FY 2019

Management's Discussion & Analysis

Kentucky Air Guardsman Earns Air Force Cross for Valor in Afghanistan

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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 protect the security of the nation. The Department is committed to ensuring the United States (U.S.) military remains the best prepared and most lethal Joint 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 established following World War II. Rapid advances in commercial technologies such as big data analytics, artificial intelligence, robotics, quantum science, autonomy, 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.

Infantry Soldiers with 1st Battalion, 8th Infantry Regiment, 3rd Armored Brigade Combat Team, 4th Infantry Division, fire an FGM-148 Javelin during a combined arms live fire exercise in Jordan on August 27, 2019, in support of Eager Lion.

U.S. Army photo by Sgt. Liane Hatch

In response to this complex global security environment, the Department continues to carry out its mission objectives as outlined in the January 2018 National Defense Strategy (*NDS*). 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. It also articulates an effective strategy to address global security challenges and provide for the common defense. The NDS continues to serve 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.

The Department continues to faithfully implement these lines of effort thanks to the ongoing congressional support provided through the *Bipartisan Budget Act of 2019*, the National Defense Authorization Act *(NDAA) for Fiscal Year 2019*, and the *DoD Appropriations Act of 2019*. This support has enabled the Department to continue to adapt and improve as necessary to execute its critical mission on behalf of the President, the Congress, and the American people. Through the use of creative approaches, sustained investments, and disciplined execution in the field, the Department will continue to foster a dominant Joint Force that will protect the security of the nation, increase American influence, preserve access to markets that will improve the American standard of living, and strengthen cohesion among allies and partners. Although, the Department is currently operating under a continuing resolution, which disrupts progress towards these goals and reduces buying power, the Department appreciates and looks forward to a swift resolution and enactment of the Fiscal Year 2020 authorization and appropriation bills.

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 potential adversaries from aggression. This 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. As such, the Department's management structure and processes are not written in stone, rather, they are a means to an end—empowering the warfighter with the knowledge, equipment, and support systems to fight and win. DoD leaders adapt, consolidate, eliminate, or restructure their organizational structures as needed to best support the Joint Force.

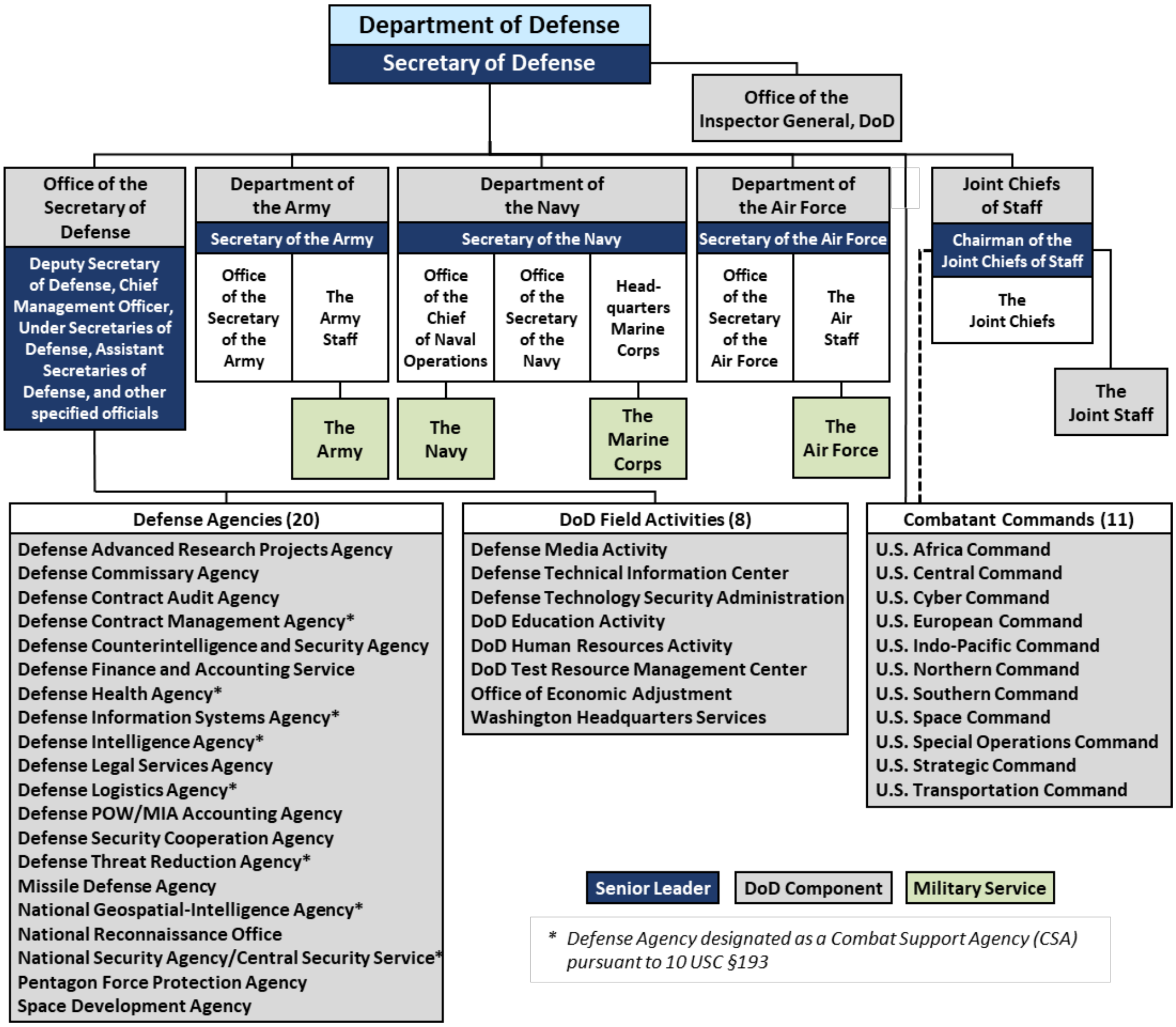
The Department is one of the nation's largest employers, with approximately 1.3 million personnel in the Active Component, nearly 800,000 personnel serving in the National Guard and Reserve forces, and approximately 770,000 civilian employees. DoD Military Service members and civilians operate globally 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 16,000 aircraft and over 290 Battle Force ships.

The Department manages one of the Federal Government's largest portfolios of real property, with nearly 573,000 assets (buildings, structures, and linear structures) located on over 4,500 sites worldwide as of the beginning of Fiscal Year 2019. The Department's assets are situated on sites located in all 50 states, 7 U.S. territories, and over 40 foreign countries. These sites represent a total of nearly 26.3 million acres that individually vary in size from training ranges with over 3.3 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. The acreage consists of various interest types ranging from fee interest (i.e., owned by the U.S. Government) to other legal interests 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

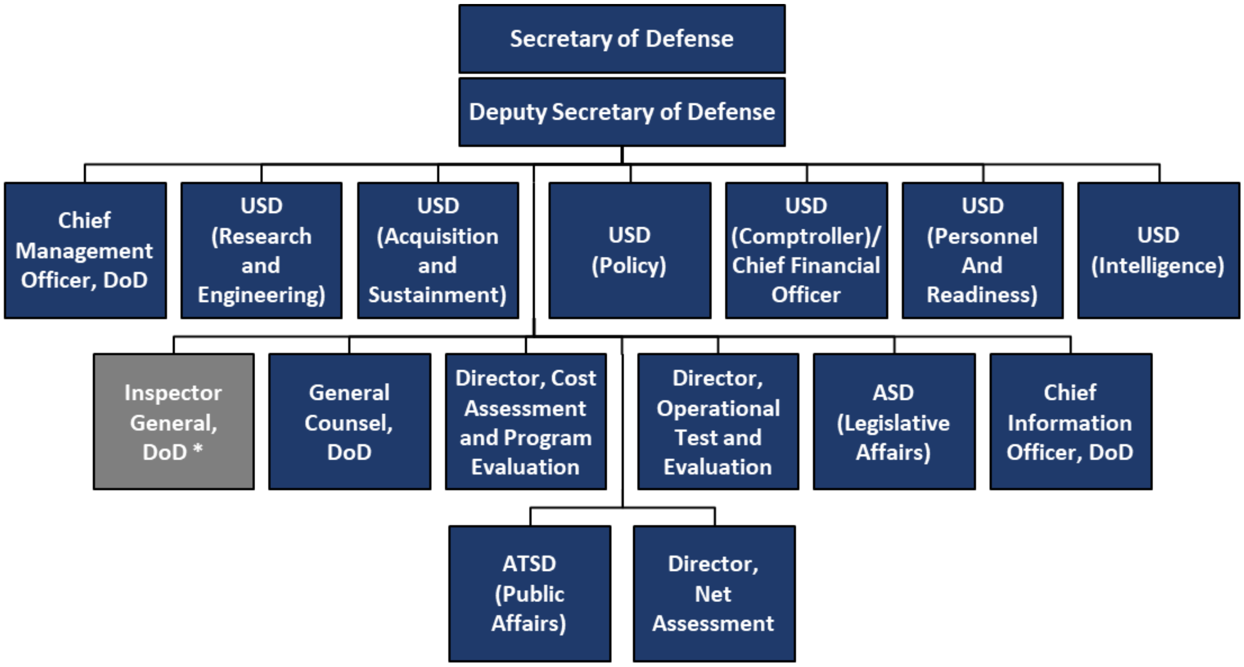


Office of the Secretary of Defense

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 comprises the Deputy Secretary of Defense, 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 under their purview (see Figure 2).

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), and provide administrative and logistics support to the Combatant Commands by managing operational costs and execution. The Combatant Commands are responsible for maintaining the readiness of the forces assigned or allocated to them and are responsible for conducting 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 (see 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, and 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.

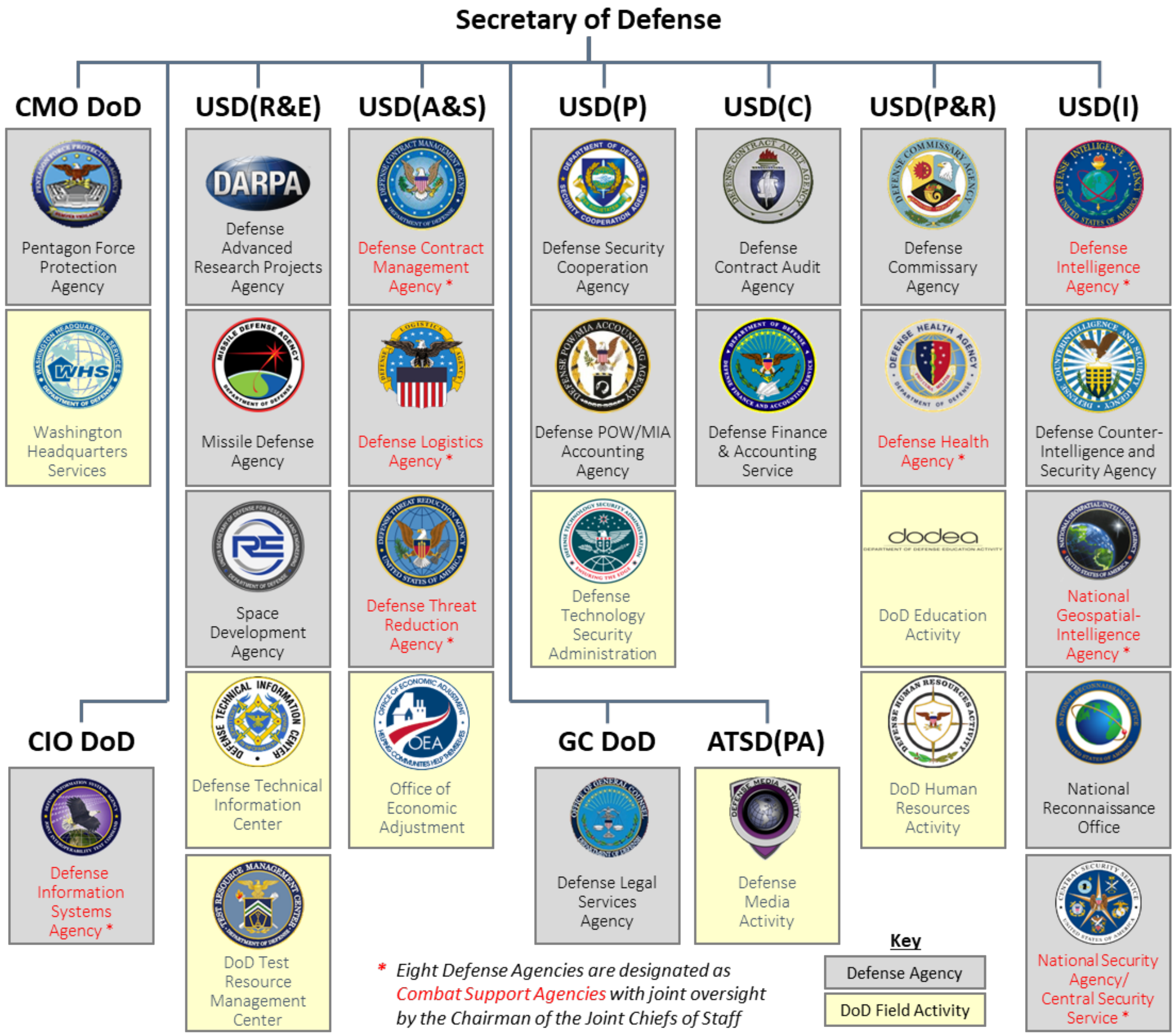
When ordered to active duty for national emergencies or other events, units of the National Guard or Reserve Forces of the Military Services are placed under operational control of the appropriate Combatant Commander or provide support to a Military Service. The National Guard and Reserve Forces are recognized as indispensable and integral parts of the nation's defense and are 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 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 directly support the Combatant Commands. Each of the 20 Defense Agencies and eight DoD Field Activities operate under the authority, direction, and control of the Secretary of Defense through an OSD Principal Staff Assistant (see Figure 4).

Figure 4. Defense Agencies and DoD Field Activities



Combatant Commands

The Commanders of the Combatant Commands are responsible for accomplishing the military missions assigned to them (see Figure 5). 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.

This year, the Department established the United States Space Command (*USSPACECOM*) as the eleventh Unified Combatant Command. The USSPACECOM increases the ability of the Joint Force to project power and influence, reduces decision timelines for space operations, and brings focused attention to defending U.S. interests in space. The USSPACECOM is distinct from and complementary to the proposed U.S. Space Force.

Among Combatant Commands, the U.S. Special Operations Command (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 on the Military Services for ensuring combat readiness of the forces assigned to it.

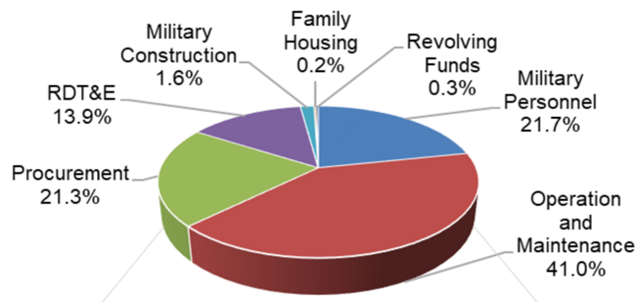
Figure 5. Combatant Commands

Resources

In Fiscal Year (FY) 2019, the Department had discretionary budget authority of $687.8 billion. Figure 6 displays FY 2019 DoD budget authority by appropriation category. These resources and the programs they funded supported the Department's operations consistent with the three NDS lines of effort.

