/204,131 (-0.4%)	205,000/192,267 (-6.2%)
Navy Reserve	87,913 (-1.1%)	87,958 (+1.1%)	88,156 (+0.4%)	85,900/82,558 (-3.9%)	83,400/77,484 (-7.1%)
Marine Corps Reserve	39,810 (+0.6%)	39,905 (+0.9%)	41,046 (+3.8%)	39,600/39,644 (+0.1%)	39,600/40,318 (+1.8%)
Air National Guard	108,485 (+0.4%)	112,071a (+3.4%)	108,137 (+1.4%)	107,030/106,822 (-0.2%)	106,800/105,964 (-0.8%)
Air Force Reserve	74,869 (+0.7%)	76,632 (+2.6%)	74,754 (-1.1%)	75,800/75,322 (-0.6%)	76,100/75,499 (-0.8%)
Coast Guard Reserve	7,976 (-0.3%)	7,816 (-2.3%)	7,720 (-14.2%)	10,000/8,011 (-19.9%)	10,000/8,146 (-18.5%)

[A] Selected actual results for prior years were found to be in error and were updated in FY 2005.
[B] FY 2005 data are final as of the third quarter.

Metric Description

End of year strength authorizations for each of the seven Reserve components are set forth in the National Defense Authorization Act for the fiscal year. The DoD components are compelled to budget and execute to that end strength by the end of the fiscal year. By law, the Secretary of Defense may authorize the DoD components to vary, by no more than two percent, their authorized end strength for the end of that fiscal year, if determined to be in the national interest. A recent change in law added a quarterly measure and requires that the Secretary, within the DoD's budgetary documentation for the fiscal year, report the strength levels of each DoD component for each of the first three quarters of the fiscal year, and the maximum allowable variance from those prescribed strengths. The DoD component actual end strength for each quarter is evaluated against the prescribed end of quarter strength. The DoD is evaluating the Reserve components' quarterly strengths against the year-end authorization, and is considering changing that measure to relate actual end of quarter strengths against the quarterly prescribed strengths. While under partial mobilization, the Secretary may, as authorized by the President, waive all end strength limitations, if deemed appropriate.

Performance Results for FY 2005

The President waived the end strength limitations during this time of national emergency. The Secretary has directed DoD components to attempt to meet the two percent criterion, though exceptions are authorized based on the operational situation. At the end of the third quarter, four DoD components are outside the prescribed two percent criterion as evaluated against the end of year authorization. Army National Guard, Army Reserve, Navy Reserve, and Coast Guard Reserve are under their authorizations. The primary reason for the shortfall in the two Army Reserve components is a shortfall in recruiting. The shortfall in the Navy Reserve is due primarily to budgeted and programmed Navy Reserve downsizing. This equated to a 2,500 reduction in FY 2005, and a planned reduction of about 10,000 for FY 2006. In addition, the Coast Guard Reserve shortfall is exaggerated because of certain strength accounting rules, which count 897 Reserve members in the Active Coast Guard strength. Additionally, the Coast Guard Reserve budgeted for an end strength of 9,000 instead of the Congressionally-authorized 10,000, which makes its end strength achievement appear even lower. Finally, the Coast Guard Reserve is part of the new Department of Homeland Security, not the DoD. Based on budgeted manpower ramps, the current end strength status may approximate year-end data.

Metric 1.2.4: Critical Skill Recruit Needs					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/Actual[A]
Percentage of accession mission met for all skills	No historical data; new metric			≥95% fill for all skills/3 of the 63 designated skills (5%) filled less than 95%	≥95% fill for all skills/22 of the 67 designated skills (33%) filled less than 95%
Accession missions for each skill are set by the Services based upon required manning levels in the current and future force and expected losses in training. Data was not collected for this metric prior to FY 2004. [A] FY 2005 data are final as of the third quarter.					

Metric Description

The Department is now implementing a "critical skill recruit needs" metric whereby Services will identify annually the 10 percent of their skills that are most critical for recruitment focus in the coming year. At this time, the metric is applied only to Active duty enlisted recruits. "Critical skill recruit needs" consist of a certain type of recruiting emphasis (e.g., enlistment bonuses, college funds, incentives to recruiters) and meet one or more of the following criteria:

- Crucial to combat readiness,
- Undermanned in the force,
- Unfilled class seats,
- High volume required,
- High entrance standards, and
- Undesirable duty.

The exact fill rate for each skill will be measured, and each Service will be rated based on the recruit rate of its lowest skill rating.

The Department's overall readiness rating system, the Status of Resources and Training System, uses the following criteria for evaluating unit readiness with respect to skill match. The categories and percentages depict whether unit personnel have the skills to fit the unit's missions.

C1 Fully Mission Capable	85% or above
C2 Mostly Mission Capable	75% to 84%
C3 Major Parts Mission Capable	65% to 74%
C4 Some Parts Mission Capable	64% and below

Performance Results for FY 2005

At the end of the third quarter, 22 of 67 designated skills were filled to less than 95 percent. The challenging recruiting environment experienced thus far in FY 2005 is beginning to affect the depth of the critical skills shortage. In particular, the Army reports notable declines in a significant majority of critical skills. This more challenging recruiting environment may prove that targets, established in a favorable timeframe, are very ambitious. The DoD projects further decline for fourth quarter results.

Metric 1.2.5: Selected Reserve Component Enlisted Attrition Ceiling

Selected Reserve Component	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/Actual[A]
Army National Guard	20.0[B]	20.6[B]	18.1[B]	18.0/18.6[B]	19.5[B]/15.6
Army Reserve	27.4	24.6	22.1	28.6/22.6	28.6/17.2
Navy Reserve	27.6	26.5	26.5	36.0/28.2	36.0/23.9
Marine Corps Reserve	26.4	26.0	21.4	30.0/26.3	30.0/16.0
Air National Guard	9.6	7.3	12.7	12.0/11.5	12.0/7.8
Air Force Reserve	13.4	8.7	17.0	18.0/13.6	18.0/11.1

[A] FY 2005 data are final as of the third quarter.
[B] The ceiling for Army Reserve National Guard enlisted attrition has been corrected to reflect enlisted attrition only, vice the previously documented total (officer + enlisted) DoD component attrition ceiling.

Note: All numbers are percentages representing total losses divided by average strength.

Metric Description

The DoD uses attrition rather than retention rates to assess retention trends in the Reserve components. Attrition is computed by dividing total losses from the selected Reserve of a specific DoD component for a fiscal year by the average personnel strength of that component's selected Reserve for that year. This metric is preferable to retention rates because only a small portion of the Reserve component population is eligible for reenlistment during any given year. In addition to monitoring attrition, the DoD established annual attrition targets for Reserve component personnel. These targets, which took effect in FY 2000, represent the maximum number of losses deemed acceptable in a given fiscal year by establishing a ceiling for personnel departures. The attrition goal is actually a ceiling, which is not to be exceeded.

Performance Results for FY 2005

The Presidential Declaration of National Emergency by Reason of Certain Terrorist Threats and accompanying Executive Order, giving the Military Departments the authority to implement "stop loss" programs, remains in effect as the global war on terrorism and operations in Afghanistan and Iraq continue. The only Military Department that continues to use a "stop loss" program is the Army. Depending on the number of members mobilized, this influences attrition rates, since mobilized Army Reserve component members are subject to "stop loss" for the duration of their mobilization, plus a transition period of 90 days after demobilization. Through the end of the third quarter FY 2005, Reserve component enlisted attrition remained within acceptable limits. There is nothing remarkable or unexpected in attrition figures for FY 2005 to date. However, continued vigilance is prudent, especially considering the large number of forces supporting the ongoing contingency operations and the ongoing Army "stop loss" program.

Metric 1.2.6: Manning Level of Critical Skills					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
The percentage of skills that are deemed critical for retention relative to a DoD-wide benchmark.	No historical data; new metric		• Started to define critical skills • Services developed list of critical skills	• Established common definition for critical skill • Tested data collection	Began tracking the metric during the second quarter FY 2005.
[A] FY 2005 data are final as of the third quarter.					

Metric Description

The DoD is developing a way to measure its effectiveness at retaining the military skills most critical to its mission. To be designated as "critical," a skill must meet two tests: (1) it must be short of its targeted manning and (2) it must be critical to the Service's mission. As a first step, the Department established a common definition and metric to monitor critical skills across the Services. The next step is to test both data collection methods and the effectiveness of the metric in monitoring manning levels.

The Department defines a critical skill as a shortage skill (objective), plus a mission-critical skill (subjective). A shortage skill is either assigned less than authorized (quantitative) and or average grade experience is substantially different from desired experience (qualitative). These shortages are actual, projected, or have a past trend of historical shortages. A mission-critical skill meets at least one of the following criteria:

- Technical skills requiring notably above average training or replacement costs,
- Skills that are in high demand in the civilian sector,
- Skills that present recruiting challenging,
- Skills crucial to combat readiness, or
- A low-density high demand skill.

The metric monitors each Service's ability to retain members in its top10 critical skills for retention. If the Service retains 95 percent or more of its desired goal for a particular skill, it is considered "Green." If the

Service retains 86 percent to 94 percent of its goal for a particular skill, it is considered "Yellow." If it retains 85 percent or less of its goal for a particular skill, it is considered "Red." The Service's overall rating will be no higher than its lowest rated designated critical skill.

Performance Results for FY 2005

Each Service began reporting its most critical skills for retention in second quarter FY 2005. To allow visibility into the full array of issues presenting retention challenges (e.g., skills in high demand in the civilian sector), the DoD chose not to focus on a single criterion, but rather investigate a variety of potential issues. The DoD began using the metric during the second quarter; therefore year-end data is not available. The DoD will track this metric as a performance measure in FY 2006.

Metric 1.2.7: Active Component Enlisted Recruiting Quality

Category	FY 2001 Actual[A]	FY 2002 Actual[A]	FY 2003 Actual[A]	FY 2004 Target/ Actual	FY 2005 Target/ Actual[B]
Percentage of recruits holding high school diplomas (education tier 1)	93	94	95	≥ 90/95	≥ 90/94
Percentage of recruits in AFQT categories I–IIIA	66	70	72	≥ 60/73	≥ 60/72
Percentage of recruits in AFQT category IV	1	0.7	0.2	≤ 4/0.3	≤ 4/1.0

[A] Official High School Diploma Graduates performance excludes 4,000 participants in the Army's GED+ pilot program, therefore the actual numbers were adjusted to reflect this factor.
[B] FY 2005 data are final as of the third quarter.

Metric Description.

DoD measures recruiting quality along two dimensions – aptitude and educational achievement of recruits. All military applicants take a written enlistment test called the Armed Services Vocational Aptitude Battery. One component of that test is the Armed Forces Qualification Test (AFQT), which measures math and verbal skills and has proven to correlate closely with trainability and on-the-job performance. The table below shows how AFQT percentiles are grouped into categories:

AFQT Test Categories and Corresponding Percentile Score Ranges

AFQT Category	Percentile Score Range
I	93-99
II	65-92
IIIA	50-64
IIIB	31-49
IV	10-30
V	1-9

Those who score at or above the 50th percentile on the AFQT are in categories I-IIIA . The DoD values these higher-aptitude recruits because their training and job performance are superior to those in the lower groupings (categories IIIB-IV). The Department also values recruits with high school diplomas because years of research and experience demonstrate that high school diploma graduates are more likely to complete their initial 3 years of service.

Quality benchmarks for recruiting were established in 1992 based on a study conducted jointly by the DoD and the National Academy of Sciences. The study produced a model linking recruit quality and recruiting resources to the job performance of enlistees. As its minimum acceptable quality thresholds, the Department has adopted the following recruiting quality targets derived from the model: 90 percent in education tier 1 (primarily high school graduates), 60 percent in categories I–IIIA, and not more than 4 percent in category IV. Adhering to these benchmarks reduces personnel and training costs, while ensuring the force meets high performance standards.

Performance Results for FY 2005

All Active components, except Army, met or exceeded their third quarter recruiting quality goals. The Army is within one percent of the education tier 1 goal of 90 percent. Current Army drop in this metric during third quarter may indicate risk for FY 2005 outcome.

Metric 1.2.8: Reserve Component Enlisted Recruiting Quality					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/Actual[C]
Percentage of recruits holding high school diplomas (education tier 1)	89	89	87	≥ 90/87[A]	≥ 90/87
Percentage of recruits in AFQT categories I–IIIA	64	66	66	≥ 60/66[B]	≥ 60/65
Percentage of recruits in AFQT category IV	1	1.1	1.5	≤ 4/2.0	≤ 4/2.0

[A] Excludes Air National Guard; see discussion in Performance Results paragraph.
[B] Excludes Air National Guard; see discussion in Performance Results paragraph.
[C] FY 2005 data are final as of the third quarter.

Metric Description

Quality benchmarks for recruiting were established in 1992 based on a study conducted jointly by the DoD and the National Academy of Sciences. The study produced a model linking recruit quality and recruiting resources to the job performance of enlistees. As its minimum acceptable quality thresholds, the Department has adopted the following recruiting quality targets derived from the model: 90 percent in education tier 1 (primarily high school graduates), 60 percent in Armed Forces Qualification Test (AFQT) categories I–IIIA, and not more than 4 percent in AFQT category IV. Adhering to these benchmarks reduces personnel and training costs, while ensuring the force meets high performance standards.

AFQT Test Categories and Corresponding Percentile Score Ranges	
AFQT Category	Percentile Score Range
I	93-99
II	65-92
IIIA	50-64
IIIB	31-49
IV	10-30
V	1-9

Performance Results for FY 2005

All of the Reserve components except for the Army National Guard met or exceeded the category I-IIIA goal and the tier 1/high school diploma goal for enlisted recruit quality through the third quarter. However, there has been a slight decrease in quality throughout the year as the recruiting force continues to face significant challenges. There is increased emphasis on the non-prior service market as the number of individuals separating from Active duty service has declined (due in part to increased emphasis on retention in the regular forces) and fewer of those who are separating are affiliating with the Reserve components. Some of the data is drawn from data systems that are incomplete or known to contain errors. The Air National Guard continues to experience difficulties in reporting recruit quality data, but reports that a solution is near. Historically it has far exceeded the DoD benchmarks. The Army National Guard continues to struggle to meet the Department's quality benchmarks, and the Army National Guard recruit quality will likely continue to remain below the DoD benchmark.

Metric 1.2.9: Active Component Enlisted Recruiting Quantity					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target[A]/Actual[B]
Number of enlisted Active Component accessions	196,355	196,472	184,879	181,360/182,631	169,587/103,006

[A] FY 2005 target has changed since last report because of changes in requirements and recruiting behavior.
[B] FY 2005 data are final as of the third quarter.

Metric Description

Department-wide targets for Active duty enlisted recruiting represent the projected number of new Service members needed each year to maintain statutory military end strengths and appropriate distributions by rank, allowing for discharges, promotions, and anticipated retirements. As personnel trends change during the year, Active component recruiting objectives may be adjusted.

Performance Results for FY 2005

All Active components, with the exception of the Army, are on track for meeting their goals. Army is showing signs of improvement, recruiting 507 more than its goal for June. However, Army's year-end goal is at risk.

Metric 1.2.10: Reserve Component Enlisted Recruiting Quantity					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/Actual[B]
Number of enlisted Reserve component accessions	141,023	147,129	133,075	126,410[A]/118,177	93,196/77,375

[A] Army Reserve and National Guard and Navy Reserve have adjusted their FY 2004 targets downward because trends changed during FY 2003. Therefore, the DoD-wide target decreased from the 139,523 previously reported to 126,410.
[B] FY 2005 data are final as of the third quarter.

Metric Description

Department-wide targets for enlisted recruiting represents the projected number of new Service members needed each year to maintain statutory military end strengths and appropriate distributions by rank, allowing for discharges, promotions, and anticipated retirements. As personnel trends change during the year, Reserve component recruiting objectives may be adjusted.

Performance Results for FY 2005

Two of the six Reserve components achieved their recruiting objectives through the third quarter – the Marine Corps Reserve and the Air Force Reserve. The Army National Guard and Army Reserve fell short of their objectives and will likely not achieve their total year recruiting objectives. Recruiting challenges remain for all Reserve components. Enhanced recruiting and retention incentives are helping, and attrition is generally lower than programmed throughout the Reserve components. Through June 30, the Reserve components, taken together, are achieving just 83 percent of their recruiting objectives.

Metric 1.2.11: Retain Balanced Mix of Non-Commissioned Officer Grade/Experience					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Number of skills/experience deficiencies in top 10 enlisted occupational groups	No historical data; new metric		Services established a promotion-timing benchmark for 10 most critical enlisted occupational specialties	• Completed study of Service retention metrics • Began policy revisions to establish a tie between grade and experience	• Contracted a study to operationalize policy changes and align enlisted grade and experience pyramids • Developed metric • Completed the revision of directive on promotion timing.

[A] FY 2005 data are final as of the third quarter.

Metric Description

This metric will measure alignment, within certain occupational skill/groups, between by-grade requirements and the supply of experience emerging from promotion and retention programs, as well as promotion bottlenecks that operate against retention. The metric will monitor the top 10 enlisted occupational skills/groups that fall outside Service-defined promotion boundaries, time-in-service, time-in-grade, and/or promotion points. Annual goals are dynamic and can adjust from year to year. The goal for this metric is to avoid skill/experience deficiencies. This information is used to evaluate the DoD's experience/skill mix and to determine where emphasis should be placed in development, promotion, and retention programs.

The DoD is assessing the Services' current retention metrics to ensure measurement tools are designed to meet force sustainment goals. The Department asked the Center for Naval Analyses to determine why promotion policies vary across the Service's (and across different communities within the Services), to suggest whether this variation is rational and supports useful objectives, and to suggest how the Department might integrate the Services' different promotion policies into Service-specific models of military force shaping.

Performance Results for FY 2005

In September, the revision of the DoD directive requiring the Services to establish baselines, goals, and metrics to determine promotion timing for enlisted grades in FY 2006 was approved; publication was pending as of the fourth quarter. The Department also has contracted the Center for Naval Analyses to make recommendations on how to (1) employ the new policy, (2) project the average experience at promotion 1-3 years in the future, and (3) provide the Services a methodology to establish the benchmarks and metrics. During FY 2006, the Services will establish a long-term baseline/goal to determine the promotion timing benchmark to help focus retention programs and evaluate outcomes. Promotion data is available now; however, the Services need to determine benchmarks for the occupations, such as time-in-service, time-in-grade at pin-on, or promotion points.

Performance Goals 1.3 - Maintain Reasonable Force Costs

Metric 1.3.1: Civilian Force Costs					
Civilian force costs (Current Year $000)	FY 2001 Actual[B]	FY 2002 Actual[C]	FY 2003 Actual[E]	FY 2004 Actual	FY 2005 Projected[F]
Total[A]	42,258,733	44,867,328	47,227,585	50,326,400	51,971,521
Basic pay	31,887,999	33,376,576	34,947,575	37,046,481	38,765,799
Premium pay[D]	1,985,502	—	—	—	—
Overtime pay	—	1,173,810	1,215,873	1,503,543	936,046
Holiday pay	—	53,772	46,787	66,610	62,161
Other pay	—	1,119,919	1,105,238	1,150,070	1,141,362
Benefit pay	8,066,742	8,822,937	9,501,778	10,276,114	10,895,709
Separation pay	318,490	320,049	410,333	283,582	170,444

[A] Totals may not add due to rounding error.
[B] FY 2001 data are from the DoD component summary of President's Budget FY 2003.
[C] FY 2002 data are from FY 2004 President's Budget.
[D] Premium pay includes overtime pay, holiday pay, and other pay. It was reported only as an aggregate number in FY 2001.
[E] FY 2003 through FY 2005 data are from FY 2005 President's Budget.
[F] FY 2005 data are projected based on FY2005 President's Budget, and includes actual results as of the second quarter.

Metric Description

In the past, civilian force costs reflected costs reported annually to the Office of Personnel Management (OPM). OPM's data were not timely, so in FY 2004, the DoD began using data from the President's Budget that provided a better source of past and present workforce cost. Consequently, premium pay costs after FY 2002 are presented with more specificity in the overtime, holiday, and other pay categories.

Although this metric provides only a broad overview of civilian compensation costs, it may become a baseline for evaluating National Security Personnel System costs. However, it is not an effective measure of the success of any individual personnel program or benefit. For example, additional benefit costs do not indicate successful use of recruitment or retention incentives. Increased recruitment bonus or retention allowance payment amounts would only reflect usage, not the change in recruitment or retention based on payment of the incentive.

The metric monitors trends in the following pay categories:
- Basic pay—the aggregate personnel compensation for full-time permanent, full-time temporary, and part-time/intermittent appointments.
- Premium pay—personnel compensation for overtime, holiday, Sunday, night differential, hazardous duty, post differential, staffing differential, supervisory differential, physicians comparability allowance, remote work site allowance, cash awards, and other.
- Benefit pay—health insurance, life insurance, retirement, social security, workers' compensation, uniform allowances, overseas allowances, non-foreign cost-of-living allowance, retention allowance, recruitment bonus, relocation bonus, and other.
- Separation pay—personnel compensation to involuntarily separated employees and payments made through the $25,000 voluntary separation incentive pay program (buyout bonuses).

Performance Results for FY 2005

In FY 2005, civilian force cost continues a relatively slight upward trend. In constant dollar terms, the FY 2005 civilian payroll costs increased 1.7 percent from FY 2004 payroll costs. Simultaneously, the size of the workforce increased 1.2 percent, or 4,228 employees.

Metric 1.3.2: Community Quality of Life Per Capita Metric					
Community Quality of Life Per Capita Cost Metric (Current $)	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual[A]	FY 2005 Target/Actual (Budget)[B]
Army	$1,125	$1,180	$1,539	$1,559/$1,628	$1,581/(-$37)
Navy	$1,121	$1,269	$1,391	$1,409/$1,365	$1,429/(-$214)
Marine Corps	$812	$940	$1,018	$1,031/$1,103	$1,045/(+$47)
Air Force	$1,507	$1,580	$1,642	$1,663/$1,884	$1,687/(+$239)

[A] FY 2004 includes emergency supplemental funding.
[B] FY 2005 data are budget estimates in the FY 2006 President's Budget. Actual funding will not be available until the FY 2007 President's Budget is approved.

Metric Description

Quality of Life (QoL) Per Capita is one metric in a three-pronged approach that combines a QoL Social Compact Improvement Index and Commitment to Military Life Index to measure the health of QoL programs and services supporting military members and families. The QoL per capita metric responds to the National Security Presidential Directive, "Improving Quality of Life," and supports the Secretary's guidance that the Department track QoL improvements and give priority to the implementation of QoL initiatives. Current deployment and high personnel tempo necessitate robust QoL support for troops and families to ensure there is adequate support to ameliorate the stress associated with the military lifestyle, and to engender commitment to military service. The QoL per capita metric will monitor trends in the Department's QoL funding investment per active duty member over time. DoD will track individual Service progress towards sustaining or improving funding for critical QoL support.

The metric will calculate per capita cost using financial data submitted annually by the Services and annual Active duty end strength data. The majority of funding to support Service QoL activities is identified in specific budget and program exhibits submitted to the Office of the Secretary of Defense on an annual basis. The metric will correlate Active duty end strength with Service direct operation and maintenance funding for the following programs: morale; welfare and recreation; childcare; family centers; voluntary education and tuition assistance; and youth programs.

Performance Results for FY 2005

FY 2005 performance reflects preliminary data based on budget estimates in the FY 2006 President's Budget. Final performance results for FY 2005 will not be available until the FY 2007 President's Budget is approved.

The FY 2006 budget estimate reveals a decline in per capita funding for Army and Navy QoL programs. The DoD notes that these reductions are due to improved management practices, and will monitor these programs for potential impact on the support provided to troops and their families.

QoL per capita will become the benchmark for QoL investments as the DoD changes its global basing profile. The goal is to keep standards high, even as the Department closes, realigns, and relocates installations and units to better fit the DoD's global defense mission. QoL per capita is a macro-level indicator that must be analyzed in conjunction with the QoL Social Compact Improvement Index and the Commitment to Military Life Index to gain insight into the best ways to support and take care of Service members and their families.

Metric 1.3.3: Cost of Basic Training					
Cost Indicator (Constant FY 2005 dollars)	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Actual[A]
Cost of basic training per enlisted recruit	$7,615.4	$8,491.9	$8,915.4	$11,359.9	$10,158.3

[A] FY 2005 data are estimated as of the third quarter.

Metric Description

Basic training is the fundamental introductory and indoctrination training provided to enlisted entrants. Each Service has different training pipelines that take different lengths of time to complete. The cost of basic training is a management cost indicator; performance/production targets are accession-driven and vary by Service and year. Funding requirements are projected by fiscal year and include manpower, support equipment, facilities, and all other costs associated with indoctrinating recruits into military culture, raising their standards of physical conditioning, and instructing them in basic military skills. (Basic training costs do not include expenses associated with initial skills training; initial skills training follows basic training, and its duration and costs vary with each military specialty.)

Performance Results for FY 2005

Basic training costs rose from $1,660.8 million in FY 2001 to $1,990 million in FY 2005, a total increase of 19.8 percent. However, the Army's costs are projected to decrease significantly this year. The mobilization and deployment of large numbers of Army Reserve and National Guard soldiers for Operations Enduring Freedom and Iraqi Freedom required expansion of the training base and its infrastructure in FY 2004, including the construction of training barracks in Afghanistan and Iraq for operations. The removal of this expense drops the Army's projected costs to a more reasonable $811.2 million, a decrease of approximately 30 percent from the $1,147.9 million expended in FY 2004. At the same time, the number of recruits entering the system increased by 4.3 percent from 77,804 to 81,116.

Metric 1.3.4: Cost Per Enlisted Recruit - Active Component					
Cost Indicator (Constant FY 2005 dollars)	FY 2000 Actual	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual[B]
Cost per Recruit[A]	$12,202	$13,620	$14,361	$14,675	$14,750

[A] Methodology and data updated from the FY 2003 Performance and Accountability report.
[B] FY 2004 data are final as of the fourth quarter.

Metric Description

The metric is a performance indicator designed to analyze costs and trends over time, not set specific annual performance targets. Each year, the DoD enlists about 200,000 new recruits for the Active components. These new Service members provide entry-level manning necessary to meet manning and readiness needs. The cost of recruiting is calculated by dividing a Service's total number of accessions into the total expenditures for enlisted recruiting. These resources are made up of recruiting personnel compensation, enlistment bonuses, college funds, advertising, communications, recruiting support (vehicles, equipment, computers, supplies, and applicant's transportation, food and lodging, etc.), and other appropriations resources within the recruiting Command/Service (i.e., other procurement and research, development, test, and evaluation funding).

Performance Results for FY 2004

Cost per enlisted recruit is a macro-level performance indicator used to analyze Service programs. Recruiting costs are driven by a host of external variables, such as the state of the economy, unemployment, youth propensity to serve, the posture of the delayed-entry program, etc. After steady growth through FY 2002, this measure has stabilized in budgets at the FY 2003 level through FY 2004, and into the FY 2005 budget. However, with steep recruiting mission requirements for the Army in FYs 2004 and beyond, coupled with a strengthening economy, the DoD expects to see growth in this measure through supplemental appropriations and in-year reprogramming in FY 2005.

Metric 1.3.5: Cost Per Enlisted Recruit - Reserve Component				
Cost Indicator (Constant FY 2005 dollars)	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004[B] Actual
Cost per Recruit – Reserve	$7,065[A]	$6,636[A]	$7,773[A]	$11,369

[A] Methodology and data updated from the FY 2003 Performance and Accountability Report.
[B] FY 2004 data are final as of the fourth quarter.

Metric Description

The metric provides an indicator to analyze costs and trends over time, not to set annual targets for performance. Each year, the DoD enlists about 200,000 new recruits for the Active components and approximately130,000 for the Reserve components. These new Service members provide the entry-level manning necessary to meet manning and readiness needs. The cost of recruiting is calculated by dividing a Service's total number of accessions into the total expenditures for enlisted recruiting. These resources are made up of recruiting personnel compensation, enlistment bonuses, college funds, advertising, communications, recruiting support (vehicles, equipment, computers, supplies and applicant's transportation, food, and lodging, etc.), and other appropriations resources within the recruiting Command/Service (i.e., other procurement and research, development, test, and evaluation funding).

Performance Results for FY 2004

The pressures of the global war on terrorism and the necessary focus of recruiting efforts on the non-prior service market have driven up sharply costs associated with Reserve recruiting. For example, from FY 2003 to FY 2004, funds dedicated to total Reserve recruiting increased as follows: college programs – $11 million; enlistment bonuses – $49 million; advertising – $59 million; and, recruiter support – $18 million. With continuing challenges and increased bonus authorities, recruiting costs will likely continue to climb.

Metric 1.3.6: Medical Cost Per Enrollee Per Month

Metric (Current $000)	FY 2000 Actual	FY 2001 Actual	FY 2002 Actual[B]	FY 2003 Actual[C]	FY 2004 Target/Actual[C]	FY 2005 Target/ Actual[D, E]
Medical cost per enrollee per month	No historical data; new metric[A]		$174	$192	$219/$206	$229/$222
Percentage change			N/A (first year data reported)	10.2%	≤ 14% / 7.3%	≤ 11%/ 11.4%

[A] Data used to calculate this metric were not available in FYs 1999 or 2000. Additionally, since the metric is based on rolling 12-month expenses from the Military Treatment Facilities, FY 2002 was first year when data could be reported.
[B] FY 2002 data have been updated to reflect additional purchased care claims and reallocation of pharmacy expenses in the calculation.
[C] The data for FYs 2003/2004 has been updated as of July 2005. The data is updated to reflect the most recent purchased care claims that have been adjudicated, a process that takes 3 years. The metric is expressed as a percentage; however, dollar amounts are shown for informational purposes.
[D] FY 2005 data are estimated as of the second quarter.
[E] FY 2005 actual data is for a 6-month period. $222 (FY 2005) is compared to $199.67 (similar period FY 2004) resulting in the actual percentage of 11.4%.

Metric Description

This metric looks at how well the Military Health System manages the care for those individuals who have chosen to enroll in a health maintenance organization-type of benefit. It is designed to capture aspects of three major management issues: (1) how efficiently the Military Treatment Facilities (MTF) provides care; (2) how efficiently the MTF manages the demand of its enrollees; and (3) how well the MTF determines which care should be produced inside the facility versus that purchased from a managed care support contractor.
This aggregate measure helps to monitor how well the Military Health System is managing the care for TRICARE Prime enrollees. It looks at all Prime enrollees, whether at the MTF or with the health support services contractors. The overall measure can be broken into multiple components that allow for review of utilization factors for both direct care and purchased care, and unit cost information for direct care and purchased care. By reviewing this information, MTFs are able to determine the cost of providing care at the

MTF, and how many times the enrollees are receiving care. While the top-level measure is used to track overall performance, the detailed measures allow for review and management at the local level.

Due to claims processing times, purchased care workload is projected to completion 6 months after the fiscal year ends; final results will not be available for approximately 3 years. Purchased care workload does not place care delivered overseas into hospital or clinic areas, so overseas workload is excluded. To ensure consistency across the program years, purchased care excludes all resource sharing, continued health care benefit plan, and TRICARE-for-Life purchased care workload. Since data will not be available until 6 months after fiscal year-end, this will be a lagging indicator.

Performance Results for FY 2005

Due to delays in claims processing and medical records coding, this measure is delayed longer than other performance measures for reporting. Through the second quarter, the system is slightly above its annual goal (11.4 percent vs. ≤ 11 percent). Yet, because of changes that occurred in claims processing this year, it is expected that the most recent months are overstated, and performance is actually below the goal. In addition, current reporting through the second quarter is based largely on projected to completion data that will improve over time. The overall metric goal of equal to or less than 11 percent is based on the average premium increase in private sector plans for calendar year 2005.

Metric 1.3.7: Military Personnel Costs—Enlisted Pay Gap					
Metric	FY 2001 Actual	FY 2002 Actual[B]	FY 2003 Actual	FY 2004 Target/Actual[B]	FY 2005 Target/Actual[C]
Percentage of enlisted pay gap closed [A]	23%	48%	61%	71%/73%	79%/88%
Percentage of remaining gap closed (annually)	N/A	31%	25%	33%	27%/54%

[A] Relative to FY 2000 baseline.
[B] Actual results for FY 2002 and FY 2004 changed from prior reports because the baseline for civilian wages was updated due to the availability of more recent data.
[C] FY 2005 data are final as of the fourth quarter.

Metric Description

The goal of military compensation is to provide sufficient military manpower to provide for the national defense. To achieve this end, military compensation must be competitive. The DoD determined that military pay that matches the 70th percentile of pay earned by comparably experienced civilian workers is an appropriate short-run measure for assessing whether military pay is competitive with civilian compensation. In the past, whenever military compensation was significantly less than the 70th percentile as compared to civilian pay, recruiting and retention problems arose. It is generally very costly, in terms of both dollars and experience mix, to correct recruiting and retention shortfalls after they have appeared. This metric tracks the percentage of the pay gap between military pay and the comparable 70th percentile for civilian counterparts that has been closed, as measured and beginning in FY 2000.

For officers, the appropriate comparison group is civilians with college degrees and advanced degrees in managerial and professional occupations. The FY 2000 pay gap for officers was eliminated in FY 2002 through a combination of targeted pay increases, across-the-board raises that exceed the average increase in the private sector, and general increases in allowances.

Measurement of the enlisted pay gap is based on civilian pay by education and years of experience and enlisted pay by pay-grade and years of service. There still is a measurable pay gap today for enlisted service members. Therefore, the DoD's goal is to close at least 25 percent of the remaining gap annually until the gap is eliminated. After the gap is closed, the goal is to ensure military pay remains commensurate with the 70th percentile of comparable civilians.

Although a good leading indicator of recruiting or retention trends, this metric alone is not sufficient to gauge the overall efficiency or effectiveness of the military personnel compensation program. Consequently, the DoD also is working on monitoring change in total military personnel costs (in current and constant dollars); the probability an enlisted member will remain in service until 15 years; and the average experience at promotion for grades affected by the pay gap.

Performance Results for FY 2005

The DoD achieved a sizeable reduction in the enlisted pay gap from 73 to 88 percent of the total gap. This was accomplished with an average pay increase of 3.5 percent, an increase in the average basic allowance for housing of 12.4 percent, and a 5 percent rise in the basic allowance for subsistence. The average civilian wage increase during this period was 3 percent.

Metric 1.3.8: TRICARE Prime Outpatient Market Share					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/ Actual[A]	FY 2005 Target/Actual[B]
TRICARE Prime outpatient market share (MTF enrolled)	84.4%	81.0%	75.1%	78%/71%	No longer reported

[A] This was a new measure for FY 2004. For FY 2004, the target is based on business plans received from Military Treatment Facilities and is contained in the Defense Health Program performance plan. Changes to the performance plan goals will result in changes to the goals for this metric.
[B] After further review of this modified measure, the value of reporting was found to be limited, and therefore this measure is being removed.

Metric Description

Outpatient encounters represent the majority of contacts between the Military Health System and its beneficiaries. This metric looks at how much of the care is delivered in the direct system rather than being purchased. Since there is a large fixed manpower cost related to the medical readiness mission, it is vital that resources are used efficiently and effectively.

Although medical care can be purchased at numerous locations throughout the United States and overseas, this measure focuses on enrollees in the United States because purchased care data are not available in sufficient detail for overseas activities. Due to the extensive medical capabilities of the hospitals compared with ambulatory clinics, the market-share percentage will vary by Military Treatment Facilities and Military Service. Over the past couple of years, the downsizing of small hospitals into ambulatory care clinics has affected the clinical capabilities of these facilities, and market share has decreased. This reduction is expected to continue for several years until the direct-care system stabilizes.

Market-share percentages for the Services are shown based on direct-care workload compared to total purchased-care plus direct-care workload for TRICARE Prime enrollees. This metric will be based on relative value units to compare more accurately the relative complexity of care instead of just a visit count. To compensate for factors that cannot be controlled under current program rules, the metric was changed in FY 2004 to focus just on the Military Treatment Facilities' TRICARE Prime enrollees. Rules under the TRICARE Prime enrollee program provide more oversight for the facility in managing the overall health and utilization of this population.

Performance Results for FY 2005

Based on results from business plan execution for the first 2 years, the value of the measure is uncertain. In the future, when business plans become more stable, the measure may be reviewed again, but for the time being, this measure has been closed.

Metric 1.3.9: Primary Care Provider Productivity					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target[A]/Actual[B]
Relative value units per primary care provider per day	13.6	13.8	14.0	≥ 14.5/14.1	≥ 14.3/14.6
[A] FY 2005 target was reset to a yearly goal that would match the Defense Health Program performance plan for FY 2005. All future years goals will be updated on an annual basis. [B] FY 2005 data are estimated as of the third quarter.					

Metric Description

To run a premier health maintenance organization (HMO), the critical focus area is primary care. The primary care provider frequently represents the first medical interaction between the beneficiary and the HMO. In this role, the primary care provider is responsible for the majority of the preventive care to keep beneficiaries healthy and away from more costly specialty care. While the HMO has a goal to reduce the overall number of encounters per beneficiary, an additional goal is to ensure that the dollars spent on medical care are used efficiently.

The targets for this metric represent stretch goals that were instituted to move the organization forward, but were not achieved in FY 2003 or FY 2004. This metric looks at the complexity of care and the number of patients seen by the primary care providers each day, with a goal of increasing the complexity, number, or both, of patients seen each day by the provider. To measure the complexity of care, and not just the count of visits, the relative value unit is used. Developed by the Centers for Medicare and Medicaid Services, this measure approximates the physician resources used during a visit. (For example, a returning visit by a patient with a simple problem might be 0.17 units, whereas arthroscopic surgery of the knee might be 16.00 units.) Due to the nature of this data reporting, the metric results will lag the actual performance by one quarter.

Performance Results for FY 2005

Prior to the beginning of the fiscal year, the performance target was adjusted to make the goal more realistic for annual performance, and to match the Defense Health Program performance plan for FY 2005. Instead of an increase of 1 relative value unit per primary care provider per day, the goal was adjusted to a .2 increase, a target that was viewed as more achievable by the Services. Based partially on that change, and an emphasis on provider productivity, two of the three Services showed immediate improvements as the fiscal year began. As of the third quarter, the last Service is also showing signs of improvement that will likely help it to achieve its goal. Assuming that performance levels remain steady, or continues to improve, the overall Military Health System will meet its goal for the year.

Metric 1.3.10: Total Costs for Contractor Support					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Trend data showing the percentage increase or decrease in costs associated with contract support	No historical data; new metric		Army assigned pilot program to contractor manpower and costs	Worked towards overcoming legal hurdles and developing processes to implement pilot program within Army	• Army began to determine DoD-wide applicability • Implemented pilot program within the Army
[A] FY 2005 data are estimated as of the fourth quarter.					

Metric Description

The contractor workforce is comprised of non-federally appointed individuals who form the third component of the Department's workforce, along with military members and civilian employees. Contractor costs will grow as the DoD continues its efforts to balance personnel investments by outsourcing non-core functions, allowing it to return military manpower slots to the kinds of operational tasks that only can be performed by a trained soldier, sailor, or Marine.

The purpose of the contract support cost indicator is to provide visibility into the total funding burden that contracted personnel render across the entire Department. To do this, the DoD must find ways to capture data about the contracted work performed, the associated costs, and the unit supported. This information is needed to satisfy fiscal accountability standards, as well to determine where contractor investments overlap, allowing DoD to propose alternative solutions, as needed.

Unfortunately, existing financial and procurement systems do not capture contractor workforce data such as direct labor hours, direct labor dollars, and the unit supported. The DoD is developing a systemic method to capture this data across the DoD; the final cost indicator will allow the Department to monitor the trends in contract investments in direct labor dollars for all Military Services.

In summer 2002, the Department approved an Army pilot program to capture contractor manpower and costs. The Army is testing a Contractor Manpower Reporting Application, documenting lessons learned, and developing a proposal for DoD-wide (Service-only) use. The Army pilot program and final proposal for DoD-wide applicability are scheduled for completion in September 2007; DoD-wide implementation is expected by 2008. Services may begin reporting total contracting support cost data in 2009.

Performance Results for FY 2005

The Secretary of the Army issued implementation guidance to include reporting requirements into applicable contracts. Contracting offices are implementing standardized contract workforce data as a line item in new Army contracts and the industry is populating the website for data collection. The Army plans to garner lessons learned and, based upon results, the Army staff will conduct a cross-Service working group to develop the DoD implementation instructions and negotiate legal and policy requirements.

Performance Goals 1.4 - Shape the Force of the Future

Metric 1.4.1: Active Component/Reserve Component Force Mix					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Benchmark of the proper balance between Active and Reserve component forces	No historical data; new metric		• Services determined spaces to be rebalanced • Services began rebalancing (rebalanced 22,486 spaces)	Services rebalanced 18,366 spaces	Services rebalanced 28,905 spaces

[A] FY 2005 data are estimated as of the fourth quarter.

Metric Description

A December 2002 study of the proper mix of Active component/Reserve component forces concluded that the DoD could enhance capability overall military by rebalancing both components' force mix and mission assignments. The Secretary of Defense directed the Services to review their force structure and, where required, rebalance their forces to ease stress on the Guard and Reserve.

The Secretary provided the Services with two force structure planning objectives. They were: (1) rebalance forces to eliminate the involuntary mobilization of Reservists during the first 15 days of a rapid response operation, and (2) limit the involuntary mobilization of Reservists to no more than 1 year out of any 6-year period.

Ongoing Research

A study of the stress on the Reserve component forces examined all specialties mobilized for current military operations and comparing the data against previous operations and recent Presidential Reserve Call-ups

(Bosnia, Kosovo, and Southwest Asia). The study measured stress using three factors: (1) frequency of call-ups; (2) duration of call-ups; and (3) percentage of inventory used (i.e., how much of the force capability was employed). The results of this study helped inform the Services as to where rebalancing was needed.

The Department began tracking rebalancing actions in FY 2003. As the environment changes, the Services will review their force structure and, where applicable, take additional rebalancing actions. Although rebalancing is an iterative and continuous process, the rebalancing actions required to compensate for the transition from the Cold War to the global war on terrorism are scheduled to be completed by September 2010.

Performance Results for 2005

The DoD estimates that 28,905 spaces will be rebalanced in 2005 (pending end of year results from the Services). The Services have each reviewed their force structure and have submitted plans for rebalancing. The number and type of spaces rebalanced varies by Service. Current Service plans call for rebalancing to continue through FY 2010.

Metric 1.4.2: Civilian Human Resources Strategic Plan

Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/Actual[A]
Percentage of Civilian Human Resources Strategic Plan tasks completed	No historical data; new metric	90% (26 of 29 tasks completed)	98% (40 of 41 tasks completed) (includes three FY 2002 carryover tasks)	80%/90% (54 of 60 tasks completed) (includes one FY 2003 carryover task)	80%/60% (20 tasks scheduled) (includes one FY 2004 rescheduled task)

[A] FY 2005 data are final as of the third quarter.

Metric Description

Good human capital management is one of the key tenets of the Department's transformation initiative. The DoD Civilian Human Resources Strategic Plan is the roadmap that provides direction and outlines the standards for achieving those transformational results. This plan links to agency mission and goals that cascade throughout the Department; progress is measured quarterly.

The DoD uses as a measure the number of tasks scheduled to the number completed on a quarterly and annual basis. A successful rating requires completing 80 percent of scheduled tasks annually. To provide more qualitative information about the overall effect of annual activities, the DoD is replacing task-dependent output measures with task-dependent outcome measures.

Performance Results for FY 2005

As of the third quarter, 12 of the 20 activities were completed. The Department expects to complete the remaining eight activities in the fourth quarter. The Civilian Human Resources Strategic Plan is being revised for FY 2006. The focus will be on analysis of DoD components' performance against specific metrics and standards than the current activity-based strategic plan.

Metric 1.4.3: Civilian Recruiting Cycle Time					
End-State Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY2005[A]
Trend data to monitor the number of days appropriated fund positions are vacant.	No historical data; new metric		• Draft Performance Measures • Benchmark with Fortune 500	• Issue reporting requirements for measure • Integrate Office of Personnel Management reporting requirements into the DoD reporting requirements.	• Collected and validated data • Began to characterize results • Metrics will be applied to the data in the fourth quarter
[A] FY 2005 data are final as of the third quarter.					

Metric Description

This measure provides a standard metric and data collection method for evaluating the efficiency of civilian recruiting cycle time across the Department. It is linked to the Strategic Management of Human Capital initiative of the President's Management Agenda and benchmarked to the "time to fill" metric used by Fortune 500 companies. Once data is collected, the Department will be able to determine the average number of days from the date the position became vacant to the effective date of the placement action.

In 2004, the Office of Personnel Management (OPM) imposed a new requirement to report on its 45-day hiring model. The OPM model tracks the number of working days from the date the vacancy announcement closed to the date the job offer was made. Since the OPM 45-day hiring requirement is a subset of the DoD "Time to Fill Metric," the DoD plans to combine the DoD and OPM requirements into a single reporting requirement.

Performance Results for FY 2005

As of the third quarter, 71 percent of the Requests for Personnel Action were completed within 90 days from the initiation date to the effective date. Additionally, 12 percent were completed within 120 days, while the remaining 17 percent were completed 120-plus days.

Metric 1.4.4: Identify Future Critical Skills					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Outcome goals that establish standards for emerging critical skills	No historical data; new metric		• Established common definitions of critical fill needs • Considered alternative metric development	• Agreed to common definition of critical skills • Identified most critical needs for recruitment and retention	Services reported metrics on skills most critical to recruiting and retention
[A] FY 2005 data are final as of the fourth quarter.					

Metric Description

The DoD needs to identify skills critical to future forces, with enough lead-time to ensure that there are trained and ready Service members with these skills when needed. The skill/experience combinations deemed critical will vary from Service to Service. The DoD needs to understand fully what makes these skill/experience combinations so important to assess adequately the capability to identify, recruit, train, retain, and sustain Service members in these skills.

Ongoing Research

The DoD developed a metric for "critical skills" to provide a comprehensive list of the most common critical skills across the Department. The next step is to review the Services' transformation programs and the Department's vision of military strategy and responsibilities for the next 25 years. Specifically, the DoD will address what skills are required to support this future strategy and which of those skills will be catalogued as "critical" (e.g., foreign area specialists, information operators, space experts) based on the criteria established in the study. The follow-on questions are many such as: How will personnel be recruited in these skills? What programs will be required – current programs, special incentives, and lateral entry? Is the training base adequately resourced with experienced personnel to provide entry level and advanced training? What retention incentives are going to be required to retain them? What jobs and education are required to provide for a viable and rewarding career path?

Performance Results for FY 2005

During the first quarter, the DoD completed the metrics for the retention portion of critical skills. However, the funding for the next step has not approved, so further action has been delayed.

Metric 1.4.5: Implement New Reserve Component Management Paradigm					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
A new baseline for managing Reserve component forces	No historical data; new metric		• Established goals such as promoting volunteerism and reachback capabilities • Employed five initiatives geared to support creating a seamless flow between Active and Reserve components	• Introduced legislative proposals • Introduced linguist program	• Certain legislative proposals approved in National Defense Authorization Act • Continued to identify potential quantitative and/or qualitative metrics for implementation • Initiated / expanded various pilot programs
[A] FY 2005 data are final as of the third quarter.					

Metric Description

A December 2002 review of the use of Reserve component forces proposed a concept of "continuum of service" that would allow a Reservist who normally trains 38 days per year to volunteer to move to full-time service for a period of time or some increased level of service between full-time and his or her normal Reserve component commitment, without abandoning civilian life. Similarly, an Active duty Service member could request transfer into the Reserve component for a period of time, or some status in between, without jeopardizing his or her full-time career and opportunity for promotion. Military retirees with hard-to-find skills could return on a flexible basis and create opportunities for others with specialized skills to serve. Some of the review's recommended initiatives will require legislative, policy, or regulatory changes and may take several years to implement.

The DoD's efforts are geared to support (1) creating a seamless flow between Active and Reserve components forces, (2) encouraging volunteerism and establishing new affiliation programs, (3) simplifying rules for accessing, employing, and separating Reserve component personnel, (4) increasing flexibility of the Reserve component compensation system, and (5) enhancing combined Active and Reserve component career development.

The DoD has not settled on a means of measuring the success of this new concept. Possible ways to measure this metric are (1) establishing specific measures for each approved and initiated program, (2) compiling results of each specific program evaluation into a single comprehensive measure, and (3) percentage of legislative proposals approved. Efforts to determine valid, useful performance measures will continue as the DoD moves forward with these multiple initiatives.

Performance Results for FY 2005

Numerous efforts have been either newly initiated or expanded from last year. The direct accession/lateral entry program has been evaluated via a report to Congress and is being considered for expansion in certain areas; the civilian employment information effort has been implemented, to include gathering information and population of a database in accordance with specific quantitative goals.

Regarding legislation, about 80 percent of proposed legislative changes have been approved and incorporated into the FY 2005 National Defense Authorization Act, including:

- Elimination of the "180-day" rule; creation of the "operational support" accounting category,
- Enhanced bonuses for language skills, and
- Changed "purpose" of the Reserve components.

Metric 1.4.6: Meeting Civilian Critical Fill Goals					
Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY2005[A]
Number of critical positions encumbered as compared to number of critical positions authorized equals percentage	No historical data; new metric		• Reviewed previously identified DoD critical positions, by core mission and critical support occupations • Issued reporting requirements	Analyzed data at the DoD and component level	Explore automated alternatives for collection of authorized data
[A] FY 2005 data are final as of the third quarter.					

Metric Description

This measure monitors the fill rate of critical positions by core mission occupations and critical support occupations. Core mission occupations, supported by critical support occupations, are an indicator of the Department's ability to accomplish its mission over the long term. Fill rate is an integral part of human capital management. As early as 1999, the U.S. Government Accountability Office asked the DoD to list core mission and critical support occupations. The DoD subsequently surveyed the Military Departments and Defense Agencies and identified 13 core mission occupations and 23 critical support occupations. The DoD is working with the Defense Manpower Data Center to develop a system to account accurately for manpower data.

Performance Results for FY 2005

Based on the metrics implemented in the third quarter of FY 2005, the overall fill rate for core mission occupations was 108.8 percent and critical support occupations was 108.1 percent. Next year, the DoD will refine this metric.

Metric 1.4.7: Military Human Resources Strategic Plan					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/ Actual	FY 2005 Target/Actual[B]
Percentage of scheduled tasks completed	No historical data; new metric	1	7	8/8 (80%/100%)[A]	9/5 (56%)

[A] In 2002, 25 funded or in-house studies were programmed to be completed by the end of FY 2005. However, in 2003, this metric was changed to be consistent with the Civilian Human Resource Strategic Plan metric. Beginning with FY 2004, the measure is the percentage of tasks (funded or in-house) scheduled for completion that the DoD completed during the fiscal year.
[B] FY 2005 data are final as of the third quarter.

Metric Description

This metric compares the number of tasks scheduled for completion under the Military Human Resources Plan with those actually completed. If 80 percent of tasks are completed, the result is considered "on track" to achieving plan goals. Beginning in FY 2004, the percentage target will be calculated by dividing the number of projects completed in a fiscal year by the number scheduled to be completed that fiscal year. Tasks are removed from the plan as they are completed.

The Military Human Resources Strategic Plan has six main goals:

- Increase the willingness of the American public to recommend military service to youth,
- Recruit the right number of quality people,
- Develop, sustain, and retain the force,
- Seamlessly transition members to and from Active and Reserve status,
- Develop a flexible, integrated human resources management information system, and
- Sustain continuous human resources process improvement.

Each goal has subordinate objectives and actions. As studies of new ideas or proposals are completed, one of four actions is taken (1) the idea is abandoned (typically, because it is ineffective or inefficient), (2) legislation is requested to implement the idea, (3) the idea is implemented and applicable metrics established, or (4) the idea scheduled for further study.

This plan establishes the legislative and policy priorities for the next several years, such as:

- Accessing enlisted personnel with the right level of education and aptitude,
- Ensuring the force is manned with the right number of military members and in the appropriate skills, and
- Implementing a demonstration program evaluating various personnel management policies and programs for extending careers, such as, an "up-and-stay" policy (versus "up-or-out") for certain high-investment specialties.

Performance Results for FY 2005

By the end of the third quarter, the DoD had completed five of nine scheduled studies and plans to complete all nine by the end of the year. The completed studies (1) developed a critical skills metric for retention, (2) evaluated the utility and availability of non-monetary incentives to support retention efforts, (3) evaluated an indefinite reenlistment option, and (4) developed policies and programs to facilitate the seamless transfer of members from the Active to the Reserve component and vice-versa.

Metric 1.4.8: Optimal Officer Career Patterns					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Percentage of officers on optimal career path for retention	No historical data; new metric		• Phase I of RAND study complete • Started Phase II	Published Phase I report	Complete Phase II draft report
[A] FY 2005 data are estimated as of the fourth quarter.					

Metric Description

The Military Personnel Human Resources Strategic Plan requires Military Personnel Policy to "conduct studies on officer career and promotion management that will extend time in job and service tenure." The DoD commissioned a study to assess management and policy implications of potential changes in officer career management. Legislative action will be required to implement such changes. RAND is conducting a study to develop alternative management processes, plans, and policies that consider:

- The cap on officer career lengths,
- The feasibility and advisability of longer assignments,
- The effects of different grade and position tenures on retention or performance,
- Past officer assignment length patterns,
- Patterns of promotion and career tenure,
- Existing system dynamics military manpower models to reflect selected changes to current officer management,
- The implications of selected changes to policy for officers' career paths, and
- The need for different or additional compensation and incentives to support any changes in existing personnel practices.

Phase I addressed General and Flag Officer careers; Phase II is addressing careers of officers in the grade of colonel and below. After Phase II is complete, the DoD will develop an implementation plan with appropriate metrics that may depend on legislative and policy changes.

The Phase I report was published in January 2004. The Phase II study began at the end of FY 2003; the final report, "Future Officer Force Modeling and Analysis," was expected by the end FY 2005. As appropriate, policy or legislative changes will be compiled in FYs 2006 and 2007, and metrics developed in FY 2007. The timeline has slipped because the scope of the project was increased to include Air Force and Marine communities, in addition to Army and Navy communities. The scope was expanded to investigate the effects of competency-based management on career patterns.

Performance Results for FY 2005

Two Phase II communities have been modeled in FY 2005: (1) Air Force Space and Missile and (2) Marine Corps officers. Progress reports were completed in January and May 2005. The Phase II draft report is scheduled for completion in early FY 2006.

Strategic Goal 2: Balancing Operational Risk – achieve and maintain operational superiority.

Performance Goal 2.1 – Maintain Force Readiness (Are Our Forces Currently Ready?)

Metric 2.1.1: Adaptive Planning					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Percentage of deliberate and crisis plans networked as "living plans" in a collaborative joint command and control environment	No historical data; new metric		Tested prototype of adaptive planning tool	Approved adaptive planning concept and matured operational prototype	• Adaptive planning used on select plans in Contingency Planning Guidance • Adaptive planning used to develop three deliberate warplans • Roadmap written, staffed and approved for implementation • Initiation phase started • Volume 1 of guidance rewritten and distributed for planner level staffing with Adaptive Planning concept incorporated

[A] FY 2005 data are estimated as of the fourth quarter.

Metric Description

As a result of a Combatant Commander's conference, the Secretary of Defense directed the Chairman of the Joint Chiefs of Staff to develop a new system to replace existing deliberate and crisis planning methods. The goal is to produce plans that are more timely, adaptive, and responsive to the current security environment, providing relevant options to the President and Secretary of Defense. The long-term goal is to have a networked capability to produce plans on demand via the Global Information Grid by 2008.

Adaptive planning will be implemented in three phases. The initiation phase (now through FY 2006) will deploy new tools and exercise portions of the adaptive planning construct on select priority plans. The implementation phase (FYs 2006 - 2008) will produce electronic plans for all contingencies in a collaborative joint command and control environment. The integration phase (beyond FY 2008) will produce and continually update "living" plans in a collaborative environment.

The Chairman established an implementation working group to provide direction to adaptive planning activities, actions, and procedures. The DoD continues to test and refine the web-based Collaborative Force Analysis, Sustainment and Transportation tool to build campaign plans. This tool provides a portal-accessible family of 30-plus web-enabled applications in an operational planning environment. Additional tools also are under consideration. Adaptive Planning efforts continue to be synchronized with numerous other Department transformational initiatives.

Performance Results for FY 2005

The DoD prepared an Adaptive Planning Roadmap.

Metric 2.1.2: Analytic Baselines					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Number and quality of analytic baselines used to support the Quadrennial Defense Review and other major Department studies	No historical data; new metric		Developed two future baselines	Developed two current and two future baselines	Developed/updated two current and three future-year analytic baselines
[A] FY 2005 data are estimated as of the fourth quarter.					

Metric Description

The Secretary of Defense directed that the DoD create a foundation for strategic analyses that relied on common scenarios and data. These analytic baselines are intended to help provide senior staff with responsive and analytically sound insights to help them make decisions on joint warfighting issues and policy. They accomplish this by establishing common starting points (scenarios and data) for the Department's major studies: the current-year analytic baselines accelerate the deliberate planning process and are based on existing Combatant Commander war planning efforts and concepts of operation; future-year analytic baselines are used in analyses of alternatives and major studies such as the Mobility Capabilities Study. Department-wide studies such as Operational Availability FY05 are often used to develop the analytic baselines. The Joint Staff is currently conducting Operational Availability 2006 in support of the 2005 Quadrennial Defense Review.

Performance Results for FY 2005

As of the third quarter, two Combatant Commands developed and released current-year analytic baselines and the Office of Program Analysis and Evaluation provided two updated and one new future-year analytic baseline.

Metric 2.1.3: Operational Lessons Learned					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Percentage of lessons-learned captured, analyzed, and implemented to improve joint warfighting capabilities.	No historical data; new metric	Chairman of the Joint Chiefs of Staff, released lessons learned development concept to U.S. Joint Forces Command	Secretary of Defense released the DoD Training Transformation Implementation Plan	Approved enhanced Joint Lessons Learned Program Study	Completed Block 1 projected outcomes
[A] FY 2005 data are final as of the fourth quarter.					

Metric Description

The Secretary of Defense and the Chairman of the Joint Chiefs of Staff highlighted the importance of an effective joint lessons learned program in the Defense Planning Guidance. The strategic plan for transforming the DoD training identifies the need to ensure that lessons learned are integrated into the development of new training processes and systems. Lessons learned from operational missions must be systematically captured and injected into the full range of preparatory and planning activities; ongoing experimentation; concept development; doctrine; and joint tactics, techniques, and procedures development. The overall purpose of this supporting action is to develop an enhanced and robust Joint Lessons Learned Program that encompasses the range of joint activities, from Active and Reserve components, specifically related to operational missions.

The Joint Staff finalized lessons learned from Operation Iraqi Freedom and introduced the first five priority lessons learned into the Joint Capabilities Integration and Development System. The Chairman directed the U.S. Joint Forces Command to expand the lessons learned program by collecting and analyzing lessons learned data collected by Combatant Commands, Services, and Defense Agencies.

Performance Results for FY 2005

The Joint Staff published a new "Joint Lessons Learned Program" that documents the Chairman's policy and guidance governing the program. It continued to fund the Joint Lessons Learned Specialists assigned to the Joint Staff, selected Combatant Commands, and Services. These actions, combined with previous years' activities will lay the groundwork for the design, documentation, and development of a common Joint Lessons Learned Information System that will facilitate knowledge management of lessons learned in concert with the Joint Training System, the Defense Readiness Reporting System, and Service systems through the Global Information Grid.

