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..... Message from the Deputy Secretary of Defense



DEPUTY SECRETARY OF DEFENSE

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November 15, 2006

In early 2001, the Department of Defense embarked on a comprehensive effort to prepare for the threats and challenges of a new era. At the heart of this effort was the transformation of not just a military still postured to fight the wars of the past, but also the myriad business systems and processes that hampered the Department's ability to support fully and efficiently the warfighters who defend the Nation. Addressing these dual challenges has been a major task of the Department of Defense for the past six years.

While transformation began well before the attacks on America of September 11, 2001, the resulting global war on terror gave urgency to the effort already underway. Some of the ways the U.S. military has been changing to meet the challenges ahead include:

- Modernizing the Nation's warfighting capabilities, to include those needed to fight and win a new kind of war.
- Standing up new organizations to protect and defend the homeland from advanced as well as conventional attack.
- Implementing a new defense strategy, a new force-sizing construct, a new approach to force planning, and a new way of balancing risk.

Recognizing the incongruity of running the military of the future with an organization anchored to the past, the Department simultaneously embarked on a course to bring its business systems and processes into the 21st century. After four years of planning and development, two comprehensive and integrated plans were released in 2005:

- The Financial Improvement and Audit Readiness Plan, which guides the effort to resolve material weaknesses, improve financial practices, and strengthen internal controls.
- The Enterprise Transition Plan, which details the actions, milestones and costs of initiatives across the Department.

These plans show the Department's continued progress in reducing the cost of operations, increasing speed and efficiency, and improving internal controls and financial accountability, thereby supporting the warfighters who defend the Nation.

Both efforts – modernizing the military, and the systems and processes that support it – have the complete and enthusiastic support of the Department's senior military and civilian leaders.

The Fiscal Year 2006 Performance and Accountability Report describes the challenges and presents the financial management and business transformation accomplishments of the Department of Defense during the past fiscal year. The report contains the most complete, reliable financial and performance data available—noting information that is either unavailable or incomplete—and discusses plans for improving the data and the progress to date. The report also includes the Department's annual statement of assurance with respect to internal controls, and our commitment to full compliance with established guidelines and standards. I am pleased to present it to the President, the Congress and the American people.





Overview

The Department of Defense Fiscal Year (FY) 2006 Performance and Accountability Report (PAR) provides the President, Congress, other Federal departments and agencies, and the American public with an overview of the Department's financial condition. Essentially, the PAR is equivalent to the private sector's annual report to their stockholders and includes an assessment of program performance. The report covers the 12-month period ending September 30, 2006 in the following four sections:

Section 1: Management's Discussion and Analysis is a high-level summary of the Department's performance and financial information for FY 2006. It highlights the Department's FY 2006 annual performance goals and results. In addition, Section 1 provides financial highlights for FY 2006 and a statement on the limitations of the financial statements; management assurances over internal controls, summaries of the Department's progress in implementing the Financial Improvement and Audit Readiness Plan, its Enterprise Transition Plan initiative, and the President's Management Agenda objectives. This section concludes with a discussion of potential future effects of current events and conditions facing the Department in 2007 and beyond.

Section 2: Performance Information presents the Department's strategic plan, strategic objectives, strategic goals, performance goals, annual performance results for FY 2006, and a summary of programs assessed using the Office of Management and Budget's Program Assessment Rating Tool.

Section 3: Financial Information includes a message from the Chief Financial Officer, the Department of Defense Inspector General Auditor's Report with its opinion on the FY 2006 financial statements, and the Department's principal financial statements and notes.

Section 4: Other Accompanying Information

includes a summary of management assurances over internal controls and corrective actions plans; the Inspector General's Summary of Management and Performance Challenges, the Government Accountability Office's high risk areas related to the Department, and management's response to these auditor assessments; the Improper Payments Information Act reporting details and corrective action plans; and the financial statements for the Executive Office of the President funds managed by the Department.

Appendixes include a glossary and a list of Internet links for documents cited in the report.

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



Year in Review



The Department of Defense continues to succeed at its mission while balancing efforts to thwart threats to our Nation and allies. We concurrently seek to transform the organization as we position ourselves for the future.

