

DEPARTMENT OF DEFENSE

***AGENCY-WIDE
FINANCIAL STATEMENTS***



OVERVIEW

OVERVIEW OF THE REPORTING ACTIVITY

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OVERVIEW OF THE REPORTING ACTIVITY

DESCRIPTION OF THE REPORTING ACTIVITY

The Department of Defense (DoD) is the largest of the fourteen Cabinet-level Departments. The mission of the DoD is to provide the military forces needed to deter war and to protect the security of our country. The major elements of these forces are the Army, Navy, Air Force, and Marine Corps. As of September 30, 1999, full-time military personnel comprising both regular and reserves on active duty and officer candidates, including cadets at the three military academies, numbered 1,385,703.

As a comparison ...

<u>Company</u>	<u>Budget/ Revenue*</u>	<u>Employees*</u>	<u>Bases/ Plants*</u>
DoD	\$270 billion	2,100,000	588
Exn-Mob	203 billion	182,000	140
GM	178 billion	608,000	220
Ford	154 billion	364,000	105
GE	91 billion	276,000	250

America's largest company * 1998 Fortune 500 & corporate data

An additional 65,000 (approximate) full-time military personnel serve reserve components and civil works functions of the U.S. Army Corps of Engineers. The DoD employed roughly 739,000 civilians as of fiscal year-end. The DoD is represented in 137 countries on six continents, in addition to the United States and Territories.

The consolidated, agency-wide DoD financial statements reflect the complex activities of the component entities. Financial statements for eight components are presented, as required by Appendix B, Bulletin 98-08 of the Office of Management and Budget (OMB). Those reporting entities are the general funds of the Departments of the Army, the Navy, and the Air Force; the

Working Capital Funds (WCF) of the Army, the Navy, the Air Force, plus the DoD Military Retirement Trust Fund, and the U.S. Army Corps of Engineers (Civil Works).

The Office of the Inspector General (OIG), DoD, renders opinions on the Department's financial statements. Opinions will be provided for the financial statements of each of the entities identified and the DoD consolidated agency-wide financial statements.

The remaining DoD organizations are included in the consolidated, agency-wide financial statements under the headings "Other Defense Organizations" and "Other Defense Working Capital Funds." These columns include the combined balances of the various Defense Agencies, as well as financial statements for that portion of Defense-wide (appropriation code "97" funds) entrusted to the Military Departments. The DoD Agency-wide statements are subject to audit by the OIG although the IG, DoD does not issue separate opinions on other defense organizations.

Each set of financial statements includes the Overview of the Reporting Activity, Principal Statements and Related Notes, Required Supplemental Stewardship Information (as necessary), Required Supplemental Information, and Other Accompanying Information. The separate financial statements include component-level eliminating entries for the balance sheet, statement of net cost and the statement of changes in net position.

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Organizational Structure of the DoD.



Under the President, who is also Commander-in-Chief, the Secretary of Defense exercises authority, direction, and control over the Department which includes the Office of the Secretary of Defense; the Chairman of the Joint Chiefs of Staff (JCS) and the Joint Staff; three Military Departments; nine Unified Combatant Commands; the IG, DoD; fifteen Defense Agencies; and nine DoD Field Activities.

The Secretary of Defense.



The Secretary of Defense is the principal defense policy advisor to the President, responsible for the formulation of general defense policy and policy related to all matters of direct and primary concern to the DoD, and for the execution of approved policy. Under the direction of the President, the Secretary exercises authority, direction, and control over the DoD.

The Deputy Secretary of Defense.



The Deputy Secretary of Defense is delegated full power and authority to act for the Secretary of Defense and to exercise the powers of the Secretary on any and all matters for which the Secretary is authorized to act pursuant to law.

The Office of the Secretary of Defense.

The Office of the Secretary of Defense (OSD) is the principal staff element of the Secretary in the exercise of policy development, planning, resource management, fiscal, and program evaluation responsibilities.