Metric 2.1.4: DoD Readiness Reporting System Implementation				
End-state Metric (New Baseline)	FY 2002	FY 2003	FY 2004	FY 2005[A]
A new DoD-wide readiness reporting system	No historical data; new metric	Awarded development contract	• Reached initial operating capability • Conducted technical capability review • Provided an operational version	• Expanded force management query capabilities with nascent business intelligence applications • Expanded scope of resource data • Joint Task Force assessment application reached initial operating capability • Published Serial 1 and 2 guidance governing identification of data sources, reporting processes, and transition from legacy reporting systems
[A] FY 2005 data are final as of the fourth quarter.				

Metric Description

The 2001 Quadrennial Defense Review directed the DoD to change fundamentally the way force readiness issues are measured, reported, and resolved. The DoD Directive 7730.65, "DoD Readiness Reporting

System," launched a series of important changes to policy and procedures to develop and field a new readiness reporting and assessment system. When mature, this system will provide a capabilities-based, adaptive, near-real-time readiness reporting system for all military units. Readiness will be assessed from the perspective of the Combatant Commanders. This is important because Combatant Commanders describe their roles and responsibilities in terms of mission essential tasks and assigned missions or core tasks first, and then assess their ability to conduct these tasks. The system concept has been validated with a proof of concept demonstration; a development team is now in the process of designing and fielding an enhanced version of the Department's decades-old Status of Resources and Training System, called the Enhanced Status of Resources and Training System. The Under Secretary of Defense (Personnel and Readiness) is managing a comprehensive research effort being conducted by two primary contractors. The system achieved initial operational capability by the end of FY 2004; full operational capability is expected by the end of 2007.

Performance Results for FY 2005

In FY 2005, the project office released the first two issuances of system serial guidance outlining policies, processes, and timelines for mission assessments, data integration, and transitions from existing or legacy reporting systems. The project office identified feeds of more than 45 authoritative data sources throughout the Department into the DoD Readiness Reporting System. These feeds contain detailed information on the status of military personnel, equipment, supplies ordnance, and training, as well as organizational structure and location information. In addition, FY 2005 marked the development of nascent business intelligence tools that allows users to conduct analyses of underlying data. The project team also developed first-generation force management applications that allow users to search for capabilities based on identifiers such as individual skill codes or unit task reporting.

Performance Goal 2.2 - Ensure Superior Capabilities Exist to Succeed (Are Our Forces Postured to Succeed?)

Metric 2.2.1: Global Force Management					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Real-time operational availability and risk assessment to guide decisions on how to source joint force capabilities	No historical data; new metric		Developed Global Force Management construct	• Established Force Management Functional Capabilities Board • Tested prototype process to source FY 2005-2006 commitment	• Executed five Boards • Global Force Management process codified in guidance • Integrate capabilities based methodology with automated tools • Started conducting Capabilities Based Assessment to determine automated tools requirements needed to support • Started developing Global Force Management data prototype to define business rules and demonstrate force structure data accessible and visible in a net-centric environment
[A] FY 2005 data are final as of the fourth quarter.					

Metric Description

In 2003, the Secretary of Defense directed the Chairman of the Joint Chiefs of Staff to develop an integrated force assignment, apportionment, and allocation methodology. The Secretary also directed the U.S. Joint Forces Command to develop a means for monitoring joint force operational availability. In response, the Department has initiated the Global Force Management process, designed to manage continuously the process that provides forces to conduct operational missions (called "sourcing") using analytically-based availability and readiness management methodologies. This process provides comprehensive insight into U.S. force postures worldwide, and accounts for ongoing operations and constantly changing unit availability. It leverages the most responsive, best-positioned force at the time of need and forms the basis of a rotational force allocation process that guides the allocating of Service forces that rotate into theater. Global Force Management also provides senior decision makers the means to assess risk in terms of forces available to source Combatant Commanders' war plans, and predicts the likely stress on the force (i.e., personnel tempo) associated with proposed allocation, assignment, and apportionment changes. Finally, to support the process with reliable, accessible, and visible information, the Secretary also directed the Chairman to develop a joint hierarchical way to organize force structure data for integration across Service lines. When mature, this metric will describe the DoD's ability to rapidly source joint force capabilities with the right units providing the right capabilities.

Several ongoing initiatives support of Global Force Management. The Joint Staff is leading the data initiative to standardize and web-enable Service and Combatant Command force structure data, as a key enabler to reliable, visible, and responsive global force availability information. This initiative is expected to achieve initial operational capability by FY 2006. The U.S. Joint Forces Command is the primary joint force provider and thus the single voice to source Combatant Command requirements. To assist, the Joint Staff is leading a capabilities-based assessment to define the capabilities needed for global visibility as primary joint force provider. A final initiative is the codification of the Global Force Management Board to establish the roles, missions, and functions of this board that will support the process.

Performance Results for FY 2005

The Secretary of Defense approved the processes in the Global Force Management guidance in May. The DoD also executed five Global Force Management Boards, which are Joint Staff-led study teams that support the Global Force Management process.

Metric 2.2.2: Theater Security Cooperation					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Annual assessment of how theater security cooperation plans are contributing to the DoD strategic goals	No historical data; new metric		• Initial security cooperation guidance developed and approved • Combatant Commands and Services developed strategies	• FY 2005 plans completed • FY 2004 strategies successfully completed	• Review Security Cooperation Guidance with new global war on terrorism focus • Combatant Command/Service plans completed
[A] FY 2005 data are final as of the third quarter.					

Metric Description

Recently, the Department initiated a comprehensive security cooperation strategy review that focused the activities of Combatant Commands, the Services, and Defense Agencies on the common goals that need to be achieved if the Department is to build the right defense partnerships with friends and allies. Security cooperation embraces all Defense interactions with foreign defense establishments, and is the primary means of building relationships that promote specific U.S. security interests. Security cooperation activities help America's allies develop military capabilities for self-defense and coalition operations. They also provide information, intelligence, and peacetime access to enroute infrastructure and other access in the event of a contingency. The title of this metric is being modified to reflect more accurately the metric's intent.

The DoD is researching appropriate assessment metrics to determine effectiveness of the security cooperation program, and evaluating the capabilities required for security cooperation. This analysis will shape an associated Joint Operating Concept. Initial metrics are slated for completion during FY 2005, in time to be used to develop the FY 2006 plans.

Performance Results for FY 2005

In FY 2005, the Security Cooperation Guidance was rewritten to focus on global war on terrorism themes oriented around the National Defense Strategy framework (assure, dissuade, deter, defeat). Under this schema, 18 objectives are organized to encompass all the DoD efforts with foreign military organizations. The FY 2004 assessment inputs from Combatant Commands served to inform the latest draft of the Security Cooperation Guidance and will inform the upcoming FY 2005 assessments. While all Combatant Commands, Services, and selected Defense Agencies must produce Security Cooperation Strategies and Plans, only Geographic Combatant Commands were required to submit assessments for FY 2005.

Performance Goal 2.3 – Align Forces Consistent with Strategic Priorities (Are Our Forces Employed Consistently With Our Strategic Priorities?)

Metric 2.3.1: Joint Concepts					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Number of concepts approved to link strategic guidance to warfighting capabilities	No historical data; new metric		Joint Operations Concepts construct approved	Joint Chiefs of Staff endorsed two of four Joint Operating Concepts; attributes of five functional concepts approved	• Last two of four Joint Operating Concepts endorsed; Secretary of Defense approved all four • Joint Chiefs of Staff approved Capstone Concept for Joint Operations
[A] FY 2005 data are final as of the fourth quarter.					

Metric Description

Joint concepts provide the operational context for the transformation of the armed forces by bridging the gap between strategic guidance and the DoD's resourcing strategy for capabilities. The Joint Operations Concepts family consists of a Capstone Concept for Joint Operations, Joint Operating Concepts, Joint Functional Concepts, and Joint Integrating Concepts.

The Capstone is the overarching concept that guides the development of future joint capabilities and leads force development and employment, primarily by providing a broad description of how the future joint force will operate across the range of military operations. It applies to operations around the globe conducted unilaterally or in conjunction with multinational military partners and other government and non-government agencies. It envisions military operations conducted within a national strategy that incorporates all instruments of national power. The three joint concepts are interwoven and describe how a Joint Force Commander, 8 – 20 years in the future, is expected to manage various aspects of a Command.

The Joint Operations Concept prescribes operations within a military campaign, linking end states, objectives, and effects. It identifies the broad capabilities considered essential for implementing the concept, including Major Combat Operations, Homeland Security, Strategic Deterrence, and Stability Operations.

A Joint Functional Concept prescribes performance of a broad military function across the full range of military operations. It identifies the capabilities required to support joint force operations and the attributes needed to compare capability alternatives and measure achievement, including Force Application, Force Protection, Focused Logistics, Force Management, Battlespace Awareness, Command and Control, Joint Training, and Net-Centric.

A Joint Integrating Concept prescribes performance of a specific operation or function derived from an operating or functional concept. These are narrowly scoped to identify, describe, and apply specific capabilities, decomposing them into the fundamental tasks, conditions, and standards required to conduct a capabilities-based assessment, and include Global Strike; Joint Logistics Distribution; Joint Command and Control; Seabasing; Integrated Air and Missile Defense; Joint Undersea Superiority; Joint Forcible Entry Operations.

Performance Results for FY 2005

The Joint Staff issued revised guidance for the various concepts, based on input from stakeholders across the Department. The Secretary approved all four Joint Operating Concepts.

Metric 2.3.2: Enhanced Planning Process					
End-state Metric (New Analytic Baseline)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
An annual assessment of issues and alternatives for providing the Department's highest priority joint capabilities.	No historical data; new metric			• Enhanced Planning Process chartered by Secretary of Defense • Resource guidance captures results	The Enhanced Planning Process was not conducted during FY 2005
[A] FY 2005 data are final as of the fourth quarter.					

Metric Description

For the first time in FY 2004, major planning and resource issues presented for decision to the Secretary of Defense were formulated and assessed via the Enhanced Planning Process, an enhanced collaborative joint planning process. By considering needs and costs simultaneously, the process enabled cost-effective programmatic options for achieving the Department's strategic policy objectives. The process underpins the framework of an executable Joint Programming Guidance, which provides the shared planning and resource assumptions used in the annual updates to the Defense program and budget.

Performance Results for FY 2005

An analytic baseline is being developed in concert with the Chairman of the Joint Chiefs of Staff and the Under Secretary of Defense (Policy). This baseline will establish common planning assumptions to be used in warfighting models, acquisition analysis, and other shared analysis tools.

The Enhanced Planning Process was not conducted during FY 2005.

Performance Goal 2.4 – Transition Forces Rapidly to Meet New Threats (Do We Have the Right Forces Available?)

Metric 2.4.1: Operational Availability					
End-state Metric (New Baseline)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Integrated data and management systems that can be used to assess percentage of force ready for specific joint tasks	No historical data; new metric			• Tested prototype process for Global Force Management system • Approved adaptive planning concept and prototype • Developed two current and two future analytic baselines	• Began Global Force Management prototype development • Updated all warfight analytical baselines and built baseline security posture baseline • Used baselines in the DoD capability assessments (e.g., mobility capabilities study, and aerial refueling)
[A] FY 2005 data are estimated as of the fourth quarter.					

Metric Description

The DoD must prevent terrorists from doing harming America, its people, and its friends and allies. The DoD must be able to rapidly transition military forces to post-hostilities operations, and identify and deter threats to the United States, while standing ready to assist civil authorities in mitigating the consequences of a terrorist attack or other catastrophic event. These diverse requirements will demand integration and leverage other elements of national power, such as strengthened international alliances and partnerships.

To meet these new missions, and to hedge against an uncertain future, the DoD is developing a broader portfolio of capabilities, and realigning forces using a building-block approach to match those capability portfolios with mission goals. Among the most important are:

- Global Force Management. This initiative will provide a database and management system that can be used to monitor U.S. force postures worldwide. It will account for ongoing operations and constantly changing unit availability, and will allow the DoD to allocate the right force for specific missions, at the right place and time.
- Adaptive Planning. The DoD's goal is to produce war and contingency plans that are more timely, adaptive, and responsive to the current security environment, thus providing relevant options to the President and Secretary of Defense. The Department plans to have a networked capability to produce plans on demand via the Global Information Grid by 2008.
- Analytic Baselines. To guide analysis for both the near- and far-term, the DoD is creating a set of common scenarios and data. These analytic baselines will underpin strategic assessments, and guide decisions on joint warfighting issues and policy.

Performance Results for FY 2005

The Strategic Planning Guidance directed the Chairman of the Joint Chiefs of Staff to develop a joint hierarchical way to organize force structure data for integration across Service lines. The Global Force Management data initiative defines how the DoD will electronically document force structure in a hierarchical way and make data transparent and easily accessible to users in a net-centric environment. This initiative will transform the Department by solving the data accuracy and standardization issues and is based on the premise that everything relates to force structure. The DoD completed three analytical baselines and created a security posture baseline. These documents were used in assessments of DoD's mobility and aerial refueling capabilities.

Strategic Goal 3: Balancing Institutional Risk – Align the organization and its resources to support the warfighter.

Performance Goal 3.1 - Improve the Readiness and Quality of Key Facilities

Metric 3.1.1: Base Realignment and Closure (BRAC) in FY 2005					
End-state Metric (New Baseline)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
A new DoD facility footprint	BRAC cited as a key element of the DoD transformation	Legislative authority for BRAC established	• 2005 BRAC authorized by the Secretary of Defense • Management structure and seven joint cross-service groups established	• Final selection criteria established • Data collection and certification begun	• Presented final recommendations to independent Commission and Congress (May 2005) • Commission provides its recommendation to President • Congress reviews BRAC recommendations
[A] FY 2005 data are estimated as of the fourth quarter.					

Metric Description

To shift defense planning from the "threat-based" model that had dominated thinking in the past to a "capabilities-based" model for the future, the DoD persuaded Congress to grant authority in the FY 2002 National Defense Authorization Act for another Base Realignment and Closure (BRAC) process in 2005.

The BRAC 2005 guidance outlined the expectations and importance of reshaping the DoD's infrastructure to better support future force structure. It established two senior-level groups to manage and oversee the process, provided for the analysis of common business-oriented functions separate from Service-unique functions, and required specific functional recommendations to undergo joint analysis within 150 days.

An Infrastructure Executive Council, headed by the Deputy Secretary of Defense and including senior DoD officials, provided policy and oversight. An Infrastructure Steering Group headed by the Under Secretary of Defense (Acquisition, Technology and Logistics) oversaw joint analysis of common military functions and ensured those efforts were coordinated with Service reviews of specific operations.

Each of the Military Departments and Joint Cross-Service Groups have established procedures and designated appropriate personnel to certify that data and information collected for use in the BRAC 2005 analyses were accurate and complete. These procedures were incorporated within the required internal control plans, and consistent with the DoD certification procedures. Both were audited by the U.S. Government Accountability Office and the DoD Office of Inspector General.

Performance Results for FY 2005

The Department met its milestones by providing the Congress with a revised Force Structure Plan in March 2005, analyzing more than 1,000 closure and realignment scenarios, and providing the Secretary with 222 final closure and realignment recommendations. The BRAC Commission forwarded its closure and realignment recommendations to the President on September 8, 2005. The President approved the recommendations and forwarded them to the Congress on September 15, 2005. Upon receipt, the Congress has 45 legislative days to vote down the Commission's recommendations on an all-or-none basis; otherwise, they take on the force and effect of law.

The Department's process is well-documented. The DoD provided the Commission and Congress a 12-volume report detailing its recommendations. The Department also established a section on the DoD's website (http://www.defenselink.mil/BRAC) containing the report volumes (with the exception of the classified force structure volume) as well as all policies, deliberative meeting minutes, and raw data used to develop the recommendations.

Metric 3.1.2: Eliminate Inadequate Family Housing by 2007					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003[C] Actual	FY 2004[C] Target/Actual	FY 2005[B, D] Projected
Number of inadequate family housing units	170,314	143,608	140,641	93,294/117,615	67,079
Percentage of total family housing units[A]	59	53	51	48	41

[A] Targets are not established for the percentage of total family housing units.
[B] Targets are based on Service military construction and family housing budget estimates for FY 2006.
[C] Actual results are updated based on subsequent budget changes and progress in planned military construction projects, demolitions, and divestitures. Results generally are final after two budget cycles.
[D] FY 2005 data are estimated as of the fourth quarter.

Metric Description

The DoD's goal is to eliminate all inadequate family housing in the continental United States by the end of FY 2007 (and by FY 2009 for overseas bases). In general, inadequate housing is any unit that requires a major repair, component upgrade, component replacement, or total upgrade. Each Service has evaluated its housing and identified inadequate units. Each Service has then developed a plan to eliminate this inadequate housing through a combination of traditional military construction, operations and maintenance support, and privatization. The plans are updated annually with the President's Budget.

Performance Results for FY 2005

Through the end of the third quarter, approximately 22,000 inadequate units have been eliminated through privatization. Final results for FY 2005 will not be available until the President's Budget for FY 2007 is submitted to Congress in February 2006.

Metric 3.1.3: Fund to a 67-year Recapitalization Rate					
Metrics	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004[A] Actual	FY 2005 Actual[E]
Facilities Recapitalization Metric (years)	192	101	149[C]	136[D]	104
Facilities Sustainment Model (percent)	70%[B]	89%[B]	93%	94%	95%

[A] Three Defense Agencies (Defense Logistics Agency, DoD Education Activity, and TRICARE Medical Activity) included beginning in FY 2004, but excluded in previous years.
[B] Estimated (the Facilities Sustainment Model was first fielded in FY 2003).
[C] The FY 2003 data are as of the FY 2003 President's Budget.
[D] The FY 2004 data are as of the FY 2004 President's Budget.
[E] The FY 2005 data are as of the FY 2005 President's Budget.

Metric Description

The facilities recapitalization metric measures the rate at which an inventory of facilities is being recapitalized. The term "recapitalization" means to restore or modernize facilities. Recapitalization may (or may not) involve total replacement of individual facilities; recapitalization often occurs incrementally over time without a complete replacement.

The performance goal for recapitalization equals the average expected service life of the facilities inventory, currently estimated at 67 years. The expected service life, in turn, is a function of facilities sustainment. "Sustainment" means routine maintenance and repair necessary to achieve the expected service life. To compute a normal expected service life, full sustainment levels must be assumed. A reduced expected service life results from less than full sustainment. For this reason, the metrics for facilities recapitalization and facilities sustainment are unavoidably linked and should be considered together.

Sustainment levels required to achieve a normal expected service life are benchmarked to commercial per unit costs; for example, $1.94 per square foot annually is needed to properly sustain the aircraft maintenance hangar inventory for a 50-year life cycle. The facilities sustainment model adjusts these costs to local areas and assigns the costs to the DoD components and funding sources.

The recapitalization rate is compared to service life benchmarks for various types of facilities. For example, the expected service life of a pier is 75 years, and the expected service life of a dental clinic is 50 years (provided the facilities are fully sustained during that time). The average of all the expected service life benchmarks, weighted by the value of the facilities represented by each benchmark, is 67 years. Weighting is required to normalize the expected service life. For example, without weighting, 50 years is the expected service life of a hypothetical inventory consisting of administrative buildings (75-year expected service life) and fences (25-year expected service life). But fences are insignificant compared to administrative buildings—the DoD has $22 billion worth of administrative buildings, but only $3 billion worth of fences and related structures—and should not have equal weight. The expected service life of this hypothetical inventory of buildings and fences when weighted by plant replacement value is 68 years, not 50 years.

For evaluating planned performance, both metrics are converted to dollars (annual funding requirements) and compared to funded programs. The sustainment rate can be measured through execution; the recapitalization rate, which is primarily—but not exclusively—a function of multi-year military construction appropriations, is not tracked for execution on an annual basis.

These metrics do not capture "actual" expenditures as the term "actual" is normally understood. For recapitalization, there is no reporting process for determining the "actual" (i.e., executed) recapitalization rate in a given year, and there is little reason to do so. Appropriations for military construction projects—which make up the bulk of the recapitalization investment—are good for 5 years and are typically executed over more than 1 year. Additionally, Congressional adds, rescissions, reprogramming, and late project adjustments all alter the "actual" recapitalization rate. There is no system yet to capture these changes at the DoD level, and an annual rate of execution for military construction appropriations has little meaning.

For sustainment, a system is in place to capture the "actual" sustainment expenditure at the DoD component level. That system has been refined since its inception in FY 2003, and the results have been made increasingly reliable. Currently, a process is being implemented that will enable the Department to distinguish between sustainment for facilities included in the budgeted DoD sustainment requirement and those that are not. This essential distinction has been blurred by the war on terrorism and global repositioning which have skewed execution results. The new process will allow for sustainment of facilities not captured in the sustainment requirement to be accounted for independently of sustainment for facilities that are captured in the requirement.

Performance Results for FY 2005

Achieving a 104-year recapitalization rate and a 95 percent sustainment rate show improvement from the FY 2004 levels of a 136-year recapitalization rate and 94 percent for sustainment. In addition to the overall improvement in performance results in FY 2005, efforts to improve the fidelity and accuracy of the tools and metrics also continued. For example, the unit costs for sustainment, with specific emphasis on utilities systems, were updated and refined using the best information available. In addition, an initiative to develop a more robust model to upgrade the existing metric for facilities recapitalization was completed. When implemented, the upgraded model will provide a more precise expected service life for each Defense component, as opposed to the "one-size-fits-all" metric of 67 years. Efforts were also initiated to improve the accuracy of the model by capturing the net effect of adding and eliminating capacity. Additionally, actions were initiated to expand the facilities metrics to areas not currently included such as family housing, test and evaluation, and industrial facilities.

While the tools and metrics are being refined continuously, there are still concerns that continuing to fall short of the targets of a 67-year recapitalization rate and full sustainment results in less than a full service life and reduced utility and performance of the Department's facilities. As a result of not achieving a 67-year recapitalization rate, for example, obsolescence in the facilities inventories increases. The cumulative and compounding effect of these shortfalls is measured by the number of deteriorated, obsolete, or otherwise inadequate facilities. The Department's goal for sustainment remains full sustainment each year; a five percent shortfall in programmed sustainment in FY 2005 cannot be offset with five percent overage in FY 2006. Furthermore, the goal for recapitalization remains 67 years on average, even though past performance already has reduced the service life of the facilities inventory. The direct effect of inadequate funding for sustainment and recapitalization is reflected in an accelerated recapitalization rate that is required to restore readiness to adequate levels by 2010.

Metric 3.1.4: Restore Readiness of Key Facilities by 2010					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Percentage of the DoD facilities restored to a high state of military readiness	No historical data; new metric		Chartered effort to standardize facility records and improve Installations Readiness Report summaries	• Implemented revised condition reporting process • Began Installations Readiness Report re-engineering • Conducted a special study to determine whether the FY 2010 goal is still viable	• Initiated independent verification and validation study of new condition ratings • Incorporated "Q" ratings into the new Office of Management and Budget-directed federal real property requirements • Continued Installations Readiness Report re-engineering with creation of multi-component integration panel
[A] FY 2005 data are final as of the fourth quarter.					

Metric Description

This goal is to restore the readiness of existing facilities to at least C-2, on average, by the end of 2010 (C-2 is the DoD's readiness rating defined as "some facility deficiencies with limited impact on capability to perform missions"). In FY 2004, the Department initiated a two-pronged approach to refine the methodology for evaluating and reporting the condition of the facilities inventory, which continued in FY 2005. First, evaluation of the condition of facilities has been improved by adoption of the "Q" rating, a standardized indicator of restoration and modernization requirements associated with an individual facility record in the inventory. These ratings will allow consistent programmatic analysis of funding needs directly from the real property inventory. In addition, the "Q" rating is consistent with new federal-wide reporting requirements issued in FY 2005 by the Office of Management and Budget and the Federal Real Property Council. Second, assessment of the impact of facility condition on unit readiness is being enhanced through integration of facilities directly into the larger Defense Readiness Reporting System, in which facilities will be considered as resources, just as personnel and equipment are currently viewed.

Defense components are now implementing the revised condition reporting methodology ("Q" ratings) for their facilities portfolios (consisting of more than 500,000 individual facility records). The rate of completion is not equal across all Defense components, however, at the end of FY 2006 the Department should have complete ratings for all seven of the largest Defense components. As part of this process, an independent verification and validation of the "Q" ratings project was launched in FY 2005 and will be complete in FY 2006.

Performance Results for FY 2005

During FY 2005, the Department:

- Completed condition ratings ("Q" ratings) for a large portion of the facilities inventory including Army, Air Force, Defense Logistics Agency, and the DoD Education Activity,
- Initiated a study to validate and verify the new condition rating ("Q" rating) across the DoD,
- Developed definitions for mission dependency index ratings consistent with Federal Real Property Council guidance, and
- Established a multi-component/multi-functional working group to oversee the integration of facilities into the Defense Readiness Reporting System. This group has developed a viable working concept and is crossing traditional "stovepipe" organizations.

Performance Goal 3.2 - Manage Overhead and Indirect Costs

Metric 3.2.1: Reduce Percentage of DoD Budget Spent on Infrastructure					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005[A] Projected
Percentage of DoD budget spent on infrastructure	46	44	42	41/42	42
[A] This is a lagged indicator. Projections based on the FY 2006 President's Budget Future Years Defense Program.					

Metric Description

The share of the Defense budget devoted to infrastructure is one of the principal measures the Department uses to gauge progress toward achieving its infrastructure reduction goals. A downward trend in this metric indicates that the balance is shifting toward less infrastructure and more mission programs. In tracking annual resource allocations, the DoD uses mission and infrastructure definitions that support macro-level comparisons of the DoD resources. These definitions are consistent with the Goldwater-Nichols Department of Defense Reorganization Act of 1986, which requires assignment of combat units and their support to the Combatant Commanders and that the Military Departments retain the activities that create and sustain those forces. This feature of U.S. law provides the demarcation line between forces (military units assigned to Combatant Commanders) and infrastructure (activities retained by the Military Departments). In addition to more precisely distinguishing forces from infrastructure, the force and infrastructure subcategories have been updated and streamlined to reflect current operational concepts.

Performance Results for FY 2004

The DoD allocated approximately 42 percent of total obligational authority to infrastructure activities in FY 2004, about the same as the preceding year. The Department continues to maintain its allocation of resources to forces fighting the global war on terrorism and meeting other operational requirements. Infrastructure requirements have decreased due to reform initiatives, including savings from previous base realignment and closure rounds, strategic and competitive sourcing initiatives, and privatization and reengineering efforts. The DoD expects infrastructure expenditures to continue to decrease as a share of the Defense budget in FY 2005 and FY 2006.

Metric 3.2.2: Link Defense Resources to Key Performance Goals					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Common resource data lexicon	No historical data; new metric			Developed draft data framework and common business rules	Establish a more flexible lexicon that supports various types of reporting and analysis
[A] The FY 2005 data are estimated as of the fourth quarter					

Metric Description

In FY 2003, the DoD opened a program office to combine or align program and budget databases that previously had been managed separately. In FY 2006, DoD will complete a review of almost 4,000 areas within the Department's program and budget data structure to ensure that the common resource management database:

- More directly aligns with Congressional and other external reporting requirements,
- Better supports internal business and policy decisions by allowing an overlay of issue taxonomies that support strategy development and reviews, and
- More easily manages data structures and improves the DoD's ability to validate data.

Performance Results for FY 2005

Preliminary findings show that today's new strategic approach is merging and blurring the traditional lines between "tooth" (deployable operational units) and "tail" (non-deploying units and central support). When the study is complete, the DoD will have a more flexible analysis interface with defense data, allowing it to build alternative ways of mapping the programming data structure and making it easier to crosswalk performance results to resource investments. In FY 2005, the DoD continued to develop standard definitions and business rules through several sub-initiatives to expand efforts to define categories and sub-categories within the framework.

Performance Goal 3.3 - Realign Support to the Warfighter

Metric 3.3.1: Reduce Customer Wait Time (Days)					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/Actual[A]
Customer wait time (in days)	18	16	19	15/23	15/21
[A] FY 2005 data are final as of the third quarter.					

Metric Description

Customer wait time measures the elapsed time from order to receipt when a customer orders an item of material. The customer's order may be filled from assets on hand at the customer's military installation or naval vessel, or through the DoD wholesale logistics system. For purposes of this enterprise-level metric, customer wait time includes orders for spare and repair parts ordered by organizational maintenance activities. Customer wait time- captured orders considered below enterprise level are maintained by each of the Military Services and the Defense Logistics Agency.

Performance Results for FY 2005

Through the third quarter, the DoD experienced an average customer wait time of 21 days. The DoD did not meet its FY 2004 goal of 15 days because of the increase in demand for critical items and delays in closing out transactions due primarily to Operation Iraqi Freedom. The DoD does not expect to achieve significant reduction in customer wait time until the conclusion of Operation Iraqi Freedom.

Metric 3.3.2: Reduce Major Defense Acquisition Program Annual Rate of Acquisition Cost Growth					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Target/Actual[B]
Percentage/annual growth in acquisition costs	+13.9[A]	+6.4	+5.0	0%/+3.5%	0% cost growth/to be determined

[A] The December Selected Acquisition Report, which reflects the President's Budget, is used for calculating acquisition cost growth. There were no December 2000 reports, because a Future Years Defense Program was not included in the FY 2002 President's Budget submit. Thus, the FY 2001 actual reflects acquisition cost growth for a 2-year period (FY 2000 and FY 2001)

[B] Results for FY 2005 will be available with the release of the December 2005 Selected Acquisition Reports in April 2006.

Metric Description

Acquisition cost growth measures the amount that acquisition costs grow from year to year. It is computed by taking the difference between the acquisition costs in the current and previous years' President's Budget, divided by the acquisition costs for the previous-year President's Budget, expressed as a percentage. A dollar-weighted average is calculated for the common major Defense acquisition programs and adjusted for changes in quantity or inflation. Acquisition cost growth can occur for various reasons, including technical risk, schedule slips, programmatic changes, or overly optimistic cost estimates. The Department's reform initiatives seek to reduce cost growth from all sources, providing an output target for procurement managers of individual systems, as well as for the aggregate procurement programs of the individual Services. The objective is to be on a downward trend toward an ultimate goal of no (zero percent) acquisition cost growth. Managerial responses are expected to include both specific cost-control initiatives and process changes.

Performance Results for FY 2005

FY 2005 results will not be available until the release of the December 2005 Selected Acquisition Reports in

April 2006.

Metric 3.3.3: Reduce Major Defense Acquisition Program Acquisition Cycle Time					
Metric (months)	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/Actual[A]
Acquisition cycle time in months (for new starts from FY 1992 through FY 2001)	102	103	102	<99/101	<99/to be determined
Acquisition cycle time in months (for new starts after FY 2001)	N/A	N/A	76	<66/80	<66/to be determined
[A] Results for FY 2005 will be available with the release of the December 2005 Selected Acquisition Reports in April 2006.					

Metric Description

Acquisition cycle time is the elapsed time, in months, from program initiation—when the Department makes a commitment to develop and produce a weapon system—until the system attains initial operational capability. This metric measures the average cycle time across all major Defense acquisition programs. During the 1960s, a typical Defense acquisition took 7 years (84 months) to complete. By 1996, a similar acquisition required 11 years (132 months) from program start to initial operational capability. To reverse this trend, the Department established an objective to reduce the average acquisition cycle time for programs started since 1992 to less than 99 months, a reduction of 25 percent. The DoD achieved that initial objective through rapid acquisition with demonstrated technology, time-phased requirements and evolutionary development, and integrated test and evaluation. To continue that improvement, the Department will seek to reduce the average cycle time to less than 66 months by introducing improvements to development and production schedules similar to those it initiated for managing system performance and cost. Rapid development and fielding of weapon systems—leveraging new technologies faster—will enable U.S. forces to stay ahead of potential adversaries.

Performance Results for FY 2005

FY 2005 results will not be available until the release of the December 2005 Selected Acquisition Reports in April of 2006.

Metric 3.3.4: Reduce Major Defense Acquisition Program Operating and Support Cost Growth					
Metric	FY 2001	FY 2002	FY 2003[A]	FY 2004 Target/Actual	FY 2005 Target/Actual[A]
Percentage of annual operating and support cost growth	No historical data; new metric		Established metric baseline from which to measure growth	0%/+2.3%	0%/Not available
[A] Results for FY 2005 will be available with the release of the December 2005 Selected Acquisition Reports in April 2006.					

Metric Description

This metric measures the amount that operating and support costs grow from year to year. It is computed by taking the difference between the total operating and support cost estimates reported in the current year's

Selected Acquisition Report against the previous year's report, then dividing by the total operating and support cost estimates reported in the previous year's report, expressed as a percentage. A dollar-weighted average is calculated for the common programs. Estimated operating and support cost growth can occur for various reasons, including technical or programmatic changes, changes in the support strategy/concept, or overly optimistic cost estimates. The objective is no (zero percent) operating and support cost growth. Managerial responses are expected to include both specific cost-control initiatives and process changes.

Performance Results for FY 2005

FY 2005 results will not be available until the release of the December 2005 Selected Acquisition Reports in April 2006.

Performance Goal 3.4 - Streamline the Decision Process, Improve Financial Management, and Drive Acquisition Excellence

Metric 3.4.1: Support Acquisition Excellence Goals					
Metric (Excellence Goal)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Acquisition Excellence with Integrity	Progress demonstrated via the following DoD scorecard metrics: major Defense acquisition program cycle time, acquisition cost growth, and operations and sustainment cost growth				Conduct quarterly capabilities-based reviews and continue evolutionary acquisition and spiral development efforts to push systems to the warfighter faster
Logistics: Integrated and Efficient	Progress demonstrated via the following DoD scorecard metric: Customer Wait Time				Continue FY 2004 initiatives and develop budget to support performance-based logistics
Systems Integration and Engineering for Mission Success	No historical data for FY 2001-2002; established goal but did not measure data for FY 2003			• Established senior-level forum • Established systems engineering framework and formal plan • Developed three continuous learning courses	• Continue efforts to lead development of systems views of integrated architectures and integrated plans and/or roadmaps • Foster interoperability, jointness, and coalition capabilities • Improve the systems engineering environment • Provide effective systems engineering policies, practices, and tools
Technology Dominance	No historical data for FY 2001-2002. Progress FY 2003 to present demonstrated via the following DoD scorecard metrics: Balanced and Focused Science and Technology and Status of Defense Technology Objectives				• Defense Technology Objectives results will be assessed in Technology Area Review and Assessment reviews during FY 2006 • The balance between funding levels in the three activities is sufficiently close to the DoD goals

Metric 3.4.1: Support Acquisition Excellence Goals					
Metric (Excellence Goal)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Resources Rationalized	No historical data for FY 2001-2002. Progress FY 2003 to present demonstrated via the following DoD scorecard metric: Base Realignment and Closure 2005				• Presented final recommendations to independent Commission and Congress (May 2005) • Commission provides its recommendation to President • Congress reviews BRAC recommendations
Industrial Base Strengthened	No historical data for FY 2001-2002. In FY 2003, increased competition by relieving contractors from covering government shortfalls in research and development			• IIdentified industrial base issues in battle space awareness and command and control • Published roadmap for transforming the industrial base	• Evaluated industrial sufficiency for key capabilities • Accessed emerging suppliers for innovative solutions • Established organizational cross-feed mechanisms for major industrial base assessment
Motivated, Agile Workforce	No historical data for FY 2001-2002. In FY 2003, supported Civilian Acquisition Workforce Personnel Demonstration (AcqDemo) Project			Created a transition plan to move from AcqDemo to best practices and the National Security Personnel System	• Released draft National Security Personnel System to Federal Register for comment • Began transition of AcqDemo participants into the system

[A] The FY 2005 data are estimated as of the third quarter.

Metric Description

The focus of the Department in the area of acquisition, technology and logistics has changed from one of "reform" to "excellence." "Excellence" stresses making the current system function better, and then institutionalizing the improved process. The Under Secretary of Defense (Acquisition, Technology, and Logistics) faces many challenges in identifying, retailoring, and institutionalizing the system's strengths to perform better.

Performance Results for FY 2005

- Acquisition Excellence with Integrity. The long-term objective is to shorten the system acquisition cycle by using evolutionary acquisition and spiral development, maximizing the use of mature and commercial technology, and expanding the use of technology demonstrations. At the same time, the DoD is working to increase the accuracy and credibility of cost estimates and thus fund all major Defense acquisition programs at the cost analysis improvement group estimate, if appropriate.

- Logistics: Integrated and Efficient. The Department is striving for integrated and efficient logistics and will adopt initiatives that reduce logistics handoffs and ensure reliable delivery of products and services; develop weapon-system support strategies based on performance-based logistics; design logistics requirements using high-reliability systems; reduce the deployable logistics footprint of operational and support forces; and reduce logistics costs of operations.

- Systems Integration and Engineering for Mission Success. The DoD needs to employ integrated architectures, plans, and roadmaps, and establish a clear mission context for Defense Acquisition Board reviews. It is important to continue to foster interoperability, enhancements to joint and coalition capabilities, and improve the systems engineering environment. The Department needs to sustain a professional systems engineering workforce, and give them the policies and analytic tools they need to assess system readiness. The DoD must continue to conduct high-standard operational tests and evaluations and reduce lifecycle costs.

- Technology Dominance. To dominate in future conflicts, the DoD must have technologically superior military systems. To achieve this dominance, the Department will employ activities such as fully leveraging Advanced Concept Technology Demonstrations, closely linking high pay-off science and technology efforts to enhance joint warfighting capabilities and align with strategic defense initiatives. Further, the Department needs to establish a new science and technology career field to better focus human capital resources.

- Resources Rationalized. The Department met its milestones for the fiscal year by providing the Congress with a revised Force Structure Plan in March 2005, analyzing more than 1,000 closure and realignment scenarios, and providing the Secretary with 222 final closure and realignment recommendations, which he approved and submitted to the Commission and Congress on May 13, 2005.

- Industrial Base Strengthened. One of the DoD's enduring goals is to ensure a Defense industrial base that is focused on and capable of supporting 21st century warfighting. To do this, it is establishing cross-feed mechanisms for major industrial base assessments, evaluating industrial sufficiency for key capabilities, developing industrial policy that creates and retains surge capacity for essential materials, and accessing emerging suppliers for innovative solutions.

- Motivated, Agile Workforce. The DoD continued efforts to create a flexible personnel system and began transitioning to the National Security Personnel System.

Metric 3.4.2: Improve the Transparency of Component Submissions for Alignment of Program Review to Strategic Trades					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY2005[A]
A DoD-wide transactional data collection process	No historical data; new metric		Established initial database integration criteria	Established single collection point for operation and maintenance data	Database integration is ongoing to achieve objective by FY 2007
Streamlined Planning, Programming, Budgeting and Execution process			Streamlined and combined the program and budget review. Instituted streamlined process for developing the FY 2005 budget	Continue with streamlining effort to place more emphasis on planning and less on resourcing decisions Created a Framework to allow greater visibility of program and resource data	Continue building the Framework to allow greater visibility of program and resource data Created a lab environment to validate the framework and data structure rationalization
[A] The FY 2005 data are estimated as of the fourth quarter.					

Metric Description

Improving the transparency of DoD component submissions will help align resource plans and provide senior-level decision makers with the insight they need to make better-informed decisions. Transparency fosters an agreement of facts, which provides a consistent baseline that serves as a common point of departure for making resource trades.

To achieve a consistent baseline, the DoD must first streamline the flow of data. Each data element should be collected once by a single authoritative source collection system and reused as needed. The agreement of all parties on the accuracy and validity of the number (and of the authority of the source that provided it) would facilitate the DoD's ability to reuse data collected once to support multiple decisions.

Efforts to improve transparency have been under way for several years, but the Department has never documented or quantified metrics to monitor progress. Evidence of success to date is mostly anecdotal. One area where the DoD can measure progress is the programming data requirements data collection and reuse initiative, which may serve as the pilot for the development of measures to be applied more broadly.

To determine the accuracy of resource data, the DoD will rely on fiscal and budgetary controls, combined with assessments of whether the data comply with strategic guidance. Where possible, the DoD established business rules to ensure existing data structures are used appropriately. The DoD also will validate data by having analysts and subject-matter experts monitor particular groups of resources or programs. Refining the submission of programming and budgeting data are tasks in progress with the Services, Defense Agencies, and the DoD Comptroller. Streamlining the data flow to eliminate dual submissions between budget and programming systems will reduce workload and improve data quality. Requirements will be standardized and reduced. Programming data requirements have been reduced from 139 in FY 2000 to 39 distinct formats in the FY 2003 cycle. This degree of reduction needs to be achieved in other areas as allowed for by legal and external agency reporting requirements.

Evaluating, validating, and improving the current program and budget data structures will significantly contribute to the alignment of programming and budgeting, and the analytic use of common data. The data structures must:

- Facilitate compliance with reporting requirements,
- Better support business and policy decisions,
- Allow for easier management of the structures to ensure validity of the data, and
- Support the overlay of taxonomies for specific analytic purposes in support of strategic reviews.

Connections to the lower-level, DoD component-maintained source data would provide further transparency as issues arise. The end-state solution should provide the ability for analysts supporting a decision maker to find data at a finer level of detail maintained by the DoD components.

Criteria that measure the improvement of transparency might include:

- Data requirements: the reduction in the number of distinct data requirements requested at each point in the cycle,
- Data structure management: the level of human effort required annually to keep the structure accurate; the amount of time and effort to create a new element, and
- Consistency of program reporting: the degree to which resource plans provide a non-ambiguous result when viewed from different perspectives; the time to create new mappings and the accuracy of the mappings to emerging requirements.

The DoD Business Management Modernization Program has set a target of full deployment of the systems supporting this metric by 2010. A unified information architecture will be implemented by FY 2008.

Performance Results for FY 2005

Validation of the program/budget framework and data structure rationalization efforts are ongoing. The DoD developed a common information model and began using it to validate the program/budget framework and data structure.

Metric 3.4.3: Increase Visibility of Trade Space					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Ability to define and cost trades within and across capabilities areas while balancing investment and risk across the entire defense program.	No historical data; new metric		Conducted Joint Defense Capabilities Study	• Published Strategic Planning Guidance • Initiated Enhanced Planning process • Issued Joint Programming Guidance using initial analytical findings	• Initiated several capability area reviews • Approved use of joint capability areas taxonomy
[A] FY 2005 data are estimated as of the fourth quarter.					

Metric Description

The planning guidance of the Secretary of Defense is the primary tool for directing how defense programs and budgets will be shaped. Previous guidance provided a list of projects of interest, and it set priorities across the Defense program. However, it did so with little fidelity. The result was fiscally unsound and unclear planning guidance that made it difficult to ensure compliance. To provide clarification and ensure compliance, in FY 2003 the DoD restructured the guidance to better define where more risk or less risk should be taken across the Defense program. This revised structure directed the Services and Agencies to apply explicit criteria for risk management, and to align their resource plans accordingly. Then, during the program and budget review, any resource proposal that varied from guidance was corrected in the President's Budget.

The DoD further strengthened the guidance as a resource decision tool by adding more details on how Services and Defense Agencies were expected to meet the Secretary's intent within fiscal constraints. The guidance—renamed Strategic Planning Guidance—marked the first attempt to estimate the direct cost of program priorities within the context of the overall defense program. However, shortfalls still exist. It is still difficult to develop a truly independent cost estimate of planning priorities, or to assess accurately all the variables associated with estimating the potential trade space created by accepting increased risk in some areas of the defense program.

The newly initiated Enhanced Planning Process will provide a continuous, open and collaborative analytic forum to examine closely issues of the greatest interest to the Secretary. The process is intended to produce programmatic recommendations that will be documented in a new annual publication, the Joint Programming Guidance.

The Department continues to improve this metric but several factors will influence progress:

- Defining "visibility" and its gradations. The DoD needs the ability to estimate accurately the costs associated with programmatic and budget trades. It must be able to frame the trade space discussion within the context of the overall Defense program and ensure clarity about the impact of making trades within and among the four risk management areas.
- Developing an index for measuring compliance. One approach to measuring increased visibility is measuring the degree of compliance. This metric might be measured in dollars failing to conform to guidance or in the number of issues of noncompliance that are raised in the program and budget review. Either index can provide a trend to show progress in achieving visibility of the trade space.
- Classification and the pre-decisional nature of document. The Secretary's planning guidance is pre-decisional, and thus not releasable. In addition, much of the guidance is classified. It is likely that some or portions of any trade-space metric would also be subject to these restrictions.

Performance Results for FY 2005

Efforts to institute a capabilities-based planning process have further improved the Department's ability to shape the overall defense program. Rather than examining systems on an individual basis only, the DoD has launched a number of "capability area reviews" that lay out and examine programs in related areas, and has produced initial drafts of capability "road-maps" in those areas.

The Secretary approved an initial taxonomy of joint capability areas, which provides a framework for defining trade-space. These areas will be incorporated as appropriate into planning scenarios, planning guidance, joint concepts, joint task lists, the joint capabilities integration development system, integrated priority lists, and program and budget databases. The Secretary has directed continued elaboration and refinement of these joint capability areas. Once fully developed and implemented, this capabilities-based approach will greatly increase the Department's ability to define and cost trade-offs both within and across capability areas to balance risk.

Metric 3.4.4: Provide Explicit Guidance for Program and Budget Development					
End-state Metric (New Baseline)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Revised planning, programming, and budgeting decision process	No historical data; new metric		Conducted the DoD-wide study of joint Defense capabilities	• Combined the program/budget review process • Implemented new joint perspective in planning and program guidance • Added execution reviews to formal process	Reevaluate resource allocation and execution procedures
[A] The FY 2005 data are estimated as of the fourth quarter.					

Metric Description

Section 113 of Title 10, U.S. Code, requires the Secretary of Defense to give the heads of the Military Departments and Defense Agencies the resource levels projected to be available for the period of time for which national security objectives and policies and military missions established as priorities under the Defense strategy are to be effective. In March 2003, the Secretary of Defense chartered a broad review of the Department's planning and resource decision process. A study team, chaired by the former Under Secretary of Defense, explored ways to make the existing defense decision process less cumbersome, more responsive, and more helpful to the Secretary's attempt to focus on managing and enhancing joint capabilities.

The Joint Defense Capabilities Study, completed in November 2003, recommended focusing the Secretary's annual planning and programming guidance on high-level strategic issues, and framing resource alternatives as capabilities rather than programs. The study also recommended that actual results become a formal part of the overall assessment process. Accordingly, the DoD Planning, Programming, and Budgeting System (PPBS) added a final "Execution" phase to the overall process – to become the PPB—"E"—S. The DoD has enhanced its planning process to focus on issues that are strategic and joint and address core military capabilities.

Performance Results for FY 2005

The Department is reevaluating its resource allocation and execution procedures in the ongoing Quadrennial Defense Review.

Strategic Goal 4: Balancing Future Challenges Risks - execute future missions successfully against an array of prospective challengers

Performance Goal 4.1 - Define and Develop Transformational Capabilities

Metric 4.1.1: Deny Enemy Advantages and Exploit Weaknesses					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY2005[A]
Explicit strategic outcomes and effectiveness measures for the DoD counterintelligence activities	No historical data; new metric	The Secretary of Defense established the Defense Counterintelligence Field Activity	The Secretary established an Under Secretary of Defense (Intelligence)	• Addressed shortfall in DoD counterintelligence policy • Developed, managed and executed the DoD polygraph program in support of Joint Task Force Guantanamo Bay • Initiated study to identify shortfalls in counterintelligence support for Pentagon • Developed standards for horizontal integration activities used to shape the DoD planning guidance • Established an Intelligence Campaign Plan concept and timeline for implementation.	• Write new policy instructions • Satisfied the Joint Task Force Guantanamo Bay Commander's FY 2004 polygraph support requirement • Completed counterintelligence plan and associated resource requirements • Included Intelligence Campaign Planning into the priority DoD Unified Command Plan for designated contingency plans • One Intelligence Campaign completed and approved; three drafted. All four Intelligence Campaigns plans underway based on spiral development concept and using approved and draft guidance. Targeting packages issued and operational activity underway in all four campaigns.

[A] FY 2005 data are final as of the fourth quarter.

Metric Description

Denying enemy advantages and exploiting weaknesses is at the core of the work by the Under Secretary of Defense (Intelligence). The long-term goal is to establish strategic outcomes and efficiency measures to help gauge the effectiveness of intelligence activities, and training and associated program structures. Many domestic, international, and organizational variables contribute to the success of the overall program, so the task of developing enduring outcome goals and measures involves a significant amount of developmental research and analysis. The DoD counterintelligence community will conduct aggressive activities to contribute to the intelligence requirements of military operations and national security. Further, the Department requires current and comprehensive policies to guide its counterintelligence community. The ongoing counterintelligence efforts included the identification of 22 directives, instructions, regulations, and manuals that need to be revised, rewritten, or cancelled.

Four fundamental areas contribute to the success of any counterintelligence program: (1) ensuring that the Defense intelligence security, strategy, policy, and processes are aligned for maximum effectiveness and efficiency, (2) ensuring the horizontal integration of Defense intelligence activities, i.e., communication among and within Agencies promotes increased information sharing, (3) aligning counterintelligence plans and architectures with the goal of improved military operations and overall national security, and (4) supporting the warfighter in the most efficient and effective manner possible.

Performance Results for FY 2005

Work continued on 20 issuances identified for revision. The DoD published the Intelligence, Surveillance, and Reconnaissance Roadmap, which cuts across the Defense intelligence community and synchronizes a large number of platforms and capabilities that require integration. The roadmap identifies integration phases in which programmatic efforts are intended to first align (2003 – 2010), then enable (2005 – 2012) and finally integrate (2007 – 2015) Defense intelligence, surveillance, and reconnaissance capabilities.

The DoD worked across intelligence community to support U.S. Central Command in improving intelligence, surveillance, and reconnaissance support to the Command's efforts.

The DoD developed, managed, and executed the polygraph program in support of the Joint Task Force Guantanamo Bay. Polygraph examinations are now given to translators and personnel before they arrive at Guantanamo Bay. The Defense Counterintelligence Field Activity is leading a multi-agency working group that is developing the plan and resource requirements for the integrated multi-agency program designed to fill the void in counterintellligence support to the DoD Agencies and activities, to include the Pentagon. This plan is almost complete.

The recent creation of the Strategic Counterintelligence Detachment concept currently in Iraq (and possible future Detachments in other theaters) has directly resulted in the denial of enemy advantages and the exploitation of enemy weaknesses. It is foreseeable that the Strategic Counterintelligence Detachment will further develop into a capability which will be employed against an array of adversaries.

Metric 4.1.2: Make Information Available on a Network that People Depend On and Trust					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
• Number of systems that support the Internet Protocol Version 6 (IPv6) • Number of systems that meet information assurance standards	No historical data; new metric			Begun transition of selected systems and weapons to IPv6	• Implemented IPv6 in limited lab/test networks • Information assurance standards remain in development
[A] FY 2005 data are final as of the third quarter.					

Metric Description

Moving information securely, quickly, and accurately is vital for combat commanders. The DoD's ability to build a worldwide information net, populate it with information needed by military commanders, and then use the network for command and control has been limited by the amount of information that can flow through the network and be processed at any given time. In response, the DoD has set the goal of building a Global Information Grid to:

- Achieve an ubiquitous, secure, and robust network,
- Eliminate bandwidth, frequency, and computing capability limitations,
- Deploy collaborative capabilities and other performance support tools, and
- Secure and assure the network and the information.

The Director, Strategic Resource Planning for the Assistant Secretary of Defense for Networks and Information Integration is working with the Deputy Chief Information Officer and a contractor to develop outcome and output metrics to measure progress toward achieving the strategic planning goals of DoD's Information Technology Plan.

Performance Results for FY 2005

Efforts to establish the grid continued through FY 2005, with significant progress gained in forming the DoD-wide policies for infrastructure, core enterprise services, and data standards. The DoD established Internet Protocol Version 6 (IPv6) as the common end-to-end network protocol to achieve net-centric war fighting requirements, with the goal of complete transition by calendar year 2008. (IPv6 is a standard used to communicate via the Internet.) The DoD will begin pilot implementation of IPv6 on networks that carry operations traffic in FY 2006. Additionally, the Defense Information Systems Agency programmed conversion from circuit-based to Internet Protocol operational capability for all teleport sites. The DoD also will establish a Department-wide software assurance tiger team to develop a holistic strategy to reduce software assurance risk and develop a software assurance strategy for use on major acquisition programs and across the Department.

4.1.3: Monitor the Status of Defense Technology Objectives					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/Actual[F]
Percentage of Defense technology objectives evaluated as progressing satisfactorily toward goals[A]	96	97	96	≥ 70/94	≥ 70/N/A[E]
Objectives evaluated in biannual review[B]	180	149[C]	163[C]	180	0
Total number of objectives[B,C,D]	326	401	386	404	404

[A] "Progressing satisfactorily" includes objectives rated as "green" or "yellow."
[B] The number of objectives evaluated and the total number of objectives are provided for information only; no targets are established.
[C] The numbers for objectives evaluated in FY 2002 and FY 2003 were transposed in the FY 2003 Performance and Accountability Report.
[D] The total number of objectives is the sum of all objectives contained in the Joint Warfighting Science and Technology Plan and the Defense Technology Area Plan, dated February of the calendar year prior to the fiscal year the reviews are conducted.
[E] The DoD implemented a new comprehensive review process that evaluates all objectives biennially. The next assessment will be in FY 2007 for FY 2005 and FY 2006 objectives.
[F] FY 2005 data are final as of the fourth quarter.

Metric Description

Technological superiority is a cornerstone of the national military strategy. Technologies such as radar, jet engines, nuclear weapons, night vision, smart weapons, stealth, the Global Positioning System, and vastly more capable information management systems have changed warfare dramatically. Today's technological edge allows the DoD to prevail decisively across a broad spectrum of conflicts and with relatively few casualties. Maintaining this technological edge has become even more important as the size of U.S. forces decreases and high-technology weapons are now readily available on the world market. Future warfighting capabilities will be determined substantially by today's investment in science and technology.

Science and technology investments are focused and guided through a series of Defense technology objectives developed by the senior DoD planners. Each of these objectives highlights a specific technological advancement, the anticipated date the technology will be available, the specific benefits that should result from the technological advance, and the funding required (and funding sources) to achieve the new capability. These objectives also specify milestones to be reached and approaches to be used, quantitative metrics that will indicate progress, and the customers who will benefit when the new technology is eventually fielded. This metric measures the percentage of defense technology objectives that are progressing satisfactorily toward the goals established for them.

Performance Results for FY 2005

The Department implemented a new comprehensive review process that evaluates all Defense technology objectives biennially. The FY 2005 and FY 2006 objectives will be assessed during FY 2007.

Metric 4.1.4: Populate the Network with New, Dynamic Sources of Information to Defeat the Enemy					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Percentage of DoD information available via net-centric solutions	No historical data; new metric			• Published net-centric checklist • Began portfolio management	Codified the DoD Net-Centric Data Strategy
[A] FY 2005 data are estimated as of the third quarter.					

Metric Description

Military commanders use information of all kinds, not only intelligence data, to "see" the battle space and outwit and overcome adversaries. The net-centric enterprise architecture will allow commanders to engage the network at anytime from anywhere using a military version of the Internet search engine, without needing cumbersome base support. Data will be posted and ready for download and analysis as soon as it arrives, anywhere on the network. The Chief Information Officer's strategy is to ensure data are visible, available, and usable when needed and where needed to accelerate decision making. This metric will be completed no later than FY 2008, by which point all DoD data will be compliant with Internet Protocol Version 6 (IPv6) standards.

Performance Results for FY 2005

The Department codified the DoD Net-Centric Data Strategy by issuing "Data Sharing in a Net-Centric Department of Defense," a directive that sets the Department's policy and responsibilities to ensure that data assets are visible, accessible, and understandable to any potential DoD user.

Performance Goal 4.2 - Define Skills and Competencies for the Future

Metric 4.2.1: Attract, Recruit, Retain, and Reward High Quality People from Government, Industry, and Academia					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY2005[A]
• Create a Defense Civilian Intelligence Personnel System • Develop policies and programs to attract, recruit, retain, and reward high-quality people	No historical data; new metric			• Designation of Office of the Under Secretary for Defense (Intelligence) as Defense Civilian Intelligence Personnel System organization and submission of 11 system subchapters for implementation • Develop and draft policies to implement the Defense Civilian Intelligence Personnel System and regulations to utilize the legislative flexibilities	• The Under Secretary submitted 11 subchapters; six were approved for interim use (subchapters will be revised to be consistent with National Security Personnel System regulations) • Successfully advocated and approved an increase in foreign language proficiency pay • Established a senior-level panel to review a 10 percent sample of the new executive and senior level performance plans
[A] FY 2005 data are final as of the fourth quarter.					

Metric Description

To accomplish its ambitious goals, the Defense intelligence community needs the best people available. The community needs to recruit people with broad and varied experiences who are agile problem solvers and can operate in an environment that changes as the threat changes. Legislation such as the National Security Personnel System provides the DoD with hiring flexibility. A key first step and an ongoing effort is the development of an overarching directive establishing a common human resources system for the DoD intelligence community.

Performance Results for FY 2005

DoD submitted 11 subchapters for the National Security Personnel System regulations; six were approved for interim use pending formal coordination and publication. The DoD also revised and upgraded the foreign language proficiency pay policy that resulted in a substantial increase in the maximum pay authorized for proficiency in a language or multiple languages.

Metric 4.2.2: Strategic Transformation Appraisal					
Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Assessment of "gaps" or adjustments needed to remain on track	No historical data; new metric		Published first transformational planning guidance	Completed first strategic transformation appraisal	Completed second strategic transformation appraisal
[A] FY 2005 data are final as of the fourth quarter.					

Metric Description

The Department's overall transformation roadmaps address activities, processes, resources, and incentives to foster and promote innovation and transformational activities, including concept-based experimentation processes, education and training programs, and the use of operational prototypes. Each Service also prepares an individual roadmap, which is updated annually; Defense Agencies submit their annual roadmap updates to the U.S. Joint Forces Command, which develops a consolidated "joint" roadmap. Each year, the Office of Force Transformation evaluates the progress and plans reported in the individual and joint roadmaps and produces an assessment of "gaps" or adjustments indicated for future action. These roadmaps point to a shared future vision and provide actionable language for implementation. They complement the program and budget process, ensuring coherence between resource allocation decisions and future concept development and experimentation and provide a baseline for managing transformational change within the force. Additionally, they articulate the Service and Defense Agency strategies for implementing and managing transformation risks.

Performance Results for FY 2005

The Office of Force Transformation completed its second full-scale strategic transformation appraisal in November 2004 that emphasized the planned development by the Services and Defense Agencies of directed energy, information warfare techniques and concepts, joint battle management, non-lethal technology, and rapid access to space. The appraisal also highlighted the dilemma of balancing near-term concerns generated by operations in Iraq against long-term science and technology needs. Beginning in FY 2007, this unclassified report (with classified annexes) will be submitted each November to the Secretary of Defense.Performance Goal 4.3 - Develop More Effective Organizations.