Appropriation Categories

Figure 6. FY 2019 DoD Budget Authority



Appropriation Category	$ in Billions	%
Operation and Maintenance	$281.8	41.0%
Military Personnel	149.4	21.7%
Procurement	146.5	21.3%
RDT&E	95.3	13.9%
Military Construction	11.3	1.6%
Revolving Funds	1.9	0.3%
Family Housing	1.6	0.2%
Total	**$687.8**	**100.0%**

Operation and Maintenance (O&M) – FY 2019 O&M funding increased $8.6 billion over the amount enacted for FY 2018. Funds in this category included major programmatic increases to programs such as the Military Departments' readiness efforts to increase the frequency and quality of individual and collective training, as well as improvements to home station and depot maintenance of weapons systems and platforms. Additionally, $1.2 billion was received to support disaster recovery efforts associated with Hurricanes Florence and Michael as well as flooding in the Midwest.

Military Personnel – FY 2019 Military Personnel funding increased $5.4 billion over the amount enacted for FY 2018. Funds in this category provided for an increase of 16,400 end strength above the FY 2018 authorized levels across all of the Military Services and supported the full implementation of the new *Blended Retirement System*. The increased end strength is designed to grow overall capacity and improve readiness through reduced operational and personnel tempo while addressing advanced capabilities (such as cyber, electronic warfare, and special operations) needed to contend with our most capable potential adversaries.

Procurement – FY 2019 Procurement funding decreased $0.9 billion over the amount enacted for FY 2018. Funds in this category 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. The funding also 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. For instance, the Navy was provided with the necessary funding for the procurement of three Arleigh Burke-class guided missile destroyers, two Virginia-class fast attack submarines, one littoral combat ship, 37 F-35 Joint Strike Fighters, and 24 F/A-18E/F fighters.

Research, Development, Test, and Evaluation (RDT&E) – FY 2019 RDT&E funding increased $3.6 billion over the amount enacted for FY 2018. Funds in this category provided for critical investments in basic and applied technologies, advanced technology development, prototypes, and design and development for major acquisition programs. The funds also provided for upgrades to ensure that weapon systems used today and those developed for the future will provide capabilities to maintain a technological advantage over our potential adversaries. Significant increases in next generation aviation and space systems development led the way, especially with such programs as the Long Range Strike Bomber, F-35 Continuous Capability Development and Delivery, 6th generation jet fighter development, modernization of nuclear enterprise systems, and the Next Generation Overhead Infrared Reconnaissance satellite development. Additionally, the Department solidified its investment in key technologies (such as artificial intelligence, hypersonics, directed energy, and autonomous/unmanned systems) that are likely to revolutionize the future of warfare.

Military Construction – Funds in this category provided for the improvement of existing infrastructure as well as the construction of new facilities for operational and training needs, barracks, and other buildings to support the DoD mission around the world. Additionally, these funds provided support for European reassurance and deterrence initiatives as well as $0.9 billion to repair or replace DoD facilities damaged as a result of Hurricane Florence, Hurricane Michael, and flooding across the American Midwest.

Revolving Funds – Funds in this category included direct appropriations to the Defense Commissary Agency (*DeCA*) that supported its commissary operations, including the cost of operating the commissaries, headquarters operations, and field operating activities.

Family Housing – Funds in this category provided for the construction of new housing, improvements to existing housing units, operation and maintenance of government-owned housing, and the leasing of housing facilities domestically and internationally. Examples of family housing construction efforts supported by these funds include the Army's projects at Vicenza, Italy; Camp Humphreys and Camp Walker in South Korea; and the Navy's project in Guam. The funds additionally provide for the oversight of the Military Housing Privatization Initiative (*MHPI*), which enables the Military Departments to leverage private sector expertise and funding to accelerate the improvement and sustainment of quality installation housing in the U.S. and its territories. Under the MHPI program, private sector partners own, operate, and maintain housing units under a ground lease with the host installation.

A B-2 Spirit Stealth Bomber, assigned to the 509th Bomb Wing at Whiteman Air Force Base, Missouri, two Royal Air Force F-35 Lightning IIs assigned to RAF Marham, England, and two F-15 Eagles assigned to the 48th Fighter Wing at RAF Lakenheath, England, fly in formation behind a KC-135 Stratotanker, assigned to RAF Mildenhall, England, during a training mission for Bomber Task Force Europe on September 16, 2019.

U.S. Air Force photo by Senior Airman Thomas Barley

Illustrative Examples of Resources Expended in Support of the NDS

Rebuilding Military Readiness and Building a More Lethal Joint Force

Prioritizing Preparedness for War

Consistent with the NDS, the FY 2019 budget provided funding to continue building the Joint Force's capacity to deter, defeat, and disrupt aggression in order to protect the American people and defend the nation's vital interests. The Department identified goals and metrics to measure and manage progress toward increasing warfighting readiness, which focus on rebuilding individual Military Service readiness while developing collective and joint capabilities.

As such, each Military Service has unique requirements for meeting its individual readiness goals, which are focused on similar objectives—training, equipment, sustainment, and installations. Readiness improvements enabled by the FY 2019 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 and the conversion of an Infantry Brigade Combat Team to an Armored Brigade Combat Team;
- The Navy achieved their goal of 80% mission-capable rate on its F-18 and F-35 fleets;
- Marine Corps continued modernization programs that directly correlate to improved readiness by reducing unit costs, increasing efficiencies, and providing needed operational capabilities sooner; and
- Air Force increased the availability of air superiority, global precision attack, and rapid global mobility platforms, such as the F-22, F-16, C-5, and KC-135.

The FY 2019 budget also included funding the Combatant Commander Exercise and Engagement and Training Transformation (CE2T2) program, including support for over 100 major annual exercises. CE2T2 exercises support Joint Force readiness, future force development and design, strategic messaging and posture (deterrence and assurance), inter-agency integration, multi-national interoperability, and strengthening of relationships with allies and partners. This is accomplished through the use of realistic and robust combat training, realistic opposing forces, feedback, and lessons learned.

NATO allies demonstrate joint capabilities on land, air and sea for an audience of distinguished visitors and media at Trondheim, Norway during exercise Trident Juncture 18 on Oct. 30, 2018.

U.S. Air Force photo by Tech. Sgt. Brian Kimball

Modernizing Key Capabilities

The FY 2019 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 2019 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 2019 RDT&E program continues its focus on the development and advancement of technologically superior systems, ensuring an overmatched capability to counter any new and emerging threats. These efforts include applied research and development; advanced prototyping to foster innovation and leverage commercial and non-traditional technologies; advanced manufacturing techniques; technology demonstrations; and technology experimentation. The Department's FY 2019 funding for the Science and Technology program increased by more than $1.0 billion to $14.1 billion, including a Defense Advanced Research Projects Agency (*DARPA*) budget of $3.4 billion to develop technologies for revolutionary, high-payoff military capabilities. The Department's increased efforts in prototyping under the 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 robust capabilities in a timely and affordable manner. In addition, the Department is addressing the erosion of technological superiority by identifying and investing in innovative technologies and processes that sustain and advance America's military dominance.

U.S. Sailors from the aviation intermediate maintenance department jet shop performs a jet engine test cell on an F/A-18 Super Hornet jet engine on the fantail aboard the aircraft carrier USS Dwight D. Eisenhower (CVN 69) in the Atlantic Ocean, April 14, 2019.

U.S. Navy photo by Mass Communication Specialist 3rd Class Andrew Waters

Strengthening Alliances and Attracting New Partners

U.S. Army Lt. Col. Angela Gentry, Washington Army National Guard, discusses battle drills with her Malaysian army counterpart, Maj. Nurkhairunisa, during Exercise Bersama Warrior in Malaysia, March 10, 2019.

U.S. Army National Guard photo by Sgt. 1st Class Jason Kriess

The Department's FY 2019 budget included $68.8 billion of Overseas Contingency Operations funds (not including $2.7 billion in Supplemental Disaster Relief funds) primarily to conduct Operation Freedom's Sentinel in Afghanistan, Operation Inherent Resolve in Iraq and Syria, efforts to support European allies and deter aggression, and global counterterrorism operations. These activities included maintaining a U.S. presence to train, advise, and assist Afghan security forces; supporting counterterrorism efforts in Afghanistan; sustaining 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.

Reforming the Department's Business Practices for Greater Performance and Affordability

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. The FY 2019 budget provided funding to support this continued effort in areas such as acquisition reform, infrastructure and support activity reform, increased availability of enterprise-wide data, audit remediation initiatives, and improved cost accounting.

The Department also continues to employ the use of multiple cross-functional teams to identify and implement reforms to improve operational effectiveness and maximize cost efficiencies across the Department, especially those that can provide immediate benefits. These teams receive oversight and guidance from the Reform Management Group—a senior leadership governance board consisting of numerous Principal Staff Assistants—and use data to propose and evaluate reform recommendations.

Additionally, the FY 2019 budget provided funding for the Department to continue the annual financial statement audit regimen in compliance with the *Chief Financial Officer's Act of 1990* and remediate the identified audit findings. 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 annual audits provide valuable feedback that enhance the Department's efforts to improve systems, processes, and internal controls across the organization.

Honoring the Commitment to DoD Personnel

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 they successfully accomplish the arduous mission of defending the U.S. and its interests. Therefore, the Department is committed to providing a robust compensation and benefits package for those individuals willing to serve their country voluntarily.

To demonstrate this commitment, the FY 2019 budget provided for a 2.6% military pay raise effective January 1, 2019 to ensure the Department remains appropriately positioned to compete with the private-sector marketplace for new recruits and to retain a well-trained and quality Joint Force. This adjustment is comparable to the average annual increase in wages and salaries of private industry employees and represents the largest military pay raise in nine years. Additionally, the new Blended Retirement System allows the roughly 80% of Military Service members who serve for fewer than 20 years to accrue a retirement benefit that transitions with them. 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 approximately 9.5 million eligible beneficiaries including all Active Military Service members, retirees, military families, dependent survivors, and certain eligible Reserve Component members.

The DoD civilian workforce—a vital element in maintaining the viability and capabilities of the Joint Force—provide a wide range of services including logistics and supply chain management, financial management, human resource management, cyber defense, information technology management, health care management, and community services. The Department actively utilizes the distinct capabilities provided by Military Service members (in both the Active and Reserve Components), civilian personnel, and contract support to fulfill the DoD mission effectively and efficiently. The Department continues to assess and adjust this personnel mix, as necessary, and employs process automation to realign personnel efforts to high value, high impact areas. Cost savings from these efforts can be repurposed to support force readiness and modernization initiatives.

A U.S. Marine jumps from an MV-22B Osprey aircraft during parachute training operations, Marine Corps Air Station Kaneohe Bay, Marine Corps Base Hawaii, June 7, 2019.

U.S. Marine Corps photo by Cpl. Luke Kuennen

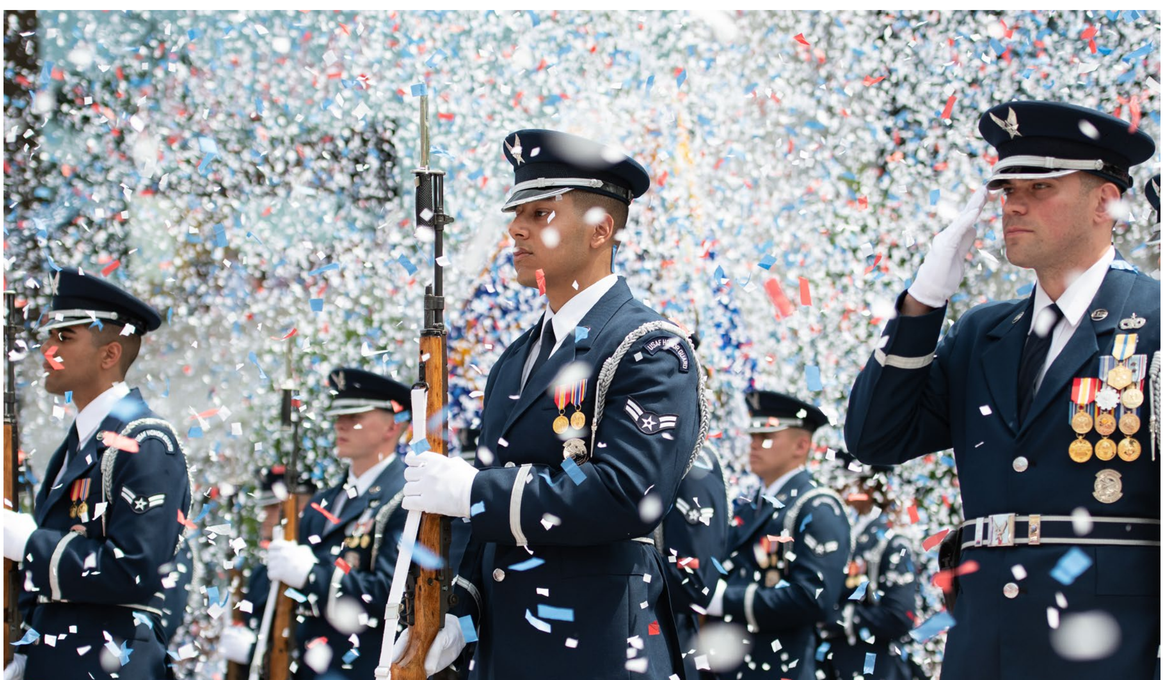
Performance Overview

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. The FY 2018 – FY 2022 National Defense Business Operations Plan (*NDBOP*) guides the execution of the DoD mission by aligning the daily activities of the Department to the lines of effort established in the NDS:

- 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.

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 Department measures implementation of both the NDS and the NDBOP by tracking performance goals and measures that evidence progress towards achieving the NDS lines of effort.

This section provides an overview of the Department's performance results through Quarter 3 (Q3), FY 2019, based on the *FY 2020 Annual Performance Plan* (which covers the FY 2019 budget execution year). Detailed narrative information and performance results that support this overview are available in the Third Quarter, FY 2019 *Performance Results Summary*, which succeeds and fulfills the purpose formerly accomplished by the *Organizational Assessment Report*. Complete FY 2019 performance results through fiscal year-end will be published in the *Annual Performance Report* section of the Department's FY 2021 President's Budget Request in February 2020, which will be available on the Office of the Chief Management Officer's website at *https://cmo.defense.gov*.



