FY 2018

Management's Discussion & Analysis

Face of Defense: Marines React, Save Lives During Las Vegas Tragedy

For the full article, click icon

Mission Overview

The enduring mission of the Department of Defense (DoD or the Department) is to provide the military forces needed to deter war and to protect the security of our country. The Department is committed to ensuring the United States (U.S.) military remains the best prepared and most lethal warfighting force in the world, and that the President and American diplomats negotiate from a position of strength. Should deterrence fail, the U.S. military is prepared to fight and win.

Today, the U.S. faces an increasingly dynamic and unpredictable security environment characterized by a decline in the long-standing free and open international order that was established following World War II. Long-term strategic competition with China and Russia has re-emerged as a central challenge to U.S. prosperity and security as these nations seek to apply their authoritarian model abroad. Nearly two decades of conflict have left the U.S. with narrowing military advantages that, if left unchecked, will undermine the ability to deter aggression and coercion. Rapid advances in commercial technologies such as big data analytics, artificial intelligence, robotics, and additive manufacturing (e.g., 3D printing) present both important opportunities as well as threats and will shape the character of future wars. Additionally, non-state actors and rogue regimes remain a concern, enabled by increasingly sophisticated capabilities.

Marines set up perimeter security around a V-22 Osprey aircraft after conducting fast-roping during vertical insertion during Exercise Forest Light at Camp Sendai, Sendai, Japan, Feb. 19, 2018.

Marine Corps photo by Lance Cpl. Damion Hatch Jr.

In response to this complex global security environment, the Department developed a new National Defense Strategy (*NDS*) in January 2018. The NDS builds on the December 2017 *National Security Strategy*, and provides a thorough examination of the U.S. military's capabilities, capacity, posture, and readiness as well as articulates an effective strategy to address global security challenges and to provide for the common defense. The NDS now serves as the key strategic document driving the Department's priorities, investments, and programmatic decisions along three distinct lines of effort:

- Rebuilding military readiness and building a more lethal Joint Force,
- Strengthening alliances and attracting new partners, and
- Reforming the Department's business practices for greater performance and affordability.

With the congressional support provided by the *Bipartisan Budget Act of 2018*, the National Defense Authorization Act *(NDAA) for Fiscal Year (FY) 2018*, and the *DoD Appropriations Act of 2018*, the Department will receive the funds needed to implement the NDS and begin rebuilding the U.S. military's competitive advantage. Through the use of creative approaches, sustained investments, and disciplined execution in the field, the Department will foster a dominant Joint Force that can compete, deter, and win in this increasingly complex security environment.

Organizational Structure

The Department maintains and, when directed, uses armed forces to support and defend the Constitution; protect the security of the United States, its possessions, and areas vital to its interests; and deter war. In this era of inter-state strategic competition (e.g., from China and Russia), the DoD mission requires a lethal, resilient, and rapidly innovating Joint Force; strong relationships with allies and partners; and continued efforts to reform the Department's business practices for performance and affordability.

The Department is one of the nation's largest employers, with approximately 1.3 million personnel in the Active Component, nearly 800,000 personnel serving in the National Guard and Reserve forces, and approximately 770,000 civilians. DoD Military Service members and civilians operate globally and in all domains, including air, land, sea, space, and cyber space. In carrying out the Department's mission to protect national security, Military Service members operate approximately 15,700 aircraft and over 280 Battle Force ships.

A U.S. Air Force B-52 Stratofortress, F-15C Eagles and Moroccan air force F-16s fly in a formation in skies over Morocco, April 20, 2018, during African Lion, a U.S.-Moroccan military exercise.

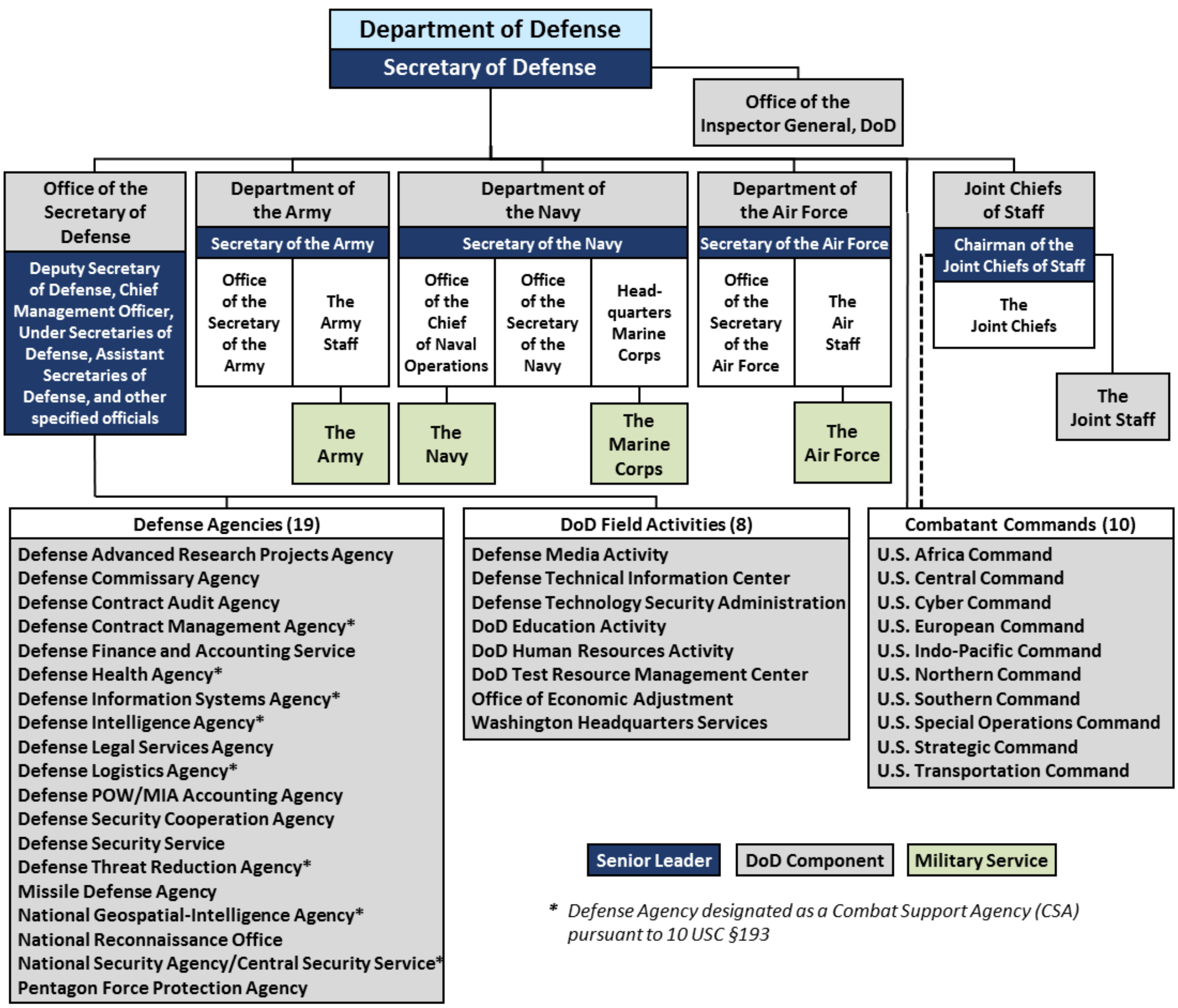
Air Force photo by Senior Airman Malcolm Mayfield

The Department manages a worldwide real property portfolio that spans all 50 states, U.S. territories, and many foreign countries. The Department's real property infrastructure includes more than 585,000 facilities (buildings and structures) located on more than 4,700 sites worldwide. These sites represent nearly 26.9 million acres that individually vary in size from training ranges with over 3.5 million acres, such as the *White Sands Missile Range*, to single weather towers or navigational aids isolated on sites of less than one one-hundredth (0.01) of an acre. Only about 33 percent of the land managed by the Department is held in fee interest (i.e., owned by the U.S. Government) with the remainder controlled through other legal means, such as leases, licenses, permits, public land orders, treaties, and agreements. Beyond the mission-specific areas of installations, such as runways, training areas, and industrial complexes, DoD installations also contain many types of facilities and operations found in municipalities or on university campuses, such as hospital and medical facilities, public safety facilities, community support complexes, housing and dormitories, dining facilities, religious facilities, utility systems, and roadways.

The Secretary of Defense is the principal assistant and advisor to the President in all matters relating to the Department, and exercises authority, direction, and control over the Department, in accordance with title 10, United States Code, section 113(b) (10 U.S.C. §113(b)). The Department is composed of the Office of the Secretary of Defense; Joint Chiefs of Staff; Joint Staff; DoD Office of the Inspector General; Military Departments; Defense Agencies; DoD Field Activities; Combatant Commands; and other offices, agencies, activities, organizations, and commands established or designated by law, the President, or the Secretary of Defense (see Figure 1).

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 and the Secretary of Defense to the Commanders of the Combatant Commands.

Figure 1. Department of Defense Organizational Structure

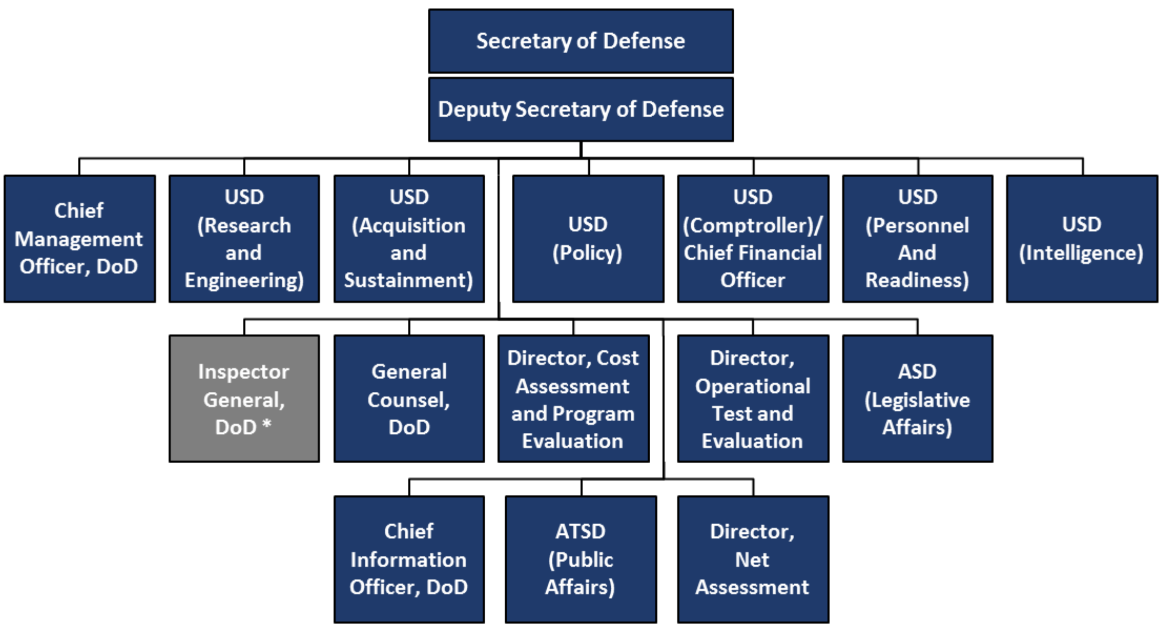


Office of the Secretary of Defense

The function of the Office of the Secretary of Defense (OSD) is to assist the Secretary of Defense in carrying out his duties and responsibilities as prescribed by law. The OSD is composed of the Deputy Secretary of Defense, who also serves as the Chief Operating Officer of the DoD; the Chief Management Officer (CMO) of the DoD; the Under Secretaries of Defense (USDs); the General Counsel (GC) of the DoD; the Assistant Secretaries of Defense (ASDs); the Inspector General of the DoD; and other staff offices within OSD established by law or by the Secretary of Defense.

The OSD Principal Staff Assistants are responsible for the oversight and formulation of defense strategy, policy, and resource allocation, as well as for overseeing and managing the Defense Agencies and DoD Field Activities (Figure 2) under their purview.

Figure 2. Office of the Secretary of Defense Principal Staff Assistants



* *Although the Inspector General, DoD is statutorily part of OSD and is under the general supervision of the Secretary of Defense, the **Office** of the Inspector General functions as an independent and objective unit of the DoD*

The Joint Chiefs of Staff and the Joint Staff

The Joint Chiefs of Staff (JCS), supported by the Joint Staff under the direction of the Chairman, constitute the immediate military staff of the Secretary of Defense. The JCS consist of the Chairman (CJCS), the Vice Chairman (VCJCS), the Chief of Staff of the Army (CSA), the Chief of Naval Operations (CNO), the Chief of Staff of the Air Force (CSAF), the Commandant of the Marine Corps (CMC), and the Chief of the National Guard Bureau (CNGB). The JCS 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 DoD Office of the Inspector General (*DoD OIG*) is an independent unit within the Department that conducts and supervises audits and investigations relating to the Department's programs and operations. The DoD Inspector General serves as the principal advisor to the Secretary of Defense on all audit and criminal investigative matters relating to the prevention and detection of fraud, waste, and abuse in the programs and operations of the Department.

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 *Coast Guard* becomes a special component of the Navy; otherwise, it is part of the *Department of Homeland Security*. The Army, Navy, Marine Corps, Air Force, and Coast Guard are referred to as the Military Services. The three Military Departments organize, train, and equip the four Military Services (or five when including the Coast Guard). These trained and ready forces are assigned or allocated to a Combatant Command responsible for maintaining readiness to conduct military operations.