Performance Goal 4.3 - Develop More Effective Organizations

Metric 4.3.1: Enhance Homeland Defense and Consequence Managementl					
End-state Metric (New Baseline)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Strategy and an associated resource and technology roadmap	No historical data; new metric		• Established an Assistant Secretary for Homeland Defense • Established U.S. Northern Command	• Began developing first homeland defense strategy • Developed initial resource and technology roadmaps	• Finalized homeland defense strategy during the first quarter • Promulgated homeland defense implementation guidance during the third quarter • Published Policy Memorandum 5 regarding use of the strategy in BRAC 2005 considerations during the first quarter • Published the National Response Plan during the first quarter • The DoD, Department of Homeland Security, and U.S. Coast Guard memorandum of understanding - U.S. Coast Guard support to DoD maritime homeland defense operations during first quarter • Standing Rules for the Use of Force during third quarter FY 2005 • Established 11 new Weapons of Mass Destruction – Civil Support Teams and initiated training and certification during first quarter FY 2005 • Established with Departments of Homeland Security and Justice a standardized process to transfer technology, equipment, and expertise to federal, state, and local responders
[A] FY 2005 data are estimated as of the fourth quarter.					

Metric Description

The DoD's highest priority is protecting the U.S. homeland from attack; the Department must be able to succeed at the full range of tasks associated with an active defense-in-depth, including military missions in the forward regions, approaches to the United States, the U.S. homeland, and the global commons. Specifically, the Department must be able to:

- Conduct military missions to prevent, deter, defend, and defeat attacks on America, its people, and its Defense critical infrastructure (homeland defense), and
- Support civil authorities directed by the President or Secretary of Defense as part of a comprehensive national response to prevent and protect against terrorist incidents or manage the consequences of attack or disaster (homeland security). Enhance contributions of domestic and foreign partners to homeland security and homeland defense.

To meet the challenges of the post-9/11 threat environment, the Secretary of Defense directed the development of the first comprehensive, Defense-wide strategy for homeland defense and civil support. This new strategy relies on an integrated threat assessment to define the DoD's strategic goals, key objectives, and core capabilities for homeland defense and civil support. The strategy describes associated force structure, technology, and resource implications. The completed strategy articulates a number of actions for immediate implementation to transform the DoD's capabilities for homeland defense and civil support in each of the core capability areas, including providing maximum threat awareness; interdiction and defeat of threats at safe distance; mission assurance; improved interagency and international capabilities; and managing the consequences of a chemical, biological, radiological, nuclear, or explosive incident.

Performance Results for FY 2005

Several actions were taken to support implementation of the Strategy for Homeland Defense and Civil Support, published in June, along with implementation guidance that directs specific actions to support accomplishment of the strategic goals and objectives.

Metric 4.3.2: Establish a Standing Joint Force Headquarters					
End-state Metric (New baseline)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
The ability to rapidly execute transformational command and control functions for joint force operations	Development of Standing Joint Force Headquarters directed in 2001 Quadrennial Defense Review	Concept released	• Experiments conducted • Implementation guidelines developed	Headquarters established and staffed at Geographic Combatant Commands (except U.S. Central Command)	• Headquarters in Geographic Combatant Commands complete initial training • Regional Combatant Command Standing Joint Force Headquarters participated in Joint Training Exercise • U.S. Joint Forces Command established a headquarters to be employed by Geographic Combatant Commands when required

[A] FY 2005 data are estimated as of the fourth quarter.

Metric Description

In 2003, the Secretary of Defense directed Geographic Combatant Commands to establish Standing Joint Force Headquarters by FY 2005. These headquarters reflect standards established by U.S. Joint Forces Command and incorporate the lessons learned from 2002 joint exercises. Each Geographic Combatant Commands has a 58-person core Standing Joint Force Headquarters that serves as a planning staff during day-to-day operations. In the event of a crisis, the in-place headquarters is prepared immediately to execute command and control functions for the integrated employment of air, land, maritime, and information forces. The headquarters is made up of joint-trained personnel skilled in using computer-based analysis tools and joint information and processes. To operate in the field, each deployable headquarters must have a deployable joint command and control capability.

The U.S. Joint Forces Command is continuing an extensive program of research, development, and experimentation to advance the key enabling concepts of knowledge management, effects-based planning and operations, and a collaborative information environment.

Performance Results for FY 2005

All of the Geographic Combatant Commands have accomplished the assigned task, except U.S. Central Command. In addition, all Commands' Standing Joint Force Headquarters participated in a Joint Training Exercise during FY 2005, completing their initial training cycle.

Metric 4.3.3: Transform DoD Training					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Target/Actual	FY 2005 Target/ Actual[A]
Percentage of military officers in critical positions certified as joint-trained or educated	No historical data; new metric.			50% / 54.2%	52.5% / 53.8%
[A] FY 2005 data are final as of the second quarter.					

Metric Description

Training Transformation (T2) is designed to provide dynamic, capabilities-based training in support of national security requirements across the full spectrum of service, joint, interagency, intergovernmental, and multinational operations. Starting in FY 2004, DoD began transitioning from activity-based to outcome-based measures.

One of the leading indicators of training transformation is the overall percentage of the force that has received joint training or joint education. A higher percentage correlates to increased performance in jobs that require knowledge of joint matters that relate to national military strategy, strategic and contingency planning, and command and control of combat operations under a Combatant Commander. Although the entire force is not measurable at this time, the DoD is measuring the critical positions filled by officers at Combatant Commander staffs.

To be joint-trained, an officer must complete a joint duty assignment, a joint billet that is 2-3 year position in a multi-Service or multinational Command or activity involved in the integrated employment or support of the land, sea, and air forces of at least two of the three Military Departments. An officer is considered to have received joint education if he or she graduates from a course certified as Joint Professional Military Education Phase 2 (Joint and Combined Warfighting School, National War College, or the Industrial College of the Armed Forces).

T2 measures will constantly evolve through a process of spiral-development and will consider the overall outputs and desired outcomes of the Joint Knowledge Development and Distribution Capability, Joint

National Training Capability, and transformation as a whole. The DoD expects to have a complete set of outcome-based measures and assessments across the areas of quantity, quality, and responsiveness for both individual and collective training by the end of FY 2006.

Performance Results for FY 2005

The Joint Assessment and Enabling Capability continued the shift to outcome-based measures in FY 2005 and is on track to complete its first block assessment of T2 by the end of the year. Transition will be complete by the end of FY 2006, with measures encompassing the areas of quantity, quality, and responsiveness for both individual and collective training. However, the spiral development of T2 measures is an ongoing process as program objectives constantly evolve in response to current and future mission requirements.

The DoD continued to track Combatant Commander critical positions filled by joint-trained or joint-educated officers through the second quarter. At that time, 53.8 percent of military officers filling critical positions were certified as joint-trained or joint-educated, surpassing the goal of 52.5 percent. The Department is refining and expanding current metrics to better assess the degree to which T2 meets Combatant Commander needs.

Performance Goal 4.4 - Drive Innovative Joint Operations

Metric 4.4.1: Experiment with New Warfare Concepts					
End-state Metric	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005[A]
Percentage of goals met	No historical data; new metric	Developed guidance	Revised guidance	• Conducted four major experimentation exercises • Submitted joint experimentation plan for approval • Fielded Standing Joint Force Headquarters prototypes	• Conducted four major experimentation events • Began FY 2006-2013 Joint Concept Development and Experimentation Campaign Plan • Began Joint Experimentation Work Plan • Initiated Joint Experimentation Knowledge portal
[A] FY 2005 data are estimated as of the fourth quarter					

Metric Description

The goal of the Department's experimentation program is to convert rapidly innovative warfighting concepts to prototypes to fielded capabilities. Accordingly, the April 2003 transformation planning guidance directed the development of the Joint Concept Development and Experimentation Campaign Plan to describe the role of joint experimentation as a major generator of transformational change.
The plan follows two paths:

- The Joint Concept Development Program explores innovative concepts for improving future joint warfighting. These concepts result from an iterative experimentation program that relies on frequent, small-scale sets of experiments conducted in a joint wargaming environment. Once concepts prove viable through continuous refinement and experimentation, they are transferred to the prototype team.
- The Joint Prototype Program improves current warfighting capabilities and matures new capabilities through continuous experimentation in which are part of Combatant Command joint exercise programs. The plan will identify capabilities proposals for rapid prototyping and provide actionable recommendations for future resource investments based on experimentation results.

Performance Results for FY 2005

U.S. Joint Forces Command is revising the 2006-2013 Joint Concept Development and Experimentation Campaign Plan to capture joint experimentation guidance from the Unified Command Plan and the Chairman of the Joint Chiefs of Staff. The Command also is developing a work plan to ensure concepts are programmed adequately into efforts over the next 2 years. Joint efforts for FY 2005 included a national security workshop, campaigning planning from the strategic to operational levels, unified quest, and joint urban warrior. Results from these events have helped inform many of the current concepts as well as generate new ideas for additional concepts.

Metric 4.4.2: Maintain Balanced and Focused Science and Technology					
Metric	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Actual
	Percentage of Science and Technology budget				
Basic research	16%	14.8%	14%	12.8%	12.6%
Applied research	42.7%	42%	38%	35.9%	36.8%
Advanced technology development	41.3%	43.2%	48%	51.3%	50.6%

Metric Description

The DoD science and technology program consists of research and development investments in Basic Research, Applied Research, and Advanced Technology Development. This metric is designed to ensure a balanced and focused investment by funding Basic Research, Applied Research, and Advanced Technology Development to 15 percent, 35 percent, and 50 percent respectively, of the total annual science and technology budget.

Performance Results for FY 2005

The balance between the funding levels for FY 2005 in the three categories is sufficiently close to the DoD goals.

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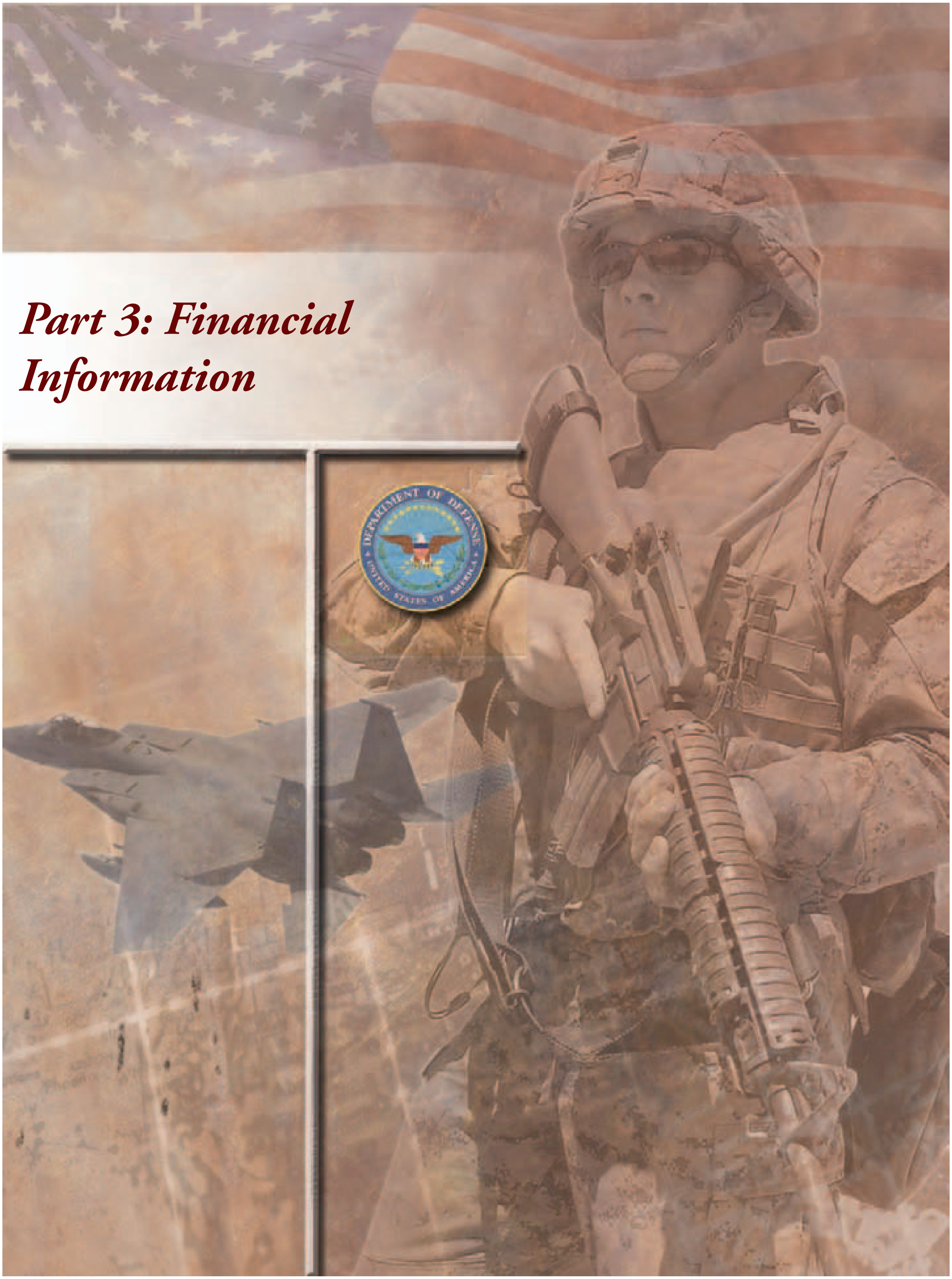
Part 3: Financial Information



Message from the Chief Financial Officer

November 15, 2005

Throughout Fiscal Year 2005, the Department of Defense continued to improve financial management to provide better accountability to the taxpayers.

Today a comprehensive plan for business transformation and financial management improvement is in place and underway. The plan has three major components: the Business Enterprise Architecture, the Business Transition Plan, and the Financial Improvement and Audit Readiness (FIAR) Plan, which provides a roadmap for improving the Department's financial management capabilities.

The Financial Improvement and Audit Readiness Plan targets four strategic areas for improvement in the short term, and includes milestones that can be easily understood, measured, and adjusted as necessary. Each of the focus areas – Military Equipment, Real Property, Environmental Liabilities, and Health Care Liabilities – are central to achieving an unqualified audit opinion.

We developed and published the first phase of Standard Financial Information Structure (SFIS) which standardizes the budget and accounting codes used to classify financial activity across the Department. The SFIS not only complies with accounting standards and facilitates standard data entry but will enable us to consistently trace financial activity by maintaining a clean audit trail across the Department.

The challenges we face are complex, but I am confident that the plans and strategies we have put in place to address them are sound. Continued progress will depend on the timely implementation of critical business and financial systems modernization plans, committed and involved senior leadership, and adequate funding.

I am inspired by the many talented and hard-working DoD financial management professionals who are building upon past accomplishments and moving ahead with critical initiatives that will further improve the Department's financial performance and accountability.

Tina W. Jonas

Independent Auditors' Report on the Principal Statements

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

November 12, 2005

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

SUBJECT: Independent Auditor's Report on the Fiscal Year 2005 Department of Defense Agency-Wide Financial Statements (Report No. D-2006-022)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying DoD Agency-Wide Consolidated Balance Sheet as of September 30, 2005 and 2004, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, the Combined Statement of Financing, and the Statement of Custodial Activity for the fiscal years then ended. The financial statements are the responsibility of DoD management. DoD is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Fiscal Year 2005 DoD financial statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

Disclaimer of Opinion on the Financial Statements

The Under Secretary of Defense (Comptroller)/Chief Financial Officer acknowledged to us that the FY 2005 DoD Agency-Wide Financial Statements would not substantially conform to generally accepted accounting principles, and DoD financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2005. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. DoD has also acknowledged, and prior audits have identified, the material weaknesses listed in the Summary of Internal Control. These material weaknesses also affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the principal financial statements.[1] Therefore, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

Summary of Internal Control

In planning our audit, we considered DoD internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance. However, previously identified reportable conditions, all of which are material, continue to exist in the following areas.

- Financial Management Systems
- Fund Balance with Treasury
- Inventory
- Operating Materials and Supplies
- Property, Plant, and Equipment
- Government-Furnished Material and Contractor-Acquired Material
- Environmental Liabilities
- Intragovernmental Eliminations
- Accounting Entries
- Statement of Net Cost
- Statement of Financing

Material weaknesses are reportable conditions in which internal controls do not reduce (to a relatively low level) the risk of misstatements that are material to the financial statements and that might not be timely detected by employees while performing their normal, assigned functions.

In addition, we identified weaknesses in Accounts Payable, Accounts Receivable, and Contingent Legal Liabilities, which we consider to be reportable conditions. Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal

[1] The annual financial statements include the principal financial statements, management discussion and analysis, consolidating and combining financial statements, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

Our internal control work would not necessarily disclose all reportable conditions. See the Attachment for additional details on reportable conditions, most of which we consider to be material internal control weaknesses.

Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged, and prior audits confirm, that instances of noncompliance continue to exist. The Under Secretary of Defense (Comptroller)/Chief Financial Officer acknowledged to us that DoD financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether DoD was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

Management Responsibility

Management is responsible for:

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

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

Paul J. Granetto

Paul J. Granetto, CPA
Assistant Inspector General
Defense Financial Auditing
Service

Attachment:
As stated

Report on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses and reportable conditions that could adversely affect a favorable opinion on internal control.

Material Weaknesses. Management acknowledged that previously identified reportable conditions, all of which are material, continue to exist.

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

In addition, reviews of five DoD financial management systems and Defense Information Systems Agency Computing Services identified several common vulnerabilities. Controls over security planning, access controls, and software controls did not comply with DoD information assurance requirements. As a result, potential system and procedural vulnerabilities threatened the confidentiality, integrity, and availability of financial data.

Fund Balance with Treasury. The U.S. Treasury Financial Manual and DoD Financial Management Regulation 7000.14-R require DoD to resolve financial and accounting inconsistencies to accurately report Fund Balance With Treasury. However, inconsistencies continue to exist related to in-transit disbursements, unmatched disbursements, negative unliquidated obligations, unreconciled differences in suspense accounts, and unreconciled differences between U.S. Treasury records and DoD accounting records.

Inventory. DoD is required by the Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," to use historical cost, the latest acquisition cost (adjusted for holding gains and losses), or moving average cost for valuing

Attachment

Inventory. However, DoD acknowledged that the existing inventory valuation at most activities does not approximate historical cost. Additionally, DoD does not distinguish between Inventory Held for Sale and Inventory Held in Reserve for Future Sale, as required by the standard.

Operating Materials and Supplies. Statement of Federal Financial Accounting Standards No. 3 also states that Operating Materials and Supplies must be expensed when the items are consumed. DoD has acknowledged that significant amounts of Operating Materials and Supplies were expensed when purchased instead of when consumed. In addition, DoD acknowledged that significant amounts of Operating Materials and Supplies in the possession of contractors were not included in the Operating Materials and Supplies account balance.

General Property, Plant, and Equipment. DoD is required by Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," to record Property, Plant, and Equipment at acquisition cost, capitalize improvement costs, and recognize depreciation expense. However, DoD has acknowledged that it is unable to accurately report the value of Property, Plant, and Equipment on its financial statements. DoD legacy property and logistics systems were not designed to capture acquisition cost and costs of modifications and upgrades or to calculate depreciation. In addition, the value of DoD Property, Plant, and Equipment is not reliably reported because of a lack of supporting documentation.

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

Environmental Liabilities. DoD acknowledged that guidance and audit trails for estimating environmental liabilities are incomplete. Environmental liability estimates are unreliable because activities do not have effective controls in place to ensure that:

- they have adequate audit trails and supporting documentation for estimates,
- they comply with established guidance in developing estimates, and
- they maintain reliable feeder and coordination systems.

In addition, DoD has not developed policies, procedures, and methodologies needed to ensure that cleanup costs for all of its ongoing and inactive or closed operations are identified, consistently estimated, and appropriately reported.

Intragovernmental Eliminations. DoD acknowledged that it made unverifiable adjustments because of the inability to reconcile most intragovernmental transactions. For example, Defense Finance and Accounting Service Indianapolis entered more than $26 billion in unsupported adjustments to Army intragovernmental accounts to bring them into agreement with related amounts reported by its trading partners.

Attachment

Other Accounting Entries. DoD acknowledged that it continues to enter material amounts of unsupported accounting entries. For example, Defense Finance and Accounting Service Indianapolis recorded $248.5 billion (excluding adjustments for intragovernmental transactions) in unsupported accounting entries to prepare the FY 2005 Army General Fund Financial Statements.

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

- The amounts presented for General Funds may not report actual accrued costs.
- Although the funds are generally recorded on an accrual basis for Working Capital Funds, as is required by generally accepted accounting principles, the systems do not always capture actual costs in a timely manner.
- Current financial processes and systems do not capture and report accumulated costs for major programs based on performance measures as required by the Government Performance and Results Act.
- DoD accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Consequently, DoD was unable to reconcile intragovernmental revenue balances with its trading partners.

Statement of Financing. Statement of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting," states that the Statement of Financing should reconcile resources obligated during the period to the net cost of operations. However, DoD acknowledged that it is unable to reconcile budgetary obligations to net costs without making adjustments. Specifically, budgetary data are not in agreement with proprietary expenses. DoD disclosed in Note 21 that the Statements of Financing and Net Cost were adjusted by $11,378.9 million to bring them into agreement. Finally, DoD presented the Statement of Financing on a combined basis instead of a consolidated basis as required by Office of Management and Budget Circular A-136, "Financial Reporting Requirements."

Other Reportable Conditions. During FY 2005, we noted reportable conditions related to Accounts Payable, Accounts Receivable, and Contingent Legal Liabilities.

Accounts Payable. Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government," states, "a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future." DoD acknowledged that the accounts payable do not always accurately reflect the liabilities associated with the actual receipt of goods and services in the appropriate time period. Also, our reports on Internal Control for the DoD Components disclosed that some Accounts Payable were not recorded timely, unsupported adjustments were made to Accounts Payable, and supporting documentation could not be provided in a timely manner.

Accounts Receivable. Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," states "A receivable should be recognized when a Federal entity establishes a claim to cash or other assets against other entities, either based on legal provisions,…or goods and services provided." DoD has acknowledged weaknesses in Accounts Receivable because policy is not always followed in relation to the recording, reporting, collecting, and reconciling of accounts receivable. Also, our reports on Internal Control for the DoD Components showed deficiencies such as inadequate audit trails and reconciliations with subsidiary records, and a general lack of controls to ensure that Accounts Receivable balances are supportable at the transaction level.

Contingent Legal Liabilities. Statement of Federal Financial Accounting Standards No. 5 requires contingent liabilities to be disclosed if there is at least a reasonable possibility that a loss may be incurred. DoD did not disclose in its legal representation letter an undetermined amount of cases that individually did not exceed the reporting threshold requested by the auditors, but in aggregate exceeded the materiality threshold. DoD and its Components had not established adequate procedures and controls to provide this information. As a result, we were unable to determine the magnitude of these potential losses. We plan to issue a separate report early in FY 2006 discussing deficiencies in the DoD process for reporting contingent legal liabilities, which will include additional information concerning this reportable condition and appropriate recommendations for correction actions.

Compliance with Laws and Regulations

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

Statutory Financial Management Systems Reporting Requirements. DoD is required to comply with the following financial management systems reporting requirements.

- Section 3512, title 31, United States Code, incorporates the reporting requirements of the Federal Managers' Financial Integrity Act of 1982 and requires DoD to evaluate its systems and to annually report whether those systems are in compliance with requirements prescribed by the Comptroller General.

- The Federal Financial Management Improvement Act of 1996 requires DoD to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. The Federal Financial Management Integrity Act also requires DoD to develop a remediation plan when its financial management systems do not comply with Federal financial management systems requirements. The remediation plan is to include remedies, resources required, and milestones.

Attachment

For FY 2005, DoD did not fully comply with the statutory reporting requirements identified in these provisions. Specifically, DoD acknowledged that many of its critical financial management and feeder systems did not comply substantially with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2005. In an attempt to remedy these long-standing financial management systems deficiencies, DoD is developing a DoD-Wide Business Enterprise Architecture. Until the architecture is fully developed and implemented, DoD will continue to be unable to fully comply with the statutory reporting requirements. We did not perform tests of compliance for these requirements.

Government Performance and Results Act. Congress enacted the Government Performance and Results Act of 1993 (The Act) to establish strategic planning and performance measurement in the Federal Government. Strategic plans, annual performance plans, and annual program performance reports comprise the main elements of The Act.

DoD did not fully comply with The Act and subsequent implementation guidance in Office of Management and Budget Circular A-11, "Preparation, Submission, and Execution of the Budget." Specifically, DoD did not have a compliant strategic plan for FY 2005 because it designated the Quadrennial Defense Review report as its Government Performance and Results Act strategic plan, without consideration of The Act's requirements. In addition, the DoD performance budget and performance report for FY 2005 did not comply with The Act and Office of Management and Budget Circular A-11 because The Act strategic plan provides the framework for implementing all other parts of The Act. We plan to issue a separate report on compliance with The Act in early FY 2006 with a specific recommendation to correct this deficiency.

Antideficiency Act. Section 1341, title 31, United States Code states that a Federal employee may not "make or authorize an expenditure or obligation exceeding the amount available in an appropriation or fund for the expenditure or obligation." Additionally, DoD, and its agents, may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. During FY 2005, DoD investigated 20 cases of potential violations of the Antideficiency Act and determined 15 cases to be actual violations.

Sections 1349 and 1351 of the Antideficiency Act also require DoD to immediately report the nature of violations to the President and Congress, and to take appropriate disciplinary action against those responsible for such violations. In implementing this requirement, the DoD Financial Management Regulation requires that all investigations and reports of violations be completed within one year from the date of discovery. DoD took an average 45 months to investigate and report violations. During FY 2005, DoD took an average of 16 months to identify violations of the Antideficiency Act and begin investigations. In addition, DoD Components were not consistent in disciplining personnel responsible for Antideficiency Act violations.

Prompt Payment Act. The Prompt Payment Act requires DoD to pay vendors within specified timeframes and pay interest penalties for late payments. Office of Management and Budget Circular A-123, "Management's Responsibility for Internal Control," December 21, 2004, also requires management to develop and maintain effective internal control to ensure compliance with applicable laws and regulations. A review of invoices paid at Defense Finance and

Attachment

Accounting Service Columbus during FY 2004 showed that incorrect interest payments or noncompliance with certain provisions of the Prompt Payment Act occurred for an estimated 11 percent of invoices paid. The errors occurred because DoD did not have effective systems or personnel controls in place to ensure compliance. We plan to issue a separate report on compliance with the Prompt Payment Act in early FY 2006 with specific recommendations to correct these deficiencies and improve controls.

Audit Disclosures

The Under Secretary of Defense (Comptroller)/Chief Financial Officer acknowledged to us on March 21, 2005, that the DoD financial management systems cannot provide adequate evidence supporting various material amounts on the financial statements. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: Provisions Governing Claims of the United States Government (including provisions of the Debt Collection Improvement Act), Federal Credit Reform Act, and the Pay and Allowance System for Civilian Employees.

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

Attachment

Principal Financial Statements and Notes

The principal financial statements included in this report have been prepared in accordance with the requirements of the Chief Financial Officers Act of 1990 (P.L. 101-576), the Government Management Reform Act of 1994, and the Office of Management and Budget's (OMB) Circular A-136, "Financial Reporting Requirements." The responsibility for the integrity of the financial information included in these statements rests with management of the Department of Defense. The Department's fiscal years 2005 and 2004 principal financial statements were audited by the Office of Inspector General. The auditors' report accompanies the principal statements.

The Department's principal financial statements for fiscal years 2005 and 2004 consisted of the following:

The Consolidated Balance Sheet

The Consolidated Balance Sheet, which present as of September 30, 2005 and 2004 those resources owned or managed by DoD which are available to provide future economic benefits (assets); amounts owed by DoD that will require payments from those resources or future resources (liabilities) and residual amounts retained by DoD, comprising the difference (net position).

The Consolidated Statement of Net Cost

The Consolidated Statement of Net Cost, which present the net cost of DoD operations for the years ended September 30, 2005 and 2004. DoD's net cost of operations includes the gross costs incurred by DoD less any exchange revenue earned from DoD activities.

The Consolidated Statement of Changes in Net Position

The Consolidated Statement of Changes in Net Position, which present the change in DoD's net position resulting from the net cost of DoD operations, budgetary financing sources other than exchange revenues and other financing sources for the years ended September 30, 2005 and 2004.

The Combined Statement of Budgetary Resources

The Combined Statement of Budgetary Resources, which present the budgetary resources available to DoD during FY 2005 and 2004, the status of these resources at September 30, 2005 and 2004, and the outlay of budgetary resources for the years ended September 30, 2005 and 2004.

The Consolidated Statement of Financing

The Consolidated Statement of Financing, which reconciles the net cost of operations with the obligation of budgetary resources for the years ended September 30, 2005 and 2004.

The Combined Statement of Custodial Activity

The Combined Statement of Custodial Activity, which present the sources and disposition of nonexchange revenues collected or accrued by DoD on behalf of other recipient entities for the years ended September 30, 2005 and 2004.

Limitations of Financial Statements

The following limitations apply to the preparation of the fiscal year 2005 financial statements:

The principal financial statements have been prepared to report the financial position and results of operations of the Department of Defense, pursuant to the requirements of 31 U.S.C. 3515 (b). The statements are prepared from the books and records of the Department in accordance with OMB Bulletin A-136 and to the extent possible generally accepted accounting principles. 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. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Principal Statements

CONSOLIDATED BALANCE SHEET
Department of Defense
As of September 30
($ in millions)

	2005	2004 Restated
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Notes 2 and 3)	$ 290,657.1	$ 289,598.9
Investments (Note 4)	263,367.8	231,069.7
Accounts Receivable, Net (Note 5)	1,291.3	1,118.3
Other Assets (Note 6)	1,394.2	1,011.9
Total Intragovernmental Assets	556,710.4	522,798.8
Cash and Other Monetary Assets (Note 7)	2,072.7	2,178.1
Accounts Receivable, Net (Note 5)	7,615.5	7,427.8
Loans Receivable (Note 8)	75.6	70.7
Inventory and Related Property (Note 9)	222,573.3	220,505.6
General Property, Plant and Equipment (Note 10)	460,699.3	440,898.6
Investments (Note 4)	605.0	406.5
Other Assets (Note 6)	23,822.1	21,486.3
Total Assets	$ 1,274,173.9	$ 1,215,772.4
LIABILITIES		
Intragovernmental		
Accounts Payable (Note 12)	$ 2,058.0	$ 1,888.4
Debt (Note 13)	467.1	591.8
Other Liabilities (Notes 15 and 16)	11,150.8	10,726.9
Total Intragovernmental Liabilities	13,675.9	13,207.1
Accounts Payable (Note 12)	28,575.4	28,309.0
Military Retirement Benefits and Other Employment Related Actuarial Liabilities (Note 17)	1,736,057.8	1,569,704.7
Environmental Liabilities (Note 14)	65,027.6	64,367.2
Loan Guarantee Liability (Note 8)	41.1	34.4
Other Liabilities (Notes 15 and 16)	29,985.4	34,491.2
Total Liabilities	$ 1,873,363.2	$ 1,710,113.6
NET POSITION		
Unexpended Appropriations	$ 271,493.6	$ 243,813.9
Cumulative Results of Operations	(870,682.9)	(738,155.1)
Total Net Position	$ (599,189.3)	$ (494,341.2)
Total Liabilities and Net Position	$ 1,274,173.9	$ 1,215,772.4

CONSOLIDATED STATEMENT OF NET COST (Note 18)
Department of Defense
As of September 30
($ in millions)

	2005	2004
Program Costs		
Intragovernmental Gross Costs	$ 24,510.0	$ 23,574.5
(Less: Intragovernmental Earned Revenue)	(18,264.1)	(15,429.0)
Intragovernmental Net Costs	$ 6,245.9	$ 8,145.5
Gross Costs With the Public	$ 655,576.6	$ 619,573.8
(Less: Earned Revenue From the Public)	(26,943.0)	(22,354.4)
Net Costs With the Public	$ 628,633.6	$ 597,219.4
Net Cost of Operations	$ 634,879.5	$ 605,364.9

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION (Note 19)
Department of Defense
As of September 30
($ in millions)

	2005		2004	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations Restated	Unexpended Appropriations
Beginning Balances	$ (745,441.3)	$ 243,813.9	$ (621,610.7)	$ 192,955.8
Prior Period Adjustments				
Changes in Accounting Principles	3,632.4	-	699.5	-
Correction of Errors	7,256.5	-	(8,301.8)	25,913.7
Beginning Balances, as adjusted	$ (734,552.4)	$ 243,813.9	$ (629,213.0)	$ 218,869.5
Budgetary Financing Sources				
Appropriations received	$ -	$ 524,990.1	$ -	$ 512,194.5
Appropriations transferred in(out)		(651.7)		485.6
Other adjustments (recissions, etc)		(5,078.2)		(9,114.6)
Appropriations used	491,580.5	(491,580.5)	478,621.1	(478,621.1)
Nonexchange revenue	1,665.0	-	1,469.7	(0.1)
Donations and forfeitures of cash and cash equivalents	42.6	-	7.0	0.1
Transfers in(out) without reimbursement	3,176.4	-	10,568.6	-
Other budgetary financing sources	0.5	-	4,511.5	-
Other Financing Sources				
Donations and forfeitures of property	$ 1.5	$ -	$ 0.4	$ -
Transfers in(out) without reimbursement	(14.3)	-	(2,848.6)	-
Imputed financing from costs absorbed by others	4,465.3	-	4,092.5	-
Other	(2,168.5)	-	0.6	-
Total Financing Sources	$ 498,749.0	$ 27,679.7	$ 496,422.8	$ 24,944.4
Net Cost of Operations	$ 634,879.5	$ -	$ 605,364.9	$ -
Net Change	$ (136,130.5)	$ 27,679.7	$ (108,942.1)	$ 24,944.4
Ending Balance (Note 19)	$ (870,682.9)	$ 271,493.6	$ (738,155.1)	$ 243,813.9

COMBINED STATEMENT OF BUDGETARY RESOURCES (Note 20)
Department of Defense
As of September 30
($ in millions)

	2005		2004	
	Budgetary Financing Accounts	Non-Budgetary Financing Accounts	Budgetary Financing Accounts	Non-Budgetary Financing Accounts
BUDGETARY RESOURCES				
Budget Authority:				
Appropriations received	$ 604,969.5	$ -	$ 582,010.7	$ -
Borrowing authority	-	170.3	0.1	114.6
Contract authority	56,753.1	-	34,855.8	-
Net transfers	(220.0)	-	(519.3)	-
Other	-	-	-	-
Unobligated balance:				
Beginning of period	$ 73,282.9	$ 24.6	$ 256,659.0	$ 21.8
Net transfers, actual	484.5	-	782.0	-
Spending authority from offsetting collections:				
Earned:				
Collected	$ 158,928.0	$ 16.9	$ 146,274.3	$ 17.4
Receivable from federal sources	(18.2)	-	(79.7)	(0.6)
Change in unfilled customer orders:				
Advanced received	642.0	-	360.5	-
Without advance from federal sources	5,065.9	40.6	980.0	47.2
Subtotal	$ 164,617.7	$ 57.5	$ 147,535.1	$ 64.0
Recoveries of prior year obligations	$ 36,376.7	$ -	$ 33,681.9	$ -
Temporarily not available pursuant to Public Law	(31,875.4)	-	(10.0)	-
Permanently not available	(58,299.7)	(2.2)	(40,338.0)	20.7
Total Budgetary Resources	$ 846,089.3	$ 250.2	$ 1,014,657.2	$ 221.1
STATUS OFBUDGETARY RESOURCES				
Obligations Incurred:				
Direct	$ 601,516.8	$ 215.2	$ 568,053.7	$ 196.6
Reimbursable	175,983.1	-	152,658.9	-
Subtotal	$ 777,499.9	$ 215.2	$ 720,712.6	$ 196.6
Unobligated balance:				
Apportioned	$ 59,206.9	$ 1.5	$ 58,631.0	$ 1.4
Exempt from apportionment	725.9	-	183,488.1	-
Other available	(0.4)	-	0.3	-
Unobligated Balances Not Available	$ 8,657.0	$ 33.5	$ 51,825.3	$ 23.1
Total, Status of Budgetary Resources	$ 846,089.3	$ 250.2	$ 1,014,657.3	$ 221.1
Relationship of Obligations to Outlays:				
Obligated Balance, Net - beginning of period	$ 233,234.1	$ 155.7	$ 214,371.9	$ 29.9
Obligated Balance transferred, net	-	-	(14.1)	-
Obligated Balance, Net - end of period:				
Accounts Receivable	$ (10,118.7)	$ -	$ (10,136.8)	$ -
Unfilled customer order from federal sources	(44,468.0)	(123.7)	(39,402.0)	(83.1)
Undelivered orders	250,153.2	446.3	228,801.3	238.8
Accounts payable	50,292.3	-	53,470.6	-
Outlays:				
Disbursements	$ 723,450.6	$ 7.7	$ 667,755.1	$ 24.1
Collections	(159,570.1)	(16.9)	(146,634.7)	(17.4)
Subtotal	$ 563,880.5	$ (9.2)	$ 521,120.4	$ 6.7
Less: Offsetting receipts	(55,072.9)	-	(46,546.4)	-
Net Outlays	$ 508,807.6	$ (9.2)	$ 474,574.0	$ 6.7

CONSOLIDATED STATEMENT OF FINANCING (Note 21)
Department of Defense
As of September 30
($ in millions)

		2005		2004
Resources Used to Finance Activities				
Bugetary Resources Obligated	$	777,715.1	$	720,909.2
Obligations incurred				
Less: Spending authority from offsetting collections and recoveries		(201,052.5)		(181,281.0)
Obligations net of offsetting collections and recoveries		576,662.6		539,628.2
Less: Offsetting receipts		(55,072.9)		(46,546.4)
Net Obligations		521,589.7		493,081.8
Other Resources				
Donations and forfeitures of property	$	1.5	$	0.4
Transfers in(out) without reimbursement		(14.3)		(2,848.6)
Imputed financing from costs absorbed by others		4,465.3		4,092.5
Other		(2,168.5)		0.6
Net other resources used to finance activities		2,284.0		1,244.9
Total Resources used to finance activities	$	523,873.7	$	494,326.7
Resources Used to Finance Items not Part of the Net Cost of Operations				
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided				
Undelivered Orders	$	(42,391.5)	$	(13,925.6)
Unfilled Customer Orders		5,748.6		1,387.4
Resources that fund expenses recognized in prior periods		(2,610.0)		(2,637.4)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations		3,325.1		2,645.4
Resources that finance the acquisition of assets		(112,714.7)		(86,943.6)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations				
Less: Trust or Special Fund Receipts Related to Exchange		(10.0)		(10.0)
Other		2,176.3		2,855.5
Total resources used to finance items not part of the Net Cost of Operations	$	(146,476.2)	$	(96,628.3)
Total resources used to finance the Net Cost of Operations	$	377,397.5	$	397,698.4
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period				
Components Requiring or Generating Resources in the Future Period:				
Increase in annual leave ability	$	615.1	$	514.8
Increase in environmental and disposal liability		1,100.3		3,864.6
Upward(Downward) reestimates of credit subsidy expense		-		14.9
Increase in exchange revenue receivable from the public		40.5		(73.8)
Other		168,069.4		139,064.9
Total components of Net Cost of Operations that will require or generate resources in future periods	$	169,825.3	$	143,385.4
Components not Requiring or Generating Resources:				
Depreciation and amortization	$	48,944.0	$	42,249.2
Revaluation of assets and liabilities		1,775.1		(5,712.6)
Other				
Trust Fund Exchange Revenue		(26,007.0)		(24,285.4)
Cost of Goods Sold		46,172.4		41,421.8
Operating Materials and Supplies Used		246.8		4,655.9
Other		16,525.4		5,952.2
Total components of Net Cost of Operations that will require not require or generate resources	$	87,656.7	$	64,281.1
Total components of Net cost of Operations that will not require or generate resources in the current period	$	257,482.0	$	207,666.5
Net Cost of Operations	$	634,880	$	605,365

COMBINED STATEMENT OF CUSTODIAL ACTIVITY (Note 22)
Department of Defense
As of September 30
($ in millions)

	2005	2004
SOURCE OF COLLECTIONS		
Deposits by Foreign Governments	$ 10,693.1	$ 11,237.5
Seized Iraqi Cash	-	118.3
Total Cash Collections	10,693.1	11,355.8
Accrual Adjustments	-	0.9
Total Custodial Collections	$ 10,693.1	$ 11,356.7
DISPOSITION OF COLLECTIONS		
Disbursed on Behalf of Foreign Governments and International Organizations	$ 11,070.7	$ 9,998.8
Seized Assets Disbursed on behalf of Iraqi People	52.1	283.1
Increase (Decrease) in Amounts to be Transferred	(377.6)	1,239.5
Seized Assets Retained for Support of the Iraqi People	(52.1)	(164.7)
Total Disposition of Collections	$ 10,693.1	$ 11,356.7
NET CUSTODIAL COLLECTION ACTIVITY	$ -	$ -

Notes to the Principal Statements

Note 1 - Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the Department in accordance with the "DoD Financial Management Regulation," Office of Management and Budget Circular A-136, (Financial Management Reporting Requirements), and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the Department is responsible. Starting in FY 2005, the Department's Statements of Financing is presented as Consolidated and Consolidating in accordance with OMB Circular A-136. The methodology used to compute the line amounts has not changed from prior years. Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified.

The Department is unable to fully implement all elements of GAAP and Office of Management and Budget Circular A-136 due to limitations of its financial management processes and systems, and non-financial systems and processes that feed into the financial statements. The Department derives its reported values and information for major asset and liability categories largely from non-financial systems, such as inventory systems and logistics systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The Department continues to implement process and system improvements addressing these limitations. The Department currently has 11 auditor-identified financial statement material weaknesses: (1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Accounting Entries, (4) Fund Balance with Treasury, (5) Environmental Liabilities, (6) General Property, Plant and Equipment, (7) Government Property and Material in Possession of Contractors, (8) Inventory, (9) Operating Materials and Supplies, (10) Statement of Net Cost, and (11) Statement of Financing.

1.B. Mission of the Reporting Entity

The National Security Act of 1947 established the Department of Defense. The Department's mission is to organize, train, and equip armed forces to deter aggression and, if necessary, defeat aggressors against the United States and its allies. Fiscal year (FY) 2005 is the 10th year that the Department has prepared audited DoD Agencywide financial statements as required by the Chief Financial Officers Act and Government Management Reform Act. Auditors are required to audit the financial statements of the following stand-alone reporting entities: (1) Army General Fund, (2) Army Working Capital Fund, (3) Navy General Fund, (4) Navy Working Capital Fund, (5) Air Force General Fund, (6) Air Force Working Capital Fund, (7) Military Retirement Fund, (8) DoD Medicare-Eligible Retiree Health Care Fund, and (9) U.S. Army Corps of Engineers (Civil Works).

In addition to the nine stand-alone reporting entities, separate columns in the combining/consolidating statements are included with the financial information of the "Other Defense Organizations General Funds" and "Other Defense Organizations Working Capital Funds." The Office of the Inspector General will not issue separate audit opinions on the statements of the Other Defense Organizations; instead, the financial statements and records of those organizations are included in the audit performed to support the opinion issued on the DoD Agencywide financial statements.

The Department requires the following Defense Agencies to prepare internal stand-alone auditable financial statements: (1) Defense Logistics Agency, (2) Defense Finance and Accounting Service, (3) Defense Information Systems Agency, (4) Defense Contract Audit Agency, (5) Defense Commissary Agency, (6) Defense Security Service, (7) Defense Threat Reduction Agency, (8) Defense Advanced Research Projects Agency, (9) Chemical Biological and Defense Program, and (10) Missile Defense Agency.

1.C. Appropriations and Funds

The Department receives its appropriations and funds as general, working capital (revolving), trust, special, and deposit funds. The DoD components use these appropriations and funds to execute their missions and report on resource usage.

General funds (GF) are used for financial transactions funded by Congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and military construction accounts.

Working capital funds (WCFs) receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial startup. The WCF entities provide goods and services on a reimbursable basis. Reimbursable receipts fund ongoing operations and generally are available in their entirety for use without further Congressional action.

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

Special fund accounts are used to process government receipts earmarked for a specific purpose.

Deposit funds are used to record amounts held temporarily until ownership is determined. The Department is acting as an agent or a custodian for funds awaiting distribution, for example, payroll taxes.

1.D. Basis of Accounting

For FY 2005, the Department's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Department's financial and non-financial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the Department's legacy systems were designed to record information on a budgetary basis.

The Department has undertaken efforts to determine the actions required to bring its financial and non-financial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Standard General Ledger (USSGL). Until all of the Department's financial and non-financial feeder systems and processes are updated to collect and report financial information as required by GAAP, the DoD's financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from non-financial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, the Department identifies program costs based upon the major appropriation groups provided by the Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government and Performance and Results Act (GPRA). The Department is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by GPRA and the Statement of Federal Financial Accounting Standard (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

The Department receives Congressional appropriations as financing sources for general funds on either an annual or multi-year basis. When authorized, these appropriations are supplemented by revenues generated by sales of goods or services. The Department recognizes revenue as a result of costs incurred for goods and services provided to other federal agencies and the public. Full cost pricing is the Department's standard policy for services provided as required by OMB Circular A-25. The Department recognizes revenue when earned within the constraints of current system capabilities. In some instances, revenue is recognized when bills are issued.

The Department does not include non-monetary support provided by U.S. allies for common defense and mutual security in amounts reported in its Statements of Net Cost and Financing. The U.S. has cost-sharing agreements with other countries. 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.

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because the Department'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, environmental liabilities, and unbilled revenue. The Department's expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses.

1.G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within the Department or between two or more federal agencies. However, the Department cannot accurately identify most of its intragovernmental transactions by customer because DoD's systems do not track buyer and seller data needed to match related transactions. Seller entities within the Department provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. Intra-DoD intragovernmental balances are then eliminated. Starting in FY 2005, the Department properly eliminates the revenue resulting from intra-DoD sales of capitalized assets. The Department is developing 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 after-the-fact reconciliation cannot be accomplished effectively with the existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the Department and other federal agencies. The Treasury Financial Manual Part 2 – Chapter 4700 "Agency Reporting Requirements for the Financial Report of the United States Government," and the Treasury's "Federal Intragovernmental Transactions Accounting Policies Guide," provide guidance for reporting and reconciling intragovernmental balances. While the Department is unable to fully reconcile intragovernmental transactions with all federal partners, the Department is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DoL), and benefit program transactions with the Office of Personnel Management (OPM). The Department's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debt and its related costs to federal agencies. The DoD'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 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.

1.H. Transactions with Foreign Governments and International Organizations

Each year, the DoD components sell defense 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 Department has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Payment is required in advance.

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

The Department's monetary financial resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Services, the U.S. Army Corps of Engineers (USACE), and the Department of State's financial service centers process the majority of the Department's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on check issues, electronic fund transfers, and interagency transfers and deposits.

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account. Differences between the Department's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled.

1.J. Foreign Currency

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

The majority of cash and all foreign currency is classified as non-entity and, therefore, restricted. Amounts reported consist primarily of cash and foreign currency held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange missions. Cash seized during Operation Iraqi Freedom is restricted for use to assist the Iraqi people and support the reconstruction of Iraq.

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

1.K. 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 other federal agencies. Claims against other federal agencies are to be resolved between the agencies (per the Code of Federal Regulations 4 CFR 101).

The DoD components use a variety of techniques for estimating the Allowance for Uncollectible Accounts Receivable from the public. While the exact details differ among the DoD components, estimates are usually based on either a percentage of actual prior-year write-offs or a percentage of aged accounts receivable from the public.

1.L. Loans Receivable

The Department operates a direct loan and loan guarantee program authorized by the National Defense Authorization Act for FY 1996 Public Law 104-106, Statute 186, Section 2801. The Act includes a series of authorities that allow the Department to work with the private sector to renovate military housing. The Department's goals are to obtain private capital to leverage government dollars, make efficient use of limited resources, and use a variety of private sector approaches to build and renovate military housing faster and at a lower cost to American taxpayers.

The Act also provides the Department with a variety of authorities to obtain private sector financing and expertise to improve military housing. The Department uses these authorities individually or in combination. They include guarantees (both loan and rental); conveyance/leasing of existing property and facilities; differential lease payments; investments (both limited partnerships and stock/bond ownership); and direct loans. In addition, the Federal Credit Reform Act of 1990 governs all amended direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees.

The Department also operates a loan guarantee program designed to encourage commercial use of inactive government facilities. The revenue generated from property rental offsets the cost of maintaining these facilities.

1.M. Inventories and Related Property

Most of the Department's inventories are currently reported at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, the DoD components have transitioned, and are continuing to transition, their inventory to the moving average cost method. Upon full implementation, the Department will be compliant with SFFAS No. 3. Approximately 35 percent of the Department's inventory value is now being reported from systems that have transitioned to moving average cost functionality. However, since the on-hand balances which transitioned were not, for the most part, baselined to auditable historical cost, the reported values remain noncompliant with SFFAS No. 3 and GAAP.

The Department manages only military or government-specific materiel under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DoD materiel management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The Department holds materiel based on military need and support for contingencies. Therefore, the Department does not attempt to account separately for "inventory held for sale" and "inventory held in reserve for future sale" based on SFFAS No. 3 definitions.

Related property includes operating materials and supplies (OM&S) and stockpile materials. OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored such as ammunition and engines, are generally recorded using the consumption method and reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the Department uses the purchase method - that is, materials and supplies are expensed when purchased. For FY 2005, the Department expensed significant amounts using the purchase method either because the systems could not support the consumption method or because management deemed that the item was in the hands of the end user.

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

The Department recognizes condemned materiel as "Excess, Obsolete, and Unserviceable." The net value of condemned materiel is zero, because the costs of disposal are greater than the potential scrap value. Potentially redistributable materiel, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in "Held for Use" or "Held for Repair" categories according to its condition.

Past audits identified uncertainties about the completeness and existence of the reported values of inventory. Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the Department. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. It is more economical to repair than to procure these inventory items. Because the Department often relies on weapon systems and machinery no longer in production, the Department supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Finally, work in process balances include costs related to the production or servicing of items, including direct materiel, direct labor, applied overhead, and other direct costs. Work in process also includes the value of finished products or completed services pending the submission of bills to the customer. The work in process designation may also be used to accumulate amounts paid to contractors under cost reimbursable contracts, including amounts withheld from payment to ensure performance, and amounts paid to other government plants for accrued costs of end items of materiel ordered but not delivered. Work in process includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services.

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

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

The Department invests in both marketable and non-marketable securities. Marketable securities are investments trading on a public market. The two types of non-marketable securities are par value and market-based intragovernmental securities. The Bureau of Public Debt issues non-marketable par value intragovernmental securities. Non-marketable, market-based intragovernmental securities mimic marketable securities, but are not traded publicly.

The Department's Net Investments are supported by various Trust Funds in each of the reporting entities. These Trust Funds are comprised of the Military Retirement Trust Fund (MRF); Medicare-Eligible Retiree Health Care Fund (MERHCF); Other Defense Organizations General Fund (ODO GF) trust funds; donations (Gift Funds); and the USACE South Dakota Terrestrial Habitat Restoration, Inland Waterways, and Harbor Maintenance Trust Fund accounts

1.O. General Property, Plant and Equipment

The SFFAS No. 23 establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, and weapons) in federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades for accounting periods beginning after September 30, 2002. The Department uses data from the Bureau of Economic Analysis to calculate a value for military equipment.

General Plant, Property, 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, except for the USACE and WCF as discussed below. Also, the DoD requires capitalization of improvement costs over the DoD capitalization threshold of $100,000 to General PP&E. The Department depreciates all General PP&E, other than land, on a straight-line basis.

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for FYs 1993, 1994, and 1995, respectively, and an estimated useful life of 2 or more years. General PP&E previously capitalized at amounts below $100,000 were written off General Fund financial statements in FY 1998. No adjustment was made for WCF assets. These assets remain capitalized and reported on WCF financial statements.

The USACE Civil Works General 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 exceeds $25,000. One exception is all buildings and structures related to hydropower projects are capitalized regardless of cost. During 2003, the Corps increased its buildings and structures threshold from $0 to $25,000 for all Civil Works appropriations with the exception of Revolving Fund and Power Marketing Agency assets. All Civil Works buildings and structures currently capitalized under $25,000 (excluding Revolving Fund and Power Marketing Agency) were expensed in FY 2003 and removed from the Corps of Engineers Financial Management System. Beginning in FY 2004, all Civil Works Buildings and Structures under $25,000 are expensed except for Power Marketing Agency assets.

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

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 Department reports only the government property in the possession of contractors that is maintained in the DoD's property systems.

To bring the DoD 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 their 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.

1.P. Advances and Prepayments

The Department records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. In addition, when the Department receives the related goods and services, it recognizes advances and prepayments as expenses.

1.Q. Leases

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

Office space and leases entered into by the Department in support of contingency operations are the largest components of operating leases. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Inter-service Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. Equipment leases have a variety of lease terms, which are not expected to be renewed upon expiration. Other operating leases are generally 1-year leases. The Department expects to continue to reduce the level of owned assets while increasing the number of leased assets. The Department will strive to displace commercial leases with more economical GSA leases.

1.R. Other Assets

The Department conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the Department provides financing payments. One type of financing payment that the Department makes for real property is based upon a percentage of completion. In accordance with SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported in General PP&E on the Balance Sheet and in General PP&E, Net.

The Federal Acquisition Regulation allows the Department to make financing payments, under fixed price contracts. The Department reports these financing payments as "Other Assets" because the Department becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the Department is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the Department for the full amount of the advance.

1.S. Contingencies and Other Liabilities

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

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

Other liabilities arise as a result of anticipated disposal costs for the Department's assets. This type of liability has two components: non-environmental and environmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Non-environmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon the Department's policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of the Federal Government." The Department recognizes non-environmental disposal liabilities for National Defense PP&E nuclear-powered assets when placed into service. Such amounts are developed in conjunction with, and not easily separately identifiable from, environmental disposal costs.

1.T. Accrued Leave

The Department reports as liabilities civilian annual leave and military leave that has been accrued and not used as of the Balance Sheet date. The liability reported at the end of the accounting period reflects the current pay rates.

1.U. Net Position

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

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

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

1.V. Treaties for Use of Foreign Bases

The DoD components have the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The Department purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the DoD components continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any non-retrievable capital assets. This takes place after negotiations between the U.S. and the host country have determined the amount to be paid to the U.S. for such capital investments.

1.W. Comparative Data

Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet or 10 percent from the previous period presented are generally explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

The Department obligates funds to provide goods and services for outstanding orders not yet delivered. The financial statements do not reflect this liability for payment for goods and services not yet delivered.

1.Y. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the Departmental accounting reports. In-transit payments are those payments that have been made to other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities' outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

The Department of Defense policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. The majority of the DoD components reported following this allocation procedure. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities.

Note 2 - Nonentity Assets

As of September 30	2005	2004
	(Amounts in millions)	
Intragovernmental Assets		
Fund Balance with Treasury	$1,653.5	$1,913.5
Accounts Receivable	0.3	8.2
Total Intragovernmental Assets	1,653.8	1,921.7
Nonfederal Assets		
Cash and Other Monetary Assets	1,959.4	2,079.6
Accounts Receivable	4,469.6	5,107.7
Other Assets	156.9	0.6
Total Nonfederal Assets	6,585.9	7,187.9
Total Nonentity Assets	8,239.7	9,109.6
Total Entity Assets	1,265,934.2	1,206,662.9
Total Assets	$1,274,173.9	$1,215,772.5

Nonentity assets are assets for which the Department maintains stewardship accountability and responsibility to report, but are not available for the Department's operation.

Fluctuations

Nonentity Fund Balance with Treasury decreased a net of $260 million (14 percent). The decrease is primarily due to the reclassification of Budget Clearing Accounts from Nonentity to Entity assets, $143.3 million in

FY 2005. The Department also misclassified $61.6 million of Deposit Funds as Entity versus Nonentity funds in FY 2005. The Department also disbursed $52.1 million of Iraqi seized funds for support of the Iraqi people in FY 2005.

Nonfederal Accounts Receivable decreased $638.2 million (12 percent). This decrease represents receivables on appropriations that closed. The decrease is due to management initiatives and emphasis in identifying valid accounts receivable and taking the appropriate corrective action to collect these receivables.

Nonfederal Other Assets increased $156.3 million (261 percent). The increase is attributed to the reclassification of advances to contractors to Other Assets.

Other Disclosures

Intragovernmental Assets

Nonentity Fund Balance With Treasury is comprised of four elements: Iraqi Custodial Fund, Development Fund for Iraq, Foreign Military Sales (FMS) Trust Fund, and deposit and specific suspense accounts. The Iraqi Custodial Fund represents Iraqi cash seized by coalition forces during Operation Iraqi Freedom. The Development Fund for Iraq contains funds transferred from the Interim Iraqi Government to the Multi-National Force-Iraq. These funds are used to support the Iraqi people. Under authority of the Arms Export and Control Act, the FMS Trust Fund receives collections from foreign governments that are dedicated specifically to FMS purchases. The deposit and suspense accounts primarily represent various deposits and Thrift Savings Plan balances.

The Nonentity accounts receivable are primarily from cancelled year appropriations. These receivables will be returned to the Treasury as miscellaneous receipts once collected.

Non-Federal Assets

Nonentity Cash and Other Monetary Assets consist of cash held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange missions. Foreign currency is valued using the Department of Treasury Prevailing Rate of Exchange.

Nonentity Accounts Receivable are primarily related to accrued interest on advance payments made to contractors which remain in litigation; long-term receivables due from state and local municipalities for water storage contracts, hydraulic mining, and the leasing of land for flood control purposes; and accrued interest, penalties, fines and administrative fees receivable.

Nonentity Other assets primarily represent advances to contractors as part of an advance-payment pool agreement with Massachusetts Institute of Technology and other nonprofit institutions. Advance-payment pool agreements are used for the financing of cost-type contracts with nonprofit educational or research institutions for experimental or research and development work when several contracts or a series of contracts require financing by advance payments.

Note 3 - Fund Balance with Treasury

As of September 30	2005	2004
	(Amounts in millions)	
Fund Balances		
Appropriated Funds	$278,565.8	$267,067.5
Revolving Funds	8,249.0	9,036.3
Trust Funds	406.2	1,955.5
Special Funds	344.3	0.0
Other Fund Types	3,091.8	11,539.6
Total Fund Balances	290,657.1	289,598.9
Fund Balances Per Treasury Versus Agency		
Fund Balance per Treasury	294,103.0	293,082.2
Fund Balance per	290,657.1	289,598.9
Reconciling Amount	$3,445.9	$3,483.3

	2005			2004
Reporting Entity	Fund Balance with Treasury	Fund Balance per Entity Books	Reconciling Amount	Reconciling Amount
	(Amounts in millions)			
Navy GF	$86,922.1	$86,079.2	$842.9	$986.4
Air Force GF	63,268.8	62,350.2	918.6	896.8
Army GF	87,795.0	87,093.3	701.7	
ODO GF	48,732.8	47,784.2	948.6	1,055.7
Corps of Engineers	3,180.2	3,146.1	34.1	520.3
MERHCF	5.0	5.0		
MRF	22.9	22.9		
Air Force WCF	1,038.6	1,164.2	(125.6)	652.8
Army WCF	623.3	623.3		
ODO WCF	1,536.4	1,410.8	125.6	(628.7)
Navy WCF	977.9	977.9		
Total	$294,103.0	$290,657.1	$3,445.9	$3,483.3

Analysis of Reconciling Amounts

The Department of Defense (DoD) shows a reconciling net difference of $3.4 billion with the Department of the Treasury, which is comprised of:

- $842.9 million, for the Navy General Fund (GF), that is primarily from $792.3 million in canceling appropriated authority withdrawn by the Department of the Treasury at the end of the fiscal year and $50.6 million in receipt account transactions unavailable to the Navy.