The OSD includes the immediate offices of the Secretary and Deputy Secretary of Defense, Under Secretary of Defense (Acquisition, Technology and Logistics), Under Secretary of Defense (Policy), Under Secretary of Defense (Comptroller), Under Secretary of Defense (Personnel and Readiness), Director of Defense Research and Engineering, Assistant Secretaries of Defense, General Counsel, Director of Operational Test and Evaluation, Assistants to the Secretary of Defense, Director of Administration and Management, and such other staff offices as the Secretary establishes to assist in carrying out assigned responsibilities.

- The Under Secretary of Defense (Acquisition, Technology and Logistics)

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(USD(AT&L)) is the principal staff assistant and advisor for all matters relating to the DoD acquisition system; research and development; advanced technology; test and evaluation; production; logistics; military construction; procurement; economic security; and atomic energy.

- The Under Secretary of Defense (Policy) (USD(P)) is the principal staff assistant and advisor for all matters concerning the formulation of national security and defense policy and the integration and oversight of DoD policy and plans to achieve national security objectives.
- The Under Secretary of Defense (Comptroller) (USD(C)) is the principal advisor and assistant for budgetary and fiscal matters (including financial management, accounting policy and systems, budget formulation and execution, and contract audit administration and organization), DoD program analysis and evaluation, and general management improvement programs. In addition, the USD(C) is the Chief Financial Officer (CFO) of the DoD.
- The Under Secretary of Defense (Personnel and Readiness) (USD(P&R)) is the principal staff assistant and advisor for Total Force management as it relates to readiness; National Guard and Reserve component affairs; health affairs; training; and personnel requirements and management, including equal opportunity, morale, welfare, and quality of life matters.
- The Assistant Secretary of Defense (Command, Control, Communications, and Intelligence) (ASD(C3I)) is the principal staff assistant and advisor for

C3I, information management, information operations, counter-intelligence, and security countermeasures matters, including warning, reconnaissance, and intelligence and intelligence-related activities conducted by the DoD.

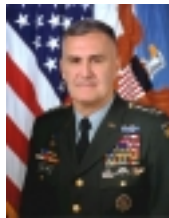
- The Assistant Secretary of Defense (Legislative Affairs) (ASD(LA)) is the principal staff assistant and advisor to the Secretary and Deputy Secretary of Defense for DoD relations with the members of the Congress.
- The Assistant Secretary of Defense (Public Affairs) (ASD(PA)) is the principal staff advisor and assistant to the Secretary and Deputy Secretary of Defense for DoD public information, internal information, the Freedom of Information Act, mandatory declassification review and clearance of DoD information for public release, community relations, information training, and audiovisual matters.
- The General Counsel (GC) of the DoD serves as chief legal officer of the DoD. The GC, DoD is responsible for providing advice to the Secretary and Deputy Secretary of Defense, OSD organizations and, as appropriate, other DoD Components, regarding all legal matters and services performed within, or involving, the DoD.
- The Director of Operational Test and Evaluation (OT&E) is the principal staff assistant and advisor on OT&E in the DoD and is the principal OT&E official within the senior management of the DoD.
- The Assistant to the Secretary of Defense (Intelligence Oversight)

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(ASD(IO)) is responsible for the independent oversight of all intelligence activities in the DoD, to include ensuring that all activities performed by intelligence units and all intelligence activities performed by nonintelligence units are conducted in compliance with Federal law and other laws as appropriate, Executive Orders and Presidential Directives, and DoD Directives System issuances.

- The Director of Administration and Management is the principal staff assistant and advisor on DoD-wide organizational and administrative management matters.

The Joint Chiefs of Staff.



