UNITED STATES DEPARTMENT OF DEFENSE
AGENCY FINANCIAL REPORT
FISCAL YEAR 2013

MANAGEMENT DISCUSSION AND ANALYSIS

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MANAGEMENT'S DISCUSSION AND ANALYSIS

FISCAL YEAR 2013 OVERVIEW

The Department of Defense (DoD) is made up of a civilian and military workforce, with our military tracing its roots back to pre-Revolutionary times. As such, the Department is arguably the nation's oldest and largest government agency, though it took its present shape with the passage of the National Security Act of 1947.

Chuck Hagel
Secretary of Defense

Today, more than six decades later, the Department fields, sustains, and employs the military capabilities necessary to protect the United States and its allies and to advance our national interests. America's national security depends on military and civilian personnel, defense installations, and facilities that are in the right place, at the right time, with the necessary qualities and capacities. The Department is also one of the nation's largest employers, with approximately 1.4 million personnel on active duty, 790,000 civilians, and 835,000 men and women in the National Guard and Reserve forces. There are also more than 2 million military retirees and family members receiving benefits.

In fiscal year (FY) 2013, the Department began implementing the Defense Strategic Guidance (DSG) issued by the President and the Secretary of Defense in 2012. Entitled *Sustaining U.S. Global Leadership: Priorities for 21st Century Defense,* this new guidance revised the Department's strategy from the 2010 *Quadrennial Defense Review* (QDR). The DSG addressed emerging strategic and fiscal circumstances, including budget cuts mandated by the *Budget Control Act of 2011* (BCA), as well as the drawdown from Iraq and the planned transition in Afghanistan. The DSG was built around four overarching principles: (1) to maintain the world's finest military, (2) to avoid hollowing out the force, (3) to take needed reductions in a balanced, strategy-driven manner, and (4) to preserve the quality of the All-Volunteer Force by keeping faith with men and women in uniform and their families.

The Defense Strategic Guidance called for a future military force that is smaller and leaner, but which is agile, flexible, rapidly deployable, and technologically advanced. As a result, the Department took steps to implement force structure reductions (including ground forces and tactical air), while lessening the risks of a smaller force by emphasizing readiness across the Military Services and missions.

This approach requires further investments in new capabilities, including the F-35 Joint Strike Fighter, a new bomber, undersea capabilities, munitions, and intelligence, reconnaissance, and surveillance (ISR) platforms. The goal of these investments is to maintain the most technologically advanced military, able to meet challenges from both state and non-state adversaries through the availability of key capabilities such as ISR and strengthened by Special Operations Forces, space systems, ballistic missile defense, cyber security, homeland defense, and the ability to counter weapons of mass destruction.

The new defense strategy also supports the U.S. rebalance toward the Asia-Pacific region, an area that is vital to U.S. economic and security interests and which presents emerging challenges and opportunities. The strategy involves expanded networks of cooperation with partners throughout the region, strengthened missile defense posture, investment in intellectual capital, and enhanced access and sustainment across the region.

In FY 2013, the Department also continued efforts across a range of other mission areas. Priorities included countering the threat of terrorism globally, defeating Al Qaida, protecting the homeland against attack, and conducting operations in and around the Middle East. These priority defense efforts occurred in a constantly evolving security environment, with both strategic opportunities and challenges presented by political developments in the Middle East and North Africa.

To support these ongoing operations, as well as to preserve operational readiness for future challenges, the Department is also maintaining its capacity to operate in multiple theaters and to project power through the use of carriers, bombers, forward-staging bases,

Deputy Secretary of Defense Ashton B. Carter visits with Pacific Command personnel to thank them for their service during a critical transition of U.S. forces in the Asia-Pacific theater.

DoD photo by Tech. Sgt. Michael Holzworth, U.S. Air Force large-deck amphibious ships, and tactical airlift. Additionally the Department developed agreements between Combatant Commands (COCOMs) to allow force sharing of critical high-demand, low-density assets. These actions are expanding DoD's ability to respond to threats across multiple theaters.

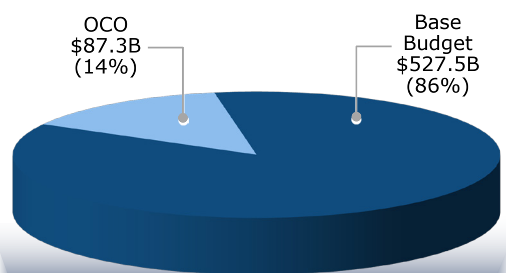
Throughout the year, the Department continued activities to deny safe haven to al Qaida and to deny the Taliban the ability to overthrow the government of Afghanistan. For more than a decade, the United States has provided most of the support needed by the International Security Assistance Force (ISAF), which is focused on developing the capabilities of the Afghan National Security Forces (ANSF).

The ANSF has nearly doubled in size since 2009 and is now at 98 percent of its authorized end strength. The ANSF conducts 95 percent of conventional operations and 98 percent of special operations in Afghanistan. The focus of the ANSF development mission has shifted to improving the sustainability of the ANSF in order to ensure that its progress is enduring. The ISAF assistance to the ANSF targets five operational pillars, which are key to long-term sustainability: leadership, command and control, logistics and sustainment, combined arms integration, and training. In FY 2013, the ANSF assumed security lead across the country, and will assume full responsibility for security on January 1, 2015.

Building partnership capacity worldwide is also important for sharing the costs and responsibilities of global leadership. The Department has pursued emerging partnerships with a growing number of nations. We are advancing low-cost, small-footprint approaches to achieve security objectives, relying on exercises, rotational presence, and advisory capabilities. The United States has also helped to develop the capacity of allies and partners to support American interests and objectives across a range of security challenges. Additionally, the Department identified more cost-effective ways to conduct security cooperation, including new and more efficient use of existing authorities, such as the Global Security Contingency Fund and Section 1206 of the National Defense Authorization Act for FY 2006.

The Department's FY 2013 enacted budget of $614.8 billion (Figure 1) consisted of two parts: $527.5 billion in base operating funds, and $87.3 billion to support Overseas Contingency Operations (OCO). The budget incorporated funding reductions that reduced future spending by $228 billion during FY 2012 – FY 2016, and $487 billion during FY 2012 – FY 2021.

Figure 1. DoD FY 2013 Enacted Budget ($614.8B)



Budget by Appropriation	*$ in Billions*
Military Personnel	$149.7
Operation and Maintenance	$272.8
Procurement	$109.8
RDT&E	$69.6
Military Construction	$8.9
Family Housing	$1.6
Revolving Funds	$2.5
Total	**$614.8**

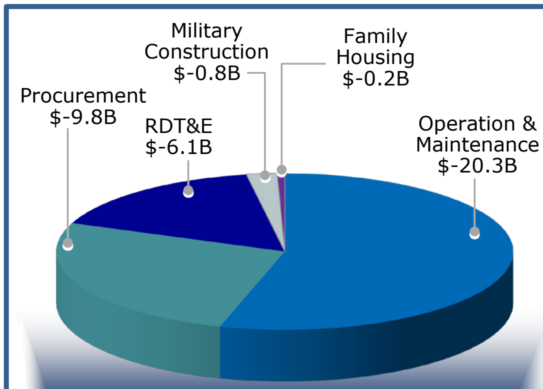
Note: Amounts may not add due to rounding B13-17

What the FY 2013 budget did not take into consideration is the devastating impact that would result from sequestration, the permanent cancellation of budgetary resources by a uniform percentage applied to all programs, projects, and activities within a budget account.

The BCA sought to reduce the annual Federal deficit by $1.2 trillion by the end of 2021. When lawmakers failed to accomplish this, the BCA triggered automatic budget cuts. The budget cuts total $1.2 trillion over 10 years, split roughly equally between defense and domestic discretionary spending. The effects of sequestration on many budget items was increased by the exclusion of a large fraction of the overall DoD budget, namely military pay and benefits. Other budget areas had to absorb larger percentage cuts so that the Department could meet its overall mandatory reductions.

Anticipating the possibility of sequestration, the Department began taking action in January 2013 to slow spending. The Department imposed hiring freezes, laid off temporary and term employees, cut travel and conferences, and reduced facilities maintenance.

Figure 2. DoD FY 2013 Sequester Impact (-$37.2B)



Budget by Appropriation	$ in Billions
Military Personnel	--
Operation and Maintenance	$-20.3
Procurement	$-9.8
RDT&E	$-6.1
Military Construction	$-0.8
Family Housing	$-0.2
Revolving Funds	--
Total	**$-37.2**

Note: Amounts may not add due to rounding B13-45

In March, the triggering of sequestration resulted in a reduction of $37 billion (Figure 2) during the last six months of the fiscal year. Coupled with the unexpected shortfall in wartime or OCO funding, which led to a total operating shortfall of $30 billion, the effects of sequestration on the Department's operations was damaging and far-reaching. The Department endured major cuts in training and maintenance, seriously damaging military readiness. The Air Force shut down flying at 13 combat-coded fighter and bomber squadrons and curtailed exercises. The Army cancelled seven combat training center rotations and five brigade-level exercises that are essential in preparation for deploying units. The Navy delayed deployment of the USS TRUMAN carrier strike group to the Persian Gulf, curtailed the sailing of the USNS COMFORT to Latin America, and cancelled other ship deployments. In addition, the Department was forced to impose unpaid furloughs on civilian employees, with approximately 650,000 civilian employees affected for six days.

Sequestration deprived the Department of its ability to implement the BCA-mandated FY 2013 reductions in a balanced, strategy-driven manner. The adverse effects on the Department's operations have been damaging and far reaching, especially with regard to readiness.

Despite the continuing uncertainty, the Department must have a plan for future budgets. In March 2013, Secretary Hagel directed Deputy Secretary Ashton Carter to conduct a Strategic Choices and Management Review (SCMR), with the support of the Chairman of the Joint Chiefs of Staff, General Martin Dempsey, and the Department's civilian and military leadership. The SCMR developed a menu of choices for aligning Defense strategy with a range of budget scenarios.

The SCMR focused on both strategic and managerial choices, ranging from options for future force structure needs to institutional reform, efficiencies, and compensation. The SCMR sought to preserve the key tenets of the President's 2012 DSG, and to optimize savings gained from reducing overhead and structural costs with minimal impact on the capability and readiness of the force. The SCMR will help guide the Services and defense agencies in developing budgets for FY 2015 – FY 2019. It will also serve as an input to the 2014 QDR, which will determine the Department's strategic course in the years ahead.

Throughout FY 2013, the Department remained dedicated to obtaining, investing, and effectively using its financial resources to ensure the security of the United States and meet the needs of both the warfighter and the ever-changing battlefield. Taking care of our people, reshaping and modernizing the force in the current fiscal environment, and supporting our troops in the field remain the highest priorities for the Department.

President Barack Obama, Defense Secretary Chuck Hagel and Army General Martin Dempsey, Chairman, Joint Chiefs of Staff, during a ceremony for 9/11 victims.

DOD photo by Erin A. Kirk-Cuomo

PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

OVERVIEW

Each year, the Department develops and tracks performance measures to assess our progress in meeting DoD's Strategic Plan priorities, as defined in the *Quadrennial Defense Review* (QDR). This section reports on the results of 15 key DoD performance measures as of third quarter, FY 2013, and 2 key measures as of the end of FY 2013. These 17 performance measures best align to the following financial management themes:

- Act as good stewards of the public funds
- Implement and deepen program alignment to the new defense strategy
- Create a force that is ready across a spectrum of missions
- Keep people central to our plans.

U.S. soldiers patrol down a mountain after visiting an Afghan border police observation point in Kunar province, Afghanistan.

U.S. Army photo by Sgt. Jon Heinrich

The sequestration provisions of the *Budget Control Act of 2011*, which resulted in across-the-board cuts in nearly all of the Department's FY 2013 discretionary spending areas, already has significantly impacted the Department's ability to achieve its strategic goals. As training exercises and operational budgets are reduced to meet sequestration targets, the readiness of DoD organizations will likely be affected. In September 2013 testimony on Capitol Hill, the Service Secretaries stated that the extent of sequestration's impact could be significant to U.S. forces and, therefore, will almost certainly affect performance results in FY 2014.

Despite these fiscal challenges, the Department made progress in FY 2013. Of the performance measures highlighted in this section, 14 (82 percent) are on track to meet year-end goals. The final results and associated trend analysis for all 75 of the Department's performance measures will be addressed in the Department's FY 2013 Annual Performance Report (APR), submitted with the Department's FY 2015 Congressional Budget Justification in February 2014. The APR can be viewed at *http://comptroller.defense.gov/budget.html* or on Performance.gov, *http://goals.performance.gov/agency/dod*, under "Agency Plans and Reports."

Strategic Goal 1: Prevail in Today's Wars

The United States military protects the nation's economic vitality and interests throughout the world. In this environment of significant mission requirements, coupled with current and future budget reductions, the DoD Combatant Commander's ability to execute 100 percent of current operations is critical. Current operations are intended to help us prevail in today's wars by continuing to develop functional relationships and conduct joint exercises with coalition partners. As it relates to the Afghan National Security Force (ANSF), the North Atlantic Treaty Organization International Security Assistance Force is on track to transition full security responsibility to the Afghan government by the end of 2014. As of third quarter FY 2013, all COCOMs reported meeting the goal to be 100 percent ready to execute current operations (Strategic Objective 1.1-OCO).