- $918.6 million, for the Air Force GF, that is primarily from $783.3 million in canceling appropriated authority withdrawn by the Department of the Treasury at the end of the fiscal year and $123.8 million in preclosed receipt account balances.

- $701.7 million, for the Army GF, primarily from a combination of $555.1 million in canceling appropriated authority withdrawn by the Department of the Treasury at the end of the fiscal year and $166.8 million in receipt account transactions unavailable to the Army, reduced by $52.3 million in parent transfers reported in the fund balance for Army but not in the fund balance per Treasury for Army.

- $948.6 million, for the Other Defense Organizations (ODO) GF, that primarily consists of the net of the positive reconciling difference for the DoD component level accounts offset by the aggregated negative reconciling difference of approximately 50 defense agencies and organizations.

- $34.1 million, for the US Army Corps of Engineers, consisting of approximately $83.8 million in parent account allocations for the reporting of trust funds (Inland Waterways and Harbor Maintenance) for the Bureau of Public Debt offset by $117.9 million in preclosed receipt account balances.

- ($125.6) million, for the Air Force Working Capital Fund (WCF) and an offsetting $125.6 million for the ODO Working Capital Fund. These reconciling differences represent the Fund Balance with Treasury for the United States Transportation Command, which is reported to the Treasury as part of the Air Force Working Capital Fund. The accounting for these funds is actually performed within the entity Financial Statements of ODO Working Capital Fund. For financial reporting, the Fund Balance with Treasury for the ODO Working Capital Fund is adjusted downward to reconcile with the Air Force Working Capital Fund.

Other Information Related to Fund Balance with Treasury

The Army General Fund includes approximately $34.7 million in Vested Iraqi Cash. This cash represents frozen Iraqi deposits in the United States and is vested in accordance with the International Emergency Economic Powers Act, Section 1701, and is used in support of the Iraqi people. The Army has collected $1.7 billion in Vested Iraqi Cash and has disbursed $1.7 billion benefiting the Iraqi people as follows:

	Disbursed *($ in millions)*
Iraqi Salaries	$1,184.8
Repair/Reconstruction/Humanitarian Assistance	147.8
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	356.8
Total Disbursed	**$1,689.4**

Special Funds increased to approximately $341.3 million from zero. Special Funds is a new category for FY 2005. These funds are receipt and expenditure accounts used to obligate and expend for special programs in accordance with specific provisions of law. Amounts reported in FY 2004 for these funds were reported in one of the other four categories.

The Other Fund Types decreased approximately $8.4 billion (73 percent) primarily as a result of reclassifying the Iraqi Relief and Reconstruction Fund from Other Fund Types to Appropriated Funds. The Iraqi Relief and Reconstruction Fund reported a balance of $9.4 billion in FY 2004.

Status of Fund Balance with Treasury		
As of September 30	2005	2004
	(Amounts in millions)	
Unobligated Balance		
Available	$59,934.1	$248,483.7
Unavailable	8,690.4	45,485.4
Obligated Balance not yet Disbursed	556,162.3	284,832.8
Non-Budgetary FBWT	8,783.4	1,913.5
Non-FBWT Budgetary Accounts	(342,387.7)	(302,305.5)
Total	$291,182.5	$278,409.9

The Status of Fund Balance with Treasury consists of unobligated and obligated balances. These balances reflect the budgetary authority remaining for disbursements against current or future obligations. In addition, the Status includes various accounts that affect either budgetary reporting or Fund Balance with Treasury, but not both.

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

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received or services that have not been performed.

Non-Budgetary Fund Balance with Treasury (FBWT) includes entity and nonentity FBWT accounts which do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

Non-FBWT Budgetary Accounts include budgetary accounts that do not affect FBWT, such as contract authority, borrowing authority and investment accounts. This category reduces the Status of Fund Balance with Treasury.

Fluctuations

Many of fluctuations are due to a further breakout of this note to comply with recently published Office of Management and Budget Circular A-136, to more closely reconcile the budgetary and proprietary aspect of Fund Balance with Treasury with the President's Budget. Specifically, the last categories (Lines 3 and 4) have been added. In addition, various accounts previously reported on Lines 1 and 2 have been transferred to Lines 3 and 4 and new accounts have been added. These changes are intended to more closely reconcile the budgetary and proprietary aspects of FBWT.

Disclosures Related to Suspense/Budget Clearing Accounts				
As of September 30	2003	2004	2005	Decrease/Increase from FY 2004 - 2005
Account	(Amounts in millions)			
F3875	($628.8)	($608.5)	$263.5	$872.0
F3880	(6.0)	(1.4)	11.9	13.3
F3882	(21.6)	(59.5)	83.5	143.0
F3885	(399.5)	(118.2)	(211.6)	(93.4)
F3886	0.2	0.2	(4.9)	(5.1)
Total	($1,055.7)	($787.4)	$142.4	$929.8

A description of the suspense and budget clearing accounts and their respective balances follows:
Account F3875 reported a positive balance of approximately $263.5 million that represents the Disbursing Officer's (DO) suspense. Account F3885, which includes the Interfund/IPAC suspense transactions, reported a negative balance of approximately $211.6 million. Account F3886 has a negative balance of approximately $4.9 million represented by the (payroll) Thrift Savings Plan suspense. These three suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation.

The F3880 suspense account reported a positive balance of approximately $11.9 million. This amount represents the balance of Treasury checks that (1) have either been lost by the payee and need to be reissued, (2) have never been cashed by the payee, or (3) have been cancelled by the Treasury and need to be transferred to the original appropriation.

The F3882 suspense account reported a positive balance of approximately $83.5 million. This account was established for the Uniformed Services Thrift Savings Plan in FY 2002. The amounts in this account represent a timing difference between the posting of the Thrift Savings Plan deductions by the U.S.D.A. National Finance Center and the posting of these same amounts in the military accounting systems in the following month.

Disclosures Related to Problem Disbursements and In-Transit Disbursements				
As of September 30	2003	2004	2005	Decrease/Increase from FY 2004 - 2005
	(Amounts in millions)			
Total Problem Disbursements, Absolute Value				
Unmatched Disbursements (UMDS)	$854.3	$734.6	$2,221.9	$1,487.3
Negative Unliquidated Obligations (NULO)	124.9	94.8	95.1	0.3
Total In-transit Disbursements, Net	$4,675.5	$5,197.8	$4,557.5	($640.3)

The DoD reported $2.2 billion (absolute value) in UMDs, which is an increase of $1.5 billion. A UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

The DoD reported $95.1 million (absolute value) in NULOs, which is an increase of $0.3 million. A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The DoD reported $4.6 billion (net) for In-transits, which is a decrease of $640.3 million. The In-transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

Note 4 - Investments and Related Interest

	2005					2004
As of September 30	Par Value/ Cost	Amortization Method	Unamortized (Premium/ Discount)	Investments, Net	Market Value Disclosure	Investments, Net
	(Amounts in millions)					
Intragovernmental Securities						
Non-Marketable, Market Based	$234,915.8	Effective Interest	$24,509.0	$259,424.8	$262,243.7	$227,069.5
Accrued Interest	3,943.0			3,943.0	3,943.0	4,000.2
Total Intragovernmental Securities	238,858.8		24,509.0	263,367.8	266,186.7	231,069.7
Other Investments	605.0		0.0	605.0	N/A	406.5

The amortization method used for non-marketable, market-based securities is effective interest. Other Investments represent limited partnerships, entered into on behalf of the U.S. Government by the Army and Navy in support of the Military Housing Privatization Initiative authorized by Public Law 104-106, Stat. 186, on February 11, 1996. These investments do not require market value disclosure.

Intragovernmental Securities

Net Investments increased $32.3 billion (14 percent) in non-marketable, market-based securities. This increase is primarily due to positive cash flows of $22.1 billion for the Medicare-Eligible Retiree Health Care Fund, $9.8 billion for the Military Retirement Fund, and $0.4 billion for the Inland Waterways, Harbor Maintenance, and South Dakota Terrestrial Wildlife Habitat Restoration Trust Funds.

Other Investments

Other Investments increased $198.5 million (49 percent) from new investments in limited partnerships by the Army ($163.9 million) and Navy ($34.6 million) in support of military housing. A summary of the Department's total investments in these limited partnerships follows:

Installation	Q4 FY 2004 Balance	Month Invested	New Investments	Month Invested	Q4 FY 2005 Total
Beaufort/Paris ISL/Quantico	97.1	Oct-03			$ 7.1
Ft. Campbell, Kentucky *	52.2	Jan-04	$7.9	Mar-05	60.1
Ft. Hood, Texas	52.0	Nov-01			52.0
Ft. Bragg, North Carolina	49.4	Dec-03			49.4
Ft. Stewart, Georgia	37.4	Feb-04			37.4
South Texas, Texas	29.4	Feb-02			29.4
New Orleans Naval Complex, Louisiana	23.1	Oct-01			23.1
San Diego, California	20.9	Jun-03			20.9
Everett NAS, Washington	12.2	Dec-00			12.2
Kingsville NAS, Texas	4.3	Dec-00			4.3
Ft. Hamilton, New York	2.2	May-04			2.2
Ft. Detrick, Maryland	1.3	Sep-04			1.3
Ft. Polk, Louisiana*			53.6	Feb-05	53.6
Oahu, Hawaii	25.0	May-04			25.0
Yuma Naval Air Station **			18.7	Dec-04	18.7
Pacific Northwest **			15.9	Mar-05	15.9
Ft. Sam Houston, Texas*			6.6	Jun-05	6.6
Ft. Eustis, Virginia*			14.8	Apr-05	14.8
Ft. Drum, New York*			52.0	Jun-05	52.0
Ft. Leonard Wood, Missouri*			29.0	Sep-05	29.0
TOTALS	$406.5		$198.5		$605.0

**Army investments in FY 2005*
***Navy investments in FY 2005*

Note 5 - Accounts Receivable

As of September 30	2005			2004
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
	(Amounts in millions)			
Intragovernmental Receivables	$1,291.3	N/A	$1,291.3	$1,118.3
Nonfederal Receivables (From the Public)	7,990.7	(375.2)	7,615.5	7,427.8
Total Accounts Receivable	$9,282.0	($375.2)	$8,906.8	$8,546.1

Fluctuations

Intragovernmental receivables increased $173.0 million (16 percent). This was primarily due to increased receivables for support provided to the Federal Emergency Management Agency (FEMA) for hurricane relief efforts in the Gulf Coast. The support provided was in a broad range of areas, including helicopter search and rescue operations, medical assistance, contract medical support, and the provision of food, water, and other supplies.

Note 6 - Other Assets

As of September 30	2005	2004
	(Amounts in millions)	
Intragovernmental Other Assets		
Advances and Prepayments	$1,394.2	$1,011.9
Total Intragovernmental Other Assets	1,394.2	1,011.9
Nonfederal Other Assets		
Outstanding Contract Financing Payments	21,776.1	18,451.6
Other Assets (With the Public)	2,046.0	3,034.7
Total Nonfederal Other Assets	23,822.1	21,486.3
Total Other Assets	$25,216.3	$22,498.2

Fluctuations

Intragovernmental Other Assets

Advances and Prepayments increased $382.3 million (38 percent). This increase is primarily attributed to the improved visibility in identifying and recording government advances to the Departments of Interior, Transportation and Homeland Security that are procuring goods and services for the Department of Defense.

Nonfederal Other Assets

Outstanding Contract Financing Payments increased $3.3 billion (18 percent). The increase is attributable to the acquisition of the V-22 Osprey and F/A-18 Hornet aircraft and the replenishment of weapons, ammunition, missiles, and combat vehicles.

Other Assets (With the Public) decreased $988.7 million (33 percent). This is primarily due to increased collection efforts of outstanding travel advances, a decrease in the amount of returns to vendors pending credit, and the reclassification from Other Assets (With the Public) for Foreign Military Sales to Nonfederal Accounts Receivable and progress payments to Outstanding Contract Financing Payments.

Note 7 - Cash and Other Monetary Assets

As of September 30	2005	2004
	(Amounts in millions)	
Cash	$1,494.0	$1,811.1
Foreign Currency (non-purchased)	578.7	367.0
Total Cash, Foreign Currency, and Other Monetary Assets	$2,072.7	$2,178.1

Other Information

The majority of cash and all foreign currency are classified as nonentity and their use is, therefore, restricted. Approximately $1.38 billion in cash and $578.7 million in foreign currency are restricted.

Note 8 - Direct Loan and/or Loan Guarantee Programs

As of September 30

The Department operates the following direct loan and/or Loan guarantee program(s)
- Military Housing Privatization Initiative
- Armament Retooling & Manufacturing Support Initiative

The Federal Credit Reform Act of 1990 governs all amended direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees.
Direct loans are reported at the net present value of the following projected cash flows:

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

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

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

Military Housing Privatization Initiative

The Military Housing Privatization Initiative (MHPI) includes both Direct Loan and Loan Guarantee Programs. The Department obtains private sector capital to leverage government dollars. The Department provides protection against specific risks, such as base closure or member deployment, for the private sector partner. The Loan Guarantee Program is authorized by the National Defense Authorization Act for FY 1996, Public Law (P.L.) 104-106 Statute 186, Section 2801.

Armament Retooling and Manufacturing Support Initiative

The Armament Retooling and Manufacturing Support Initiative (ARMS), Title 10 USC 4551-4555, is a Loan Guarantee Program designed to encourage commercial use of the Army's Inactive Ammunition Plants through many incentives for businesses willing to locate to a government ammunition production facility. The production capacity of these facilities is greater than current military requirements; however, this capacity may be needed by the military in the future. The revenues from the property rental are used to pay for the operation, maintenance and environmental cleanup at the facilities. The resulting savings in overhead costs lower the production cost of the goods manufactured and fund environmental cleanup at no cost to the government.

Direct Loans Obligated After FY 1991		
As of September 30	2005	2004
Loan Programs	*(Amounts in millions)*	
Military Housing Privatization Initiative		
Loans Receivable Gross	$141.5	$141.5
Interest Receivable	0.0	0.0
Foreclosed Property	0.0	0.0
Allowance for Subsidy Cost (Present Value)	(65.9)	(70.8)
Value of Assets Related to Direct Loans	75.6	70.7
Total Loans Receivable	$75.6	$70.7

Subsidy costs are recognized when direct loans are disbursed to borrowers and are re-estimated each year as of the date of the financial statements. The allowance for subsidy cost is the difference between the outstanding principal of the loans and the present value of their net cash flows. The decrease in the allowance for subsidy is the result of FY 2005 subsidy re-estimates and subsidy amortization. Interest subsidy amortization is the net of interest revenue and interest expense. The subsidy amortization represents the difference between net borrowing from Treasury and gross loans receivable. For additional information, see the Schedule for Reconciling Subsidy Cost Allowance Balances for Post-1991 Direct Loans.

Gross direct loans for the MHPI program from inception consists of the following:

	(in Millions)
Dyess Air Force Base, Texas	$28.9
Elmendorf Air Force Base, Alaska	48.0
Lackland Air Force Base, Texas	10.4
Robins Air Force Base, Georgia	22.3
Camp Pendleton Marine Corps Base, California	29.4
Kingsville Air Force Base, Texas	2.5
Total Loans Receivable Gross	**$141.5**

Total Amount of Direct Loans Disbursed		
As of September 30	2005	2004
Direct Loan Programs	*(Amounts in millions)*	
Military Housing Privatization Initiative	0.0	12.4
Total	0.0	12.4

The Department disbursed no new direct loans in the current fiscal year. The demand for direct loans by private developers varies from year to year depending upon the progression of planned construction and renovation, and upon economic factors unrelated to the operations of the Department of Defense.

Subsidy Expense for Post-1991 Direct Loans					
As of September 30 *(Amounts in millions)*					
2004	Interest Differential	Defaults	Fees	Other	Total
1. New Direct Loans Disbursed:					
Military Housing Privatization Initiative	7.7	0.5	0.0	0.0	8.2
2005	Modifications	Interest Rates	Technical Reestimates	Total Reestimates	Total
2. Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	(0.3)	(0.9)	(3.6)	(4.5)	(4.8)
2004					
3. Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	(0.7)	(2.0)	0.1	(1.9)	(2.6)

	2005	2004
4. Total Direct Loan Subsidy Expense:		
Military Housing Privatization Initiative	(4.8)	5.6

The total subsidy expense for direct loans decreased by $10.5 million (187 percent) due to no new direct loans disbursed in FY 2005 and an increase in the downward re-estimate. The total direct loan subsidy expense includes interest differential, defaults, modification and re-estimates.

Subsidy Rate for Direct Loans					
As of September 30	Interest Differential	Defaults	Fees	Other	Total
Military Housing Privatization Initiative	24.17%	9.78%	0.00%	0.00%	33.95%

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

Schedule for Reconciling Subsidy Cost Allowance Balances for Post-1991 Direct Loans		
As of September 30	2005	2004
	(Amounts in millions)	
Beginning Balance of the Subsidy Cost Allowance	$70.7	$65.1
Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component		
Interest Rate Differential Costs	0.0	7.7
Default Costs (Net of Recoveries)	0.0	0.5
Total of the above Subsidy Expense Components	0.0	8.2
Adjustments		
Subsidy Allowance Amortization	(0.3)	(0.6)
Total of the above Adjustment Components	(0.3)	(0.6)
Ending Balance of the Subsidy Cost Allowance before Re-estimates	70.4	72.7
Add or Subtract Subsidy Re-estimates by Component		
Interest Rate Re-estimate	(0.9)	(2.0)
Technical/default Re-estimate	(3.6)	0.1
Total of the above Re-estimate Components	(4.5)	(1.9)
Ending Balance of the Subsidy Cost Allowance	$65.9	$70.8

Subsidy Expense

The total decrease of $8.2 million (100 percent) relates to zero direct loans issued in FY 2005 compared to one loan in FY 2004.

Adjustments

The total increase of $0.3 million (52 percent) in subsidy allowance amortization resulted from internal analysis which computed the Interest Revenue (Treasury and Borrower) less Interest Expense (Interest to Treasury on borrowed funds). This adjustment can increase or decrease subsidy costs.

Subsidy Re-estimates

The total decrease in re-estimates of $2.6 million (141 percent) is related to the analysis of cash flows for direct loans. The last re-estimate of cash flow is compared with the new analysis of cash flow and any deviation from the projections will result in a change (re-estimate).

Defaulted Guarantee Loans from Post-1991 Guarantees

As of September 30, 2005, the Department had no default guaranteed loans.

Guaranteed Loans Outstanding		
As of September 30	Outstanding Principal, Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
	(Amounts in millions)	
Military Housing Privatization Initiative	$551.8	$551.8
Armament Retooling & Manufacturing Support Initiative	27.0	24.2
Total	$578.8	$576.0
2005		
New Guaranteed Loans Disbursed		
Military Housing Privatization Initiative	165.0	165.0
Armament Retooling & Manufacturing Support Initiative	0.7	0.6
Total	$165.7	$165.6
2004		
Military Housing Privatization Initiative	0.0	0.0
Armament Retooling & Manufacturing Support Initiative	0.0	0.0
Total	$0.0	$0.0

The Guaranteed Loans Outstanding for the MHPI program as of the 4th Quarter, FY 2005 consists of the following:

	(in Millions)
Robins Air Force Base, Georgia	$25.6
Fort Carson, Colorado	144.9
Kirtland Air Force Base, New Mexico	74.0
Wright Patterson Air Force Base, Ohio	65.0
Elmendorf Air Force Base, Alaska	48.0
Lackland Air Force Base, Texas	29.3
Fort Polk, Louisiana (New for FY 2005)	165.0
Total Guaranteed Loans Outstanding	**$551.8**

Liability for Post-1991 Loan Guarantees, Present Value		
As of September 30	2005	2004
	(Amounts in millions)	
Loan Guarantee Program		
Military Housing Privatization Initiative	$28.7	$22.1
Armament Retooling & Manufacturing Support Initiative	12.4	12.3
Total	$41.1	$34.4

The liability for loan guarantees increased by $6.7 million (20 percent) due to one loan guarantee disbursed in FY 2005 for Fort Polk, Louisiana. For additional information, see the Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees.

Subsidy Expense for Post-1991 Loan Guarantees					
As of September 30 *(Amounts in millions)*					
2005	Interest Differential	Defaults	Fees	Other	Total
1. New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	0.0	10.3	0.0	0.0	10.3
Total	$0.0	$10.3	$0.0	$0.0	$10.3
2004					
2. New Loan Guarantees Disbursed:					
Armament Retooling & Manufacturing Support Initiative	0.0	0.2	(0.1)	0.0	0.1
Total	$0.0	$0.2	($0.1)	$0.0	$0.1

2005	Modifications	Interest Rates	Technical Reestimates	Total Reestimates	Total
3. Modifications and Reestimates:					
Military Housing Privatization Initiative	1.1	(1.5)	(3.4)	(4.9)	(3.8)
Total	$1.1	($1.5)	($3.4)	($4.9)	($3.8)
2004					
4. Modifications and Reestimates:					
Military Housing Privatization Initiative	1.9	0.0	(4.4)	(4.4)	(2.5)
Armament Retooling & Manufacturing Support Initiative	0.0	0.0	7.5	7.5	7.5
Total	$1.9	$0.0	$3.1	$3.1	$5.0

	2005	2004
5. Total Loan Guarantee:		
Military Housing Privatization Initiative	6.5	(2.5)
Armament Retooling & Manufacturing Support Initiative	0.0	7.6
Total	$6.5	$5.1

The total subsidy expense for loan guarantees increased by $1.4 million (30 percent) due to a new loan guarantee disbursed in FY 2005 for Fort Polk, Louisiana. Expense activity occurs at the point when a new loan guarantee is disbursed. There was also a modification and re-estimate of loan guarantee activity in FY 2005 due to an internal analysis performed at the end of the fiscal year.

Subsidy Rate for Loan Guarantees					
	Interest Supplements	Defaults	Fees and other Collections	Other	Total
Loan Guarantees:					
Military Housing Privatization Initiative	0.00%	9.65%	0.00%	0.00%	9.65%
Armament Retooling & Manufacturing Support Initiative	0.00%	3.75%	-1.79%	0.00%	1.96%

The subsidy rates disclosed pertain only to loan agreements made during the current fiscal year. These rates cannot be applied to the guarantees of loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year result from disbursements of loans from both current year loan agreements and prior year(s) loan agreements. The subsidy expense reported in the current year also includes modifications and re-estimates.

Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees		
As of September 30	2005	2004
	(Amounts in millions)	
Beginning Balance of the Loan Guarentee Liability	$34.4	$25.9
Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component		
Default Costs (Net of Recoveries)	10.3	0.2
Fees and Other Collections	0.0	(0.1)
Total of the above Subsidy Expense Components	10.3	0.1
Adjustments		
Fees Received	0.1	0.0
Interest Accumulation on the Liability Balance	1.1	5.3
Total of the above Adjustments	1.2	5.3
Ending Balance of the Loan Guarantee Liability before Re-estimates	45.9	31.3

Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees		
As of September 30	2005	2004
Add or Subtract Subsidy Re-estimates by Component		
Interest Rate Re-estimate	(1.5)	0.0
Technical/default Re-estimate	(3.3)	3.1
Total of the above Re-estimate Components	(4.8)	3.1
Ending Balance of the Loan Guarantee Liability	$41.1	$34.4

Subsidy Expense
The subsidy expense components increased by $10.2 million due to one loan guarantee disbursed in FY 2005 for Fort Polk, Louisiana. This disbursement caused an increase in subsidy default costs. This disbursement was issued in the 1st Quarter, FY 2005.

Adjustments
The $4.1 million decrease in total adjustments is primarily due to the re-estimated loan amortization amount from the Treasury. The accumulation is interest revenue from the Treasury.

Subsidy Re-estimates
The subsidy re-estimates decreased by $8.0 million primarily due to the downward re-estimate of subsidy.

Administrative Expenses

Administrative Expense is limited to separately identified expenses administered to direct and guaranteed loans. DoD does not maintain a separate program to capture the expenses related to direct and guaranteed loans for the MHPI. Administrative Expense for the ARMS is a fee paid to the US Department of Agriculture Rural Business-Cooperative Service (RBS) for administering the loan guarantees under the ARMS, which is a joint program. There were no administrative expenses in FY 2005.

Note 9 - Inventory and Related Property

As of September 30	2005	2004
	(Amounts in millions)	
Inventory, Net	$79,699.1	$75,494.2
Operating Materials & Supplies, Net	141,533.6	143,489.7
Stockpile Materials, Net	1,340.6	1,521.8
Total	$222,573.3	$220,505.7

Inventory, Net					
As of September 30	2005			2004	
	(Amounts in millions)				Valuation Method
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	
Inventory Categories					
Available and Purchased for Resale	$80,033.8	($25,582.2)	$54,451.6	$49,660.8	LAC,MAC
Held for Repair	27,961.0	(3,507.0)	24,454.0	24,657.9	LAC,MAC
Excess, Obsolete, and Unserviceable	6,835.6	(6,835.6)	0.0	0.0	NRV
Raw Materials	25.8	0.0	25.8	21.3	MAC,SP,LAC
Work in Process	767.7	0.0	767.7	1,154.2	AC
Total	$115,623.9	($35,924.8)	$79,699.1	$75,494.2	
Legend for Valuation Methods:					
Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses NRV = Net Realizable Value SP = Standard Price O = Other AC = Actual Cost MAC = Moving Average Cost					

Generally, there are no restrictions on the use, sale, or disposition of inventory except in the following situations:

- Distributions without reimbursement are made when authorized by Department of Defense directives.
- War reserve materiel includes fuels and subsistence items that are considered restricted.
- Inventory, with the exception of safety stocks, may be sold to foreign, state and local governments, private parties, and contractors in accordance with the current policies and guidance or at the direction of the President.

General Composition of Inventory

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

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

Fluctuations

Inventory Available and Purchased for Resale increased $4.8 billion (10 percent). The primary reason for the increase was due to a revaluation of Inventory and prior-period adjustments by the Air Force of $11.3 billion. Air Force FY 2004 Inventory was restated (increased) by $7.3 billion for accounting errors; the remaining

$4.0 billion was recorded as an adjustment and an increase to FY 2005 Inventory. Further information on this prior period adjustment is in Note 19, "Statement of Changes in Net Position."

Operating Materials and Supplies, Net					
As of September 30	2005			2004	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
	(Amounts in millions)				
OM&S Categories					
Held for Use	126,300.0	0.0	126,300.0	127,765.1	SP, LAC
Held for Repair	17,341.7	(2,108.1)	15,233.6	15,724.6	SP, LAC
Excess, Obsolete, and Unserviceable	3,664.5	(3,664.5)	0.0	0.0	NRV
Total	$147,306.2	$(5,772.6)	$141,533.6	$143,489.7	
Legend for Valuation Methods:					
Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses SP = Standard Price AC = Actual Cost NRV = Net Realizable Value O = Other					

Operating Materials and Supplies (OM&S) include spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally managed aircraft engines held for consumption by General Funds. Generally, there are no restrictions on the use or disposition of operating materials and supplies.

Stockpile Materials, Net					
As of September 30	2005			2004	
	Stockpile Materials Amount	Allowance for Gains (Losses)	Stockpile Materials, Net	Stockpile Materials, Net	Valuation Method
	(Amounts in millions)				
Stockpile Materials Categories					
Held for Sale	$1,246.5	$0.0	$1,246.5	$1,427.7	AC, LCM
Held in Reserve for Future Sale	94.1	0.0	94.1	94.1	AC, LCM
Total	$1,340.6	$0.0	$1,340.6	$1,521.8	
Legend for Valuation Methods:					
LAC = Latest Acquisition Cost NRV = Net Realizable Value SP = Standard Price			LCM = Lower of Cost or Market AC = Actual Cost O = Other		

Stockpile materials are strategic and critical materials held due to statutory requirements, for use in national defense, conservation or national emergencies. All materials held by the National Defense Stockpile are classified as Material Held in Reserve until Congressional action declares the materials are no longer required to be stockpiled, and are available for sale on the open market. When National Defense Stockpile receives authorization to offer materials for sale, National Defense Stockpile removes the materials from Material Held in Reserve and reclassifies them as Materials Held for Sale. Disposals cannot be made from the stockpile except under the following situations: (1) necessary upgrading, refining, or processing; (2) necessary rotation to prevent deterioration; (3) determination as excess with potential financial loss if retained, and (4) as authorized by law. The estimated market price of the stockpile materials held for sale is $1.6 billion.

Note 10 - General PP&E, Net

As of September 30	2005					2004
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
	(Amounts in millions)					
Major Asset Classes						
Land	N/A	N/A	$10,479.4	N/A	$10,479.4	$10,103.0
Buildings, Structures, and Facilities	S/L	20 or 40	163,929.6	(95,378.3)	68,551.3	67,983.7
Leasehold Improvements	S/L	Lease Term	308.3	(131.8)	176.5	42.8
Software	S/L	2-5 or 10	7,889.7	(4,405.4)	3,484.3	2,496.0
General Equipment	S/L	5 or 10	63,478.7	(46,896.5)	16,582.2	15,971.8
Military Equipment	S/L	Various	1,202,889.8	(862,080.0)	340,809.8	324,440.0
Assets Under Capital Lease	S/L	Lease Term	630.5	(445.5)	185.0	206.7
Construction-in-Progress	N/A	N/A	20,304.3	N/A	20,304.3	19,574.6
Other			159.3	(32.8)	126.5	80.0
Total General PP&E			$1,470,069.6	$(1,009,370.3)	$460,699.3	$440,898.6
[1] Note 15 for additional information on Capital Leases						
Legend for Valuation Methods:						
S/L = Straight Line N/A = Not Applicable						

Fluctuations

General Property, Plant and Equipment (PP&E) increased $19.8 billion (5 percent).

Assets Under Capital Lease		
As of September 30	2005	2004
	(Amounts in millions)	
Entity as Lessee, Assets Under Capital Lease		
Land and Buildings	$619.6	$574.6
Equipment	10.9	11.3
Accumulated Amortization	(445.5)	(379.2)
Total Capital Leases	$185.0	$206.7

Assets Under Capital Lease consist primarily of leases for the Section 801 Family Housing Program.

Note 11 - Liabilities Not Covered by Budgetary Resources

As of September 30	2005	2004
	(Amounts in millions)	
Intragovernmental Liabilities		
Accounts Payable	$0.0	$9.2
Debt	14.3	15.0
Other	7,619.4	5,303.1
Total Intragovernmental Liabilities	7,633.7	5,327.3
Nonfederal Liabilities		
Accounts Payable	425.4	695.8
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,483,425.0	1,348,776.0
Environmental Liabilities	62,239.1	60,979.4
Other Liabilities	14,014.3	15,158.0
Total Nonfederal Liabilities	1,560,103.8	1,425,609.2
Total Liabilities Not Covered by Budgetary Resources	1,567,737.5	1,430,936.5
Total Liabilities Covered by Budgetary Resources	305,625.7	279,177.1
Total Liabilities	$1,873,363.2	$1,710,113.6

Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered by realized budgetary resources as of the Balance Sheet date.

Fluctuations

Intragovernmental Accounts Payable

Intragovernmental Accounts Payable decreased $9.2 million to $0. In FY 2004, several activities recognized federal accounts payable from cancelled appropriations. These cancelled year accounts payable have now been resolved or settled.

Intragovernmental – Other

Intragovernmental Liabilities - Other increased $2.3 billion (44 percent) primarily due to the reclassification of $1.6 billion of Uncollected Custodial Liability from Liabilities Covered by Budgetary Resources to Liabilities Not Covered by Budgetary Resources as required by Treasury Guidance.

Nonfederal Accounts Payable

Nonfederal Accounts Payable decreased $270 million (39 percent) primarily due to a concentrated effort in FY 2005 to clean up unsupported accounts payable in cancelled appropriations.

Note 12 - Accounts Payable

As of September 30	2005			2004
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
	(Amounts in millions)			
Intragovernmental Payables	$2,058.0	N/A	$2,058.0	$1,888.4
Non-Federal Payables (to the Public)	28,573.9	1.5	28,575.4	28,309.0
Total	$30,631.9	$1.5	$30,633.4	$30,197.4

Note 13 - Debt

As of September 30	2005			2004
	Beginning Balance	Net Borrowings	Ending Balance	Ending Balance
	(Amounts in millions)			
Agency Debt				
Debt to the Treasury	$85.5	$0.1	$85.6	$85.5
Debt to the Federal Financing Bank	506.3	(124.8)	381.5	506.3
Total Debt	$591.8	($124.7)	$467.1	$591.8

Debt to the Federal Financing Bank

Debt owed to the Federal Financing Bank decreased $124.8 million (25 percent) primarily due to a semiannual payment of $112 million made in July 2005. As part of the Afloat Prepositioning Force program, the Department makes loan repayments to the Federal Financing Bank on behalf of ship owners in lieu of capital lease payments to ship owners. Payments are made twice a year, in January and July.

Note 14 - Environmental Liabilities and Disposal Liabilities

As of September 30	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
	(Amounts in millions)			
Environmental Liabilities – Non Federal				
Accrued Environmental Restoration (DERP funded) Costs:				
Active Installations--Environmental Restoration (ER)	$1,063.6	$9,060.3	$10,123.9	$10,868.2
Active Installations--ER for Closed Ranges	44.7	7,037.3	7,082.0	7,709.0
Formerly Used Defense Sites (FUDS) -- ER	110.7	4,116.8	4,227.5	4,321.3
FUDS--ER for Transferred Ranges	69.2	14,514.8	14,584.0	14,084.3
Other Accrued Environmental Costs (Non-DERP funds)				
Active Installations--Environmental Corrective Action	29.1	594.1	623.2	569.6
Active Installations--Environmental Closure Requirements	5.9	170.6	176.5	178.5
Active Installations--Environ. Response at Active Ranges	6.5	297.6	304.1	279.6
Other	1.0	560.5	561.5	9.2
Base Realignment and Closure (BRAC)				
BRAC Installations--Environmental Restoration (ER)	335.0	2,514.2	2,849.2	3,120.9
BRAC Installations--ER for Transferring Ranges	23.2	676.1	699.3	535.9
BRAC Installations--Environmental Corrective Action	13.6	192.9	206.5	167.8
Other	123.7	219.2	342.9	209.3
Environmental Disposal for Weapons Systems Programs				
Nuclear Powered Aircraft Carriers	0.0	6,426.1	6,426.1	5,693.0
Nuclear Powered Submarines	42.4	5,794.8	5,837.2	5,188.7
Other Nuclear Powered Ships	0.0	223.9	223.9	287.5
Other National Defense Weapons Systems	2.4	195.4	197.8	271.9
Chemical Weapons Disposal Program	557.9	9,892.1	10,450.0	10,769.5
Other	54.2	57.8	112.0	103.0
Total Environmental Liabilities:	$2,483.1	$62,544.5	$65,027.6	$64,367.2

Service Component – Environmental Restoration (Cleanup) Liabilities and Environmental Disposal Liabilities	Army	Navy	Air Force	ODO	Total
	(Amounts in millions)				
Environmental Liabilities-Nonfederal					
Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) funded) Costs:					
Active Installations-Environmental Restoration (ER)	$3,212.0	$2,666.5	$4,006.6	$238.8	$10,123.9
Active Installations--ER for Closed Ranges	5,182.7	554.5	1,344.8		7,082.0
Formerly Used Defense Sites (FUDS) –ER	4,227.4				4,227.4
FUDS--ER for Transferred Ranges	14,584.0				14,584.0
Other Accrued Environmental Costs (Non-DERP funds)					
Active Installations--Environmental Corrective Action	379.6		138.4	105.2	623.2
Active Installations--Environmental Closure Requirements	96.8		51.7	28.0	176.5
Active Installations--Environ. Response at Active Ranges	304.1				304.1
Other	529.6			31.9	561.5
Base Realignment and Closure (BRAC)					
BRAC Installations--Environmental Restoration (ER)	523.4	1,079.3	1,201.4	45.1	2,849.2
BRAC Installations--ER for Transferring Ranges	634.1	65.2			699.3
BRAC Installations--Environmental Corrective Action	54.1		152.4		206.5
Other	112.1		230.8		342.9
Environmental Disposal for Weapon Systems Programs					
Nuclear Powered Aircraft Carriers		6,426.1			6,426.1
Nuclear Powered Submarines		5,837.2			5,837.2
Other Nuclear Powered Ships		223.9			223.9
Other National Defense Weapon Systems		197.8			197.8
Chemical Weapons Disposal Program	10,450.0				10,450.0
Other				112.0	112.0
Total Nonfederal Environmental Liabilities:	$40,290.0	$17,050.5	$7,126.1	$561.0	$65,027.6

Others Category Disclosure Comparative Table

	September 30, 2005 *($ in Millions)*
Other Accrued Environmental Costs (Non-DERP funds) – Other	
U.S. Army Corps of Engineers Formally Utilized Sites Remedial Action Program	$529.6
Defense Commissary Agency estimate includes costs associated with asbestos and lead paint contamination.	$31.9
Total	**$561.5**
Base Realignment and Closure (BRAC) – Other	
Army's BRAC unliquidated obligations that cannot be identified to a specific program/project.	$112.1
Air Force's BRAC unliquidated obligations that cannot be identified to a specific program/project.	$230.8
Total	**$342.9**
Environmental Disposal for Weapons Systems Programs – Other	
National Defense Stockpile–Other Defense Organizations (ODO)	$54.2
ODO's Environmental Disposal unliquidated obligations that cannot be identified to a specific program/project.	$57.8
Total	**$112.0**

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

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

The DoD has clean up requirements for the Defense Environmental Restoration Program (DERP) sites at active installations, BRAC installations, Formerly Used Defense Sites (FUDS), non-DERP sites at active installations, weapon systems programs, and chemical weapons disposal programs. The DoD follows the Comprehensive Environmental Response, Compensation Liability Act (CERCLA) and the Superfund

Amendment and Reauthorization Act (SARA) to clean up DERP-eligible contamination. Non-DERP eligible contamination clean up is performed in accordance with the Resource Conservation and Recovery Act (RCRA). The CERCLA and RCRA require DoD to clean up contamination in coordination with regulatory agencies, current property owners of property damaged by the Department, and third parties that have a partial responsibility for the environmental restoration. Failure to comply with agreements and legal mandates can put DoD at risk of incurring fines and penalties.

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

The Chemical Weapons Disposal Program is based on the FY 1986 National Defense Authorization Act (PL 99-145, as amended by subsequent acts) that directed the DoD to destroy the unitary chemical stockpile by April 29, 2004. The current guidelines for destruction are based on the Chemical Weapons Convention treaty. The United States ratified the treaty in April 1997 that required the stockpile of chemical weapons to be destroyed by April 2007, according to the terms outlined. The Army, as Executive Agent within the DoD, provides policy, direction, and oversight for both the Chemical Stockpile Program and the Non-Stockpile Chemical Materiel Project. As such, the Army is responsible for the safe and economical disposal of the U.S. stockpile of lethal and incapacitating chemical warfare agents and munitions.

The estimated total clean up liability for the current operating period is assigned based on the amount of the current year appropriation and unliquidated obligations that will be disbursed within 12 months from the Balance Sheet date. The non-current clean up liability is the portion of the clean up liability that will be disbursed more than 12 months from the Balance Sheet date.

The DoD has not identified any unrecognized portion of the estimated total clean up cost associated with General PP&E. The Department requires the unrecognized clean up cost associated with General PP&E to be disclosed and is working with the Military Departments to ensure this policy is properly implemented.

The Department had changes in estimates resulting from overlooked or previously unknown contaminants, better site characterization with sampling, re-estimation based on different assumptions, and lessons-learned. Environmental liabilities can also change in the future due to changes in laws and regulation, changes in agreements with regulatory agencies, and advances in technology.

The Department is working on processes to disclose: the amount of operating and capital resources disbursed to remediate legacy waste; the unrecognized portion of the estimated costs associated with General PP&E; and changes in estimates due to laws and technology.

In addition to the liabilities reported above, the Army has a liability to take environmental restoration/ corrective action for buried chemical munitions and agents. The Army is unable to provide a reasonable estimate at this time because the extent of the buried chemical munitions and agents is not known.

Note 15 - Other Liabilities

As of September 30	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
	(Amounts in millions)			
Intragovernmental				
Advances from Others	$394.6	$0.0	$394.6	$749.6
Deposit Funds and Suspense Account Liabilities	742.1	0.0	742.1	561.6
Disbursing Officer Cash	2,092.0	0.0	2,092.0	2,071.8
Judgment Fund Liabilities	162.6	0.0	162.6	379.8
FECA Reimbursement to the Department of Labor	588.9	806.5	1,395.4	1,432.2
Other Liabilities	4,707.4	1,656.7	6,364.1	5,531.9
Total Intragovernmental Other Liabilities	8,687.6	2,463.2	11,150.8	10,726.9
Nonfederal				
Accrued Funded Payroll and Benefits	7,382.8	0.0	7,382.8	10,871.8
Advances from Others	1,697.5	0.0	1,697.5	1,741.6
Deferred Credits	11.8	0.0	11.8	4.2
Deposit Funds and Suspense Accounts	413.9	0.0	413.9	322.6
Temporary Early Retirement Authority	0.4	0.3	0.7	2.1
Nonenvironmental Disposal Liabilities				
Military Equipment (Nonnuclear)	18.5	665.0	683.5	565.8
Excess/Obsolete Structures	53.8	182.1	235.9	435.3
Conventional Munitions Disposal	0.0	1,318.4	1,318.4	1,325.9
Accrued Unfunded Annual Leave	8,566.1	0.0	8,566.1	7,991.5
Capital Lease Liability	184.6	132.6	317.2	299.9
Other Liabilities	8,526.2	831.4	9,357.6	10,930.5
Total Nonfederal Other Liabilities	26,855.6	3,129.8	29,985.4	34,491.2
Total Other Liabilities	$35,543.2	$5,593.0	$41,136.2	$45,218.1

Nonfederal Other Liabilities – Fluctuations

Nonfederal Other Liabilities decreased $4.5 billion (13%) primarily due to changes in Accrued Funded Payroll and Benefit, Other Liabilities, and Accrued Unfunded Annual Leave.

The Accrued Funded Payroll and Benefit decreased $3.5 billion primarily due to the reclassification of Incurred But Not Reported Costs to Other Accrued Liabilities and decreased accrual for military pay. In FY 2004, the liability reflected an accrual of one-half month of military payroll. Since military pay disbursements were paid on September 30, 2005, no additional accruals were necessary in FY 2005.

The Other Liabilities, comprised of Contingent Liabilities, Custodial Liabilities, Other Accrued Liabilities, and Other Liabilities, decreased $1.6 billion.

- Contingent Liabilities decreased $2.3 billion due to a change in the accounting methodology used for items held for repair (reparable carcasses) and a reclassification of chemical demilitarization contingent liabilities as Environmental Liabilities.

- Custodial liabilities decreased by $1.7 billion for foreign military sales primarily due to the transfer of Japanese funds from the Foreign Military Sales Trust Fund to the Federal Financing Bank.

- The Other Accrued Liabilities increased $2.3 billion primarily due to increased Incurred But Not Reported Costs for TRICARE Management Activity and the Medicare-Eligible Retiree Health Care Fund, and the reclassification of these costs as Other Accrued Liabilities. The increased cost is due to changes in the methodology used to estimate these costs, including the medical rate of inflation, authorized beneficiaries, and increasing numbers of retirees taking full advantage of their benefits.

The Accrued Unfunded Annual Leave increase of $574.7 million is consistent with the fluctuation reported in previous annual statements.

Intragovernmental Other Liabilities

Intragovernmental Other Liabilities are comprised primarily of custodial liabilities resulting from accounts receivable for cancelled appropriations and interest, penalties, fines, and administrative fees from the public. The amounts collected cannot be used by DoD and must be distributed to the Department of Treasury.

Nonfederal Other Liabilities

Nonfederal Other Liabilities include employer contributions and payroll taxes payable, contingent liabilities, contract holdbacks, contract incentives, and incurred but not reported costs. Incurred but not reported costs result from medical care provided at nonfederal facilities which have not yet been billed to DoD.

Capital Lease Liability				
As of September 30	2005 - Asset Category			2004
	Land and Buildings	Equipment	Total	Total
	(Amounts in millions)			
Future Payments Due				
2006	$63.8	$0.2	$64.0	$66.4
2007	57.9	1.1	59.0	66.0
2008	47.1	4.0	51.1	61.1
2009	43.9	0.1	44.0	51.0
2010	43.9	0.0	43.9	43.9
After 5 Years	137.6	0.0	137.6	129.3
Total Future Lease Payments Due	394.2	5.4	399.6	417.7
Less: Imputed Interest Executory Costs	82.0	0.4	82.4	117.8
Net Capital Lease Liability	$312.2	$5.0	317.2	299.9
Capital Lease Liabilities Covered by Budgetary Resources			74.1	219.4
Capital Lease Liabilities Not Covered by Budgetary Resources			$243.1	$80.5

For the Department of Defense, all leases prior to FY 1992 are funded on an annual basis and subject to the availability of funds. Noncurrent amounts for these leases are shown as not covered by budgetary resources.

Leases originating after FY 1992 are required to be fully funded in the year of their inception. Therefore, budgetary resources show the present value of those lease payments as covered by budgetary resources.

Note 16 - Commitments and Contingencies

Legal Contingencies

The Department is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests. The Department has accrued contingent liabilities for legal actions where the Department's Office of the General Counsel considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. The Department records Judgment Fund liabilities in Note 15, "Other Liabilities" and Note 12 "Accounts Payable." See Notes 15 and 12 for details.

The Department's General Counsel reported 42 legal actions with individual claims greater than the DoD-wide materiality threshold of $171.4 million for fiscal year 2005. The total claim amount of these 42 actions is approximately $342 billion. The Department's General Counsel identified 35 of these cases ($331 billion) as unable to determine the outcome.

Other Commitments and Contingencies

The Department also has a number of potential claims that individually do not meet the $171.4 million threshold materiality at the DoD-wide level, but do meet individual DoD Component level thresholds. These claims should be disclosed in the Component's financial statements.

Note 17 - Military Retirement Benefits and Other Employment Related Actuarial Liabilities

As of September 30	2005				2004
	Actuarial Present Value of Projected Plan Benefits	Assume Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
	(Amounts in millions)				
Pension and Health Benefits					
Military Retirement Pensions	$892,111.6	$6	($191,138.9)	$700,972.7	$653,449.0
Military Retirement Health Benefits	296,473.2	6.25	0.0	296,473.2	221,242.0
Medicare-Eligible Retiree Benefits	537,397.0	6.25	(59,816.0)	477,581.0	465,987.9
Total Pension and Health Benefits	1,725,981.8		(250,954.9)	1,475,026.9	1,340,678.9
Other					
FECA	6,918.9	5.02	0.0	6,918.9	6,958.7
Voluntary Separation Incentive Programs	1,495.7		(649.6)	846.1	892.0
DoD Education Benefits Fund	1,661.4		(1,028.4)	633.0	246.4
Total Other	10,076.0		(1,678.0)	8,398.0	8,097.1
Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$1,736,057.8		($252,632.9)	$1,483,424.9	$1,348,776.0
Actuarial Cost Method Used: Aggregate entry-age normal method Assumptions: See Below Market Value of Investments in Market-based and Marketable Securities: $262.2 billion					

Fluctuations

The unfunded liability for Military Retirement and Other Employment-Related Actuarial Liabilities increased $124.7 billion (9 percent) and is attributable to an increase of $156.4 billion (10 percent) in the actuarial liability that was partially offset by an increase of $31.7 billion in the value of assets available to pay benefits.

Military Retirement Benefits

The unfunded actuarial liability increased $47.5 billion (7 percent). This increase is attributable to an increase of $57.5 billion in the actuarial liability that is offset by an increase of $10.0 billion in the value of assets available to pay benefits. The increase in the actuarial liability is primarily the result of an amendment to the Military Retirement Fund (MRF) Plan established by the National Defense Authorization Act for FY 2005 increasing survivor benefits.

The Military Retirement System is a single-employer, defined benefit plan. Administrative costs of the Fund are not ascertainable. Projected revenues into the Fund, authorized by PL 98-94, come from three sources: interest earnings on Fund assets, monthly DoD contributions, and annual contributions from the Treasury Department. The monthly DoD contributions are determined as a percentage (approved by the DoD Retirement Board of Actuaries) of basic pay. The contribution from Treasury is paid into the Fund at the beginning of each fiscal year, and represents the amortization of the unfunded liability for service performed prior to October 1, 1984, as well as the amortization of actuarial gains and losses that have arisen since then. Effective FY 2005, Treasury began making an annual contribution to the Fund that represents the normal cost amount for the new concurrent receipt provisions of the 2004 National Defense Authorization Act. The Board determines Treasury's contribution and the Secretary of Defense directs the Secretary of Treasury to make the payment.

The long-term economic assumptions for each valuation are set by the DoD Retirement Board of Actuaries. The long-term assumptions for the FY 2004 valuation were 6.25 percent interest, 3.0 percent Consumer Price Index, and 3.75 percent salary increase. The long-term economic assumptions did not change for the FY 2005 valuation. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience. Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year valuation results as reported in the DoD Office of Actuary Valuation of the Military Retirement System. In calculating the FY 2005 roll-forward amount, the following assumptions were used:

	Inflation	Salary	Interest
Fiscal Year 2005	2.7 percent (actual)	3.5 percent (actual)	6.25 percent
Fiscal Year 2006	4.1 percent (actual)	3.1 percent (estimated)	6.25 percent
Long-Term	3.0 percent	3.75 percent	6.25 percent

For purposes of the Fund's financial reporting, this roll-forward process is applied annually.

Actuarial Cost Method Used: Aggregate entry-age normal method.
Market Value of Investments in Market-Based and Marketable Securities: $197.4 billion

	FY 2005 (Amounts in millions)
Actuarial Liability as of 9/30/04	$834,582.1
Expected Normal Cost for FY 05	14,857.2
Plan Amendment Liability	25,835.9
Assumption Change Liability	4,904.2
Expected Benefit Payments for FY 05	(38,704.4)
Interest Cost for FY 05	51,427.4
Actuarial (gains)/losses due to changes in trend assumptions	(709.9)
Actuarial Liability as of 09/30/05	$892,111.6
Change in Actuarial Liability	**$57,529.5**

Military Retirement Health Benefits (MRHB)

The unfunded actuarial liability for the Military Retirement Health Benefits increased $75.2 billion (34 percent). In FY 2005, there was a significant actuarial loss attributable to medical cost experience; this loss is included in "Actuarial (gains)/losses due to other factors" in the table above. Other (gains)/losses in this line include new population data, other actuarial experience being different from assumed and actuarial assumption changes other than the change in trend assumptions.

Change in MRHB Actuarial Liability

	(Amounts in millions)
Actuarial Liability as of 09/30/04 (DoD pre-Medicare + all Uniformed Services medicare cost-basis effect)	$221,242.0
Expected Normal Cost for FY05	7,686.0
Expected Benefit Payments for FY05	(7,718.0)
Interest Cost for FY05	13,827.0
Actuarial (gains)/losses due to other factors	20,323.0
Actuarial (gains)/losses due to changes in trend assumptions	41,113.0
Actuarial Liability as of 09/30/05 (DoD pre-Medicare + all Uniformed Services medicare cost-basis effect)	*$296,473.0
Change in Actuarial Liability	**$75,231.0**

* MRHB Actuarial Liability is comprised of the following components not previously seperately identified:

Tricare Management Activity Actuarial Liability as of 9/30/05	$155,155.0
Service Management Activity Actuarial Liability as of 9/30/05	141,318.0
Total MRHB Actuarial Liability	***$296,473.0**

Assumptions in Calculation of MRHB Liability
Interest Rate: 6.25%

Medical Trend

Medicare Inpatient:	3.2% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Outpatient:	5.6% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Prescriptions (Direct Care):	10.0% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Prescriptions (Purchased Care):	15.2% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Non-Medicare Inpatient:	6.1% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Non-Medicare Outpatient:	6.25% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Non-Medicare Prescription:	15.1% from FY04 to FY05, ultimate rate of 6.25% in 2029.

Other Information

The DHP liability includes pre-Medicare liabilities for the Department of Defense, plus a cost-basis effect related to the direct care portion of Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2005, liability was:

	(Amounts in millions)
DoD	$295,962.0
Coast Guard	453.0
Public Health Service	54.0
National Oceanic & Atmospheric Administration (NOAA)	4.0
Total	**$296,473.0**

Prior to the end of FY 2005, the "DHP" liability included pre-Medicare liabilities for the Department of Defense, plus a cost-basis effect related to the direct care portion of Medicare liabilities for all Uniformed Services. The cost-basis effect is approximately $22.3 billion as of September 30, 2005, and arises because liabilities for direct care in the total Military Retirement Health Benefits liability are valued at a higher cost basis than they are in the Medicare Eligible Retiree Health Care Fund (MERHCF) liability.

Actuarial Cost Method Used for DHP Actuarial Liability: Aggregate Entry-Age Normal

Medicare-Eligible Retiree Benefits

The MERHCF unfunded actuarial liability increased $11.6 billion (2 percent). This increase is attributable to an increase of $33.3 billion in the actuarial liability that is offset by an increase of $21.7 billion in the value of assets available to pay benefits.

Change in MERHCF Actuarial Liability

	(Amounts in millions)
Actuarial Liability as of 09/30/04 (all Uniformed Services Medicare)	$504,073.8
Expected Normal Cost for FY05	10,613.8
Expected Benefit Payments for FY05	(6,546.9)
Interest Cost for FY05	31,629.8
Actuarial (gains)/losses due to other factors	(14,902.7)
Actuarial (gains)/losses due to changes in trend assumptions	12,529.3
Actuarial Liability as of 09/30/05 (all Uniformed Services Medicare)	$537,397.2
Change in Actuarial Liability	**$33,323.3**

Assumptions in Calculation of MERHCF Liability
Interest Rate: 6.25%

Medical Trend

Medicare Inpatient:	3.2% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Outpatient:	5.6% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Prescriptions (Direct Care):	10.0% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Prescriptions (Purchased Care):	15.2% from FY04 to FY05, ultimate rate of 6.25% in 2029.

The MERHCF liability includes Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2005, liability was:

	(Amounts in millions)
DoD	$526,082.5
Coast Guard	10,176.7
Public Health Service	1,067.0
NOAA	71.0
Total	**$537,397.2**

FY 2005 Service contributions to the MERHCF were:

	(Amounts in millions)
DoD	$10,220.0
Coast Guard	236.7
Public Health Service	32.1
NOAA	1.5
Total	**$10,490.3**

Assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience. Claims cost assumptions for direct care were based on actual experience; assumptions for purchased care were developed from industry-based cost estimates adjusted to approximate the military retired population.

Projected revenues into the Medicare Eligible Retiree Health Care Fund, authorized by Chapter 56 of Title 10, United States Code, come from three sources: interest earnings on Fund assets, monthly Uniformed Services "normal cost" contributions, and annual contributions from the Treasury Department. The monthly contributions are determined as a per-capita amount (approved by the DoD Medicare Eligible Retiree Health Care Board of Actuaries) times end strength. The contribution from Treasury is paid into the Fund at the beginning of each fiscal year and represents the amortization of the unfunded liability for service performed prior to October 1, 2002, as well as the amortization of actuarial gains and losses that have arisen since then. The Board determines Treasury's contribution, and the Secretary of Defense directs the Secretary of Treasury to make the payment. Starting in FY 2006, the beginning-of-fiscal-year Treasury contribution will also include the total normal cost amount for the year, determined based on Board-approved per capita normal cost rates and expected average force strengths for the Uniformed Services. Thus, starting in FY 2006, the Services will no longer make monthly contributions into the Fund.

The actuarial liability reported above does not include $762.2 million in incurred but not reported liabilities as of September 30, 2005. These liabilities are disclosed in the Liabilities Not Covered and Covered by Budgetary Resources note, and the Other Liabilities note.

Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year's results. For purposes of the Fund's financial reporting, this process is applied annually.

Actuarial Cost Method Used for MERHCF Liability: Aggregate Entry-Age Normal
Market Value of Investments in Market-Based and Marketable Securities: $60.0 billion

Federal Employees Compensation Act (FECA)

The unfunded liability for FECA decreased 1 percent.

The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

Year 1	4.53%
Year 2	5.02%
Year 3 and thereafter	5.02%

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2005 were also used to adjust the methodology's historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections for various charge back years (CBY) were as follows:

CBY	COLA	CPIM
2005	2.20%	4.33%
2006	3.33%	4.09%
2007	2.93%	4.01%
2008	2.40%	4.01%
2009+	2.40%	4.01%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on three tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments; (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year calculated for the current projection to the liability-payment ratio calculated for the prior projection; and (3) a comparison of the incremental paid losses (the medical component in particular) in CBY 2005 (by injury cohort) to the average pattern observed during the prior three charge back years.

Voluntary Separation Incentive Programs (VSI)

The unfunded actuarial liability decreased $45.9 million (5 percent) as a result of a decrease of $97.8 million in the actuarial liability and a decrease of $51.9 million in the value of assets available to pay benefits.

The VSI program was established by Public Law 102-190. The intent of this program is to reduce the number of military personnel on active duty. This plan was offered to personnel with a minimum of six years of service who do not qualify for retirement. The incentive payments are spread over a period equivalent to twice the years of active service. The annual payment is based on 2.5 percent of the person's basic pay at the time they leave service multiplied by the number of years of service. The September 30, 2005, VSI Actuarial Present Value of Projected Plan Benefits (Actuarial Liability) was calculated at an assumed annual interest rate of 4 percent.

Since the VSI program is discontinued for new takers, each year the Actuarial Liability is expected to decrease with benefit outlays, and increase with interest cost. In the absence of (1) actuarial gains and losses, and (2) assumption changes, a decrease of $94 million in the Actuarial Liability was expected during FY 2005. The September 30, 2005, Actuarial Liability includes changes due to experience, which resulted in a net gain of $3 million. This reflects the new population on which the September 30, 2005, Actuarial Liability is based, as well as other economic experience being different than assumed.

The Present Value of Projected Plan Benefits (Actuarial Liability) for the VSI Fund, as of September 30, 2005, is $1.5 billion. It has been calculated as in prior years; namely, as the present value, as of September 30, 2005, of all remaining VSI payments.

Market Value of Investments in Market-based and Marketable Securities: $624 million.

DoD Education Benefits Fund

The estimated present value of benefit (PVB) for the Department of Defense Education Benefits Fund as of September 30, 2004, increased over what was reported on the FY 2004 statement because of a new educational benefit for mobilized reservists under Chapter 1607 of Title 10. Chapter 1607, in turn, reduced the liabilities under Chapter 1606. In addition, the PVB includes more complete experience, a different interest rate (5.1 percent vs. 5.3 percent), and somewhat different modeling. The net effect of these changes was to increase the PVB by $386 million (157 percent). For the numbers reported as of September 30, 2005, there is a further increase (net $21 million) (2 percent) due to an additional year of new entrants, the inclusion of National-Call-to-Service benefits (10USC510), and calculating the present value of benefits as of a year later.

The Education Benefits Fund was established by Public Law 98-525. The program is designed to accumulate funds for the Educational Assistance program, to promote the recruitment and retention of members for the All-Volunteer Forces program and the Total Force Concept of the Armed Forces, and aid in the readjustment of members of the Armed Forces to civilian life after separation from military service.