Chairman
General Henry H. Shelton

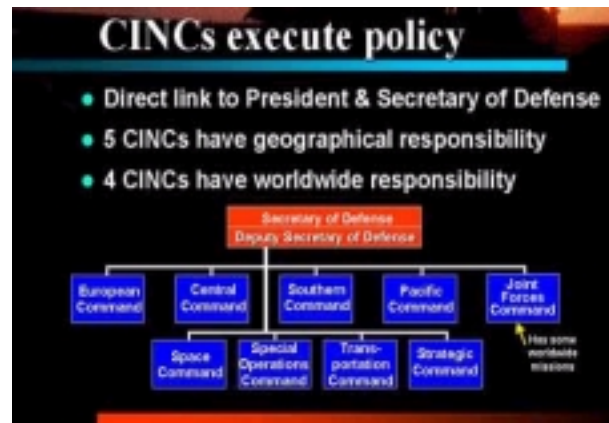
The Joint Chiefs of Staff (JCS), headed by the Chairman of the JCS, consists of the Chairman; the Vice-Chairman, JCS; the Chief of Staff, U.S. Army; the Chief of Naval Operations; the Chief of Staff, U.S. Air Force; and the Commandant of the Marine Corps. Subject to the authority, direction, and control of the Chairman, the Joint Staff supports the JCS. The JCS constitute the immediate military staff of the Secretary of Defense. The Chairman of the JCS is the principal military advisor to the President, the National Security Council, and the Secretary of Defense.

The Chiefs of Service are the senior military officers of their respective Services and are military advisers to the President, the

National Security Council, and the Secretary of Defense, responsible for keeping the Secretaries of the Military Departments fully informed on matters considered or acted upon by the JCS. The Vice Chairman of the JCS performs such duties as may be prescribed by the Chairman with the approval of the Secretary of Defense. When there is a vacancy in the Office of the Chairman or in the absence or disability of the Chairman, the Vice Chairman acts as Chairman and performs the duties of the Chairman until a successor is appointed or the absence or disability ceases.

The Unified Commands.

The Unified Combatant Commands are responsible to the President and the



Secretary of Defense for accomplishing the military missions assigned to them. Commanders of the Unified Combatant Commands exercise command authority over forces assigned to them 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 Unified Combatant Commands. The Chairman of the JCS functions within the chain of command by transmitting to the Commanders of the Unified Combatant

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Commands the orders of the President or the Secretary of Defense. Unified Combatant Commands include the European Command, Pacific Command, Joint Forces Command, Southern Command, Central Command, Special Operations Command, Strategic Command, Transportation Command, and Space Command.

Department of the Army.

Since the birth of our nation, America's Army has served the United States with distinction, both at home and abroad, in peace and in war. At the threshold of the 21st century, the Army is a Total Force, an institution with people at its core-- Active, National Guard, Army Reserve, civilian employees, families, and retired members. The strength and character of the Army's soldiers and civilians are the linchpin in maintaining our Army as the finest in the world.



The Army includes land combat and service forces and such aviation and water transport as have been determined to be necessary. It is organized, trained, and equipped primarily for prompt and sustained combat incident to operations on land. It is responsible for the preparation and sustainment of land forces necessary for the effective prosecution of war except as otherwise assigned and, according to integrated joint mobilization plans, for the expansion of the peacetime components of the Army to meet the needs of war.

The Army's Mission:

A new global security environment exists as a result of social, political, and military changes during the past decade. No longer a world in which two hostile

superpowers face each other, today's environment includes threats--and opportunities--in a wide number of areas. The Army has evolved to be a strategically relevant joint force to meet the challenges of today's world. It is our nation's force of decision--a full spectrum force--trained and ready to respond to a wide range of crises, from fighting and winning major theater wars, to peacekeeping, to humanitarian relief missions and to disaster relief in communities at home. America's Army is a central element of our National Military Strategy, in shaping the international security environment, responding to a wide range of crises, and preparing now for an uncertain future.



The primary mission of America's Army remains constant: to fight and win the nation's wars. In an uncertain world, the Total Army also performs a wide variety of other missions around the world and at home, including:

- Deterring potential adversaries, reassuring and lending stability to allies, and supporting our communities in times of emergency;

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- Preserving the peace and security, and provide for the defense of the United States, the Territories, Commonwealths, and Possessions, and any areas occupied by the United States;
- Supporting national policies;
- Implementing national objectives; and
- Overcoming any nations responsible for aggressive acts that imperil the peace and security of the United States.