STRATEGIC GOAL 1: PREVAIL IN TODAY'S WARS.				
Key Performance Measures	Strategic Plan Long-Term Performance Goals	Performance Goals/Results		
		FY 2012 Results	FY 2013 Q3 Goals	FY 2013 Q3 Results
Strategic Objective 1.1-OCO: Degrade the Taliban to levels manageable by the ANSF, while increasing the size and capability of the ANSF.				
1.1.1-OCO: Percent of the Combatant Commanders' (COCOMs) Current Operations which they report ready to execute.	1.1.1-OCO: For each FY, Combatant Commanders (COCOMs) will be ready to execute 100% of Current Operations.	100%	100%	■ 100%

■ Met or Exceeded Target ■ Did Not Meet Target

Strategic Goal 2: Prevent and Deter Conflict

The following performance measures (Strategic Objective 2.1-1F1) are critical to satisfying the Department's deterrence missions, which rely upon our ability to quickly confront and defeat aggression from any adversary, anytime, anywhere.

The Department exceeded strategic measure 2.1.3-1F1, the percent of Army Brigade Combat Teams (BCT) converted to a modular design and available to meet operational demands. The modular design shifts the Army away from a division-centric force structure to a brigade-centric force structure, where BCTs with a modular design possess more organic capabilities and are less reliant upon division-level support. The Army's conversion of BCTs to a modular design has resulted in a force that is more capable, standardized, and flexible to respond to a wide range of missions.

At the end of the third quarter, the Army completed the modular conversion of 71 BCTs. Additionally, the Army completed the modular conversion of its 228 planned Multi-functional and Functional Support (MFF) brigades.

STRATEGIC GOAL 2: PREVENT AND DETER CONFLICT.				
Key Performance Measures	**Strategic Plan Long-Term Performance Goals**	**Performance Goals/Results**		
		FY 2012 Results	**FY 2013 Q3 Goals**	**FY 2013 Q3 Results**
Strategic Objective 2.1-1F1: Extend a global posture to prevail across all domains by increasing capacity in general purpose forces and by enhancing stability operations and foreign security force competency.				
2.1.3-1F1: Cumulative percent of Army Brigade Combat Teams (BCTs) converted to a modular design and available to meet military operational demands.	2.1.3-1F1: By FY 2014, 100% of Army BCTs will have concerted to a modular design and be available to meet military operational demands.	69%	99%	■ 100%
2.1.4-1F1: Cumulative number of Army Multi-functional and Functional Support (MFF) brigades converted to a modular design and available to meet military operational demands.	2.1.4-1F1: By FY 2013, the DoD will convert 228 Army Multi-functional and Functional Support (MFF) brigades to a modular design.	228	228	■ 228

■ Met or Exceeded Target ■ Did Not Meet Target

Strategic Goal 3: Prepare to Defeat Adversaries and Succeed in a Wide Range of Contingencies

In an increasingly dangerous world, the Department's ability to respond to natural and manmade disasters is of paramount importance. To that end, the Department continues to focus on improving the responsiveness and flexibility of the Consequence Management Response forces. Consequence management responses can be defined as the steps taken by the government to restore general security and health, to restore core government functions (police, fire, etc.), and to provide emergency relief to those affected by the consequences of a chemical, biological, nuclear, or high-yield explosive scenario. The ability to train, equip, evaluate, and validate these response units is critical to ensure the Department is prepared to respond to catastrophic events.

Marines assigned to aircraft rescue and firefighting units work together to put out a fire at the air station burn pit during a training fire exercise on Marine Corps Air Station, Beaufort, S.C. Their gear protects them from flames that reach 1200 degrees.

U.S. Marine Corps photo by Lance Cpl. Justin M. Boling

In partnership with other Federal agencies, the Department continues to prioritize a return to full-spectrum training. Several of the performance measures tracked are associated with the readiness of the Chemical, Biological, Radiological, or Nuclear (CBRN) response force.

The CBRN response force performs life-saving capabilities in emergency medical situations, search and extraction, decontamination, security incidents, and command and control needs. The 18,000-person enterprise supporting these efforts is ready to deploy within three hours following an incident.

This Strategic Objective (3.1-1F2B) includes measures for the Homeland Response Forces (HRF) and the Chemical, Biological, Radiological/Nuclear, and Explosive (CBRNE) – Enhanced Response Force Package (CERFP). These forces perform life-saving activities and are distributed throughout the nation to ensure rapid arrival at major metropolitan areas impacted by CBRN incidents. The 10 HRFs and 17 CERFPs undergo rigorous training and yearly exercises to ensure they can achieve the highest performance standards for their incident response missions. Both the CERFPs and the HRFs met their third quarter performance goals.

Another critical element used to measure improvement in the responsiveness and flexibility of Consequence Management Response forces relates to the response times for the 5,000-person Defense CBRNE Response Force (DCRF) and two, 1,500-person Control Response Elements (C2CRE). The DCRFs and C2CREs combine together to provide the initial Federal CBRN response capabilities at one catastrophic incident site, or separately at multiple sites affected by lower-magnitude incidents.

STRATEGIC GOAL 3: PREPARE TO DEFEAT ADVERSARIES AND SUCCEED IN A WIDE RANGE OF CONTINGENCIES.				
Key Performance Measure	**Strategic Plan Long-Term Performance Goals**	**Performance Goals/Results**		
		FY 2012 Results	**FY 2013 Q3 Goals**	**FY 2013 Q3 Results**
Strategic Objective 3.1-1F2B: Improve the responsiveness and flexibility of Consequence Management Response forces.				
3.1.1-1F2B: Cumulative number of Homeland Response Forces (HRFs) trained, equipped, evaluated, and validated at a reduced response time of 6-12 hours.	3.1.1-1F2B: By FY 2012, the DoD will have and maintain 10 National Guard HRFs trained, equipped, evaluated, and validated at a reduced response time of 6-12 hours to a very significant or catastrophic event.	10	10	■ 10
3.1.2-1F2B: Cumulative number of Chemical, Biological, Radiological, Nuclear and High-Yield Explosives Enhanced Response Force Packages (CERFPs) trained, equipped, evaluated, and validated at a response time of 6-12 hours.	3.1.2-1F2B: By FY 2012, the DoD will have and maintain 17 National Guard CERFPs trained, equipped, evaluated, and validated at a response time of 6-12 hours in order to backfill existing CERFPs that will convert to HRFs.	17	17	■ 17
3.1.3-1F2B: Number of Defense CBRNE Response Forces (DCRFs) trained, equipped, evaluated, and certified at a response time of 24-48 hours.	3.1.3-1F2B: By FY 2012, the DoD will have and maintain one DCRF trained, equipped, evaluated, and certified at a response time of 24–48 hours.	1	1	■ 1

STRATEGIC GOAL 3: PREPARE TO DEFEAT ADVERSARIES AND SUCCEED IN A WIDE RANGE OF CONTINGENCIES.				
Key Performance Measure	Strategic Plan Long-Term Performance Goals	Performance Goals/Results		
		FY 2012 Results	FY 2013 Q3 Goals	FY 2013 Q3 Results
3.1.4-1F2B: Number of Command and Control (C2) CBRNE Response Elements (C2CREs) trained, equipped and evaluated, as well as certified or validated as applicable at a response time of 96 hours.	3.1.4-1F2B: By FY 2012, the DoD will have and maintain two C2CREs trained, equipped and evaluated as well as certified or validated as applicable at a response time of 96 hours.	2	2	■ 2

■ Met or Exceeded Target ■ Did Not Meet Target

Strategic Goal 4: Preserve and Enhance the All-Volunteer Force

During the past decade, the men and women who comprise the All-Volunteer Force (AVF) – to include Active, Reserve and National Guard Components—have shown unwavering resourcefulness, flexibility, and commitment. The AVF is the backbone of the U.S. military, and the Department continues to provide high-quality care to all military personnel, their dependents, and retirees (Strategic Objective 4.1-2M). The Department has prioritized critical programs, such as assistance to help veterans transition to civilian life, wounded warrior care, suicide prevention, and sexual assault prevention and response.

The Nation faces many challenges worldwide, and as a result, often must be prepared to respond on very short notice. Therefore, it is critical that Service members are medically ready to deploy quickly.

The Department assesses how well the Military Health System (MHS) manages care for Service members. As of third quarter, MHS exceeded the goal to maintain an average Defense Health Program (DHP) medical cost at or below the average private-sector healthcare cost.

Additionally, through the Individual Medical Readiness (IMR) programs, Commanders can evaluate the medical readiness of each Service member. Medical readiness means that Service members are free from health-related conditions that could limit their ability to carry out assigned duties. The Department met its third quarter medical readiness target.

The Department remains committed to ensuring that Wounded, Ill, or Injured (WII) Service members, or those at the end of their service, are processed in a timely manner through the Integrated Disability Evaluation System (IDES), a joint DoD and Department of Veterans Affairs (VA) system. The Department and the VA fell short in this performance measure and did not meet its third quarter FY 2013 goal of 60 percent of Service members processed through the IDES within 295 days (Active) and 305 days (Reserve Components). The Department is dedicated to preventing personnel from over-exposure to combat and operational deployments while at the same time ensuring it has the right force structure to accomplish the mission (Strategic Objective 4.2-2P).

Deployment-to-Dwell metrics and policies were established to mitigate stress on the force due to increased operational tempo for Operation Iraqi Freedom (OIF) and Operation Enduring Freedom (OEF). Deployment to Dwell (D2D) is a unit and individual management metric based on time deployed versus time not deployed. The purpose of the metric is to establish a consistent set of standards to characterize and manage the employment of the total force in order to preclude the over-exposure of personnel to combat operational deployments. The Secretary of Defense has established goals and thresholds for D2D ratios at 1:2 and 1:1, respectively. However, there are challenges associated with ensuring completeness and accuracy of reporting across Services, as well as ensuring common definitions are applied. As a result, the Department is re-writing the existing policy to apply more broadly than OIF and OEF.

An Air Force Master Sergeant hugs his children after returning from a deployment.

U.S. Air Force photo by Master Sgt. Mark Olsen

The DoD civilian workforce supports the all-volunteer force with professionalism and dedication. The Department relies on its civilian workforce to perform a variety of key missions in support of the military. As of the third quarter, the Department did not meet its goal to improve and maintain the timely hiring of skilled professionals. The Department is committed to reducing the number of days it takes to hire a civilian employee to 80 days or less; however, achieving this target has been impacted by Component hiring freezes, workforce furloughs, and concerns over future funding cuts.

STRATEGIC GOAL 4: PRESERVE AND ENHANCE THE ALL-VOLUNTEER FORCE.				
Key Performance Measures	**Strategic Plan Long-Term Performance Goals**	**Performance Goals/Results**		
		FY 2012 Results	**FY 2013 Q3 Goals**	**FY 2013 Q3 Results**
Strategic Objective 4.1-2M: Provide top-quality physical and psychological care to wounded warriors, while reducing growth in overall healthcare costs.				
4.1.1-2M: Average percent variance in Defense Health Program (DHP) annual cost per equivalent life increase compared to average civilian sector increase.	4.1.1-2M: Beginning in FY 2007, the DoD will maintain an average DHP medical cost per equivalent life increase at or below the average healthcare premium increase in the civilian sector.	-6.4%	≤0%	-2.1%

STRATEGIC GOAL 4: PRESERVE AND ENHANCE THE ALL-VOLUNTEER FORCE.				
Key Performance Measures	Strategic Plan Long-Term Performance Goals	Performance Goals/Results		
		FY 2012 Results	FY 2013 Q3 Goals	FY 2013 Q3 Results
4.1.2-2M: Percentage of Armed Forces who meet Individual Medical Readiness (IMR) requirements.	4.1.2-2M: By FY 2015, 85% of the Armed Forces will have an IMR that indicates readiness for deployment.	84%	82%	■ 82%
4.1.3-2M: Percent of Service members who are processed through Integrated Disability Evaluation System (IDES) within 295 days (Active) and 305 days (Reserve) Components.	4.1.3-2M: By FY 2014, 80% of Service members will be processed through the IDES within 295 days (Active) and 305 days (Reserve) Components.	24%	60%	■ 26%
Strategic Objective 4.2-2P: Ensure the Department has the right workforce size and mix, manage the deployment tempo with greater predictability, and ensure the long-term viability of the Reserve Component.				
4.2.3-2P: Percentage of the Department's active duty Army who meet the planning objectives for time deployed in support of combat operations versus time at home.	4.2.3-2P: By FY 2015, at least 95% of active duty Army personnel will meet the deployment to dwell objective of 1:2.	91%	83.8%	■ 96%
4.2.8-2P: Number of days for external civilian hiring (end-to-end timeframe).	4.2.8-2P: Beginning in FY 2013, the Department will improve and maintain its timeline for all external (direct hire authority, expedited hire authority, and delegated examining) civilian hiring actions at 80 days or less.	83 days	80 days	■ 98 days

■ Met or Exceeded Target ■ Did Not Meet Target

Strategic Goal 5: Reform the Business and Support Functions of the Defense Enterprise

To effectively manage business capabilities, the Department maintains a portfolio of strategic initiatives across core support functions, such as Financial Management (FM), Personnel and Readiness, Acquisition and Logistics, and Information Technology (IT). Reorienting the management of Defense business around cross-functional, end-to-end processes enables informed enterprise-wide decisions, guides the selection of targeted investments in business capabilities, and drives interoperability, efficiency, and a reduction of duplicative systems. The Department is transforming its business through key initiatives, including audit readiness, better buying power (BBP), and mobile and web-enabled applications. Ultimately, the Department cannot execute its core war fighting mission without the efficient execution of business operations.