Market Value of Investments in Market-based and Marketable Securities: $1.0 billion

Note 18 - Disclosures Related to the Statement of Net Cost

General Disclosures Related to the Statement of Net Cost

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.

For General Funds, the amounts presented in the Statement of Net Cost are based on obligations and disbursements and therefore may not, in all cases, accrue actual costs. While the Department's Working Capital Funds generally record transactions on an accrual basis, the systems do not always capture actual costs in a timely manner. As such, information presented in the Statement of Net Cost is based on budgetary obligations, disbursements, and collection transactions, as well as non-financial feeder systems, adjusted to record known accruals for major items such as payroll expenses, accounts payable and environmental liabilities.

Fluctuations

Intragovernmental Earned Revenue
Intragovernmental Earned Revenue increased $2.8 billion (18 percent) primarily due to a $2.1 billion increase in interest on investments and increased reimbursable work performed for the Federal Emergency Management Agency (FEMA) for hurricane relief efforts.

Gross Costs With the Public
Gross Costs With the Public increased $36.0 billion (6 percent) primarily due to a $32.2 billion increase in future funded expenses related to actuarial liability estimates.

Earned Revenue From the Public
Earned Revenue From the Public increased $4.6 billion (21 percent) primarily due to a $2.3 billion increase for real property additions and inventory revaluation gains. In addition, the Army incurred a $2.0 billion increase primarily due to inventory reporting errors in the Logistics Modernization Program. This resulted in revenues and expenses being overstated in FY 2005. The Department is working to resolve the issue.

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

As of September 30	2005		2004	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
	(Amounts in millions)			
Prior Period Adjustments Increases (Decreases) to Net Position				
Changes in Accounting Standards	$3,632.4	$0.0	$699.5	$0.0
Errors and Omissions in Prior Year Accounting Reports	7,256.5	0.0	(7,257.0)	25,913.7
Other Prior Period Adjustments	0.0	0.0	(1,044.7)	0.0
Total Prior Period Adjustments	10,888.9	0.0	(7,602.2)	25,913.7
Imputed Financing				
Civilian CSRS/FERS Retirement	1,604.1	0.0	1,658.6	0.0
Civilian Health	2,457.1	0.0	2,248.7	0.0
Civilian Life Insurance	24.7	0.0	22.4	0.0
Judgment Fund	379.4	0.0	162.8	0.0
Intra-Entity	0.0	0.0	0.0	0.0
Total Imputed Financing	$4,465.3	$0.0	$4,092.5	$0.0

Prior Period Adjustments

The Department of Defense recorded $10.9 billion (net) in prior period adjustments to Cumulative Results of Operations. In FY 2005, the Air Force completed conversion of its inventory valuation method from Latest

Acquisition Cost to Moving Average Cost. This resulted in adjustments to eliminate allowance for gains and losses, establish an allowance for repair and revalue the inventory. Total inventory revaluation was $11.3 billion. The revaluation was offset by the $0.4 billion reversal of erroneous gains and losses from prior years.

All adjustments comply with guidance provided by SFAS 16, APB 20, and SFFAS No. 21, all of which address the treatment of errors and disclosure of prior period adjustments.

Imputed Financing

The amounts the Department of Defense remits to the Office of Personnel Management by and for employees covered by the Civil Service Retirement System, the Federal Employees' Retirement System, the Federal Employees' Health Benefits program, and the Federal Employees' Group Life Insurance program 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 employees and DoD's contributions for them. The Office of Personnel Management provides cost factors for the computation of imputed financing costs, and their inclusion in the Department's financial statements.

Fluctuations

Cumulative Results of Operations
Budgetary Financing Sources, Transfers-in/out Without Reimbursement decreased $7.4 billion primarily due to the Department receiving less budgetary resources for the Iraqi Relief and Reconstruction Fund. The Department reported $2.9 billion in FY 2005 and $10.3 billion in FY 2004.

Other Budgetary Financing Sources, Other decreased $4.5 billion due to a correction in the treatment of reconciling adjustments. Due to system deficiencies, the Department is unable to fully reconcile budgetary and proprietary trial balances and must make reconciling adjustments. Prior to FY 2005, these adjustments were being reflected incorrectly on this line. These adjustments are now correctly reflected as Other Financing Sources, Other.

Other Financing Sources, Transfers-in/out Without Reimbursement (net transfers) decreased by $2.8 billion. In FY 2004, the Department transferred-in a large actuarial liability from the U.S. Coast Guard to the Medicare Eligible Retiree Health Care Fund. Net transfers in FY 2005 consist of a downward subsidy reestimate on loan guarantees for Military Housing Privatization and property transfers.

Other Financing Sources, Other decreased $2.2 billion due to the reclassification of budgetary/proprietary adjustments from Other Budgetary Financing Sources, Other discussed above.

Unexpended Appropriations
The $12.8 billion increase in appropriations received resulted primarily from:

- An increase of approximately $24.8 billion in appropriations received in the FY 2005 Appropriations Act.
- A net decrease in supplemental appropriations received of $13.4 billion in FY 2005 as compared to FY 2004.

During FY 2005, the Department received supplementals totaling $77.8 billion in support of the Global War on Terror, tsunami relief, and hurricane relief. During FY 2004, the Department received two supplementals totaling $91.2 billion.

Other Disclosures

There is a difference of $80 billion between Appropriations Received that are reported on the Statement of Changes in Net Position ($524.9 billion) and Appropriations Received in the Statement of Budgetary Resources ($604.9 billion). Trust Funds are duplicated in the Statement of Budgetary Resources but not in the Statement of Changes in Net Position. See Note 20, "Statement of Budgetary Resources," for further disclosures.

Note 20 -Disclosures Related to the Statement of Budgetary Resources

As of September 30	2005	2004
	(Amounts in millions)	
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$275,627.9	$233,505.4
Available Borrowing and Contract Authority at the End of the Period	28,006.3	25,314.3

The Net Amount of Budgetary Resources Obligated for Undelivered Orders increased $42.1 billion (18 percent). The increase is due to increased support of contingency missions Operations Enduring Freedom, Iraqi Freedom, and Noble Eagle, appropriations received for the Global War on Terror, Tsunami and Hurricane Relief, and replacement of lost, damaged, and destroyed military equipment.

Available Borrowing and Contract Authority at the end of the period increased $2.7 billion (11 percent). This fluctuation was primarily attributable to increased activity in support of the following contingency missions: Operations Enduring Freedom, Iraqi Freedom, and Noble Eagle, as well as to the increased authority available to incur obligations for Foreign Military Sales administrative expenses.

The Budgetary Financing, Budgetary Resources Section of the Statement of Budgetary Resources (SBR) reflects a decrease of $168.6 billion (17 percent). The decrease is primarily attributed to a reporting change in unobligated fund balances for special and trust funds, such as the Medicare-Eligible Retiree Health Care Fund (MERHCF) and the Military Retirement Fund (MRF). Brought forward balances from Fiscal Year 2004 were decreased by $220.7 billion to correct an inconsistency in presentation with the President's Budget. The overall decrease was partially offset by increased funding provided in support of contingency missions Operations Enduring Freedom, Iraqi Freedom, Noble Eagle, the Global War on Terror, and Tsunami and Hurricane Relief.

The Nonbudgetary Financing, Budgetary Resources Section of the SBR reflects an increase of $29.1 million (13 percent). This section of the SBR reports activity for the Military Housing Privatization Initiative. This fluctuation was primarily due to an increased number of direct loan contracts that were scheduled to be disbursed in FY 2005; however, the contracts are now scheduled for completion and disbursement in FY 2006.

The Navy incorrectly reported an appropriation transfer of $25.2 million as Appropriations Received, resulting in an overstatement of Appropriations Received.

Permanent Indefinite Appropriations

The Department of Defense received the following permanent indefinite appropriations:

- Department of the Army General Gift Fund (10 USC 2601(b)(1))
- Department of the Navy General Gift Fund (10 USC 2601(b)(2))
- Department of the Air Force General Gift Fund (10 USC 2601 (b)(3))
- Foreign National Employees Separation Pay Account, Defense (10 USC 1581)
- United States Naval Academy Gift and Museum Fund (10 USC 6973-4)
- Ship Stores Profits, Navy (10 USC 7220, 31 USC 1321)
- Midshipmen's Store (10 USC 6971B)
- Burdensharing Contributions Account (10 USC 2350j)
- Forest Program (10 USC 2665)
- Department of Defense Base Closure Account (BRAC 10 USC 2687 note)
- Medicare Eligible Retiree Health Care Fund (10 USC 1111)
- Military Retirement Fund (10 USC 1461)
- Education Benefits Fund (10 USC 2006)
- Reserve Mobilization Income Insurance Fund (RII) (10 USC 12528)
- Host Nation Support for U.S. Relocation Activities (10 USC 2350k)
- National Defense Sealift Fund (10 USC 2218)
- Environmental Restoration, Navy (10 USC 2702)
- Hydraulic Mining Debris Reservoir (33 USC 683)
- Maintenance and Operation of Dams and Other Improvements of Navigable Waters (16 USC 810(a))
- Payments to States (33 USC 701c-3)
- Wildlife Conservation (16 USC 670-670f)
- Ainsworth Bequest (IAW 31 USC 1321)

Reconciliation Differences

The Department of the Treasury issues annual warrants to pay amortized payments for the unfunded actuarial liabilities of the MRF and MERHCF. This amount is credited and expended from the Other Defense Organizations – General Funds to the MRF and MERHCF in accordance with the Office of Management and Budget (OMB) guidance. The OMB is aware of and approves of this duplicate reporting. As a result, $38.6 billion is duplicated in Appropriations Received on the SBR.

The MERHCF, MRF, Education Benefits and Voluntary Separation Incentive Program report Appropriations Received for contributions paid by the Army, Navy, and Air Force. These Military Departments also include these amounts in Appropriations Received. As a result, $25.4 billion is duplicated on the SBR.

There is a difference of $25.0 billion between undelivered orders (UDOs) reported on line 1 in the table above ($275.6 billion) and the amount of UDOs on the SBR ($250.6 billion). This difference is primarily attributable to the process of reporting UDOs with advances. Line 1 reports UDOs with advances, but the SBR does not. In addition, the SBR reports transferred obligations for UDOs without advances, but line 1 in the table above does not.

Intra-Entity Transactions

The SBR includes intra-entity transactions because the statements are presented as combined and combining.

Direct Obligations - Apportionment Categories				
Reporting Entity	Category A	Category B	Exempt from Apportionment	Totals
	(Amounts in millions)			
Army General Fund	$174,140.9	$945.3		$175,086.2
Navy General Fund - see disclosure below	85,776.8	51,917.6		137,694.4
Air Force General Fund	70,014.7	54,673.4	1.3	124,689.4
US Army Corps of Engineers	5,710.5		29.0	5,739.5
Military Retirement Fund	39,166.2			39,166.2
Medicare-Eligible Retiree Health Care Fund	6,398.7			6,398.7
Other Defense Organizations – General Fund	110,700.4	649.2	466.0	111,815.6
Other Defense Organizations – Working Capital Fund	1,142.0			1,142.0
Totals	$493,050.2	$108,185.5	$496.3	$601,732.0

Reimbursable Obligations - Apportionment Categories				
Reporting Entity	Category A	Category B	Exempt from Apportionment	Totals
	(Amounts in millions)			
Army General Fund	$20,206.7	$4,300.0		$24,506.7
Navy General Fund - see disclosure below		13,463.8		13,463.8
Air Force General Fund	8,543.7	3,904.9		12,448.6
Army Working Capital Fund		11,850.8	4,971.6	16,822.4
Navy Working Capital Fund		23,936.0		23,936.0
Air Force Working Capital Fund		15,892.1		15,892.1
US Army Corps of Engineers	6,901.4		1.0	6,902.4
Other Defense Organizations – General Fund	5,447.4			5,447.4
Other Defense Organizations – Working Capital Fund	56,563.7			56,563.7
Totals	$97,662.9	$73,347.6	$4,972.6	$175,983.1

Due to system limitations, the Navy General Fund could not categorize obligations. Therefore, all of Navy's direct and reimbursable obligations are reported in the above table as Category "A."

NOTE:
1. Category "A" relates to appropriations for a specific period of time (e.g., Military Personnel appropriation).
2. Category "B" relates to appropriations for a specific project (e.g., Military Construction appropriation).

Note 21 - Disclosures Related to the Statement of Financing

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

Resources That Finance the Acquisition of Assets	$11,095.5 million
Other Components Not Requiring or Generating Resources	$283.1 million
Statement of Net Cost*	$.3 million

*The U.S. Army Corps of Engineers adjusted the Statement of Net Cost instead of the Statement of Financing.

The following Statement of Financing lines are presented as combined instead of consolidated due to intra-agency budgetary transactions not being eliminated:

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

Resources Used to Finance Activities

Offsetting Receipts increased $8.5 billion due primarily to increases in contributions to the Military Retirement Fund and the Medicare-Eligible Retiree Health Care Fund.

Transfers In/Out Without Reimbursement decreased $2.8 billion due primarily to the reduction of transfers in from other federal agencies. In FY 2004, the U.S. Coast Guard transferred $2.8 billion to the Medicare-Eligible Retiree Health Care Fund, which completed the U.S. Coast Guard liability transfer. There were no Coast Guard transfers in FY 2005.

Other Resources – Other decreased $2.1 billion primarily due to Component adjustments to gains and losses necessary to reconcile the proprietary and budgetary accounts and adjustments to reconcile trading partner differences.

Resources Used to Finance Items not Part of the Net Cost of Operations

Resources That Finance the Acquisition of Assets increased $25.8 billion due primarily to a revision of military equipment projections provided by the Bureau of Economic Analysis (BEA), Department of Commerce. For further disclosure on military equipment see Note 10.

Components of the Net Cost of Operations Requiring or Generating Resources in the Future Periods

Increase in Environmental and Disposal Liability reported decreased $2.8 billion (72%) due to the reduction of environmental liabilities related to closed ranges. For further disclosure on environmental liabilities see Note 14.

Components Requiring Resources in Future Periods - Other consists of unfunded expenses relating to contingent liabilities, actuarial and other unfunded employment-related liabilities. The $29.0 billion increase resulted primarily from changes in actuarial liabilities for the Military Retirement Fund, Medicare-Eligible Retiree Health Care Fund and the Defense Health Program. For further disclosure on actuarial liabilities see Note 17.

Components not Requiring or Generating Resources

Depreciation and amortization increased $6.7 billion due primarily to the revision of military equipment projections provided by the BEA, Department of Commerce.

Revaluation of Assets or Liabilities increased $7.5 billion primarily due to the gains reported by the Air Force after converting their inventory valuation method from Latest Acquisition Cost to Moving Average Cost.

Note 22 - Disclosures Related to the Statement of Custodial Activity

The Statement of Custodial Activity displays current year collections and disbursements for three custodial accounts: Foreign Military Sales, Development Fund for Iraq, and Seized Assets. Funds held in a custodial activity are only used for the stated purposes and are not available for the Department's use.

Foreign Military Sales (FMS)

Current year Deposits by Foreign Governments into the FMS Trust Fund are $10.7 billion and disbursements on Behalf of Foreign Governments and International Organizations equal $11.1 billion.

Under authority of the Arms Export and Control Act, the FMS Trust Fund receives collections from foreign governments that are dedicated specifically to FMS purchases. Funds collected into the Trust Fund are in advance of the performance of services or sale of articles. These advance collections constitute a fiduciary relationship with the countries.

FMS neither recognizes nor reports revenue. The only exception is cost clearing accounts, which are reflected in all other principle financial statements. Since various DoD Components actually perform the services and sell the articles, recognition of revenue and expense occurs in the financial statements of the applicable DoD Components.

Development Fund for Iraq (DFI)

The DFI is for urgent humanitarian assistance, reconstruction, and other projects carried out for the benefit of the Iraqi people. Current year deposits from the Interim Iraqi Government transferred to the Multi-National Force-Iraq are $136.0 million with $82.6 million in disbursements.

(Amounts in millions)

	During FY 2005	Cumulative from Inception
Source of Collections		
Deposits By Foreign Governments	$136.0	$136.0
Disposition of Collections		
Security and Law Enforcement	.8	.8
Electric Sector	24.4	24.4
Oil Infrastructure	.4	.4
Water Resources and Sanitation	6.7	6.7
Transportation and Telecommunications	5.2	5.2
Roads, Bridges and Construction	4.2	4.2
Health Care	2.7	2.7
Private Sector Development	3.8	3.8
Education, Refugees, Human Rights, and Governance	34.4	34.4
Total Disbursed on Behalf of Foreign Governments	82.6	82.6
Retained for Future Support of Foreign Governments (note)	53.4	53.4
Total Disposition of Collections	**$136.0**	**$136.0**
Net Custodial Collection Activity	**$0**	**$0**

Note – Reported on Statement of Custodial Activity under Disposition of Collections, Increase (Decrease) in Amounts to be Transferred.

Seized Assets

During Operation Iraqi Freedom, the U.S. Government seized assets from the former Iraqi Government that are used in support of the Iraqi people. As of September 30, 2005, $61.4 million of seized monetary assets remain to be disbursed in support of the Iraqi people as shown in the table below.

	During FY 2005	Cumulative from Inception *(Amount in millions)*
Source of Collections		
Seized Iraqi Cash	$0.0	$927.2
Disposition of Collections		
Iraqi Salaries	0.0	30.8
Repair/Reconstruction/Humanitarian Assistance	51.2	495.0
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	.8	264.7
Fuel/Supplies	0	75.3
Total Disbursed on behalf of Iraqi People	52.0	865.8
Retained for Future Support of the Iraqi People	(52.0)	61.4
Total Disposition of Collections	**$0**	**$927.2**
Net Custodial Collection Activity	**$0**	**$0**

Note 23 - Other Disclosures

As of September 30	2005			
	Land and Buildings	Equipment	Other	Total
	(Amounts in millions)			
ENTITY AS LESSEE-Operating Leases				
Future Payments Due (Fiscal Year)				
2006	$198.8	$0.2	$133.3	$ 332.3
2007	195.4	0.0	136.0	331.4
2008	216.2	0.0	138.7	354.9
2009	230.7	0.0	141.4	372.1
2010	231.2	0.0	144.3	375.5
After 5 Years	206.9	0.0	147.2	354.1
Total Future Lease Payments Due	$1,279.2	$0.2	$ 840.9	$2,120.3

Consolidating and Combining Statements

Department of Defense
Agency Wide
CONSOLIDATING BALANCE SHEET
As of September 30, 2005 and 2004
($ in Millions)

	Army General Fund	Navy General Fund	Air Force General Fund
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 86,799.0	$ 85,734.7	$ 62,273.0
Non-Entity Seized Iraqi Cash	61.4	0.0	0.0
Non-Entity-Other	232.9	344.5	77.3
Investments (Note 4)	3.5	9.5	0.7
Accounts Receivable (Note 5)	276.7	281.4	653.6
Other Assets (Note 6)	824.3	672.3	428.0
Total Intragovernmental Assets	$ 88,197.8	$ 87,042.4	$ 63,432.6
Cash and Other Monetary Assets (Note 7)	$ 1,482.0	$ 305.4	$ 151.8
Accounts Receivable (Note 5)	584.0	3,267.7	1,028.3
Loans Receivable (Note 8)	0.0	0.0	0.0
Inventory and Related Property (Note 9)	37,703.4	55,584.8	47,169.0
General Property, Plant and Equipment (Note 10)	120,401.7	158,328.8	123,646.1
Investments (Note 4)	0.0	0.0	0.0
Other Assets (Note 6)	3,844.5	6,988.8	11,179.0
TOTAL ASSETS	$ 252,213.4	$ 311,517.9	$ 246,606.8
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 1,918.4	$ 1,208.8	$ 1,651.9
Debt (Note 13)	0.0	0.0	0.0
Other Liabilities (Note 15 & Note 16)	2,372.3	3,826.0	1,589.9
Total Intragovernmental Liabilities	$ 4,290.7	$ 5,034.8	$ 3,241.8
Accounts Payable (Note 12)	$ 10,137.0	$ 1,180.0	$ 5,851.2
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,663.6	1,532.8	1,147.4
Environmental Liabilities (Note 14)	39,760.5	17,050.5	7,126.2
Loan Guarantee Liability (Note 8)	12.4	0.0	0.0
Other Liabilities (Note 15 and Note 16)	6,401.9	4,459.8	4,179.5
TOTAL LIABILITIES	$ 62,266.1	$ 29,257.9	$ 21,546.1
NET POSITION			
Unexpended Appropriations	$ 74,704.7	$ 89,739.9	$ 63,716.6
Cumulative Results of Operations	115,242.6	192,520.1	161,344.1
TOTAL NET POSITION	$ 189,947.3	$ 282,260.0	$ 225,060.7
TOTAL LIABILITIES AND NET POSITION	$ 252,213.4	$ 311,517.9	$ 246,606.8

Department of Defense
Agency Wide
CONSOLIDATING BALANCE SHEET
As of September 30, 2005 and 2004
($ in Millions)

	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 623.3	$ 977.9	$ 1,164.2
Non-Entity Seized Iraqi Cash	0.0	0.0	0.0
Non-Entity-Other	0.0	0.0	0.0
Investments (Note 4)	0.0	0.0	0.0
Accounts Receivable (Note 5)	366.8	494.5	510.6
Other Assets (Note 6)	0.0	0.4	48.5
Total Intragovernmental Assets	$ 990.1	$ 1,472.8	$ 1,723.3
Cash and Other Monetary Assets (Note 7)	$ 0.0	$ 0.0	$ 0.0
Accounts Receivable (Note 5)	12.0	29.7	219.9
Loans Receivable (Note 8)	0.0	0.0	0.0
Inventory and Related Property (Note 9)	15,933.1	15,610.8	32,701.7
General Property, Plant and Equipment (Note 10)	1,228.2	3,730.5	1,205.6
Investments (Note 4)	0.0	0.0	0.0
Other Assets (Note 6)	333.7	536.7	440.3
TOTAL ASSETS	$ 18,497.1	$ 21,380.5	$ 36,290.8
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 105.7	$ 199.6	$ 199.8
Debt (Note 13)	0.0	381.5	0.0
Other Liabilities (Note 15 & Note 16)	75.6	457.5	146.5
Total Intragovernmental Liabilities	$ 181.3	$ 1,038.6	$ 346.3
Accounts Payable (Note 12)	$ 295.8	$ 2,152.1	$ 546.7
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	286.5	1,192.6	233.7
Environmental Liabilities (Note 14)	0.0	0.0	0.0
Loan Guarantee Liability (Note 8)	0.0	0.0	0.0
Other Liabilities (Note 15 and Note 16)	642.5	3,450.7	1,389.3
TOTAL LIABILITIES	$ 1,406.1	$ 7,834.0	$ 2,516.0
NET POSITION			
Unexpended Appropriations	$ 0.0	$ 6.3	$ 0.0
Cumulative Results of Operations	17,091.0	13,540.2	33,774.8
TOTAL NET POSITION	$ 17,091.0	$ 13,546.5	$ 33,774.8
TOTAL LIABILITIES AND NET POSITION	$ 18,497.1	$ 21,380.5	$ 36,290.8

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	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 22.9	$ 3,138.2	$ 46,854.7
Non-Entity Seized Iraqi Cash	0.0	0.0	0.0
Non-Entity-Other	0.0	7.8	929.5
Investments (Note 4)	197,807.1	3,127.8	1,727.6
Accounts Receivable (Note 5)	0.0	614.0	432.7
Other Assets (Note 6)	0.0	0.0	502.2
Total Intragovernmental Assets	$ 197,830.0	$ 6,887.8	$ 50,446.7
Cash and Other Monetary Assets (Note 7)	$ 0.0	$ 1.1	$ 18.5
Accounts Receivable (Note 5)	26.7	1,750.9	196.7
Loans Receivable (Note 8)	0.0	0.0	75.6
Inventory and Related Property (Note 9)	0.0	117.4	1,409.3
General Property, Plant and Equipment (Note 10)	0.0	26,780.1	20,996.9
Investments (Note 4)	0.0	0.0	605.0
Other Assets (Note 6)	0.0	0.0	286.9
TOTAL ASSETS	$ 197,856.7	$ 35,537.3	$ 74,035.6
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 0.0	$ 87.2	$ 590.2
Debt (Note 13)	0.0	14.6	71.0
Other Liabilities (Note 15 & Note 16)	1.1	1,956.9	1,504.5
Total Intragovernmental Liabilities	$ 1.1	$ 2,058.7	$ 2,165.7
Accounts Payable (Note 12)	$ 0.0	$ 535.9	$ 2,411.9
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	892,111.6	0.0	299,981.7
Environmental Liabilities (Note 14)	0.0	529.6	520.4
Loan Guarantee Liability (Note 8)	0.0	0.0	28.7
Other Liabilities (Note 15 and Note 16)	3,321.3	600.9	3,993.1
TOTAL LIABILITIES	$ 895,434.0	$ 3,725.1	$ 309,101.5
NET POSITION			
Unexpended Appropriations	$ 0.0	$ 1,005.8	$ 42,270.5
Cumulative Results of Operations	(697,577.3)	30,806.4	(277,336.4)
TOTAL NET POSITION	$ (697,577.3)	$ 31,812.2	$ (235,065.9)
TOTAL LIABILITIES AND NET POSITION	$ 197,856.7	$ 35,537.3	$ 74,035.6

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	Other Defense Organizations Working Capital Funds	DoD Medicare-Eligible Retiree Health Care Fund
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	$ 1,410.8	$ 5.0
Non-Entity Seized Iraqi Cash	0.0	0.0
Non-Entity-Other	0.0	0.0
Investments (Note 4)	0.0	60,691.7
Accounts Receivable (Note 5)	2,152.1	32.9
Other Assets (Note 6)	0.2	0.0
Total Intragovernmental Assets	$ 3,563.1	$ 60,729.6
Cash and Other Monetary Assets (Note 7)	$ 113.9	$ 0.0
Accounts Receivable (Note 5)	488.3	11.3
Loans Receivable (Note 8)	0.0	0.0
Inventory and Related Property (Note 9)	16,343.8	0.0
General Property, Plant and Equipment (Note 10)	4,381.4	0.0
Investments (Note 4)	0.0	0.0
Other Assets (Note 6)	212.2	0.0
TOTAL ASSETS	$ 25,102.7	$ 60,740.9
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 614.6	$ 0.0
Debt (Note 13)	0.0	0.0
Other Liabilities (Note 15 & Note 16)	308.1	0.0
Total Intragovernmental Liabilities	$ 922.7	$ 0.0
Accounts Payable (Note 12)	$ 5,223.1	$ 241.7
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	510.8	537,397.1
Environmental Liabilities (Note 14)	40.4	0.0
Loan Guarantee Liability (Note 8)	0.0	0.0
Other Liabilities (Note 15 and Note 16)	784.2	762.2
TOTAL LIABILITIES	$ 7,481.2	$ 538,401.0
NET POSITION		
Unexpended Appropriations	$ 49.8	$ 0.0
Cumulative Results of Operations	17,571.7	(477,660.1)
TOTAL NET POSITION	$ 17,621.5	$ (477,660.1)
TOTAL LIABILITIES AND NET POSITION	$ 25,102.7	$ 60,740.9

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	Combined Total	Elimination	2005 Consolidated
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 289,003.7	$ 0.0	$ 289,003.7
Non-Entity Seized Iraqi Cash	61.4	0.0	61.4
Non-Entity-Other	1,592.0	0.0	1,592.0
Investments (Note 4)	263,367.9	0.1	263,367.8
Accounts Receivable (Note 5)	5,815.3	4,524.0	1,291.3
Other Assets (Note 6)	2,475.9	1,081.7	1,394.2
Total Intragovernmental Assets	$ 562,316.2	$ 5,605.8	$ 556,710.4
Cash and Other Monetary Assets (Note 7)	$ 2,072.7	$ 0.0	$ 2,072.7
Accounts Receivable (Note 5)	7,615.5	0.0	7,615.5
Loans Receivable (Note 8)	75.6	0.0	75.6
Inventory and Related Property (Note 9)	222,573.3	0.0	222,573.3
General Property, Plant and Equipment (Note 10)	460,699.3	0.0	460,699.3
Investments (Note 4)	605.0	0.0	605.0
Other Assets (Note 6)	23,822.1	0.0	23,822.1
TOTAL ASSETS	$ 1,279,779.7	$ 5,605.8	$ 1,274,173.9
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 6,576.2	$ 4,518.2	$ 2,058.0
Debt (Note 13)	467.1	0.0	467.1
Other Liabilities (Note 15 & Note 16)	12,238.4	1,087.6	11,150.8
Total Intragovernmental Liabilities	$ 19,281.7	$ 5,605.8	$ 13,675.9
Accounts Payable (Note 12)	$ 28,575.4	$ 0.0	$ 28,575.4
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,736,057.8	0.0	1,736,057.8
Environmental Liabilities (Note 14)	65,027.6	0.0	65,027.6
Loan Guarantee Liability (Note 8)	41.1	0.0	41.1
Other Liabilities (Note 15 and Note 16)	29,985.4	0.0	29,985.4
TOTAL LIABILITIES	$ 1,878,969.0	$ 5,605.8	$ 1,873,363.2
NET POSITION			
Unexpended Appropriations	$ 271,493.6	$ 0.0	$ 271,493.6
Cumulative Results of Operations	(870,682.9)	0.0	(870,682.9)
TOTAL NET POSITION	$ (599,189.3)	$ 0.0	$ (599,189.3)
TOTAL LIABILITIES AND NET POSITION	$ 1,279,779.7	$ 5,605.8	$ 1,274,173.9

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	2004 Consolidated Restated
ASSETS (Note 2)	
Intragovernmental:	
Fund Balance with Treasury (Note 3)	
Entity	$ 287,685.5
Non-Entity Seized Iraqi Cash	113.4
Non-Entity-Other	1,800.0
Investments (Note 4)	231,069.7
Accounts Receivable (Note 5)	1,118.3
Other Assets (Note 6)	1,011.9
Total Intragovernmental Assets	$ 522,798.8
Cash and Other Monetary Assets (Note 7)	$ 2,178.1
Accounts Receivable (Note 5)	7,427.8
Loans Receivable (Note 8)	70.7
Inventory and Related Property (Note 9)	220,505.6
General Property, Plant and Equipment (Note 10)	440,898.6
Investments (Note 4)	406.5
Other Assets (Note 6)	21,486.3
TOTAL ASSETS	$ 1,215,772.4
LIABILITIES (Note 11)	
Intragovernmental:	
Accounts Payable (Note 12)	$ 1,888.4
Debt (Note 13)	591.8
Other Liabilities (Note 15 & Note 16)	10,726.9
Total Intragovernmental Liabilities	$ 13,207.1
Accounts Payable (Note 12)	$ 28,309.0
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,569,704.7
Environmental Liabilities (Note 14)	64,367.2
Loan Guarantee Liability (Note 8)	34.4
Other Liabilities (Note 15 and Note 16)	34,491.2
TOTAL LIABILITIES	$ 1,710,113.6
NET POSITION	
Unexpended Appropriations	$ 243,813.9
Cumulative Results of Operations	(738,155.1)
TOTAL NET POSITION	$ (494,341.2)
TOTAL LIABILITIES AND NET POSITION	$ 1,215,772.4

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	Army General Fund	Navy General Fund	Air Force General Fund
Program Costs			
A. Military Personnel			
Intragovernmental Gross Costs	$ (0.7)	$ 8,103.2	$ 349.2
(Less: Intragovernmental Earned Revenue)	(133.3)	(501.5)	(299.4)
Intragovernmental Net Costs	$ (134.0)	$ 7,601.7	$ 49.8
Gross Costs With the Public	53,307.0	31,742.5	30,090.4
(Less: Earned Revenue From the Public)	(0.5)	0.0	(112.9)
Net Costs With the Public	$ 53,306.5	$ 31,742.5	$ 29,977.5
Total Net Cost	$ 53,172.5	$ 39,344.2	$ 30,027.3
B. Operation and Maintenance			
Intragovernmental Gross Costs	$ 8,870.2	$ 1,907.5	$ 19,221.4
(Less: Intragovernmental Earned Revenue)	(11,077.0)	(6,896.3)	(4,397.1)
Intragovernmental Net Costs	$ (2,206.8)	$ (4,988.8)	$ 14,824.3
Gross Costs With the Public	68,994.7	45,630.7	31,909.5
(Less: Earned Revenue From the Public)	(930.8)	0.0	(582.3)
Net Costs With the Public	$ 68,063.9	$ 45,630.7	$ 31,327.2
Total Net Cost	$ 65,857.1	$ 40,641.9	$ 46,151.5
C. Procurement			
Intragovernmental Gross Costs	$ 970.0	$ (82.4)	$ 17,606.6
(Less: Intragovernmental Earned Revenue)	(927.3)	(1,022.3)	(316.7)
Intragovernmental Net Costs	$ 42.7	$ (1,104.7)	$ 17,289.9
Gross Costs With the Public	10,210.1	20,547.3	12,496.1
(Less: Earned Revenue From the Public)	(49.4)	(605.2)	(92.3)
Net Costs With the Public	$ 10,160.7	$ 19,942.1	$ 12,403.8
Total Net Cost	$ 10,203.4	$ 18,837.4	$ 29,693.7

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	Other Defense Organizations General Funds	Combined Total	Elimination
Program Costs			
A. Military Personnel			
Intragovernmental Gross Costs		$ 8,451.7	$ 0.0
(Less: Intragovernmental Earned Revenue)		(934.2)	0.0
Intragovernmental Net Costs		$ 7,517.5	$ 0.0
Gross Costs With the Public		115,139.9	0.0
(Less: Earned Revenue From the Public)		(113.4)	0.0
Net Costs With the Public		$ 115,026.5	$ 0.0
Total Net Cost		$ 122,544.0	$ 0.0
B. Operation and Maintenance			
Intragovernmental Gross Costs	$ 13,405.8	$ 43,404.9	$ 2,366.1
(Less: Intragovernmental Earned Revenue)	(2,652.5)	(25,022.9)	(1,833.6)
Intragovernmental Net Costs	$ 10,753.3	$ 18,382.0	$ 532.5
Gross Costs With the Public	101,554.0	248,088.9	0.0
(Less: Earned Revenue From the Public)	(284.0)	(1,797.1)	0.0
Net Costs With the Public	$ 101,270.0	$ 246,291.8	$ 0.0
Total Net Cost	$ 112,023.3	$ 264,673.8	$ 532.5
C. Procurement			
Intragovernmental Gross Costs	$ 368.4	$ 18,862.6	$ 0.0
(Less: Intragovernmental Earned Revenue)	(21.5)	(2,287.8)	0.0
Intragovernmental Net Costs	$ 346.9	$ 16,574.8	$ 0.0
Gross Costs With the Public	2,886.3	46,139.8	0.0
(Less: Earned Revenue From the Public)	42.7	(704.2)	0.0
Net Costs With the Public	$ 2,929.0	$ 45,435.6	$ 0.0
Total Net Cost	$ 3,275.9	$ 62,010.4	$ 0.0

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	2005 Consolidated	2004 Consolidated
Program Costs		
A. Military Personnel		
Intragovernmental Gross Costs	$ 8,451.7	$ 16,533.8
(Less: Intragovernmental Earned Revenue)	(934.2)	(1,104.8)
Intragovernmental Net Costs	$ 7,517.5	$ 15,429.0
Gross Costs With the Public	115,139.9	96,919.3
(Less: Earned Revenue From the Public)	(113.4)	(87.8)
Net Costs With the Public	$ 115,026.5	$ 96,831.5
Total Net Cost	$ 122,544.0	$ 112,260.5
B. Operation and Maintenance		
Intragovernmental Gross Costs	$ 41,038.8	$ 37,562.8
(Less: Intragovernmental Earned Revenue)	(23,189.3)	(21,412.2)
Intragovernmental Net Costs	$ 17,849.5	$ 16,150.6
Gross Costs With the Public	248,088.9	172,818.9
(Less: Earned Revenue From the Public)	(1,797.1)	(1,896.8)
Net Costs With the Public	$ 246,291.8	$ 170,922.1
Total Net Cost	$ 264,141.3	$ 187,072.7
C. Procurement		
Intragovernmental Gross Costs	$ 18,862.6	$ 2,022.9
(Less: Intragovernmental Earned Revenue)	(2,287.8)	(1,824.3)
Intragovernmental Net Costs	$ 16,574.8	$ 198.6
Gross Costs With the Public	46,139.8	79,695.3
(Less: Earned Revenue From the Public)	(704.2)	(714.8)
Net Costs With the Public	$ 45,435.6	$ 78,980.5
Total Net Cost	$ 62,010.4	$ 79,179.1

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	Army General Fund	Navy General Fund	Air Force General Fund
D. Research, Development, Test & Evaluation			
Intragovernmental Gross Costs	$ 3,077.4	$ 0.0	$ 9,218.5
(Less: Intragovernmental Earned Revenue)	(3,411.9)	(382.7)	(3,174.5)
Intragovernmental Net Costs	$ (334.5)	$ (382.7)	$ 6,044.0
Gross Costs With the Public	10,373.7	16,105.6	14,262.6
(Less: Earned Revenue From the Public)	(127.1)	0.0	(160.7)
Net Costs With the Public	$ 10,246.6	$ 16,105.6	$ 14,101.9
Total Net Cost	$ 9,912.1	$ 15,722.9	$ 20,145.9
E. Military Construction/Family Housing			
Intragovernmental Gross Costs	$ 3,657.7	$ 0.0	$ 264.9
(Less: Intragovernmental Earned Revenue)	(3,725.3)	(723.3)	1.2
Intragovernmental Net Costs	$ (67.6)	$ (723.3)	$ 266.1
Gross Costs With the Public	934.3	3,957.7	(68.2)
(Less: Earned Revenue From the Public)	(138.9)	(1,963.4)	0.0
Net Costs With the Public	$ 795.4	$ 1,994.3	$ (68.2)
Total Net Cost	$ 727.8	$ 1,271.0	$ 197.9
F. Military Retirement Fund			
Intragovernmental Gross Costs			
(Less: Intragovernmental Earned Revenue)			
Intragovernmental Net Costs			
Gross Costs With the Public			
(Less: Earned Revenue From the Public)			
Net Costs With the Public			
Total Net Cost			

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	Military Retirement Fund	Other Defense Organizations General Funds	DoD Medicare-Eligible Retiree Health Care Fund
D. Research, Development, Test & Evaluation			
Intragovernmental Gross Costs		$ 2,795.4	
(Less: Intragovernmental Earned Revenue)		(452.9)	
Intragovernmental Net Costs		$ 2,342.5	
Gross Costs With the Public		13,521.5	
(Less: Earned Revenue From the Public)		25.2	
Net Costs With the Public		$ 13,546.7	
Total Net Cost		$ 15,889.2	
E. Military Construction/Family Housing			
Intragovernmental Gross Costs		$ 55.1	
(Less: Intragovernmental Earned Revenue)		0.0	
Intragovernmental Net Costs		$ 55.1	
Gross Costs With the Public		481.5	
(Less: Earned Revenue From the Public)		(0.1)	
Net Costs With the Public		$ 481.4	
Total Net Cost		$ 536.5	
F. Military Retirement Fund			
Intragovernmental Gross Costs	$ 0.0		$ 1,561.3
(Less: Intragovernmental Earned Revenue)	(48,812.2)		(28,412.4)
Intragovernmental Net Costs	$ (48,812.2)		$ (26,851.1)
Gross Costs With the Public	96,694.4		38,415.0
(Less: Earned Revenue From the Public)	0.0		0.0
Net Costs With the Public	$ 96,694.4		$ 38,415.0
Total Net Cost	$ 47,882.2		$ 11,563.9

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	Combined Total	Elimination	2005 Consolidated
D. Research, Development, Test & Evaluation			
Intragovernmental Gross Costs	$ 15,091.3	$ 5.9	$ 15,085.4
(Less: Intragovernmental Earned Revenue)	(7,422.0)	(234.3)	(7,187.7)
Intragovernmental Net Costs	$ 7,669.3	$ (228.3)	$ 7,897.6
Gross Costs With the Public	54,263.4	0.0	54,263.4
(Less: Earned Revenue From the Public)	(262.6)	0.0	(262.6)
Net Costs With the Public	$ 54,000.8	$ 0.0	$ 54,000.8
Total Net Cost	$ 61,670.1	$ (228.3)	$ 61,898.4
E. Military Construction/Family Housing			
Intragovernmental Gross Costs	$ 3,977.7	$ 10.1	$ 3,967.6
(Less: Intragovernmental Earned Revenue)	(4,447.4)	0.0	(4,447.4)
Intragovernmental Net Costs	$ (469.7)	$ 10.1	$ (479.8)
Gross Costs With the Public	5,305.3	0.0	5,305.3
(Less: Earned Revenue From the Public)	(2,102.4)	0.0	(2,102.4)
Net Costs With the Public	$ 3,202.9	$ 0.0	$ 3,202.9
Total Net Cost	$ 2,733.2	$ 10.1	$ 2,723.1
F. Military Retirement Fund			
Intragovernmental Gross Costs	$ 1,561.3	$ 1,561.3	$ 0.0
(Less: Intragovernmental Earned Revenue)	(77,224.6)	(63,886.4)	(13,338.2)
Intragovernmental Net Costs	$ (75,663.3)	$ (62,325.1)	$ (13,338.2)
Gross Costs With the Public	135,109.4	0.0	135,109.4
(Less: Earned Revenue From the Public)	0.0	0.0	0.0
Net Costs With the Public	$ 135,109.4	$ 0.0	$ 135,109.4
Total Net Cost	$ 59,446.1	$ (62,325.1)	$ 121,771.2

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		2004 Consolidated
D. Research, Development, Test & Evaluation		
Intragovernmental Gross Costs	$	6,582.4
(Less: Intragovernmental Earned Revenue)		(5,981.1)
Intragovernmental Net Costs	$	601.3
Gross Costs With the Public		56,536.7
(Less: Earned Revenue From the Public)		(293.4)
Net Costs With the Public	$	56,243.3
Total Net Cost	$	56,844.6
E. Military Construction/Family Housing		
Intragovernmental Gross Costs	$	2,716.3
(Less: Intragovernmental Earned Revenue)		(4,008.2)
Intragovernmental Net Costs	$	(1,291.9)
Gross Costs With the Public		11,982.1
(Less: Earned Revenue From the Public)		(178.9)
Net Costs With the Public	$	11,803.2
Total Net Cost	$	10,511.3
F. Military Retirement Fund		
Intragovernmental Gross Costs	$	0.0
(Less: Intragovernmental Earned Revenue)		(11,288.3)
Intragovernmental Net Costs	$	(11,288.4)
Gross Costs With the Public		164,796.6
(Less: Earned Revenue From the Public)		0.0
Net Costs With the Public	$	164,796.6
Total Net Cost	$	153.508.2

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	Army General Fund	Navy General Fund	Air Force General Fund
G. Civil Works			
Intragovernmental Gross Costs			
(Less: Intragovernmental Earned Revenue)			
Intragovernmental Net Costs			
Gross Costs With the Public			
(Less: Earned Revenue From the Public)			
Net Costs With the Public			
Total Net Cost			
H. Working Capital Funds			
Intragovernmental Gross Costs			
(Less: Intragovernmental Earned Revenue)			
Intragovernmental Net Costs			
Gross Costs With the Public			
(Less: Earned Revenue From the Public)			
Net Costs With the Public			
Total Net Cost			
I. Other			
Intragovernmental Gross Costs	$ 23,412.7	$ 29,316.8	$ (16,814.9)
(Less: Intragovernmental Earned Revenue)	10,783.7	6,045.9	3,978.9
Intragovernmental Net Costs	$ 34,196.4	$ 35,362.7	$ (12,836.0)
Gross Costs With the Public	(27,640.5)	(33,618.0)	10,845.9
(Less: Earned Revenue From the Public)	(2.7)	(2,132.4)	68.4
Net Costs With the Public	$ (27,643.2)	$ (35,750.4)	$ 10,914.3
Total Net Cost	$ 6,553.2	$ (387.7)	$ (1,921.7)

Department of Defense
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CONSOLIDATING STATEMENT OF NET COST
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
G. Civil Works			
Intragovernmental Gross Costs			
(Less: Intragovernmental Earned Revenue)			
Intragovernmental Net Costs			
Gross Costs With the Public			
(Less: Earned Revenue From the Public)			
Net Costs With the Public			
Total Net Cost			
H. Working Capital Funds			
Intragovernmental Gross Costs	$ 2,016.2	$ 5,567.5	$ 5,312.7
(Less: Intragovernmental Earned Revenue)	(7,556.4)	(20,715.9)	(10,643.2)
Intragovernmental Net Costs	$ (5,540.2)	$ (15,148.4)	$ (5,330.5)
Gross Costs With the Public	10,600.4	19,256.8	5,201.5
(Less: Earned Revenue From the Public)	(6,918.3)	(1,524.5)	(771.7)
Net Costs With the Public	$ 3,682.1	$ 17,732.3	$ 4,429.8
Total Net Cost	$ (1,858.1)	$ 2,583.9	$ (900.7)
I. Other			
Intragovernmental Gross Costs			
(Less: Intragovernmental Earned Revenue)			
Intragovernmental Net Costs			
Gross Costs With the Public			
(Less: Earned Revenue From the Public)			
Net Costs With the Public			
Total Net Cost			

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	US Army Corps of Engineers	Other Defense Organizations General Funds	Other Defense Organizations Working Capital Funds
G. Civil Works			
Intragovernmental Gross Costs	$ 1,378.8		
(Less: Intragovernmental Earned Revenue)	(2,152.8)		
Intragovernmental Net Costs	$ (774.0)		
Gross Costs With the Public	8,882.5		
(Less: Earned Revenue From the Public)	(428.8)		
Net Costs With the Public	$ 8,453.7		
Total Net Cost	$ 7,679.7		
H. Working Capital Funds			
Intragovernmental Gross Costs			$ 3,450.3
(Less: Intragovernmental Earned Revenue)			(39,742.2)
Intragovernmental Net Costs			$ (36,291.9)
Gross Costs With the Public			47,375.2
(Less: Earned Revenue From the Public)			(8,968.7)
Net Costs With the Public			$ 38,406.5
Total Net Cost			$ 2,114.6
I. Other			
Intragovernmental Gross Costs		$ 38,324.9	
(Less: Intragovernmental Earned Revenue)		(1,419.6)	
Intragovernmental Net Costs		$ 36,905.3	
Gross Costs With the Public		12,324.3	
(Less: Earned Revenue From the Public)		(1,284.6)	
Net Costs With the Public		$ 11,039.7	
Total Net Cost		$ 47,945.0	

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CONSOLIDATING STATEMENT OF NET COST
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($ in Millions)

	Agency-Wide Component	Combined Total	Elimination
G. Civil Works			
Intragovernmental Gross Costs		$ 1,378.8	$ 433.7
(Less: Intragovernmental Earned Revenue)		(2,152.8)	(850.1)
Intragovernmental Net Costs		$ (774.0)	$ (416.4)
Gross Costs With the Public		8,882.5	0.0
(Less: Earned Revenue From the Public)		(428.8)	0.0
Net Costs With the Public		$ 8,453.7	$ 0.0
Total Net Cost		$ 7,679.7	$ (416.4)
H. Working Capital Funds			
Intragovernmental Gross Costs		$ 16,346.7	$ 12,762.7
(Less: Intragovernmental Earned Revenue)		(78,657.7)	(75,561.5)
Intragovernmental Net Costs		$ (62,311.0)	$ (62,798.9)
Gross Costs With the Public		82,433.9	0.0
(Less: Earned Revenue From the Public)		(18,183.2)	0.0
Net Costs With the Public		$ 64,250.7	$ 0.0
Total Net Cost		$ 1,939.7	$ (62,798.9)
I. Other			
Intragovernmental Gross Costs	$ (6.3)	$ 74,233.2	$ 141,658.4
(Less: Intragovernmental Earned Revenue)	1,698.2	21,087.1	(16,432.3)
Intragovernmental Net Costs	$ 1,691.9	$ 95,320.3	$ 125,226.1
Gross Costs With the Public	(1,698.2)	(39,786.5)	0.0
(Less: Earned Revenue From the Public)	0.0	(3,351.3)	0.0
Net Costs With the Public	$ (1,698.2)	$ (43,137.8)	$ 0.0
Total Net Cost	$ (6.3)	$ 52,182.5	$ 125,226.1

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	2005 Consolidated	2004 Consolidated
G. Civil Works		
Intragovernmental Gross Costs	$ 945.1	$ 893.3
(Less: Intragovernmental Earned Revenue)	(1,302.7)	(609.6)
Intragovernmental Net Costs	$ (357.6)	$ 283.7
Gross Costs With the Public	8,882.5	8,658.7
(Less: Earned Revenue From the Public)	(428.8)	(368.0)
Net Costs With the Public	$ 8,453.7	$ 8,290.7
Total Net Cost	$ 8,096.1	$ 8,574.4
H. Working Capital Funds		
Intragovernmental Gross Costs	$ 3,584.0	$ 3,380.9
(Less: Intragovernmental Earned Revenue)	(3,096.2)	(1,339.3)
Intragovernmental Net Costs	$ 487.9	$ 2,041.6
Gross Costs With the Public	82,433.9	74,938.5
(Less: Earned Revenue From the Public)	(18,183.2)	(13,788.4)
Net Costs With the Public	$ 64,250.7	$ 61,150.1
Total Net Cost	$ 64,738.6	$ 63,191.7
I. Other		
Intragovernmental Gross Costs	$ (67,425.2)	$ (46,117.9)
(Less: Intragovernmental Earned Revenue)	37,519.4	32,138.8
Intragovernmental Net Costs	$ (29,905.8)	$ (13,979.1)
Gross Costs With the Public	(39,786.5)	(46,772.3)
(Less: Earned Revenue From the Public)	(3,351.3)	(5,026.3)
Net Costs With the Public	$ (43,137.8)	$ (51,798.6)
Total Net Cost	$ (73,043.6)	$ (65,777.7)

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	Army General Fund	Navy General Fund	Air Force General Fund
J. Total Program Costs			
Intragovernmental Gross Costs	$ 39,987.3	$ 39,245.1	$ 29,845.7
(Less: Intragovernmental Earned Revenue)	(8,491.1)	(3,480.2)	(4,207.6)
Intragovernmental Net Costs	$ 31,496.2	$ 35,764.9	$ 25,638.1
Gross Costs With the Public	116,179.3	84,365.8	99,536.3
(Less: Earned Revenue From the Public)	(1,249.4)	(4,701.0)	(879.8)
Net Costs With the Public	$ 114,929.9	$ 79,664.8	$ 98,656.5
Total Net Cost	$ 146,426.1	$ 115,429.7	$ 124,294.6
Cost Not Assigned to Programs	0.0	0.0	0.0
(Less:Earned Revenue Not Attributable to Programs)	0.0	0.0	0.0
Net Cost of Operations	$ 146,426.1	$ 115,429.7	$ 124,294.6

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	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
J. Total Program Costs			
Intragovernmental Gross Costs	$ 2,016.2	$ 5,567.5	$ 5,312.7
(Less: Intragovernmental Earned Revenue)	(7,556.4)	(20,715.9)	(10,643.2)
Intragovernmental Net Costs	$ (5,540.2)	$ (15,148.4)	$ (5,330.5)
Gross Costs With the Public	10,600.4	19,256.8	5,201.5
(Less: Earned Revenue From the Public)	(6,918.3)	(1,524.5)	(771.7)
Net Costs With the Public	$ 3,682.1	$ 17,732.3	$ 4,429.8
Total Net Cost	$ (1,858.1)	$ 2,583.9	$ (900.7)
Cost Not Assigned to Programs	0.0	0.0	0.0
(Less:Earned Revenue Not Attributable to Programs)	0.0	0.0	0.0
Net Cost of Operations	$ (1,858.1)	$ 2,583.9	$ (900.7)

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	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
J. Total Program Costs			
Intragovernmental Gross Costs	$ 0.0	$ 1,378.8	$ 54,949.6
(Less: Intragovernmental Earned Revenue)	(48,812.2)	(2,152.8)	(4,546.5)
Intragovernmental Net Costs	$ (48,812.2)	$ (774.0)	$ 50,403.1
Gross Costs With the Public	96,694.4	8,882.5	130,767.6
(Less: Earned Revenue From the Public)	0.0	(428.8)	(1,500.8)
Net Costs With the Public	$ 96,694.4	$ 8,453.7	$ 129,266.8
Total Net Cost	$ 47,882.2	$ 7,679.7	$ 179,669.9
Cost Not Assigned to Programs	0.0	0.0	0.0
(Less:Earned Revenue Not Attributable to Programs)	0.0	0.0	0.0
Net Cost of Operations	$ 47,882.2	$ 7,679.7	$ 179,669.9

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	Other Defense Organizations Working Capital Funds	DoD Medicare-Eligible Retiree Health Care Fund	Agency-Wide Component
J. Total Program Costs			
Intragovernmental Gross Costs	$ 3,450.3	$ 1,561.3	$ (6.3)
(Less: Intragovernmental Earned Revenue)	(39,742.2)	(28,412.4)	1,698.2
Intragovernmental Net Costs	$ (36,291.9)	$ (26,851.1)	$ 1,691.9
Gross Costs With the Public	47,375.2	38,415.0	(1,698.2)
(Less: Earned Revenue From the Public)	(8,968.7)	0.0	0.0
Net Costs With the Public	$ 38,406.5	$ 38,415.0	$ (1,698.2)
Total Net Cost	$ 2,114.6	$ 11,563.9	$ (6.3)
Cost Not Assigned to Programs	0.0	0.0	0.0
(Less:Earned Revenue Not Attributable to Programs)	0.0	0.0	0.0
Net Cost of Operations	$ 2,114.6	$ 11,563.9	$ (6.3)

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	Combined Total	Elimination	2005 Consolidated
J. Total Program Costs			
Intragovernmental Gross Costs	$ 183,308.2	$ 158,798.2	$ 24,510.0
(Less: Intragovernmental Earned Revenue)	(177,062.3)	(158,798.2)	(18,264.1)
Intragovernmental Net Costs	$ 6,245.9	$ 0.0	$ 6,245.9
Gross Costs With the Public	655,576.6	0.0	655,576.6
(Less: Earned Revenue From the Public)	(26,943.0)	0.0	(26,943.0)
Net Costs With the Public	$ 628,633.6	$ 0.0	$ 628,633.6
Total Net Cost	$ 634,879.5	$ 0.0	$ 634,879.5
Cost Not Assigned to Programs	0.0	0.0	0.0
(Less:Earned Revenue Not Attributable to Programs)	0.0	0.0	0.0
Net Cost of Operations	$ 634,879.5	$ 0.0	$ 634,879.5

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	2004 Consolidated
J. Total Program Costs	
Intragovernmental Gross Costs	$ 23,574.5
(Less: Intragovernmental Earned Revenue)	(15,429.0)
Intragovernmental Net Costs	$ 8,145.5
Gross Costs With the Public	619,573.8
(Less: Earned Revenue From the Public)	(22,354.4)
Net Costs With the Public	$ 597,219.4
Total Net Cost	$ 605,364.9
Cost Not Assigned to Programs	0.0
(Less:Earned Revenue Not Attributable to Programs)	0.0
Net Cost of Operations	$ 605,364.9

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CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2005 and 2004
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	Army General Fund	Navy General Fund	Air Force General Fund
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 109,208.0	$ 188,170.3	$ 168,982.1
Adjustments (+/-)			
Changes in Accounting Principles (+/-)	(0.2)	0.0	0.0
Correction of Errors (+/-)	(0.1)	0.0	0.0
Beginning Balances, as adjusted	109,207.7	188,170.3	168,982.1
Budgetary Financing Sources:			
Appropriations received	0.0	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	150,048.8	119,015.7	114,970.0
Nonexchange revenue	9.5	0.2	0.9
Donations and forfeitures of cash and cash equivalents	5.4	29.6	1.9
Transfers-in/out without reimbursement (+/-)	3,721.7	150.0	967.4
Other budgetary financing sources (+/-)	2.1	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	528.1	(1.7)	(25.6)
Imputed financing from costs absorbed by others	1,092.8	585.7	742.0
Other (+/-)	(2,947.4)	0.0	0.0
Total Financing Sources	152,461.0	119,779.5	116,656.6
Net Cost of Operations (+/-)	146,426.1	115,429.7	124,294.6
Net Change	6,034.9	4,349.8	(7,638.0)
Ending Balance	$ 115,242.6	$ 192,520.1	$ 161,344.1
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 73,238.3	$ 79,161.8	$ 49,660.7
Prior period adjustments (+/-)			
Changes in Accounting Principles (+/-)	0.0	0.0	0.0
Correction of Errors (+/-)	0.0	0.0	0.0
Beginning Balances, as adjusted	73,238.3	79,161.8	49,660.7
Budgetary Financing Sources:			
Appropriations received	149,831.9	130,972.5	128,888.2
Appropriations transferred-in/out (+/-)	2,560.7	164.7	1,631.2
Other adjustments (rescissions, etc) (+/-)	(877.4)	(1,543.4)	(1,493.5)
Appropriations used	(150,048.8)	(119,015.7)	(114,970.0)
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0	0.0
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	1,466.4	10,578.1	14,055.9
Net Cost of Operations (+/-)			
Net Change	1,466.4	10,578.1	14,055.9
Ending Balance	$ 74,704.7	$ 89,739.9	$ 63,716.6

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	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 15,370.8	$ 16,021.9	$ 21,890.4
Adjustments (+/-)			
Changes in Accounting Principles (+/-)	0.0	0.0	3,632.6
Correction of Errors (+/-)	0.0	0.0	7,256.6
Beginning Balances, as adjusted	15,370.8	16,021.9	32,779.6
Budgetary Financing Sources:			
Appropriations received	0.0	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	0.1	288.0	0.0
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	(516.0)	(84.8)	(73.9)
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	147.1	552.6	168.4
Other (+/-)	230.9	(653.6)	0.0
Total Financing Sources	(137.9)	102.2	94.5
Net Cost of Operations (+/-)	(1,858.1)	2,583.9	(900.7)
Net Change	1,720.2	(2,481.7)	995.2
Ending Balance	$ 17,091.0	$ 13,540.2	$ 33,774.8
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 0.1	$ 0.0	$ 0.0
Prior period adjustments (+/-)			
Changes in Accounting Principles (+/-)	0.0	0.0	0.0
Correction of Errors (+/-)	0.0	0.0	0.0
Beginning Balances, as adjusted	0.1	0.0	0.0
Budgetary Financing Sources:			
Appropriations received	0.0	298.0	0.0
Appropriations transferred-in/out (+/-)	0.0	(3.7)	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	(0.1)	(288.0)	0.0
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0	0.0
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	(0.1)	6.3	0.0
Net Cost of Operations (+/-)			
Net Change	(0.1)	6.3	0.0
Ending Balance	$ 0.0	$ 6.3	$ 0.0