The Army provides the nation with unique capabilities for implementing the National Security Strategy. Throughout history, wars have been won by forces on the ground. Only soldiers on the ground can take and hold territory. America's Total Army, with a full spectrum of capabilities, is able to project its forces and establish direct, continuous, and comprehensive control over land, resources, and people to achieve victory and ensure an enduring peace. Whatever the mission, committing the Army commits the Nation. There is no greater expression of national resolve and will than to put our soldiers--America's sons and daughters--on the ground.

Responding to the Nation's Taskings during Fiscal Year 1999

The National Military Strategy requires that the Army be able to respond anywhere in the world across the full-spectrum of military operations. Our capability to deploy worldwide is demonstrated both in exercises and in real-world missions. For FY 1999, the Army averaged 27,504 soldiers (22,901 active duty, 2,780 National Guard and 1,823 Army Reserve) deployed in 70 countries for operations and training missions.

The Army's ability to deploy and fight in a variety of environments was tested in several exercises in FY 1999. Exercise Northern Viking deployed forces from the New York Army National Guard and the U.S. Army Reserve as part of a joint force to defend Iceland. Exercise Intrinsic Action saw the deployment of a heavy task force to Kuwait that utilized prepositioned equipment and trained with Kuwaiti forces. Three rotations of Intrinsic Action were successfully completed during FY 1999.

The Army also demonstrated its capabilities in real-world missions. In FY 1999, the 1st Brigade (-) of the 3rd Infantry Division (Mechanized) deployed to Kuwait when Iraq refused to comply with UN weapons inspections. The brigade (-) deployed by air and used prepositioned equipment to assume a ready posture within 96 hours. Reserve component soldiers provided chemical detection, logistics, air defense, communications, and aviation support. The presence of these soldiers was a clear deterrent to hostile Iraqi activity.

The deployment of the 1st Cavalry Division (-) in late FY 1998 and FY 1999 to the NATO peacekeeping mission in Bosnia is another example of the Army's ability to support global contingencies. By replacing the Europe-based 1st Armored Division, which performed this mission through most of FY 1998, the 1st Cavalry Division (-) released other Europe-based units for much-needed readiness training. The reserve component again provided essential support, with more than 1,300 soldiers mobilized.

Another important illustration of Army readiness was the deployment of elements of V Corps (Task Force Hawk) into Albania as part of NATO Operation Allied Force in response to the crisis in Kosovo. More than 400 reserve component soldiers supported this deployment. Then, as a political solution

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was reached, American soldiers deployed through Macedonia into Kosovo to assume duties as part of the peace-implementation force in Kosovo—KFOR.

In addition to its military operations, the Army is frequently deployed both at home and abroad in response to natural disasters. At home, we provided substantial support to relief operations associated with hurricanes (Georges and Floyd), tornadoes (Oklahoma), wild fires (California and Florida), floods (Texas), and winter storms (New York). Abroad, we responded with support and relief assistance in Nicaragua, Guatemala, and El Salvador following Hurricane Mitch, the worst natural disaster to strike Central America in more than 200 years. During this operation, the Army repaired or replaced 19 bridges, repaired 145 kilometers of road, made more than 1,000 rescues, and provided medical treatment to more than 21,000 victims.

Department of the Navy.

The Department of the Navy (DoN)



consists of two uniformed Services: the United States Navy and the United States Marine Corps. The National Military Strategy specifies three tasks for the

armed forces:

- Shape the international environment;
- Respond to the full spectrum of crises; and
- Prepare now for an uncertain future.

Forward-deployed naval forces are engaged around the world on a daily basis to accomplish each of these tasks. Carrier battle groups and amphibious ready groups

with embarked Marine expeditionary units provide the National Command Authorities (NCA) with a rapid, flexible response capability that is multifaceted and deployable around the world.