To improve the financial management and stewardship of taxpayer funds, the Department aims to provide decision makers with accurate, reliable, and relevant financial management information. Continuous improvements in acquisition processes and the improved functionality and interoperability of the business and financial information systems will continue to contribute to reforming business and support functions (Strategic Objective 5.3-2E). Successful implementation of these business initiatives will position the Department to achieve an audit-ready Schedule of Budgetary Activity (SBA) by the end of FY 2014 and ensure that all financial statements are audit ready by the end of FY 2017 (Strategic Objective 5.5-2U/V).

STRATEGIC GOAL 5: REFORM THE BUSINESS AND SUPPORT FUNCTIONS OF THE DEFENSE ENTERPRISE.				
Key Performance Measures	Strategic Plan Long-Term Performance Goals	Performance Goals/Results		
		FY 2012 Results	FY 2013 Q3 Goals	FY 2013 Q3 Results
Strategic Objective 5.5-2U/V: Improve financial management and increase efficiencies in headquarters and administrative functions, support activities, and other overhead accounts.				
5.5.1-2U: Percentage of DoD's general funds, FBWT, validated as audit-ready.	5.5.1-2U: By FY 2014, 100% percent of DoD's FBWT will be validated as audit ready.	9%	9%	■ 9%
5.5.2-2U: Percentage of DoD's general fund SBR for material Components validated as audit-ready.	5.5.2-2U: By FY 2014, 100% of DoD's general fund SBR for material Components will be validated as audit-ready.	14%	14%	■ 19%
5.5.4-2U: Percentage of SBR for Appropriations Received validated as audit-ready.	5.5.4-2U: By FY 2013, the DoD will improve its audit readiness on the SBR for Appropriations Received to 100%.	88%	88%	■ 100%

■ Met or Exceeded Target ■ Did Not Meet Target

The Department met its Quarter 3, FY 2013 goal to validate 9 percent of its Fund Balance with Treasury (FBWT) as audit ready. In addition, it exceeded the Quarter 3, FY 2013 goal, which is to validate 14 percent of the DoD's General Fund Statement of Budgetary Resources (SBR) as audit ready, by four percent.

As of the third quarter, the Department met its FY 2013 goal by validating 100 percent of the Appropriations Received reported on the SBR as ready for audit. Meeting the goal of audit readiness on the General Fund SBR for Appropriations Received demonstrates that the Department can accurately account for and distribute funds provided by Congress to the right accounts, in accordance with law. In addition, audit readiness of Appropriations Received helps ensure that future activities supporting the auditability of the General Fund SBR are successful

In the area of acquisition (Strategic Objective 5.3-2E), the Department's Better Buying Power 2.0 (BBP 2.0) guidance in early FY 2013 mandated affordability as a requirement and emphasized the affordability constraints imposed in the first BBP effort. The BBP 2.0 focuses on seven areas to achieve greater efficiency and productivity in defense spending:

- Achieve Affordable Programs;
- Control Costs Throughout the Product Life Cycle;
- Incentivize Productivity and Innovation in Industry and Government;
- Reduce Unproductive Processes and Bureaucracy;
- Promote Effective Competition;
- Improve Tradecraft in Acquisition of Services, and
- Improve the Professionalism of the Acquisition Workforce

The goals and results for the following two key measures for improving acquisition processes, Strategic Objective 5.3-2E, are reported through Quarter 4 FY 2013.

STRATEGIC GOAL 5: REFORM THE BUSINESS AND SUPPORT FUNCTIONS OF THE DEFENSE ENTERPRISE.				
Key Performance Measures	**Strategic Plan Long-Term Performance Goals**	**Annual Performance Goals/Results**		
		FY 2012 Results	**FY 2013 Goals**	**FY 2013 Results**
Strategic Objective 5.3-2E: Improve acquisition processes, from requirements definition to the execution phase, to acquire military-unique and commercial items.				
5.3.1-2E: Percentage of contract obligations competitively awarded.	5.3.1-2E: Beginning in FY 2012, the Department will increase, by 1% annually, the amount of contract obligations competitively awarded.	57.5%	60%	■ 56.9%
5.3.6-2E: Average rate of acquisition cost growth from the previous year for Major Defense Acquisition Programs (MDAPs) starting in FY 2002.	5.3.6-2E: Beginning in FY 2012, the DoD will ensure that average rate of acquisition cost growth from the previous year for MDAPs starting in FY 2002 does not exceed 3%.	-0.27%	3%	■ -1.42%

■ Met or Exceeded Target ■ Did Not Meet Target

The Department did not meet its FYE 2013 goal of 60 percent for competitive contract obligations in FY 2013. The Department continues to share best practices at quarterly competition meetings and is exploring initiatives to support the BBP 2.0 competition guidance. The BBP 2.0 will promote competition by emphasizing how vital it is to create and maintain competitive environments when acquiring both products and services. The Department did, however, significantly reduce the average rate of acquisition cost growth from the previous year for Major Defense Acquisition Programs (MDAPs).

FINANCIAL OVERVIEW

The previous sections of this report provide an overview of the Department's operations in FY 2013 and the results for a few of the key performance metrics that measure how we met the Department's goals and objectives as of the third quarter of FY 2013. Meeting our defense goals requires financial resources, which are reported in the Department's financial statements that appear later in this report.

At present, the Department cannot produce auditable financial statements, and management cannot provide unqualified assurance as to the effectiveness of our internal controls over financial reporting. While we are confident we know where taxpayer funds are obligated, the Department lacks the ability to prove reliable and well-controlled business processes and consistently provide supporting documentation to auditors in a timely manner. The Financial Improvement and Audit Readiness (FIAR) initiative, which is briefly discussed later in this report, guides the Department's efforts to improve our financial management. Our goal is to achieve audit readiness for the Department's budgetary activities in FY 2014, and for all financial statements by 2017.

Despite the Department's financial statement auditability challenges, we have been able to effectively use the financial data summarized in this section to regularly and timely pay employees and vendors, adequately track payments made, and successfully manage overall operations.

FINANCIAL HIGHLIGHTS AND ANALYSIS

The principal financial statements have been prepared to report the financial position and results of operations of the Department, pursuant to the requirements of *31 U.S.C. 3515(b).* The statements have been prepared from the accounting records of the Department in accordance with *OMB Circular No. A-136*, Financial Reporting Requirements, and to the extent possible, U.S. Generally Accepted Accounting Principles (USGAAP) for Federal entities, and the *DoD Financial Management Regulation*. The statements, in addition to supporting financial reports, are used to monitor and control budgetary resources. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

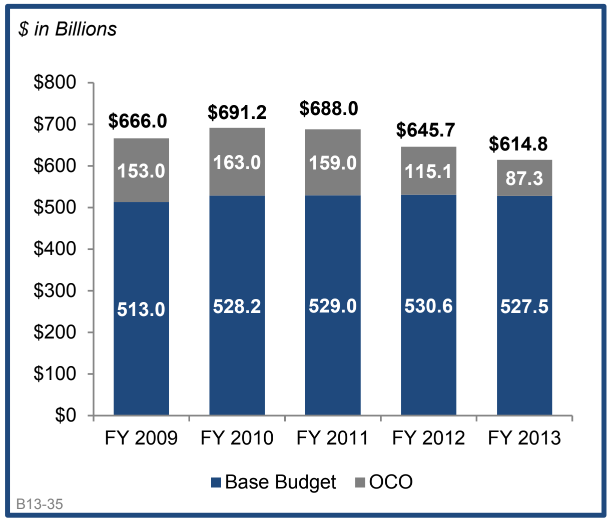
The Defense Finance and Accounting Service (DFAS) prepared the consolidated financial statements and explanatory notes, located in the Financial Information section of this report. The principal financial statements include:

- Statement of Budgetary Resources
- Balance Sheet
- Statement of Net Cost
- Statement of Changes in Net Position

Statement of Budgetary Resources

One of the most critical financial improvement and audit readiness priorities in the Department involves the processes, controls, and systems that provide the information most often used to manage the Department, namely, budgetary resources. The Statement of Budgetary Resources (SBR) presents the Department's total budgetary resources, their status at the end of the year, and the relationship between the budgetary resources and the outlays made against them. In accordance with Federal statutes and implementing regulations, obligations may be incurred and payments made only to the extent that budgetary resources are available to cover such items.

Figure 3. Trend in DoD Enacted Appropriations



As discussed in the Overview section and depicted in Figure 3, the Department's FY 2013 enacted appropriations total $614.8 billion. The change in FY 2013 enacted amounts is mostly attributable to decreases in appropriations for overseas contingency operations (OCO) and sequestration actions required by the *Budget Control Act of 2011*.

As shown in Figure 4, the Department reported $1.1 trillion in FY 2013 total budgetary resources. The total appropriations amount of $733.5 billion reported on the Statement of Budgetary Resources consists of enacted appropriations and appropriations provided by the U.S. Treasury for DoD retirement and health benefits. The Department also receives appropriations to finance civil work projects managed by the U.S. Army Corps of Engineers. Current year trust fund receipts, including the Military Retirement Fund and the Medicare Eligible Retiree Health Care Fund, are also included in the SBR "Total Appropriations" line. Trust fund receipts, labeled as "Temporarily not available," represent budget authority the Department will execute in future years to pay the current unfunded liabilities carried in these large funds.

Figure 4. Composition of DoD Total Budgetary Resources

Description	FY 2013 *($ in billions)*
DoD Enacted Appropriations	$614.8
Sequestration	(37.2)
U.S. Treasury contribution for Military Retirement and Health Benefits	80.7
Civil Works Projects executed by the USACE	8.9
Trust Fund Receipts	123.9
Trust Fund Resources Temporarily not Available	(57.6)
Total Appropriations Reported on SBR	$733.5
Brought Forward Unobligated Budget Authority	195.0
Spending Authority from Offsetting Collections	103.7
Contract Authority	65.6
Total Budgetary Resource	**$1,097.8**

Additional budgetary resources include $195.0 billion of unobligated balances stemming from prior year budget authority, $103.7 billion in spending authority from offsetting collections, and $65.6 billion of contract authority.

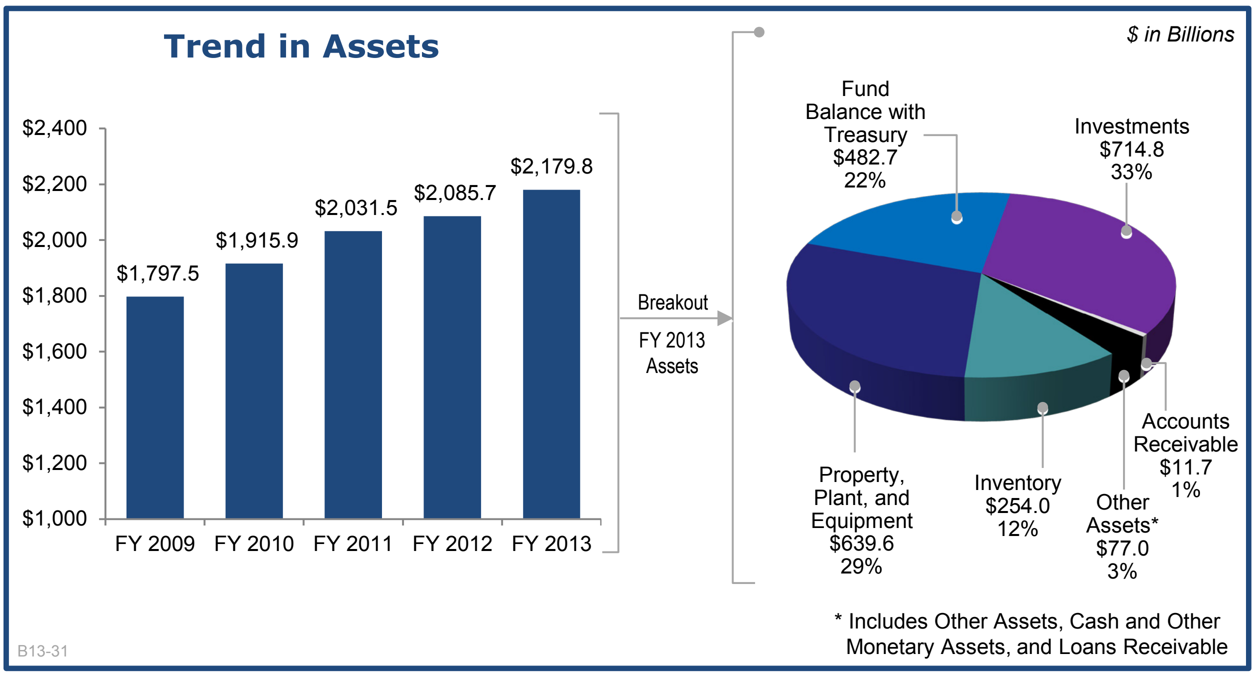
Of the $1.1 trillion in total budgetary resources, $954 billion were obligated and $922 billion of obligations were disbursed. The remaining unobligated budgetary resources balance relates to appropriations that are available to cover multi-year investment projects. These projects require additional time to procure. Additionally, appropriations that are expired for purposes of new obligations remain available for valid upward adjustments to prior year obligations.