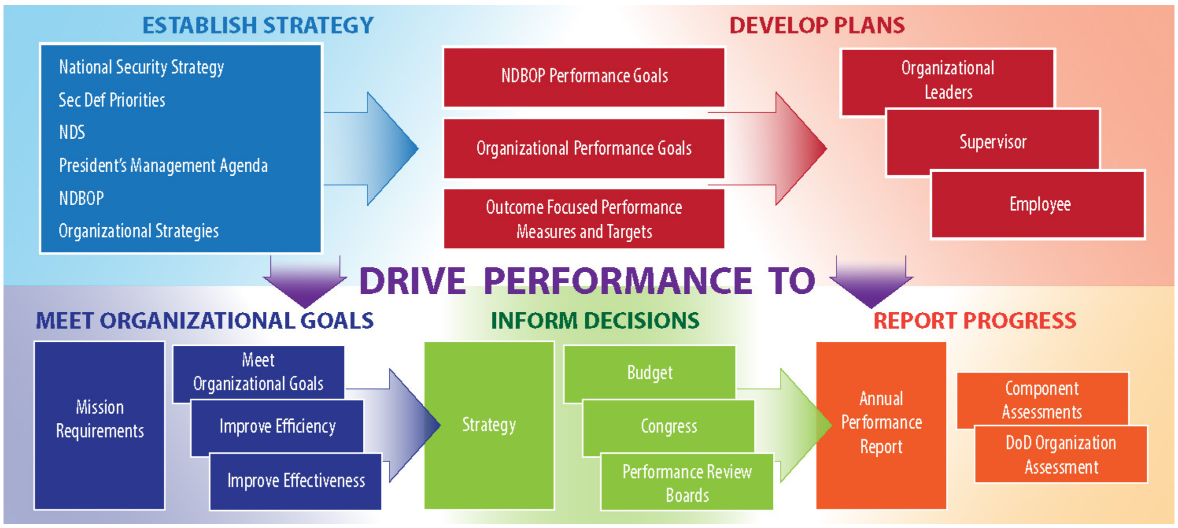
Members of the U.S. Air Force Honor Guard Drill Team stand at attention during the playing of The Star-Spangled Banner prior to the 500 Festival Parade in Indianapolis, May 25, 2019.

U.S. Air National Guard photo by Senior Airman Jonathan W. Padish

Enterprise Performance Management

The Department is a performance-based organization committed to using performance data to drive decision-making and improve business operations. Leaders at all levels throughout the Department are responsible for meeting the performance goals and measures set out in the Annual Performance Plan (APP) that relate to their functional areas. Additionally, the APP performance goals and measures are used to inform critical elements of senior executive performance plans in order to empower leaders to focus on achieving measurable outcomes that align with the NDS and NDBOP (see Figure 7).

Figure 7. DoD Performance Measurement and Evaluation Process



In addition to the APP performance goals and measures, the Department employs hundreds of other performance measures to help assess progress in key areas such as reform, acquisition performance, military readiness, audit remediation, and business process improvement. Together, these datasets help DoD management monitor the entire breadth and scope of the Department's worldwide responsibilities and guide the effective and efficient use of resources. This performance information supports multiple decision-making and accountability efforts such as provision to the Deputy Secretary and Secretary of Defense to inform management decisions, inclusion in budget exhibits to justify funding requests, and submission to the Congress through a wide range of reports to facilitate proper legislative oversight.

A U.S. Army mobile gun system Stryker variant belonging to Quickstrike Troop, 4th Squadron, 2nd Cavalry Regiment fires upon several targets during a week long gunnery range at the Grafenwoehr Training Area, Germany, Feb. 14, 2019.

U.S.Army photo by Sgt. Timothy Hamlin

Summary of Strategic Goals, Objectives, and Performance Results

Figure 8. DoD Strategic Goals and Objectives

Strategic Goal	Strategic Objective
Goal 1: Rebuild Military Readiness and Build a More Lethal Joint Force	1.1 – Restore military readiness to build a more lethal force
	1.2 – Modernize key capabilities
	1.3 – Enhance information technology and cybersecurity defense capabilities
	1.4 – Deliver timely and relevant intelligence to warfighters and decision makers to provide decisive and dominant advantage over adversaries
	1.5 – Implement initiatives to recruit and retain the best total force to bolster capabilities and readiness
	1.6 – Ensure the U.S. technological advantage
	1.7 – Evolve innovative operational concepts
Goal 2: Strengthen Alliances and Attract New Partners	2.1 – Reform the Security Cooperation Enterprise
	2.2 – Expand regional consultative mechanisms and collaborative planning
Goal 3: Reform the Department's Business Practices for Greater Performance and Affordability	3.1 – Improve and strengthen business operations through a move to DoD-enterprise or shared services; reduce administrative and regulatory burden
	3.2 – Expand our data analytics capability and cultivate data-driven solutions
	3.3 – Improve the quality of budgetary and financial information that is most valuable in managing the DoD
	3.4 – Streamline rapid, iterative approaches from development to fielding
	3.5 – Harness and protect the National Security Base

Through Q3, FY 2019 the Department has been successful in meeting or exceeding 92% of the APP performance targets for which performance results were available, including those related to achieving efficiencies, effectiveness, and cost savings; audit remediation; and reforming the Department's business operations. Results for performance targets not measured at Q3 as well as updated performance results for the entire fiscal year (i.e., measured as of Q4) will be published in the Annual Performance Report.

The Department assesses its progress towards the achievement of performance goals and measures using the following threshold definitions:

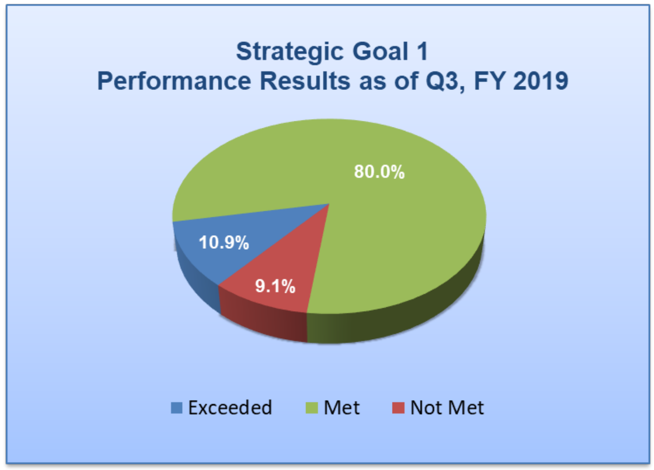
- Exceeded: Actual performance more than 100% of target
- Met: Actual performance 90-100% of target
- Not Met: Actual performance below 90% of target

To ensure the quality of the assessed performance data, the Office of the Chief Management Officer requires written attestation from DoD goal owners attesting that (1) all performance information is complete, accurate, and reliable, and (2) verification and validation procedures were performed on the data, the procedures were documented, and supporting documentation is available upon request.

Strategic Goal 1: Rebuild Military Readiness and Build a More Lethal Joint Force

The surest way to prevent war is to be prepared to win. This requires a competitive approach to force development and a consistent, multiyear investment to restore warfighting readiness. The nation must field a capable and lethal Joint Force that possesses decisive advantages for any likely conflict, while remaining proficient across the entire spectrum of conflict. To support this goal, the Department must gain and maintain information superiority; modernize key capabilities, such as space and cyberspace warfighting domains; and evolve innovative operational concepts for the ways the Joint Force is organized and deployed.

Figure 9. Strategic Goal 1 Performance Result Summary



Central to the achievement of this goal are the people who comprise the DoD workforce. Recruiting, developing, and retaining a high-quality military and civilian workforce is essential for the Department's warfighting and deterrent success. Cultivating a lethal, agile Joint Force requires more than new technologies and posture changes—it depends on the ability of Military Service members and the DoD civilian workforce to integrate new capabilities, adapt warfighting approaches, and improve business practices in order to achieve mission success. The creativity and talent of the combined DoD workforce is the Department's greatest enduring strength, and one that is not taken for granted.

Figure 9 provides summary performance results for the Strategic Goal 1 performance targets measured at of Q3, FY 2019 (55 of 87 performance targets). Updated performance results for all performance targets will be available in the Annual Performance Report.

A formation of U.S. Air Force F-35 Lightning IIs assigned to the 388th and 419th Fighter Wings stationed at Hill Air Force Base perform aerial maneuvers during as part of a combat power exercise over Utah Test and Training Range, Nov. 19, 2018.

U.S. Air Force photo by Staff Sgt. Cory D. Payne

Illustrative Performance Results

Readiness Recovery Framework

During FY 2019, the Department continued to utilize the Readiness Recovery Framework (R2F) to measure, assess, and understand the various metrics that indicate Joint Force readiness. The R2F metrics and goals measure each Military Service's progress related to key readiness drivers such as personnel accessions and retention, training, equipment availability, and maintenance shortfalls. The Department uses this R2F data to help inform policy and programming decisions to improve readiness conditions in line with the NDS, address risks to national security, and identify opportunities for modernization and innovation.

Marines with Combat Logistics Battalion 31 ride aboard a landing craft after completing a simulated Humanitarian Assistance-Disaster Relief mission, Philippine Sea, Feb. 3, 2019.

U.S. Marine Corps photo by Lance Cpl. Harrison C. Rakhshani

As of Q3, FY 2019 the Department conducted semi-annual assessments of Military Service force elements, thereby maturing and improving management's understanding of DoD readiness drivers, contextualizing the number of force elements facing readiness shortfalls, and providing an assessment of progress toward readiness recovery. The R2F was also validated and updated where necessary through the Executive Readiness Management Group (comprised of General/Flag Officers and Senior Executive Service members with expertise in readiness) and reported to the Deputy Secretary of Defense, Secretary of Defense, and Congress. The Department has identified that external factors—such as the lack of stable, predictable, and adequate funding; changes in operational tempo; and real-world actions of near-peer adversaries—may pose challenges to the R2F.

Civilian Time to Hire

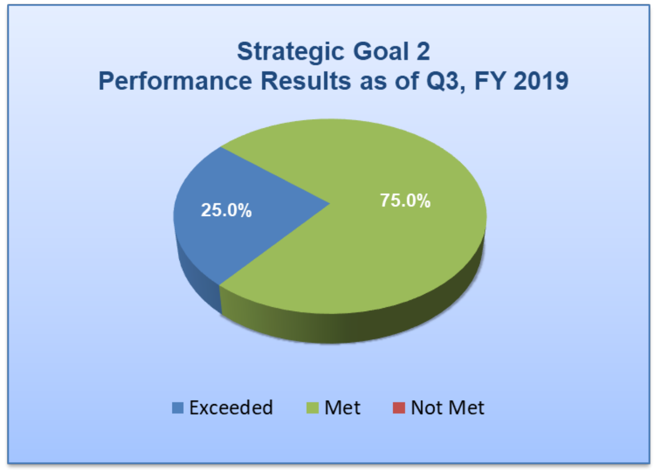
Having a well-staffed and highly capable workforce is of utmost importance to the Department's efforts to improve Joint Force readiness and increase lethality. To accomplish this, the Department must efficiently and effectively hire a diverse cadre of top-quality candidates to provide the skills needed to support the success of the DoD mission now and in the future. The length of the hiring process has a direct impact on the accomplishment of this goal—prolonged hiring times force DoD leaders to operate with limited resources for longer intervals and may result in the loss of top talent to competing opportunities, leaving hiring managers with less qualified candidates.

The Department uses Time to Hire (TTH) as a metric to measure and assess its ability to hire new talent efficiently. The goal for this metric, 80 days, is established by the *Office of Personnel Management* Hiring Elements End-to-End *Hiring Roadmap*. As a result of targeted initiatives—such as Department-wide collaboration on hiring improvement, increased use of available direct hire authorities, and streamlining of the *Priority Placement Program*—the average civilian TTH as of Q3, FY 2019 decreased by nine days as compared to the FY 2018 average of 100 days.

Strategic Goal 2: Strengthen our Alliances & Attract New Partners

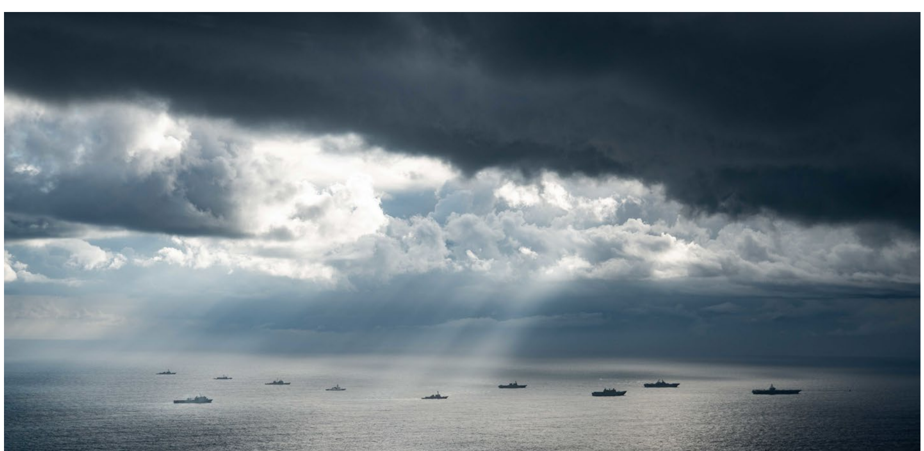
Mutually beneficial alliances and partnerships are crucial to the Department's strategy of providing a durable, asymmetric strategic advantage that no competitor or rival can match. By working together with allies and partners, the Department amasses the greatest possible strength for the long-term advancement of American interests and maintaining favorable balances of power that deter aggression and support the stability of economic growth. Allies and partners provide a wealth of benefits to the accomplishment of the DoD mission such as providing access to critical regions; providing unique perspectives, regional relationships, and information; and supporting a widespread basing and logistics system that underpins the Department's global reach.

Figure 10. Strategic Goal 2 Performance Result Summary



The Department of Defense is part of a broad interagency team working with the *Department of State* and other stakeholders to build international cooperation through bilateral, regional, and broader relationships toward mutually beneficial strategic and operational outcomes. The Department achieves a robust network of allies and partners through a wide range of programs and activities designed to improve security, interoperability and preparedness, and increased capability and capacity. These programs include provision of defense articles and services, institutional capacity building, exercises and training events, military-to-military exchanges, professional military education at U.S. military schools, and collaborating to develop key technological capabilities.

Figure 10 provides summary performance results for the Strategic Goal 2 performance targets measured at of Q3, FY 2019 (8 of 10 performance targets). Updated performance results for all performance targets will be available in the Annual Performance Report.



The Royal Australian Navy amphibious assault ship HMAS Canberra (L 02), the U.S. Navy Nimitz-class aircraft carrier USS Ronald Reagan (CVN 76), the U.S. Navy amphibious assault ship USS Wasp (LHD 1), and the Japan Maritime Self-Defense Force helicopter destroyer JS Ise (DDH-182) sail in formation with 14 other ships from the U.S. Navy, U.S. Coast Guard, Royal Australian Navy, Royal Canadian Navy and Japan Maritime Self-Defense Force (JMSDF) during Talisman Sabre 2019.