The Navy's Mission:

The mission of the Navy is to maintain,



train, and equip combat-ready Naval forces capable of:

- Winning wars,
- Deterring aggression, and
- Maintaining freedom of the seas.

As our Nation looks forward to the dawning of the 21st Century, the DoN continues its campaign to redefine sea power while ensuring that enduring capabilities are sustained. The Navy-Marine Corps team has been addressing numerous challenges to meet the requirements, missions, and threats of the next 25 years and beyond.

Responding to the Nation's Taskings during Fiscal Year 1999

The visibility of U.S. Naval power as a vital instrument of national security was clearly demonstrated in Fiscal Year (FY) 1999 operations. Our Naval forces capabilities and operational flexibility was engaged worldwide. During FY 1999, five Carrier Battle Groups and five Amphibious

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Readiness Groups, manned by more than 55,000 sailors, and more than 33,000 Marine Corps personnel were deployed and ready worldwide. During FY 1999, the nation called upon the Navy and Marine Corps units to:

- Play a key role in Kosovo, including humanitarian aid
- Maintain a continuous carrier presence in the Arabian Gulf
- Provide overseas engagement and promote U.S. influence in East Asia
- Conduct exercises and engagement operations with friends and allies around the globe, thereby enhancing relationships and promoting regional stability
- Provide a wide range of assistance to the Turkish authorities in the wake of the devastating earthquake in Turkey

Throughout the 1990s the support provided by the Naval Reserves has increased each year. During FY 1999, the support provided by the Naval Reserves reached over 2.3 million workdays. In Kosovo, Naval reservists provided more than one-third of the Naval staff for the Joint Task Force headquarters and of the Construction Battalion personnel; all of the Navy air maintenance and ground security force; and flew many EA-6B strike support missions.

The Reserve Civil Affairs Marines were continuously deployed in support of operation Joint Forge, which was a combat and humanitarian operation in Bosnia and Kosovo. The reserve KC-130s provided humanitarian assistance following Hurricanes Mitch and Georges while the engineer and medical detachments of the 4th Force Service Support Group later deployed

to relieve the Active units that were providing hurricane relief in the Dominican Republic.

Operational Challenges for the 21st Century.

The Joint Chiefs of Staff (JCS) publication, *Joint Vision 2010*, defined a common direction for all U.S. military services to meet the challenging and uncertain future. New technologies are to be merged with innovative operational concepts that aim to improve America's ability to conduct joint operations across the full range of peacetime, crisis, and wartime missions. The Navy has responded to the direction in *Joint Vision 2010* and to significant changes at home and abroad by embracing numerous opportunities to be innovative and creative regarding the nation's needs for effective and affordable Naval forces.

Our transformation for the future is, itself, a Revolution in Military Affairs (RMA) driven by technological advances and operational, organizational, and institutional change. Largely the product of rapid commercial innovation, this transformation involves much more than the acquisition of new military systems; it calls for harnessing new civilian technologies and innovative practices to support the Navy-Marine Corps Team's advanced concepts, doctrine and operations.

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“The accomplishments of 1999 underscore that we are dealing with a different kind of world – one in which Naval power reaches further than its traditional domain as an instrument everywhere in the world.”

Richard Danzig
Secretary of the Navy

The Navy’s SmartShip Program has been used to identify the most promising laborsaving technologies available today for back-fit into existing ships and for forward-fit into future designs. The program will “push the edge of technologies” that will save manpower funds and allow a greater proportion of crews to focus on warfighting. The SmartShip approach is also shaping the Navy’s programs for future aircraft carriers, destroyers, and amphibious assault warships.

The United States Marine Corps.