Balance Sheet

The Balance Sheet, which reflects the Department's financial position as of September 30, 2013, reports amounts available to provide future economic benefits (Assets) owned or managed by the Department, amounts owed (Liabilities) requiring use of available assets, and the difference between them (Net Position).

The $2.2 trillion in assets shown in Figure 5 represent amounts the Department owns and manages. Investments, General Property, Plant, and Equipment, and Fund Balance with Treasury (FBWT) represent 84 percent of the Department's assets. General Property, Plant, and Equipment is largely comprised of military equipment and buildings, structures, and facilities used to support the Department's mission requirements.

Figure 5. Summary of Total Assets



Total Assets increased $94.1 billion (5 percent) from FY 2012, largely due to $69.8 billion increase in Investments in U.S. Treasury securities and $38.2 billion increase in General Property, Plant, and Equipment, which were offset by $29.5 billion decrease in the Department's FBWT.

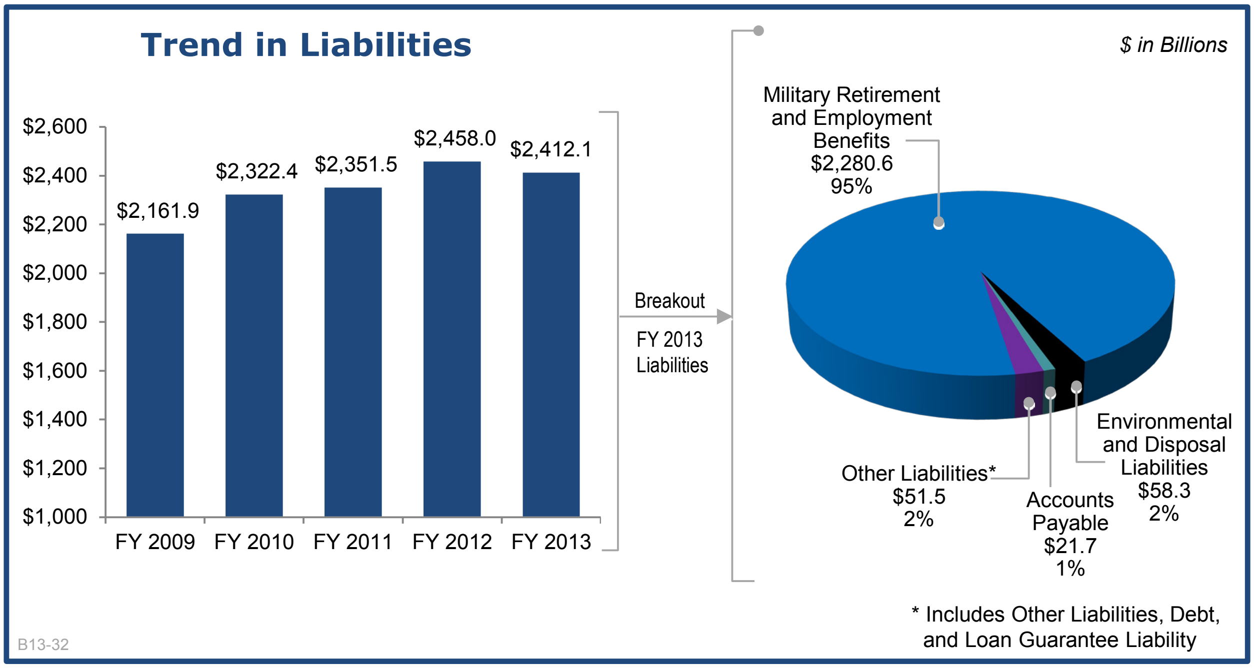
Investments increased by $69.8 billion due to the $66.8 billion deposit of additional funds from the U.S. Treasury and Military Sservices to cover the normal growth of future military retirement and health benefits. Funds not needed to cover current benefits are invested in U. S. Treasury Securities.

The $38.2 billion increase in the Department's General Property, Plant, and Equipment is primarily the result of the ongoing audit readiness efforts to validate existence and completeness and improve the valuation of its assets. As the Department continues to review property accountability records, adjustments are made to properly report assets not previously recorded and properly value assets previously recorded.

The $29.5 billion reduction in the Department's Fund Balance with Treasury is largely related to the $37.2 billion decrease in appropriations required by the sequestration actions in the Budget Control Act of 2011.

As seen in Figure 6, the Department's total liabilities decreased $46 billion during FY 2013, almost exclusively due to downward adjustments in the estimated actuarial liability associated with military retirement pension and health care benefits. The Department's Office of the Actuary revised the cost basis for the estimate as well as the actuarial assumptions used to determine the projected liability.

Figure 6. Summary of Total Liabilities

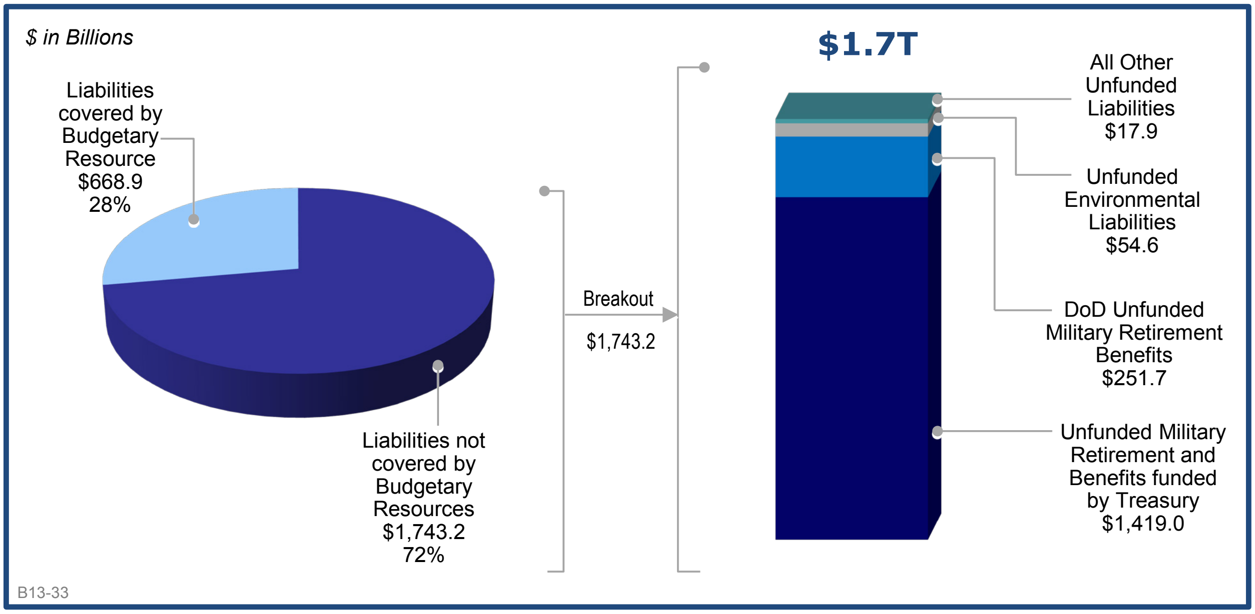


The Department is confident in its ability to meet its financial obligations for the $2.4 trillion of liabilities reported in FY 2013. Figure 7 identifies the unfunded liabilities that will require future resources. The U.S. Treasury is responsible for funding the actuarial liability that existed at the inception of the military retirement and health care programs. This actuarial liability accounts for approximately $1.4 trillion (81 percent) of the total $1.7 trillion in liabilities that are not currently covered by budgetary resources. Additionally, the Department has resources available to cover approximately $668.9 billion of the remaining liabilities, including funds primarily invested in U.S. Treasury securities.

Statement of Net Cost

The Statement of Net Cost presents the net cost of all the Department's programs, including military retirement benefits. The statement reports total expenses incurred less revenues earned from external sources to finance those expenses. Generally, the resulting balance of net cost is equivalent to the outlays reported on the SBR, plus accrued liabilities, less the assets purchased and capitalized on the Balance Sheet. Differences between outlays of budgetary resources and net cost generally arise from the timing of expense recognition.

Figure 7. Unfunded Liabilities

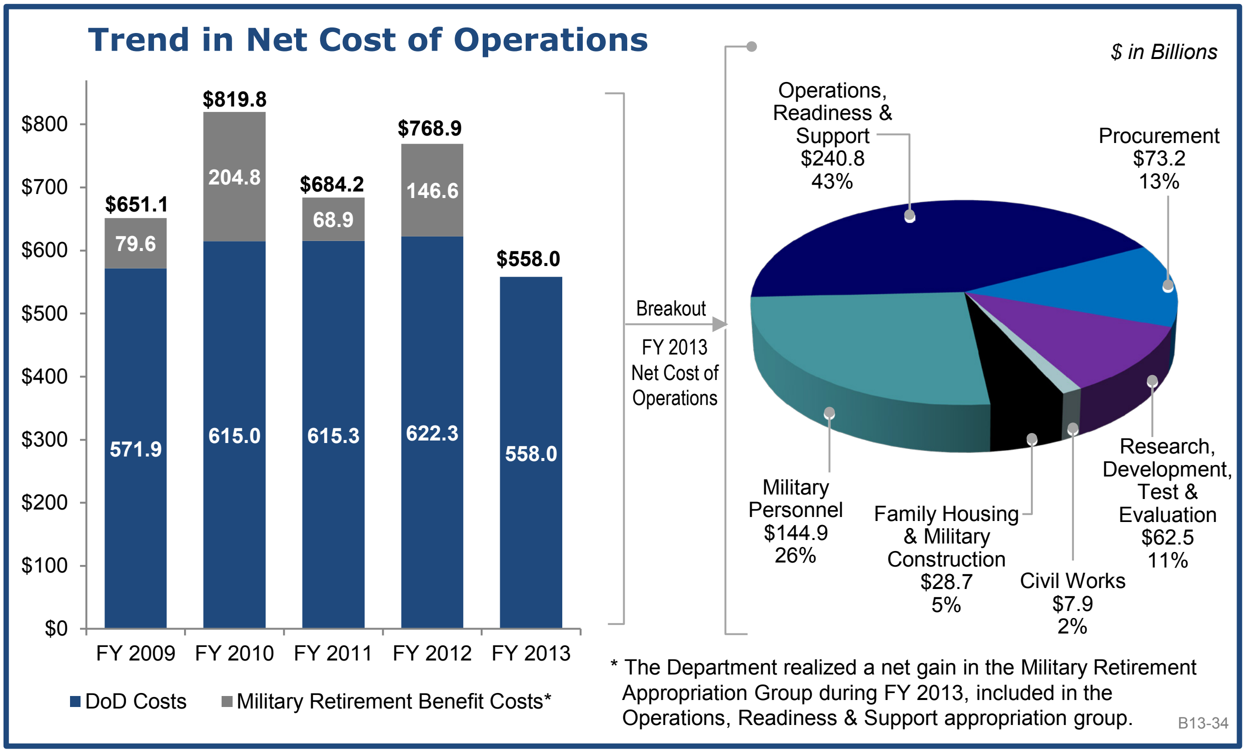


The Department's costs incurred relate primarily to operations, readiness, and support activities, military personnel cost, and costs related to the Department's procurement programs. These costs were offset with investment earnings and contributions to support retirement and health benefit requirements, as well as earnings from reimbursed activities. This activity resulted in $558 billion in net costs of operations during the fiscal year.

As depicted in Figure 8 (below), the $558 billion in net costs of operations represents a $210.9 billion decrease (27 percent) from FY 2012 reported net costs.

The largest impact to costs during FY 2013 is a $133.3 billion change to actuarial assumptions used in estimating and recording accruals for future estimated payments of military retirement and health care benefits. The change in actuarial assumptions is reflected as a gain on the net cost of operations and has the impact of reducing the overall net cost of operations and reducing the liabilities on the balance sheet.

Figure 8. Summary of Net Cost of Operations



There is also a decrease in net cost resulting from FY 2013 and FY 2012 audit readiness efforts to properly report the value of property, plant, and equipment, including the accumulated depreciation of assets. The impact in FY 2013 is $23.8 billion and in FY 2012 is $17.3 billion.

Statement of Changes in Net Position

The Statement of Changes in Net Position (SCNP), located in the Financial Information section of this report, presents the total cumulative results of operations since inception and unexpended appropriations at the end of the fiscal year. The SCNP displays the components of net position separately to enable the user to better understand the nature of changes to net position as a whole. The statement focuses on how the net cost of operations as presented on the Statement of Net Cost is financed, as well as displaying the other items financing the Department's operations.

Financial Performance Summary

Key information reflecting the Department's financial statements is summarized in Figure 9 below. This figure represents the Department's condensed financial position, results of operations, and budgetary resources, and includes comparisons of financial balances from the current year to the prior year. As noted, the lack of auditable financial data is a limiting factor in the ability of the Department to explain all material variances presented in the comparative statements.