The Military Departments include both 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. The Reserve Component includes the *National Guard* and the Reserve Forces of each Military Service (Figure 3). The National Guard, which has a unique dual mission with both federal and state responsibilities, can be called into action during local, statewide, or other emergencies (such as storms, drought, civil disturbances) and in some cases to support federal purposes for training or other duty (non-federalized service) when directed by the governor of each State or territory.

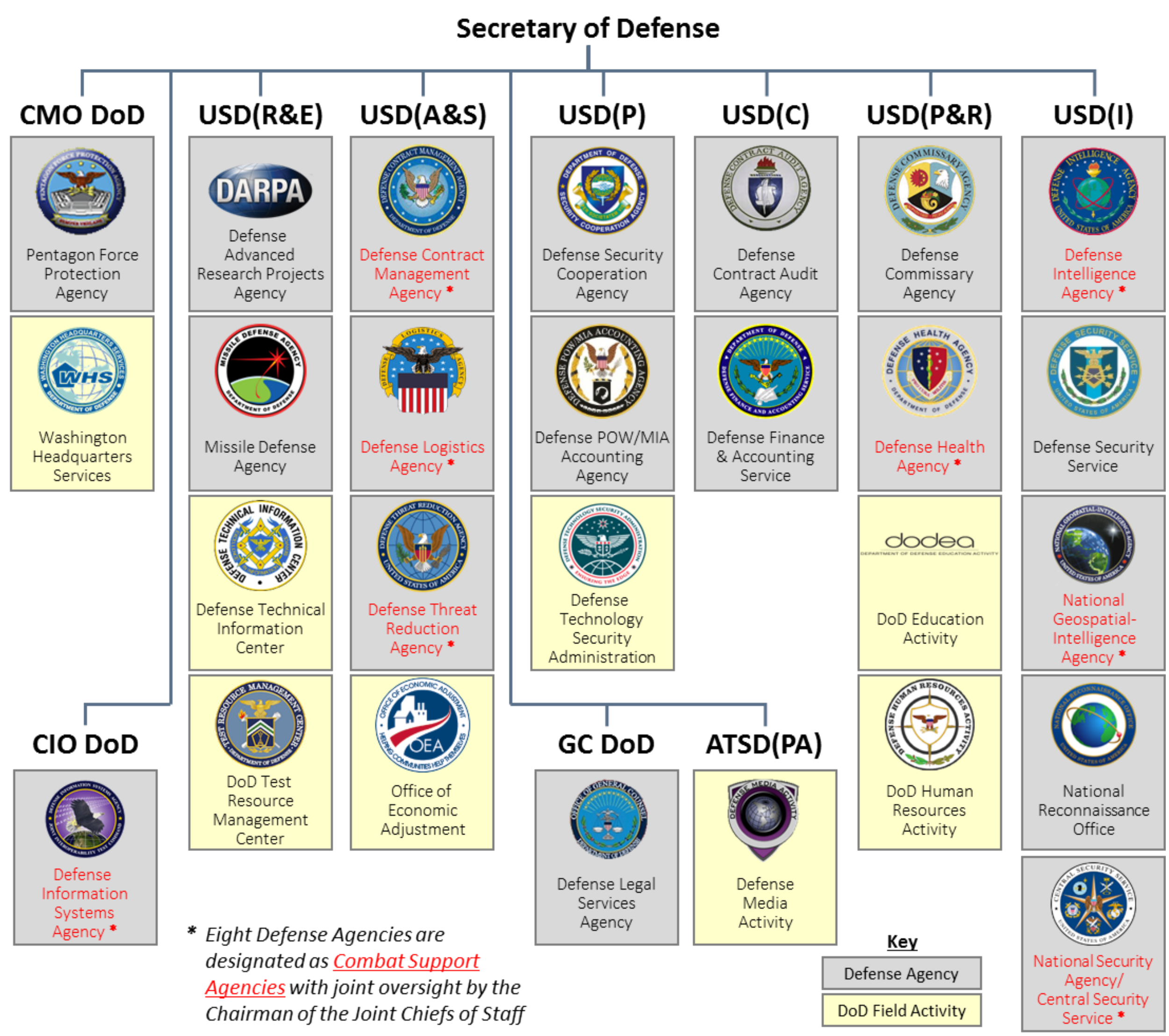
When ordered to active duty for national emergencies or other events, units of the National Guard or Reserve Forces of the Military Services are placed under operational control of the appropriate Combatant Commander or provide support to a Military Service. The National Guard and Reserve Forces are recognized as indispensable and integral parts of the Nation's defense and fully part of the applicable Military Department.

Figure 3. Reserve Components – Reserve and National Guard

Defense Agencies and DoD Field Activities

Defense Agencies and DoD Field Activities (Figure 4) are established as DoD Components by law, the President, or the Secretary of Defense to provide, on a Department-wide basis, a supply or service activity common to more than one Military Department when it is more effective, economical, or efficient to do so. Although both Defense Agencies and DoD Field Activities fulfill similar functions, the former tend to be larger, normally provide a broader scope of supplies and services, and can be designated as Combat Support Agencies to support the Combatant Commands directly. Each of the 19 Defense Agencies and 8 DoD Field Activities operate under the authority, direction, and control of the Secretary of Defense through an OSD Principal Staff Assistant.

Figure 4. Defense Agencies and DoD Field Activities



Combatant Commands

The Commanders of the Combatant Commands (Figure 5) are responsible for accomplishing the military missions assigned to them. Combatant Commanders exercise command authority over assigned and 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 CJCS 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. Cyber Command (*USCYBERCOM*), U.S. Special Operations Command (*USSOCOM*), U.S. Strategic Command (*USSTRATCOM*), and U.S. Transportation Command (*USTRANSCOM*) 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 (SOF), and developing SOF's strategy, doctrine, tactics, and procedures. The USSOCOM is reliant upon the Military Services for ensuring combat readiness of the forces assigned to it.

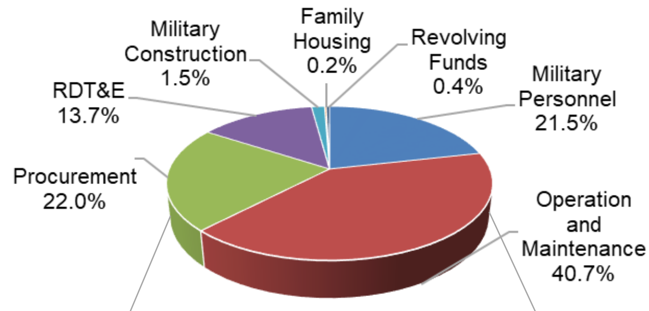
In addition to supplying assigned and allocated forces and capabilities to the Combatant Commands, the Military Departments provide administrative and logistics support by managing the operational costs and execution of these commands.

Figure 5. Combatant Commands

Resources

The DoD FY 2018 budget was the first full budget from the new administration and provided increases above the cap formally imposed by the *Budget Control Act of 2011*. The increases in the FY 2018 budget continued the progress began by the *FY 2017 Request for Additional Appropriations* in addressing warfighting readiness shortfalls and restoring program imbalances caused by the budget cuts of previous fiscal years. In FY 2018, the Department had discretionary budget authority of $670.6 billion; Figure 6 displays FY 2018 DoD budget authority by appropriation category. The Department's three lines of effort outlined in the NDS (rebuilding military readiness and a more lethal Joint Force, strengthening alliances, and reforming business practices) were further supported and sustained through the programs and resources provided for in the FY 2018 budget.

Figure 6. FY 2018 DoD Budget Authority



Budget by Appropriation	*$ in Billions*
Operation and Maintenance	$273.2
Procurement	147.4
Military Personnel	144.0
RDT&E	91.7
Military Construction	10.4
Revolving Funds	2.5
Family Housing	1.4
Total	**$670.6**

Appropriation Categories

Operation and Maintenance – The FY 2018 budget featured major programmatic increases, including increased readiness funding for the Military Departments' efforts to increase the frequency and quality of individual and collective training, and improve home station and depot maintenance of weapons systems and platforms. Additional benefits were realized from the increases in this category:

- Army increased flying hours and undergraduate flight training for pilot certification;
- Navy focused heavily on hiring and training its workforce in support of ship depot maintenance and improving flight-line aircraft readiness;
- Air Force invested in building their maintenance capability for the F-22 and F-35 aircraft as well as other platforms, and also made prudent investments in their training infrastructure, allowing for more institutional pilot training;
- Defense-wide activities increased their ability to validate, award, and audit contract actions, and also sustained family assistance programs in the most critical locations.

Procurement – The FY 2018 budget provided for the acquisition of equipment including unmanned aerial systems, air and missile defense systems across the operational force, additional aircraft to replace combat-worn strike fighters, ammunition, spare parts for existing equipment to maintain combat readiness, and individual personal protective gear to support the warfighter. Additionally, the budget provided the Navy with necessary funding for the procurement of two Arleigh Burke-class guided missile destroyers and three littoral combat ships. The increased funding in FY 2017 and FY 2018 has allowed for increased rates of procurement for new and replacement weapons systems, resulting in accelerated transition timelines from legacy platforms and increased lethality and efficiency across the Military Services.

Military Personnel – The FY 2018 budget provided for increases of over 20,000 in end strength levels across all of the Military Services. The increased end strength is designed to restore a larger, more capable, and more lethal force to defeat emerging regional and global peer adversaries while addressing critical shortfalls in pilot and maintenance personnel and targeting special skills like those required for special operations, intelligence operations, electronic information, and cyber warfare. Appropriations in this category also supported the implementation of the new *Blended Retirement System*, which makes substantial changes to the military retirement system by adding a defined contribution *Thrift Savings Plan* component – allowing the roughly 80 percent of Military Service members who serve for less than 20 years to accrue a retirement benefit that transitions with them.

Research, Development, Test, and Evaluation (RDT&E) – The FY 2018 budget provided funding for basic research and development efforts to ensure the U.S. maintains its technological edge, including the development of tools required by the USCYBERCOM Cyber Mission Force to accomplish its mission (see the *DoD Cyber Strategy* for more information). Additional funds were also provided for enhanced missile defense and the space enterprise along with other increases across the research and development arena.

Military Construction – The FY 2018 budget included funding for the improvement of existing infrastructure as well as for the construction of new facilities for operational and training needs, barracks, and other buildings to support the DoD mission around the world. Appropriations in this category also included funding for European reassurance and deterrence initiatives (e.g., *Operation Atlantic Resolve*). In addition, Congress appropriated over $700 million to repair or replace DoD facilities in Texas, Florida, Puerto Rico, and the U.S. Virgin Islands that were damaged or destroyed by hurricanes Harvey, Irma, and Maria.

Revolving Funds – This category of the FY 2018 budget included direct appropriations to the Defense Commissary Agency that supported its commissary operations, including the cost of operating the commissaries, headquarters operations, and field operating activities.

Family Housing – The FY 2018 budget provided funding for the construction of new housing, improvements to existing housing units, operation and maintenance of government-owned housing, and the leasing of housing facilities. Significant family housing construction efforts in FY 2018 include the Army's projects at Camp Humphreys, South Korea and South Camp Vilseck, Germany, as well as the Navy's project in Guam.

Puerto Rico Army Reservists, Coast Guard Investigative Service agents, Coast Guard Tactical Law Enforcement team members, Puerto Rico Treasury Department agents and a Puerto Rico Ports Authority agent deliver food and water to those affected by Hurricane Maria in the mountains around Utuado, Puerto Rico, Oct. 12, 2017.

Air Force photo by Master Sgt. Joshua L. DeMotts

Rebuilding Military Readiness and Building a More Lethal Joint Force

Prioritizing Preparedness for War

In line with the NDS, the FY 2018 budget provided funding to support fielding sufficient, capable forces that are prepared to defeat enemies and achieve sustainable outcomes that protect the American people as well as the Nation's vital interests. The Department identified goals and metrics to gauge progress toward increasing warfighting readiness, which focuses on rebuilding individual Military Service readiness while also developing collective and joint capabilities.

Each Military Service has unique requirements for meeting its readiness goals, which are focused on similar objectives – training, equipment, sustainment, and installations. Readiness improvements enabled by the FY 2018 budget include:

- Army increased use of Combat Training Centers and home station training to help develop crucial anti-access and area-denial capabilities for full-spectrum warfare;
- Navy increased funding to its Ship Maintenance program, enabling the reduction of the backlog of previously deferred maintenance while executing the requirement for current scheduled maintenance;
- Air Force optimization of the Flying Hours Program and investment in rebuilding home station high-end training, which resulted in a reduced deployment-to-dwell ratio; and
- Marine Corps funded Integrated Combined Arms Exercises for all elements of the Marine Air-Ground Task Forces to recover full-spectrum readiness and maintain its role as the Nation's crisis response force.

The FY 2018 budget also included funding for the Combatant Command Exercise and Engagement and Training Transformation program to support the development of Military Service and Combatant Command joint capabilities and training to meet wartime requirements. These events improve the readiness of the force to conduct joint operations, highlight U.S. capabilities, deter potential adversaries, and build partner capacity. The funding provided supports over 100 major exercises annually that prepare U.S. forces to execute operational plans, train the Combatant Command staffs, provide presence and regional expertise to U.S. allies and partners, and build relationships and trust.

