

UNITED STATES DEPARTMENT OF DEFENSE

AGENCY FINANCIAL REPORT

FISCAL YEAR 2014





FOREWORD

Agency Financial Report (AFR)

This report, the U.S. Department of Defense Agency Financial Report (AFR) for Fiscal Year (FY) 2014, provides an executive-level overview of the Department, including our mission, organization, performance, highlights from the financial statements, internal controls and legal compliance, and challenges facing the Department. The Financial Section contains the agency-wide financial statements and notes, along with the Independent Auditor's Report. Additional and/or detailed information is available in the Other Information Section and appendices to this report.

The Department has produced the Agency Financial Report as an alternative to the Performance and Accountability Report (PAR). The AFR is intended to simplify and summarize information while providing transparent financial and performance reporting.

The Department will publish two additional required reports that provide varying details on financial and performance information:

Annual Performance Report (APR)

Published with the Department's annual budget submission in February 2015, the APR will provide a detailed description of performance measures and FY 2014 results.

Summary of Performance and Financial Information (SPFI)

The SPFI, published in February 2015 and available for viewing on the Under Secretary of Defense (Comptroller) public website, is a succinct summary of the FY 2014 financial and performance information previously reported in the AFR and APR, making the information more transparent and accessible to Congress, the public, and other key constituents.



U.S. Sailors and Marines conduct visit, board, search and seizure training in a rigid-hull inflatable boat in the Gulf of Aden.

Photo by Lance Cpl. Lonzo-Grei D. Thornton

ABOUT THE DEPARTMENT OF DEFENSE AGENCY FINANCIAL REPORT

The Department of Defense Agency Financial Report is required by law, including the Government Management and Reform Act of 1994 (GMRA) and the Chief Financial Officers Act of 1990. This report includes five main sections.

The **Message from the Deputy Secretary of Defense**, the Honorable Robert O. Work, introduces the Agency Financial Report.

The **Management's Discussion and Analysis (MD&A) Section** provides an executive-level overview of the Department of Defense (DoD) and our use of taxpayer resources in fiscal year 2014. The MD&A describes the Department's organization and strategic priorities, and provides summary-level reporting on DoD performance based on measurable objectives through the third quarter of FY 2014. The MD&A also includes a Financial Overview section, introduced by the Chief Financial Officer, that reports on FY 2014 financial highlights from the agency-wide consolidated financial statements, and updates on the Department's financial management improvement initiatives. The MD&A section ends with an overview of the Department's Managers' Internal Controls program, business and financial management systems' improvement strategy, and improper payments and recoveries program.

The **Agency-Wide Financial Statements Section** includes the FY 2014 Department of Defense financial statements and explanatory notes, required supplementary information, and the Independent Auditor's report on these statements and on the Department's internal controls.

The **Other Information Section** reports detailed information on material weaknesses in internal controls, improper payments and recoveries, "Freeze the Footprint" real property, the Schedule of Spending, and DoD Inspector General-identified significant performance and management challenges facing the Department, along with DoD management responses.

The **Appendices Section** includes the Defense Security Cooperation Agency – Security Assistance Accounts financial statements and explanatory notes, accounts the Department executes on behalf of the Executive Office of the President. The Appendices section also includes a list of acronyms and abbreviations, useful websites, and an index of figures and tables included throughout this report.

The estimated cost of report or study for the Department of Defense is approximately \$179,000 in Fiscal Years 2014 – 2015.

This includes \$68,000 in expenses and \$111,000 in DoD labor.

Generated on 2014Nov13 RefID: 2-73362DA

This Page Left Blank Intentionally

Table of Contents

About the Department of Defense Agency Financial Report i

Message from the Deputy Secretary of Defense v

Management’s Discussion and Analysis

Department of Defense Overview	1
Resources	3
Looking Forward	6
Organization	6
Performance Overview	13
Message from the Chief Financial Officer	19
Financial Overview	20
Financial Highlights and Analysis	21
Financial Management Improvement Initiatives	28
Financial Improvement and Audit Readiness Initiative	28
Financial Management Certification Program	30
More Disciplined Use of Resources	31
Internal Controls Overview	32
Managers’ Internal Control Program	32
Statement of Assurance	33
Business and Financial Management Systems	35
Improper Payment Reporting	39

Agency-Wide Financial Statements

Principal Financial Statements and Notes	41
Required Supplementary Stewardship Information	108
Required Supplementary Information	111
Independent Auditor’s Report	118

Other Information

Managers’ Internal Control Program Detailed Report	131
Improper Payment and Payment Recapture Programs Detailed Report	145
Freeze the Footprint	170
Schedule of Spending	171
Inspector General’s Statement of Management and Performance Challenges	172

Appendices

Appendix A: Defense Security Cooperation Agency – Security Assistance Accounts Financial Statements and Notes	A-1
Appendix B: List of Acronyms and Abbreviations	B-1
Appendix C: Useful Web Sites	C-1
Appendix D: Index of Figures and Tables	D-1

This Page Left Blank Intentionally

A MESSAGE FROM THE DEPUTY SECRETARY OF DEFENSE

We are living in a turbulent and challenging period – driven by unsettling events around the world, from terrorism in the Middle East to unrest in Eastern Europe to the threat of Ebola. So many of these global events call for the skills and organizational resources that only the United States military can provide.

At the same time, we have financial challenges within the Department of Defense. In recent years we have experienced a series of developments that have been like “canaries in a coal mine,” warning us of impending problems. One was the reduction in the Defense budget in the Budget Control Act of 2011. A second was the triggering of sequestration in 2013, despite all expectations to the contrary. And a third was the Department’s own Strategic Choices and Management Review, which pointed to the consequences for national security if further budget cuts are made in days ahead.



In short, the Department faces a new and challenging fiscal environment at the same time the Nation faces a rapidly changing security environment. And because of the unpredictable threats around the world, we face tough choices to ensure our Armed Forces retain their capabilities while we continue to pursue reforms to reduce our cost of doing business.

It is with these concerns in mind that the Department releases this report, which contains the most complete summary of the Department’s finances and the use of nearly \$582 billion in fiscal year 2014 appropriated funds. The information contained in these pages provides valuable insight into the Department’s management of financial resources. It also should reassure the American public that the Department is committed to carefully managing their tax dollars.

This report also includes a brief update on our financial management improvement initiatives, including our audit readiness efforts and actions to resolve material weaknesses in our business controls necessary to support a financial audit. As Defense Secretary Chuck Hagel has stated, audits will demonstrate that the Department of Defense manages its money with the same confidence and precision that we bring to our military operations. In the final analysis, mission readiness and audit readiness are two sides of the very same coin.

I would encourage all concerned Americans to read this report. I am confident that they will come away with new appreciation for the Department’s commitment to fiscal transparency and effectiveness.

A handwritten signature in black ink that reads "Robert O. Work". The signature is fluid and cursive.

Robert O. Work
Deputy Secretary of Defense

This Page Left Blank Intentionally