Figure 9. Financial Performance Summary

Dollars in Billions

	FY 2013	Restated FY 2012	Change	% Change
ASSETS				
Fund Balance with Treasury	$ 482.7	$ 512.1	$ (29.4)	-6.0%
Investments	714.8	644.9	69.9	11.0%
Accounts Receivable	11.7	13.0	(1.3)	-10.0%
Other Assets	77.0	71.0	$6.0	8.0%
Inventory and Related Property, Net	254.0	243.3	10.7	4.0%
General Property, Plant and Equipment, Net	639.6	601.4	$ 38.2	6.0%
TOTAL ASSETS	**$ 2,179.8**	**$ 2,085.7**	**$ 94.1**	**5.0%**
LIABILITIES				
Accounts Payable	$ 21.7	$ 21.3	$ 0.4	1.9%
Other Liabilities	51.5	50.2	1.3	2.6%
Military Retirement and Other Federal Employment Benefits	2,280.6	2,323.9	(43.3)	-1.9%
Environmental and Disposal Liabilities	58.3	62.6	(4.3)	-6.9%
TOTAL LIABILITIES	**$ 2,412.1**	**$ 2,458.0**	**$ (45.9)**	**-1.9%**
TOTAL NET POSITION (ASSETS MINUS LIABILITIES)	**$ (232.3)**	**$ (372.3)**	**$ 140.0**	**37.6%**
Total Financing Sources	727.2	728	(0.8)	-0.1%
Less: Net Cost	558.0	768.9	$ (210.9)	-27.4%
NET CHANGE OF CUMULATIVE RESULTS OF OPERATIONS	169.2	(40.9)	$ 210.1	513.7%
TOTAL BUDGETARY RESOURCES	**$ 1,097.8**	**$ 1,204.8**	**$ (107.0)**	**-8.9%**

FINANCIAL MANAGEMENT IMPROVEMENT INITIATIVES

In FY 2013, the Department carried out its mission in the face of unprecedented budgetary challenges. Continuing resolutions, sequestration, and furloughs became a regular part of our vocabulary. Although it was not "business as usual," the financial management (FM) workforce remained committed to focusing on every element of our mission to support America's warfighters. We are dedicated to improving FM and providing the financial resources necessary to meet our national security objectives.

The Honorable Jessica L. Wright, Acting Under Secretary of Defense for Personnel and Readiness, and the Honorable Robert F. Hale, Under Secretary of Defense (Comptroller)/Chief Financial Officer, brief reporters on the Department's civilian furlough planning efforts as a result of sequestration.

DOD photo by U.S. Navy Petty Officer 1st Class Chad J. McNeeley

Despite the changing economic landscape, we continued to focus our attention on providing our leaders and managers with timely and accurate financial information for decision-making, cost management, and audit readiness. The following initiatives are examples of our progress toward improving financial management.

FINANCIAL MANAGEMENT CERTIFICATION PROGRAM

In this era of budgetary uncertainty, it would be easy to put training and professional development on a back burner; however, that would be a mistake. The greater the fiscal challenges, the greater the need for experienced, well-trained, and knowledgeable FM personnel. For this reason, the Under Secretary of Defense (Comptroller)/Chief Financial Officer decided that the Department's *Financial Management Certification Program*, an initiative that began in FY 2012, would continue to move forward.

The FM Certification Program, signed into policy on March 22, 2013, promotes a well-trained, flexible FM workforce that can effectively support our mission, achieve auditable financial statements, and adapt to the changing fiscal landscape. The FM Certification Program's goals are to:

- Advance the professionalism of the Department's FM workforce.
- Encourage career broadening and leadership training for employees.
- Improve employee knowledge and skills related to audit readiness and decision support.
- Establish a standard DoD FM body of knowledge.
- Apply the benefits resulting from implementing the Department's Enterprise Resources Planning (ERP) systems.
- Strengthen public confidence in the Department's financial management.

Within the program, each civilian and military FM position is assigned a certification level (1, 2 or 3) that requires a minimum number of training hours that are targeted to financial management, leadership, and specific topics, such as audit readiness, fiscal law, and ethics. In addition to the training, a minimum number of years of financial management experience are required for each certification level. Upon meeting the certification level conditions, employees must meet continuing education requirements every two years.

Full implementation of the FM Certification Program is targeted for the end of FY 2014. As we continue to face budgetary challenges, the Department's FM Certification Program will enable us to do an even better job managing the Department's financial challenges, supporting our warfighters, and producing auditable financial information.

More Disciplined Use of Resources

In continuation of the reform agenda advanced in previous budgets, the Department reviewed all budgetary areas for potential savings in its "More Disciplined Use of Resources" campaign. Strategies to realize savings include achieving new efficiencies, eliminating duplication and overhead, tightening personnel costs, enhancing contract competition, and reevaluating modernization programs.

As a result of these efforts, the Department has proposed about $60 billion in cost reductions over the period of FY 2013 through FY 2017 (Future Years Defense Program) from the amount of funds requested in the Department's FY 2012 budget. Examples of some of the savings include:

- Streamlining Business Practices and Support Services. The Department saved $21 billion by streamlining business practices and support services, such as installation and administrative functions, contracting, and staffing.
- Adjusting Civilian Pay Raises. The Department saved $10 billion from reducing civilian pay increases from FY 2013 through 2016.
- Promoting Better Buying Power and Strategic Sourcing. The Department saved $8 billion by obtaining greater efficiency and productivity in defense spending and improving the way the Department acquires critical defense goods and services.
- Consolidating Information Technology Enterprise Services. The Department saved $4 billion by consolidating Army, Navy, and Air Force information technology (IT) enterprise services.

The Department remains committed to performing its mission while operating efficiently, reducing costs, and effectively managing taxpayer dollars. As the military force structure draws down, the Department will continue to examine other opportunities to streamline installation support and management overhead to match capacity to the new force structure.

Financial Flexibility for Warfighters

Financial flexibility for warfighters is a critical component in the Department's efforts to protect our national security in an unpredictable world. Financial flexibility provides the agility to adjust priorities, and make investment decisions quickly, inside of the two-year standard needed for the Department's deliberate budgeting process. The Department works closely with the Congress to use financial flexibility and to ensure that response to urgent needs remains top priority.

The contingencies in Iraq and Afghanistan prompted the development of the quick reaction organizations, and significant U.S. force elements will remain engaged in Afghanistan and around the world for the foreseeable future. Clearly, the Department must continue to address emerging warfighter requirements rapidly. Last year, the Department, in a report to Congress, published *Review of Acquisition Processes for Rapid Fielding of Capabilities in Response to Urgent Operational Needs*, which explained a process for integrating efforts across a number of organizations that respond quickly to emerging warfighter needs, and addressed processes for urgent needs, requirements, acquisition, funding, operation and sustainment, and ultimate disposition of capabilities acquired in response to urgent needs.

Also, last year, the Deputy Secretary of Defense issued DoD Directive 5000.71, The Rapid Fulfillment of Combatant Commander Urgent Operational Needs, that documents the role of the Warfighter Senior Integration Group (SIG) and its oversight of financial flexibility to fulfill these urgent needs. The SIG continues to lead and facilitate agile and rapid responses to combatant commander urgent operational needs, and for rapidly adjusting program and budgetary priorities. The Deputy Secretary of Defense chairs the SIG, which prioritizes actions and resources to resolve urgent warfighter issues. The SIG facilitates decisions and action to provide our forces with timely solutions to address previously unforeseen threats.

This year, the Deputy's Management Action Group reviewed the Department's quick reaction processes and determined these processes must become an enduring capability, even as our forces in Afghanistan transition to an advisory role. Moving forward, the SIG will continue to coordinate rapid response efforts through the Joint Improvised Explosive Device Defeat Organization, the Intelligence, Surveillance & Reconnaissance Task Force, the Joint Rapid Acquisition Cell, and the Afghanistan Resources Oversight Council.

Recently, the Secretary of Defense applied the Rapid Acquisition Authority (RAA) provisions of *Public Law 107-314*, in determining the Secretary of the Army could waive specific administrative regulations and laws, as necessary, to allow the use of DoD funds for the rapid delivery of lethal miniature aerial munitions to support urgent operational needs of our forces in Afghanistan. Units in Afghanistan had proven the effectiveness of this developmental weapon during field operational assessments, and subsequently the Joint Staff validated their urgent requirement. Upon receiving the Defense Secretary's RAA determination, the Secretary of the Army used $40 million of available funds to contract for the improved capability.

Given the delayed enactment of the Department's FY 2013 appropriations, as well as the effects of the BCA, the Department has, whenever possible, exercised the full range of available financial flexibility tools to resolve warfighter urgent needs. Among these tools is the ability to reprogram a small percentage of the Department's budget using general transfer authority, and transfer accounts like the Joint Improvised Explosive Device Defeat Fund, the Joint Urgent Operational Needs Fund, and the Global Security Contingency Fund. For urgent needs beyond the scope of these appropriations, the Department uses other tools, such as RAA, as amended. These authorities allow the Department to be financially agile in a rapidly changing world.

A U.S. soldier during a mission to maintain freedom of movement for military and commercial traffic in Wardak province, Afghanistan.

U.S. Army photo by Spc. Chenee' Brooks

FINANCIAL IMPROVEMENT AND AUDIT READINESS INITIATIVE

The Department remains committed to achieving audit readiness on all financial statements by September 30, 2017. Achieving audit readiness means the Department has reliable financial management practices, systems, and internal controls that are capable of producing accurate and complete financial information.

Financial statement auditability is important to the Department for many reasons. It is required by law, but will also confirm that the Department is properly and effectively managing and executing the resources entrusted to it by Congress and the public. The FIAR initiative carries out the Department's strategy to achieve audit readiness for all financial statements.

Focusing first on improving the information most often used to manage DoD operations, the FIAR Initiative targeted two financial reporting priorities: Budgetary information validated as audit ready by September 30, 2014, and the existence and completeness of mission-critical assets validated by June 30, 2016. Meeting these priorities will ensure the Department makes the best use of every dollar while supporting its national security mission.

Figure 10. Transactions Processed by DFAS in FY 2013

Description	FY 2013
Number of Active DoD Appropriations Managed	1,232
Number of Pay Transactions	161.8 million
Number of People/Accounts	6.6 million
Disbursements to Pay Recipients	$579 billion
Number of Travel payments	6 million
Number of Commercial Invoices Paid	10.3 million
Military Retirement and Health Benefit Funds Managed	$700 billion

Part of the challenge in successfully passing a financial statement audit lies with DoD's unique size and mission. Figure 10 shows the magnitude of financial activities processed by DFAS in FY 2013, excluding processing by other DoD entities, such as the U.S. Army Corps of Engineers (USACE) or the Defense Health Agency[1]. The Department tracks audit readiness progress through financial statement audit opinions, DoD OIG or Independent Public Accounting firm examinations, and audit readiness assertions. Substantial progress is being made, as reflected in the $235 billion (19 percent) of total budgetary resources that have an opinion or are currently under audit. Six DoD organizations received unqualified audit opinions on their FY 2012 financial statements, and three DoD reporting organizations received qualified opinions.

To achieve full audit readiness by September 30, 2017 and begin full financial statement audits in FY 2018, the DoD Components that have not achieved a financial statement audit are employing a mandatory, comprehensive strategy comprising four waves:

- Wave 1 – Appropriations Received have been validated as audit ready.
- Wave 2 – Statement of Budgetary Resources – procedures currently are being performed to achieve audit readiness.

[1] Effective October 1, 2013, the Department established the Defense Health Agency, which absorbed the functions of the TRICARE Management Activity and assumed responsibility for common clinical and business processes across the Military Health System.

- Wave 3 – Mission Critical Asset Existence and Completeness – procedures currently are being currently performed to achieve audit readiness by type of assessable unit and must be completed prior to achieving Wave 4.
- Wave 4 – Full Financial Statement Audit has been started, as discussed below.

In March 2013, the Department validated audit readiness of Appropriations Received and completed Wave 1. Additionally, for both budgetary resources and mission critical assets existence and completeness, 26 examinations have been completed or are in sustainment and 30 examinations are underway, pending, or have found that additional corrective actions are needed.

Secretary Hagel recently recorded an all-hands message that underscores the importance of the FIAR initiative. The video message may be viewed at *http://comptroller.defense.gov/fiar/index.html*. Detailed information on the status of the Department's FIAR initiative can be found in the Department's biannual FIAR Plan Status Reports at *http://comptroller.defense.gov/fiar/plan.html*.

The Department also manages the *Managers' Internal Control Program* (MICP) with the goal of providing instructions, guidance, and training on how to effectively execute an internal control program, enhance knowledge and understanding of audit readiness goals and priorities, and disseminate best practices and lessons learned. An overview of the Department's MICP program is contained in the next section, entitled Systems, Controls, and Legal Compliance, with more detailed information reported in Addendum A.

U.S. sailors conduct a visit, board, search and seizure exercise with Bangladeshi sailors during Cooperation Afloat Readiness and Training Bangladesh 2013 in Chittagong, Bangladesh. The sailors are assigned to the Maritime Civil Affairs and Security Training Command.

U.S. Navy photo by Petty Officer 1st Class Jay C. Pugh

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

MANAGERS' INTERNAL CONTROL PROGRAM

The Department has a fundamental responsibility to be an effective steward of government money. Effective internal controls provide reasonable assurance that an organization achieves its objectives through:

(1) Effective and efficient operations.