The United States Marine Corps, within the DoN, includes not less than three combat divisions and three air wings, and such other land combat, aviation and other services as have been determined to be necessary. The Marine Corps is organized, trained, and equipped to provide fleet marine forces of combined arms, together with supporting air components, for service with the fleet in the seizure or defense of advanced naval bases and for the conduct of such land operations as may be essential to the prosecution of a naval campaign.



In addition, the Marine Corps provides detachments and organizations for service on armed vessels of the Navy, provides security detachments for the protection of naval property at naval stations and bases, and performs such other duties as the President may direct. However, these additional duties may not detract from or interfere with the operations for which the Marine Corps is primarily organized.



The Marine Corps develops, in coordination with the Army and the Air Force, those phases of amphibious operations that pertain to the tactics, techniques, and equipment used by landing forces. The Marine Corps is responsible, in accordance with integrated joint mobilization plans, for the expansion of peacetime components of the Marine Corps to meet the needs of war.

Department of the Air Force.

Since its inception, the Air Force has built a proud legacy defending the interests of America and its allies around the globe. With the transition from the Cold War security environment complete, the Service has reduced its force structure by one-third and its foreign basing by two-thirds. However, post-Cold War foreign policy has



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required a four-fold growth in the number of overseas deployments since 1989. The Air Force is entering a new era—one in which expeditionary aerospace power is the cornerstone of America’s military strategy and continuous temporary deployments of Air Force resources is the norm. To meet this challenge, the Air Force must convert to an air expeditionary force structure, drawing on the Total Force team of active duty, Air National Guard, Air Force Reserve, and civilian employees. The Expeditionary Aerospace Force (EAF) reorganization adapted a year ago, and just recently implemented, meets both current and future national security requirements and brings with it global reach, power, vigilance, and leadership to the nation.

Air Force Core Competencies

Aerospace Superiority
Rapid Global Mobility
Global Attack
Precision Engagement
Information Superiority
Agile Combat Support.

Organized to Win

Peacetime contingency operations over the past decade have placed heavy demands on Air Force people and equipment. To meet these requirements, the Air Force adopted the Expeditionary Aerospace Force reorganization and related Total Force and aerospace integration reforms.

Expeditionary Aerospace Force

In August 1998, the Secretary and Chief of the Staff of the Air Force announced the EAF concept. EAF provides the commanders in chief (CINCs) better forces and provides more stability and

predictability to the force. EAF represents a major change to the Air Force’s Total Force structure and culture. The concept takes advantage of the unique characteristics of aerospace power—range, speed, flexibility, and precision—and is a powerful tool to U.S. combatant commanders that can be precisely tailored to meet regional requirements. The Air Force operationally linked geographically separated units into 10 Aerospace Expeditionary Force (AEFs), each with a full complement of aerospace power. AEFs are scheduled on a 15-month cycle with 90-day vulnerability periods, while two Aerospace Expeditionary Wings are available for quick response in crisis situations. AEFs provide greater stability and predictability to our force, and allow the Air Force to closely monitor a broad spectrum of its day-to-day costs of doing business and measure the effect of its deployments on major theater war plans. The Air Force continues to hone this concept, incorporating lessons learned from ongoing aerospace expeditionary force deployments.

Total Force Integration

The United States Air Force is an integrated force that relies on critical contributions from active-duty members, guardsmen, reservists, civilians, and contractors. Each brings unique and complementary characteristics to produce a strong and versatile team. The active component drawdown, in concert with the increase in operating tempo, dramatically increased Air Force reliance on the Air National Guard and Reserve.

During this past year, the Air National Guard and Reserve have been called upon to address a growing range of peacetime and contingency operations with their participation instrumental to success.

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Aerospace Integration

The Air Force is committed to further integrating its people and air and space capabilities into a fully capable aerospace force. This objective includes fielding a seamless, integrated aerospace force with the full range of capabilities to control and exploit the aerospace continuum. The Service's overarching objective is to master the application of aerospace power to



support the nation's interests. As the Air Force modernizes both its air and space force structure and develops its aerospace leaders, it will continue to pursue opportunities to enhance its warfighting capabilities for the joint team and nation. The Air Force will make tradeoffs between air, space, and information capabilities to achieve desired effects that will produce the right results. In the long term, the Air Force will be prepared to conduct combat operations in, from, and through space should national policy so dictate.