U.S. Navy photo by Mass Communication Specialist 3rd Class Jason Tarleton

Illustrative Performance Results

Foreign Military Sales

In accordance with *22 U.S.C. §2752*, the *Secretary of State* is responsible for management and supervision of all aspects of U.S. security cooperation programs – including the Foreign Military Sales (*FMS*) program. The Secretary of Defense implements FMS programs to transfer defense articles and services to the countries and international organizations approved by the Secretary of State. The Department of Defense also prepares the Security Assistance Accounts (SAA) financial statements, which include FMS program financial activity and position. (Note: The SAA financial statements are not consolidated in the DoD Agency-Wide financial statements but are consolidated directly into the *Financial Report of the United States Government* as a separate stand-alone Significant Reporting Entity in accordance with Treasury Financial Manual Volume 1, Part 2, Chapter 4700, *Appendix 1a*.)

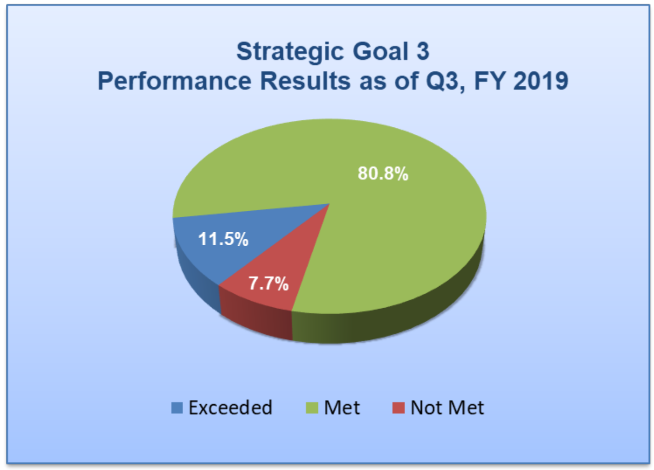
The Defense Security Cooperation Agency (*DSCA*) administers the execution of individual FMS cases by leveraging its existing acquisition and accounting systems to fill orders, primarily by placing them on DoD contracts. In carrying out this role, the DSCA continued focusing on improving overall FMS case development performance through the implementation of incremental process and policy improvements. "Case development" refers to the process for responding to the submission of a Letter of Request for information from an eligible foreign partner; see Security Assistance Management Manual (*SAMM*), *Chapter 5* for additional information about FMS case development. One key performance target established in the SAMM is for implementing agencies to offer or implement 85% of their Letter of Offer and Acceptance documents on or before the relevant anticipated offer date timeline. As of Q3, FY 2019 the performance of this metric increased to 76%, from 70% in FY 2018. Additionally, based on detailed analyses and reviews, the DSCA lowered the FMS administrative surcharge from 3.5% to 3.2% and reduced seven FMS transportation rates by varying amounts.

U.S. Soldiers assigned to the 65th Field Artillery Brigade, and soldiers from the Kuwait Land Forces fire their High Mobility Artillery Rocket Systems (U.S.) and BM-30 Smerch rocket systems (Kuwait) during a joint live-fire exercise, Jan. 8, 2019, near Camp Buehring, Kuwait.

U.S. Army photo by Sgt. James Lefty Larimer

Strategic Goal 3: Reform the Department's Business Practices for Greater Performance and Affordability

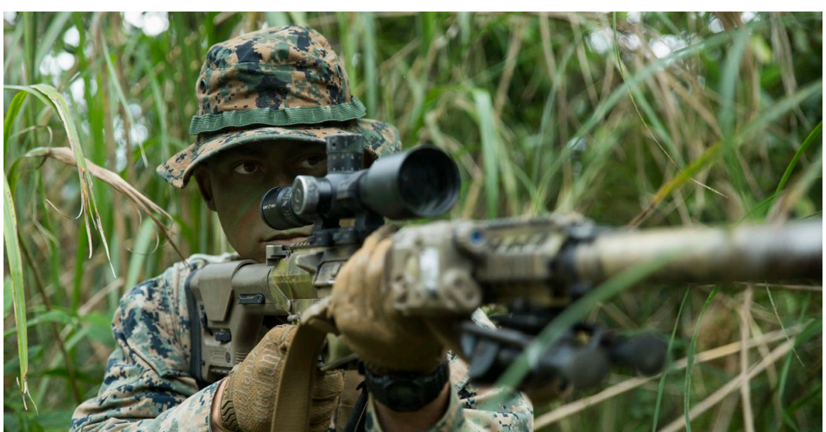
Figure 11. Strategic Goal 3 Performance Result Summary



Over time, the lack of standard business processes have allowed the Department's decision-making to become overly cumbersome, costly, and risk-averse in an attempt to ensure quality of performance. The Department recognizes that in order to face the challenges of its complex and dynamic operating environment, reforms must be implemented to increase the speed with which decisions, policies, capabilities, and information are provided in support of the warfighter. As such, the Department must transition to a management system that allows leadership to harness opportunities for improved efficiency, thereby assuming greater risk at the headquarters level in order to reduce operational risk to the warfighter. This management system must also be coupled with a transition to a culture of performance where results and accountability matter. Together, these changes will help support the Department's goals of supporting Joint Force lethality and fulfilling the responsibility of gaining full value from every taxpayer dollar spent on defense.

In line with this vision, the Department continues to examine all of its business operations to identify time, money, and manpower that can be reallocated to higher priorities (such as enhancing lethality, readiness, and modernization). The reform examinations will be based on cost-informed performance data measured, tracked, and reported by the Office of the Chief Management Officer. This effort is currently demonstrating value as the Department continues to execute the reform agenda outlined in the FY 2019 – FY 2023 Defense Program Review—an estimated $6 billion budget savings have been realized.

Figure 11 provides summary performance results for the Strategic Goal 3 performance targets measured at of Q3, FY 2019 (26 of 60 performance targets). Updated performance results for all performance targets will be available in the Annual Performance Report.



U.S. Marine Corps Cpl. Chancelor J. Kelso, a scout sniper team leader with Weapons Company, Battalion Landing Team, 1st Battalion, 4th Marines, posts security during reconnaissance and surveillance training at Camp Hansen, Okinawa, Japan, Dec. 12, 2018.
U.S. Marine Corps photo by Lance Cpl. Tanner D. Lambert

Illustrative Performance Results

Information Technology

The Department continues to evaluate reform activities related to Information Technology (IT). In FY 2019, the IT reform activities achieved the following:

- Fourth Estate Network and Service Optimization: The Department completed assessments and migration plans for 14 Fourth Estate (i.e., OSD, Defense Agencies, and DoD Field Activities) networks to facilitate migration to a single service provider. The Department also issued a Global Service Desk Request for Quote (RFQ) to enable the consolidation of 17 Fourth Estate help desks to a single enterprise solution and initiated the development of a business case to identify the solution that offers the greatest benefit to the Department.
- Fourth Estate Cloud and Data Center Optimization: The Department completed assessments of approximately 800 Fourth Estate applications/systems to identify opportunities for migration and data center closures. Migration plans were then developed to understand resource requirements and enable tracking of Fourth Estate consolidation progress. This enabled the successful migration of 244 systems to enterprise-level hosting environments and the closure of 17 Fourth Estate data centers.
- Enterprise Collaboration and IT Tools: The Department developed an acquisition strategy to support the issuance of the Defense Enterprise Office Solution (*DEOS*) RFQ. The DEOS contract will create an enterprise collaboration capability for the Department to enable the migration of over 3.1 million Non-classified Internet Protocol Router (NIPR) Network users and over 600 thousand Secret Internet Protocol Router (SIPR) Network users to an enterprise collaboration solution.

Logistics and Supply Chain

In collaboration with the senior logistics commanders and staffs, the Logistics Reform Team developed a portfolio of 24 initiatives around four key themes: (1) standardizing processes and reducing duplication; (2) establishing single process owners and governance structures; (3) leveraging data and data interoperability; and (4) adopting well-aligned and authoritative performance measures. The team then prioritized each initiative by assessing it against projected impact on readiness, projected return on investment, and ease of implementation in order to deliver reform improvements quickly. Against this prioritized list, the Logistics Reform Team developed a number of proofs of concept, most of which are scheduled to be completed by the end of calendar year 2019. These proofs of concept will validate or reject the initial estimated cost/readiness improvements and determine whether the initiatives should be implemented across the enterprise. Examples of logistics reform successes through Q3, FY 2019 include:

- The Secretary of Defense approved three initiatives for implementation:
  - Alternatives to Forecasting Methods provides strategies for setting stock levels that will improve cost and supply availability performance for items with inherently unforecastable demand patterns compared against conventional forecasting methodologies.
  - Enterprise Buying (formerly Strategic Sourcing of Sustainment for Commodity Procurement) will rely on a single organization as the primary buyer to achieve savings through economies of scale.
  - Non-tactical Warehouse Integration (NWI) study showed that vast improvements in space utilization are possible. The Warehouse Utilization effort will implement the findings from the NWI study across the Department.

- Defense Logistics Agency (*DLA*) anticipates $84 million cost avoidance during FY 2019 from efficiencies implemented through consolidation of Industrial Supply, Storage, and Distribution functions.
- DLA realized $25 million in savings in FY 2019 through the Whole of Government initiative, which expanded support to the *Department of Veteran's Affairs* and increased DLA's buying power.

Reduce Regulatory Burden

U.S. Marines with the 12th Marine Regiment, 3rd Marine Division, compete against each other during a field meet at Camp Hansen, Okinawa, Japan, Jan. 18 2019.

U.S. Marine Corps photo by Lance Cpl. D'Angelo Yanez.

A key Administration priority is to reform regulatory requirements that negatively impact the U.S. economy. In accordance with *Executive Order 13777* and OMB *Memorandum M-17-23*, the Department established a goal to review all 716 DoD codified regulations in order to evaluate regulations for consolidation and to eliminate unnecessary, outdated, or ineffective regulations by 25%. This effort will help reduce burden and costs to the public; identify priority regulations that align with the Secretary of Defense's priorities; and improve the business process of issuing regulations.

The DoD Regulatory Reform Task Force review, which was completed by Q1, FY 2019, recommended 248 (35%) regulations for repeal, 49 (7%) for replacement, 80 (11%) for modification, and 339 (47%) for retention. The Department has established a goal of implementing at least 50 Task Force recommendations a year. In FY 2019, through Q3, the Department implemented 44 recommendations that resulted in repealing 35 regulations, replacing 3, modifying 3, and retaining 3.

Enterprise Data

In FY 2018, the Department established its first Chief Data Officer (CDO) to lead the extraction and analysis of data to support business reform. The CDO, in partnership with the Office of the Under Secretary of Defense (Comptroller), is establishing data as a stand-alone shared service, allowing data to be the foundation for business decisions. Data is a strategic, mission-essential asset, rather than an IT consideration. DoD leaders require data-driven insights that provide a "fair and accurate," Department-wide representation of DoD operations and management. Readily available, good quality data (i.e., data that is complete, correct, and current) enables DoD leaders to manage mission performance and accountability, as well as to prioritize and ensure the best use of resources.

In Q3, FY 2019 the CDO developed and implemented Enterprise Cost Management pilot programs for three lines of business (Acquisition, Supply Chain/Maintenance, and Human Resources) to extract common enterprise data from relevant systems and analyze the data to generate operational insights that answer critical business questions from DoD leaders. These pilot programs will evolve into a data management and analytics shared services for the purposes of supporting enhanced oversight and management.

Forward-Looking Information

Over recent fiscal years, the Department has made great strides to improve its current readiness, while simultaneously making significant investments in future capabilities and force modernization. Given the breadth and complexity of its mission, the Department faces a myriad of emerging risks and challenges. Nevertheless, the Department is committed to ensuring a clear-eyed appraisal of these risks and in identifying every opportunity that may optimize its operational performance. These risks include:

Inaccurate/incomplete General Property, Plant and Equipment (PP&E) data may negatively affect decision-making.

Incomplete system records, inability to demonstrate the right of occupancy or ownership, and missing/inadequate supporting documentation for General PP&E may cause inaccuracy in the financial records used by DoD leaders for decision-making. As a result, there exists a risk that DoD leaders may make inefficient asset acquisition and deployment decisions based on inaccurate and incomplete data. To mitigate this risk, DoD leaders prioritized floor-to-book and book-to-floor physical inventories for General PP&E to ensure that all General PP&E are properly accounted for in an accountable property system of record.

The disparate systems that comprise the DoD Information Network may be vulnerable to unauthorized access by internal and external parties.

Over the past decade, DoD core functions have become increasingly reliant on the internet and other networks at various classification levels. Many of these functions (such as financial management, logistics, and personnel services) are split across multiple systems owned by various DoD Components. This wide and disparate systems infrastructure complicates the efficient sharing of information (such as requests for removal or modification of user access); increases the number of attack vectors adversaries could use to gain unauthorized access to sensitive or classified data; and increases the difficulty of implementing consistent, effective cybersecurity protocols. The Department is implementing a wide range of initiatives to mitigate these risks, including increased management and review of user access rights, consolidation of networks through the deployment of Joint Regional Security Stacks, and increased collaboration with private-sector partners through the Defense Industrial Base (DIB) Cybersecurity Program. Additionally, the Department maintains the DoD Cybersecurity Policy Chart to assist cybersecurity professionals in remaining cognizant of the breadth of applicable policies.

The Department's use of unsupported journal vouchers may increase the risk of material misstatements in the DoD financial statements.

The Department continues to operate hundreds of financial and feeder systems across the enterprise. These legacy systems, many of which were designed and implemented in the 1960s, are not able to capture all of the transaction-level data attributes needed to satisfy various accountability and reporting requirements. As a result, the Department must perform manual work-around processes utilizing journal vouchers, some of which are not adequately supported by substantiating documentation. In the absence of support, the accuracy and applicability of the data captured by journal vouchers cannot be verified. To mitigate this risk, the Department is continuing its efforts to aggressively retire and replace legacy systems while conducting analyses to determine the root causes of unsupported journal vouchers to inform the development of corrective actions.

Budget impasses and continuing resolutions may negatively impact DoD planning and readiness.

The Department relies on predictable and timely appropriations in order to conduct long-term planning for continued recovery of military readiness and other key capabilities. The absence of fully enacted appropriations at the beginning of a fiscal year prevent the Department from implementing new operational improvement initiatives, restricts the operations of certain civilian and Reserve Component personnel, and affects the availability of funding for critical weapon systems acquisition and personnel compensation. To mitigate this risk, the Department closely monitors the appropriation process throughout the year and develops contingency plans to ensure the continuation of essential operations in the absence of available appropriations.

Natural disasters may disrupt DoD operations, pose danger to DoD property and personnel, and necessitate additional funding to support disaster recovery efforts.

As DoD installations and personnel are located around the globe, the Department is often affected by a variety of natural disasters. The effects of these events may manifest as costs incurred for preventative relocation of assets and personnel and/or costs to conduct significant repairs. Additionally, supporting American disaster recovery efforts and those of our allies is inherent to the Department's mission of protecting the American people and national interests. To mitigate the financial and operational risks presented by natural disasters, the Department maintains robust continuity of operations plans to ensure availability of critical assets, capabilities, and infrastructure. The DoD OIG conducted an audit of the extent of the Department's natural disaster preparedness as described in *DODIG-2019-086* and found that the Department has implemented a framework of guidance, recurring exercises in disaster scenarios, corrective action programs that incorporate lessons learned and after-action reports, training, advanced contracts, and agreements.