Modernizing Key Capabilities

The FY 2018 budget addressed resource gaps in the capabilities, readiness, and capacity needed to project power globally in contested environments, while emphasizing preparedness for future high-end security challenges. The Department must be able to address near-term threats while maintaining competitive military advantages in the future, particularly through anti-access and area denial capabilities, systems, and corresponding strategies. The increased funding in the FY 2018 budget was invested in advanced capabilities to reassert a technological edge over potential future adversaries, while shifting emphasis toward a more surge-capable posture for warfighting.

The Department's FY 2018 RDT&E Program is focused on efforts that advance the technical superiority of the U.S. military's ability to counter new and emerging threats. These areas include early-stage research and development; prototyping for technology incubation and transition; repurposing commercial and non-traditional technologies; advanced manufacturing techniques; technology demonstrations; and technology experimentation. The Department's FY 2018 budget for the Science and Technology program of $13.2 billion, a 5.6 percent increase over FY 2017, included a *Basic Research* program of $2.2 billion and the Defense Advanced Research Projects Agency (*DARPA*) budget of

$3.1 billion to develop technologies for revolutionary, high-payoff military capabilities. The Department's increased efforts in prototyping under the RDT&E Advanced Component Development and Prototype program and the System Development and Demonstration program will help drive down technical risk; gain warfighter feedback to better inform requirements; and ensure that concepts going forward into acquisition programs provide the needed capability and are timely, robust, and affordable. In addition, the Department is addressing the erosion of technological superiority by identifying and investing in innovative technologies and processes to sustain and advance America's military dominance.

The FY 2018 budget additionally enabled the Department to enhance the ability of its forces to operate in a cyber-contested environment through the fielding of 133 Cyber Mission Force teams. The Department has three primary missions in cyberspace: defend DoD networks, systems, and information; defend the U.S. and its interests against cyber-attacks of significant consequence; and provide Combatant Commands with integrated cyber capabilities to support military operations and contingency plans.

Strengthening Alliances

The Department's FY 2018 budget included $65.9 billion of Overseas Contingency Operations (OCO) funds (not including $5.8 billion in Emergency Supplemental funds) primarily to conduct Operation Freedom's Sentinel in Afghanistan, Operation Inherent Resolve in Iraq and Syria, increasing efforts to support European allies and deter aggression, and global counterterrorism operations. The budget provided for several activities including maintaining a U.S. presence to train, advise, and assist Afghan security forces as well as support counterterrorism efforts in Afghanistan; sustain personnel forward-deployed to the Middle East to conduct operations to defeat the Islamic State of Iraq and Syria (ISIS); building the capacity of the Iraqi security forces and Syrian opposition forces to counter ISIS in support of the U.S. comprehensive regional strategy; and enhancing U.S. assurance and deterrence activities in Eastern Europe to support North Atlantic Treaty Organization (*NATO*) allies and partners and deter aggressive actions.

UNDISCLOSED LOCATION, Iraq (Nov. 27, 2017) – U.S. Marines deployed in support of Combined Joint Task Force- Operation Inherent Resolve pose with Iraqi service members in Iraq. CJTF - OIR is the global Coalition to defeat ISIS in Iraq and Syria. Marines deployed in support of CJTF-OIR advice and assist Iraqi Security Forces as they liberate the country from ISIS.

U.S. Marine Corps photo by Capt. Christian Lopez

Reforming the Department's Business Practices

As outlined in the NDS, the Department is committed to reforming its business practices and maintaining its responsibility to gain full value from every taxpayer dollar entrusted to it. Reform effort focus areas include acquisition reform, infrastructure and support activity reform, the Department's audit remediation initiatives, and cost accounting.

Acquisition reform in FY 2018 was mainly focused on the disestablishment of the Under Secretary of Defense for Acquisition, Technology, and Logistics; and the establishment of the Under Secretary of Defense for Research and Engineering and the Under Secretary of Defense for Acquisition and Sustainment, as enacted by the *NDAA for FY 2017*. Additionally, FY 2018 reforms included the use of cross-functional teams to improve effectiveness and maximize efficiencies across the Department with a focus on systems ownership cost and lifecycle management.

The FY 2018 budget included infrastructure and support activity reform efforts with a focus on business practices in the Fourth Estate (i.e., OSD, Defense Agencies, and DoD Field Activities) that were intended to provide immediate results as well as to improve the way the Department does business in the future. These included implementation of a policy requiring that the Office of the CMO approve any Fourth Estate business information technology (IT) investment of $1 million over the projected amount reflected in the Future Years Defense Program.

The Department's audit remediation initiatives result from its efforts to achieve compliance with the *Chief Financial Officers Act of 1990* and to support annual full-scope financial statement audits, the first of which took place in FY 2018. The focus of the audit remediation efforts is on improving the quality and timeliness of financial information through sustaining reliable and well-controlled business processes. The ongoing audits will provide valuable feedback that enhances the Department's efforts to improve systems, processes, and internal controls across the organization. The Department is also developing processes and procedures to collect financial data to provide increased insight into the cost of operations and relationship to the mission. To support this effort the Department established the Cost Decision framework, which leverages commercial best practices adapted to DoD operations and will serve as the authoritative source for enterprise-level cost information.

Balancing FY 2018 Resources

The Military – Active, Reserve, and National Guard – and Civilian personnel are the foundation of the Department and constitute its premier asset. As such, they must have the full support of the Nation and the Department to ensure that they successfully accomplish the arduous mission of defending the U.S. and its interests. The Department's commitment to a generous compensation package for those individuals willing to serve their country voluntarily is supported by the FY 2018 budget.

Combined, military and civilian personnel costs comprise roughly one third of the Department's budget. The Department is vigilant in its efforts to ensure that these costs are appropriately balanced against the Department's strategic goals. Specifically, the Department cannot allow its personnel costs to crowd out investments in readiness and modernization that are essential to providing the training and equipment needed to accomplish the vast array of missions undertaken around the globe. Balancing resources is essential as the Department reshapes the forces needed to remain effective in today's complex security environment, while providing a robust pay and benefits package which must be sustained in order to execute the NDS.

To meet the needs of its diverse workforce and mission set, the Department's FY 2018 efforts included a focus on developing cost savings through improved management of military compensation and managing the military compensation increases in basic pay, implementing the *TRICARE* Modernization Plan, strengthening military families, and supporting DoD civilians. The Department also manages the Military Health System (*MHS*), a complex system that incorporates health care delivery, medical education, public health, private sector partnerships, and cutting edge medical research and development. The MHS provides health care for 9.4 million eligible beneficiaries including all Military Service members, retirees and their families, dependent survivors, and certain eligible Reserve Component members and their families.

Sailors operate on a patient aboard the hospital ship USNS Comfort in the Caribbean Sea near San Juan, Puerto Rico, Oct. 18, 2017, while supporting Hurricane Maria relief efforts.

Navy photo by Petty Officer 2nd Class Stephane Belcher

Against the backdrop of a competitive military compensation and health benefit package, the Department has done a significant amount of work to explore how it can balance the rate of growth in military pay, benefit costs, and individual compensation incentives in a way that is both responsible and fair. Caring for the Department's people remains a top priority for the Department.

The military life cycle is complex, dynamic, and key to military readiness. The Department must attract nearly 250,000 qualified new recruits to replenish the military workforce each year. However, nearly two decades of conflict have taken a toll on the military forces. Multiple deployments with less respite between them, extensive use of the Guard and Reserves, and force reductions have all contributed to a more complex and demanding environment. Declining budgets made it harder to reset the Joint Force while sustaining the readiness needed for requirements such as deterring ISIS. The increased resources received in FY 2017 and FY 2018 have begun to reverse those trends and have measurably increased readiness and lethality.

Also vital to readiness and lethality is the DoD civilian workforce, who help sustain the viability and capabilities of the Joint Force by providing a wide range of services including logistics and supply chain management, financial management, human resource management, cyber defense and IT management, health care management, and community services. Properly leveraging the right mix of Military Service members (in both the Active and Reserve Components), civilian personnel, and contract support is fundamental to ensuring efficient and effective execution of the DoD mission. The Department continues to assess and adjust this personnel mix, as necessary, and reinvests cost savings into force readiness and modernization efforts.

Performance Overview

As stated in the NDS, the Nation must focus on fielding a larger, more capable, and more lethal Joint Force to protect the American people and U.S. vital interests. To support this, the Department is dedicated to reforming its business operations for greater effectiveness and efficiency, thus freeing up funds for higher priority warfighting requirements. The FY 2018 – FY 2022 National Defense Business Operations Plan (*NDBOP*) addresses each of the lines of effort established in the NDS from a business operations and support perspective, and is aligned and structured to contribute directly to NDS priorities. The NDBOP fulfills requirements of the Government Performance and Results Act of 1993 (*GPRA*), the GPRA Modernization Act of 2010 (*GPRAMA*), and the Office of Management and Budget (*OMB*) *Circular No. A-11*. The NDS and the NDBOP focus on tracking performance goals and measures that support achievement of the Department's major lines of effort to:

- Rebuild military readiness and build a more lethal Joint Force;
- Strengthen alliances and attract new partners; and,
- Reform the Department's business practices for greater performance and affordability.

This section provides an overview of performance results through Quarter 3, FY 2018, based on the *FY 2019 Annual Performance Plan* (which covers the FY 2018 budget execution year). Complete FY 2018 performance results will be published in the *Annual Performance Report* section of the Department's FY 2020 President's Budget Request in February 2019 which will be available on the Office of the Chief Management Officer's website at *https://cmo.defense.gov*.

A soldier hoists a battle axe in the air to mark the finish line for paratroopers as they finish a 2.2-mile run and prepare their weapons for simulated battle during training in Italy, April 4, 2018.

Army Photo by Lt. Col. John Hall

Rebuilding Military Readiness and Building a More Lethal Joint Force

Improving the Ability to Measure, Assess, and Understand Readiness

On May 30, 2018, the Under Secretary of Defense for Personnel and Readiness (*USD(P&R)*) submitted a 45-Day Readiness Review to the Deputy Secretary of Defense in accordance with the requirements of the Defense Planning Guidance. At the June 2018 meeting of the Readiness Management Group, the existing Readiness Recovery Framework (R2F) metrics were revalidated and aligned to the findings of the 45-Day Readiness Review. The Readiness Management Group will monitor, assess, and manage readiness recovery progress moving forward. The Readiness Management Group is also responsible for continued validation, refinement, and updates to the R2F as well as reporting on progress to the Deputy Secretary of Defense, Secretary of Defense, and Congress.

The metrics identified in the R2F measure the Military Services' progress towards rebuilding warfighting readiness by tracking key programs such as personnel accessions and retention, training, equipment availability, and maintenance shortfalls. Each metric is tailored to a specific challenge and readiness inhibitor and is designed to be a leading indicator of larger, systemic readiness recovery.

Improving Cybersecurity

Improving Cybersecurity – This effort consists of three focus areas: ensuring strong authentication, hardening devices, and reducing the attack surface within the cybersecurity domain. Performance measures related to these focus areas are measured across all DoD Components on a regular basis and are reported to OMB quarterly in accordance with OMB *Memorandum M-18-02* and the Federal Information Security Modernization Act of 2014 (*FISMA*). At the end of Quarter 3, FY 2018, 100 percent of DoD quarterly performance measures were on track to meet the annual goals by the close of FY 2018.

Implementing Joint Regional Security Stack Capabilities – The goal of this effort is to provide network security capabilities (such as firewall functions, intrusion detection and prevention, and management) as an enterprise service deployed in regional architectures to replace legacy DoD Component-owned and -operated network security solutions. Joint Regional Security Stacks (*JRSS*) improve the Department's ability to protect against, detect, and respond to cyber threats and attacks; improve the effectiveness and efficiency of Department of Defense Information Network (DoDIN) operations; and enable the cybersecurity concept of the Joint Information Environment (*JIE*). At the end of Quarter 3, FY 2018, 100 percent of DoD quarterly performance measures for JRSS on the Non-Classified Internet Protocol Router Network (NIPRNet) are on track to meet the FY 2018 annual goals

Expanding and Refining Defense Industrial Base Cybersecurity Activities – The goal of this effort is to improve the protection of DoD unclassified information residing on or transmitting over Defense Industrial Base (*DIB*) information networks or systems. Successes for this effort in FY 2018 included the expansion of DIB Cybersecurity Program outreach to eligible companies and improvements to the DoD Cyber Crime Center's (*DC3*) capabilities to respond to increased DIB participation and reporting. At the end of Quarter 3, FY 2018, 100 percent of DoD quarterly performance measures were on track to meet the annual goals by the close of FY 2018.

Implementing Initiatives to Recruit and Retain the Best Total Force to Bolster Capabilities and Readiness

The Department's ability to replace the loss of skills and experience with new talent depends on the capability to efficiently (Time to Hire) and effectively (Quality of Hire) recruit, hire, and retain high-performing employees. The Department's goal is not merely to hire individuals as quickly as possible, but to recruit and hire a diverse group of top-quality candidates with the right skills for the Department's mission needs today and in the future. To date, the current federal hiring process can result in the loss of prime talent due to prolonged hiring times, thus leading to less qualified talent pools. In addition, the longer it takes to fill vacancies, the longer managers must operate with inadequate resources, which could strain existing resources or result in failure to accomplish the mission. The newly established Hiring Improvement Initiatives (HII) Working Group (WG) is overseeing execution of DoD Component-level Hiring Action Plans which are designed to decrease Time to Hire and measure/track Quality of Hire. In addition to regular data-driven performance reviews, the HII WG sponsored a Department-wide Hiring Improvement workshop to enable DoD Components to share their lessons learned and best practices as well identify areas for enterprise-wide collaboration.