(2) Reliable financial reporting.

(3) Compliance with laws and regulations.

Effective internal controls represent an organization's plans, methods, and procedures used to meet its mission, goals, and objectives, and serve as the first line of defense in safeguarding assets and preventing and detecting errors, fraud, waste, abuse, and mismanagement.

Figure 11. Commitment to MICP

- The Office of the Under Secretary of Defense (Comptroller) is responsible for implementing and managing the Secretary of Defense's program over internal management controls.

- The Federal Managers' Financial Integrity Act (FMFIA) is implemented through the DoD Managers' Internal Control Program (MICP).

- The MICP requires all DoD managers to review, assess, and report on the effectiveness of internal management controls within the Department of Defense.

DoDI 5010.40 – May 30, 2013

The Department is responsible for establishing, supporting, and assessing internal controls in order to provide reasonable assurance that it meets the objectives of the *Federal Managers' Financial Integrity Act*, PL 97-255, sections 2 and 4; the *Federal Financial Management Improvement Act*, PL 104-208; and the *Office of Management and Budget's Circular (OMB) No. A-127*, entitled "Financial Management Systems."

OMB Circular No. A-123, entitled "Management's Responsibility for Internal Control in the Federal Government," requires agencies and individual Federal managers to take the following systematic and proactive measures:

- Develop and implement appropriate, cost-effective internal controls.
- Assess the adequacy of internal controls in Federal programs and operations.
- Assess and document internal controls over financial reporting and financial management systems.
- Identify deficiencies and necessary improvements.
- Take corresponding corrective actions.
- Report annually on internal controls through management assurance statements.

Based on the Department's assessment of internal controls, the Secretary of Defense has signed the following Statement of Assurance.

STATEMENT OF ASSURANCE

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

DEC 16 2013

The leaders of the Department of Defense (the Department) recognize the importance of establishing and maintaining effective internal controls and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA), the Federal Financial Management Improvement Act (FFMIA), and Office of Management and Budget (OMB) Circular A-127, "Financial Management Systems." Despite a resource-constrained environment, the Department continues to focus on strengthening its Managers' Internal Control Program so that it can meet program objectives.

The Department conducted its assessment of the effectiveness of internal controls over operations in accordance with OMB Circular A-123, "Management's Responsibility for Internal Control." Based on the results of this assessment, the Department provides qualified assurance that its internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations achieved the objectives of the FMFIA, as of September 30, 2013. Details of the material weaknesses identified are available in Addendum A, "Other Accompanying Information."

The Department conducted its assessment of the effectiveness of internal controls over financial reporting in accordance with OMB Circular A-123, Appendix A, "Internal Control over Financial Reporting." This assessment determined that, while the Department continues to achieve measurable progress, it cannot provide reasonable assurance that internal controls over financial reporting were effective as of June 30, 2013. Related to this financial reporting assessment, as of September 30, 2013, the Department's financial systems are not in compliance with the FFMIA and OMB Circular A-127. Details of the material weaknesses also are available in Addendum A.

Improvements in the Department's financial processes remain the focus of the Department's Financial Improvement and Audit Readiness initiative and systems modernization efforts. The Department remains fully committed to establishing and sustaining a culture centered on an effective control environment.

Christine H. Fox
Acting

The Department supports and provides oversight of an MICP, led by the Office of the Under Secretary of Defense, Comptroller (OUSD(C)). The OUSD(C) provides the instructions, guidance, and training needed to accomplish the following goals:

- Share knowledge and insight with the DoD Components on effective execution of an internal control program.
- Enhance the Department's knowledge and understanding of its audit readiness goals and priorities.
- Disseminate best practices and lessons learned, and assess the 49 DoD Components' internal control programs during on-site validations, designed to measure the progress of organizations as well as their strengths and challenges.

Accomplishments

An internal control could be defined as a business practice, policy, or procedure established within an organization to create value or minimize risk. In most cases our focus is on reducing risk and addressing weaknesses, but organizational submissions by management also include accomplishments which, in the judgment of their Commanders, have created value by improving or strengthening the way we do business. The MICP also plays a role in ensuring these kinds of improvements are sustained and remain relevant to mission needs.

The following examples highlight a few of the many improvements brought about through efforts to improve internal controls.

- Force Readiness Reporting. In FY 2013, the Air Force assessed the effectiveness of its corrective actions to remediate its material weakness in the timely and accurate reporting of force readiness assessments. The Air Force established policies for monitoring the Air and Space Expeditionary Force Unit Type Code Reporting Tool (ART) for late and unreported Unit Type Codes, which represent manpower and/or equipment capabilities, as well as updating its policies and procedures for submitting reclamas (requests to reconsider proposed action taken). The Air Force has consistently met the timeliness standards for ART reporting (97 percent) and reclama processing (90 percent), demonstrating that its material weakness has been mitigated.
- Communications Security (COMSEC). The Pentagon Force Protection Agency (PFPA) overhauled the COMSEC accountability system to improve efficiency. The PFPA eliminated excess equipment, updated files and records, provided additional training to hand receipt holders, and effectively provided semi-annual inventories of 100 percent of account holdings. As a result, an audit of the PFPA COMSEC account received its first-ever satisfactory rating with no discrepancies. In addition, PFPA was commended for its excellent accountability and control of more than 2,000 COMSEC items, resulting in the ability to complete the COMSEC audit with increased efficiency.
- MICP Documentation Retention. The Joint Improvised Explosive Device Defeat Organization, the Joint Staff, and the United States Special Operations Command (USSOCOM) developed and deployed SharePoint sites or similar portals to improve standardization, consistency, and availability of MICP supporting documentation. Policies and procedures within each Component's MICP guide their respective teams on how to load documentation to their sites, to provide appropriate documentation for easy

retrieval upon request, and to establish requirements and workflow streams for supporting documentation review. The implementation of the SharePoint sites/portals has increased the Components' efficiency by greatly enhancing organizational collaboration, refining documentation collection and retention, facilitating timely feedback to managers, improving the ability to determine program status by assessable unit, and allowing team members to digitally store and access supporting documentation by way of an online library.

- MICP Evaluation Checklist. The Navy prepared a MICP Evaluation Checklist to facilitate control self-assessments and provide its organizations with core areas that can be independently assessed outside of independent audits and inspections. The checklists serve as a baseline tool that the 19 Major Assessable Units can use to report their Statement of Assurance on non-financial operations, which ultimately are reflected in the Navy's Statement of Assurance. Practical toolsets, such as the MICP Evaluation Checklist, is an important part of an effective, risk-based process for addressing deficiencies within the Department, as identified by the Government Accountability Office (GAO).
- MICP Computer-Based Training (CBT). In FY 2013, the Army added a seventh training course to its current CBT MICP curriculum. The MICP training is available Army-wide at no cost, as opposed to relying on an external vendor that would charge approximately $595 per person.

The MICP also plays a role in ensuring that these kinds of improvements are sustained and remain relevant to mission needs.

Assessment

The Department's management uses the following criteria to classify conditions as material weaknesses in internal control:

- Merits the attention of the Executive Office of the President and the relevant Congressional oversight committees.
- Impairs fulfillment of essential operations or mission.
- Significantly weakens established safeguards against waste, loss, unauthorized use or misappropriation of funds, property, other assets, or conflicts of interest.
- Constitutes substantial noncompliance with laws and regulations.
- Represents nonconformance with government-wide, financial management system requirements.

Individual DoD Components issue assurance statements assessing and certifying the effectiveness of internal controls. The Components' assurance statements serve as the primary basis for the Secretary's assurance statement on the effectiveness of the Department's entity wide internal controls. Information gathered from various sources serves as the basis for the assurance statements. This information includes management-initiated internal controls testing, program reviews, and evaluations. In addition, the DoD IG and the Government Accountability Office (GAO) conduct reviews, audits, inspections, and investigations, and the findings are considered in the individual

Component's assurance statements and provide the foundation for their individual assessments.

The Department has effective processes in many key areas. As a result, there has been significant progress toward improving both financial and operational internal controls. However, it remains clear the most daunting of challenges remain ahead, and more emphasis on effective and efficient operations is critical. In the upcoming fiscal year, the Department will continue to provide best practices and facilitate more validation assessments in order to meet the challenge.

Material Weaknesses

The Department's list of outstanding material weaknesses in Financial Reporting (16), Financial Systems, and Non-Financial operations (16 weaknesses) for FY 2013 are listed in Figure 12. Additional details related to the material weaknesses reported in Figure 12, such as corrective action plans and timelines, are detailed in Addendum A, "Managers' Internal Control Program," of this report.

A U.S. Army Staff Sergeant scans the surrounding area to look for potential enemy movement.

U.S. Army photo by Sgt. Justin A. Moeller

Figure 12. Summary List of Outstanding Material Weaknesses

	Areas of Material Weakness	Number of Material Weaknesses	Year Identified	Component	Target Correction Year
FINANCIAL REPORTING – 16 Material Weaknesses					
1	Financial Reporting	16	FY 2001	Department-wide	FY 2017
FINANCIAL SYSTEMS					
2	Financial Management Systems	1	FY 2001	Department-wide	FY 2017
NON-FINANCIAL OPERATIONS – 16 Material Weaknesses					
3	Acquisition	1	FY 2011	Department-wide	Reassessed annually based on incremental improvements
4	Security	3	FY 2006	Air Force; DSCA; DTRA; Navy; USEUCOM; USFOR-A; USSOCOM	FY 2016
5	Information Technology	1	FY 2010	USAFRICOM	FY 2014
6	Comptroller and/or Resource Management	3	FY 2011	Department-wide	FY 2017
7	Contract Administration	2	FY 2009	Department-wide	Reassessed annually based on incremental improvements
8	Force Readiness	1	FY 2011	Air Force	FY 2014
9	Personnel and/or Organizational Management	3	FY 2006	Department-wide	FY 2015
10	Property Management	1	FY 2011	Department-wide	FY 2016
11	Supply Operations	1	FY 2011	Department-wide	Reassessed annually based on incremental improvements
	Total Material Weaknesses	**33**			

Business and Financial Management Systems

The Department recognizes that to successfully meet our goal of achieving and sustaining improvements in our internal controls, financial management and auditable financial statements, we must improve our business systems. The Department remains committed to delivering a streamlined, 21st-century systems environment with IT capabilities that support effective and efficient business processes and operations.

For example, in FY2013, the Department deployed the Enterprise-wide Contractor Manpower Reporting Application to improve visibility and accountability for more than a quarter trillion dollars DoD spends each year on contracts for services. The entire Department now has the reporting capability to comply with the requirement at *10 USC § 2330a* to collect direct labor hours and associated cost information. The information provided by this capability can be used along with civilian and military workforce planning factors to ensure appropriate utilization, cost effectiveness, and alignment to mission for contracted services. Additionally, this information is critical to the Department's compliance with *10 USC § 235*, to provide budgetary projections associated with contracted service, which will help the Department's long-term traceability of funds and financial auditability.

A Staff Sergeant holds an engine brake for his mechanic teammate during the third annual 800th Logistics Support Brigade Truck Rodeo Competition.

Photo Credit: Staff Sgt. Emily Anderson, 80th Training Command Public Affairs

Following the passage of Section 901 of the FY 2012 National Defense Authorization Act, now codified at *10 USC § 2222* and entitled, "Defense business systems: architecture, accountability, and modernization," the Department significantly changed its requirements for investment reviews and the certification of defense business systems, which now must occur before funds, whether appropriated or non-appropriated, could be obligated.

For example, in FY 2012 the Department created the *Defense Business Council* (DBC), responsible for managing defense business operations and serving as the Department's single Investment Review Board (IRB) for defense business systems. The DBC/IRB, chaired by the Deputy Chief Management Officer (DCMO), reviews the planning, design, acquisition, development, deployment, operation, maintenance, modernization, and cost benefit analysis of any defense business system with a total cost in excess of $1 million over the period of the current Future-Years Defense Program.

The IRB reviews investments totaling over $7 billion in funding for business systems information technology. The Department's new investment management process ensures IT investments are aligned with strategies, allows the Department to make more informed investment decisions, eliminates legacy systems no longer required, enhances interoperability, and helps the Department transform to an environment where business applications can be rapidly deployed on a common computing infrastructure. The process also ensures that each investment is an appropriate use of taxpayer dollars and aligns to the Department's goal of delivering agile, effective, and efficient business solutions that support and enable our warfighters.

In April, 2013, the DCMO issued guidance to ensure that the Department continues to treat its business system investments with the discipline to enable cost savings that will be redirected to support critical warfighter needs. The guidance, now updated annually, created an integrated business framework that aligns the DoD strategy with the functional and organizational strategies from investment decision through system implementation. This framework will provide a basis for portfolio review from multiple perspectives, such as cost, utility, and strategic alignment.

Members of the 618th Tanker Airlift Control Center use information technology to coordinate with aircrews, maintenance personnel and aerial porters around the world from the unit's operations floor at Scott Air Force Base, IL.

U.S. Air Force photo by Staff Sgt. Chad Trujillo

The updated FM functional strategy, explained in the *Defense Business Systems Investment Management Process Guidance*, provides business direction toward achieving results linked to the business goals in the Department's *Strategic Management Plan*. For the first time, the DBC was able to analyze and review entire organizational portfolios of Defense business systems and make decisions on capital improvements and inform changes needed in the Business Enterprise Architecture. The DBC will oversee the implementation of this guidance as it reviews functional strategies, approves organizational execution plans, defines the Department's target business environment, and approves the content for the DoD Business Enterprise Architecture. In addition, the portfolio review provided necessary feedback to improve the Functional Strategy itself.