U.S. Air Force Tech. Sgt. Frank Babauta, a structural craftsman with the 254th Rapid Engineer Deployable Heavy Operational Repair Squadron Engineers, assesses a home damaged by Super Typhoon Yutu in the village of Koblerville, Saipan, Commonwealth of Northern Mariana Islands, Nov. 12, 2018.

U.S. Air Force photo by Tech. Sgt. Joshua J. Garcia

Emergence of a new health advisory and potential regulation by the Environmental Protection Agency of an emerging chemical of concern, found in fire-fighting foam used by the Department may necessitate the need for additional funding.

Poly- and Per-Fluoronated Alkyl Substances (PFAS) are a group of chemicals found in everyday consumer items such as non-stick cookware, microwave popcorn bags, fast-food wrappers, water-resistant clothing, shampoo, dental floss, nail polish, and eye makeup. They are also found in firefighting foam, known as aqueous film-forming foam (AFFF), used by the Department, commercial airports, and other industries. In 2016, the *Environmental Protection Agency* issued a drinking water lifetime Health Advisory for perfluorooctane sulfonate (PFOS) and perfluorooctanoic acid (PFOA), two PFASs used widely throughout the United States. The Department is addressing past releases of these chemicals from DoD activities under *42 U.S.C. §9601*, assessing the potential health impacts of exposure to Military Service members; researching fire-fighting alternatives, and evaluating options/requirements involved in altering or replacing equipment used for AFFF distribution.

GAO High Risk List

The Government Accountability Office (GAO) issues a biannual list of programs and operations across the Federal Government that they deem to be a high risk due to their vulnerabilities to fraud, waste, abuse, and mismanagement, or that need transformation. The FY 2019 GAO High Risk List (*GAO-19-157SP*) included the following risks specifically related to the Department:

- DoD Approach to Business Transformation
- DoD Business System Modernization
- DoD Contract Management
- DoD Financial Management
- DoD Support Infrastructure Management
- DoD Weapon Systems Acquisition

GAO measures agency progress in addressing the risks identified in their list along five criteria: leadership commitment; capacity; action plan; monitoring; and demonstrated progress. Based on these criteria, the GAO removed one DoD-specific area (DoD Supply Chain Management) from the previous (FY 2017) High Risk List and documented progress made toward addressing three of the remaining risks (DoD Support Infrastructure Management, DoD Financial Management, and DoD Business System Modernization). The Department is committed to driving continual progress towards addressing these risks in support of more effective and efficient operations.

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 books and 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*). Reports used to monitor and control budgetary resources are prepared from the same books and records. The financial statements should be read with the realization that they are for a component of the U.S. Government.

The DoD Agency-Wide financial statements and accompanying explanatory notes are located in the Financial Section of this report. The principal financial statements include:

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

Engineman 2nd Class Christian McCain of Arlington, Texas engages opposing forces while dismounted with a M240 machine gun. The Coastal Riverine Squadron (CRS) 1 convoy section is being assessed for measure of performance at Naval Air Station Point Mugu, Calif. CRS-1 is qualifying for future mobilization requirements.

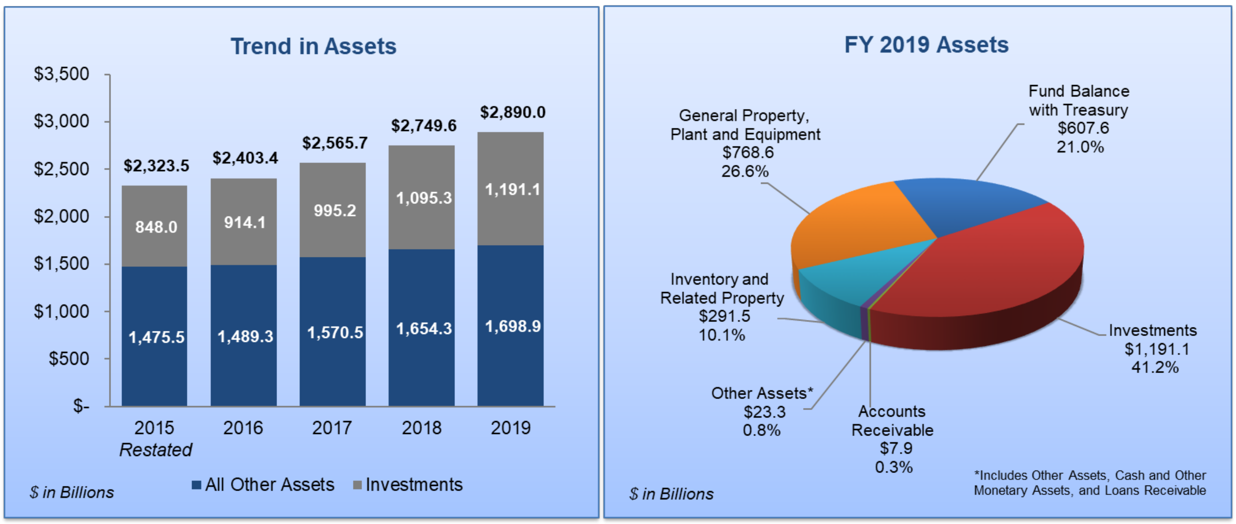
U.S. Navy photo by Hospital Corpsman 1st Class Kenji Shiroma

Balance Sheet

The Balance Sheet, which reflects the Department's financial position as of September 30, 2019 and September 30, 2018, reports probable future economic benefits obtained or controlled by the Department (Assets), claims against those assets (Liabilities), and the residual amounts (Net Position). The Department anticipates annual fluctuations in the Balance Sheet as a result of changes in budget authority and the annual audit, which is driving improved internal controls and more disciplined accounting and financial reporting.

The $2.9 trillion in assets shown in Figure 12 represents amounts the Department owns and manages. Fund Balance with Treasury (FBwT), Investments, Inventory and Related Property (I&RP), and General PP&E represent 98.9% of the Department's assets.

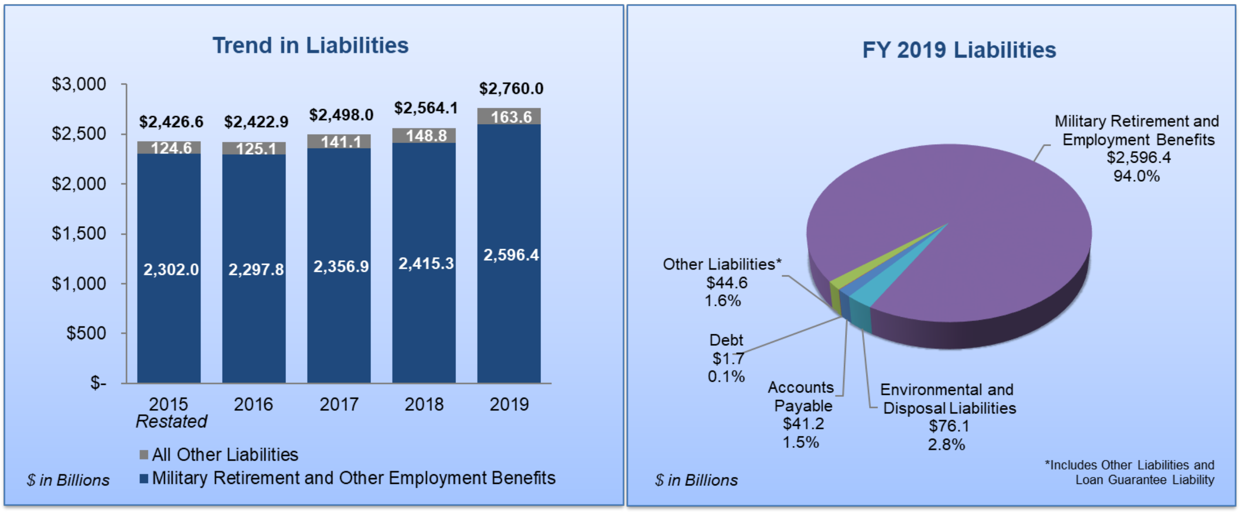
Figure 12. Summary of Total Assets



During FY 2019, total assets increased $140.4 billion (5.1%) from FY 2018, primarily attributable to additional investments in Department of Treasury (*Treasury*) securities ($95.8 billion) to cover the future cost of Military Retirement and Health Benefits. Each year, Treasury contributes a specified sum to cover unfunded Military Retirement and Health Benefits and the Uniformed Services (i.e., the Military Services, National Oceanic and Atmospheric Administration, and the Public Health Service) fund the Department's current year cost. The remaining $44.6 billion increase is primarily attributable to increases in FBwT, I&RP, and General PP&E as a result of additional budget authority (in recent years) and more disciplined accounting practices (e.g., completeness and existence of I&RP and General PP&E, asset valuation, and compliance with accounting standards (capitalization versus expense)).

The Department's $2.8 trillion of liabilities shown in Figure 13 are backed by the full faith and credit of the U.S. Government. Military Retirement/Other Federal Benefits and Environmental/Disposal Liabilities represent 96.8% of the Department's liabilities.

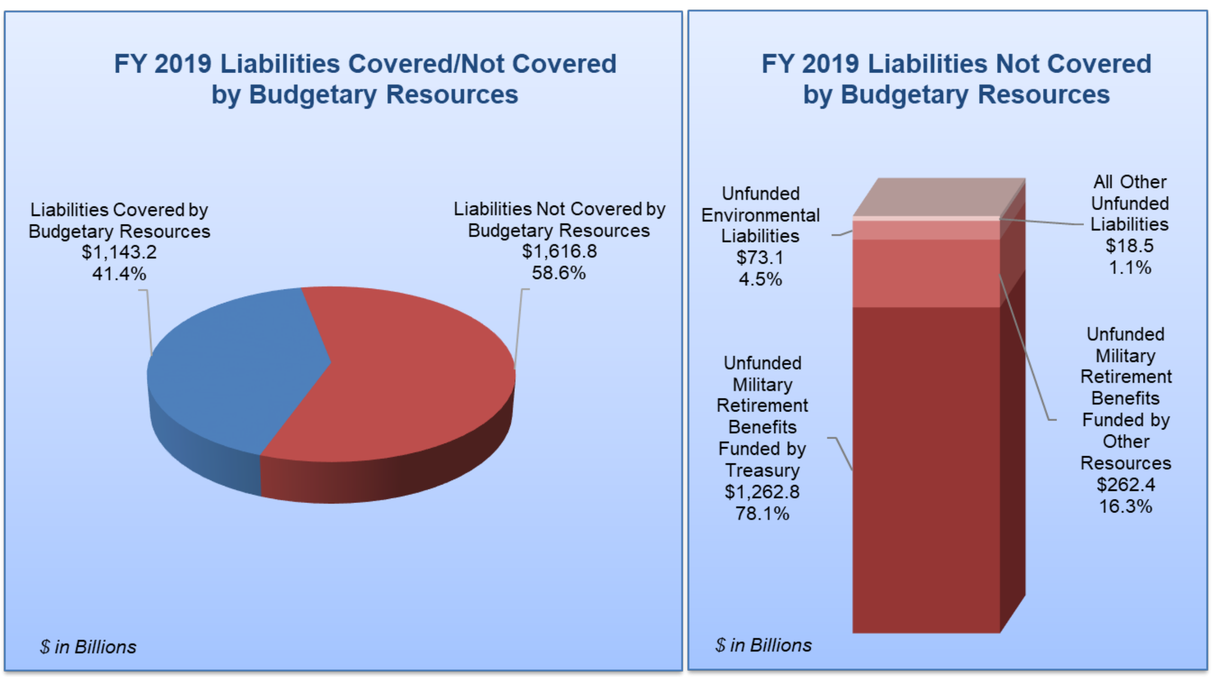
Figure 13. Summary of Total Liabilities



During FY 2019, the Department's total liabilities increased $195.9 billion (7.6%) primarily due to revised actuarial estimates associated with Military Retirement Benefits (an increase of $181.1 billion). This actuarial adjustment considers expected interest costs, normal costs, and changes in actuarial assumptions, net of benefit outlays. The remaining $14.8 billion increase is primarily attributable to additional Environmental and Disposal Liabilities ($5.7 billion) and all other liabilities ($9.1 billion).

Figure 14 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 to be funded by Treasury.

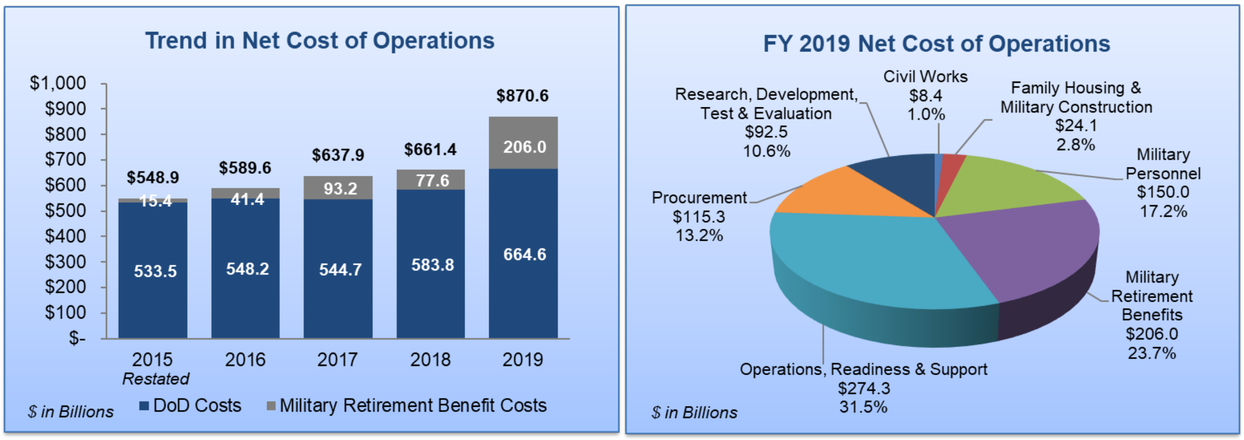
Figure 14. Liabilities Covered/Not Covered by Budgetary Resources



Statement of Net Cost

The Statement of Net Cost presents the net cost of all the Department's programs. The statement reports total expenses incurred less revenues earned from external sources to finance those expenses. Generally, the differences between net costs reflected on the Statement of Net Cost and net outlays reported on the Statement of Budgetary Resources arise from the timing of expense recognition. These timing differences include the capitalization of assets purchased during the fiscal year; changes to the balances of various assets and accrued liabilities; and the depreciation expense on property, plant and equipment. Additional information regarding these differences is located in the Financial Section of this report.

Figure 15. Summary of Net Cost of Operations



Note: The FY 2019 Military Retirement Benefits net program cost does not include a $2.4 billion Loss from Actuarial Assumptions related to pre-Medicare-Eligible Health Benefits that is included in the net program cost of Operations, Readiness and Support.