In support of this objective, the Department also implemented organizational initiatives to promote diversity and inclusion. On February 8, 2018, the Department issued a comprehensive harassment prevention and response policy (*DoD Instruction 1020.03*), which strengthens the Department's commitment and accountability by establishing a Department-wide oversight framework. The policy bolsters prevention and response efforts, enhances oversight, and provides additional protections and requirements to better protect our Military Service members. The policy addresses all forms of harassment including hazing, bullying, sexual harassment, and harassment conducted via electronic communications. The policy sends a clear message that the Department will not tolerate any kind of harassment by any Military Service member. The policy also reassures current and prospective Military Service members that they will be treated with dignity and respect while serving their country. The Department will continue working with the Components to review and identify gaps in the current published policy.

Strengthening Alliances

Reforming the Security Cooperation Enterprise

The Department made significant progress in implementing the reforms to Security Cooperation (SC) as enacted by the *NDAA for FY 2017*. These include adjusting planning and execution timelines to meet enhanced congressional notification requirements; creating a more transparent and consolidated budget request; and implementing a new assessment, monitoring, and evaluation (AM&E) framework to more rigorously evaluate the effectiveness of DoD efforts to achieve strategic ends through the use of SC tools.

In FY 2018, the Department advanced the planning of DoD SC activities two full fiscal years forward, publishing both FY 2018 and FY 2019 planning orders; this facilitated the development of more comprehensive programs within eight congressional notification packages in FY 2018. As a result, the Department implemented over 174 capacity-building programs globally, totaling over $1.4 billion in acquisitions, training, and services for our allies and partners. These efforts have put the Department on pace to be fully aligned with the budget and global force management processes by the beginning of the FY 2021 budget planning process, which will result in greater transparency and more strategic investment of SC tools based on realistic force availability. The Department also submitted to Congress its first consolidated budget display for FY 2019, which displays the cumulative total of DoD SC investments in a manner that can be easily sorted by program, region, or functional mission area.

Starting in FY 2019, the Department will commence strategic evaluations of DoD SC consistent with law and DoD policy regarding AM&E. These evaluations will provide valuable feedback to SC planners and additional insights to DoD leadership, Congress, and the American taxpayer. Additionally, the Department continues to consult with outside experts and to train and educate the SC workforce on AM&E.

As the responsible organization for the administration and execution of DoD SC, the Defense Security Cooperation Agency (*DSCA*) worked to advance the professionalization of the SC workforce, most notably by issuing the first-ever DoD SC Workforce Development Program guidance for the DoD SC workforce (approximately 20,000 civilian and military positions). This included an inventory of DoD positions with SC responsibilities, developing a framework for the mandatory SC workforce certification program, identifying SC-specific competencies to help focus training and other developmental efforts, and establishing standards for the identification of key positions within the SC workforce.

DSCA also continues to improve its management of the Foreign Military Sales (*FMS*) program in cooperation with the Office of the Under Secretary of Defense for Acquisition & Sustainment. With statutory responsibility for export control and FMS, DSCA has developed several new performance measures, including FMS milestones and performance targets, which are coordinated with the various implementing agencies and geographic Combatant Commands.

Defense Secretary James N. Mattis and British Defense Secretary Gavin Williamson speak to Marines during a Marine Corps parade at the Lincoln Memorial in Washington, D.C., Aug. 7, 2018.

DoD photo by Tech. Sgt. Vernon Young Jr.

Reforming the Department's Business Practices

The Secretary of Defense, the Executive Office of the President (including the OMB), and Congress continue to drive reform within the Department. While the Secretary of Defense has charged the Chief Management Officer to lead an enterprise-level business operations reform effort, DoD Components also are charged to identify and pursue opportunities to improve the performance and productivity of their business operations.

To this end, the Secretary of Defense directed the establishment of the Reform Management Group, which consists of reform teams identifying and pursuing reforms across a number of lines of business: health care management, IT and IT business systems; financial management; logistics and supply chain; contract management; human resources management; real property; community services; and test and evaluation. Cross functional coordination of reform activities is routine; for example, the contract management reform team works closely with other teams on category management, and the IT and IT business systems team coordinates consolidation of technology solutions associated with business process improvements across reform teams.

Results related to the third NDS line of effort of reforming the Department's business practices for greater performance and affordability include:

Health Care Management – The goals of this effort are to develop and maintain a medically ready force, resize the DoD-owned system to focus on warfighting needs, and provide quality health care for all beneficiaries through the most cost-effective means. Major accomplishments to date include implementation of a management framework to transfer authority, direction, and control of military treatment facility healthcare delivery and business operations to the *Defense Health Agency* and improvements to the TRICARE-2017 Managed Care Support Contracts administration fee structure.

IT and IT Business Systems – The goals of this effort are optimizing enterprise IT to improve business operations, eliminate duplication, reduce the Department's spend, and exploit information to deliver strategic value to the warfighter. Major initiatives include implementing changes to the *Defense Travel System*, data center modernization, Military Health System IT, and enterprise software licensing.

Financial Management – Financial management (FM) reform is focused primarily on initiatives that will reduce operational costs within the DoD FM line of business by simplifying and standardizing business processes and systems, while improving auditability and security. Major initiatives include standardizing financial data, system consolidation, reducing expiring and cancelling funds, and assessing the future role of the Defense Finance and Accounting Services (*DFAS*) within DoD financial management. The Department's financial statement audit, Enterprise Costs Framework, and data analytics efforts are also foundational to achieving the target financial management end-state.

Additionally, the Office of the Under Secretary of Defense (Comptroller) sponsors a number of strategic initiatives which focus on strengthening the Department's financial management workforce. In FY 2018 these initiatives included the development and publication of a DoD FM strategic workforce plan, an FM competency skills gap assessment, an automated individual development plan tool for the FM workforce, a new Department-wide developmental assignment program, and the continued maturation of the *DoD FM Certification Program*. These initiatives were all designed to build and maintain the technical and leadership competence of individual FM members in support of the Department's strategic objective to reform business processes.

Logistics and Supply Chain – The goal of this effort is to identify and achieve business process improvements that enhance Joint Force readiness and lethality. Major initiatives include establishing metrics that enable better resource decision making and increased materiel availability, producing cost savings through increased financial and operational efficiencies, and improving governance structures.

Contract Management – The goals of this effort are to implement private-sector best practices to improve how the Department purchases common goods and services. Major initiatives include reviewing and updating requirements to optimize pricing and reducing unneeded, redundant, or low priority contracting requirements.

Human Resources Management – The goal of this effort is to increase the productivity of human resources (HR) functions through the establishment of enterprise-level systems and solutions. Major initiatives include streamlining, standardizing, and modernizing the Department's numerous hiring processes and compensation systems; implementing a Department-wide civilian performance management system; and executing a comprehensive Civilian Human Capital Operating Plan.

Real Property – The goals of this reform effort are to reduce the cost of lifecycle real property management through improved use of DoD-owned and leased facilities, improved productivity of real property operations through better use of data management, and holistic enterprise-wide facility asset management. Major initiatives of this effort include category management of facilities and construction; best practices in project prioritization and scoping; reducing/optimizing the use of excess property on existing installations; and reducing/optimizing the use of leased space, focusing on those high-cost leases in close proximity to existing DoD facilities or to lower cost leased space.

Community Services – Community Services include key quality of life functions such as exchange, commissary, lodging, morale, welfare, recreation programs, and DoD schools. The goals of this reform effort include improving the quality and productivity of Community Services business operations, increasing the use of enterprise services, reducing the appropriated fund cost and liabilities of retail operations, and optimizing resale logistics and supply. A task force has been established to evaluate practical opportunities to implement these efforts as a means to achieving the goal of strengthening and preserving Community Services benefits provided to Military Service members and their families.

Air Force Capt. Wale Lawal of the Air Force Research Laboratory teaches students about properties of metals during the USA Science & Engineering Festival in Washington, D.C., April 6, 2018.

DoD photo by EJ Hersom

Test and Evaluation – The goals of this effort are to increase test productivity and move to enterprise management of test infrastructure to improve and expand test capabilities. Major initiatives include integrating and optimizing developmental and operational test activities to reduce test timelines, improving the design of experiments, and improving the effectiveness of test processes.

Regulatory Burden – The goal of this effort is to reduce regulatory burden and the associated taxpayer cost in accordance with Executive Order *(EO) 13777* and OMB *Memorandum M-17-23*. To accomplish this, the Department established the Regulatory Reform Task Force to conduct a review of all DoD regulations; reduce unnecessary, outdated, and/or ineffective regulations by 25 percent; ensure that all remaining regulations align with the NDS priorities; and identify opportunities to improve the business process of issuing regulations.

Optimizing Organizational Structures

The Department's management structures and processes could inhibit or prevent the pursuit of lethality. This requires consolidating, eliminating, restructuring, and/or streamlining wherever possible to ensure that U.S. military forces can compete, deter, and win.

Until February 2018, the Deputy Secretary of Defense served as Chief Operating Officer (COO) and Chief Management Officer (CMO) of the Department of Defense. The NDAA for FY 2017 elevated the Deputy Chief Management Officer to the Chief Management Officer and the *NDAA for FY 2018* further defined the role of the CMO to focus on a broad set of enhanced responsibilities, including enterprise business operations, shared business services, OSD and DoD organization and management, defense reform, and compliance. The CMO supports the Deputy Secretary of Defense in the role of COO to ensure that DoD leaders are unified and aligned appropriately across all assigned responsibilities and functions, through strong management practices, integrated processes, and best value business investments.

The Office of the Under Secretary of Defense for Acquisition, Technology and Logistics was also reorganized into two separate organizations in accordance with the NDAA for FY 2017. This reorganization refocused the OSD's principal role from program oversight to that of directing major Department investments to ensure integrated, technically superior capability that consistently outpaces the threat. Further, Congress provided the Department with the impetus to significantly streamline the acquisition organization and assign greater responsibility and accountability to the Military Departments for program execution and performance.

In order to achieve the cost saving goal established by the *NDAA for FY 2016*, the Deputy Secretary of Defense directed a 25 percent reduction from the FY 2016 baseline across all appropriations for DoD Major Headquarters Activities in the Military Departments, OSD, the Joint Staff, Defense Agencies, DoD Field Activities, and Combatant Commands. In FY 2017 – FY 2018, the Department achieved savings of approximately $2 billion.

Looking Forward

The Department is a performance-based organization, and as such is committed to managing towards specific, measurable goals using performance data to continually improve operations and combat the erosion of the competitive edge of U.S. military power. In striving to accomplish these goals, the Department faces numerous challenges – ranging from strategic competition and aggression from other nations and the threat of terrorism to the concern of securing the funding necessary to accomplish the mission. However, the Department has outlined and analyzed these challenges and more in the NDS, as well as defined the path forward for overcoming them. As outlined in the NDS, the Department will continue its focus on modernizing and increasing the agility, lethality, and readiness of the Joint Force; strengthening and supporting our alliances while attracting new mutually beneficial partnerships; and installing a culture, centered on the importance of results and accountability, that supports the reformation and improvement of business processes. Through the pursuit of these efforts, the Department will ensure the Joint Force is ready to compete, deter, and (if necessary) win against any adversary; that the U.S can work with its allies and partners to advance its interests, maintain favorable balances of power, and support economic growth; and that DoD management can harness available opportunities and ensure effective stewardship of taxpayer resources.

Financial Highlights and Analysis

The principal financial statements are 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 are prepared from the accounting records of the Department in accordance with the formats prescribed by OMB *Circular No. A-136* and, to the extent possible, with U.S. Generally Accepted Accounting Principles for federal entities as prescribed by the Federal Accounting Standards Advisory Board (*FASAB*). 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.

The consolidated financial statements and accompanying explanatory notes are located in the Financial 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

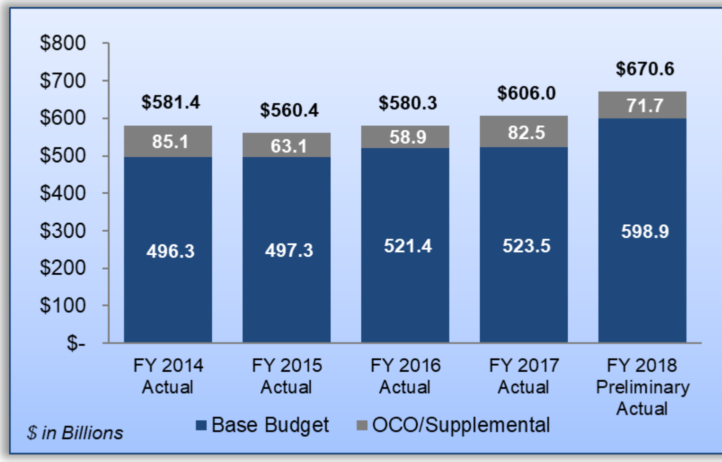
Marines provide simulated security during a dive mission in Key West, Fla., Jan. 24, 2018. The Marines, assigned to Charlie Company, 2nd Reconnaissance Battalion, were preparing for an upcoming deployment.

Marines Corps photo by Lance Cpl. Brennon A. Taylor

Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) presents the Department's total budgetary resources, their status at the end of the fiscal year, and the relationship between the budgetary resources and the outlays made against them. In accordance with federal statutes and related regulations, obligations may be incurred and payments made only to the extent that budgetary resources are available to cover such items. As depicted in Figure 7, the Department's FY 2018 total budget authority is $670.6 billion.

Figure 7. Trend in DoD Budget Authority



Note: The "Actual" amounts shown for FY 2014 – FY 2017 align with the National Defense Budget Estimates for FY 2019 and differ from the amounts presented in prior years.