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	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ (649,695.1)	$ 32,276.3	$ (199,854.0)
Adjustments (+/-)			
Changes in Accounting Principles (+/-)	0.0	0.0	0.0
Correction of Errors (+/-)	0.0	0.0	(1,290.6)
Beginning Balances, as adjusted	(649,695.1)	32,276.3	(201,144.6)
Budgetary Financing Sources:			
Appropriations received	0.0	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	0.0	4,009.7	101,789.8
Nonexchange revenue	0.0	1,632.7	0.3
Donations and forfeitures of cash and cash equivalents	0.0	0.0	5.7
Transfers-in/out without reimbursement (+/-)	0.0	326.3	5.6
Other budgetary financing sources (+/-)	0.0	0.3	(1.9)
Other Financing Sources:			
Donations and forfeitures of property	0.0	1.5	0.0
Transfers-in/out without reimbursement (+/-)	0.0	(3.0)	(692.2)
Imputed financing from costs absorbed by others	0.0	241.6	632.9
Other (+/-)	0.0	0.7	1,737.9
Total Financing Sources	0.0	6,209.8	103,478.1
Net Cost of Operations (+/-)	47,882.2	7,679.7	179,669.9
Net Change	(47,882.2)	(1,469.9)	(76,191.8)
Ending Balance	$ (697,577.3)	$ 30,806.4	$ (277,336.4)
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 0.0	$ 396.4	$ 40,827.5
Prior period adjustments (+/-)			
Changes in Accounting Principles (+/-)	0.0	0.0	0.0
Correction of Errors (+/-)	0.0	0.0	1,290.6
Beginning Balances, as adjusted	0.0	396.4	42,118.1
Budgetary Financing Sources:			
Appropriations received	0.0	4,629.5	107,949.5
Appropriations transferred-in/out (+/-)	0.0	27.5	(4,881.3)
Other adjustments (rescissions, etc) (+/-)	0.0	(37.9)	(1,126.0)
Appropriations used	0.0	(4,009.7)	(101,789.8)
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0	0.0
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	0.0	609.4	152.4
Net Cost of Operations (+/-)			
Net Change	0.0	609.4	152.4
Ending Balance	$ 0.0	$ 1,005.8	$ 42,270.5

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	Other Defense Organizations Working Capital Funds	DoD Medicare-Eligible Retiree Health Care Fund	Agency-Wide Component
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 18,284.2	$ (466,096.2)	$ 0.0
Adjustments (+/-)			
Changes in Accounting Principles (+/-)	0.0	0.0	0.0
Correction of Errors (+/-)	1,290.6	0.0	0.0
Beginning Balances, as adjusted	19,574.8	(466,096.2)	0.0
Budgetary Financing Sources:			
Appropriations received	0.0	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	1,458.4	0.0	0.0
Nonexchange revenue	21.4	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	(1,319.9)	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	180.1	0.0	0.0
Imputed financing from costs absorbed by others	308.5	0.0	(6.3)
Other (+/-)	(537.0)	0.0	0.0
Total Financing Sources	111.5	0.0	(6.3)
Net Cost of Operations (+/-)	2,114.6	11,563.9	(6.3)
Net Change	(2,003.1)	(11,563.9)	0.0
Ending Balance	$ 17,571.7	$ (477,660.1)	$ 0.0
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 529.1	$ 0.0	$ 0.0
Prior period adjustments (+/-)			
Changes in Accounting Principles (+/-)	0.0	0.0	0.0
Correction of Errors (+/-)	(1,290.6)	0.0	0.0
Beginning Balances, as adjusted	(761.5)	0.0	0.0
Budgetary Financing Sources:			
Appropriations received	2,420.5	0.0	0.0
Appropriations transferred-in/out (+/-)	(150.8)	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	(1,458.4)	0.0	0.0
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0	0.0
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	811.3	0.0	0.0
Net Cost of Operations (+/-)			
Net Change	811.3	0.0	0.0
Ending Balance	$ 49.8	$ 0.0	$ 0.0

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Combined Total	Elimination	2005 Consolidated
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ (745,441.3)	$ 0.0	$ (745,441.3)
Adjustments (+/-)			
Changes in Accounting Principles (+/-)	3,632.4	0.0	3,632.4
Correction of Errors (+/-)	7,256.5	0.0	7,256.5
Beginning Balances, as adjusted	(734,552.4)	0.0	(734,552.4)
Budgetary Financing Sources:			
Appropriations received	0.0	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	0.0	0.0
Appropriations used	491,580.5	0.0	491,580.5
Nonexchange revenue	1,665.0	0.0	1,665.0
Donations and forfeitures of cash and cash equivalents	42.6	0.0	42.6
Transfers-in/out without reimbursement (+/-)	3,176.4	0.0	3,176.4
Other budgetary financing sources (+/-)	0.5	0.0	0.5
Other Financing Sources:			
Donations and forfeitures of property	1.5	0.0	1.5
Transfers-in/out without reimbursement (+/-)	(14.3)	0.0	(14.3)
Imputed financing from costs absorbed by others	4,465.3	0.0	4,465.3
Other (+/-)	(2,168.5)	0.0	(2,168.5)
Total Financing Sources	498,749.0	0.0	498,749.0
Net Cost of Operations (+/-)	634,879.5	0.0	634,879.5
Net Change	(136,130.5)	0.0	(136,130.5)
Ending Balance	$ (870,682.9)	$ 0.0	$ (870,682.9)
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 243,813.9	$ 0.0	$ 243,813.9
Prior period adjustments (+/-)			
Changes in Accounting Principles (+/-)	0.0	0.0	0.0
Correction of Errors (+/-)	0.0	0.0	0.0
Beginning Balances, as adjusted	243,813.9	0.0	243,813.9
Budgetary Financing Sources:			
Appropriations received	524,990.1	0.0	524,990.1
Appropriations transferred-in/out (+/-)	(651.7)	0.0	(651.7)
Other adjustments (rescissions, etc) (+/-)	(5,078.2)	0.0	(5,078.2)
Appropriations used	(491,580.5)	0.0	(491,580.5)
Nonexchange revenue	0.0	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0	0.0
Other Financing Sources:			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0	0.0
Other (+/-)	0.0	0.0	0.0
Total Financing Sources	27,679.7	0.0	27,679.7
Net Cost of Operations (+/-)			
Net Change	27,679.7	0.0	27,679.7
Ending Balance	$ 271,493.6	$ 0.0	$ 271,493.6

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2005 and 2004
($ in Millions)

		2004 Consolidated Restated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$	(621,610.7)
Adjustments (+/-)		
Changes in Accounting Principles (+/-)		699.5
Correction of Errors (+/-)		(8,301.8)
Beginning Balances, as adjusted		(629,213.0)
Budgetary Financing Sources:		
Appropriations received		0.0
Appropriations transferred-in/out (+/-)		0.0
Other adjustments (rescissions, etc) (+/-)		0.0
Appropriations used		478,621.1
Nonexchange revenue		1,469.7
Donations and forfeitures of cash and cash equivalents		7.0
Transfers-in/out without reimbursement (+/-)		10,568.6
Other budgetary financing sources (+/-)		4,511.5
Other Financing Sources:		
Donations and forfeitures of property		0.4
Transfers-in/out without reimbursement (+/-)		(2,848.6)
Imputed financing from costs absorbed by others		4,092.5
Other (+/-)		0.6
Total Financing Sources		496,422.8
Net Cost of Operations (+/-)		605,364.9
Net Change		(108,942.1)
Ending Balance	$	(738,155.1)
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$	192,955.8
Prior period adjustments (+/-)		
Changes in Accounting Principles (+/-)		0.0
Correction of Errors (+/-)		25,913.7
Beginning Balances, as adjusted		218,869.5
Budgetary Financing Sources:		
Appropriations received		512,194.5
Appropriations transferred-in/out (+/-)		485.6
Other adjustments (rescissions, etc) (+/-)		(9,114.6)
Appropriations used		(478,621.1)
Nonexchange revenue		0.0
Donations and forfeitures of cash and cash equivalents		0.0
Transfers-in/out without reimbursement (+/-)		0.0
Other budgetary financing sources (+/-)		0.0
Other Financing Sources:		
Donations and forfeitures of property		0.0
Transfers-in/out without reimbursement (+/-)		0.0
Imputed financing from costs absorbed by others		0.0
Other (+/-)		0.0
Total Financing Sources		24,944.4
Net Cost of Operations (+/-)		
Net Change		24,944.4
Ending Balance	$	243,813.9

Department of Defense
Agency Wide
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Army General Fund	Navy General Fund	Air Force General Fund
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 149,846.9	$ 131,002.4	$ 128,891.0
Borrowing authority	0.0	0.0	0.0
Contract authority	0.0	0.0	0.0
Net transfers (+/-)	1,046.6	361.3	638.2
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	22,880.9	18,027.9	9,043.4
Net transfers, actual (+/-)	2,369.2	(46.6)	1,960.3
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	20,948.2	8,830.6	8,923.5
Receivable from Federal sources	(415.1)	696.7	142.9
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	77.7	147.7	349.7
Without advance from Federal sources	2,159.9	(636.4)	388.5
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Previously unavailable	0.0	0.0	0.0
Transfers for trust funds	0.0	0.0	0.0
Subtotal	22,770.7	9,038.6	9,804.6
Recoveries of prior year obligations	17,033.4	11,446.4	1,300.2
Temporarily not available pursuant to Public Law	0.0	0.0	0.0
Permanently not available	(877.5)	(1,543.4)	(1,493.5)
Total Budgetary Resources	$ 215,070.2	$ 168,286.6	$ 150,144.2
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 175,086.2	$ 137,694.4	$ 124,689.4
Reimbursable	24,506.7	13,463.8	12,448.6
Subtotal	199,592.9	151,158.2	137,138.0
Unobligated balance:			
Apportioned	13,665.5	15,607.5	11,756.9
Exempt from apportionment	12.0	0.0	3.2
Other available	(0.1)	(0.1)	0.0
Unobligated Balances Not Available	1,799.9	1,521.0	1,246.1
Total, Status of Budgetary Resources	$ 215,070.2	$ 168,286.6	$ 150,144.2
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ 57,022.4	$ 63,856.2	$ 51,504.1
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	(1,478.3)	(1,234.2)	(1,619.6)
Unfilled customer order from Federal sources	(14,873.1)	(2,166.6)	(1,215.9)
Undelivered orders	66,772.3	68,731.0	42,643.7
Accounts payable	13,948.6	3,362.2	9,197.1
Outlays:			
Disbursements	173,467.6	134,815.3	137,805.1
Collections	(21,026.0)	(8,978.3)	(9,273.2)
Subtotal	152,441.6	125,837.0	128,531.9
Less: Offsetting receipts	(195.2)	(115.8)	(123.2)
Net Outlays	$ 152,246.4	$ 125,721.2	$ 128,408.7

Department of Defense
Agency Wide
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 0.0	$ 298.0	$ 0.0
Borrowing authority	0.0	0.0	0.0
Contract authority	10,951.9	865.3	9,744.3
Net transfers (+/-)	0.0	(3.8)	0.0
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	1,530.1	2,749.8	134.4
Net transfers, actual (+/-)	(515.9)	(84.6)	(73.9)
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	14,180.3	23,151.3	16,559.4
Receivable from Federal sources	(29.4)	(233.7)	50.4
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	19.3	8.2	(121.4)
Without advance from Federal sources	(774.2)	250.0	692.7
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Previously unavailable	0.0	0.0	0.0
Transfers for trust funds	0.0	0.0	0.0
Subtotal	13,396.0	23,175.8	17,181.1
Recoveries of prior year obligations	1,435.6	0.0	0.0
Temporarily not available pursuant to Public Law	0.0	0.0	0.0
Permanently not available	(8,798.8)	(247.8)	(10,801.2)
Total Budgetary Resources	$ 17,998.9	$ 26,752.7	$ 16,184.7
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 0.0	$ 0.0	$ 0.0
Reimbursable	16,822.4	23,936.0	15,892.1
Subtotal	16,822.4	23,936.0	15,892.1
Unobligated balance:			
Apportioned	1,176.5	2,768.1	292.7
Exempt from apportionment	0.0	(143.7)	0.0
Other available	0.0	0.0	(0.1)
Unobligated Balances Not Available	0.0	192.3	0.0
Total, Status of Budgetary Resources	$ 17,998.9	$ 26,752.7	$ 16,184.7
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ 3,968.1	$ 4,238.7	$ 4,756.0
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	(433.2)	(356.8)	(1,009.2)
Unfilled customer order from Federal sources	(3,748.5)	(7,281.4)	(3,958.2)
Undelivered orders	9,775.6	7,468.9	6,461.7
Accounts payable	555.9	5,198.4	2,159.6
Outlays:			
Disbursements	14,008.7	23,129.3	16,251.0
Collections	(14,199.6)	(23,159.5)	(16,438.0)
Subtotal	(190.9)	(30.2)	(187.0)
Less: Offsetting receipts	0.0	0.0	0.0
Net Outlays	$ (190.9)	$ (30.2)	$ (187.0)

Department of Defense
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COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 49,172.0	$ 5,987.9	$ 109,222.0
Borrowing authority	0.0	0.0	0.0
Contract authority	0.0	0.0	367.0
Net transfers (+/-)	0.0	265.0	(2,376.4)
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	(0.1)	1,693.3	15,374.9
Net transfers, actual (+/-)	0.0	(7.6)	(2,504.9)
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	0.0	6,471.7	7,215.4
Receivable from Federal sources	0.0	11.1	(313.0)
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	0.0	(34.3)	44.3
Without advance from Federal sources	0.0	3,306.3	(94.8)
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Previously unavailable	0.0	0.0	0.0
Transfers for trust funds	0.0	0.0	0.0
Subtotal	0.0	9,754.8	6,851.9
Recoveries of prior year obligations	0.0	0.0	5,072.5
Temporarily not available pursuant to Public Law	(10,005.7)	(10.0)	(20.2)
Permanently not available	0.0	(38.4)	(1,497.5)
Total Budgetary Resources	$ 39,166.2	$ 17,645.0	$ 130,489.3
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 39,166.2	$ 5,739.5	$ 111,600.4
Reimbursable	0.0	6,902.4	5,447.4
Subtotal	39,166.2	12,641.9	117,047.8
Unobligated balance:			
Apportioned	0.0	4,421.1	9,462.2
Exempt from apportionment	0.0	582.0	81.6
Other available	0.0	(0.1)	0.1
Unobligated Balances Not Available	0.0	0.1	3,897.6
Total, Status of Budgetary Resources	$ 39,166.2	$ 17,645.0	$ 130,489.3
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ 3,120.2	$ 1,038.7	$ 32,929.2
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	0.0	(235.8)	(753.7)
Unfilled customer order from Federal sources	0.0	(5,214.2)	(1,272.4)
Undelivered orders	0.0	2,862.4	31,136.1
Accounts payable	3,321.1	1,083.0	4,635.0
Outlays:			
Disbursements	38,965.4	11,867.7	111,567.4
Collections	0.0	(6,437.4)	(7,259.7)
Subtotal	38,965.4	5,430.3	104,307.7
Less: Offsetting receipts	(22,897.0)	(1,744.7)	(1,617.6)
Net Outlays	$ 16,068.4	$ 3,685.6	$ 102,690.1

Department of Defense
Agency Wide
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Other Defense Organizations Working Capital Funds	DoD Medicare-Eligible Retiree Health Care Fund	Agency-Wide Component
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 2,420.5	$ 28,128.8	$ 0.0
Borrowing authority	0.0	0.0	0.0
Contract authority	34,824.6	0.0	0.0
Net transfers (+/-)	(150.9)	0.0	0.0
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	1,641.7	206.6	0.0
Net transfers, actual (+/-)	(611.5)	0.0	0.0
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	52,647.6	0.0	0.0
Receivable from Federal sources	71.9	0.0	0.0
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	150.8	0.0	0.0
Without advance from Federal sources	(226.1)	0.0	0.0
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Previously unavailable	0.0	0.0	0.0
Transfers for trust funds	0.0	0.0	0.0
Subtotal	52,644.2	0.0	0.0
Recoveries of prior year obligations	88.6	0.0	0.0
Temporarily not available pursuant to Public Law	0.0	(21,839.5)	0.0
Permanently not available	(33,001.6)	0.0	0.0
Total Budgetary Resources	$ 57,855.6	$ 6,495.9	$ 0.0
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 1,142.0	$ 6,398.7	$ 0.0
Reimbursable	56,563.7	0.0	0.0
Subtotal	57,705.7	6,398.7	0.0
Unobligated balance:			
Apportioned	(40.8)	97.2	0.0
Exempt from apportionment	190.8	0.0	0.0
Other available	(0.1)	0.0	0.0
Unobligated Balances Not Available	0.0	0.0	0.0
Total, Status of Budgetary Resources	$ 57,855.6	$ 6,495.9	$ 0.0
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ 10,538.4	$ 262.1	$ 0.0
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	(2,997.9)	0.0	0.0
Unfilled customer order from Federal sources	(4,737.7)	0.0	0.0
Undelivered orders	14,155.3	146.2	0.0
Accounts payable	6,589.7	241.7	0.0
Outlays:			
Disbursements	55,300.2	6,272.9	0.0
Collections	(52,798.4)	0.0	0.0
Subtotal	2,501.8	6,272.9	0.0
Less: Offsetting receipts	0.0	(28,379.4)	0.0
Net Outlays	$ 2,501.8	$ (22,106.5)	$ 0.0

Department of Defense
Agency Wide
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
($ in Millions)

	2005 Combined	2004 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 604,969.5	$ 582,010.7
Borrowing authority	0.0	0.1
Contract authority	56,753.1	34,855.8
Net transfers (+/-)	(220.0)	(519.3)
Other	0.0	0.0
Unobligated balance:		
Beginning of period	73,282.9	256,659.0
Net transfers, actual (+/-)	484.5	782.0
Anticipated Transfers Balances	0.0	0.0
Spending authority from offsetting collections:		
Earned	0.0	0.0
Collected	158,928.0	146,274.3
Receivable from Federal sources	(18.2)	(79.7)
Change in unfilled customer orders	0.0	0.0
Advance received	642.0	360.5
Without advance from Federal sources	5,065.9	980.0
Anticipated for the rest of year, without advances	0.0	0.0
Previously unavailable	0.0	0.0
Transfers for trust funds	0.0	0.0
Subtotal	164,617.7	147,535.1
Recoveries of prior year obligations	36,376.7	33,681.9
Temporarily not available pursuant to Public Law	(31,875.4)	(10.0)
Permanently not available	(58,299.7)	(40,338.0)
Total Budgetary Resources	$ 846,089.3	$ 1,014,657.3
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 601,516.8	$ 568,053.7
Reimbursable	175,983.1	152,658.9
Subtotal	777,499.9	720,712.6
Unobligated balance:		
Apportioned	59,206.9	58,631.0
Exempt from apportionment	725.9	183,488.1
Other available	(0.4)	0.3
Unobligated Balances Not Available	8,657.0	51,825.3
Total, Status of Budgetary Resources	$ 846,089.3	$ 1,014,657.3
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	$ 233,234.1	$ 214,371.9
Obligated Balance transferred, net (+/-)	0.0	(14.1)
Obligated Balance, Net - end of period:		
Accounts receivable	(10,118.7)	(10,136.8)
Unfilled customer order from Federal sources	(44,468.0)	(39,402.0)
Undelivered orders	250,153.2	228,801.3
Accounts payable	50,292.3	53,470.6
Outlays:		
Disbursements	723,450.6	667,755.1
Collections	(159,570.1)	(146,634.7)
Subtotal	563,880.5	521,120.4
Less: Offsetting receipts	(55,072.9)	(46,546.4)
Net Outlays	$ 508,807.6	$ 474,574.0

Department of Defense
Agency Wide
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Army General Fund
NONBUDGETARY FINANCING ACCOUNTS	
BUDGETARY RESOURCES	
Budget Authority:	
Appropriations received	$ 0.0
Borrowing authority	0.0
Contract authority	0.0
Net transfers (+/-)	0.0
Other	0.0
Unobligated balance:	
Beginning of period	1.4
Net transfers, actual (+/-)	0.0
Anticipated Transfers Balances	0.0
Spending authority from offsetting collections:	
Earned	0.0
Collected	0.1
Receivable from Federal sources	0.0
Change in unfilled customer orders	0.0
Advance received	0.0
Without advance from Federal sources	0.0
Anticipated for the rest of year, without advances	0.0
Previously unavailable	0.0
Transfers from trust funds	0.0
Subtotal	0.1
Recoveries of prior year obligations	0.0
Temporarily not available pursuant to Public Law	0.0
Permanently not available	0.0
Total Budgetary Resources	$ 1.5
STATUS OF BUDGETARY RESOURCES	
Obligations incurred:	
Direct	$ 0.0
Reimbursable	0.0
Subtotal	0.0
Unobligated balance:	
Apportioned	1.5
Exempt from apportionment	0.0
Other available	0.0
Unobligated Balances Not Available	0.0
Total, Status of Budgetary Resources	$ 1.5
Relationship of Obligations to Outlays:	
Obligated Balance, Net ? beginning of period	$ 0.0
Obligated Balance transferred, net (+/-)	0.0
Obligated Balance, Net - end of period:	
Accounts receivable	0.0
Unfilled customer order from Federal sources	0.0
Undelivered orders	0.0
Accounts payable	0.0
Outlays:	
Disbursements	0.0
Collections	(0.1)
Subtotal	(0.1)
Less: Offsetting receipts	0.0
Net Outlays	$ (0.1)

Department of Defense
Agency Wide
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
NONBUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 0.0	$ 0.0	$ 0.0
Borrowing authority	0.0	0.0	170.3
Contract authority	0.0	0.0	0.0
Net transfers (+/-)	0.0	0.0	0.0
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	0.0	0.0	23.2
Net transfers, actual (+/-)	0.0	0.0	0.0
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	0.0	0.0	16.8
Receivable from Federal sources	0.0	0.0	0.0
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	0.0	0.0	0.0
Without advance from Federal sources	0.0	0.0	40.6
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Previously unavailable	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	0.0	0.0	57.4
Recoveries of prior year obligations	0.0	0.0	0.0
Temporarily not available pursuant to Public Law	0.0	0.0	0.0
Permanently not available	0.0	0.0	(2.2)
Total Budgetary Resources	$ 0.0	$ 0.0	$ 248.7
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 0.0	$ 0.0	$ 215.2
Reimbursable	0.0	0.0	0.0
Subtotal	0.0	0.0	215.2
Unobligated balance:			
Apportioned	0.0	0.0	0.0
Exempt from apportionment	0.0	0.0	0.0
Other available	0.0	0.0	0.0
Unobligated Balances Not Available	0.0	0.0	33.5
Total, Status of Budgetary Resources	$ 0.0	$ 0.0	$ 248.7
Relationship of Obligations to Outlays:			
Obligated Balance, Net ? beginning of period	$ 0.0	$ 0.0	$ 155.7
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	0.0	0.0	0.0
Unfilled customer order from Federal sources	0.0	0.0	(123.7)
Undelivered orders	0.0	0.0	446.3
Accounts payable	0.0	0.0	0.0
Outlays:			
Disbursements	0.0	0.0	7.7
Collections	0.0	0.0	(16.8)
Subtotal	0.0	0.0	(9.1)
Less: Offsetting receipts	0.0	0.0	0.0
Net Outlays	$ 0.0	$ 0.0	$ (9.1)

Department of Defense
Agency Wide
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
($ in Millions)

	2005 Combined	2004 Combined
NONBUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 0.0	$ 0.0
Borrowing authority	170.3	114.6
Contract authority	0.0	0.0
Net transfers (+/-)	0.0	0.0
Other	0.0	0.0
Unobligated balance:		
Beginning of period	24.6	21.8
Net transfers, actual (+/-)	0.0	0.0
Anticipated Transfers Balances	0.0	0.0
Spending authority from offsetting collections:		
Earned	0.0	0.0
Collected	16.9	17.4
Receivable from Federal sources	0.0	(0.6)
Change in unfilled customer orders	0.0	0.0
Advance received	0.0	0.0
Without advance from Federal sources	40.6	47.2
Anticipated for the rest of year, without advances	0.0	0.0
Previously unavailable	0.0	0.0
Transfers from trust funds	0.0	0.0
Subtotal	57.5	64.0
Recoveries of prior year obligations	0.0	0.0
Temporarily not available pursuant to Public Law	0.0	0.0
Permanently not available	(2.2)	20.7
Total Budgetary Resources	$ 250.2	$ 221.1
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 215.2	$ 196.6
Reimbursable	0.0	0.0
Subtotal	215.2	196.6
Unobligated balance:		
Apportioned	1.5	1.4
Exempt from apportionment	0.0	0.0
Other available	0.0	0.0
Unobligated Balances Not Available	33.5	23.1
Total, Status of Budgetary Resources	$ 250.2	$ 221.1
Relationship of Obligations to Outlays:		
Obligated Balance, Net ? beginning of period	$ 155.7	$ 29.9
Obligated Balance transferred, net (+/-)	0.0	0.0
Obligated Balance, Net - end of period:		
Accounts receivable	0.0	0.0
Unfilled customer order from Federal sources	(123.7)	(83.1)
Undelivered orders	446.3	238.8
Accounts payable	0.0	0.0
Outlays:		
Disbursements	7.7	24.1
Collections	(16.9)	(17.4)
Subtotal	(9.2)	6.7
Less: Offsetting receipts	0.0	0.0
Net Outlays	$ (9.2)	$ 6.7

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF FINANCING
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Army General Fund	Navy General Fund	Air Force General Fund
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations incurred	$ 199,592.9	$ 151,158.2	$ 137,138.0
Less: Spending authority from offsetting collections and recoveries (-)	(39,804.4)	(20,485.1)	(11,104.9)
Obligations net of offsetting collections and recoveries	159,788.5	130,673.1	126,033.1
Less: Offsetting receipts (-)	(195.2)	(115.8)	(123.2)
Net obligations	159,593.3	130,557.3	125,909.9
Other Resources			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers in/out without reimbursement (+/-)	528.1	(1.7)	(25.6)
Imputed financing from costs absorbed by others	1,092.8	585.7	742.0
Other (+/-)	(2,947.4)	0.0	0.0
Net other resources used to finance activities	(1,326.5)	584.0	716.4
Total resources used to finance activities	158,266.8	131,141.3	126,626.3
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 (-)	(10,942.9)	(13,332.3)	(11,681.8)
Unfilled Customer Orders	2,237.7	(488.7)	738.2
Resources that fund expenses recognized in prior periods	(1,282.3)	(269.7)	(606.5)
Budgetary offsetting collections and receipts that do not affect net cost of operations	195.3	0.0	123.2
Resources that finance the acquisition of assets	(26,752.5)	(14,697.5)	(18,029.6)
Other resources or adjustments to net obligated resources that do not affect net cost of operations			
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0.0	0.0	0.0
Other (+/-)	2,419.3	1.7	25.6
Total resources used to finance items not part of the net cost of operations	(34,125.4)	(28,786.5)	(29,430.9)
Total resources used to finance the net cost of operations	124,141.4	102,354.8	97,195.4
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	91.4	170.0	81.0
Increase in environmental and disposal liability	(0.3)	1,028.8	0.0
Upward/Downward reestimates of credit subsidy expense (+/-)	0.0	0.0	0.0
Increase in exchange revenue receivable from the the public (-)	0.0	0.0	0.0
Other (+/-)	54.9	69.1	13.7
Total components of Net Cost of Operations that will require or generate resources in future periods	146.0	1,267.9	94.7
Components not Requiring or Generating Resources:			
Depreciation and amortization	16,965.2	15,844.3	11,743.1
Revaluation of assets or liabilities (+/-)	1.1	(1,785.3)	787.8
Other (+/-)			
Trust Fund Exchange Revenue	(0.1)	0.0	0.0
Cost of Goods Sold	0.0	0.0	0.0
Operating Material & Supplies Used	0.0	(2,244.2)	2,037.8
Other	5,172.5	(7.8)	12,435.8
Total components of Net Cost of Operations that will not require or generate resources	22,138.7	11,807.0	27,004.5
Total components of net cost of operations that will not require or generate resources in the current period	22,284.7	13,074.9	27,099.2
Net Cost of Operations	146,426.1	115,429.7	124,294.6

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF FINANCING
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Army Working Capital Fund	Navy Working Capital Fund	Air Force Working Capital Fund
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations incurred	$ 16,822.4	$ 23,936.0	$ 15,892.1
Less: Spending authority from offsetting collections and recoveries (-)	(14,831.6)	(23,175.8)	(17,181.1)
Obligations net of offsetting collections and recoveries	1,990.8	760.2	(1,289.0)
Less: Offsetting receipts (-)	0.0	0.0	0.0
Net obligations	1,990.8	760.2	(1,289.0)
Other Resources			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers in/out without reimbursement (+/-)	0.0	0.0	0.0
Imputed financing from costs absorbed by others	147.1	552.6	168.4
Other (+/-)	230.9	(653.6)	0.0
Net other resources used to finance activities	378.0	(101.0)	168.4
Total resources used to finance activities	2,368.8	659.2	(1,120.6)
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 (-)	(1,514.9)	(684.7)	180.3
Unfilled Customer Orders	(754.9)	258.2	571.3
Resources that fund expenses recognized in prior periods	(21.3)	0.0	(5.8)
Budgetary offsetting collections and receipts that do not affect net cost of operations	0.0	0.0	0.0
Resources that finance the acquisition of assets	(7,999.0)	(4,342.3)	(5,376.8)
Other resources or adjustments to net obligated resources that do not affect net cost of operations			
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0.0	0.0	0.0
Other (+/-)	(230.9)	653.6	0.0
Total resources used to finance items not part of the net cost of operations	(10,521.0)	(4,115.2)	(4,631.0)
Total resources used to finance the net cost of operations	(8,152.2)	(3,456.0)	(5,751.6)
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	28.9	0.0	0.0
Increase in environmental and disposal liability	0.0	0.0	0.0
Upward/Downward reestimates of credit subsidy expense (+/-)	0.0	0.0	0.0
Increase in exchange revenue receivable from the the public (-)	0.0	0.0	0.0
Other (+/-)	0.0	24.3	6.0
Total components of Net Cost of Operations that will require or generate resources in future periods	28.9	24.3	6.0
Components not Requiring or Generating Resources:			
Depreciation and amortization	95.9	205.2	190.7
Revaluation of assets or liabilities (+/-)	699.9	1,236.0	3.2
Other (+/-)			
Trust Fund Exchange Revenue	0.0	0.0	0.0
Cost of Goods Sold	6,025.4	4,574.4	5,026.6
Operating Material & Supplies Used	0.0	0.0	416.0
Other	(556.0)	0.0	(791.6)
Total components of Net Cost of Operations that will not require or generate resources	6,265.2	6,015.6	4,844.9
Total components of net cost of operations that will not require or generate resources in the current period	6,294.1	6,039.9	4,850.9
Net Cost of Operations	(1,858.1)	2,583.9	(900.7)

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF FINANCING
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations incurred	$ 39,166.2	$ 12,641.9	$ 117,263.0
Less: Spending authority from offsetting collections and recoveries (-)	0.0	(9,754.9)	(11,981.8)
Obligations net of offsetting collections and recoveries	39,166.2	2,887.0	105,281.2
Less: Offsetting receipts (-)	(22,897.0)	(1,744.7)	(1,617.6)
Net obligations	16,269.2	1,142.3	103,663.6
Other Resources			
Donations and forfeitures of property	0.0	1.5	0.0
Transfers in/out without reimbursement (+/-)	0.0	(3.0)	(692.2)
Imputed financing from costs absorbed by others	0.0	241.6	632.9
Other (+/-)	0.0	0.7	1,737.9
Net other resources used to finance activities	0.0	240.8	1,678.6
Total resources used to finance activities	16,269.2	1,383.1	105,342.2
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 (-)	0.0	(839.1)	(721.1)
Unfilled Customer Orders	0.0	3,272.0	(9.9)
Resources that fund expenses recognized in prior periods	0.0	(25.8)	(257.0)
Budgetary offsetting collections and receipts that do not affect net cost of operations	0.0	1,744.7	1,261.9
Resources that finance the acquisition of assets	0.0	(13.1)	(3,879.1)
Other resources or adjustments to net obligated resources that do not affect net cost of operations			
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0.0	(10.0)	5.8
Other (+/-)	0.0	1.6	(1,045.7)
Total resources used to finance items not part of the net cost of operations	0.0	4,130.3	(4,645.1)
Total resources used to finance the net cost of operations	16,269.2	5,513.4	100,697.1
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	0.0	0.0	243.8
Increase in environmental and disposal liability	0.0	0.0	31.4
Upward/Downward reestimates of credit subsidy expense (+/-)	0.0	0.0	0.0
Increase in exchange revenue receivable from the the public (-)	0.0	0.0	(14.6)
Other (+/-)	57,529.6	540.6	76,232.8
Total components of Net Cost of Operations that will require or generate resources in future periods	57,529.6	540.6	76,493.4
Components not Requiring or Generating Resources:			
Depreciation and amortization	0.0	1,195.6	2,107.6
Revaluation of assets or liabilities (+/-)	0.0	1,046.7	129.0
Other (+/-)			
Trust Fund Exchange Revenue	(25,915.2)	0.0	(58.7)
Cost of Goods Sold	0.0	2.8	156.9
Operating Material & Supplies Used	0.0	0.0	0.0
Other	(1.4)	(619.4)	144.6
Total components of Net Cost of Operations that will not require or generate resources	(25,916.6)	1,625.7	2,479.4
Total components of net cost of operations that will not require or generate resources in the current period	31,613.0	2,166.3	78,972.8
Net Cost of Operations	47,882.2	7,679.7	179,669.9

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF FINANCING
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Other Defense Organizations Working Capital Funds	DoD Medicare-Eligible Retiree Health Care Fund	Agency-Wide Component
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations incurred	$ 57,705.7	$ 6,398.7	$ 0.0
Less: Spending authority from offsetting collections and recoveries (-)	(52,732.9)	0.0	0.0
Obligations net of offsetting collections and recoveries	4,972.8	6,398.7	0.0
Less: Offsetting receipts (-)	0.0	(28,379.4)	0.0
Net obligations	4,972.8	(21,980.7)	0.0
Other Resources			
Donations and forfeitures of property	0.0	0.0	0.0
Transfers in/out without reimbursement (+/-)	180.1	0.0	0.0
Imputed financing from costs absorbed by others	308.5	0.0	(6.3)
Other (+/-)	(537.0)	0.0	0.0
Net other resources used to finance activities	(48.4)	0.0	(6.3)
Total resources used to finance activities	4,924.4	(21,980.7)	(6.3)
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 (-)	(2,841.7)	(13.3)	0.0
Unfilled Customer Orders	(75.3)	0.0	0.0
Resources that fund expenses recognized in prior periods	(141.6)	0.0	0.0
Budgetary offsetting collections and receipts that do not affect net cost of operations	0.0	0.0	0.0
Resources that finance the acquisition of assets	(31,624.8)	0.0	0.0
Other resources or adjustments to net obligated resources that do not affect net cost of operations			
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	(5.8)	0.0	0.0
Other (+/-)	351.1	0.0	0.0
Total resources used to finance items not part of the net cost of operations	(34,338.1)	(13.3)	0.0
Total resources used to finance the net cost of operations	(29,413.7)	(21,994.0)	(6.3)
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	0.0	0.0	0.0
Increase in environmental and disposal liability	40.4	0.0	0.0
Upward/Downward reestimates of credit subsidy expense (+/-)	0.0	0.0	0.0
Increase in exchange revenue receivable from the the public (-)	55.1	0.0	0.0
Other (+/-)	4.3	33,594.1	0.0
Total components of Net Cost of Operations that will require or generate resources in future periods	99.8	33,594.1	0.0
Components not Requiring or Generating Resources:			
Depreciation and amortization	596.4	0.0	0.0
Revaluation of assets or liabilities (+/-)	(343.3)	0.0	0.0
Other (+/-)			
Trust Fund Exchange Revenue	0.0	(33.0)	0.0
Cost of Goods Sold	30,386.3	0.0	0.0
Operating Material & Supplies Used	37.2	0.0	0.0
Other	751.9	(3.2)	0.0
Total components of Net Cost of Operations that will not require or generate resources	31,428.5	(36.2)	0.0
Total components of net cost of operations that will not require or generate resources in the current period	31,528.3	33,557.9	0.0
Net Cost of Operations	2,114.6	11,563.9	(6.3)

Department of Defense
Agency Wide
CONSOLIDATING STATEMENT OF FINANCING
For the periods ended September 30, 2005 and 2004
($ in Millions)

	2005 Combined	2004 Combined
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 777,715.1	$ 720,909.2
Less: Spending authority from offsetting collections and recoveries (-)	(201,052.5)	(181,281.0)
Obligations net of offsetting collections and recoveries	576,662.6	539,628.2
Less: Offsetting receipts (-)	(55,072.9)	(46,546.4)
Net obligations	521,589.7	493,081.8
Other Resources		
Donations and forfeitures of property	1.5	0.4
Transfers in/out without reimbursement (+/-)	(14.3)	(2,848.6)
Imputed financing from costs absorbed by others	4,465.3	4,092.5
Other (+/-)	(2,168.5)	0.6
Net other resources used to finance activities	2,284.0	1,244.9
Total resources used to finance activities	523,873.7	494,326.7
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered Orders (-)	(42,391.5)	(13,925.6)
Unfilled Customer Orders	5,748.6	1,387.4
Resources that fund expenses recognized in prior periods	(2,610.0)	(2,637.4)
Budgetary offsetting collections and receipts that do not affect net cost of operations	3,325.1	2,645.4
Resources that finance the acquisition of assets	(112,714.7)	(86,943.6)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	(10.0)	(10.0)
Other (+/-)	2,176.3	2,855.5
Total resources used to finance items not part of the net cost of operations	(146,476.2)	(96,628.3)
Total resources used to finance the net cost of operations	377,397.5	397,698.4
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	615.1	514.8
Increase in environmental and disposal liability	1,100.3	3,864.6
Upward/Downward reestimates of credit subsidy expense (+/-)	0.0	14.9
Increase in exchange revenue receivable from the the public (-)	40.5	(73.8)
Other (+/-)	168,069.4	139,064.9
Total components of Net Cost of Operations that will require or generate resources in future periods	169,825.3	143,385.4
Components not Requiring or Generating Resources:		
Depreciation and amortization	48,944.0	42,249.2
Revaluation of assets or liabilities (+/-)	1,775.1	(5,712.6)
Other (+/-)		
Trust Fund Exchange Revenue	(26,007.0)	(24,285.4)
Cost of Goods Sold	46,172.4	41,421.8
Operating Material & Supplies Used	246.8	4,655.9
Other	16,525.4	5,952.2
Total components of Net Cost of Operations that will not require or generate resources	87,656.7	64,281.1
Total components of net cost of operations that will not require or generate resources in the current period	257,482.0	207,666.5
Net Cost of Operations	634,879.5	605,364.9

Department of Defense
Agency Wide
COMBINING STATEMENT OF CUSTODIAL ACTIVITY
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Army General Fund	Navy General Fund	Air Force General Fund
SOURCE OF COLLECTIONS			
Deposits by Foreign Governments	$ 136.0	$ 0.0	$ 0.0
Seized Iraqi Cash	0.0	0.0	0.0
Other Collections	0.0	0.0	0.0
Total Cash Collections	$ 136.0	$ 0.0	$ 0.0
Accrual Adjustments (+/-)	$ 0.0	$ 0.0	$ 0.0
Total Custodial Collections	$ 136.0	$ 0.0	$ 0.0
DISPOSITION OF COLLECTIONS			
Disbursed on Behalf of Foreign Governments and International Organizations	$ 82.6	$ 0.0	$ 0.0
Seized Assets Disbursed on behalf of Iraqi People	52.1	0.0	0.0
Increase (Decrease) in Amounts to be Transferred	53.4	0.0	0.0
Collections Used for Refunds and Other Payments	0.0	0.0	0.0
Retained by The Reporting Entity	0.0	0.0	0.0
Seized Assets Retained for Support of the Iraqi People	(52.1)	0.0	0.0
Total Disposition of Collections	$ 136.0	$ 0.0	$ 0.0
NET CUSTODIAL COLLECTION ACTIVITY	$ 0.0	$ 0.0	$ 0.0

Department of Defense
Agency Wide
COMBINING STATEMENT OF CUSTODIAL ACTIVITY
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Military Retirement Fund	US Army Corps of Engineers	Other Defense Organizations General Funds
SOURCE OF COLLECTIONS			
Deposits by Foreign Governments	$ 0.0	$ 0.0	$ 10,557.1
Seized Iraqi Cash	0.0	0.0	0.0
Other Collections	0.0	0.0	0.0
Total Cash Collections	$ 0.0	$ 0.0	$ 10,557.1
Accrual Adjustments (+/-)	$ 0.0	$ 0.0	$ 0.0
Total Custodial Collections	$ 0.0	$ 0.0	$ 10,557.1
DISPOSITION OF COLLECTIONS			
Disbursed on Behalf of Foreign Governments and International Organizations	$ 0.0	$ 0.0	$ 10,988.1
Seized Assets Disbursed on behalf of Iraqi People	0.0	0.0	0.0
Increase (Decrease) in Amounts to be Transferred	0.0	0.0	(431.0)
Collections Used for Refunds and Other Payments	0.0	0.0	0.0
Retained by The Reporting Entity	0.0	0.0	0.0
Seized Assets Retained for Support of the Iraqi People	0.0	0.0	0.0
Total Disposition of Collections	$ 0.0	$ 0.0	$ 10,557.1
NET CUSTODIAL COLLECTION ACTIVITY	$ 0.0	$ 0.0	$ 0.0

Department of Defense
Agency Wide
COMBINING STATEMENT OF CUSTODIAL ACTIVITY
For the periods ended September 30, 2005 and 2004
($ in Millions)

	2005 Combined	2004 Combined
SOURCE OF COLLECTIONS		
Deposits by Foreign Governments	$ 10,693.1	$ 11,237.5
Seized Iraqi Cash	0.0	118.3
Other Collections	0.0	0.0
Total Cash Collections	$ 10,693.1	$ 11,355.8
Accrual Adjustments (+/-)	$ 0.0	$ 0.9
Total Custodial Collections	$ 10,693.1	$ 11,356.7
DISPOSITION OF COLLECTIONS		
Disbursed on Behalf of Foreign Governments and International Organizations	$ 11,070.7	$ 9,998.8
Seized Assets Disbursed on behalf of Iraqi People	52.1	283.1
Increase (Decrease) in Amounts to be Transferred	(377.6)	1,239.5
Collections Used for Refunds and Other Payments	0.0	0.0
Retained by The Reporting Entity	0.0	0.0
Seized Assets Retained for Support of the Iraqi People	(52.1)	(164.7)
Total Disposition of Collections	$ 10,693.1	$ 11,356.7
NET CUSTODIAL COLLECTION ACTIVITY	$ 0.0	$ 0.0

Required Supplementary Stewardship Information

Heritage Assets

DEPARTMENT OF DEFENSE CONSOLIDATED HERITAGE ASSETS For Fiscal Year Ended September 30, 2005					
Categories	Unit of Measure	As of 10/01/04	Additions	Deletions	As of 9/30/05
Museums	Each	166	75		241
Monuments & Memorials	Each	2,087		77	2,010
Cemeteries & Archeological Sites	Sites	25,694	68,833	56	94,471
Buildings and Structures	Each	23,533	1,778		25,311
Major Collections	Each	12	78		90

Heritage Assets are real and personal property with importance at the national level due to their significant historical (e.g., buildings on the National Registry of Historical Buildings), natural, cultural, educational, artistic, architectural, or, aesthetic value. Heritage Assets can include museums and/or their collections, art and other collections, archival records, cemeteries, monuments and memorials, and archeological sites.

Establishing items as having heritage significance varies among categories and type of assets. Subject matter experts, criteria such as listing on the National Register of Historic Places, and Federal statutes, all play a significant role in characterizing these assets.

The FY 2005 categories are defined as follows:

Museums. Buildings that house collection-type items including artwork, archeological artifacts, archival materials, and other historical artifacts. The primary use of such buildings is the preservation, maintenance and display of collection-type Heritage Assets.

Monuments and Memorials. Sites and structures built to honor and preserve the memory of significant individuals and/or events in history.

Cemeteries and Archeological Sites. Land on which gravesites of prominent historical figures are located, honored individuals, and/or items of archeological significance are located.

Buildings and Structures. Includes buildings and structures that are listed on, or are eligible for listing on, the National Register of Historic Places, including Multi-Use Heritage Assets. These buildings do not include museums.

Major Collections. Significant collections that are maintained outside of a museum.

Stewardship Land

DEPARTMENT OF DEFENSE CONSOLIDATED STEWARDSHIP LAND For Fiscal Year Ended September 30, 2005				
Land Use	As of 10/01/04	Additions	Deletions	As of 9/30/05
	(Acres in Thousands)			
Mission	16,664	5		16,669
Parks and Historic Sites	1	--	--	1
Total	16,665			16,700

Stewardship Land is land that is not acquired for, or in connection with, items of General Property, Plant and Equipment. All land, regardless of its use, provided to the Department from the Public Domain, or at no cost, is classified as Stewardship Land. Stewardship Land is reported in physical units (acres) rather than cost or fair value.

Nonfederal Physical Property

DEPARTMENT OF DEFENSE CONSOLIDATED NONFEDERAL PHYSICAL PROPERTY Annual Investments in State and Local Governments For Fiscal Years 2001 through 2005					
Categories	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
	(In Millions of Dollars)				
Transferred Assets:					
National Defense Mission Related	$95	$7	$85	$54	$71
Funded Assets:					
National Defense Mission Related	$20	$21	$11	$18	$8
Total	$115	$28	$96	$72	$79

The Department incurs investments in Nonfederal Physical Property for the purchase, construction, or major renovation of physical property owned by state and local governments, including major additions, alterations, and replacements, and the purchase of major equipment; and the purchase or improvement of other physical assets. In addition, Nonfederal Physical Property Investments include federally-owned physical property transferred to state and local governments.

Investment values included in this report are based on Nonfederal Physical Property outlays (expenditures). Outlays are used because current DoD accounting systems are unable to capture and summarize costs in accordance with Federal Accounting Standards Advisory Board requirements.

Investments In Research And Development

DEPARTMENT OF DEFENSE CONSOLIDATED INVESTMENTS IN RESEARCH AND DEVELOPMENT Annual Investments in Research and Development For Fiscal Years 2001 through 2005					
Categories	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
	(In Millions of Dollars)				
Basic Research	$1,311	$1,356	$1,444	$1,554	$1,404
Applied Research	3,843	4,311	4,388	4,639	4,527
Development					
Advanced Technology Development	4,383	4,604	5,080	6,178	7,045
Demonstration and Validation	8,166	10,525	11,928	14,779	15,971
Engineering and Manufacturing Development	8,831	9,500	11,234	14,633	16,190
Research, Development, Test & Evaluation Management Support	2,946	3,351	3,210	4,188	4,431
Operational Systems Development	11,000	11,804	12,289	14,906	16,324
Total	$40,480	$45,451	$49,573	$60,877	$65,892

Investment values included in this report are based on Research, Development, Test and Evaluation (RDT&E) outlays (expenditures). Outlays are used because current DoD accounting systems are unable to capture and summarize costs in accordance with the Federal Accounting Standards Advisory Board requirements.

The DoD Research and Development programs are classified in the following categories: Basic Research, Applied Research, and Development. The following table presents representative program examples for each of the major Research and Development categories and highlights outcomes.

Department of Defense Investment in Research and Development	
Major Program Areas	Outcomes
Basic Research Systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts • Without specific applications, processes, or products in mind	
Defense Research Sciences	• Provides new technologies for the Army's Future Force, and fosters innovation in niche areas where investment is lacking due to limited markets.
University and Industry Research Centers	• Leverages research in the private sector through Collaborative Technology Alliances, Centers of Excellence, and the University Affiliated Research Centers. Partners with academia, entertainment and gaming industries to leverage innovation research and concepts for training and design.
Digital Signal Processing	• Improved digital signal processing through holography. Holographic technology enables systems to record events in nanoseconds. Advances could lead to significant improvements in our capability to track and identify enemy aircraft and missile threats.
Studying Dolphins to Improve Sonar Techniques	• Improved sonar capabilities that can be leveraged in military, scientific, and natural science applications.
Stress and Mutations - New Method of Fighting Antibiotic Resistance by Stopping Evolution	• Elimination of antibiotic resistance by Identifying biochemical compounds that prevent mutation of bacteria.
Improved Semiconductor Devices	• Enables improved electronics that can perform in harsh environments. Possible applications include: remote-sensing platforms, light-emitting diodes, laser diodes for optical data storage, solar-blind shield surveillance systems, and biological agent detectors.
Biological Simulation Program for Intra-Cell Evaluation (Bio-SPICE)	• Cutting-edge computer modeling, simulation and analysis program, that allows researchers to use molecular methods to detect and assess the threat from pathogens, and to develop radically new methods of molecular medicine for soldier health protection. • Bio-SPICE will all be used to study and develop interventions both natural (immunologic) and therapeutic (pharmacologic).
Magnetism without Magnets	• New and unique way to obtain spin polarized carriers without having ferromagnetic injectors or contacts. This effect is very sensitive to any applied magnetic field and thus is a way to simplify structures non-magnetically and can be immediately applied for military magnetic field sensing.
Applied Research Systematic study to understand the means to meet a recognized specific national security requirement • Systematic application of knowledge to develop useful materials, devices, and system or methods	
Materials Technology	• Matures materials technology for armor and armaments lethality and survivability capabilities to be fielded in the Future Combat Systems and Future Force systems. • Translates new nanomaterials concepts into applications to increase performance and reduce weight of soldier support equipment, armor, armaments, aircraft, and ground combat vehicles.
Combat Vehicle and Automotive Technology	• Improves survivability, mobility, sustainability, and maintainability of Army ground vehicles. • Supports transformation goals by reducing reliance on heavy passive armor using a layered approach, substituting long-rang situational awareness, multi-spectral signature reduction, active protection systems and advanced lightweight armor. • Advanced technologies for critical power, propulsion and electric components, including energy storage, power distribution and pulse forming networks.
Scientists Create World's Tiniest Organic Particles	• Creation of particles, measured in hundreds of nanometers, for carrying genetic material, pharmaceuticals and other compounds of unprecedented small size and uniformity into the human body. • Profound positive impact on future human health care, including chemotherapy, gene therapy, disease detection and drug delivery.
Expeditionary Unit Water Purifier	• Mobile water purification systems that can be airlifted using transport planes to provide potable water for reconstruction, humanitarian aid and disaster relief. • Treatment of water from a variety of sources including turbid or saline water, and feed water that has nuclear, biological or chemical contamination.

Department of Defense Investment in Research and Development	
Major Program Areas	**Outcomes**
Therapy for Sleep Deprivation	• Identification of biochemical pathways that account for inter-individual differences in sleep requirements, the characterization of sleep deprivation resistant brain pathways, nutraceutical interventions for neuron preservation and enhanced learning, and novel pharmaceutical approaches that target sleep induced changes in neural signaling. The first potential transition from this program is an ampakine compound that completely reverses defects in memory and psychomotor performance caused by sleep deprivation.
Chip-Scale Atomic Clock	• Development of a small and power efficient atomic clock for use in portable applications that depend heavily on accurate timing, including jam-resistant global positioning systems, high security communications with ultra-fast frequency hopping rates or long silence intervals, high-channel density communications, high-confidence identification of friends or foes, and missile and even munitions guidance.
High Energy Liquid Laser Area Defense System	• A revolutionary 150 kW high energy laser weapon system for use on tactical platforms at a system weight of 750 kg (5kg/kW) or less.
Kits for Armored Gun Truck for Convoy Escort	• Development of a "Gun Truck" to escort convoys of unarmored or lightly armored vehicles by retrofitting standard 5-ton trucks with kits including steel and armor panels and other hardware. An early prototype truck has been operational in theater with 7th Transportation Battalion for 6 months, and 8 of the newly arrived kits have been fully assembled and are ready for use.
Development Takes what has been discovered or learned from basic and applied research and uses it to establish: • Technological feasibility • Assessment of operability • Production capability Development is comprised of five stages: • Advanced technology development • Advanced component development and prototypes • System development and demonstration • RDT&E management support • Operational systems development	
Test Ranges & Facilities and RDT&E Management Support	Sustains the Department's required developmental test and evaluation capability and operates the developmental test activities required by weapons systems developers. • Operates White Sands Missile Range (NM), Aberdeen Test Center (MD), Yuma Proving Ground (AZ), Aviation Technical Test Center (AL) and Redstone Arsenal (AL). • Supports R&D efforts and includes test ranges, military construction, maintenance support of laboratories, and O&M of test aircraft and ships. • Funds the planning, improvements and modernization for three national asset test centers. - Two efforts utilizing these unique test capabilities are the Propulsion Wind Tunnel Upgrade at Arnold Engineering Development Center and the Threat Simulator Development/Low Radar Cross Section threat modeling and simulation • Provides resources for test planning and safety verification and confirmation. • Achieved successful launches of military satellites, utilizing Titan and Atlas & Delta. • Develops the Family of Advanced Beyond Line of Sight Terminals (FAB-T) to provide robust, secure, strategic and tactical global communications for nuclear and conventional forces.

Electronic Warfare Advanced Technology	• Provides technologies for a secure, mobile, wireless network that operates in diverse and complex terrain.
	• Also matures:
	  - Protection technologies for tactical wireless networks
	  - Smart communication technologies to enable network and control of unmanned systems shortening the sensor-decider-engagement time to defeat critical targets.

Advanced Tank Armament System	• Improves the deployability and operational effectiveness of rapid response/early entry forces. • Provides immediate response by a lethal, versatile, tactically agile joint force capable of operational maneuver once in the Area of Operations • Leverages common platform/common chassis design which reduces requirements for repair parts and logistics support in the area of operations.
Multiple Launch Rocket System (MLRS) Product Improvement Program	• Supports improvements to MLRS: High Mobility Artillery Rocket System (HIMARS), M270A1, Guided Multiple Launch Rocket System (GMLRS) and GMLRS Unitary munition which provide precision strike capability.

Department of Defense Investment in Research and Development	
Major Program Areas	Outcomes
Unmanned Aerial Vehicles Collaborate	• Initiation of the Joint Operational Test Bed System with the goal of improving the war fighting capabilities of unmanned aerial vehicles using a communications network between the vehicles and base stations.
Fast and Flexible, X-CRAFT/ 'Sea Fighter' May Transform Naval Warfare	• Development of new Littoral Combat Ships (LCS) that are fast, highly maneuverable in shallow waters with minimal crew. Designed to help the Navy fight modern-day battles in ways that hulking battleships and giant aircraft carriers can not. The new class of ships is designed for patrolling coastlines, dropping mines or sensors, delivering assault teams, and intercepting or outrunning small terrorist boats. At the same time, they are designed to carry enough missiles and other weapons to bombard a good-sized city or support battlefield troops hundreds of miles inland.
Aluminum Combustor Demonstration Program	• Igniting and fully reacting aluminum with seawater vapor and integration of this technology into undersea power generating systems that power torpedoes and mini-subs.
Advanced Component Development and Prototypes	Comprises programs of system specific advanced technology integration efforts in an operational environment. • Demonstrates Fighter Aircraft Command and Control Enhancement, providing improved, beyond-line-of-sight command and control line with fighter aircraft.
Space Based Infrared System (SBIRS)	• Continues development for the Transformational Satellite Communications System (TSAT), the next-generation communication satellite. • Delivers the Counter Communications System, now operational, which is a transportable ground-based system that denies adversary satellite communications through reversible, non-destructive methods.
Air Defense Command, Control and Intelligence -- Engineering Development	• Integrates Air and Missile Defense (AMD) operations. • Provides joint command and control interoperability and horizontal integration with Patriot, the Terminal High-Altitude Area Defense (THAAD) program, the Medium Extended Air Defense System (MEADS), the Joint Land Attack Cruise Missile Defense Elevated Netted Sensor System (JLENS) and short-range air defense weapon systems.
System Demonstration and Engineering Development (SD&ED)	Further develops projects which have not received approval for full production: • Space Based Infrared System Increment 1 Mission Control System (MCS), which reduces manpower by 58% and operations and maintenance costs by 25% • F/A-22 Raptor program, continuing development of the Air Force's next-generation air dominance fighter. Significant accomplishments include: - Completion of Fatigue Testing through 2.68 lifetimes - Commencement of Initial Operational Test and Evaluation - Completion of multiple supersonic AMRAAM and AIM-9 missile shots - Exceeding over 3,100 flight test missions • F-35 Joint Strike Fighter program, developing a family of strike fighter aircraft with maximum commonality among the variants to minimize life cycle costs. Significant accomplishments include: - Completion of the Air System Design Integration and Maturity Review - Pratt & Whitney F135 First Engine to Test - General Electric F136 First Engine to Test

Required Supplementary Information

Deferred Maintenance of Real Property

Sustainment is the maintenance and repair activities necessary to keep the Department's real property (buildings, structures, and utilities) in good working order. It includes regularly scheduled adjustments and inspections, preventive maintenance tasks, and emergency response and service calls for minor repairs. It also includes major repairs or replacement of facility components (usually accomplished by contract) that are expected to occur periodically throughout the life cycle of facilities. This work includes regular roof replacement, refinishing of wall surfaces, repairing and replacement of heating and cooling systems, replacing tile and carpeting, and similar types of work. It does not include environmental compliance costs, facility leases, or other tasks associated with facilities operations (such as custodial services, grounds services, waste disposal, and the provision of central utilities). The Department's fiscal year 2005 sustainment requirements were $7.8 billion and DoD received $6.0 billion to fund these requirements leaving a deferred sustainment requirement of $1.8 billion this year. Deferred sustainment amounts were derived from the Facility Sustainment Model (FSM) output for requirements, subtracting out appropriate fiscal year execution amounts. The Department's deferred sustainment trend for the past few years is summarized in the table below:

Annual Deferred Sustainment Trend ($ Millions)						
Property Type	FY 2000	FY 2001	FY 2002	FY2003	FY2004	FY2005
Buildings, Structures, and Utilities	$629*	$2,036	$1,762	$1,555	$2,127	$1,876

*Army data only

Restoration is the restoration of the Department's real property (buildings, structures, and utilities) to such a condition that it may be used for its designated purpose. Restoration includes repair or replacement work to restore facilities damaged by inadequate sustainment, excessive age, natural disaster, fire, accident, or other causes. Modernization is the alteration or replacement of facilities solely to implement new or higher standards, to accommodate new functions, or to replace building components that typically last more than 50 years (such as the framework or foundation).

The Department's restoration and modernization requirements have steadily increased over the past few years from $41.2 billion in fiscal year 2002, to $73.6 billion in fiscal year 2004. Beginning in fiscal year 2005, the Department began transitioning to a more consistent and verifiable methodology to assess the total restoration and modernization requirements of the facilities portfolio, using a standardized quality rating system (Q rating) to replace the former Service-defined condition ratings. This transition is still in progress and will not be fully implemented and validated until early 2006. During the transition, the Department is unable to report its backlog of R&M requirements.

The United States Army Corps of Engineers reports $1,200 of deferred maintenance for water resources projects. This amount is reported separately due to the nature of the projects and the different methodology used to calculate the amount reported.

Deferred Maintenance of Military Equipment

Depot maintenance requirements for military equipment are developed during the annual budget process. The depot maintenance requirements for individual items are determined by considering numerous factors. Analysis factors include: changes in the fleet size or in-use inventory; the date of last overhaul or operating hours since last overhaul; the current maintenance engineering plan expressed as a time interval or as an operational factor; and the planned operating tempo expressed in miles, flying hours, or steaming hours.

The depot maintenance cost for each major program is determined using costing models. Fiscal constraints determine requirements that are funded. The deferred maintenance numbers reported in the table above reflect the difference. The DoD Components' financial statements contain detailed information on each program.