The Department's seven major programs are reflected in Figure 15. The below outlines the types of costs incurred during the fiscal years ended September 30, 2019 and September 30, 2018, by program:

- Operations, Readiness, and Support includes expenditures from which benefits are derived for a limited period of time, such as salaries and related benefits, minor construction projects, expenses of operational military forces, training and education, recruiting, depot maintenance, purchases from Defense Working Capital Funds (e.g., spare parts), base operations support, and assets with a system unit cost less than the current capitalization threshold.
- Military Personnel includes expenditures for the salaries and other compensation for active military personnel, reserve, and guard forces. Other compensation includes a variety of expenditures, such as housing, subsistence, and other allowances; special pay categories (e.g., incentive pay for hazardous duty); and contributions for future benefits under the Medicare-Eligible Retiree Health Care Fund.
- Procurement includes expenditures for the acquisition of items which provide long-term benefits as well as all costs necessary to bring the items to the condition and location for their intended operational use.
- Military Retirement Benefits includes expenditures that cover eligible members' retirement pay, disability retirement pay, and/or health care benefits for Medicare-eligible members and their dependents or survivors.
- Research, Development, Test, and Evaluation includes expenditures related to efforts that increase the Department's knowledge and understanding of emerging technologies, determine solutions for specific recognized needs, and establish technological feasibility of new developments. These

efforts include all costs necessary to develop and test prototypes, including purchases of end-items, weapons, equipment, components, and materials, as well as the performance of services.

- Family Housing includes expenditures associated with purchasing, leasing, and support services for property that house Military Service members and their families.
- Military Construction includes expenditures related to planning, designing, constructing, altering, and improving the Department's worldwide portfolio of military facilities.
- Civil Works includes expenditures related to Energy and Water Development programs executed by the U.S. Army Corps of Engineers (*USACE*) that primarily fulfill three mission areas: commercial navigation; flood and storm damage reduction; and aquatic ecosystem restoration.

The major programs comprising the greatest share of the Department's costs incurred during FY 2019 were Operations, Readiness, and Support; Military Personnel; and Procurement. The Department's gross costs were offset by 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 $870.6 billion during the fiscal year.

Net Costs increased $209.2 billion (31.6%) in FY 2019, primarily as the result of a $122.1 billion loss from actuarial assumption changes for Military Retirement Benefits, which consider factors such as actual/projected demographic trends and plan amendments.

U.S. Air Force Airman 1st Class Noah Coger, a broadcast journalist with the 86th Airlift Wing public affairs office, shows video to some students of the Home de la vierge des Pauvres Gatagara/Nyanza in the Nyanza District, Rwanda, March 5, 2019.

U.S. Air Forces photo by Tech. Sgt. Timothy Moore

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 obtain a better understanding of the nature of changes to Net Position as a whole. The statement focuses on how the Department's Net Cost of Operations is financed and the resulting effect on the Department's Net Position. The Department's ending Net Position decreased $55.5 billion (29.9%) during FY 2019, which was predominately attributable to the $209.2 billion increase in Net Cost of Operations.

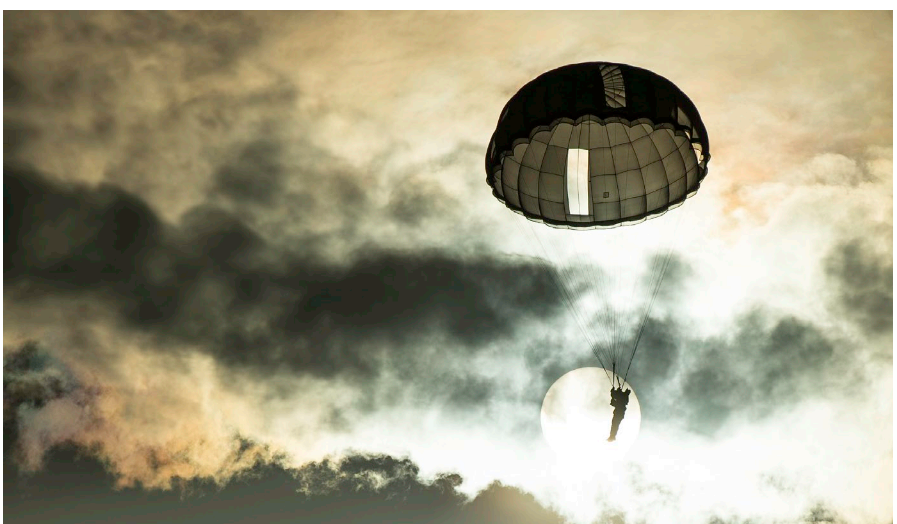
The Department started FY 2019 with a Net Position of $185.6 billion and its Net Cost of Operations in FY 2019 was $870.6 billion. These costs were financed by reduced unexpended appropriation balances ($15.4 billion), adjustments to the beginning Cumulative Results of Operations ($11.5 billion), budgetary financing sources ($766.5 billion), and other financing sources ($21.6 billion) to end FY 2019 with a Net Position of $130.0 billion.

Unexpended appropriations increased $15.4 billion from $529.8 billion in FY 2018 to $545.2 billion in FY 2019, primarily due to a large unexpended balance carried forward from FY 2018 ($71.9 billion) and increased DoD budget authority ($17.2 billion).

The beginning Cumulative Results of Operations were adjusted upward by $7.2 billion through corrections of an error under FASAB Statement of Federal Financial Accounting Standards *(SFFAS) 21*. In addition, the Department adjusted the beginning Cumulative Results of Operations upward by $4.3 billion due to changes in accounting principles primarily related to establishing opening balances and revising valuations for General PP&E, which also increased by the same amount, as the Department continued to implement *SFFAS 48* and *SFFAS 50*.

Budgetary Financing Sources increased by $64.5 billion primarily due to an increase in appropriations used ($62.7 billion), appropriations are the primary source of the Department's financing.

Other Financing Sources increased $13.9 billion primarily due to a $22.0 billion gain from the revaluation of the net book value of equipment being reclassified as inventory offset by $10.3 billion in losses from revaluation of inventory.



A U.S. Army paratrooper descends to a drop zone near Camp Lemonnier, Djibouti, June 10, 2019.

U.S. Air Force photo by Staff Sgt. Devin Boyer

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. In FY 2019, the Department reported \$1.3 trillion in total budgetary authority (as shown in Figure 16).

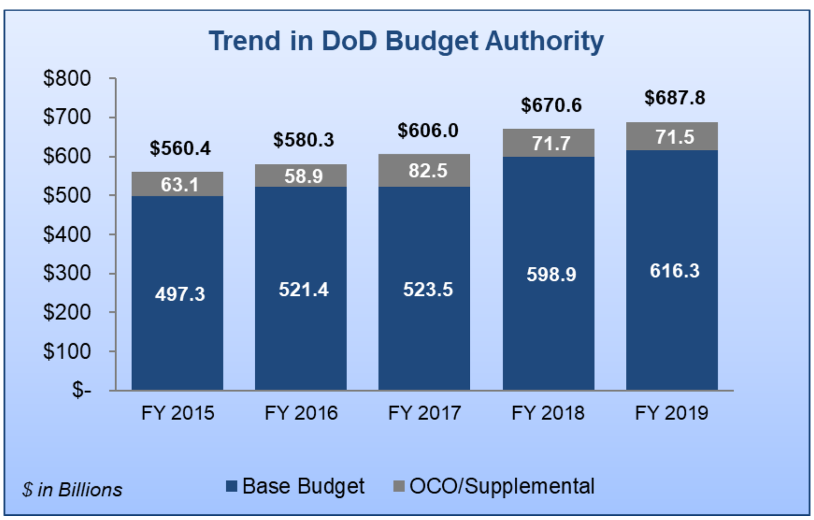
Figure 16. Composition of DoD Total Budgetary Resources

Description	FY 2019 (*\$ in Billions*)	FY 2018 (*\$ in Billions*)
DoD Budget Authority *	\$ 687.8	\$ 670.6
Treasury contribution for Military Retirement and Health Benefits	101.6	96.3
Civil Works Projects executed by USACE	8.2	22.8
Trust Fund Receipts	172.5	164.2
Trust Fund Resources Temporarily not Available	(95.7)	(90.3)
Appropriations (Discretionary and Mandatory) Reported on SBR	**\$874.4**	**\$863.6**
Unobligated Balances from Prior Year Budget Authority	226.8	181.0
Spending Authority from Offsetting Collections	113.0	119.4
Contract Authority	86.8	88.4
Total Budgetary Resource	**\$1,301.0**	**\$1,252.4**

** FY 2019 DoD Budget Authority from Figure 6 and Figure 17*

The total amount of \$874.4 billion for "Appropriations (Discretionary and Mandatory)" reported on the SBR primarily consists of appropriations enacted for the Department, contributions for DoD military retirement and health benefits made by the Treasury, and Civil Works appropriations managed by USACE. Current year Trust Fund Receipts, including those received into the Military Retirement Fund and the Medicare-Eligible Retiree Health Care Fund, 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 17. Trend in DoD Budget Authority



Of the \$1.3 trillion in total budgetary resources, \$1.1 trillion was obligated and \$0.8 trillion 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.

In FY 2019, the Department reduced the amount of expired unobligated balances by \$5.0 billion (\$27.7 billion in FY 2018 to \$22.7 billion in FY 2019) by improving its financial management of expiring resources. In carrying out its operations, the Department must balance the goal of prudently obligating available budget resources before they expire with the mandate to avoid over-obligating or over-expending funds in violation of the Antideficiency Act. The vast amount and variety of contracts, projects, and activities (e.g., construction projects, complex acquisitions, cutting-edge technology efforts, and contingency operations) that must be carried out without exceeding available budget authority often result in adjustments that must be recorded beyond the year(s) of initial obligation, as authorized by *31 U.S.C. §1553*. Consequently, the Department must always maintain a prudent level of expired unobligated appropriations to facilitate these adjustments.

Financial Performance Summary

The Department's financial performance is summarized in Figure 18. This table represents the Department's condensed financial position and results of operations, including comparisons of financial balances from the current year to the prior year. Although the Department received a Disclaimer of Opinion on its financial statements, audit remediation efforts will continue to improve the Department's financial information.

Figure 18. Financial Performance Summary

Dollars in Billions	FY 2019	FY 2018	Increase/(Decrease) $	Increase/(Decrease) %
COSTS				
Total Financing Sources	$ 788.1	$ 709.7	$ 78.4	11.0%
Less: Net Cost	(870.6)	(661.4)	(209.2)	31.6%
Net Change of Cumulative Results of Operations	**$ (82.5)**	**$ 48.3**	**$ (130.8)**	**-270.8%**
NET POSITION				
Assets:				
Fund Balance with Treasury	$ 607.6	$ 580.2	$ 27.4	4.7%
Investments	1,191.1	1,095.3	95.8	8.7%
Accounts Receivable	7.9	7.6	0.3	3.9%
Other Assets *	23.3	32.0	(8.7)	-27.2%
Inventory and Related Property, Net	291.5	275.7	15.8	5.7%
General Property, Plant and Equipment, Net	768.6	758.8	9.8	1.3%
Total Assets	**$ 2,890.0**	**$ 2,749.6**	**$ 140.4**	**5.1%**
Liabilities:				
Accounts Payable	$ 41.2	31.1	$ 10.1	32.5%
Other Liabilities **	46.3	47.3	(1.0)	-2.1%
Military Retirement and Other Federal Employment Benefits	2,596.4	2,415.3	181.1	7.5%
Environmental and Disposal Liabilities	76.1	70.4	5.7	8.1%
Total Liabilities	**$ 2,760.0**	**$ 2,564.1**	**$ 195.9**	**7.6%**
Net Position (Assets minus Liabilities)	**$ 130.0**	**$ 185.5**	**$ (55.5)**	**-29.9%**

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

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

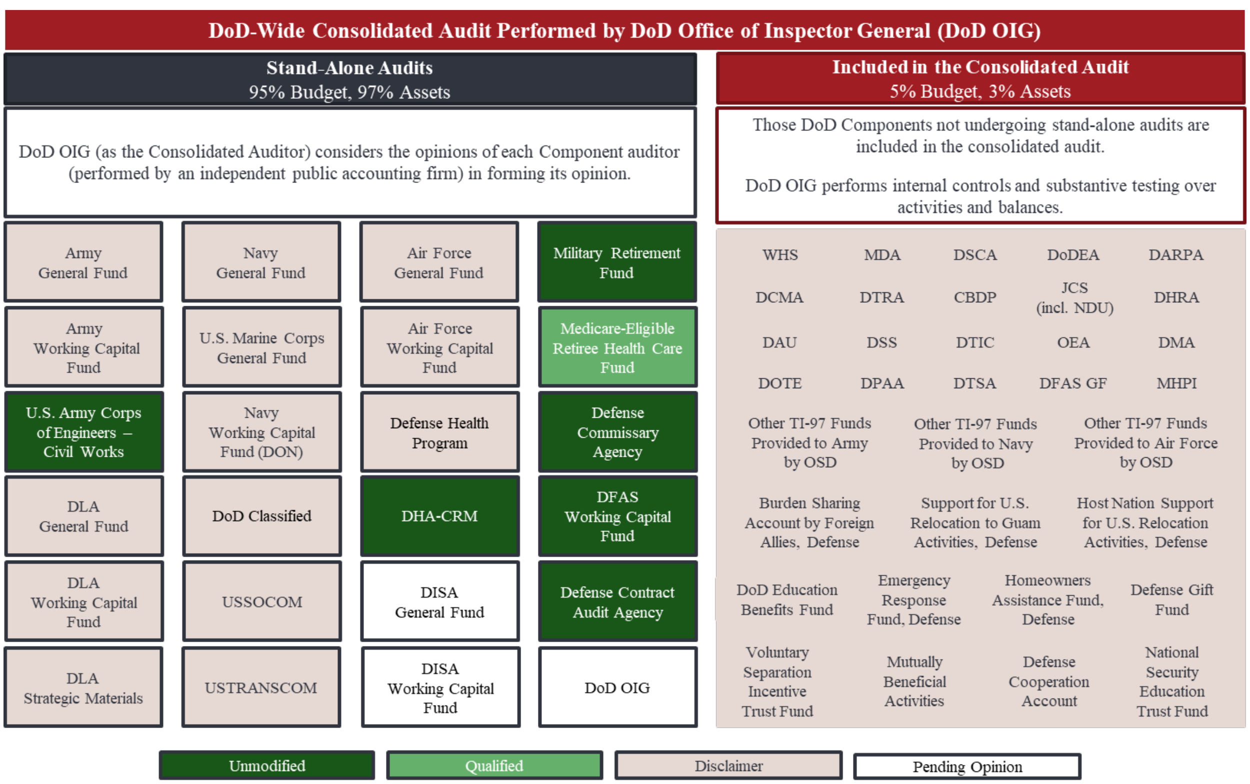
Audit Overview

The annual financial statement audit regimen is foundational to reforming the Department's business practices consistent with the NDS. Data from the audits provide an additional means to define our remediation goals, measure progress, and evaluate alternatives. The FY 2019 audit covered the Department's total assets of more than $2.9 trillion and involved more than 1,400 auditors, who conducted over 600 site visits. Auditor findings and recommendations help DoD leaders prioritize improvements, drive efficiencies, identify issues with systems, measure progress, and inform business reform efforts. The outcomes of the audit remediation efforts will include greater financial data integrity, better support for the warfighter, and increased transparency for Congress and the American people.