In FY 2018, the Department reported $1.3 trillion in total budgetary resources (as shown in Figure 8). The total amount of "Appropriations (Discretionary and Mandatory)" in the amount of $863.6 billion reported on the SBR consists of appropriations enacted for the Department, contributions for DoD military retirement and health benefits made by the Department of the Treasury (*Treasury*) from the Treasury's general fund, and appropriations to finance civil works projects managed by the U.S. Army Corps of Engineers (*USACE*). Current year Trust Fund Receipts, including those received into the Military Retirement Fund (MRF) and the Medicare Eligible Retiree Health Care Fund (MERHCF), are also included in the SBR line item amount. Trust Fund Resources Temporarily not Available represent budget authority that the Department will execute in future years to pay the current unfunded liabilities carried in these large funds.

Figure 8. Composition of DoD Total Budgetary Resources

Description	FY 2018 ($ in Billions)
DoD Budget Authority *	$670.6
Treasury contribution for Military Retirement and Health Benefits	96.3
Civil Works Projects executed by USACE	22.8
Trust Fund Receipts	164.2
Trust Fund Resources Temporarily not Available	(90.3)
Appropriations (Discretionary and Mandatory) Reported on SBR	**$863.6**
Unobligated Balances from Prior Year Budget Authority	181.0
Spending Authority from Offsetting Collections	119.4
Contract Authority	88.4
Total Budgetary Resource	**$1,252.4**

* *FY 2018 DoD Budget Authority from Figure 6 and Figure 7*

Additional budgetary resources include $181.0 billion of unobligated balances stemming from prior year budget authority, $119.4 billion in spending authority from offsetting collections, and $88.4 billion of contract authority.

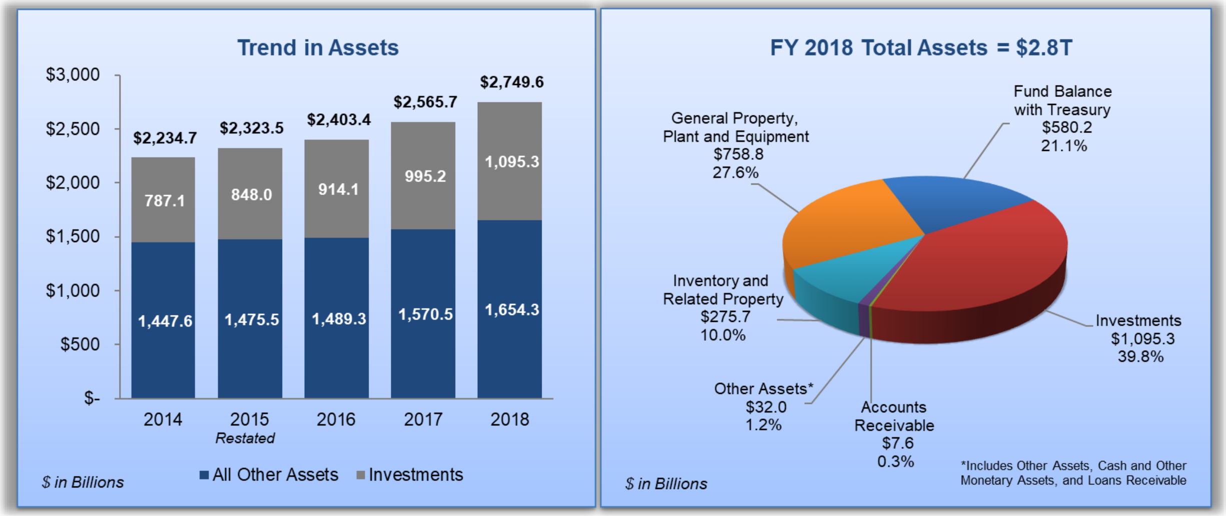
Of the $1.3 trillion in total budgetary resources, $1.1 trillion was obligated and $944.0 billion of obligations were disbursed. The remaining unobligated budgetary resources balance relates primarily to appropriations available to cover multi-year investment projects. These projects require additional time for delivery of goods and services. Expired appropriations remain available for valid upward adjustments to prior year obligations but are not available for new obligations.

Balance Sheet

The Balance Sheet, which reflects the Department's financial position as of September 30, 2018 and September 30, 2017, reports probable future economic benefits obtained or controlled by the Department (Assets), claims against those assets (Liabilities), and the difference between them (Net Position).

The $2.8 trillion in assets shown in Figure 9 represent amounts the Department owns and manages. Investments; General Property, Plant, and Equipment; and Fund Balance with Treasury represent 89% 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 9. Summary of Total Assets



Total assets increased $183.9 billion (7%) from FY 2017, largely due to increases in Investments in Treasury Securities of $100.1 billion and Fund Balance with Treasury of $78.6 billion. The investments increase was primarily due to normal growth in the MRF. As displayed in Figure 9, the Department has realized growth in investments over the last several years. The growth results from investment of contributions from the Treasury and the Uniformed Services (i.e., the Military Services, National Oceanic and Atmospheric Administration, and the Public Health Service) to cover military retirement and other federal employment benefits. Under the Department's current strategy, invested balances will continue to grow to cover unfunded portions of future benefits. Funds not needed to cover current benefits were invested in Treasury securities. The increase in Fund Balance with Treasury resulted from additional appropriations provided through the *Bipartisan Budget Act of 2018* and the *Consolidated Appropriations Act of 2018* for procurement, research and development, operations and maintenance, and Hurricane Maria disaster relief.

As seen in Figure 10, the Department's total liabilities increased $66.1 billion during FY 2018, largely due to adjustments in the estimated actuarial liability associated with military retirement benefits. This change is primarily attributable to expected interest costs, normal costs, and changes in actuarial assumptions, net of benefit outlays. The Department's $2.6 trillion of liabilities reported in FY 2018 are backed by the full faith and credit of the U.S. Government.

Figure 10. Summary of Total Liabilities

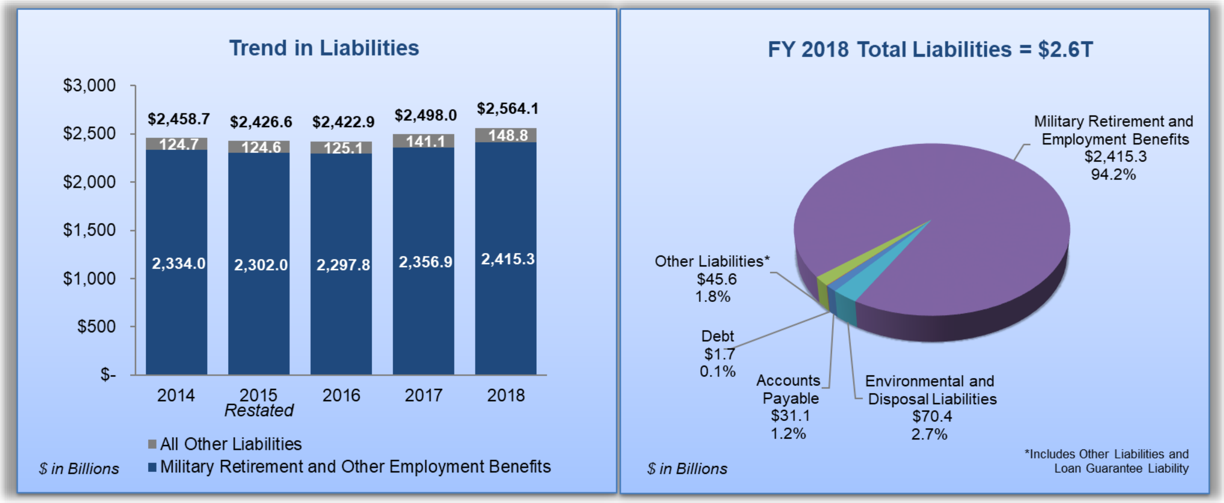
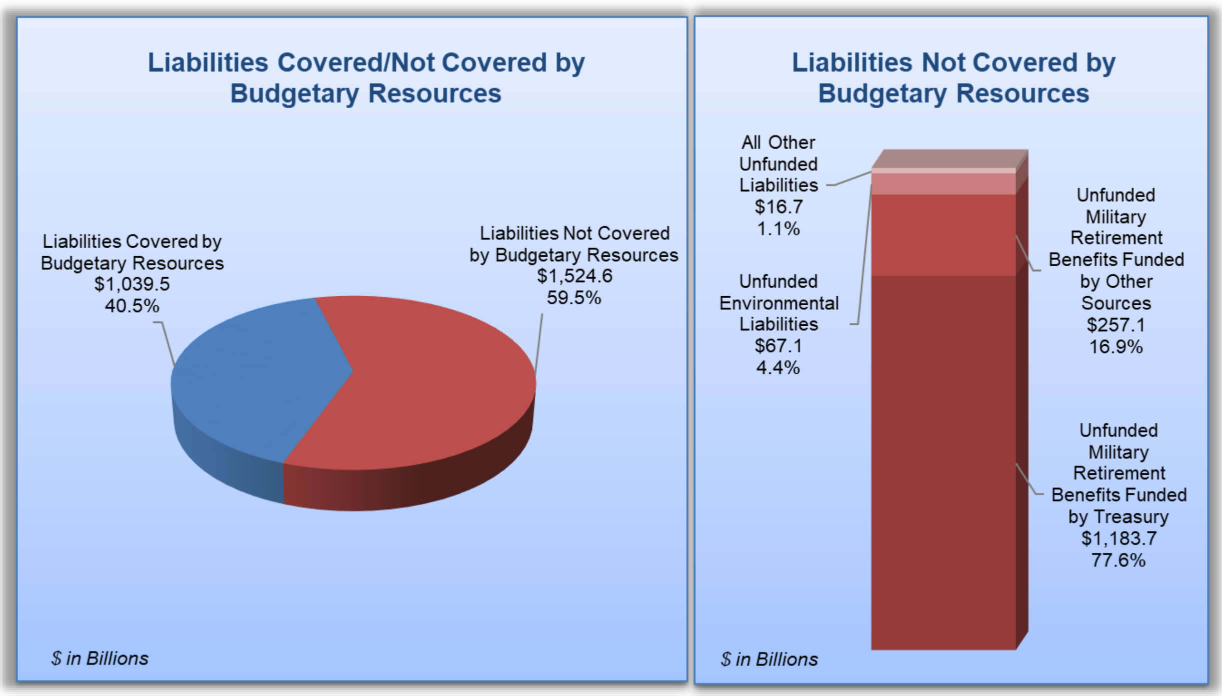


Figure 11 shows the amount of liabilities covered by budgetary resources and the amount that is not covered by budgetary resources. It also shows the composition of liabilities not covered by budgetary resources, which primarily consists of unfunded military retirement benefits funded by Treasury.

Figure 11. Liabilities Covered/Not Covered by Budgetary Resources

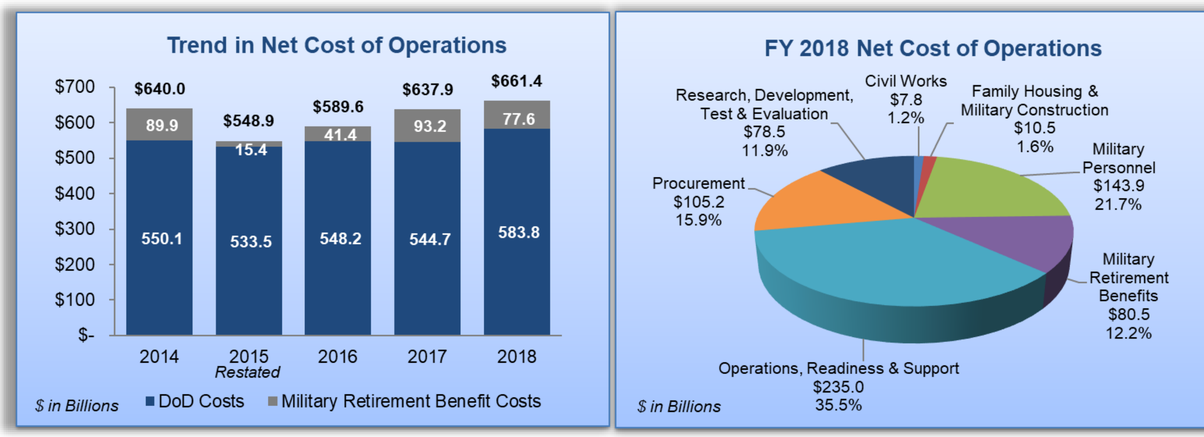


Statement of Net Cost

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 (minus) the change in accrued liabilities, less the amount of assets purchased and capitalized on the Balance Sheet during the fiscal year. The differences between reported outlays of the budgetary resources and reported net cost generally arise from when expenses are recognized.

The Department's costs incurred relate primarily to Operations, Readiness, and Support activities; Military Personnel costs; 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 a Net Cost of Operations of $661.4 billion during the fiscal year.

Figure 12. Summary of Net Cost of Operations



Statement of Changes in Net Position

The Statement of Changes in Net Position (SCNP) 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 financial statement 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 and displays the other sources financing the Department's operations. The Department's ending net position increased $117.8 billion during FY 2018. The increase primarily reflects the increase in assets due to additional funding as reflected in Fund Balance with Treasury and the normal growth in investments in the MRF, offset by an increase in liabilities primarily attributable to military retirement benefits. The growth is attributable to investment of contributions from the Treasury and the Uniformed Services, net of benefits paid. Under the Department's current strategy, invested balances are expected to continue growing to cover unfunded portions of future benefits.