Military Equipment Type	**Deferred Maintenance**
	($ millions)
Aircraft	$200.4
Ships	54.2
Missiles	71.3
Combat Vehicles	191.0
Other Weapon Systems	435.4
Total	**$952.3**

Intragovernmental Amounts

The intragovernmental amounts displayed in the following schedules represent transactions between the department and other federal entities.

Schedule A - Intragovernmental Assets As of September 30, 2005					
Trading Partner	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Investments	Other
	(Amounts in millions)				
Unidentifiable Federal Agency Entity (Other than DoD entities)	00		$0.5		
Architect of the Capitol	01		0.1		
Government Accountability Office	05		0.1		
Executive Office of the President	11		2.1		
Department of Agriculture	12		17.3		$0.6
Department of Commerce	13		6.7		17.4
Department of the Interior	14		374.3		933.2
Department of Justice	15		39.3		1.3
Department of Labor	16		7.1		
United States Postal Service	18		0.8		
Department of State	19		43.2		

Schedule A - Intragovernmental Assets As of September 30, 2005					
Trading Partner	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Investments	Other
	(Amounts in millions)				
Department of the Treasury	20	$290,657.1	8.6	$263,367.8	0.2
Resolution Trust Corporation	22		0.1		
Office of Personnel Management	24				167.2
Social Security Administration	28		0.2		
Nuclear Regulatory Commission	31		0.1		
John F. Kennedy Center	33		0.9		
Department of Veterans Affairs	36		30.1		
General Service Administration	47		21.3		2.3
National Science Foundation	49		13.7		1.6
Central Intelligence Agency	56		45.7		
Tennessee Valley Authority	64		0.1		
Environmental Protection Agency	68		19.7		15.6
Department of Transportation	69		60.0		103.5
Homeland Security	70		398.7		71.6
Agency for International Development	72		1.4		
Small Business Administration	73		4.6		0.6
Department of Health and Human Services	75		29.5		0.1
National Aeronautics and Space Administration	80		34.8		69.3
Armed Forces Retirement Home	84		0.4		
Department of Housing and Urban Development	86		0.4		
Department of Energy	89		90.2		9.7
Department of Education	91		1.6		
Independent Agencies	95		19.3		
The General Fund of the Treasury	99		18.4		
TOTAL		$290,657.1	$1,291.3	$263,367.8	$1,394.2

Schedule B - Intragovernmental Liabilities As of September 30, 2005				
Trading Partner	Treasury Index	Accounts Payable	Debts/Borrowings From Other Agencies	Other
	(Amounts in millions)			
Unidentifiable Federal Agency Entity (Other than DoD entities)	00			
Library of Congress	03			
Government Printing Office	04	$3.4		$6.8
Executive Office of the President	11			46.8
Department of Agriculture	12	11.2		0.7

Schedule B - Intragovernmental Liabilities As of September 30, 2005				
Trading Partner	Treasury Index	Accounts Payable	Debts/Borrowings From Other Agencies	Other
	(Amounts in millions)			
Department of Commerce	13	8.5		1.2
Department of the Interior	14	35.3		1.0
Department of Justice	15	8.7		93.6
Department of Labor	16	19.6		1,651.7
United States Postal Service	18	1.7		
Department of State	19	26.3		11.2
Department of the Treasury	20	290.2	$467.1	175.6
Office of Personnel Management	24	43.2		288.8
Federal Communications Commission	27	2.3		
Nuclear Regulatory Commission	31	0.2		0.6
John F. Kennedy Center	33			1.0
Department of Veterans Affairs	36	17.7		1.0
General Service Administration	47	1,032.1		1.9
National Science Foundation	49	5.0		22.0
Central Intelligence Agency	56			0.3
Consumer Product Safety Commission	61			0.1
Tennessee Valley Authority	64	9.5		
Environmental Protection Agency	68	10.7		
Department of Transportation	69	96.1		1.6
Homeland Security	70	145.9		140.0
Agency for International Development	72	11.8		0.2
Small Business Administration	73	0.2		(0.1)
Department of Health and Human Services	75	2.9		50.7
National Aeronautics and Space Administration	80	93.7		0.7
Department of Housing and Urban Development	86			(0.1)
Department of Energy	89	163.9		9.2
Department of Education	91	0.1		0.2
Independent Agencies	95	(0.4)		0.3
The General Fund of the Treasury	99	18.2		8,643.8
TOTAL		$2,058.0	$467.1	$11,150.8

Schedule C - Intragovernmental Earned Revenues As of September 30, 2005		
Trading Partner	Treasury Index	Earned Revenue
	(Amounts in millions)	
Unidentifiable Federal Agency Entity (Other than DoD entities)	00	$0.6
Architect of the Capitol	01	9.8
Library of Congress	03	4.1
Government Printing Office	04	2.5
Government Accountability Office	05	2.4
Executive Office of the President	11	141.1
Department of Agriculture	12	86.8
Department of Commerce	13	64.1
Department of the Interior	14	54.0
Department of Justice	15	336.3
Department of Labor	16	12.3
United States Postal Service	18	6.2
Department of State	19	412.7
Department of the Treasury	20	13,199.1
Resolution Trust Corporation	22	0.2
Office of Personnel Management	24	11.8
National Credit Union Administration	25	2.2
Social Security Administration	28	0.4
Nuclear Regulatory Commission	31	2.4
John F. Kennedy Center	33	12.2
Department of Veterans Affairs	36	62.1
Merit Systems Protection Board	41	0.7
General Service Administration	47	62.7
National Science Foundation	49	91.6
Advisory Commission on Intergovernmental Relations	55	0.2
Central Intelligence Agency	56	346.5
Tennessee Valley Authority	64	0.3
Environmental Protection Agency	68	105.0
Department of Transportation	69	238.9
Homeland Security	70	2,230.9
Agency for International Development	72	94.6
American Battle Monuments	74	0.1

Schedule C - Intragovernmental Earned Revenues As of September 30, 2005		
Trading Partner	Treasury Index	Earned Revenue
Department of Health and Human Services	75	148.4
National Aeronautics and Space Administration	80	318.3
Export-Import Bank of the United States	83	1.0
Department of Housing and Urban Development	86	1.2
National Archives and Records Administration	88	0.1
Department of Energy	89	153.9
Department of Education	91	8.9
Independent Agencies	95	37.5
TOTAL		$18,264.1

Scedule D - Intragovernmental Gross Cost As of September 30, 2005		
Budget Functional Classification	Budget Function Code	Gross Cost
	(Amounts in millions)	
Department of Defense Military	051	$23,280.9
Water Resources by U.S. Army Corps of Engineers	301	942.6
Pollution Control and Abatement by U.S. Army Corps of Engineers	304	2.5
Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund	702	284.0
TOTAL		$24,510.0

Schedule E - Intragovernmental Nonexchange Revenues As of September 30, 2005			
Trading Partner	Treasury Index:	Transfers In	Transfers Out
		(Amounts in millions)	
Executive Office of the President	11	$2,866.5	
Department of the Interior	14	58.1	$3.2
Department of the Treasury	20	0.0	9.4
Office of Personnel Management	24	0.0	16.3
Tennessee Valley Authority	64	0.0	0.2
Department of Transportation	69	1.6	
Homeland Security	70	0.0	1.7
Department of Energy	89	228.2	
The General Fund of the Treasury	99	900.1	861.6
TOTAL		$4,054.5	$892.4

Statement of Disaggregated Budgetary Resources

Department of Defense
Agency Wide
STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Military Retirement Fund	Other	Research, Development, Test & Evaluation
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 77,300.8	$ 59,258.3	$ 66,695.7
Borrowing authority	0.0	0.0	0.0
Contract authority	0.0	367.0	0.0
Net transfers (+/-)	0.0	(2,868.6)	(466.7)
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	206.6	7,730.1	8,157.7
Net transfers, actual (+/-)	0.0	(3,670.5)	135.6
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	0.0	3,415.6	7,677.3
Receivable from Federal sources	0.0	(190.5)	157.0
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	0.0	(22.6)	286.8
Without advance from Federal sources	0.0	(93.1)	1,573.1
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	0.0	3,109.4	9,694.2
Recoveries of prior year obligations	0.0	1,687.0	2,543.7
Temporarily not available pursuant to Public Law	(31,845.3)	(20.2)	0.0
Permanently not available	0.0	(531.7)	(1,231.0)
Total Budgetary Resources	$ 45,662.1	$ 65,060.8	$ 85,529.2
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 45,564.9	$ 52,764.7	$ 65,792.0
Reimbursable	0.0	2,380.3	9,812.3
Subtotal	45,564.9	55,145.0	75,604.3
Unobligated balance:			
Apportioned	97.2	7,480.1	9,699.7
Exempt from apportionment	0.0	96.8	0.0
Other available	0.0	0.0	0.0
Unobligated Balances Not Available	0.0	2,338.9	225.2
Total, Status of Budgetary Resources	$ 45,662.1	$ 65,060.8	$ 85,529.2
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ 3,382.3	$ 8,112.2	$ 27,233.4
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	0.0	(78.1)	(812.6)
Unfilled customer order from Federal sources	0.0	(157.5)	(4,523.7)
Undelivered orders	146.2	4,112.3	32,029.9
Accounts payable	3,562.8	4,323.2	1,965.7
Outlays:			
Disbursements	45,238.3	53,654.1	69,904.6
Collections	0.0	(3,393.0)	(7,964.2)
Subtotal	45,238.3	50,261.1	61,940.4
Less: Offsetting receipts	(51,276.4)	(2,051.8)	0.0
Net Outlays	$ (6,038.1)	$ 48,209.3	$ 61,940.4

Department of Defense
Agency Wide
STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
($ in Millions)

	Civil Works	Operation and Maintenance	Procurement
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 5,987.9	$ 167,376.3	$ 96,023.7
Borrowing authority	0.0	0.0	0.0
Contract authority	0.0	0.0	0.0
Net transfers (+/-)	265.0	3,589.4	903.1
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	1,693.3	22,458.6	20,170.9
Net transfers, actual (+/-)	(7.5)	3,357.8	2,775.9
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	6,471.7	26,685.5	2,379.2
Receivable from Federal sources	11.1	343.9	(68.4)
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	(34.3)	286.1	35.0
Without advance from Federal sources	3,306.3	(652.3)	690.9
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	9,754.8	26,663.2	3,036.7
Recoveries of prior year obligations	0.0	19,755.4	5,884.0
Temporarily not available pursuant to Public Law	(10.0)	0.0	0.0
Permanently not available	(38.4)	(1,723.4)	(1,416.7)
Total Budgetary Resources	$ 17,645.1	$ 241,477.3	$ 127,377.6
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 5,739.5	$ 203,776.4	$ 97,984.7
Reimbursable	6,902.4	30,300.2	4,186.4
Subtotal	12,641.9	234,076.6	102,171.1
Unobligated balance:			
Apportioned	4,421.1	3,216.1	24,188.4
Exempt from apportionment	582.0	0.0	0.0
Other available	0.0	0.0	0.0
Unobligated Balances Not Available	0.1	4,184.6	1,018.1
Total, Status of Budgetary Resources	$ 17,645.1	$ 241,477.3	$ 127,377.6
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ 1,038.7	$ 71,601.8	$ 82,758.9
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	(235.8)	(3,567.0)	(260.4)
Unfilled customer order from Federal sources	(5,214.2)	(7,608.8)	(2,403.8)
Undelivered orders	2,862.4	69,855.9	91,056.9
Accounts payable	1,083.0	14,901.2	6,354.5
Outlays:			
Disbursements	11,867.7	212,650.1	83,676.2
Collections	(6,437.4)	(26,971.6)	(2,414.2)
Subtotal	5,430.3	185,678.5	81,262.0
Less: Offsetting receipts	(1,744.7)	0.0	0.0
Net Outlays	$ 3,685.6	$ 185,678.5	$ 81,262.0

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STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES
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($ in Millions)

	Military Personnel	Military Construction/Family Housing	Working Capital Funds
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 121,177.8	$ 8,430.5	$ 2,718.5
Borrowing authority	0.0	0.0	0.0
Contract authority	0.0	0.0	56,386.1
Net transfers (+/-)	(1,437.8)	(49.7)	(154.7)
Other	0.0	0.0	0.0
Unobligated balance:			
Beginning of period	2,163.7	4,645.8	6,056.2
Net transfers, actual (+/-)	(461.9)	(358.9)	(1,286.0)
Anticipated Transfers Balances	0.0	0.0	0.0
Spending authority from offsetting collections:			
Earned	0.0	0.0	0.0
Collected	1,127.5	4,632.6	106,538.6
Receivable from Federal sources	(79.9)	(50.7)	(140.7)
Change in unfilled customer orders	0.0	0.0	0.0
Advance received	0.0	34.1	56.9
Without advance from Federal sources	6.0	292.7	(57.7)
Anticipated for the rest of year, without advances	0.0	0.0	0.0
Transfers from trust funds	0.0	0.0	0.0
Subtotal	1,053.6	4,908.7	106,397.1
Recoveries of prior year obligations	4,044.9	937.5	1,524.2
Temporarily not available pursuant to Public Law	0.1	0.0	0.0
Permanently not available	(323.3)	(185.7)	(52,849.5)
Total Budgetary Resources	$ 126,217.1	$ 18,328.2	$ 118,791.9
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 121,223.6	$ 7,529.0	$ 1,142.0
Reimbursable	4,093.7	5,093.6	113,214.2
Subtotal	125,317.3	12,622.6	114,356.2
Unobligated balance:			
Apportioned	266.0	5,641.8	4,196.5
Exempt from apportionment	0.0	0.0	47.1
Other available	(0.2)	0.0	-(0.2)
Unobligated Balances Not Available	634.0	63.8	192.3
Total, Status of Budgetary Resources	$ 126,217.1	$ 18,328.2	$ 118,791.9
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ 8,258.3	$ 7,347.4	$ 23,501.1
Obligated Balance transferred, net (+/-)	0.0	0.0	0.0
Obligated Balance, Net - end of period:			
Accounts receivable	(172.3)	(195.4)	(4,797.1)
Unfilled customer order from Federal sources	(19.9)	(4,814.3)	(19,725.8)
Undelivered orders	282.7	11,945.3	37,861.6
Accounts payable	2,462.8	1,135.6	14,503.5
Outlays:			
Disbursements	127,051.2	10,719.2	108,689.2
Collections	(1,127.5)	(4,666.7)	(106,595.5)
Subtotal	125,923.7	6,052.5	2,093.7
Less: Offsetting receipts	0.0	0.0	0.0
Net Outlays	$ 125,923.7	$ 6,052.5	$ 2,093.7

Department of Defense
Agency Wide
STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004

($ in Millions)	2005 Combined	2004 Combined
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 604,969.5	$ 582,010.7
Borrowing authority	0.0	0.1
Contract authority	56,753.1	34,855.8
Net transfers (+/-)	(220.0)	(519.3)
Other	0.0	0.0
Unobligated balance:		
Beginning of period	73,282.9	256,659.0
Net transfers, actual (+/-)	484.5	782.0
Anticipated Transfers Balances	0.0	0.0
Spending authority from offsetting collections:		
Earned	0.0	0.0
Collected	158,928.0	146,274.3
Receivable from Federal sources	(18.2)	(79.7)
Change in unfilled customer orders	0.0	0.0
Advance received	642.0	360.5
Without advance from Federal sources	5,065.9	980.0
Anticipated for the rest of year, without advances	0.0	0.0
Transfers from trust funds	0.0	0.0
Subtotal	164,617.7	147,535.1
Recoveries of prior year obligations	36,376.7	33,681.9
Temporarily not available pursuant to Public Law	(31,875.4)	(10.0)
Permanently not available	(58,299.7)	(40,338.0)
Total Budgetary Resources	$ 846,089.3	$ 1,014,657.3
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 601,516.8	$ 568,053.7
Reimbursable	175,983.1	152,658.9
Subtotal	777,499.9	720,712.6
Unobligated balance:		
Apportioned	59,206.9	58,631.0
Exempt from apportionment	725.9	183,488.1
Other available	-(0.4)	0.3
Unobligated Balances Not Available	8,657.0	51,825.3
Total, Status of Budgetary Resources	$ 846,089.3	$ 1,014,657.3
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	$ 233,234.1	$ 214,371.9
Obligated Balance transferred, net (+/-)	0.0	(14.1)
Obligated Balance, Net - end of period:		
Accounts receivable	(10,118.7)	(10,136.8)
Unfilled customer order from Federal sources	(44,468.0)	(39,402.0)
Undelivered orders	250,153.2	228,801.3
Accounts payable	50,292.3	53,470.6
Outlays:		
Disbursements	723,450.6	667,755.1
Collections	(159,570.1)	(146,634.7)
Subtotal	563,880.5	521,120.4
Less: Offsetting receipts	(55,072.9)	(46,546.4)
Net Outlays	$ 508,807.6	$ 474,574.0

Department of Defense
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STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES
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	Military Retirement Fund	Other
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 0.0	$ 0.0
Borrowing authority	0.0	170.3
Contract authority	0.0	0.0
Net transfers (+/-)	0.0	0.0
Other	0.0	0.0
Unobligated balance:		
Beginning of period	0.0	24.6
Net transfers, actual (+/-)	0.0	0.0
Anticipated Transfers Balances	0.0	0.0
Spending authority from offsetting collections:		
Earned	0.0	0.0
Collected	0.0	16.9
Receivable from Federal sources	0.0	0.0
Change in unfilled customer orders	0.0	0.0
Advance received	0.0	0.0
Without advance from Federal sources	0.0	40.6
Anticipated for the rest of year, without advances	0.0	0.0
Transfers from trust funds	0.0	0.0
Subtotal	0.0	57.5
Recoveries of prior year obligations	0.0	0.0
Temporarily not available pursuant to Public Law	0.0	0.0
Permanently not available	0.0	(2.2)
Total Budgetary Resources	$ 0.0	$ 250.2
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 0.0	$ 215.2
Reimbursable	0.0	0.0
Subtotal	0.0	215.2
Unobligated balance:		
Apportioned	0.0	1.5
Exempt from apportionment	0.0	0.0
Other available	0.0	0.0
Unobligated Balances Not Available	0.0	33.5
Total, Status of Budgetary Resources	$ 0.0	$ 250.2
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	$ 0.0	$ 155.7
Obligated Balance transferred, net (+/-)	0.0	0.0
Obligated Balance, Net - end of period:		
Accounts receivable	0.0	0.0
Unfilled customer order from Federal sources	0.0	(123.7)
Undelivered orders	0.0	446.3
Accounts payable	0.0	0.0
Outlays:		
Disbursements	0.0	7.7
Collections	0.0	(16.9)
Subtotal	0.0	(9.2)
Less: Offsetting receipts	0.0	0.0
Net Outlays	$ 0.0	$ (9.2)

Department of Defense
Agency Wide
STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
($ in Millions)

	2005 Combined	2004 Combined
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 0.0	$ 0.0
Borrowing authority	170.3	114.6
Contract authority	0.0	0.0
Net transfers (+/-)	0.0	0.0
Other	0.0	0.0
Unobligated balance:		
Beginning of period	24.6	21.8
Net transfers, actual (+/-)	0.0	0.0
Anticipated Transfers Balances	0.0	0.0
Spending authority from offsetting collections:		
Earned	0.0	0.0
Collected	16.9	17.4
Receivable from Federal sources	0.0	(0.6)
Change in unfilled customer orders	0.0	0.0
Advance received	0.0	0.0
Without advance from Federal sources	40.6	47.2
Anticipated for the rest of year, without advances	0.0	0.0
Transfers from trust funds	0.0	0.0
Subtotal	57.5	64.0
Recoveries of prior year obligations	0.0	0.0
Temporarily not available pursuant to Public Law	0.0	0.0
Permanently not available	(2.2)	20.7
Total Budgetary Resources	$ 250.2	$ 221.1
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 215.2	$ 196.6
Reimbursable	0.0	0.0
Subtotal	215.2	196.6
Unobligated balance:		
Apportioned	1.5	1.4
Exempt from apportionment	0.0	0.0
Other available	0.0	0.0
Unobligated Balances Not Available	33.5	23.1
Total, Status of Budgetary Resources	$ 250.2	$ 221.1
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	$ 155.7	$ 29.9
Obligated Balance transferred, net (+/-)	0.0	0.0
Obligated Balance, Net - end of period:		
Accounts receivable	0.0	0.0
Unfilled customer order from Federal sources	(123.7)	(83.1)
Undelivered orders	446.3	238.8
Accounts payable	0.0	0.0
Outlays:		
Disbursements	7.7	24.1
Collections	(16.9)	(17.4)
Subtotal	(9.2)	6.7
Less: Offsetting receipts	0.0	0.0
Net Outlays	$ (9.2)	$ 6.7

Segment Information

Segment Information As of September 30, 2005								
Segment Information	Defense Information Systems Agency	Defense Commissary Agency	Joint Logistics Systems Center	Defense Security Service	Defense Logistics Agency	Defense Finance & Accounting Service	U.S. Transportation Command	Total
	(Amounts in millions)							
PART A.								
Fund Balance	$0.0	$292.0	$0.0	($114.2)	$0.0	$0.0	($125.6)	$52.2
Accounts Receivable	411.5	50.4	0.0	0.0	1,567.0	122.2	815.4	2,966.5
Property Plant and Equipment	403.1	29.4	119.5	16.0	1,896.0	789.6	1,090.0	4,343.6
Other Assets	2.9	446.9	0.0	0.0	16,206.0	0.1	18.9	16,674.8
Total Assets	$817.5	$818.7	$119.5	($98.2)	$19,669.0	$911.9	$1,798.7	$24,037.1
Liabilities Due and Payable for Goods and Services Received	985.4	550.3	0.0	1.6	2,800.2	173.4	1,241.6	5,753.8
Deferred Revenue	181.4	0.0	0.0	0.0	146.7	4.1	0.7	332.9
Other Liabilites	32.7	283.8	0.4	0.8	537.8	149.0	312.1	1,315.3
Total Liabilities	1,199.5	834.1	0.4	2.4	3,484.7	326.5	1,554.4	7,402.0
Unexpended Appropriations	0.0	49.8	0.0	0.0	0.0	0.0	0.0	49.8
Cumulative Results of Operations	(382.0)	(65.2)	119.1	(100.6)	16,184.3	585.4	244.3	16,585.3
Total Net Position	(382.0)	(15.4)	119.1	(100.6)	16,184.3	585.4	244.3	16,635.1
Total Liabilities And Net Position	$817.5	$818.7	$119.5	($98.2)	$19,669.0	$911.9	$1,798.7	$24,037.1
PART B.								
The Full Cost of Goods and Services Provides	3,757.1	6,602.4	0.6	106.1	33,095.5	1,718.2	8,992.7	54,272.6
The Related Exchange Revenue	(3,824.4)	(5,398.9)	0.0	(90.0)	(32,391.1)	(1,613.6)	(8,896.0)	(52,214.0)
The Excess of Costs Over Exchange Revenue	(67.3)	1,203.5	0.6	16.1	704.4	104.6	96.7	2,058.6

Explanation of Segment Information

Defense Information Systems Agency

The Defense Information Systems Agency (DISA) is a Defense Working Capital Fund (DWCF) entity. The Defense Megacenters and the Communications Information Services Activity provide data processing, telecommunication, and information systems service and support to the Department and other federal government customers under a revolving fund concept. DISA's major customers are the Army, Navy, Air Force, DLA, and DFAS.

Defense Commissary Agency

The Commissary Operations Fund finances the cost of operations for retail stores, command and region headquarters, and the operations support center. This fund also receives appropriated funds annually.

The Commissary Resale Stock Fund finances the purchases of inventory for resale items to be sold to commissary patrons. Revenues from sales are used to replace inventory sold.

Joint Logistics Systems Center

On August 18, 1997, the Acting Under Secretary of Defense (Comptroller) approved the decision to terminate Joint Logistics Systems Center. All of its programs and responsibilities were returned to the individual components. FY 2004 is the seventh year JLSC operated as a residual activity. There was minimal financial activity during fiscal year 2005.

Defense Security Service

Effective October 1, 1998, Defense Security Service (DSS) was transferred from a direct appropriation to a separate activity group in the DWCF. This transfer also reflected a name change from the Defense Investigative Service to the DSS. Full implementation of the DSS as a DWCF entity began with fiscal year 2000.

The DSS was chartered to administer two major programs: Personnel Security Investigations (PSI) and National Industrial Security Programs (NISP). The mission of the PSI program is to conduct background investigations on individuals assigned to or affiliated with the Department. The purpose of the NISP is to ensure that private industry, while performing on government contracts, properly safeguards classified information in its possession. The DSS also administers the Key Asset Protection Program and the Arms, Ammunition, and Explosives Program.

Defense Logistics Agency

The Defense Logistics Agency (DLA) is a combat support agency responsible for worldwide logistics support throughout the DoD. The primary focus of DLA is to provide logistics support to the war fighter. In addition, DLA provides support to relief efforts during times of national emergency. DLA's major DoD customers are the Army, Navy, and Air Force. Other major federal government customers include the Department of Agriculture and the Department of Transportation. The DLA organization has active entity sub-organizations funded through the DWCF. These sub-organizations are referred to as activity groups and are as follows:

- The Supply Management Activity Group (Supply helps carry out its mission by procuring, managing and supplying consumable items to Military Departments, other DoD Components, federal agencies and selected foreign governments.

- The Distribution Depot Activity Group (Distribution receives, stores, and distributes commodities, principal end items, and depot level reparables for the Military Departments, other DoD Components, federal agencies, and selected foreign governments.
- The Defense Reutilization and Marketing Service Activity Group (DRMS provides utilization services which include receiving, classifying, segregating, demilitarizing, accounting for, and reporting excess material for screening, lotting, merchandising, and sale. They also have the mission of hazardous property disposal and the economic recovery of precious metals from excess and surplus precious metal-bearing material.

- The Information Services Activity Group provides information management support. The mission of this information services business is to provide integrated information management support by delivering products and services of increasing quality and decreasing cost, on time and within budget.

- The Defense Automated Printing Service Activity Group (DAPS) is responsible for document automation and printing within the DoD, encompassing electronic conversion, retrieval, output, and distribution of digital and hardcopy.

Defense Finance and Accounting Service

Defense Finance and Accounting Service (DFAS) was created in 1991. The mission of DFAS is to provide responsive, professional finance and accounting service to the Department. DFAS has prepared the annual financial statements as required by the CFO Act and the GMRA since 1994.

U.S. Transportation Command

Secretary of Defense memorandum, dated February 14, 1992, prescribed the creation of a consolidated service transportation command. United States Transportation Command (USTRANSCOM) represents the single DoD financial manager for all common-user transportation. Its components include Headquarters, USTRANSCOM (HQTRANS); (Military) Surface Deployment and Distribution Command (SDDC); Military Sealift Command (MSC); Air Mobility Command (AMC); and, Defense Courier Service (DCS). The Army and Navy continue to manage their own service-unique transportation functions.

Other Accompanying Information

Improper Payments Information Act (IPIA) Reporting Details

As discussed in Part 1, "Management's Discussion and Analysis," the Department conducted a review of the improper payments relating to the Military Retirement and Military Health Benefits programs per the Office of Management and Budget (OMB) guidance. Results of the review follow.

Risk Assessment

The Department reviewed all of its programs and activities and determined that seven programs/activities were susceptible to erroneous payments. DoD performed risk assessments for each of the seven programs/activities that addressed the strength of the internal controls in place to prevent improper payments (such as prepayment reviews), system weaknesses identified internally or by outside audit activities, voluntary returns of overpayments by vendors, etc. The Department deemed one program, Military Pay, susceptible to high risk. The Military Retirement and Military Health Benefits programs were identified previously in Section 57 as susceptible to erroneous payments.

Statistical Sampling

The statistical sampling processes used for the Military Retirement, Military Health Benefits and Military Pay programs are outlined below:

Military Retirement. In FY 2004, the Military Retired and Annuitant Pay began monthly random reviews of confirmed deceased retiree accounts, in addition to monthly random reviews from the overall population of retired and annuity pay accounts. Both of these sampling plans were designed to produce annual estimates of improper payments, with probability of 95 percent and sample precision of plus or minus 2.5 percent.

DoD targeted the review of confirmed deceased accounts as a subset of the population highly at risk for improper payments. A monthly sample of accounts (approximately 138) is selected from the population of confirmed deceased accounts. Each account is audited to determine if the member was overpaid after the member's death was reported to Military Retired and Annuitant Pay. Statistics collected from the review include the number of accounts reviewed, number with overpayments, dollar amount of the overpayment, amount of correct pay (what the payment should have been), and the dollar amount collected back from the member's account/estate within the first 60 days after notification. These sample statistics are projected to the population of deceased retirees to then determine an improper payment rate population estimate for deceased accounts.

Population estimates from the deceased account reviews are then added to any improper payments identified through other than retired pay random audits, to then determine an overall improper payments population estimate for retired pay.

Military Health Benefits. To determine the statistically valid estimate of the annual amount of erroneous payments, the Department uses the following sampling methodology to pull TRICARE Encounter Data records for the Annual Target Health Care Cost audits of the Managed Care Support Services contracts.

For each contract option period, a statistically valid sample of claims with care end dates within the specified option period is selected for payment error auditing. Variable sampling, using stratified sampling with optimum allocation, is used to calculate the sample size for the payment errors. The sample size is determined with a 90 percent confidence level and 1 percent precision.

Claims with a cost less than $100 are not sampled (except claims for TRICARE dual eligibles). One stratum includes all claims $100,000 and more. Claims with a cost of greater than $100 but less than $100,000 are broken down into 12 strata. A formula is applied to calculate the sample size for each stratum. A finite population correction is then applied to each stratum sample size with the final sample size calculated by summing all the corrected stratum sample sizes. Finite population correction is first applied on each stratum, before the summation of sample sizes of all strata. A minimum sample size of 30 is forced into each stratum. If the stratum universe count is less than 30, all the claims in that stratum are audited. The audit process for payment samples projects universe value based on the audit results. The samples are projected separately to the universe of claims for each quarter. The results of these projections are then combined into the following categories: Total number of claims in the universe, government payment estimation, correct government payment, error amount, and the estimated error percent in the universe of claims. The percentage of overpayments is applied to all the payments to determine the amount of allowable cost. The percentage will be recovered based on total overpayments, not net of underpayments, due to "zero tolerance" for errors.

Military Pay. The Defense Finance and Accounting Service (DFAS) uses a stratified sampling plan design based on a maximum annual target sample of approximately 1,530 accounts per component (monthly sample of approximately 128 accounts per component). Components are defined as the Active and Reserve/Guard entities of the Army, Air Force, Navy, and Marine Corps. The annual sample provides estimates at the component level of 95 percent probability with sampling precision of plus or minus 2.5 percent. This process has been in place for over 5 years with recent year modifications to capture specific statistics in support of the IPIA.

Pay analysts review the monthly randomly selected accounts, using the most current Leave and Earnings Statement in the respective system and review all entitlements and deductions for accuracy, providing written detail about any erroneous computations. Specific details for each sampled account include the reason and source of the erroneous calculation as well as the net pay and improper payment (overpayments and underpayments) dollar values. Appropriate pay system and operational managers are notified of any discrepant accounts for correction. These data elements are captured and recorded in an electronic database for consolidation and review. Results of the monthly review are analyzed and reported to senior managers.

The improper payment rate is calculated by dividing the dollar value of all erroneous payments identified in the sample by the total net of sampled accounts to arrive at a sample rate for improper payments. Then the sample rate is multiplied times the total net pay of the population to determine an estimated improper payment dollar value. Any improper payments identified through means other than the random review are summarized and added to the population estimate (from the random review) to determine an overall population improper payment estimate for military pay.

Corrective Action Plans

Military Retirement. Military Retirement and Annuitant Pay places great emphasis on methods to reduce the dollar value of improper payments to deceased retirees. It fully recognizes that a certain number of retirees will be paid after death, simply by virtue of the inability to predict death and the fact that families have more pressing issues to address immediately following death than to notify the Military Retired and Annuitant Pay customer contact center. To minimize the impact of a delay in death notification, it has substantially improved its internal processing methods as well as streamlining and automating listings and data mining techniques with the Social Security Administration. This process allows DoD to receive death notice information through an automated system match on military retirees. In many cases, this death notification process will prevent the payment system from generating an improper payment. Preliminary assessment of the FY 2005 estimates suggest that these death match process improvement initiatives are contributing to a reduction of improper payments to deceased personnel. FY 2004 improper payments to deceased retirees were estimated at $51.8 million (the initial estimate of $26.2 million was incorrect and raised subsequently to $51.8 million). FY 2005 improper payments to deceased retirees are estimated to be $46.5 million. The Department expects to recover over 95 percent of this amount within 60 days of notification.

Military Health Benefits. The Medical Health Benefits Program currently audits statistically valid samples that over the years have consistently produced an error rate of less than the 2 percent standard contained in the TRICARE contracts—an amount less than the 2.5 percent threshold allowed by the IPIA Act as implemented by OMB. The TRICARE Management Agency audits payments, extrapolates the results of the payments to the universe, and disallows the full amount of the extrapolated total representing a statistical projection of overpayments.

Improperly submitted claims by the provider community, as well as a minimal degree of human error that can be expected with handling a large volume of claims within the tight time parameters established through the prompt payment regulations, cause errors in health care claims processing. Using statistically valid samples and assessing the contractor making the disbursement on behalf of the Department with financial penalties minimizes the error rate. The construct of the managed care contracts effectively reduces improper payments to zero.

Military Pay. DFAS is responsible for the military pay systems and places substantial emphasis on the correctness of the pay calculation from these systems. It has established several processes to ensure correctness of pay and thus prevent improper payments within the military pay systems. These measures include both random and targeted pre-payroll (payday) reviews, and producing pay abnormality and inconsistent condition reports and listing.

In the pre-payroll review process, DFAS selects random individual pay accounts from the Air Force, Army, and Navy for review prior to mid-month and end-of-month payroll release. The goal is to identify any incorrect pay generated by a systems or procedural issue. The pay systems staff produces a Leave and Earnings Statement, which is reviewed for each selected pay account. Based on the review findings, the pay systems staff is advised to complete the payroll or rerun it.

Pay abnormality lists are generated by the pay systems to identify accounts that are receiving pay at a rate of

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

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

The following table summarizes the Department's improper payment reduction outlook for each of these programs from FY 2004 through FY 2008.

Program	Prior Year			Calendar Year			Calendar Year +1		
	Outlays ($)	(%)	($)	Outlays ($)	IP (%)	IP ($)	Est. Outlays ($)	IP (%)	IP ($)
Military Retirement (Note 1)	34.0B	0.1942	66.0M	35.7B	0.1381	49.3M	35.7B	0.1332	47.5M
Military Health Benefits (Notes 2, 3 & 4)	7.6B	1.31	99.6M	7.5B	2.0	150M	9.1B	2.0	182M
Military Pay (Note 1)	n/a	n/a	n/a	69.1B	0.6254	432.0M	70.1B	0.5551	389.0M

Program	Calendar Year +2			Calendar Year +3		
	Est. Outlays ($)	IP (%)	IP ($)	Est. Outlays ($)	IP (%)	IP ($)
Military Retirement (Note 1)	35.7B	0.1283	45.8M	35.7B	0.1234	44.1M
Military Health Benefits (Notes 2, 3 & 4)	10.2B	2.0	204M	10.9B	2.0	218M
Military Pay (Note 1)	72.1B	0.5019	361.9M	74.3B	0.4676	347.0M

Note 1. The initial estimate of erroneous payments for Military Retirement for FY 2004 was computed incorrectly at $34.1 million or 0.952 percent. The figures shown in the table reflect the corrected amounts. Military Retirement and Military Pay dollars represent net amounts (e.g., net of Federal and State withholdings).

Note 2. The audits have now completed the administrative process and the final payment error rate for FY 2004 is 1.31 percent. The preliminary error rate for FY 2003 was 1.36 percent and the final rate was 0.85 percent. The information for FY 2005 is not yet available. Projections for FY 2005 through FY 2008 are that the erroneous payment rate will be below the 2 percent performance standard required in the contracts. Historically, the final overall percentage has been below the 2 percent threshold. Even though the contract performance standard is 2 percent, the Department has a zero tolerance for unallowable costs. If the contractor pays a claim that's not allowable, the Department will not reimburse the contractor. The construct of the managed care contracts effectively reduces improper payments to zero.

Note 3. The FY 2004 Outlay includes all benefit dollars subjected to the audit process. The total was computed as $7.6 billion as reflected in this chart. Fee for service claims are determined to be susceptible to erroneous payments as payment is made based upon an individual claim being submitted by a provider or beneficiary based on a certification that the services were provided as billed. The $7.6 billion does not include contracts that are capitated or otherwise 100 percent at risk, such as the dental and the U.S. Family Health Plan contracts. Any erroneous payments in the 100 percent at risk contracts are the sole responsibility of the contractor—there is no shared risk with the government. Administrative or change order costs are also not included as those costs do not fall into the definition of areas susceptible to erroneous payments.

Note 4. Pharmacy claims for FY 2005 were not included in the audit process. The contract transitioned and an audit process is being established for the outyears.

Recovery Auditing

The Department of Defense utilizes a number of different mechanisms to prevent, identify, and collect improper payments. This effort is divided into two parts, contract audit and recovery audit.

Contract Audit. 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). The objective of these audits is 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 received by DFAS are predicated on costs incurred and approved provisional billing rates. DCAA also performs paid voucher reviews at major contractors and special purpose audits at contractor locations when a risk factor for improper payments is identified and neither a billing system review nor a test of paid vouchers is planned. For both contract payments and vendor payments, the DFAS payment offices utilize various duplicate payment detection applications/system edits, some of which are embedded in the entitlement systems to detect potential duplicate contract and vendor payments prior to disbursement.

Recovery Audit. The Department maintains an extensive post-payment process for identifying improper payments. This process utilizes post-payment review techniques performed both internally and by recovery auditing contractors paid from the proceeds actually recovered. For contract and vendor payments, this process includes reviews by the DFAS-Internal Review and recovery auditing contractors. The process also includes the use of data-mining for purchase and travel card transactions by the Office of the Inspector General, Department of Defense. For purchased health care payments, the TRICARE Management Activity has established a statistically valid post-payment process that can accurately estimate improper payments. The TRICARE Management Activity also is using a recovery auditing contractor that specializes in identifying overpayments to hospitals that fail to submit amended cost reports.

DFAS-Internal Review maintains a post-payment process that reviews commercial payments vouchered in a DFAS entitlement system within 180 days of disbursement. Application of this process to FY 2003 payment data resulted in the identification of $122 million in duplicate payments, of which $119 million has been recouped. For FY 2004 payment data, $40 million has been identified as duplicate payments of which $30 million has been recouped.

The Department has recouped more than $19 million in erroneous commercial payments since the inception of the program in 1996, $1.9 million of which was recovered in FY 2005. Most of the recoveries occurred on disbursements made by the Defense Logistics Agency and the Naval Supply Systems Command. These recoveries were achieved by providing the recovery auditing contactor access to DFAS payment data files. The Department anticipates that the recovery auditing performed by recovery auditing contractors will be expanded in FY 2006.

The TRICARE Management Activity utilizes contractors to perform the entitlement process related to purchased health care claims. To ensure the integrity of the payments made, it has another contractor that performs post-payment reviews using statistical methods to quantify the amount of improper payments. The improper payments estimate becomes an unallowable cost to the vendor making the payment. The TRICARE Management Activity also is utilizing a recovery audit contractor to recapture overpayments made to hospitals that failed to submit amended cost reports from calendar years (CY) 1992 through 2004. From October 2003 to July 2005, these reviews have realized over $16.2 million in collections.

Agency Component (if applicable)	Amount subject to Review for Current Year Reporting	Actual Amount Reviewed and Reported	Amounts Identified for Recovery	Amounts Identified / Actual Amount Reviewed	Amounts recovered Current Year	Amounts recovered Prior Years(s)
Agency-wide Commercial Payments (Note 1)	$222.8B	$222.8B	$469.5M	0.2108%	$414.9M	(Note 1)
Commercial Payments Recovery Auditing Contractor (Notes 2 and 3)	n/a	n/a	$1.9 M	n/a	$1.9 M	$17.1 M
TRICARE Management Activity Health Care Purchased Care Recovery Auditing Contractor (Notes 3 and 4)	n/a	n/a	$1.6 M	n/a	$1.7 M	$16.3 M

Footnotes:

1. *The amount identified for recovery includes both underpayments (67%) and overpayments (33%). $460.1 million or 98 percent of the amount identified for recovery is attributable to DFAS disbursements and represents both internal recovery audit efforts and recoveries identified by other means (to include contract reconciliation and statistical sampling and contractor voluntary refunds). Of the amount initially identified by the DFAS for recovery, $19.8 million was subsequently determined to be valid. Recovery efforts have recouped $103.7 million in overpayments and disbursed $307.6 million in underpayments. The remaining $28.9 million remains in the recovery process or has been referred to the DFAS debt management office for collection. This is the first year the Department has included this information (no prior year amounts are being reported).*

2. *These are recoupments resulting from commercial payment recovery audits performed by recovery auditing contractors for the Defense Logistics Agency and the Department of the Navy. The recoupments represent duplicate payments, discounts not taken, etc.*

3. Because of timing differences between the recovery auditing efforts and the recovery actually made (e.g., recovery audit effort may have been performed in a previous fiscal year on disbursements made in multiple fiscal years), there is no relationship between these two amounts. As a result, the table is limited to the actual amounts recovered in FY 2005 and in prior years.

4. These are recoupments resulting from overpayments to hospitals that failed to submit amended cost reports.

Accountability

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

In addition, the Department is establishing performance metrics to track and reduce erroneous payments. These metrics will include all programs/activities that the Department has identified as having a risk of erroneous payments.

Information Systems

Military Retirement. At the current time, Military Retired and Annuitant Pay has the information and infrastructure needed to reduce improper payments.

Military Health Benefits. The TRICARE Management Agency has a national claims database that captures fee-for-service claims for care rendered and paid for by TRICARE. Derived from data forwarded by TRICARE Managed Care Support Contractors in a specific format that is compared against a specific set of quality control edits; the database maintains information on covered beneficiaries and the care each receives. The extensive data requirement contributes to data integrity and the fiscal soundness of a single audit trail and allows for close oversight of the claims paid by TRICARE. In addition, the TRICARE Management Agency has had performance standards in place for a number of years and contractors have continually met or exceeded them. Contractors already have a financial incentive to pay claims correctly and to stay below 2 percent, given that the agency will not fund unallowable costs (overpayments) submitted by its contractors making the disbursements.

Military Pay. At the current time, Military pay has the information and infrastructure needed to reduce improper payments.

Statutory or Regulatory Barriers

Military Retirement. Two barriers impede the agency's ability to take corrective actions in reducing improper payments, the Federal Acquisition Regulation and the Retired and Annuitant Pay service contract. On January 28, 2002, the servicing of Retired and Annuitant Pay came under the purview of a government contractor. Although most functions remain unchanged from when the government performed these functions, there are now contractual limits to the government's involvement in the day-to-day operations of Retired and Annuitant Pay. The Continuing Government Activities office was formed to oversee the Retired and Annuitant Pay contract, to ensure the contractual requirements are followed, however, the government can no longer direct how the work is accomplished. To bring about an operational change, both the government and the contractor must agree on how to effect and fund a change. Any deviation from the current contract requires a contract modification, which is detailed in the Federal Acquisition Regulation.

Military Health Benefits. There are currently no statutory or regulatory barriers that limit the Department's corrective actions for this program. In addition, as previously mentioned erroneous payments are continually less than the 2 percent error rate for this program.

Military Pay. There are currently no statutory or regulatory barriers that limit the Department's corrective actions for this program.

Funds Appropriated to the President
Administered by the Department of Defense

BALANCE SHEET As of September 30, 2005 ($ in Millions)		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
ASSETS							
Fund Balance With Treasury	$	82.4	1,913.3	10.1	6.7	-	37.8
Accounts Receivable		-	-	-	-	-	16.0
Other Assets		-	-	-	-	-	-
Loans Receivable		-	-	221.4	-	3,237.8	703.3
Inventory and Related Property, Net		-	-	-	-	-	-
Other Assets		-	-	-	-	-	-
Total Assets	**$**	**82.4**	**1,913.3**	**231.5**	**6.7**	**3,237.8**	**757.1**
LIABILITIES							
Debt	$	-	-	231.5	-	3,237.8	404.7
Other Liabilities		-	-	-	-	-	352.4
Accounts Payable		27.1	0.3	-	-	-	-
Other Liabilities		-	-	-	-	-	-
Total Liabilities	**$**	**27.1**	**0.3**	**231.5**	**-**	**3,237.8**	**757.1**
NET POSITION							
Unexpended Appropriation	$	55.3	1,911.3	-	-	-	-
Cumulative Results of Operations		-	1.7	-	6.7	-	-
Total Net Position	**$**	**55.3**	**1,913.0**	**-**	**6.7**	**-**	**-**
Total Liabilities and Net Position	**$**	**82.4**	**1,913.3**	**231.5**	**6.7**	**3,237.8**	**757.1**

Funds Appropriated to the President
Administered by the Department of Defense

STATEMENT OF NET COST As of September 30, 2005 ($ in Millions)		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
Program Costs:							
Intragovernmental Gross Cost	$	-	-	11.5	-	119.2	41.5
Less: Intragovernmental Earned Revenue		-	-	-	-	-	(41.5)
Intragovernmental Net Costs		-	-	11.5	-	119.2	-
Gross Costs With the Public		82.9	4,882.7	-	-	7.5	(72.8)
Less: Earned Revenues From The Public		-	(0.2)	(11.5)	-	(119.2)	-
Net Cost With the Public	**$**	**82.9**	**4,882.5**	**(11.5)**	**-**	**(111.7)**	**(72.8)**
Total Net Costs	**$**	**82.9**	**4,882.5**	**-**	**-**	**7.5**	**(72.8)**
Costs not Assigned to Programs		-	-	-	-	-	-
Less: Earned Revenues not Attributable to Programs		-	-	-	-	-	-
Net Cost of Operations	**$**	**82.9**	**4,882.5**	**-**	**-**	**7.5**	**(72.8)**

Funds Appropriated to the President
Administered by the Department of Defense

STATEMENT OF CHANGES IN NET POSITION As of September 30, 2005 ($ in Millions)		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
Cumulative Results of Operations							
Beginning Balance	$	-	1.5	-	16.7	-	-
Prior Period Adjustments (+/-)		-	-	-	-	-	-
Beginning Balance, as adjusted	$	-	1.5	-	16.7	-	-
Budgetary Financing Sources							
Appropriation Received	$	-	-	-	-	-	-
Appropriations Transferred in/out (+/-)		-	-	-	-	-	-
Other Adjustments (rescissions, etc.) (+/-)		-	-	-	-	-	-
Appropriations Used		82.9	4,882.7	-	-	7.5	-
Nonexchanged Revenue		-	-	-	-	-	-
Donations and Forfeitures of Cash and Cash Equivalents		-	-	-	-	-	-
Transfers in/out Without Reimbursement (+/-)		-	-	-	(10.0)	-	(72.8)
Other Budgetary Financing Sources (+/-)		-	-	-	-	-	-
Other Financing Sources:							
Donations and forfeitures of property	$	-	-	-	-	-	-
Transfers in/out Without Reimbursement (+/-)		-	-	-	-	-	-
Imputed financing from costs absorbed by others		-	-	-	-	-	-
Other (+/-)		-	-	-	-	-	-
Total Financing Sources	$	82.9	4,882.7	-	(10.0)	7.5	(72.8)
Net Cost of Operations (+/-)	$	82.9	4,882.5	-	-	7.5	(72.8)
Ending Balances	$	-	1.7	-	6.7	-	-
Unexpended Appropriations							
Beginning Balance	$	49.1	1,801.6	-	-	-	-
Prior Period Adjustments (+/-)		-	-	-	-	-	-
Beginning Balance, as adjusted	$	49.1	1,801.6	-	-	-	-
Budgetary Financing Sources							
Appropriation Received	$	89.8	5,033.5	-	-	7.5	-
Appropriations Transferred in/out (+/-)		-	(2.8)	-	-	-	-
Other Adjustments (rescissions, etc.) (+/-)		(0.7)	(38.3)	-	-	-	-
Appropriations Used		(82.9)	(4,882.7)	-	-	(7.5)	-
Nonexchanged Revenue		-	-	-	-	-	-
Donations and Forfeitures of Cash and Cash Equivalents		-	-	-	-	-	-
Transfers in/out Without Reimbursement (+/-)		-	-	-	-	-	-
Other Budgetary Financing Sources (+/-)		-	-	-	-	-	-
Other Financing Sources:							
Donations and forfeitures of property	$	-	-	-	-	-	-
Transfers in/out Without Reimbursement (+/-)		-	-	-	-	-	-
Imputed financing from costs absorbed by others		-	-	-	-	-	-
Other (+/-)		-	-	-	-	-	-
Total Financing Sources	$	6.2	109.7	-	-	-	-
Net Cost of Operations (+/-)	$	-	-	-	-	-	-
Ending Balances	$	55.3	1,911.3	-	-	-	-

Funds Appropriated to the President
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STATEMENT OF BUDGETARY RESOURCES As of September 30, 2005 ($ in Millions)		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
Budgetary Financing Accounts							
Budgetary Resources							
Budget Authority							
Appropriation Received	$	89.7	5,033.5	-	-	7.5	-
Borrowing Authority		-	-	-	-	-	-
Contract Authority		-	-	-	-	-	-
Net Transfers (+/-)		-	-	-	-	-	-
Other		-	-	-	-	-	-
Unobligated Balance							
Beginning of Period		7.7	0.3	-	16.7	-	-
Net Transfers, Actual (+/-)		-	(2.8)	-	-	-	-
Anticipated Transfer Balances		-	-	-	-	-	-
Spending Authority from Offsetting Collections							
Earned		-	-	-	-	-	-
Collected		-	0.2	-	-	-	-
Receivable from Federal Sources		-	-	-	-	-	-
Change in unfilled Customer Orders		-	-	-	-	-	-
Advance Received		-	-	-	-	-	-
Without advance from Federal Sources		-	-	-	-	-	-
Anticipated for the rest of the Year, Without Advances		-	-	-	-	-	-
Transfers from Trust Funds		-	-	-	-	-	-
Subtotal	$	-	0.2	-	-	-	-
Recoveries of Prior Year Obligations		12.1	4.6	-	-	-	-
Temporarily Not Available Pursuant to Public Law		-	-	-	-	-	-
Permanently Not Available		(2.2)	(38.5)	-	(10.0)	-	-
Total Budgetary Resources	$	107.3	4,997.3	-	6.7	7.5	-
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred							
Direct	$	95.2	4,997.0	-	-	7.5	-
Reimbursable		-	-	-	-	-	-
Subtotal	$	95.2	4,997.0	-	-	7.5	-
Unobligated Balance							
Apportioned		1.1	0.1	-	-	-	-
Exempt from Apportionment		-	-	-	-	-	-
Other Available		-	-	-	-	-	-
Unobligated Balances Not Available		11.0	0.2	-	6.7	-	-
Total, Status of Budgetary Resources	$	107.3	4,997.3	-	6.7	7.5	-
Relationship of Obligations to Outlays							
Obligated Balance, Net - Beginning of Period	$	67.4	1,803.4	-	-	-	-
Obligated Balance Transferred, Net (+/-)		-	-	-	-	-	-
Obligated Balance, Net - End of Period:							
Accounts Receivable		-	-	-	-	-	-
Unfilled Customer Order from Federal Sources		-	-	-	-	-	-
Undelivered Orders		41.6	1,912.5	-	-	-	-
Accounts Payable		27.1	0.3	-	-	-	-
Outlays							
Disbursements		81.8	4,883.0	-	-	7.5	-
Collections		-	(0.2)	-	-	-	-
Subtotal	$	81.8	4,882.8	-	-	7.5	-
Less: Offsetting Receipts		-	-	-	-	-	-
Net Outlays	$	81.8	4,882.8	-	-	7.5	-

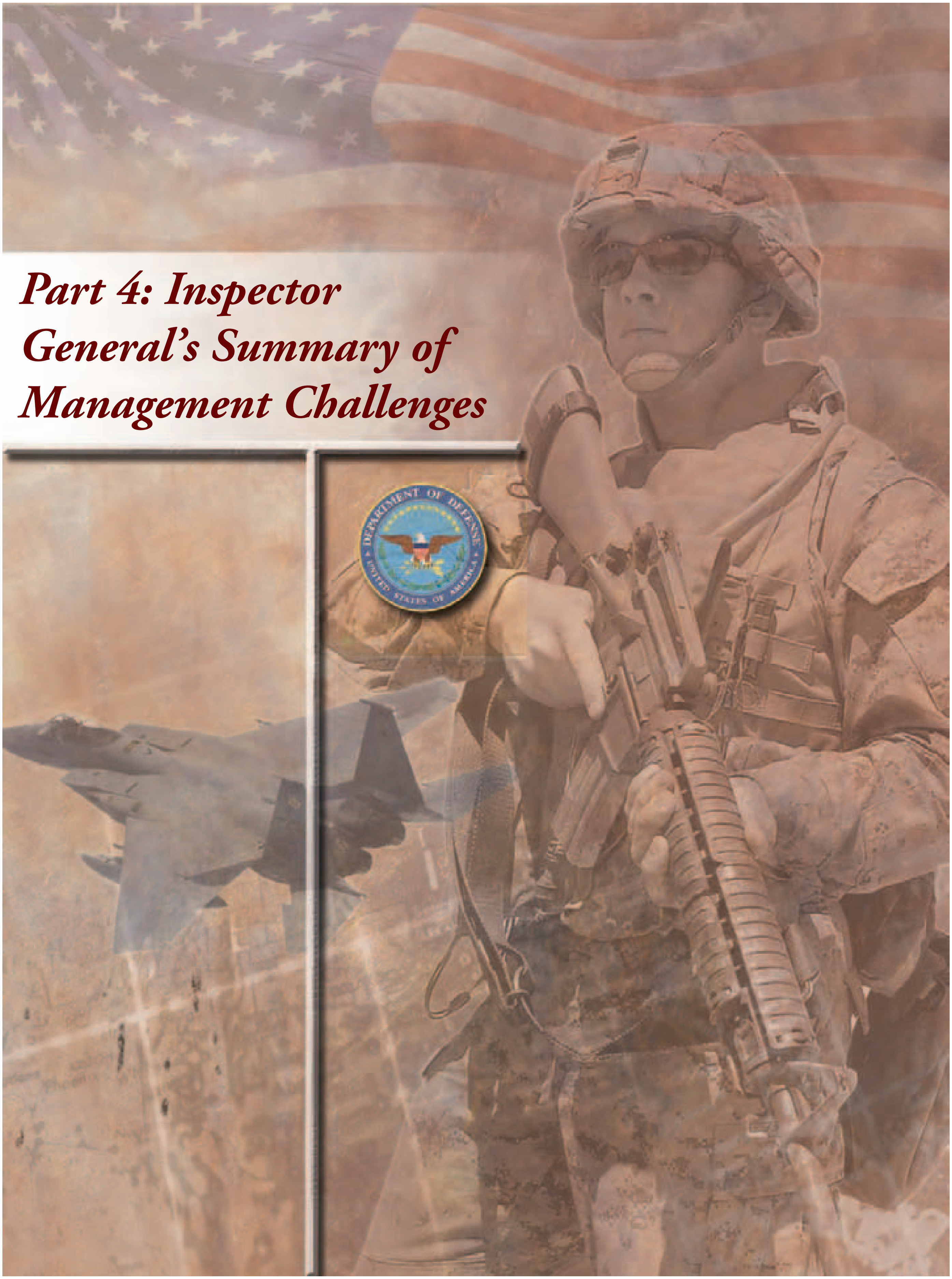
Funds Appropriated to the President
Administered by the Department of Defense

STATEMENT OF BUDGETARY RESOURCES **As of September 30, 2004** **($ in Millions)**		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
NONBUDGETARY FINANCING ACCOUNTS							
BUDGETARY RESOURCES							
Budget Authority							
Appropriation Received	$	-	-	-	-	-	2.6
Borrowing Authority		-	-	3.1	-	-	56.2
Contract Authority		-	-	-	-	-	-
Net Transfers (+/-)		-	-	-	-	-	-
Other		-	-	-	-	-	-
Unobligated Balance							
Beginning of Period		-	-	5.0	-	-	34.5
Net Transfers, Actual (+/-)		-	-	-	-	-	-
Anticipated Transfer Balances		-	-	-	-	-	-
Spending Authority from Offsetting Collections							
Earned		-	-	-	-	-	-
Collected		-	-	13.6	-	323.6	556.8
Receivable from Federal Sources		-	-	-	-	-	-
Change in unfilled Customer Orders		-	-	-	-	-	-
Advance Received		-	-	-	-	-	-
Without advance from Federal Sources		-	-	-	-	-	-
Anticipated for the rest of the Year, Without Advances		-	-	-	-	-	-
Transfers from Trust Funds		-	-	-	-	-	-
Subtotal	$	-	-	13.6	-	323.6	556.8
Recoveries of Prior Year Obligations		-	-	-	-	-	-
Temporarily Not Available Pursuant to Public Law		-	-	-	-	-	-
Permanently Not Available		-	-	-	-	(317.8)	(509.9)
Total Budgetary Resources	$	-	-	21.7	-	5.8	140.2
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred							
Direct	$	-	-	11.5	-	5.8	102.4
Reimbursable		-	-	-	-	-	-
Subtotal	$	-	-	11.5	-	5.8	102.4
Unobligated Balance							
Apportioned		-	-	2.7	-	-	-
Exempt from Apportionment		-	-	-	-	-	-
Other Available		-	-	-	-	-	-
Unobligated Balances Not Available		-	-	7.5	-	-	37.8
Total, Status of Budgetary Resources	$	-	-	21.7	-	5.8	140.2
Relationship of Obligations to Outlays							
Obligated Balance, Net - Beginning of Period	$	-	-	-	-	-	3,628.9
Obligated Balance Transferred, Net (+/-)		-	-	-	-	-	-
Obligated Balance, Net - End of Period:							
Accounts Receivable		-	-	-	-	-	-
Unfilled Customer Order from Federal Sources		-	-	-	-	-	-
Undelivered Orders		-	-	-	-	-	3,417.5
Accounts Payable		-	-	-	-	-	-
Outlays							
Disbursements		-	-	11.5	-	5.8	313.5
Collections		-	-	(13.6)	-	(323.6)	(556.8)
Subtotal	$	-	-	(2.1)	-	(317.8)	(243.3)
Less: Offsetting Receipts		-	-	-	-	-	-
Net Outlays	$	-	-	(2.1)	-	(317.8)	(243.3)

Funds Appropriated to the President
Administered by the Department of Defense

STATEMENT OF FINANCING **As of September 30, 2005** **($ in Millions)**		International Military Education and Training 11*1081	Foreign Military Financing Program Grants 11*1082	Military Debt Reduction Financing 11x4174	Special Defense Acquisition Fund 11x4116	Foreign Military Loan Liquidating Account 11x4121	Foreign Military Financing, Direct Loan Financing 11x4122
Resources Used to Finance Activities:							
Budgetary Resources Obligated							
Obligations Incurred	$	95.2	4,997.0	11.5	-	13.3	102.2
Less: Spending Authority from Offsetting Collections and Recoveries (-)		(12.0)	(4.8)	(13.6)	-	(323.5)	(556.8)
Obligations Net of Offsetting Collections and Recoveries	$	83.2	4,992.2	(2.1)	-	(310.2)	(454.6)
Less: Offsetting Receipts (-)		-	-	-	-	-	-
Net Obligations	$	**83.2**	**4,992.2**	**(2.1)**	**-**	**(310.2)**	**(454.6)**
Other Resources							
Donations and Forfeitures of Property	$	-	-	-	-	-	-
Transfers In/Out Without Reimbursement (+/-)		-	-	-	(10.0)	-	(72.8)
Imputed Financing from Costs Absorbed by Others		-	-	-	-	-	-
Other (+/-)		-	-	-	-	-	-
Net Other Resources Used to Finance Activities		-	-	-	**(10.0)**	-	**(72.8)**
Total Resources Used to Finance Activities	$	**83.2**	**4,992.2**	**(2.1)**	**(10.0)**	**(310.2)**	**(527.4)**
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 (-)	$	(0.3)	(109.7)	-	-	-	211.3
Unfilled Customer Orders		-	-	-	-	-	-
Resources that fund expenses recognized in Prior Periods		-	-	-	-	-	-
Budgetary Offsetting Collections and Receipts that do not affect Net Cost of Operations		-	-	13.6	-	323.5	556.8
Resources that Finance the Acquisition of Assets		-	-	(11.5)	-	(5.8)	(313.5)
Other Resources or Adjustments to net Obligated Resources that do not affect Net Costs of Operations							
Less: Trust or Special Fund Receipts related to exchange in the Entity's Budget (-)		-	-	-	-	-	-
Other (+/-)		-	-	-	10.0	-	72.8
Total Resources Used to Finance Items not part of the Net Cost of Operations	$	**(0.3)**	**(109.7)**	**2.1**	**10.0**	**317.7**	**527.4**
Total Resources Used to Finance the Net Cost of Operations	$	**82.9**	**4,882.5**	**-**	**-**	**7.5**	**-**
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 Periods							
Increase in Annual Leave Liability	$	-	-	-	-	-	-
Increase in Environmental and Disposal Liability		-	-	-	-	-	-
Upward/Downward Reestimates of Credit Subsidy Expense (+/-)		-	-	-	-	-	(72.8)
Increase in Exchange Revenue Receivable from the Public (-)		-	-	-	-	-	-
Other (+/-)		-	-	-	-	-	-
Total Components of Net Cost of Operations that will require or generate Resources in Future Periods	$	**-**	**-**	**-**	**-**	**-**	**(72.8)**
Components Not Requiring or Generating Resources							
Depreciation and Amortization	$	-	-	-	-	-	-
Revaluation of Assets or Liabilities (+/-)		-	-	-	-	-	-
Other (+/-)		-	-	-	-	-	-
Total Components of Net Cost of Operations that will not Require or Generate Resources	$	**-**	**-**	**-**	**-**	**-**	**-**
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$	**-**	**-**	**-**	**-**	**-**	**(72.8)**
Net Cost of Operations	$	**82.9**	**4,882.5**	**-**	**-**	**7.5**	**(72.8)**

Part 4: Inspector General's Summary of Management Challenges



Part 4. Inspector General's Summary of Management Challenges

This part of the report contains the complete text of the Inspector General's summary of the most significant management challenges facing the Department. Management's response to the Inspector General's assessment is at the end of this section.