FY 2019 Audit Results

Auditors conducted 24 standalone audits of DoD reporting entities and the DoD OIG performed the overarching consolidated audit. Six reporting entities received unmodified opinions, one received a qualified opinion, and three are pending opinion as shown in Figure 19. Opinions for the Defense Information Systems Agency (*DISA*) General Fund, DISA Working Capital Fund, and the DoD OIG are expected to be received in January 2020.

Figure 19. FY 2019 Audit Structure and Results



All other DoD reporting entities received a Disclaimer of Opinion. A Disclaimer of Opinion means the auditor was unable to obtain sufficient appropriate audit evidence on which to base an opinion on the financial statements. The Department's leadership fully expected these results, as receiving a Disclaimer of Opinion is consistent with the experiences of other large and complex federal agencies during their initial years under financial statement audit.

As of November 15, 2019, the FY 2019 audits resulted in the issuance of more than 1,300 Notices of Findings and Recommendations (NFRs). The Department anticipates receiving significantly more NFRs as the auditors finish compiling their findings and developing the related NFRs. In addition to issuing NFRs, each auditor identified the audited DoD Component's material weaknesses in their Independent Auditor's Report. Understanding how the various DoD Component NFRs align to the DoD Agency-wide material weaknesses provides a consistent framework for categorizing NFRs, allows DoD leaders to better prioritize corrective actions, and focuses remediation efforts on the challenges that are the most significant and widespread.

The DoD OIG's Independent Auditor's Report on the FY 2019 DoD Agency-wide financial statements is available in the Financial Section. A summary of the DoD Agency-wide audit- and management-identified material weaknesses, as well as planned corrective actions, is available in Other Information.

FY 2019 Audit Priorities

The Department established its FY 2019 financial statement audit priorities by focusing corrective actions on operational improvements that provided the greatest value to the warfighters in the near-term. Although some issues related to these business areas may require long-term solutions (such as retiring legacy systems), the FY 2019 audit priorities contained various opportunities that were immediately actionable at multiple levels throughout the Department. The FY 2019 audit priorities were:

- Real Property (Existence and Completeness)
- Inventory, and Operating Materials and Supplies
- Government Property in the Possession of Contractors
- Access Controls for IT Systems

Examples of Military Department progress in addressing these priorities include:

- The Army's IT application controls over the Logistics Modernization Program system were found by auditors to be effective and no exceptions were noted in auditor testing;
- The Navy completed 100% inventory of real property assets resulting in a 98% accuracy rate; and
- Air Force completed floor-to-book and book-to-floor inventories over 96% of its buildings.

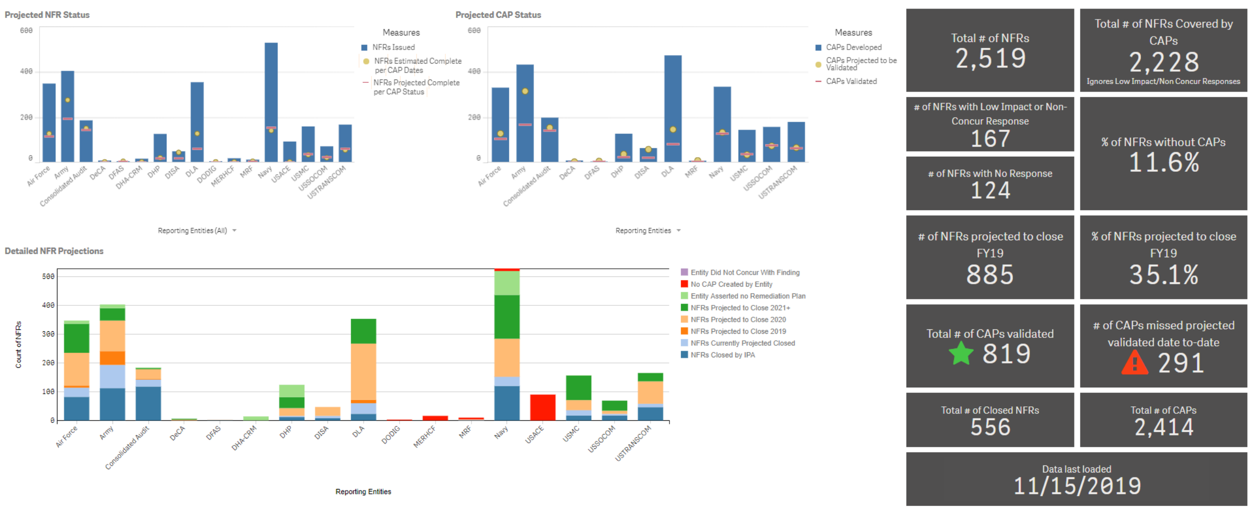
A U.S. Navy MH-60R Seahawk helicopter assigned to the "Spartans" of Helicopter Maritime Strike Squadron (HSM) 70 shoots an AGM-114N Hellfire missile during exercise Baltic Operations (BALTOPS) 2019 in the Baltic Sea, June 14, 2019.

U.S. Navy photo by Mass Communication Specialist 1st Class Theodore Green

Measuring Progress

The number of auditor findings closed and material weaknesses downgraded from year to year is the independent benchmark for measuring progress toward achieving an unmodified audit opinion. During FY 2019, the Department succeeded in closing over 20% of the NFRs issued during the FY 2018 audit. However, many of the corrective actions implemented were not in effect long enough for the auditors to validate their effectiveness in addressing the issues identified in the NFRs. As such, the Department anticipates NFRs closing at increased rates over time as the audit and related remediation efforts mature. As the closings of these NFRs grow, the related material weaknesses are expected to downgrade or be resolved as the effect of implemented corrective actions continue to manifest. See Figure 20 for a snapshot of the status of the Department's FY 2018 NFRs and CAPs as of November 15, 2019. (Note: the numbers in this figure include progress made after the FY 2019 end date of September 30, 2019.)

Figure 20. FY 2018 DoD NFRs and CAPs as of November 15, 2019



Additionally, the Department measures progress by:

- Tracking the achievement of major milestones towards the remediation of complex NFRs;
- Assessing the quality of corrective action plan (CAP) preparation and implementation by comparing them to those previously validated by the auditors as successfully addressing NFRs;
- Identifying areas where auditors are able to rely on internal controls and moving validated CAPs into sustainment;
- Expanding Statement on Standards for Attestation Engagements (SSAE) No. 18 examinations and increasing reliance on System and Organizational Control (SOC) reports over service providers; and
- Increasing reliance on Advana, the Department's advanced data analytics platform, for audit sampling, supporting transaction details in response to auditor requests, monitoring remediation activities, and inspiring data-driven conversation with Components and other stakeholders.

Ultimately, the Department will track progress by the number of reporting entities moving from disclaimers of opinion to qualified opinions and from qualified opinions to unmodified opinions.

Statement of Assurance

November 15, 2019

The Department's management is responsible for establishing and maintaining effective internal controls to comply with the Federal Managers' Financial Integrity Act of 1982 (FMFIA) and the Federal Financial Management Improvement Act of 1996 (FFMIA). In FY 2019, the DoD Office of Inspector General completed its second annual full-scope audit of DoD's consolidated financial statements. The Department continues to use a risk-based approach to address audit findings, and prioritize remediation activities and corrective actions affecting the financial statements. As the Department matures its audit posture, it will continue to improve its controls to support reliable financial reporting; effective and efficient programmatic operations; and compliance with applicable laws and regulations, including federal financial management systems requirements.

The Department assessed the effectiveness of internal controls over financial reporting in accordance with FMFIA §2 and OMB Circular No. A-123. While DoD internal controls continue to improve, the Department concluded that the controls in place to support reliable financial reporting as of September 30, 2019, were not effective to provide reasonable assurance that the financial statements were fairly stated in all material respects. Deficiencies in the design and 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.

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 to support effective and efficient programmatic operations and compliance with applicable laws and regulations as of September 30, 2019. The Department continues to address all material weaknesses, with increased focus in the areas of acquisition, contract administration, resource management, and cyber security.

The Department assessed the compliance of DoD financial management systems with federal financial management systems requirements in accordance with FMFIA §4; FFMIA §803(a); and OMB Circular No. A-123, Appendix D. This requires federal agencies to implement and maintain financial management systems that comply with federal financial management system requirements, applicable federal accounting standards, and the U.S. Standard General Ledger at the transaction-level. 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 comply with the requirements of FMFIA §4 and FFMIA §803(a) as of September 30, 2019.

FMFIA §2, FMFIA §4, and FFMIA §803(a) material weaknesses and corrective actions are further described in Other Information.

The Department remains committed to making significant and measureable improvements in its ability to provide reliable, timely, and useful financial and managerial information to support management decisions. Findings from the annual financial statement audits provide valuable insight critical to achieving the Department's business reform goals and demonstrating its continued commitment to financial accountability and transparency.

Matt T. Esper

Dr. Mark T. Esper
Secretary of Defense

Management Assurances

The Department is committed to ensuring an effective system of internal controls to provide reasonable assurance that its critical mission is met. 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 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 to support effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. The Office of the Chief Management Officer (*OCMO*) and the Office of the Under Secretary of Defense (Comptroller), Office of the Deputy Chief Financial Officer (*ODCFO*) lead the Department's effort in fulfilling this requirement via Enterprise Risk Management (ERM) and Internal Control Program (ICP) responsibilities. The DoD ERM/ICP holds both operational and financial managers accountable for ensuring they are effectively managing risks and internal controls in their areas of responsibility. In accordance with Office of Management and Budget (*OMB*) *Circular No. A-123* and GAO Standards for Internal Control in the Federal Government ("*Green Book*"), the Department continually strives to integrate proactive risk management and effective internal controls into existing business activities.

U.S. Navy Chief Mass Communication Specialist Shannon E. Renfroe photographs F/A-18E Super Hornets from Strike Fighter Squadron (VFA) 136 Knighthawks as they fly in formation during a photo exercise over the Pacific Ocean, March 12, 2019.

U.S. Navy photo by Mass Communication Specialist 2nd Class Morgan K. Nall

The Department advocates a "tone-at-the-top" approach, with an emphasis on the importance of the internal control program. 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. Central to the governance model is the Financial Improvement Audit Remediation Governance Board (FGB). This Senior Executive Committee serves as the Senior Management Council, chartered to assess and monitor deficiencies in internal controls. FGB membership includes the Under Secretary of Defense (Comptroller)/CFO 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 Department-wide deficiencies are reported in a timely manner and associated CAPs are monitored throughout the DoD Components.

In relation to this, the Department continues to work toward the goal of implementing and incorporating ERM into the decision-making process at all levels of management. ERM promotes the identification of a full spectrum of risk registers and prioritizes them into a risk portfolio to inform and impact strategic, operational, reporting, and compliance objectives. In FY 2019, the Department made progress in maturing the ERM/ICP with the goal of integrating risk management and internal controls testing. To achieve this, the Department conducted a thorough risk assessment through the Statement of Assurance process to establish a business operations risk register. This assessment process will ensure that significant business operation risks are identified, addressed, and aligned to DoD Component significant deficiencies and material weaknesses. This risk-based approach assists the 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 the Department has the appropriate oversight to prioritize and mitigate systemic, operational, and financial risks.

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 improvement opportunities 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 financial 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 negatively impact the mission. In addition, the Department is leveraging the financial statement audit as a tool to identify high-risk areas and integrate audit and internal control remediation efforts.

FY 2019 Improvements in Internal Controls

Strong internal controls are essential to achieving and sustaining an efficient and effective organization. Despite many challenges, the Department is steadily improving internal controls, which resulted in cost avoidance and operational improvements. Some significant accomplishments to the internal control environment are highlighted below.

Department of the Army

As of Q4, FY 2019, the Department of the Army has completed the implementation of corrective actions for 65% of the NFRs issued during their FY 2018 financial statement audit related to Information Technology General Controls (ITGCs) over its material ERPs and Legacy Financial and Non-Financial systems. The implemented corrective actions improved the Army's ITGCs related to a variety of systems process areas including access controls, segregation of duties, configuration management, security management, and contingency planning. During FY 2019, the independent public accounting firm conducting the Army's standalone financial statement audit reviewed and validated the effectiveness of 97% of the implemented ITGC corrective actions.

Department of the Navy

In FY 2019, the Department of the Navy initiated an assessment of 30 financially significant applications to identify possible segregation of duties conflicts. To facilitate the assessment, the Navy created an automated tool that allows time-consuming and labor-intensive reviews to be automated. This tool generates a report in as few as five minutes that previously would have taken days to weeks to complete.

The Navy completed a full inventory of all Real Property assets located on Navy installations. The inventory included over 115,000 assets and found approximately 19,600 errors. The errors were evenly divided between existence (the asset was reflected in Navy records but were previously disposed of), completeness (the asset was present on a Navy installation but not reflected in the records), and data attributes (information about the asset was incorrectly reflected in Navy records, such as the use of the wrong facility category code). Navy corrected all of the errors in the accountable property system of record (APSR). Correcting these errors improved the completeness, existence, and accuracy of the data reflected on the Navy's Balance Sheet related to General Property, Plant, and Equipment and contributed to downgrading the associated Navy material weakness.

Department of the Air Force

In FY 2019, the Air Force identified the complete population of programs where contractors possess and manage Air Force-owned spare parts. In order to improve its accountability over Government Furnished Material, the Air Force implemented updated procedures to require contractors to perform an annual review of all Air Force-owned spare parts in their possession and provide the data for reconciliation with the APSR. Sustaining these procedural changes will allow the Air Force to maintain full accountability of its spare parts in the possession of contractors.

Defense Finance and Accounting Service (DFAS)

DFAS implemented new policies and procedures to strengthen its system of internal controls in response to audit findings related to suspense account balances, the Treasury Statement of Differences (SOD), and Cash Management Report (CMR) variances. This resulted in a 95% reduction ($34.0 billion) in DoD suspense account balances, $3.8 billion reduction in Treasury SODs, and $1.5 billion reduction in

CMR variances. As a result, DFAS was able to deliver a complete universe of transactions for these Fund Balance with Treasury risk areas, including beginning balances.

Defense Health Agency (DHA)

DHA developed a series of reconciliations that tie the General Ledger (GL) details from six unique accounting systems to the financial statements. As a result, DHA was able to support the financial statement line items down to the supporting GL system detail for over $22.2 billion in assets. DHA was also able to reconcile trial balances produced by different systems, which helped resolve almost $213.0 billion in variances.

Department of Defense Agency-Wide

Multiple IT NFRs were issued across the Department during the FY 2018 audit related to ineffective or non-existent Access Controls. These NFRs comprised 46% of all FY 2018 NFRs issued. During FY 2019, the Office of the Under Secretary of Defense (Comptroller) partnered with the Office of the Chief Management Officer and the Office of the Chief Information Officer to identify the root causes and begin remediating these NFRs. In July 2019, a joint memo was issued from these offices instructing DoD Components to take action on audit deficiencies with both a high audit impact and high cybersecurity impact. The status of corrective actions for these high priority deficiencies is being actively monitored. In addition, an automated solution for provisioning and managing access to audit-impacting applications has been selected for DoD Components that do not already have this capability in place. This solution will be put in place as the Department pursues a longer term identity and credential management capability. Once fully implemented, the Department anticipates that auditors will validate the effectiveness of these tools in addressing the NFRs, which should be closed as a result.