In addition, the Department adjusted the beginning Cumulative Results of Operations downward by $2.5 billion through prior period adjustments. These adjustments were attributable to changes in accounting principles primarily related to establishing opening balances for land and buildings, which were also reduced for the same amount, as the Department continued to implement FASAB Statement of Federal Financial Accounting Standards *(SFFAS) 48* and *SFFAS 50*.

Financial Performance Summary

The Department's financial performance is summarized in Figure 13. This table 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. Though the Department has received a Disclaimer of Opinion on its financial statements, audit remediation efforts will continue to improve the Department's financial information.

Figure 13. Financial Performance Summary

Dollars in Billions	FY 2018	FY 2017	Increase/(Decrease) $	Increase/(Decrease) %
COSTS				
Total Financing Sources	$ 709.7	$ 680.0	$ 29.7	4.4%
Less: Net Cost	(661.4)	(637.9)	(23.5)	3.7%
Net Change of Cumulative Results of Operations	**$ 48.3**	**$ 42.1**	**$ 6.2**	**14.7%**
NET POSITION				
Assets:				
Fund Balance with Treasury	$ 580.2	$ 501.6	$ 78.6	15.7%
Investments	1,095.3	995.2	100.1	10.1%
Accounts Receivable	7.6	7.3	0.3	4.1%
Other Assets *	32.0	33.1	(1.1)	-3.3%
Inventory and Related Property, Net	275.7	266.8	8.9	3.3%
General Property, Plant and Equipment, Net	758.8	761.7	(2.9)	-0.4%
Total Assets	**$ 2,749.6**	**$ 2,565.7**	**$ 183.9**	**7.2%**
Liabilities:				
Accounts Payable	$ 31.1	$ 28.0	$ 3.1	11.1%
Other Liabilities **	47.3	44.8	2.5	5.6%
Military Retirement and Other Federal Employment Benefits	2,415.3	2,356.9	58.4	2.5%
Environmental and Disposal Liabilities	70.4	68.3	2.1	3.1%
Total Liabilities	**$ 2,564.1**	**$ 2,498.0**	**$ 66.1**	**2.6%**
Net Position (Assets minus Liabilities)	**$ 185.5**	**$ 67.7**	**$ 117.8**	**174.0%**

** Other Assets includes Other Assets, Cash and Other Monetary Assets, and Loans Receivable*

*** Other Liabilities includes Debt, Other Liabilities, and Loan Guarantee Liability*

Audit Overview

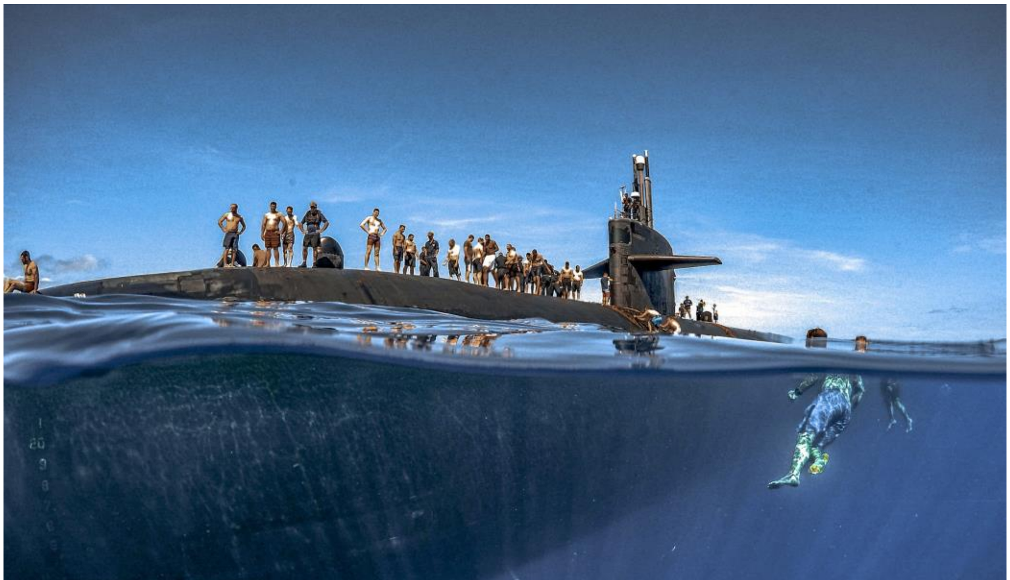
History

31 U.S.C. §3515, as amended by the Chief Financial Officers Act of 1990, requires covered executive agencies to prepare audited financial statements which must be conducted in accordance with applicable generally accepted government auditing standards. To reinforce this requirement, the NDAA for FY 2014 mandated that the Secretary of Defense ensure that an annual full-scope audit be performed over the DoD financial statements beginning in FY 2018. The Department has achieved this goal by undergoing its initial full-scope financial statement audit and remains committed to the pursuit of continued, full auditability of its operations.

This commitment is enforced in the Department's NDS – the financial statement audit directly supports this third line of effort to reform business practices and is an important component to improving the Department's operations. As stated in the NDS, the Department will continue its plan to achieve full auditability of all its operations, improving its financial processes, systems, and tools to understand, manage, and improve cost. The Department will not wait for an unmodified audit opinion to derive benefits from the audit, but expects to leverage the audit's notices of findings and recommendations (NFRs) to drive enterprise-wide improvements to standardize business processes and improve the quality of the Department's data.

Size

With approximately $2.8 trillion in total assets (accounting for over 70 percent of the U.S. Government's assets), the FY 2018 DoD consolidated audit is arguably one of the largest and most complex financial statement audit ever undertaken. The audit is comprised of over 20 standalone audits (representing 97 percent of the Department's total assets) being conducted by independent public accounting firms and an overarching consolidated audit performed by the DoD OIG. Combined, this effort will engage the use of approximately 1,200 auditors.



Sailors assigned to Los Angeles-class fast-attack submarine USS Olympia participate in a swim call at sea in the Pacific Ocean, July 31, 2018.

Navy photo by Senior Chief Petty Officer Vien Nguyen

Value

The Department is accountable to the American people. Taxpayers deserve a high level of confidence that the Department's financial statements present a true and accurate picture of its financial condition and operations. Transparency, accountability, and business process reform are some of the benefits that will result from undergoing annual, full-scope financial statement audits:

- Transparency: audit remediation efforts in response to NFRs will improve the quality of the Department's financial statements and underlying data available to the public, bolstering confidence that the financial statements present a reliable picture of assets, liabilities, and spending.
- Accountability: the audit will highlight areas for improvement of accountability over assets and resources, allowing for a streamlined identification and prioritization process for remediation.
- Business Process Reform: the combination of better data resulting from audit remediation, retirement of legacy systems, business process reengineering, and the use of modern data analytics directly supports the Department's efforts to bring business reform to its operations.

Measuring Progress

To increase the effectiveness of audit remediation efforts, the Department established the NFR Database, which is a tool to capture, prioritize, assign responsibility for, and develop corrective action plans (CAPs) to address audit findings. This tool is used to consolidate and track the status of auditor-issued NFRs and CAPs resulting from both the standalone and consolidated audits. The NFR Database is expected to help the Department gain efficiencies by sharing best practices and successes as well as raising accounting challenges to the Department-wide level for the identification of solutions to be leveraged across the Department. As audit NFRs are issued, the Department will take into consideration the extent of the impact of the audit findings to operations. NFRs will then be prioritized to ensure resolution of findings in the most cost-effective manner possible. The Department will then measure and report progress toward closing reported NFRs and achieving an unmodified audit opinion.

In FY 2018, the Department's audit remediation efforts have already paid dividends. For example:

- The Army created a computer application to store and analyze its transactional data for audit. This new application increased the Army's transparency and visibility into its cost drivers and strengthened its leadership's ability to commit resources to programs with the highest mission impact and strategic value.
- The Navy's Commander, U.S. Pacific Fleet enhanced internal controls over its obligation management process. This initiative resulted in freeing up purchasing power to fund $4.4 million in ship repair costs for the *USS Paul Hamilton (DDG 60)*.
- The Air Force improved its physical inventory procedures at *Hill Air Force Base* in Utah. The redesigned process for validating the condition of assets in property systems resulted in the accurate capture of approximately $53 million in assets that would have otherwise been misstated.

These efforts demonstrate how the Department is leveraging the audit as a foundational element in support of the NDS line of effort to reform business practices for greater performance and affordability.

STATEMENT OF ASSURANCE

The Department's leaders are responsible for establishing and maintaining effective internal controls to meet the Federal Managers' Financial Integrity Act of 1982 (FMFIA) and the Federal Financial Management Improvement Act of 1996 (FFMIA). In FY 2018, as the Department underwent its first full-scope financial statement audit, a risk-based approach was implemented to prioritize remediation and implement corrective actions impacting material financial statement line items. As the Department's audit posture matures, it will continue to improve its controls to support reliable financial reporting, effective and efficient programmatic operations, and compliance with applicable laws and regulations as well as increase the compliance of financial management systems with Federal financial management systems requirements.

The Department assessed the effectiveness of its internal controls over financial reporting in accordance with FMFIA §2 and Office of Management and Budget (OMB) Circular No. A-123. Based on this assessment, the Department found that controls in place on September 30, 2018 to support reliable financial reporting were not effective to provide reasonable assurance. The Department's deficiencies in the design or operation of internal controls over financial reporting include ineffective processes and controls over the posting of transactions to the general ledger and reconciling with the Department of the Treasury; ineffective processes and controls over compiling financial statements, reconciling data, and supporting entries (including journal vouchers); and ineffective processes and controls over accounting for, valuing, and supporting Property, Plant, and Equipment. FMFIA §2 material weaknesses and corrective actions are further described in the Other Information section.

The Department assessed the effectiveness of internal controls over operations and compliance with applicable laws and regulations in accordance with the FMFIA §2 and the OMB Circular No. A-123. Based on this assessment, the Department provides a modified statement of reasonable assurance of the effectiveness of internal controls in place on September 30, 2018 to support effective and efficient programmatic operations and compliance with applicable laws and regulations. The Department continues to address material weaknesses with specific concerns in the areas of acquisition, contract administration, resource management, and cyber security, as well as other areas. FMFIA §2 material weaknesses and corrective actions are further described in the Other Information section.

The Department realizes that properly planned and integrated systems, with strong internal controls, are critical to providing useful, timely, and complete financial information and achieving an unmodified audit opinion. FMFIA §4 and FFMIA §803(a) require agencies to implement and maintain financial management systems that comply with Federal financial management system requirements, applicable Federal accounting standards, and the United States Standard General Ledger at the transaction-level. The Department assessed the compliance of its financial management systems in accordance with FMFIA §4, FFMIA §803(a), and OMB Circular No. A-123, Appendix D. While the Department continues to achieve progress implementing corrective actions to address various systems limitations, the assessment found that the Department's financial management systems do not fully conform to the requirements of FMFIA §4 and FFMIA §803(a) as of September 30, 2018. FMFIA §4 and FFMIA §803(a) material weaknesses and corrective actions are further described in the Other Information section.

The Department remains committed to significant and measureable improvements in its ability to provide reliable, timely, and useful financial and managerial information to support management decisions. The findings from the full-scope financial statement audit will provide the Department with valuable insight that is critical to achieving its goals and demonstrating its commitment to financial accountability and transparency.

James N. Mattis
Secretary of Defense

Management Assurances

Enterprise Risk Management and Internal Controls

The Department is committed to ensuring an effective system of internal controls in business processes to provide reasonable assurance that its mission is met and to support the objectives of the DoD Components. An effective system of internal controls is central to supporting the NDS line of effort to reform business practices for greater performance and affordability. By appropriately assessing internal controls, the Department can identify opportunities to improve business operations and processes and support effective financial stewardship.

The Federal Managers' Financial Integrity Act of 1982 (*FMFIA*) requires federal agencies to evaluate and report on the effectiveness of the organization's internal controls in supporting effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. The Office of the Under Secretary of Defense (Comptroller), Office of the Deputy Chief Financial Officer (*ODCFO*) and the Office of the CMO lead the Department's effort in fulfilling Enterprise Risk Management (ERM) and Internal Control Program (ICP) responsibilities. The DoD ERM/ICP holds both operational and financial managers accountable for ensuring that they are effectively managing risks and internal controls in their areas of responsibility. In accordance with OMB *Circular No. A-123*, and the Government Accountability Office (*GAO*) Standards for Internal Control in the Federal Government ("*Green Book*"), the Department continuously strives to integrate proactive risk management and effective internal control into existing business activities.

In accordance with *DoD Instruction 5010.40*, each DoD Component assesses key functional, operational, and financial areas that are essential to the completion of its mission and objectives. DoD Components rely upon appointed assessable unit managers for each key area to identify and report internal control opportunities for improvement as well as deficiencies for review and remediation. DoD Components that produce standalone financial statements are also required to assert to the effectiveness of internal controls over reporting, operations, and financial management system requirements. The goal of the ERM/ICP is to support the Department's mission by implementing appropriate controls to identify, prioritize, and mitigate risks before they can negatively impact the mission. Another objective of the ERM/ICP is to leverage the financial statement audit as a tool to identify high risk areas and integrate audit and internal control remediation efforts.

In FY 2018, the Department made significant strides in maturing the ERM/ICP with the goal of integrating risk management and internal controls testing. The Department mandates each DoD Component conduct a risk assessment to ensure significant risks are identified and addressed. This risk based approach assists DoD Components with prioritizing audit remediation corrective actions, internal control testing, and risk mitigation. In addition, the ODCFO identifies Department-wide focus areas for testing based on the Department-wide materiality level and possible impact on financial statement line items. This process leverages OMB Circular No. A-123 and the Green Book to ensure that the Department has the appropriate oversight to prioritize and mitigate systemic, operational, and financial risks.