The management challenges that the Inspector General (IG) identified, based on audits, investigations, and inspections, fall into nine major areas. These areas, which have been identified in the Department of Defense (DoD) Performance and Accountability Reports since fiscal year (FY) 2002, remain significant challenges. The challenge areas, summarized here and in past Performance and Accountability Reports, are as follows:

- Joint Warfighting and Readiness,
- Homeland Defense,
- Human Capital,
- Information Technology Management,
- Acquisition Processes and Contract Management,
- Financial Management,
- Health Care,
- Logistics, and
- Infrastructure and Environment.

Joint Warfighting and Readiness

U.S. forces continue to transform to meet the threats of the 21st century and beyond. The ongoing efforts by the Services, incorporating the lessons learned of Operations Iraqi Freedom and Enduring Freedom, focus on evolving the armed forces to meet all threats, the conventional threat as well as the asymmetrical threat. But unlike previous eras, the United States finds itself with another type of readiness being required of its armed forces; the ability to conduct peacekeeping and stabilization operations. Although other management challenges encompass areas that impact joint warfighting and readiness issues, the synergy of those other management challenges will determine the extent to which the United States will be able to achieve its national objectives through joint operations.

Discussion

Our review of the management of National Committee for Employer Support of the Guard and Reserve identified several areas where controls can be improved to ensure that Reserve component personnel continue to receive support while they serve their country. Similarly, the Department's oversight of that program can also be improved.

We have also reviewed areas and identified issues in areas such as requirements generation, training, and adapting to meet changing conditions in the Department. One hurdle the armed forces face is being able to meet any threat, while operating within strict resource constraints. If the Department becomes involved in stabilization or peacekeeping operations, the resources required could be great. If that were to happen while operations in Iraq and Afghanistan continue, the Department could face difficult issues about troop strengths, recruiting and retention, and equipment readiness. In addition, the current situations involving the nuclear programs of North Korea and Iran present additional resource requirements.

DoD lacks comprehensive policy, guidance, and training concerning roles, missions, functions, and relationships of Combatant Command IGs. This significantly inhibits the ability of these IGs to perform their duties in support of the combatant command commanders. DoD Office of Inspector General (OIG) is collaborating with the Inspectors General of the Joint Staff, Combatant Commands, and Military Departments to provide the desired training and guidance for this community of IGs. DoD OIG organized and supervised the development of the Joint/Combatant Command IG course. The first class for this course was held from August 29 to September 2, 2005.

Inspector General Assessment of Progress

The Department continues to make progress in the area of Joint Warfighting and Readiness. However, much is still to be done, and the Department cannot afford to ignore new, and in some cases recurring, situations that will require its attention. The recent announcement of bases identified for closures will enable the armed forces to shape and focus their force structure in a way that will provide greater flexibility in responding to threats. The announced drawdown, and coinciding reorganization of forces in the European and Pacific theaters will add to the ability of the armed forces to respond as required. The OIG, as well as the U.S. Government Accountability Office (GAO), the Army Audit Agency, the Naval Audit Service, and the Air Force Audit Agency each have covered topics related to improving the ability of the armed forces to respond to threats to the United States. During the past 5 years we have seen inconsistent and poor guidance used in selected programs of the Department. For example, reviews of depot repair, logistics support, and weather programs have each shown where improvements can be made.

The lessons of Operations Iraqi Freedom and Enduring Freedom have served as reminders that joint also means the full integration of the Reserve components into operations. This full participation presents unique concerns, many revolving around dependent family members that do not always confront the Active components. Many of those issues will persist despite the best efforts of the armed forces. Although the Department is taking positive actions in order to increase its warfighting ability and readiness posture, opportunities to improve continue to exist.

Homeland Defense

The Department defines "threat" as any circumstance or event with the potential to cause harm. The global war on terror continues to heighten the level of threat from adversaries to the United States. Direct threats to the Homeland infrastructure are obvious and the DoD has been very successful in addressing those threats. However, greater challenges are presented by threats from sources such as (1) dual-use items, (2) weapons of mass destruction in the former Soviet Union, (3) lengthy personnel background security clearance checks, (4) critical infrastructure protection, and (5) "9/11."

Discussion

Dual Use Items. Dual-use items are items that can be used for both commercial and military purposes. The items may take the form of technology, software, and chemical or biological items and could be used to cause harm to the United States.

Controlling the use and transfers of dual-use items poses a significant undertaking for the Department. This undertaking is significant because controls over dual-use items are handled on a case-by-case basis and blanket rules or regulations may not be applicable. For example, teaching someone about a technology might be a legitimate technology transfer but showing the same person specifically how to produce the technology could be extremely risky to the Nation's defense. Thus, the Department is faced with identifying sub-components of systems that may be transferred legitimately. Determining the risks and benefits of transfers challenges the Department to develop controls over transfers of dual-use items in each of the following areas:

- Federal laboratories' compliance with the deemed export (a deemed export of technology or computer source code takes place when it is released to a foreign person within the United States) licensing requirements,

- Policies and procedures for developing, maintaining, and revising lists of controlled exports,
- Export licensing and review agencies' efforts to modernize and interface their automated licensing systems,
- Enforced export controls for both dual-use items and munitions (dual-use items can be used for either commercial or military purposes), and
- The Federal Government's deemed exports control laws and regulations and the export licensing process for chemical and biological commodities.

Threat Reduction. The Department continued to experience challenges in its threat reduction program. During the past 4 years, we have evaluated implementation of the Cooperative Threat Reduction Program. That program was initiated to reduce the threat posed by weapons of mass destruction in the former Soviet Union by providing assistance to former Soviet states in building facilities and operating programs to safeguard, transport, and ultimately destroy chemical, biological, and nuclear weapons, delivery systems, and infrastructure.

The Department has not sufficiently managed implementation and execution of cooperative threat reduction projects. Adequate controls for the program and its projects are vital to ensuring that the limited funds are used effectively.

Personnel Security Clearances. Obtaining timely personnel security clearances for DoD military and civilian employees is a challenge. Since at least the 1990s, GAO has documented problems with DoD personnel security clearance process, particularly problems related to backlogs and the delays in determining clearance eligibility. Since FY 2000, the Department has declared its personnel security investigations program to be a systemic weakness. In FY 2004, GAO added the personnel security clearance process to its list of High Risk Areas. In February 2005, the investigative portion of the personnel security clearance process transitioned to the Office of Personnel Management (OPM) in an effort to improve the process. Both GAO and the OIG have issued reports documenting the backlog of investigations. The Department is involved in an unprecedented transformation of the personnel security program. The scope of this initiative includes: personnel transfers and training; establishing and disestablishing offices; modifying and creating information systems; issuing new policies, and selecting contractors. The effort to transform is extraordinarily time consuming and must occur in an environment where demand for security clearances continues to exceed the Department's capacity.

Critical Infrastructure Protection. In September 2003, the Deputy Secretary of Defense realigned Critical Infrastructure Protection (CIP) oversight to the Assistant Secretary of Defense for Homeland Defense (ASD(HD)). The ASD(HD) was tasked to focus on the planning and execution of DoD resources in preventing and responding to threats to infrastructures and assets critical to DoD missions. Subsequently, the ASD(HD) requested that the OIG assist them in meeting their CIP responsibilities by evaluating the proposed CIP policy and organization; validating the efficiency and effectiveness of the vulnerability assessment methodologies; reviewing procedures related to vulnerability assessments for data collection and analysis, implementing corrective actions, and sharing lessons learned. Consequently, we announced our CIP Evaluation Program in June 2004 to assess the Defense Critical Infrastructure Program with emphasis on assets exposed to high-risks. In February 2005, the DoD OIG presented the final briefing to ASD(DH) and recommended a series of organizational changes and process improvements for the CIP program.

ASD(HD) accepted and endorsed all of the recommendations. Implementing the recommendations will present a number of management challenges. For example, the DoD must be organized to perform its mission and also provide assistance to civil agencies in the event of another terrorist attack. Organizational changes will need to be made to ensure compliance with news laws and executive guidance. Furthermore, the transformation process will need to consider human capital and resource requirements commensurate with program responsibilities and mission requirements. Lastly, the ASD(HD) will need to develop a consolidated approach for addressing responsibility, authority, and funding for the protection of Defense infrastructure both within the continental U.S. and overseas.

"9/11." The challenge is to improve response capability. The intelligence community, the DoD, and the Department of Transportation should be able to respond to a future similar event or another significant event.

Inspector General Assessment of Progress

The Department must always be aware of and vigilant in protecting the United States and its interests so the challenge of Homeland defense will likely change over time but not diminish. While the areas described require continued vigilance, the Department has made some progress in each.

Dual Use Items. In 2005, the interagency review of export licensing resulted in a positive report on the Department's process for reviewing export licenses. The Department is working with other Federal entities to expand the control list for several biological commodities. The Department must continue to thoroughly analyze the U.S. interests when participating in transfer of dual-use technology, software, chemical, and biological items.

Threat Reduction. Key oversight positions were vacant for about 5 years and oversight responsibilities were not clearly defined. However, in July 2004, a Senior Business Officer position was filled and additional oversight responsibility resides in that position. In April 2005, the Cooperative Threat Reduction Integrating Contracts Business Processes Guide that requires additional control procedures in contracting was released.

Personnel Security. The Department made changes in the area of personnel security clearances but it is uncertain whether those changes represent progress. The Department transferred responsibility for investigations to OPM and retained adjudicative responsibility. Like personnel security investigations, adjudications are backlogged. It is unclear how the Department proposes to overcome the shortage of appropriately skilled and trained personnel in the Federal and private sectors to accomplish background investigations and clearance eligibility adjudications. The OIG review of the requesting activities' role in impeding the overall clearance process will identify additional areas for progress to be made.

Critical Infrastructure Protection. The OIG examined the process used to identify critical nuclear command and control facilities and equipment. The report discussed needed improvements in DoD policy oversight and management.

9/11. The OIG conducted an accountability review of intelligence community activities before and after the attacks of September 11, 2001. The report concluded that there was no evidence of omission, commission, or failure by the National Security Agency personnel to meet professional standards, but the overall effectiveness of the agency counterterrorism mission was limited because it was inadequately resourced.

The OIG report on DoD forensic capabilities and incident reporting discussed how the DoD prepared after-action information related to the events of the 9/11 terrorist attacks and identified weaknesses in the DoD's ability to sufficiently capture and report on actions taken to respond to a future similar event or another significant event.

The Office of the Assistant Secretary of Defense for Homeland Defense and the U.S. Northern Command worked effectively to coordinate Departmental Homeland defense policy and resources. Initiatives to coordinate policy and resources at the Federal level with the Department of Homeland Security are underway.

The Defense Criminal Investigative Service (DCIS) also plays an important role in the global war on terror. DCIS continues to participate actively in several Joint Terrorism Task Force (JTTF) initiatives nationwide. Additionally, DCIS maintains a full time liaison position with the National JTTF located with the National Counterterrorism Center in Northern Virginia. DCIS HQs and field agents continue to respond to inquires and investigative assistance requests from all levels of law enforcement in regards to DoD resources and involvement in JTTF matters.

Human Capital

The challenge in the area of human capital is multifaceted. The DoD must ensure that civilian and military workforces are appropriately sized, well trained and motivated, held to high standards of integrity, encouraged to engage in intelligent risk taking, and capable of functioning in an integrated work environment and handling the emerging technologies and threats of the 21st century. That challenge involves ensuring that the Department's workforce planning is focused on acquiring, developing and retaining a total workforce to meet the needs of the future including contractor workforce. The Department employs over 3.38 million civilian and military personnel, with an annual financial investment of over $100 billion. The challenges of managing such a large workforce plus contractor personnel include the need for the Department to identify and maintain a balanced level of skills to maintain core defense capabilities and meet the 21st century challenges and threats. Without focused recruiting, knowledge management programs, and a transparent personnel system, the DoD may have difficulty hiring, developing, training, and retaining high quality people to become skilled soldiers, workers, managers, and leaders.

Discussion

The Department's challenge in human capital include four major areas: recruiting and retaining military personnel, implementing the National Security Personnel System (NSPS), minimizing disruption from Base Realignment and Closure (BRAC), and ensuring compliance with restrictions on post-government employment activities.

Military Personnel. The DoD has three major military operations that require significant military personnel. As pointed out in the section on Joint Warfighting and Readiness, new operations of any kind including stabilization or peacekeeping could further stress personnel resources. In addition to overall personnel recruitment and retention, the DoD faces continued challenge in filling "hard-to-recruit/hard to retain" occupations. The GAO reported that unlike 2004, 2005 has not seen the Department exceed or reach recruitment goals.

National Security Personnel System. As recently as July 2005, the GAO reported on challenges it identified that the DoD would face in implementing the National Security Personnel System. Among the challenges are providing adequate resources to implement the system, ensuring effective communication in implementing and evaluating the system, involving key players effectively, and sustaining committed leadership. GAO recommended creating a position and appointing a chief management official to lead NSPS and other initiatives.

BRAC. In closing and realigning installations the Department is likely to lose general and specialized skills as a result of personnel choosing to leave the workforce rather than move. The challenge for the Department is to plan for the losses and provide for the replacement of the skills so it minimizes disruption to defense operations.

Post-Government Employment Activities. Compliance with restrictions on post-government employment activities is another challenge the Department faces as it strives to maintain a high standard of integrity and public confidence. Disclosure of a Pentagon acquisition official's violation of post-employment guidelines prompted Members of Congress and senior level DoD officials to question whether current training and information provided to employees are sufficient to prevent similar irregularities. GAO issued an April 2005 report on the "Defense Ethics Program: Opportunities Exist to Strengthen Safeguards for Procurement Integrity," (Report No. GAO-05-341), which stated the Department of Defense lacks information to evaluate the DoD training and counseling process.

Inspector General Assessment of Progress

Military Personnel. The Department has used bonuses extensively to make enlistment and reenlistment more attractive. In addition to monetary bonuses, the Department offers educational opportunities of various kinds to attract recruits. The services have increased the number of recruiters as a means of reaching more people. GAO is reviewing the DoD efforts to recruit and retain military personnel and plans to report its findings this Fall.

National Security Personnel System. The DoD is phasing in the NSPS, the system designed to change how the Department hires, pays, promotes, disciplines, and fires its civilian workforce to make practices more in line with personnel practices in the private sector. The Department has conducted meetings with employees, unions, and other affected parties and has formed working groups to identify and develop options and alternatives for NSPS. The Department has adjusted its implementation schedule to better effect the changes needed for the program. It has developed communications to target groups within the Department and methodologies to gauge effectiveness. The Department efforts to gain support from the unions has not been successful and remains a major challenge within the area.

BRAC. Decisions regarding loss of human capital skills are contingent on the decisions of the BRAC Commission and approval of the of the Commission's list. Progress on planning for the loss of skills is pending.

In recognition that human capital is a crucial area within the DoD, the OIG continued its audit team dedicated to the area of human capital.

Information Technology Management

The Department defines information technology (IT) as a tool that enables the Department to perform its mission and support functions effectively and efficiently. In June 2004, the DoD Chief Information Officer (CIO) developed a strategic plan for the management and acquisition of IT. The goals of the strategic plan are to:

- Develop and implement an IT infrastructure,
- Share data and information,
- Improve business processes and train people, and
- Develop and maintain information assurance practices.

Discussion

The Department IT goals present a management challenge regarding IT action plans to implement and assess the Department's IT strategy.

IT Infrastructure. The Department has a strategy for improving bandwidth, communication capabilities, using commercial software, and developing an enterprise architecture. However, the strategy does not identify responsible officials, establish metrics, or require the development of action plans to implement the strategy or identify necessary changes to the strategy. Further, the Department has a stated goal to eliminate internal software design activities in favor of commercial-off- the shelf-software; however, if the Department acquires software on a cost-effective basis, internal design activities will cease to exist when they cannot deliver better quality than commercial sources in conformance with the President's Management Agenda on using performance and results to make decisions.

Data and Information. The Department has a stated goal to make information readily available to those who need it in a useable format. However, the strategy does not require the development of an action plan to assign responsibilities and the metrics to assess progress. The plan also does not state whether the requirement pertains to existing data in legacy systems. Historically, many system developers have opted not to convert legacy data because of the high costs attached.

Business Processes and People. The Department has established the Business Management Modernization Program to ensure the development of standard information systems. The plan lists the CIO and Chief Financial Officer as proponents of the process; however, the plan does not define the roles of the Services and Defense Agencies. Further, the plan does not discuss an action plan that defines the role of these key players as well as the necessary metrics to assess the program. The plan does describe the actions the DoD is taking to train DoD personnel; however, it does not provide a mechanism to assess the progress made.

Information Assurance. The Department has developed five priorities for information assurance: protecting information, defending systems and networks, providing situational awareness, improving information assurance capabilities, and creating a professional information assurance workforce. However, an action plan does not exist to assess the effectiveness of these initiatives.

Inspector General Assessment of Progress

In April 2005, GAO identified business system modernization as a High-Risk Area. Under the business systems modernization area, GAO stated that the Department framework was good but lacked a comprehensive and integrated plan of action. We agree based upon our review of the IT strategic plan. The Department should develop action plans to implement and refine the solutions made in the IT strategic plan. Those action plans should incorporate audit community recommendations.

The OIG reported on the DoD intelligence agencies security status for the Federal Information Security Management Act. Further, an OIG audit of Defense Contract Management Agency information technology security posture for selected programs disclosed systemic weaknesses in IT security at four selected agency field offices, including problems with the certification and accreditation process, contingency planning, incident response programs, and security awareness training.

In December 2004, the Department agreed to develop and implement a Plan of Action and Milestones to manage and close identified security performance weaknesses in information technology security. The first step toward that end is a policy memorandum establishing the process. The OIG received the policy memorandum for review on August 18, 2005.

Acquisition Processes and Contract Management

The Department buys the largest amount and biggest variety of goods and services in the world in support of its mission to preserve and defend the security of the nation. In FY 2004, the DoD spent $254 billion on acquisitions. On an average every working day, the DoD issues more than 25,000 contract actions, valued at $923 million, and makes more than 195,000 credit card transactions, valued at $44 million. There are about 1,500 weapon acquisition programs valued at $2.2 trillion over the collective lives of these programs. The amount spent to procure services, $77 billion in FY 2001, grew to $123 billion in FY 2003 as the DoD continued to expand its need for support to the private sector. In addition, in FY 2004, the DoD sent about 24,000 Military Interdepartmental Purchase Requests valued at $8.56 billion to the General Services Administration (GSA) for the purchases of goods and services. The management challenge is, despite this huge scale, to provide required materiel and services that are superior in performance, high in quality, sufficient in quantity, and reasonable in cost. Every acquisition dollar that is not prudently spent results in the unavailability of that dollar to fund the top priorities of the Secretary of Defense.

Discussion

Maintaining an effective and sustainable acquisition workforce in light of changing acquisition strategies and vehicles, prior downsizing, and an aging workforce, is a challenge. The OIG is reviewing the implications of these changes on the ability of the acquisition workforce to effectively manage the billions of dollars expended on acquisitions.

The Department must be vigilant in investigating procurement fraud and violations of procurement integrity rules to optimize the financial resources appropriated for national defense. The investigations of violations of the Procurement Integrity Act by the former Principal Deputy Secretary of the Air Force for Acquisition and Management and the former Chief Financial Officer for the Boeing Company and their impact on acquisition programs highlight the need for continued training for acquisition professionals. Adverse actions taken by very few people can cause delay for major acquisition programs, impede quick delivery of new capabilities to the warfighter, and adversely affect the public perception of the integrity of the acquisition process.

The OIG conducted an accountability review of all members of the Office of the Secretary of Defense and the Air Force to determine what happened, who was accountable, and what actions must be taken to prevent a situation like the Boeing KC-767A tanker aircraft lease from happening again. The report identified the DoD and Air Force officials accountable. Although required to do so by DoD directive, the identified officials did not comply with the DoD 5000 series of guidance, the Federal Acquisition Regulation, and the Office of Management and Budget circulars during their efforts to lease the tanker aircraft. To prevent reoccurrences of this situation, the Department of Defense must change the cultural environment in its acquisition community to ensure that the proper control environment is reestablished and followed for major weapon-system acquisitions.

The Department continues to experience a variety of shortcomings in its approach to program office and contractor designs. Significant shortcomings have occurred in placing controls in the contracting process and contract terms over life-cycle costs, in particular of designs. For example, because of cost overruns on chemical-agent disposal facilities, the Congress required the Department to certify that life-cycle costs of a specific facility would not exceed $1.5 billion in FY 2002 constant dollars. The overarching problem was that the program manager ignored the facility life-cycle cost limitation that the Department certified to the Congress, resulting in the acquisition not being executable and affecting the ability of the Department to meet its commitments.

The audit community continued to identify ways that the Department could improve acquisition of weapon system programs, including the following examples:

- Identify quantity requirements, determine weapon system affordability, obtain satisfactory operational test results, and obtain authority to operate before making investment decisions (OIG audits of the EA-6B Improved Capability III Program and Extended Range Guided Munition Program); and
- Implement effective management internal controls (OIG audits of 16 Navy and Air Force acquisition category II and III programs valued at $7.7 billion).

The Department also has significant challenges regarding purchases the GSA made for the Department. Military Interdepartmental Purchase Requests valued at about $406 million that were used primarily in the fourth quarter of FY 2004 did not comply with the U.S. Constitution, appropriations law, and the Federal Acquisition Regulation for making purchases through the GSA. Of 75 purchases:

- 68 purchases lacked acquisition planning to determine that contracting through the GSA was the best alternative available;
- 74 purchases did not have adequate interagency agreements outlining the terms and conditions of the purchases;
- 38 purchases were funded improperly, the requesting DoD organization either did not have a bona fide need for the requirement in the year of the appropriation, or did not use the correct appropriation to fund the requirements; and
- 44 purchases were not supported by an adequate audit trail.

In the GSA transactions, between $1 billion to $2 billion in Department funds were used that were no longer available.

The Defense auditing community is heavily involved in helping the Department aggressively pursue savings through the use of credit cards and reduce its vulnerability to misuse. In reports and testimony, the OIG DoD and the GAO identified where the Department needed to increase focus on negotiating discounts and to leverage $7.2 billion in DoD purchase card spending in order to achieve hundreds of millions of savings. The OIG DoD reported that controls over purchase card use were not properly implemented and were ignored by senior management at the Space and Naval Warfare Information Technology Center, New Orleans. This incident occurred between FY 1999 and FY 2002 and the OIG DoD officially closed the report for follow-up purposes on April 22, 2005. The Washington Headquarters Services revealed that agency employees made about $1.7 million of fraudulent purchases and $201,000 of improper purchases with purchase cards to including computer games, coffee mugs, radios, and power tools.

Combating government procurement fraud remains a priority for Defense Criminal Investigative Organizations. For example, the provision of sub-standard or defective products that are meant to support and/or protect our warfighters constitutes 15 percent of the 1,610 DCIS open cases as of August 1, 2005.

Inspector General Assessment of Progress

Overall, the Department has made progress improving numerous acquisition processes. Despite progress, the growing volume of acquisitions, the decrease in the number of acquisition personnel, and the numerous annual changes in regulations and processes for the acquisition professional make this a long-term challenge. During the last year, one DoD agency was developing a processing and exploitation system when a better and cheaper system already existed. In addition, the Department has had to react to previously unidentified problems related to the acquisition of major systems, such as the KC-767A Tanker aircraft and C-130J aircraft, contracting for Operation Iraqi Freedom and use of multiple-award schedule contracts from other Federal agencies. The DoD positively reacts after problems are identified; however, the sheer volume of contracting creates a challenge of correcting the problems.

The Department needs to continue with vigilant investigations of allegations of corrupt acquisition, both criminally and administratively. Undoubtedly, the works of a few to undermine the integrity of the acquisition process can setback the success of millions of acquisition actions within the department.

Proactive efforts of the DoD OIG data mining group and the Department purchase card program office have been increasing senior leadership involvement and improving management controls over the purchase card program. For example, the DoD reduced the number of purchase cards by 47 percent, from 214,000 to 114,000. Also, the Department developed a standardized training program for card holders and billing officials and improved the policies, guidance, and controls on purchase card use.

Financial Management

The Department of Defense financial management environment is probably the most complex and diverse in the world. Its FY 2004, financial statements included $1.2 trillion in assets, $1.7 trillion in liabilities, total budgetary resources of more than $1 trillion, and $605 billion in Net Cost of Operations. In FY 2004, the Defense Finance and Accounting Service, the Department's accounting services provider, on behalf of the Department: paid 12.6 million commercial invoices, made 6.9 million travel payments, processed 104 million payments to 5.9 million people (including benefits to retirees and families), made $455 billion in disbursements, managed $13.5 billion in foreign military sales, managed $226.5 billion in military retirement trust fund, and accounted for 282 active DoD appropriations.

In FY 2004, as in recent years, the Office of Management and Budget (OMB) required the Department to prepare Department-wide financial statements and obtain an audit opinion on them and on eight DoD component financial statements, including the Military Retirement Trust Fund, the Corps of Engineers and the general funds and working capital funds for the Army, Air Force, and Navy. Of those, only the Military Retirement Trust Fund received an unqualified opinion. The others, including the DoD agency-wide financial statements, received a disclaimer of opinion, and have never received other than a disclaimer of opinion. Three intelligence agencies also prepare financial statements at the direction of the Senate Select Committee on Intelligence.

Discussion

The Department faces financial management challenges that are complex, long-standing, and pervade virtually all its business operations, affecting the ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting, and policy decisions. Because the DoD's financial management problems are so significant, the GAO has stated that DoD's financial management deficiencies, taken together, represent a major impediment to achieving an unqualified opinion on the U.S. Government's consolidated financial statements.

GAO identified DoD financial management as a High Risk Area in 1995, a designation that continues to date, and which, together with the High Risk Areas of business systems modernization (designated a High Risk Area in 1995), and supply chain management (designated a High Risk Area in 1990) directly affect the Department's ability to attain an unqualified audit opinion on its financial statements. Additionally, GAO designated the DoD Approach to Business Transformation as a new High Risk Area for 2005 because the DoD lacked an integrated strategic planning approach to business transformation. In its June 30, 2005, Executive Branch Management Scorecard, OMB assessed the status of the Department's financial performance as "Unsatisfactory". The Scorecard also assessed the Department's progress at implementing the Financial Performance component of the President's Management Agenda as "Unsatisfactory".

The DoD OIG has previously identified several material control weaknesses that reflect some of the pervasive and long-standing financial management issues faced by the DoD and which also directly impact the Department's ability to attain an unqualified opinion on its financial statements. These include:

- **Financial Management Systems:** Of the material control weaknesses, the most significant is the Department's financial management systems. The Department currently relies on an estimated 4,000 systems, including accounting, acquisition, logistics, personnel, and management systems, to perform its business operations. Many of those financial management systems do not substantially comply with Federal financial management systems requirements. The DoD financial management and feeder systems were not designed to adequately support various material amounts on the financial statements. These systemic deficiencies in financial management and feeder systems and inadequate DoD business processes result in the inability to collect and report financial and performance information that is accurate, reliable, and timely.
- **Fund Balance with Treasury:** DoD did not resolve financial and reporting inconsistencies to accurately report Fund Balance with Treasury and inconsistencies continue to exist related to: in-transit disbursements; problem disbursements, including unmatched disbursements and negative unliquidated obligations; unreconciled differences in suspense accounts; and unreconciled differences between U.S. Treasury records and DoD.
- **Inventory:** The DoD process for inventory valuation does not produce an auditable approximation of historical cost because the associated gains and losses cannot be accurately tracked to specific transactions. Additionally, the DoD does not distinguish between Inventory Held for Sale and Inventory Held in Reserve for Future Sale.
- **Operating Materials and Supplies:** The DoD continues to expense significant amounts of operating material and supplies when purchased instead of when they were consumed.
- **Property, Plant, and Equipment:** The DoD's legacy property and logistic systems were not designed to capture acquisition cost, costs of modifications and upgrades, or calculate depreciation. In addition, value of DoD Property, Plant, and Equipment is not reliably reported because of a lack of supporting documentation.
- **Government-Furnished Material and Contractor-Acquired Material:** The DoD is unable to comply with applicable requirements for Government-Furnished Materials and Contractor Acquired Materials. As a result, the value of DoD property and material in the possession of contractors is not reliably reported.
- **Environmental Liabilities:** Environmental liability estimates were unreliable because certain DoD activities did not have effective controls in place to ensure adequate audit trails and supporting documentation for estimates, comply with established guidance in developing estimates, maintain reliable feeder and coordination systems, document supervisory review of estimates, and establish quality control programs.

- **Intragovernmental Eliminations:** Because DoD's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations, the DoD made unsupported adjustments because it was unable to reconcile most intragovernmental transactions.
- **Other Accounting Entries:** The DoD continues to enter material amounts of unsupported accounting entries.
- **Statement of Net Cost:** Current financial processes and systems do not capture and report accumulated costs for major programs based on performance measures identified under the requirements of the Government Performance and Results Act.
- **Statement of Financing:** The DoD is unable to reconcile budgetary obligations to net costs without making adjustments.

The Department's material control weaknesses will prevent the Federal Government from achieving an unqualified opinion on the FY 2005 consolidated financial statements. Because the FY 2002 National Defense Authorization Act limits the audit procedures that the DoD OIG can perform on DoD financial statements to those procedures consistent with DoD management's representations as to their reliability, and the DoD has consistently represented that the Department's financial statements are not reliable, additional material control weaknesses may exist which have not been specifically identified.

Inspector General Assessment of Progress

One significant measure of the ongoing progress in the area of financial management would be the Department's ability to obtain an unqualified audit opinion on its financial statements. Though sound financial management goes beyond obtaining an unqualified audit opinion, the President's Management Agenda has recognized that obtaining an unqualified opinion is a strong indicator of a well-managed organization. The DoD is far from reaching this goal as demonstrated by the audit opinions received by the Department and its components on their FY 2005 financial statements. The Department established a goal to achieve an unqualified audit opinion in FY 2007. However, GAO has concluded that an unqualified FY 07 audit opinion remains simply a goal for which there is not yet a clearly defined, well-documented, and realistic plan to achieve. However, the Department's ongoing initiatives in the area of financial management improvement as subsequently described indicate that DoD management is aggressively responding to the significant and pervasive financial management issues and is positioning itself to leverage planned systems and business improvements to achieve sustainable and long-term solutions.

The Department's plans to improve financial management is captured by its emphasis on the core business mission of Financial Management as one of five core business missions of the Business Management Modernization Program, which was established to transform business operations to achieve improved warfighter support while enabling financial accountability across the Department. One of DoD's business enterprise priorities, financial visibility, incorporates six Financial Management core business capabilities, including Financial Reporting. The Financial Reporting component will focus on the ability to provide relevant financial visibility and real-time information dashboards for DoD decision makers and to summarize financial information for the purpose of producing mandatory reports in compliance with regulatory requirements and discretionary reports in support of other requirements. The Department is making efforts to comply with specific and recent congressional mandates requiring the DoD to make concrete progress in improving its systems and business processes. One such legislation, the Ronald W. Reagan National Defense Authorization Act for fiscal year 2005, requires the DoD to develop well-defined business enterprise architecture and a transition plan by September 30, 2005, to cover all defense business systems and related business functions and activities that is sufficiently defined to effectively guide, constrain, and permit implementation of a corporate-wide solution and is consistent with the policies and procedures established by the OMB. Further, the act requires the development of a transition plan that includes not only an acquisition strategy for new systems, but also a listing of the termination dates of current legacy systems that will not be part of the corporate-wide solution, as well as a listing of legacy systems that will be modified to become part of the corporate-wide solution for addressing DoD's business management deficiencies.

During FY 2005, the Office of Undersecretary of Defense (Comptroller) established the Financial Improvement and Audit Readiness (FIAR) committee to prepare a FIAR plan which will provide a roadmap for financial improvement activities and auditability. Some of the goals of the FIAR plan include the establishment of a single, comprehensive and collaboratively managed financial improvement plan, and improving the visibility of financial improvement activities, progress, accomplishments, and audit opinion timeframes. The plan currently focuses on four primary areas: military equipment, real property, environmental liabilities, and health care. Additionally, the Department has developed business rules, which if implemented as planned, should clearly establish a process for ensuring that corrective actions, as described in the DoD component plans, are implemented and validated in order to minimize the Department's risk of unsupported claims by DoD components that reported financial information is auditable.

Health Care

The DoD Military Health System (MHS) challenge is to provide high quality health care in both peacetime and wartime. The MHS must provide quality care for approximately 9.2 million eligible beneficiaries within fiscal constraints while facing growth pressures, legislative imperatives and inflation that have made cost control difficult in both the public and private sectors. The DoD challenge is magnified because the MHS must also provide health support for the full range of military operations. Part of the challenge in delivering health care is combating fraud. As of August 1, 2005, health care fraud constitutes 9 percent of the 1,610 DCIS open cases.

The increased frequency and duration of military deployments further stresses the MHS in both the Active and Reserve components. The MHS was funded at $30.7 billion in 2005, including $18.2 billion in the Defense Health Program appropriation, $6.4 billion in the Military Departments' military personnel appropriations, $0.2 billion for military construction, and $5.9 billion from the DoD Medicare Eligible Retiree Health Care Fund to cover the costs of health care for Medicare eligible retirees, retiree family members and survivors.

Discussion

Two of the primary challenges for the MHS in 2006 will be to begin implementing the BRAC recommendations and completing the medical readiness review.

The results of the BRAC initiative will impact the numbers and types of medical facilities that will make up the MHS. The concurrent evaluation of transformational options will result in the realignment of capabilities and resources to increase the effectiveness of the MHS.

A major challenge related to medical readiness remains the completion of a Medical Readiness Review (MRR) being overseen by a steering group co-chaired by the offices of the Under Secretary of Defense for Personnel and Readiness and the Director, Program Analysis and Evaluation. The

MRR will identify medical readiness and personnel management capabilities required by the National Security Strategy and related transformation of war fighting. The MRR will examine how the capabilities will be delivered in wartime and maintained in peacetime and how the MHS will be sized for both foreign and domestic response. Ongoing challenges include providing capability for readiness of the deploying forces and the readiness of the medical staff and units. Readiness of the force means that all deployable forces are medically ready to perform their missions before deploying, while deployed, and upon return. Readiness of the medical staff and units includes ensuring that medical staff can perform at all echelons of operation and the units have the right mix of skills, equipment sets, logistics support, and evacuation and support capabilities. The Assistant Secretary of Defense (Health Affairs) requested that the DoD OIG review the medical readiness reporting system. We will begin that review in 2006. As with most DoD functions, the MHS continues to face the challenge of increased joint operations and management.

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

In addition to the peacetime and readiness challenges, the President's Management Agenda for FY 2002 identified nine agency specific initiatives. One of the specific initiatives was the coordination of the DoD and the Department of Veterans Affairs (VA) medical programs and systems. This issue is further addressed in Section 721 of the National Defense Authorization Act for FY 2003, which requires coordination and sharing of the DoD and the VA health care resources. Effective October 1, 2003, the DoD and VA are each required through 2007 to contribute annually $15 million to the DoD Veterans Affairs Health Care Sharing Incentive Fund to finance future sharing initiatives. Section 722 of the National Defense Authorization Act for FY 2003 required the DoD to contribute $3 million in FY 2003, $6 million in FY 2004, and $9 million in later years to cover a "health care resources sharing and coordination project." We believe the sharing requirement will benefit both agencies and reduce costs. The FY 2003 National Defense Authorization Act also assigned the GAO responsibility for annually assessing the coordination effort and reporting to Congress.

During FY 2005, the DoD audit community issued 15 reports addressing health care issues such as personnel requirements, medical laboratories, third party collections, financial management, provider productivity, deployment health assessment, base realignment and closure, patient movement, the medical acquisition process, global war on terrorism funding, and tactical medical support.

Inspector General Assessment of Progress

The MHS has been moving forward on improving health care while attempting to control costs. MHS has made significant progress in implementing new TRICARE contracts. TRICARE transitioned from 12 regions and 7 contracts in the United States to 3 regions and 3 contracts. The contracts provide incentives for customer satisfaction and include the managed care support contractors as partners in support of medical readiness. Transition to the new contracts is complete; however, some issues still exist that are being addressed in the administration of the TRICARE program, particularly at the regional level.

The Medical Joint Cross Service Group completed its base realignment and closure process for medical facilities and has submitted recommendations to the Secretary. The MHS must now await final decisions of the BRAC Commission, the Congress and the President before implementation can begin.

The MRR continues. Four working groups have been established to address: medical readiness capabilities, casualty estimation, capability metrics, and medical resources. Considerable progress has been made by the group. The MRR is scheduled to be completed in 2006 and should help ensure that medical requirements are included in operational planning rather than being addressed after the fact.

The Military Health System Executive Review (or MHSER) commissioned a study in 2004 that has helped to articulate improvements in process and management for the MHS. This work is called the Local Authorities Work Group recommendations. These 24 items comprise an agenda for transformation of business process at the local (market) and MTF level.

The MHSER also sanctioned the formation of the Office of MHS Transformation, which has been approved by the Deputy Secretary of Defense. The Office will stand up for a period of two years and will have as its agenda the implementation of the MRR, BRAC and the above-mentioned Local Authorities Work Group recommendations. The Transformation Office is intended to coordinate fully all of the various but inter-related transformational ideas into a comprehensive package. The effort will work under the Assistant Secretary of Defense (Health Affairs) and will be led, staffed and supported by members from MHS.

The Department also made progress toward implementing a fully integrated pharmacy program by developing a uniform formulary. Having a uniform process will make the pharmacy benefit more cost effective and will comply with the FY 2000 National Defense Authorization Act. The implementation of Federal ceiling prices for drugs has stalled because the issue is in litigation with industry. Some companies in the industry have challenged the Government's legal right to control prices by establishing ceilings. Resolving this in court will be a challenge to the Department because the DoD can realize millions of dollars of savings in pharmacy costs dispensed in the retail venue.

Progress is also being made with DoD/VA sharing initiatives. In FY 2004, 57 proposals were submitted for consideration for the DoD-Veteran Affairs Health Care Sharing Incentive Fund and 12 joint initiatives were approved with funds already released for the initiatives. Proposals are currently being considered for FY 2005 initiatives. In addition, seven sites were selected for resource sharing demonstration projects in three functions: budget and financial management, coordinated staffing and assignment, and medical information and information management. The VA/DoD Health Executive Council is monitoring the demonstration projects. The demonstrations will continue through FY 2007.

One of the major challenges identified last year was implementation of the Health Insurance Portability and Accountability Act (HIPAA). The Department made progress implementing HIPAA. A MHS-wide training program was developed and made available on the web. The MHS policy implementing the HIPAA National Provider Identifier (NPI) final rule was established in January 2005. The NPI will identify providers throughout the United States health care system in HIPAA covered standard electronic transactions. Full implementation of HIPAA remains an ongoing challenge within the MHS as well as in the industry.

Lastly, the DoD Quadrennial Defense Review (QDR) will provide the MHS the opportunity to formalize the personnel, infrastructure and process improvement ideas the MHS is pursuing as part of its transformational agenda. Medical transformation in the QDR is worked as part of the Integrated Process Team for Business Practices/Processes. The Integrated Process Team is designed to improve

DoD business practices. Results from the QDR will provide clarity to the agenda and a timeline for implementation of BRAC, Local Authorities Work, and the MRR.

Logistics

The challenge of logistics is to provide the right force the right personnel, equipment, and supplies in the right place, at the right time, and in the right quantity, across the full range of military operations. To meet this challenge, the Department is continuously transforming logistics by assessing best practices and evaluating new concepts that will provide the joint warfighter with support for all functions. Overall, DoD logistics is a $90 billion per year activity, involving over a million people. The Department provides supplies, transportation, and maintenance for a vast inventory of ships, aircraft, helicopters, ground combat and tactical vehicles, and thousands of additional mission support assets.

Discussion

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.

Since its approval in 2003, Focused Logistics is the DoD's approved joint logistics functional concept to achieve logistics capabilities in support of distributed adaptive operations. The concept defines broad joint logistics capabilities that are necessary to deploy, employ, sustain, and re-deploy forces across the full spectrum of operations. The emergence and maturation of advanced logistics concepts and technology developments require that the DoD continuously reevaluate its logistics transformation strategy and reconcile such concepts as focused logistics, force-centric logistics enterprise, and sense and respond logistics. Together these logistics concepts and the identified initiatives for implementation will remain the DoD's challenge to a successful logistics transformation.

One particular challenge for the DoD is supply chain management. The GAO identified supply chain management as a High Risk Area due to weaknesses uncovered in certain key aspects, such as distribution, inventory management, and asset visibility. GAO has reported on numerous problems associated with supply chain management, such as shortages of items due to inaccurate or inadequately funded war reserve requirements and the DoD's lack of visibility and control over the supplies and spare parts it owns.

The DoD has taken actions to improve the supply chain management, such as assigning new organizational responsibilities for distribution, developing a logistics transformation strategy, and implementing other specific process improvements. However, the DoD must be vigilant in ensuring that the strategy for logistics transformation is continuously reevaluated and that new initiatives and systems are adequately funded and effectively implemented.

In late 2003, 28 members of Congress sent a letter to the Department of Defense Inspector General that expressed concerns about reports regarding alleged lack of support for Guard units deployed in Iraq and Afghanistan. The letter requested that we conduct an assessment in five logistical areas: potable water, organizational clothing and equipment (desert combat uniforms and desert boots), food/food service, in-theater medical/dental care, and access to communications with family members. The signatories of the letter also wanted to know if there was disparity of support between the Reserve component forces and the Active forces. In response to this Congressional request, the DoD OIG conducted and recently completed an evaluation of the support provided to mobilized Army National Guard and U.S. Army Reserve units in the requested areas of logistics. Although the Army encountered significant logistical challenges to initiate and conduct sustained land combat operations in Operation Enduring Freedom and Operation Iraqi Freedom, the team concluded that support was adequate in the areas evaluated. There was no evidence of systemic disparity between support provided to Reserve component soldiers and to Active component soldiers, beyond the disparities "by design" associated with the tiered readiness system. The Army is transforming the policies and procedures of the tiered readiness system to the Active Component/Reserve Component Force Generation Model.

Another challenge for the DoD is ensuring that the President's Management Agenda's initiative on improved financial performance is adhered to while simultaneously implementing the specific initiatives for transforming DoD logistics. Several of DoD's initiatives, including business management modernization, performance-based logistics, and end-to-end distribution may require significant investment to fulfill transformation. The DoD must ensure that financial data are used to manage, make course corrections, maximize resources, and ensure that programs achieve expected results and work towards continual improvement.

Inspector General Assessment of Progress

The Department has made progress towards 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 performance-based logistics, business systems modernization, and inventory management.

Implementation of performance-based logistics has been at a slow pace. The DoD and the military services have issued policy and procedures for implementation of performance-based logistics. However, our review of performance-based logistics for the Javelin, H-60 Seahawk Helicopter, and the Joint Surveillance Target and Attack Radar System show that challenges still abound in the areas of developing effective business case analyses, performance-based agreements with warfighters, and ensuring that costs are reduced. A review of the Business System Modernization Program for the Defense Logistics Agency found favorable results in mission performance and information assurance; however, challenges still exist in addressing usability issues.

Lastly, a review of the initiatives for minimizing inventory to support special program requirements found that although actions had been taken to minimize investment in inventory to support special program requirements, the Defense Logistics Agency needs to expand its pilot program to reduce special program requirement procurement quantities in several of its defense supply centers.

In the near future, the Inspector General will also provide assessments of DoD's initiatives for airlift and sealift transportation, customer wait time, and weapon system requirements.

Infrastructure and Environment

The challenge in managing approximately 3,700 military installations and other DoD sites is to provide reasonably modern, habitable, and well-maintained facilities, which cover a spectrum from test ranges to housing. The Department's review of our defense and security needs resulted in transforming our force structure and prompting a corresponding new base structure.

This challenge of a new base structure is complicated by the need to minimize spending on infrastructure so funds can be used instead on defense capability. Unfortunately, the Department has an obsolescence crisis in facilities and environmental requirements have continually grown. Furthermore, the Department will need to efficiently and effectively implement the Base Realignment and Closure 2005 recommendations to eliminate excess capacity which will free up dollars to be used for other purposes.

Discussion

Implementing the results of "Transformation through Base Realignment and Closure 2005" will pose a significant challenge for the Department. However, implementation of Base Realignment and Closure 2005 will also provide an opportunity for the Department to eliminate excess physical capacity, transform DoD infrastructure into a more efficient structure, and provide cost savings. As part of the challenge, the Department must efficiently and effectively implement the Commission's recommendations to obtain optimal savings in the most efficient manner and with the least disruption to the Department. Until the final decisions are made, the Department will not know the full impact of the Transformation through Base Realignment and Closure.

The Department is the largest steward of properties in the world, responsible for more than 30 million acres in the United States and abroad with a physical plant of some 571,900 buildings and other structures valued at approximately $646 billion. Those installations and facilities are critical to supporting our military forces, and must be properly sustained and modernized to be productive assets. The goal of the Department is a 67-year replacement cycle for facilities and the current program would achieve that level in FY 2008. The replacement cycle was reduced from a re-capitalization rate of 136 years in FY 2004 to 107 years in FY 2005.

Beginning in 2001, the Secretary of Defense launched an executive assessment of the DoD safety program and challenged the senior leaders to reduce in two years the accident mishap rate by 50 percent. Overall responsibility for the project was tasked to the Under Secretary of Defense for Personnel and Readiness, who subsequently chartered the Defense Safety Oversight Council (DSOC) to facilitate oversight of DoD's efforts to achieve the Secretary's goal. In late 2004, DSOC deliberations concluded the 50 percent reduction goal may not be achievable. Recognizing this possibility, the Deputy Under Secretary of Defense for Readiness requested the DoD IG's assistance and asked us to conduct an evaluation/review of the DoD safety program. In November 2004, the Inspections and Evaluations Directorate announced an evaluation plan that addresses all aspects of the safety program—culture, leadership, policies, organizational structure, resources, exceptional practices, and lessons learned. Although the evaluation process is proceeding on schedule, several challenges lie ahead. One challenge is to insure appropriate resources are available to complete the project in a timely manner. Another challenge to keep all stakeholders of the military departments and offices of the Secretary of Defense, including the DSOC, informed on the project's progress and preliminary analyses. A third challenge is to establish the DoD Safety Commission. The Secretary of Defense's approval to establish this Federal Advisory Safety Commission is pending. The commission will be used to review and validate the evaluation team's findings and recommendations and to offer additional observations and suggestions.

In today's environment, the Department will also need to consider additional security measures in DoD buildings. The DoD is in the process of implementing the "DoD Minimum Antiterrorism Standards for Buildings" for new and existing inhabited buildings. The Department will need to spend additional funds for security purposes if the antiterrorism standards for buildings are fully implemented. The amount of funds the Department needs to implement the standards is unknown at this time.

As of 2nd Quarter, FY 2005, the Military Departments owned 1,865 electric, water, wastewater, and natural gas systems worldwide. The Department has implemented an aggressive program that is on track to complete privatization decisions on 90 percent of the available water, sewage, electric, and gas utility systems by September 2005. In addition, while installation commanders must strive to operate more efficiently, they must do so without sacrificing their ability to operate in the event of a terrorist attack on our homeland. Civilian control of utilities complicates comprehensive plans for preventing sabotage and responding to attacks on water and power at military installations.

As of June 30, 2005, the DoD has an estimated $64.2 billion in environmental liabilities. The Department continues to correct past material control deficiencies in identifying and tracking sites with environmental liabilities and maintaining audit trails for financial liability estimates. The Department needs to improve documentation and supervisory review of environmental liability estimates. The Base Realignment and Closure 2005 decisions will affect the amount and extent of environmental liabilities. At this juncture it is too early to know how much cleanup is required for the bases closing or how long the cleanup will take to complete.

Installation restoration (clean-up) practices at active installations and clean-up activities at closing installations are the DoD's biggest environmental expenditures. Restoration and clean up goals will be difficult to achieve anytime soon in light of fall-out from the FY 2005 round of Base Realignment and Closure and the Global Posture Initiative. The Inspections and Evaluations Directorate will review and evaluate policy and processes for sustaining the environment while protecting DoD's requirement to be mission ready. The Department of Defense is increasingly challenged to conduct the realistic training necessary to produce combat-ready forces. The operations tempo supporting combat operations increases the stress to installations and training range infrastructure. Creating sustainable DoD installations and ranges is critical to ensure mission success while reducing the stresses on the natural and developed environment. Effective environmental management systems will positively impact all elements of the risk management framework and help the Department achieve sustainable installations and ranges.

Inspector General Assessment of Progress

The Department completed the BRAC process within their required timeframe but needs to wait on the decisions made by the Commission, President, and Congress before it can move out on the recommendations. The outcome will affect the amount of excess capacity the Department ultimately reduces, the amount of savings available for other uses, and the amount of environmental cleanup needed. The Secretary's recommendations for the Base Realignment and Closure 2005 exceeded the prior BRAC efforts in 1989, 1991, 1993, and 1995. The Department of Defense Office of Inspector General spent a great deal of effort on oversight of the 2005 BRAC process which resulted in very minimal oversight of other infrastructure and environment areas.

Management's Response to the Inspector General's Assessment

In general, we agree with the Inspector General's summary of the management challenges faced by the Department. The nine areas he identified are long-standing problems that defy quick fixes. We have plans in place to resolve each of the areas, but we recognize that it will take time and resources to address the problems inherent in the Department. We are pleased to note that the Inspector General has recognized our progress.

For the most part, the Inspector General's list echoes the Government Accountability Office's (GAO) most recent High-Risk List for government operations. GAO, for example, considers human capital, homeland security, and infrastructure protection as government-wide challenges not unique to the DoD. The President's Management Agenda also addresses many of the areas identified by the Inspector General as government-wide opportunities for improvement. Part 1 of this report, Management's Discussion and Analysis, addresses the issues raised by the Inspector General.

Appendixes

Appendix A: *Glossary of Terms*

Acronym	Full Name
AC/RC	Active Component/Reserve Component
AFQT	Armed Forces Qualifying Test
AOR	Accumulated Operating Results
APB	Accounting Principles Board Opinion
ARMS	Armament Retooling and Manufacturing Support Initiative
ASD (HD)	Assistant Secretary of Defense for Homeland Defense
BMMP	Business Management Modernization Program
BRAC	Base Realignment and Closure
CERCLA	Comprehensive Environmental Response, Compensation Liability Act
CFO	Chief Financial Officer
CFR	Code of Federal Regulations
CIO	Chief Information Officer
CIP	Critical Infrastructure Program
COLA	Cost of Living Adjustment
CPI	Consumer Price Index
CPIM	Consumer Price Index Medical
CSRS	Civil Service Retirement System
CY	Current Year
DAB	Defense Acquisition Board
DCAA	Defense Contract Audit Agency
DCIS	Defense Criminal Investigative Service
DERP	Defense Environmental Restoration Program
DFAS	Defense Finance & Accounting Service
DHP	Defense Health Program
DLA	Defense Logistics Agency
DO	Disbursing Officer's
DoD	Department of Defense
DoL	Department of Labor
DSOC	Defense Safety Oversight Council
DTS	Defense Travel Service
e-Gov	Electronic Government
FBWT	Fund Balance With Treasury
FECA	Federal Employees' Compensation Act
FEGLI	Federal Employees' Group Life Insurance Program
FEHB	Federal Employees' Health Benefits

Appendix A: *Glossary of Terms*
(continued)

Acronym	Full Name
FERS	Federal Employees' Retirement System
FFB	Federal Financing Bank
FIAR	Financial Improvement and Audit Readiness
FFMIA	Federal Financial Management Improvement Act
FMFIA	Federal Managers' Financial Integrity Act
FMS	Foreign Military Sales
FUDS	Formerly Used Defense Sites
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	U.S. Government Accountability Office
GF	General Fund
GMRA	Government Management Reform Act
GPRA	Government Performance and Results Act
GSA	General Services Administration
HIPAA	Health Insurance Portability and Accountability Act
HMO	Health Maintenance Organization
HQ	Headquarters
IBNR	Incurred But Not Reported
IG	Inspector General
IPAC	Intra-Governmental Payment and Collection System
IPIA	Improper Payments Information Act
IPv6	Internet Protocol Version 6
IRAS	Intragovernmental Review and Analysis System
ISR	Intelligence, Surveillance, and Reconnaissance
IT	Information Technology
JCS	Joint Chiefs of Staff
JTTF	Joint Terrorism Task Force
MAFR	Merged Accounting & Fund Reporting System
MD&A	Management's Discussion and Analysis
MERHCF	Medicare-Eligible Retiree Health Care Fund
MHPI	Military Housing Privatization Initiative
MHS	Military Health System
MHSER	Military Health System Executive Review
MOU	Memorandum of Understanding
MRF	Military Retirement Fund

Appendix A: *Glossary of Terms*
(continued)

Acronym	Full Name
MRR	Medical Readiness Review
MRS	Military Retirement System
MTF	Military Treatment Facility
NOAA	National Oceanic and Atmospheric Administration
NORM	Navy Normalization of Data Systems
NPI	National Provider Identifier
NSPS	National Security Personnel System
NULO	Negative Unliquidated Obligations
NRV	Net Realizable Value
O&S	Operation and Support
ODO	Other Defense Organizations
ODO-GF	Other Defense Organizations – General Fund
OIG	Office of Inspector General
OM&S	Operating Materials & Supplies
OMB	Office of Management and Budget
OPM	Office of Personnel Management
OSD	Office of the Secretary of Defense
PART	Program Assessment Rating Tool
PERSTEMPO	Personnel Tempo
P.L.	Public Law
PMA	President's Management Agenda
PPBS	Planning, Programming and Budgeting System
PP&E	Property, Plant & Equipment
Q rating	Standardized indicator of facility restoration and modernization requirements
QDR	Quadrennial Defense Review
QoL	Quality of Life
RND	Results Not Demonstrated
SAR	Selected Acquisition Report
SBR	Statement of Budgetary Resources
SFAS	Statement of Financial Accounting Standards
SFFAS	Statement of Federal Financial Accounting Standards
SFIS	Standard Financial Information Structure
SoNC	Statement of Net Cost
T2	Training Transformation
TSP	Thrift Savings Plan

Appendix A: *Glossary of Terms*

(continued)

Acronym	Full Name
TOA	Total Obligation Authority
UDO	Undelivered Orders
UMD	Unmatched Disbursements
USACE	United States Army Corps of Engineers
USC	United States Code
USCENTCOM	United States Central Command
USDA	United States Department of Agriculture
USEUCOM	United States European Command
USNORTHCOM	United States Northern Command
USPACOM	United States Pacific Command
USSOUTHCOM	United States Southern Command
USSGL	United States Standard General Ledger
VA	Department of Veterans Affairs
WARS	Worldwide Ammunition Reporting System
WCF	Working Capital Fund

Appendix B: *Internet Links*

General information about the Department of Defense

LINKS	TOPIC/SUBJECT
Internal Links	
www.defenselink.mil	Main Department of Defense (DoD) website, provides daily news about DoD activities, extensive search capabilities, photographs, and links to all DoD organization websites.
www.dodig.osd.mil	DoD Office of Inspector General's website, which contains information about the OIG's activities and OIG reports.
www.dod.mil/comptroller/par	The DoD Comptroller's website, which includes the DoD Performance and Accountability Reports since 2002 and detailed FY 2005 Performance Information (summaries are provided in Part 2 of this report).
www.defenselink.mil/pubs/qdr2001.pdf	DoD Quadrennial Defense Review (2001)
www.defenselink.mil/execsec/adr2004/index.html	DoD Annual Defense Report (2004)
www.defenselink.mil/news/Mar2005/d20050318nds1.pdf	National Defense Strategy
www.defenselink.mil/news/Mar2005/d20050318nms.pdf	National Military Strategy
www.dod.mil/comptroller/defbudget/fy2006/index.html	DoD Budget (2006)
www.cpms.osd.mil/nsps	National Security Personnel System
www.brac.gov	Information about the Base Realignment and Closure process for 2005.
External Links	
www.whitehouse.gov/results	Information about the President's Management Agenda
www.whitehouse.gov/omb	Office of Management and Budget's website
www.gao.gov	U.S. Government Accountability Office's website
www.whitehouse.gov/nsc/nss.pdf	National Security Strategy
www.cfoc.gov	Chief Financial Officers Council
www.firstgov.gov	U.S. Government's Official Web Portal

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