A U.S. Marine Corps military dog, Larry, is prepared to go with the Maritime Raid Force (MRF), 26th Marine Expeditionary Unit (MEU), is prepared to conduct a raid during Realistic Urban Training (RUT) on Camp Lejeune, North Carolina, June 9, 2019.

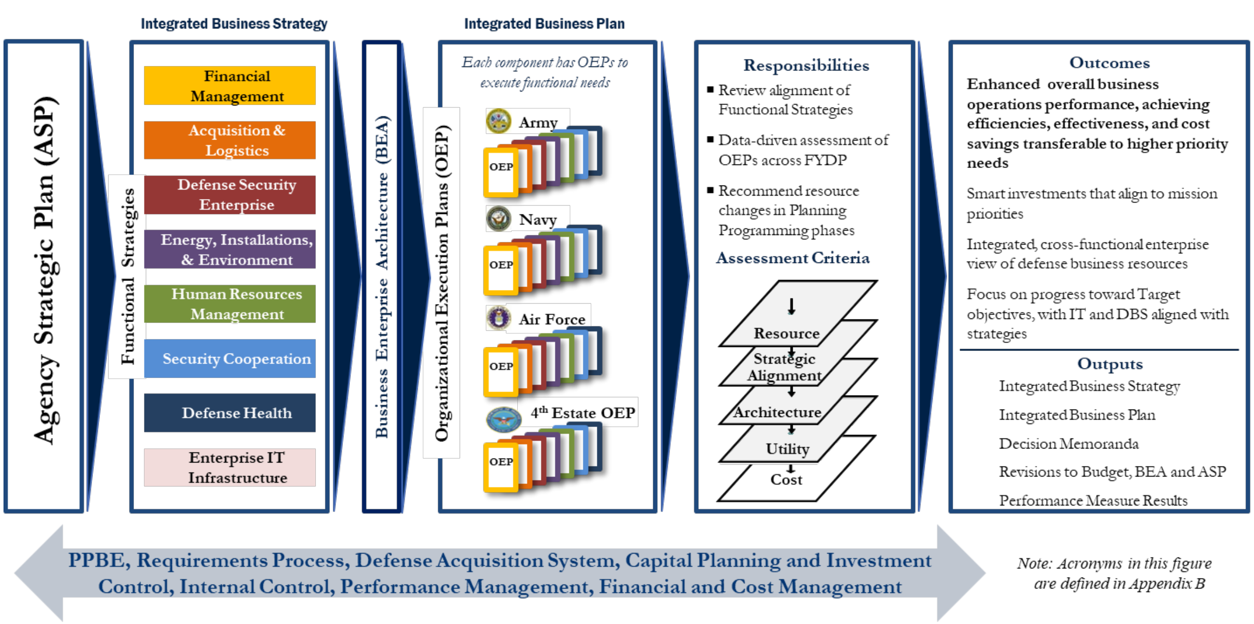
U.S. Marine Corps photo by Cpl. Tanner Seims

Systems Compliance and Strategy

The Department is engaged in a complex and challenging transformation to reform its financial management (FM) environment for enhanced mission effectiveness and auditability. This necessarily includes improving business systems 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 must occur before funds are obligated. The Department's investment review process is used to assess whether investments in business systems align with the Department-wide integrated business strategy (Figure 21). These assessments also include retirement plans for legacy financial systems. The retirement of these systems eliminates redundant activity; maximizes operating efficiency by streamlining business processes; and increases the availability of timely, accurate, and useful business information for use in data-driven decision-making.

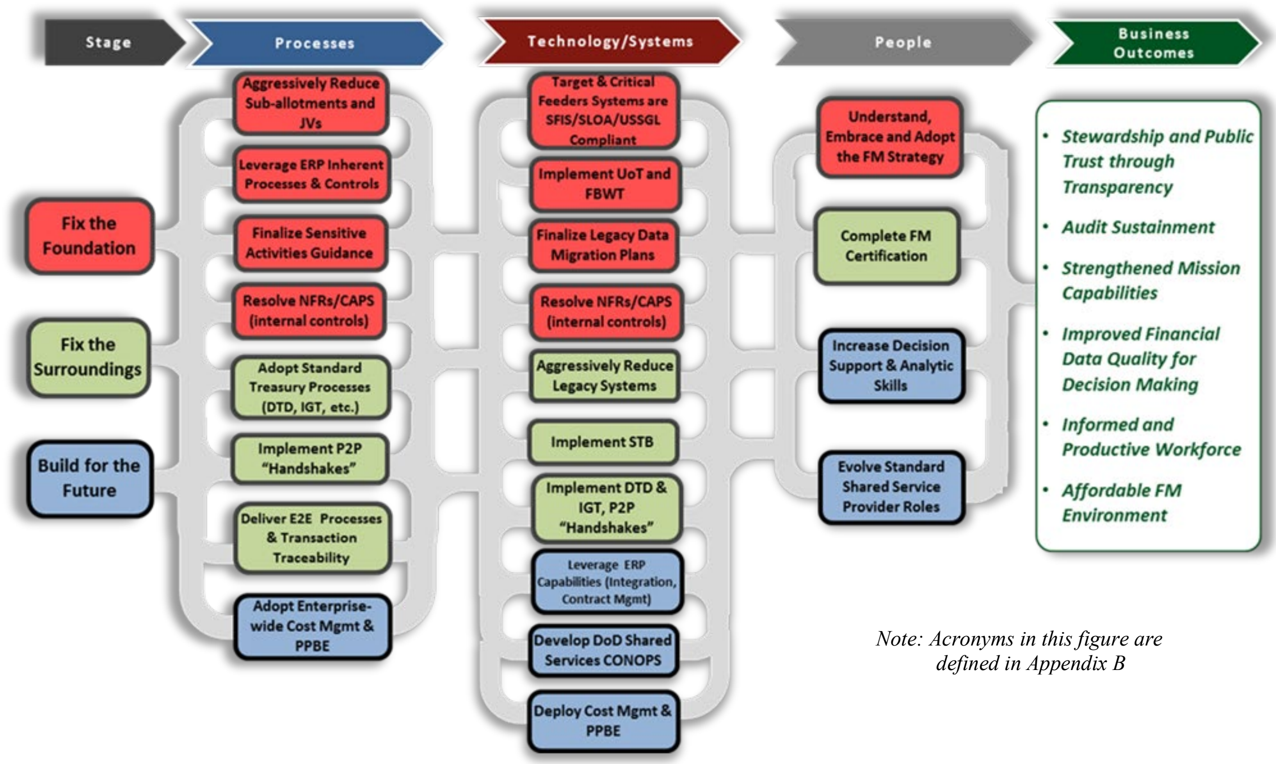
Figure 21. DoD Integrated Business Framework



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 2019 – FY 2023 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 creating data and data exchange standards, implementing system controls and enhancements, establishing standard business 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 business process improvement efforts as well as the Treasury's government-wide accounting, Treasury Disbursing Office (formerly referred to as Treasury Direct Disbursing), and *Intra-Governmental Transactions* initiatives. The Department also promotes the use of business analytics and maximizing existing Enterprise Resource Planning (ERP) systems.

Figure 22. DoD FM Systems Improvement Initiatives



Note: Acronyms in this figure are defined in Appendix B

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 enabling a sustainable audit environment. The ERPs provide a broad range of functionality to support DoD business operations in areas such as 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.

Department of the Army

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 the warfighter 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. Once fully implemented, 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.

U.S. Army Sgt. Madeliene R. Biltz (right), a maintenance chief from San Diego, California, and U.S. Army Pfc. Cody L. Rouse (left), a maintenance crew member from Bull Mountain, Texas, both assigned to Delta Company, 1st Engineers Battalion, 1st Armored Brigade Combat Team, 1st Infantry Division push an Unmanned Aerial Vehicle onto a launching ramp during UAV training at Trzebien, Poland, May 07, 2019.

U.S. Army photo by Spc. Yon Trimble

Department of the Navy

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 focused on the acquisition and implementation of the initial set of logistics capabilities to deliver improved supply, maintenance management services, inventory and equipment accountability, and rapid equipment task organization. As the technology centerpiece of the Marine Corps' overall logistics modernization effort, GCSS-MC provides advanced expeditionary logistics capabilities and functionality to ensure future combat efficiency.

Navy Personnel and Pay System (*NP2*) combines military pay and personnel functions into one seamless COTS system by streamlining existing personnel and pay systems and processes, providing an adaptable solution that meets the complex needs of Sailors, HR employees, and Navy leaders. Once fully implemented, NP2 will provide a platform for future initiatives such as improved marketplace-style detailing, enhanced performance evaluations and management, targeted compensation (e.g., bonuses), and automation of time-consuming back office functions. By streamlining processes and systems, the implementation of NP2 will improve the speed, accuracy, and quality of personnel and pay services.

Department of the Air Force

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. AF-IPPS is designed to be an FFMIA-compliant system and, once fully implemented, will enhance general and application controls.

U.S. Air Force Special Tactics Operators and Jordanian Special Forces protect a patient from sand as a medical helicopter lands for evacuation during a scenario as part of Eager Lion 2019 near Sahab District, Hashemite Kingdom of Jordan, Sept. 3, 2019.

U.S. Air Force photo by Staff Sgt. Rose Gudex

Other Defense Organization ERPs

Defense Agencies Initiative (*DAI*) is a system dedicated to addressing 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 stipulates 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 Federal 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 enhance knowledge and improve compliance with ADA requirements, the Department leverages 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) that 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 2019, four ADA violations were reported totaling $30.4 million. The cause of the cases were:

- The Department violated the purpose rule by inappropriately purchasing supplies from a contractor that did not comply with the requirements of the Berry Amendment (*10 U.S.C. §2533a*);
- The Department violated the purpose rule by incorrectly concluding that an exception to the Berry Amendment applied when executing a contract to procure protective footwear;
- The Department violated the purpose rule by inappropriately obligating and expending Operations & Maintenance (O&M) funds instead of Military Construction funds to convert a building in violation of *10 U.S.C. §§2802* and *2805*; and
- The Department violated the purpose rule by inappropriately obligating and expending O&M funds instead of Research, Development, Testing and Evaluation funds to develop and implement an IT system.

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 Federal Government is spending taxpayer funds. The DATA Act requires federal agencies to report and certify their financial and award data to the Treasury on a quarterly basis, for public consumption on USAspending.gov. This information includes the amount of funding the Department receives; the source of the funding (e.g., appropriations, transfers, and carry-forward balances from prior fiscal years); plans for spending the funding; and the actual use of the funding, to include the disclosure of the entities or organizations receiving federal funds through contract and grant awards.

The Department and USACE (for whom DATA Act submission is audited separately) have been compliant with the DATA Act reporting requirements since September 2018, when they began reporting award financial data for grant assistance and contracts. As of June 2019, the Department reported the alignment of over $52.3 billion across approximately 999,300 active contract and assistance awards (98% of the population) through DATA Act submissions. The Department is fully committed to enabling transparency into the use of the taxpayer dollars entrusted to it as the Department continues to reform and modernize its operations for greater affordability, accountability, and performance.

Federal Civil Penalties Inflation Adjustment Act

On November 2, 2015, the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015 (*the 2015 Act*)—which further amended the Federal Civil Penalties Inflation Adjustment Act of 1990 (*Inflation Adjustment Act*, *28 U.S.C. §2461, note*)—was signed into law to improve the effectiveness of civil monetary penalties and 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 purview are periodically adjusted.

The Department publishes information on these inflationary adjustments to the *Federal Register* separately for the adjustments related to the USACE and those related to the remainder of the Department. 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 within the Department's purview and their amounts is located in Other Information.

U.S. Navy Ensign Lacey Kelley, right, from Tahlequah, Oklahoma, practices taking down a member of the security forces training team after being sprayed with oleoresin capsicum spray during security reaction force basic training on the flight deck of the Arleigh Burke-class guided-missile destroyer USS Stockdale (DDG 106) in the East China Sea Nov. 23, 2018.

U.S. Navy photo by Mass Communication Specialist 3rd Class Abigayle Lutz

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 2018, the Department furthered its FRDAA compliance efforts by developing an enterprise-wide Fraud Risk Management (FRM) framework and appointed the Office of the Under Secretary of Defense (Comptroller) as the lead for supporting the DoD Components in implementing fraud controls.

In FY 2019, all DoD Components conducted enterprise fraud control and fraud risk assessments to establish a baseline for fraud programs across the Department. The results of these assessments will be used to develop a maturity plan to improve fraud mitigation efforts across the Department. The Department strengthened and communicated its commitment to FRM through an annual Town Hall, working groups, newsletters, and employee training. The Department continued to mature data analytics capabilities to detect and monitor fraud, and established an approach to use results from investigations and audits to improve fraud prevention, detection, and response. As these and other efforts progress, the Department will continue to assess the compliance and maturity of FRM across the Department, including the evaluation of internal controls related to fraud risks; the use of data analytics (including improper payments); and the number of fraud risks identified and mitigated. Detailed information regarding the Department's FY 2019 FRDAA compliance efforts is located in Other Information.

Improper Payments Elimination and Recovery Act (IPERA)

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*, the Department is 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

IPIA defines improper payments as any payments 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.

The Department is committed to improving payment accuracy in all of its programs. Each DoD disbursing activity and reporting component 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 2019, the Department accomplished the following to increase the level of oversight on improper payments:

- Implemented a more thorough review of military payroll payments;
- Developed a more thorough review of civilian payroll payments to be implemented in FY 2020; and
- Assessed additional payments (such as transportation, purchase card, civilian mariner payroll, and academy cadet stipends) for risk of improper payments.

The Department has an 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 Other Information.

Prompt Payment Act

The Prompt Payment Act (*PPA*) requires federal agencies to pay vendors timely and to pay interest penalties when payments are made late. The Department complies with the PPA when applicable by statute and regulation and within the terms of the contract. DFAS is responsible for consolidating interest penalty data for the Department; however, each DoD Component is responsible for capturing, validating, and explaining the results of their data.

The Department tracks timely payments through established metrics for interest penalties for late payments to contractors and vendors. The Department's goal is to average $90 or less in interest dollars paid per million PPA dollars disbursed monthly across all applicable contracts. This year, the Department paid an average of $135.51 per million PPA dollars disbursed monthly. The Department is researching the root causes for this deficiency and implementing Department-wide solutions to exceed the goal in the following year.

U.S. Marine Corps Cpl. Katye Spivey, a network administrator with 11th Marine Regiment, 1st Marine Division, practices sword manual for a Command Sponsored Corporals Course (CSCC), at Marine Corps Base Camp Pendleton, California, June 17, 2019.

U.S. Marine Corps Photo by Cpl. Teagan Fredericks