The Department advocates a "tone-at-the-top" approach, with emphasis on the importance of the internal control program, which permeates the entire DoD culture. The Department established a governance model comprising a variety of stakeholders to serve as the mechanism to identify and prioritize enterprise-wide risks and drive cross-functional solutions to Department-wide financial management challenges. Core to the governance model are the Financial Improvement Audit Remediation (FIAR) Governance Board (FGB) and the Defense Business Council (*DBC*), each of which serves as a Senior

Management Council, chartered to assess and monitor deficiencies in internal control. The FGB and the DBC include the Under Secretary of Defense (Comptroller)/Chief Financial Officer and the CMO; Senior Executives that cover acquisition, human capital, and information technology; and Senior Executives representing material (major) DoD Components. Additionally, Functional Councils were established to coordinate and facilitate the remediation of priority issues impacting the Department's ability to obtain an unmodified audit opinion. This governance framework supports decision-making and ensures that Department-wide deficiencies are reported in a timely manner and associated CAPs are monitored throughout the DoD Components.

A southern black racer snake slithers across the rifle barrel held by junior Army National Guard sniper Pfc. William Snyder as he practices woodland stalking in a camouflaged ghillie suit at Eglin Air Force Base, April 7, 2018.

Army photo by Staff Sgt. William Frye

FY 2018 Improvements in Internal Controls

Strong internal controls are essential to achieving and sustaining a cost-effective, efficient, and effective organization. Despite many challenges, the Department is steadily improving internal controls, which resulted in cost savings and increases in efficiency and effectiveness. Some significant accomplishments to the internal control environment and resulting savings are highlighted below.

Advances in the Effectiveness of Internal Controls

Department of the Army

As a result of corrective actions, the Army's independent auditor closed a material weakness surrounding FM Improvements. These FM internal control improvements required a collaborative effort between the Army and its service provider, DFAS, to close multiple deficiencies that were reported over a course of two years related to the oversight of financial operations.

In addition, the Army's auditor downgraded a material weakness surrounding Service Provider Oversight. The auditor cited Army for not monitoring the various service providers who perform key activities on its behalf. By implementing a process to identify and evidence the review of the annual System and Organization Controls *(SOC) 1* reports, the auditor downgraded the material weakness to a significant deficiency.

Department of the Navy

The Navy developed a policy providing updated requirements and internal controls for classifying, documenting, and approving journal vouchers (JVs) that pose the greatest risk to producing reliable and accurate financial statements and reports. In FY 2018, many budget submitting offices took action to implement this JV policy to reduce, eliminate, and automate these manual entries.

The Navy also produced a complete transaction universe from nine disparate accounting systems, which has allowed the Navy to collect financial data that was not previously available to support data analysis and compilation of financial reports across the Navy's various commands. This transaction universe has aided the auditor's ability to evaluate Navy's transactional data and assess its internal controls.

Department of the Air Force

As of March 31, 2018, the *Air Force Audit Agency* resolved 74 (44%) of 167 open recommendations and addressed $8.8 billion in identified potential savings. Additionally, the Auditor General of the Air Force collaborated with Headquarters Air Force and Major Command leadership to obtain CAPs to resolve the remaining 93 recommendations, including $49 million in additional potential savings.

In response to an audit finding over incomplete and inadequate documentation of enterprise-level internal controls testing in accordance with OMB Circular No. A-123 standards, the Air Force made significant progress building the infrastructure to support a viable ERM/ICP program. The Air Force provided training as part of establishing the groundwork necessary to adequately document, test, and report on business processes. This accomplishment will assist with resolving material weaknesses surrounding the Financial Reporting and Oversight and Monitoring processes.

Defense Finance and Accounting Service (DFAS)

In FY 2018, DFAS implemented procedures for recording, reporting, and reconciling amounts between entitlement and accounting systems. This has resulted in the correction of $57 million in prior-period beginning balance adjustments and $76 million in JVs, as well as the elimination of $58 million in an overstatement of Accounts Payable.

Defense Contract Management Agency (*DCMA*)

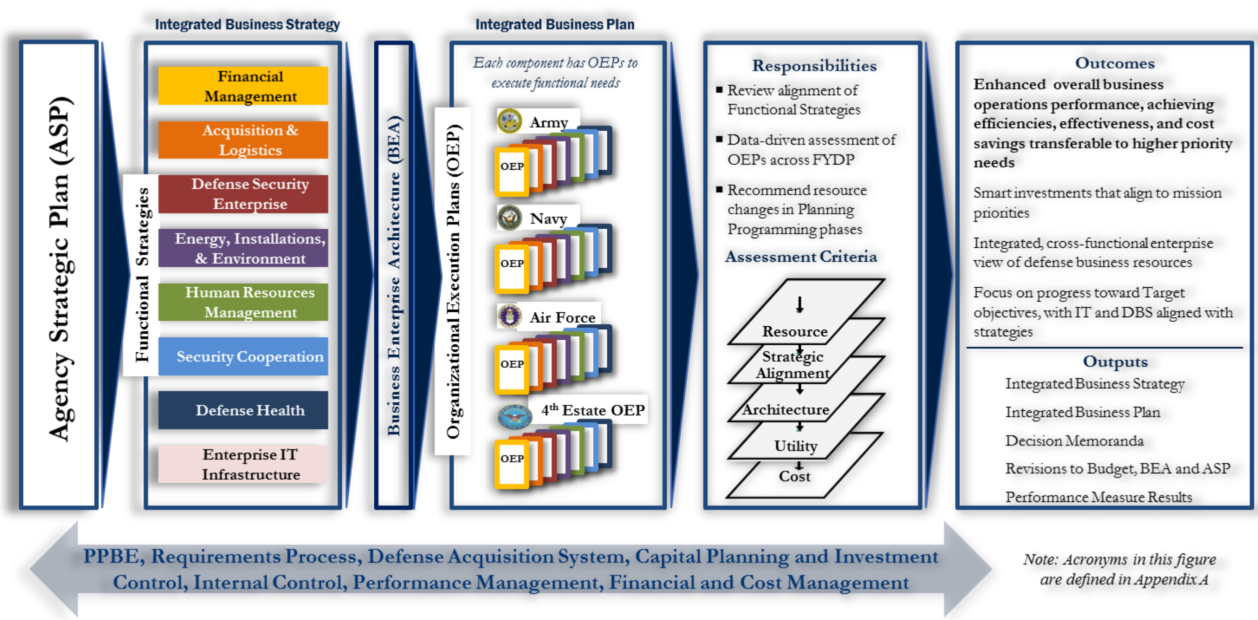
DCMA won the 2017 *David Packard Excellence in Acquisition Award* for their efforts in piloting new Quick Closeout (QCO) techniques that utilize standardized risk factors in the contract closeout process. DCMA deployed multiple initiatives throughout FY 2018 to encourage the use of the new QCO process with subcontractors and across the Department, resulting in projected savings of $613.9 million.

Systems Compliance and Strategy

The Department is engaged in a complex and challenging transformation to reform its FM environment for enhanced mission effectiveness and auditability. This necessarily includes improving business systems to be in compliance with the Federal Financial Management Improvement Act of 1996 (*FFMIA*) and OMB Circular No. A-123, *Appendix D*. Modernization and improved interoperability of DoD business systems is critical to efficiently respond to warfighter needs and sustain public confidence in the Department's stewardship of taxpayer funds.

After *10 U.S.C. §2222* was amended by the *NDAA for FY 2012* to modify requirements for review of defense business system investments, the Department significantly changed the requirement structure and processes for investment reviews and the certification of defense business systems, which now must occur before funds are obligated (appropriated or non-appropriated). The Department's investment review process ensures that decisions on investments in business systems align with the Department-wide integrated business strategy (Figure 14). These decisions also include retirement plans for legacy and non-target financial systems and ensure that systems eliminate redundant activity and maximize operating efficiency through streamlining business processes and the availability of timely, accurate, and useful business information, enabling data driven decision-making. (A legacy system has a retirement plan and date; a target system does not.)

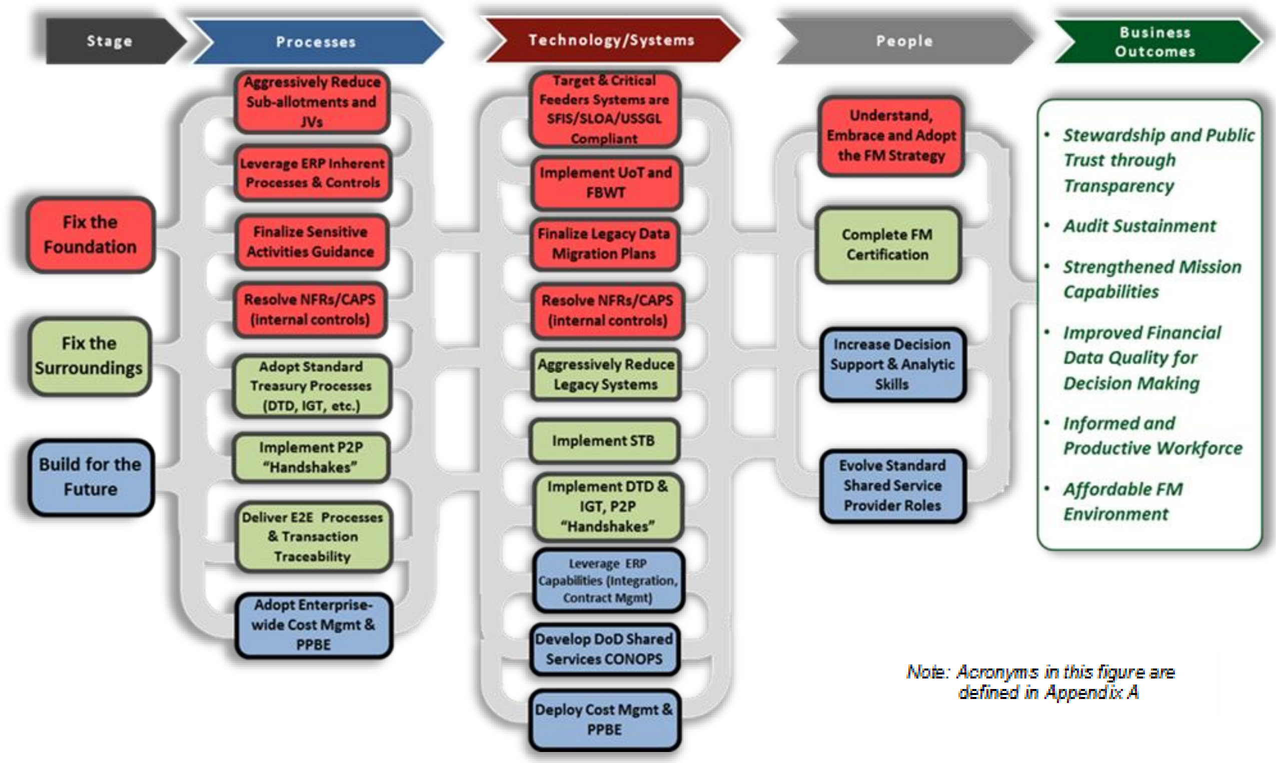
Figure 14. DoD Integrated Business Framework



The Department's FM Functional Strategy provides the Department's vision, initiatives, goals, target environment, and expected outcomes over five years. Rooted in fiscal accountability and financial improvement, the FM Functional Strategy for FY 2018 – FY 2022 will lead to strategic outcomes that are essential for the optimal utilization of the resources provided to the Department to carry out its mission.

The key components of the FM Functional Strategy include establishing data and data exchange standards, standard business processes, and system controls and enhancements that support improved processes, and leveraging technology across the Department's end to-end processes. The primary objective of the FM Functional Strategy is to achieve a fully integrated environment linked by standard processes and standard data with the fewest number of systems and interfaces. Ultimately, this strategy will lead to stronger internal controls, impacting financial reporting and auditability; improvements in end-to-end funds traceability; and linkage between budget and expenditures. Current enterprise-level initiatives include the implementation of the Standard Financial Information Structure (SFIS), the Department's standard line of accounting, which will improve funds traceability and financial reporting. The Department also participates in Federal Government-wide process improvement initiatives, such as the President's transparency and open government initiatives as well as Treasury's government-wide accounting and Direct-to-Treasury disbursing initiatives. The Department also promotes the use of business analytics and maximizing existing Enterprise Resource Planning (ERP) systems.

Figure 15. DoD FM Systems Improvement Initiatives



Enterprise Resource Planning Systems

The ERP systems are integral to implementing the strategic FM business process improvements, achieving the planned target environment and reductions in the number of legacy systems, and better enabling a sustainable audit environment. The ERPs provide a broad range of functionality to support DoD business operations in financial management, supply chain management, logistics, and human resource management. Some ERPs are fully fielded while others are in a state of development and deployment.

Army ERPs

General Fund Enterprise Business System (GFEBS) is the General Fund accounting, asset management, and financial system used to standardize, streamline, and share critical data across the active Army, Army National Guard, and Army Reserve. GFEBS is a web based ERP solution that uses commercial off-the-shelf (COTS) business enterprise software to compile and share accurate, up-to-date financial and accounting data.