Specific to FM systems, some of the FM challenges are being addressed through incremental system improvements tied to desired outcomes. These enhancements are documented in the FM functional strategy.

The updated FM functional strategy outlines an approach to improve financial information for business decisions, increase interoperability, improve funds traceability, and strengthen internal controls. Through the review process and certification of investments, the DBC will incorporate the initiatives documented in the business direction into the capital planning for system improvements. This will better align initiatives to desired outcomes.

The statutorily mandated *Enterprise Transition Plan* and *Defense Business Systems Investment Management Process Guidance* include additional information about the Department's defense business systems and the Integrated Business Framework, including the plans for acquiring new systems and modernizing or retiring legacy systems. The *Financial Improvement and Audit Readiness Plan* discusses the link between these systems and the Department's auditability efforts.

IMPROPER PAYMENTS AND RECOVERIES

The *Improper Payments Information Act of 2002 (IPIA)*, as amended by the *Improper Payments Elimination and Recovery Act of 2010* (IPERA), requires agencies to report on improper payments and payment recapture (recovery audit) programs to the President and Congress. The Department began reporting improper payments in Fiscal Year (FY) 2004 and has continued to report annually thereafter.

The Department reports improper payments in the following categories:

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

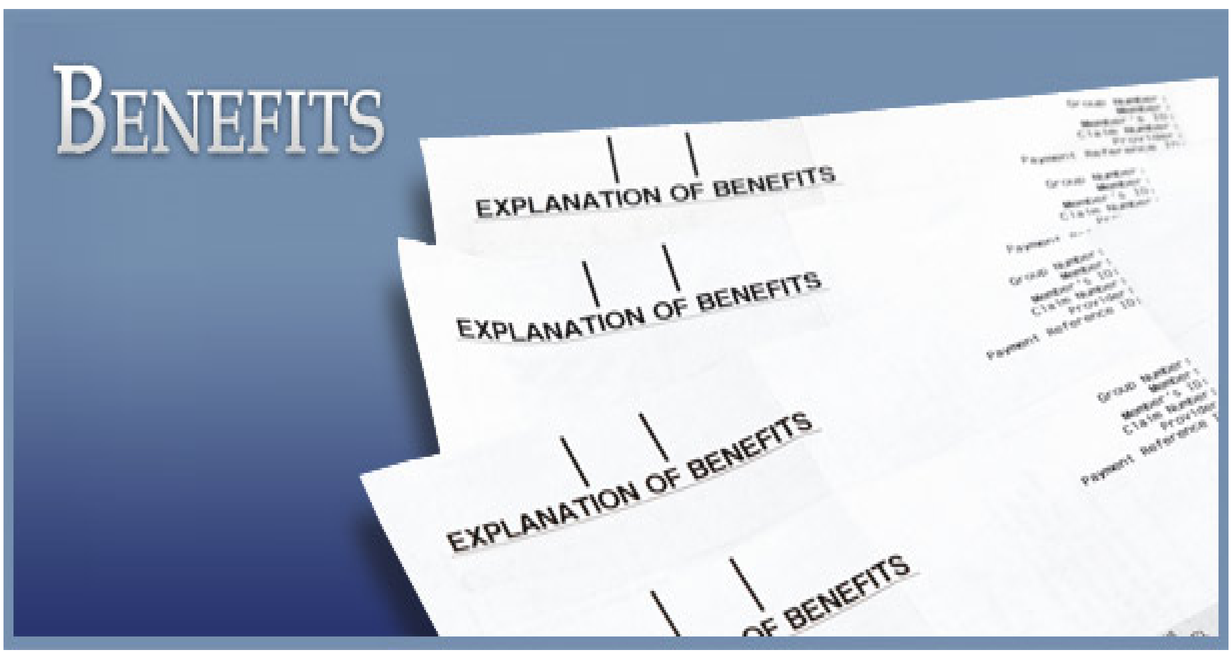
The Department continually looks for opportunities to improve its improper payment methodologies. The Department is currently implementing recommendations reflected in the DoD IG's review of the DoD program, entitled *"DoD Efforts to Meet the Requirements of the Improper Payments Elimination and Recovery Act in FY 2012*," issued in March 2013, as well as recommendations the Government Accountability Office (GAO) identified in its report, "*Significant Improvements Needed in Efforts to Address Improper Payment Requirements*," issued in May 2013. The Department is working to implement each report recommendation as quickly as possible.

The Department has also improved its payment integrity program and continues to identify additional ways to enhance the prevention, identification, and recovery of improper payments. Examples of recent successes include:

- All DoD FY 2013 payment sampling plans were approved by the Office of Management and Budget (OMB).
- The sampling methodology used for DFAS Commercial Pay in FY 2013 mirrored what was done in FY 2012. However, for FY 2014, a stratified statistical sampling will be implemented to provide confidence not only in the estimated payment error rate, but also for the estimated payment error dollars.
- For the first time in FY 2013, the Navy is reporting commercial pay improper payments recorded in its Enterprise Resource Program (ERP) System.
- The Defense Health Agency reported on its pharmacy program improper payments and has implemented a recovery audit pilot study to identify and recapture outstanding credit balances at 10 major hospitals.

- The Defense Travel Management Office (DTMO) developed and implemented a compliance tool for performing recovery audits for Travel Pay, and plans to expand it Department-wide during FY 2014. The DTMO also plans to add another recovery effort for a tax reclamation contract during FY 2014.
- The Defense Health Agency's innovative contract performance standards, which monetarily incentivize contractors to reduce improper payments, and the Business Activity Monitoring (BAM) tool, used by DFAS to review commercial payments to identify and stop potential errors before disbursements are made, continue to be government-wide best practices in preventing improper payments.

Through these efforts and others, the Department is positioning itself to be fully compliant with additional elements required by the Improper Payments Elimination and Recovery Improvement Act (IPERA) for FY 2014 reporting. However, until the Department has an auditable Statement of Budgetary Resources, it will not be possible to fully reconcile outlays to ensure all required payments are reviewed for reporting purposes. As previously discussed in this report and as reported in the DoD Financial Improvement and Audit Readiness Plan Status Report for November 2013, the Department is working hard to become fully auditable by 2017. As part of this effort, each of the Defense disbursing Components is diligently reviewing and reporting on all payments that are subject to IPERA, and ensuring the processes used are compliant with laws and regulations.



MANAGEMENT CHALLENGES

While we have made progress in managing the Department's financial resources, challenges still remain. The DoD Office of the Inspector General works to promote efficiency and effectiveness in the Department's programs and operations.

Under the *Reports Consolidation Act of 2000*, the Agency Financial Report must include a statement, prepared by the Department's Inspector General (IG), summarizing what the IG considers the most serious management and performance challenges facing the Department, along with a brief assessment of the Department's progress made in addressing those challenges. The IG-cited management and performance challenges facing the Department are in the following areas:

An Afghan Local Police (ALP) member, center, helps a coalition forces service member inspect an ALP weapon in Khost village, Farah province, Afghanistan.

U.S. Marine Corps photo by Sgt. Pete Thibodeau

- Financial Management
- Acquisition Processes and Contract Management
- Joint Warfighting and Readiness
- Cyber Security
- Health Care
- Equipping and Training Afghan National Security Forces
- The Nuclear Enterprise

Detailed information regarding these challenges, along with the Department's management response, is included in the Other Information (Addendum A) section of this report. The IG-identified challenges are in addition to those identified in the Government Accountability Office report, entitled *High Risk Series, An Update*, issued February 2013.

PATH FORWARD

The United States faces a complex and growing array of national security challenges, including the need to confront violent extremism around the globe; the proliferation of lethal weapons and materials; the destabilizing behavior of nations such as Iran and North Korea; the rise of new powers in Asia; and the new security landscape in the wake of the Arab revolutions. At the same time, the US must contend with the need to resolve difficult fiscal circumstances and uncertainty at home.

Amidst this confluence of changing strategic and fiscal circumstances, the Department's strategy calls for transitioning from an emphasis on today's wars to preparing for future challenges, while also advancing the Department's efforts to reform and support the national imperative of deficit reduction through a lower level of defense spending. As the United States draws down from operations in Afghanistan, the Department is planning how to structure its armed forces to operate in the future security environment.

Now, the Department must make tough choices amid declining budgets to ensure our Armed Forces have the capabilities and readiness they need to secure our nation's interests and to operate across the range of complex missions, ranging from counterterrorism and countering weapons of mass destruction, to maintaining a safe, secure and effective nuclear deterrent and projecting power abroad.

A paratrooper with the 82nd Airborne Division's 1st Brigade Combat Team provides overwatch security to fellow paratroopers and Afghan National Security Forces, Ghazni Province, Afghanistan. The agricultural areas surrounding Combat Outpost Giro are a haven for insurgent activities.

U.S. Army photo by Sgt. Michael J. MacLeod

As we conduct the 2014 QDR, the Department will develop a strategic course best preserving our ability to defend our national security interests in a very uncertain fiscal environment. The QDR will consider future risks and opportunities affecting our national security interests, the Administration's priorities, and fiscal limitations. Also, it will seek to ensure our Armed Forces remain capable across the full range of potential challenges we may face and the Department meets its responsibility to preserve a ready force to defend the country and America's vital interests around the world.

ORGANIZATION

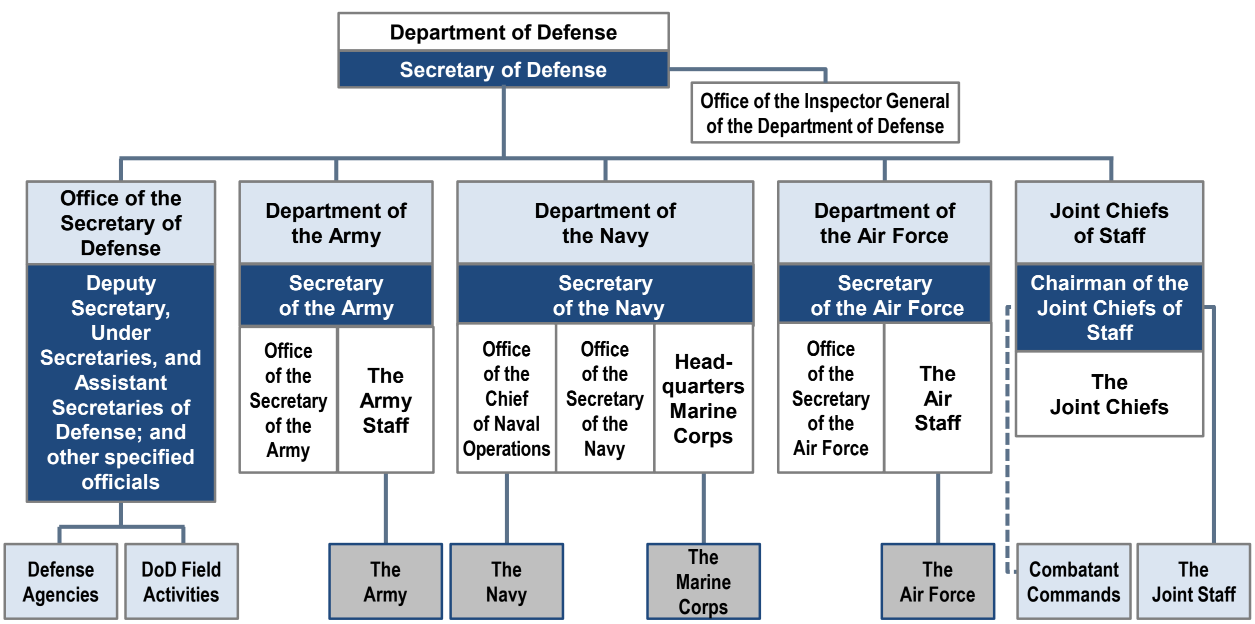
Management of a large, complex enterprise like the Department requires an equally sophisticated organization. In keeping with the information typically presented in the Agency Financial Report, the following section briefly describes the Department's organization.

Figure 13. The DoD Mission

Since the creation of America's first army in 1775, the Department and its predecessor organizations have evolved into a global presence of more than three million individuals stationed throughout the world, dedicated to defending the United States by deterring and defeating aggression and coercion in critical regions. The Department embraces the core values of leadership, professionalism, and technical knowledge; its employees are dedicated to duty, integrity, ethics, honor, courage, and loyalty.

The Secretary of Defense is the principal assistant to the President in all matters relating to the Department, and exercises authority, direction, and control over the Department. The Department is composed of the Office of the Secretary of Defense (OSD), the Joint Chiefs of Staff, the Joint Staff, the Office of the Inspector General of the Department of Defense (DoD IG), the Military Departments, the Defense Agencies, the DoD Field Activities, the Combatant Commands, and such other offices, agencies, activities, organizations, and commands established or designated by law, the President, or the Secretary of Defense.