This year marked the fifth anniversary of a horrific day in our Nation's history. While we continue to face the challenge of terrorist extremists determined to impose their radical ideology on the world, the Department

of Defense has made great progress in reducing the threat they pose. Significant sources of terrorist funding are gone. Major sanctuaries, once used to train new recruits or launch attacks, have been reclaimed by their legitimate populations, and extremists not already dead or in jail are finding their days numbered.

Such progress was made possible by the heroic efforts of the men and women of America's Armed Forces. From combat operations and training of Afghan and Iraqi security forces, to the mission of providing humanitarian assistance at home and around the world, America has witnessed a truly impressive display of the skill and dedication of young patriots – volunteers every one – who are giving everything of themselves to secure peace and freedom for our citizens and those of other nations.

While extremists in London, Mumbai, Madrid, Morocco, Bali, Beslan, Baghdad, and dozens of other places across the globe continue to murder hundreds of innocent civilians, U.S. forces are making significant strides in removing these extremists from the societies in which they hide. Pockets of remaining Taliban



Pakistani earthquake victims crowd around a U.S. Army CH-47 Chinook helicopter delivering disaster relief supplies to the earthquake devastated area surrounding the town of Oghi, Pakistan on October 17, 2005.



Year in Review

fighters meet their demise each week in Afghanistan. Abu Sayyef rebels are losing their grip on the Philippines. Abu Musab Zarqawi, the terrorist leader of al Qaeda in Iraq, who incited sectarian violence and killed thousands of innocent men, women, and children, was killed in a bombing raid. Subsequent operations have eliminated dozens of extremist leaders and terrorist safe houses in Iraq.



Iraqi voters line up outside a polling site in Barwana, Iraq during Iraq's first free, permanent parliamentary government elections on December 15, 2005.

The formation this year of the new Iraqi prime minister's cabinet was a significant step forward in strengthening the permanent government of Iraq. It is a government that not only represents all of Iraq's various communities for the first time in that nation's history, but one that is pursuing a national reconciliation with those who have remained outside the political process.

Iraq's security forces continue to gain strength as well. In October 2005, there were some 196,000 trained and equipped Iraqi security forces. A year later, that number is approaching 300,000. Through training and close mentoring, Coalition forces have moved from a lead to a supporting role in many operations, and

security responsibilities are increasingly being turned over to Iraqi forces.

In Afghanistan, the nation's security forces are receiving training and support from a growing NATO presence in that country. Although they gain relatively little public notice, reconstruction projects in Iraq continue to reach completion. Increased electricity generation is benefiting more than one million homes in Iraq, and nearly two million more Iraqis now enjoy clean drinking water. More than 200 kilometers of roads, and more than 4,000 schools, have been built in Iraq, with hundreds more in Afghanistan and the Horn of Africa, where Coalition forces have also brought water and electricity to millions in need of essential services.

All of this progress contributes to the overall advancement of civil society in troubled regions. For every new student able to pursue an education, there is a parent who sees the potential benefits that an education holds for their child's future. For each house that receives clean, running water for the first time, there is a tangible incentive to keep that house free of terrorists or weapons that would place that benefit at risk. As life improves, freedom and democracy take root and grow.



Locals wait to be seen by U.S. military medical personnel outside the compound gate in Gode, Ethiopia during a 3 day medical civic action program on November 9, 2005.



Throughout FY 2006, the Department has also provided aid and humanitarian assistance to thousands in need, from the marshes of the Gulf Coast to the jungles of the Pacific Rim. Navy and Marine Corps assets proved invaluable in evacuating thousands of American citizens from Lebanon during a terrorist crisis in that country, and the Army Corps of Engineers completed repairing and improving levees, in and around New Orleans, to heights and strengths to at least what they were prior to Hurricane Katrina.

Despite a war and major disasters, the Department of Defense transformation is moving forward, reflecting

the realities of a new age by realigning global posture, developing new technologies to safeguard our forces, and applying innovative business practices to what had been an industrial age bureaucracy.

These remarkable achievements could not have occurred without the professionalism and dedication of America's men and women in uniform, and the dedicated civilians who support them. In a world full of challenge and change, they are a shining beacon of steadfast and noble service. We thank them for all that they do, and for all that they are.