The Logistics Modernization Program (LMP) is one of the world's largest, fully integrated supply chain, maintenance, repair and overhaul, planning, execution, and financial management systems. The LMP mission is to sustain, monitor, measure, and improve the modernized, national-level logistics support solution. By modernizing both the systems and the processes associated with managing the Army's supply chain at the national and installation levels, LMP will permit planning, forecasting, and rapid order fulfillment to supply lines. It will also improve distribution, reduce theater footprint, and ensure a warfighter who is equipped and ready to respond to present and future threats.

Global Combat Support System – Army (GCSS-A) is an acquisition system that provides enterprise-wide visibility into various logistic areas and is a key enabler for the Army in achieving auditability. GCSS-A provides the tactical warfighter with supply, maintenance, property accountability, integrated materiel management center, management functionality, and support for tactical financial processes.

Integrated Personnel Pay System – Army (IPPS-A) is a hybrid solution using ERP software to deliver an integrated personnel and pay capability. IPPS-A will provide the Army with an integrated, multi-component personnel and pay system that streamlines Army Human Resources processes, enhances the efficiency and accuracy of Army personnel and pay procedures, and supports soldiers and their families. IPPS-A will improve internal controls to prevent erroneous military payments and loss of funds.

Soldiers fire the main weapon of an M1A2 Abrams tank during a gunnery qualification event at the Rodriguez live fire complex in South Korea, Nov. 28, 2017. The soldiers are assigned to the 1st Battalion, 8th Cavalry Regiment.

Army photo by Sgt. Patrick Eakin

Navy ERPs

Navy Enterprise Resource Planning (Navy ERP) is an integrated business system that provides streamlined financial, acquisition, and supply chain management to the Navy's systems commands.

Global Combat Support System – Marine Corps (GCSS-MC) is the core web-enabled, centrally managed ERP for the Marine Corps. The GCSS-MC is focused on the acquisition and implementation of the initial set of logistics capabilities to deliver improved supply and maintenance management services. As the technology centerpiece of the Marine Corps' overall logistics modernization effort, GCSS-MC will provide advanced expeditionary logistics capabilities to ensure future combat efficiency.

Air Force ERPs

Defense Enterprise Accounting and Management System (*DEAMS*) is an automated accounting and financial management execution system for the Air Force and U.S. Transportation Command. DEAMS is the core accounting and financial management solution for the Transportation Working Capital Fund and General Fund. It serves as the financial foundation for all enterprise business system modernization across the Air Force. DEAMS provides accurate and timely financial information using standardized business processes and complies with applicable federal laws, regulations, and policies.

Air Force Integrated Personnel and Pay System (*AF-IPPS*) is a comprehensive, self-service, web-based solution currently in development that integrates personnel and pay processes into one system and maintains an official member record throughout the airman's career. Designed to be an FFMIA-compliant system, AF-IPPS functionality will enhance general and application controls.

A member of the Air Force's Wings of Blue Parachute Demonstration Team jumps out of an aircraft during the opening ceremony of Aviation Nation 2017 Nellis Air and Space Expo at Nellis Air Force Base, Nev., Nov. 10, 2017.

Air Force photo by Senior Airman Kevin Tanenbaum

Other Defense Organization ERPs

Defense Agencies Initiative (*DAI*) is a system dedicated to address financial management improvements through standard end-to-end business processes delivered by COTS software. Currently DAI provides Budget to Report, Proposal to Reward, Cost Management, Order to Cash, Procure to Pay, Acquire to Retire, and Hire to Retire capabilities for Fourth Estate organizations.

Enterprise Business System (EBS) uses a COTS product to manage the Defense Logistics Agency's (*DLA*) supply chain management business. EBS also includes Electronic Procurement, Real Property, Inventory Materiel Management and Stock Positioning, and Energy Convergence modules, providing DLA leadership with the tools to respond to new challenges and trends.

Legal Compliance

Antideficiency Act (ADA)

The Antideficiency Act is codified in *31 U.S.C. §§1341(a)(1)*, *1342*, and *1517(a)*. The ADA provides that federal agencies may not obligate or expend funds in excess of the amount available in an appropriation or fund or in advance of appropriations; accept voluntary services on behalf of the Government or employ personal services in excess of that authorized by law, except as it may be necessary in emergencies involving the safety of human life or the protection of property; or obligate, authorize, or expend funds that exceed an apportionment or amount permitted by a regulation prescribed for the administrative control of an appropriation. An ADA violation is a serious matter as it represents a violation of a federal statute. A federal employee who violates the ADA may be subject to administrative sanctions (such as suspension from duty without pay or removal from office) and/or penal sanctions (such as fines or imprisonment).

To improve compliance with and enhance knowledge of ADA requirements, the Department leveraged the DoD FM Certification Program, sponsored by the Office of the Under Secretary of Defense (Comptroller), which requires the FM workforce to complete competencies and other specific courses (including fiscal law training requirements) which relate to the ADA and various other FM topics. Additionally, in keeping with the reporting requirements for violations of the Act under *31 U.S.C §1351*, the Department maintains a close cooperation with the Military Departments and Defense Agencies as they investigate suspected ADA violations. Confirmed ADA violations are reported to the President through the Director of the OMB, Congress, and the Comptroller General of the United States.

During FY 2018, four ADA violations were reported totaling $13.7 million. The cause of the cases were:

- The Department violated the purpose rule by inappropriately paying salaries and benefits;
- The Department violated the purpose rule by inappropriately using funds to train foreign military students and to subsidize cafeteria costs;
- The Department violated the purpose rule by inappropriately using funds to carry out a military construction project; and
- The Department failed to obtain certification and approval before obligating funds for the development of a Defense business system in violation of *10 U.S.C. §2222*.

The Department has implemented several measures to prevent a recurrence of these type of violations such as issuing new policies and guidance and improving procedures and internal controls. Further information about each of the Department's reported ADA violations and the remedial actions taken are included in GAO's annual compilation of *Antideficiency Act Reports*.

Digital Accountability and Transparency (DATA) Act

The Digital Accountability and Transparency Act of 2014 (*DATA Act*) amended the Federal Funding Accountability and Transparency Act of 2006 (*FFATA*) to require the public reporting of additional financial data to supplement the current contract and financial assistance award data on *USASpending.gov*. The goal of the law is to improve the ability of the public to track and understand how the government is spending their tax dollars. The DATA Act requires Agencies to report/certify their financial and award data to the Treasury on a quarterly basis, for public consumption on USASpending.gov. This information includes how much funding the Department receives; where the funding comes from (e.g., appropriations, transfers, and carry-forward balances from prior fiscal years); how the department plans to spend the funding; and how the Department actually spent the funding, to include the disclosure of the entities or organization receiving federal funding via contract and grant awards.

In April 2017, the Department and USACE (whose DATA Act information is audited separately) began submitting the summary level appropriation and obligation information in response to the DATA Act. The Department currently has a statutory waiver, granted by OMB, allowing the Department additional time to compile financial award information that ties together summary obligation data to contract and financial assistance information based on parent award identification. The Department is committed to pursuing every effort to comply with the DATA Act reporting requirements.

Federal Civil Penalties Inflation Adjustment Act

On November 2, 2015, the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015 (*the 2015 Act*) was signed into law, which further amended the Federal Civil Penalties Inflation Adjustment Act of 1990 (*Inflation Adjustment Act*, *28 U.S.C. §2461, note*), to improve the effectiveness of civil monetary penalties and to maintain their deterrent effect. The 2015 Act requires federal agencies to report the most recently published inflationary adjustments to civil monetary penalties in order to ensure that civil penalties under their cognizance are periodically adjusted.

The Department is in compliance with the 2015 Act. Each year, by January 15, the Department publishes inflationary adjustments to civil penalties as a final rule in the *Federal Register*. The implementation of the 2015 Act deters violations of law, encourages corrective action(s) of existing violations, and prevents waste, fraud, and abuse within the Department.

Additional information regarding the types of civil penalties and their amounts is located in the Other Information section of this report.

Fraud Reduction and Data Analytics Act

The Fraud Reduction and Data Analytics Act of 2015 (*FRDAA*) was enacted on June 30, 2016 to help improve the ability of federal agencies to prevent, detect, and respond to fraud. Under the FRDAA, federal agencies are required to (1) conduct an evaluation of fraud risks and use a risk-based approach to design and implement financial and administrative control activities to mitigate identified fraud risks; (2) collect and analyze data on detected fraud to monitor fraud trends and use the data and information to continuously improve fraud controls; and (3) use the results of monitoring, evaluation, audits, and investigations to improve fraud prevention, detection, and response. In FY 2017, the Department conducted a coordinated fraud risk survey throughout the DoD Components (including the Military Departments) to assess the extent of control activities currently in place related to the prevention, detection, and response to fraud. The result of this survey provided the Department with an overview of each DoD Component's knowledge of FRDAA, as well as their approach to identifying and mitigating fraud risks.

In FY 2018, the Department furthered its FRDAA compliance efforts by developing a Department-wide Fraud Risk Management framework to assist DoD Components with adopting the guidance and leading practices prescribed by the GAO, taking steps to align ERM/ICP policies and procedures with the updated OMB *Circular No. A-123*, and revising DoD internal control guidance documents to assist DoD Components with strengthening their internal controls. As these and other efforts progress, the Department will continue to assess the compliance and maturity of fraud risk management programs across the Department, including the evaluation of internal controls related to fraud risks; the use of data analytics in identifying, preventing, and responding to fraud (including improper payments); and the number of fraud risks identified and mitigated. Detailed information regarding the Department's FY 2018 FRDAA compliance efforts is located in the Other Information section of this report.

Grants Oversight and New Efficiency (GONE) Act

The *GONE Act* was enacted in January 2016 to prompt improvements in the timely closeout of federal grant awards and to improve accountability and oversight in grants management. The GONE Act requires the head of each federal agency to submit to Congress, in coordination with the Secretary of the *Department of Health and Human Services* a report on the grants and cooperative agreement awards that were not closed for which the period of performance has elapsed for more than two years. The *FY 2017 DoD Agency Financial Report* included awards meeting this criteria with a period of performance end date of September 30, 2015 or earlier. A status update to the previously reported awards is included in the Other Information section of this report.

To assure compliance with OMB priorities, DoD Components increased staff dedicated to closing awards, including hiring additional experienced senior staff to review documentation and oversee the process; prioritized work schedules to assure timely closeout of the awards; and coordinated with grantees and DoD offices to resolve issues and obtain accurate reports.

Improper Payments Elimination and Recovery Act (IPERA)

DoD Financial Management Regulation Volume 4, Chapter 14, defines improper payments as any payment that should not have been made or that was made in an incorrect amount (i.e., overpayment or underpayment) to an eligible recipient. The definition also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received, or when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation.

In accordance with the Improper Payments Information Act of 2002 (*IPIA*), as amended by the Improper Payments Elimination and Recovery Act of 2010 (*IPERA*) and the Improper Payments Elimination and Recovery Improvement Act of 2012 (*IPERIA*), and OMB Circular No. A-123, *Appendix C*, DoD Components are required to report the status and recovery of improper payments to the President and Congress in the following program categories:

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

The Department is committed to improving payment accuracy in all of its programs. Each DoD disbursing activity is committed to identifying the root causes of improper payments, establishing appropriate sampling methodologies, developing and implementing corrective action plans, and monitoring to ensure prevention of improper payments and compliance with IPERA. In FY 2018, DoD management increased the level of oversight on improper payments which resulted in the Department (1) reporting improper payment estimates below the IPERA statutory threshold of ten percent for each of its eight programs, (2) reducing the number of programs reporting over $100 million in improper payments from five to three, and (3) meeting its target rate of six percent for travel improper payments for the first time in six years.

Several accomplishments during FY 2018 include chartering the DoD Improper Payments Senior Accountable Officials Steering Committee, which will proactively provide oversight to the DoD Payment Integrity Program, implement best practices, monitor performance, and drive action for compliance with IPERA; presenting three Department-wide webinars to communicate the major errors identified in the two highest error reporting programs and inform key stakeholders of specific actions to prevent and reduce improper payments; and implementing a standard corrective action plan within the DoD Payment Integrity Program to address noncompliance and advance the Department's goal to fully comply with IPERA.

The Department has a robust improper payments estimation and reporting process that has been in place for many years, and has been iteratively improved by numerous corrective actions to prevent and reduce improper payments. Preventing and recovering improper payments are among the top financial management priorities of the Department. Detailed information regarding improper payments is located in the Other Information section of this report.

Prompt Payment Act

The Prompt Payment Act (*PPA*) requires federal agencies to pay vendors on a timely basis, to pay interest penalties when payments are made late, and to take early-payment discounts only when beneficial to the government. DFAS complies with the PPA when applicable by statute and regulation and within the terms of the contract. DFAS is responsible for consolidating interest and discount data for the Department, however each DoD Component is responsible for capturing, validating, and explaining the results of their data.

DFAS makes timely payments and has an established metric which tracks interest penalties for late payments to contractors and vendors. Avoidance of interest penalties indicates effective internal controls and efficient processes, and allows funds to be utilized for other mission requirements. The goal for this metric is to average $90 or less in interest dollars paid per million PPA dollars disbursed on a monthly basis across all applicable contracts. The Department has successfully achieved this by meeting or exceeding the average goal every month, with only one exception, since reporting of this metric began in December 2016.

A separate metric tracks the amount of discounts offered within the terms of a contract but not exercised. Although discounts may be offered within a contract they will not be taken if not cost effective, meaning the discount rate offered does not exceed the Treasury *Current Value of Funds Rate*. The quarterly goal for this metric is to average 12 percent or less of Cost Effective Discount Dollars Lost across all applicable contracts. The Department has met or exceeded the average goal five of the last eight quarters.