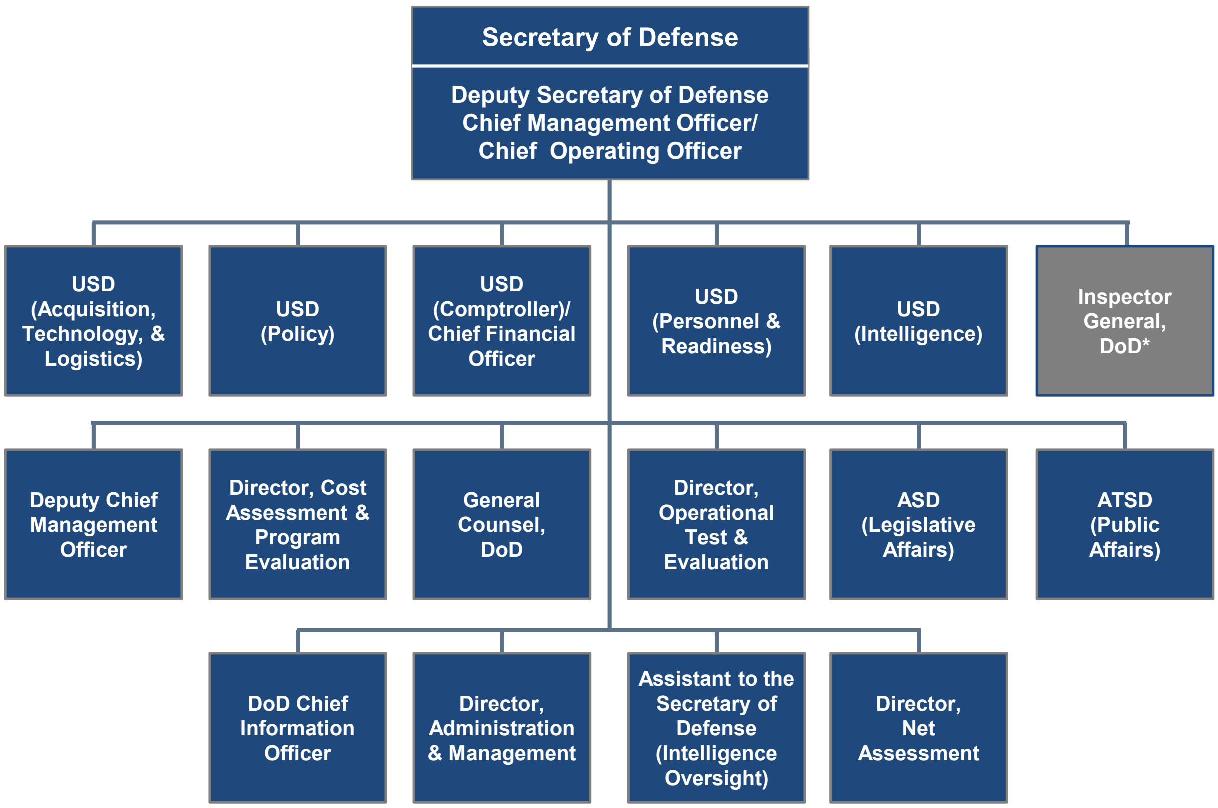
Figure 14. Department of Defense Organizational Structure



THE OFFICE OF THE SECRETARY OF DEFENSE

The function of OSD (Figure 15) is to assist the Secretary of Defense in carrying out the Secretary's duties and responsibilities and to carry out such other duties as prescribed by law. The OSD Principal Staff Assistants (PSAs) are responsible for the formulation and oversight of defense strategy and policy. The OSD is comprised of the Deputy Secretary of Defense, who also serves as the Chief Management Officer, the Under Secretaries of Defense (USDs), the Deputy Chief Management Officer (DCMO), the General Counsel, the Assistant Secretaries of Defense (ASDs), the Assistants to the Secretary of Defense, the OSD Directors, and their equivalents, the OSD Directors' staffs, the DoD IG, and the other staff offices within OSD established by law or by the Secretary.

Figure 15. Office of the Secretary of Defense Organizational Structure



Although the IG DoD is statutorily part of OSD and is under the general supervision of the Secretary of Defense, the Office of the IG DoD (OIG) functions as an independent and objective unit of the Department of Defense

THE JOINT CHIEFS OF STAFF AND THE JOINT STAFF

The *Joint Chiefs of Staff*, supported through the Chairman by the Joint Staff, constitute the immediate military staff of the Secretary of Defense. The Joint Chiefs of Staff consist of the Chairman, the Vice Chairman, the Chief of Staff of the U.S. Army, the Chief of Naval Operations, the Chief of Staff of the U.S. Air Force, the Commandant of the Marine Corps, and the Chief of the National Guard Bureau. The Joint Chiefs of Staff function as the military advisors to the President, the National Security Council, the Homeland Security Council, and the Secretary of Defense.

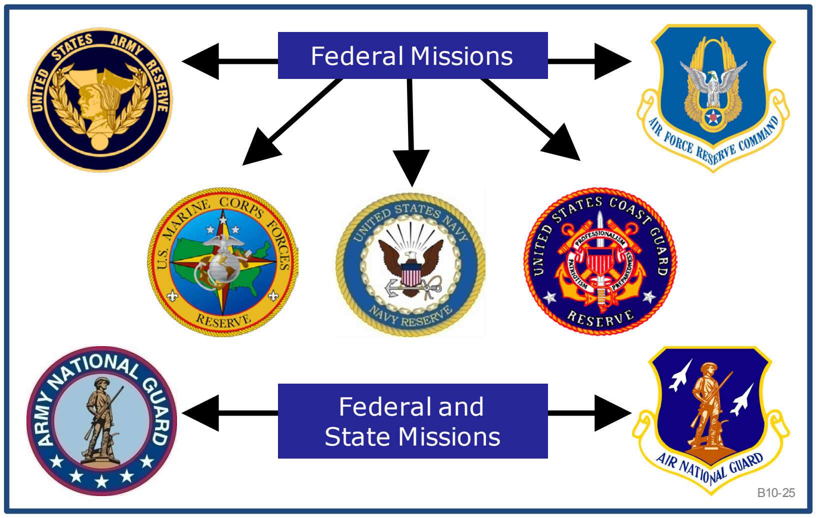
Office of the Inspector General

The *Office of Inspector General, DoD*, is an independent and objective unit within the Department which conducts and supervises audits and investigations relating to the Department's programs and operations.

Military Departments

The Military Departments consist of the Departments of the *Army*, the *Navy* (of which the *Marine Corps* is a component), and the *Air Force*. Upon the declaration of war, if Congress so directs in the declaration or when the President directs, the U.S. Coast Guard becomes a special component of the Navy; otherwise, it is part of the Department of Homeland Security. The three Military Departments organize, staff, train, equip, and sustain America's military forces and are composed of the four Military Services (or five when including the U.S. Coast Guard when directed). When the President and Secretary of Defense determine whether military action is required, these trained and ready forces are assigned or allocated to a Combatant Command responsible for conducting military operations.

Figure 16. Reserve Forces and National Guard

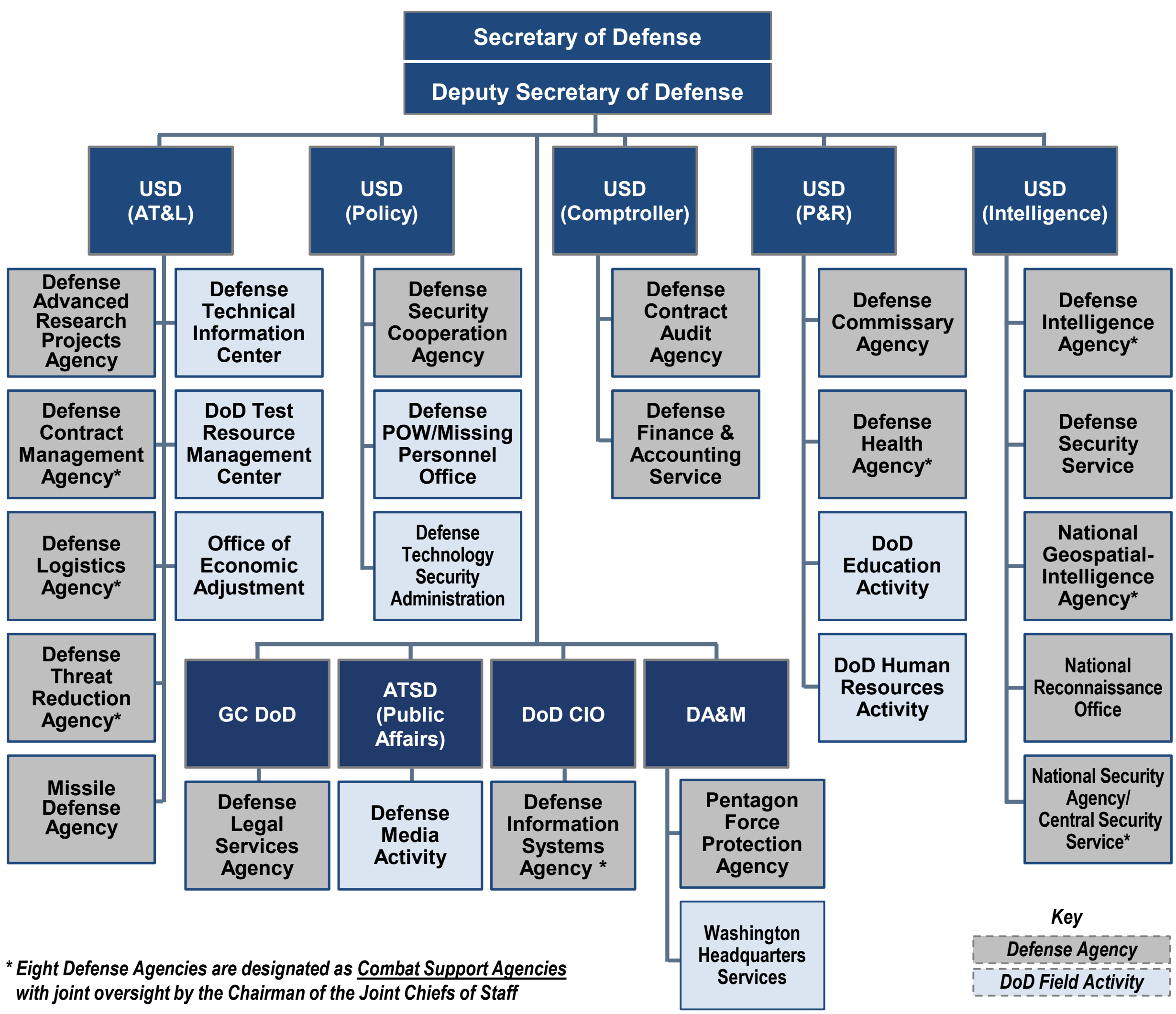


Military Departments include Active and Reserve Components. The Active Component is composed of units under the authority of the Secretary of Defense manned by active duty Military Service members, Reservists on active duty orders, or a combination of the two. The *National Guard* has a unique dual mission with both Reserve Component and State responsibilities (Figure 16). The National Guard, when commanded by the Governor of each state or territory, can be called into action during local, statewide, or other emergencies, such as storms, drought, or civil disturbances (non-federalized service). When ordered to active duty for mobilization or called into federal service for national emergencies, units of the Guard are placed under operational control of the appropriate Combatant Commander. The Guard and Reserve forces are recognized as indispensable and integral parts of the Nation's defense and fully part of the applicable Military Department.

Defense Agencies and DoD Field Activities

Defense Agencies and DoD Field Activities (Figure 17) are established as DoD Components by law, the President, or the Secretary of Defense to provide for the performance, on a DoD-wide basis, of a supply or service activity common to more than one Military Department when it is determined to be more effective, economical, or efficient to do so. Each of the 18 Defense Agencies and 9 DoD Field Activities operate under the authority, direction, and control of the Secretary of Defense, through an OSD Principal Staff Assistant (PSA) or the Chairman of the Joint Chiefs of Staff.

Figure 17. Defense Agencies and DoD Field Activities



Combatant Commands

The Commanders of the Combatant Commands (Figure 18) are responsible to the President and the Secretary of Defense for accomplishing the military missions assigned to them and shall exercise command authority over assigned and/or allocated forces as directed by the Secretary of Defense. The operational chain of command runs from the President to the Secretary of Defense to the Commanders of the Combatant Commands. The Chairman of the Joint Chiefs of Staff functions within the chain of command by transmitting the orders of the President or the Secretary of Defense to the Commanders of the Combatant Commands.

The *U.S. Strategic Command* (STRATCOM), *U.S. Transportation Command* (TRANSCOM), and *U.S. Special Operations Command* (USSOCOM) are functional Combatant Commands, each with unique functions as directed by the President in the Unified Command Plan. Among Combatant Commands, the USSOCOM has additional responsibilities and authorities similar to a number of authorities exercised by the Military Departments and Defense Agencies, including programming, budgeting, acquisition, training, organizing, equipping, and providing Special Operations Forces, and developing Special Operations Forces strategy, doctrine, tactics, and procedures. The USSOCOM is reliant upon the Services for common support and base operating support.

In addition to supplying assigned and allocated forces and capabilities to the Combatant Commands, the Military Departments provide administrative and logistics support by managing the operational costs and execution of these commands. The USSOCOM is the only Combatant Command directly receiving Congressional appropriations.

Figure 18. Combatant Commands Geographic and Functional Areas