Conclusion

Our national security depends on aerospace power. It will be the dominant force in expeditionary operations in the 21st century. To that end, your Air Force is organized to

win, preparing for the future, and committed to supporting this aerospace nation's security needs anytime and anywhere.

Responding to the Nation's Taskings during Fiscal Year 1999

During the past year the Air Force has responded to a large number of crises and contingencies in a substantial, significant and successful way. These successes ranged from putting bombs on target in Kosovo and Iraq, preventive contingency operation's, and humanitarian actions at home and around the globe. This year our missions included:

- **Operation Desert Fox** – In November 1998, we again increased our forces in the Persian Gulf area to nearly 350 aircraft and 10,000 people.
- **Allied Force** – Yugoslav's President Milosevic actions in Kosovo started to pose a serious threat to stability in the Balkans. During this mission, the Air Force:
 - *Deployed more than 17,000 people and 500 aircraft;*
 - *Flew more than 11,000 aircraft sorties moving hundreds of millions of pounds of cargo;*
 - *Operated from five fixed and about 24 expeditionary bases throughout Europe including locations in Hungary, France, Crete, Spain and other North Atlantic Treaty Organization (NATO) countries;*
 - *Flew for the first time in combat the stealthy B-2 bomber.*

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- **Operation Northern/Southern Watch**
The Air Force continues to fly extensive sorties as part of Operation Northern/Southern Watch. Constantly patrolling no fly zones in northern and southern IRAQ - in support of United Nations' (U.N.) resolutions subsequent to the Gulf War.
- **Operation Stabilize** - The Air Force is providing logistical support, mainly through C-130 sorties, for the U. N. peacekeeping operation in East Timor. In addition to this military support the Air Force is also flying food and other supplies to tens of thousands of refugees in both East and West Timor.
- **Counterdrug/Counterterrorism** - The Air Force continues to play an important role assisting drug enforcement agencies. To combat terrorism, the Air Force created new vulnerability assessment teams and conducted 36 vulnerability assessments at air bases and operating locations around the globe.
- **Humanitarian Missions** - The Air Force continues to respond to humanitarian needs around the globe. The U. S. Air Force, along with the other services, deployed to Tirana, the capital of Albania, in support of Operation Shining Hope -- an international effort to feed, cloth and shelter hundreds of thousands of Albanian refugees who were displaced, by the civil conflict in Kosovo. Throughout the year the Air Force went to such diverse places as, Nicaragua and El Salvador in the wake of Hurricane Mitch. The Air Force also played a key humanitarian role here at home. When floods devastated North Carolina, the 920th Rescue Group flew 10 to 12 hours a night for three

consecutive nights helping to save more than 300 people stranded by the floods.

The Inspector General of the Department of Defense.

The Inspector General of the DoD (IG, DoD) serves as an independent official in the DoD who is responsible for initiating, conducting, supervising and monitoring investigations and inspections relating to programs and operations of the DoD.

The Defense Agencies.

The Defense Agencies, authorized by the Secretary of Defense pursuant to the provisions of Title 10, United States Code, perform selected support and service functions on a Department-wide basis. Defense Agencies that are assigned wartime support missions are designated as Combat Support Agencies.

- The Defense Advanced Research Projects Agency (DARPA), as the central research and development organization of the DoD, is primarily responsible for maintaining U.S. technological superiority and guarding against unforeseen technological advances by potential adversaries.
- The Ballistic Missile Defense Organization (BMDO) is responsible for managing, directing, and executing the DoD's Ballistic Missile Defense (BMD) Program, focusing on three areas: Theater Missile Defense, National Missile Defense, and advanced BMD technologies based on continuing research and development of follow-on technologies that are relevant for long-term BMD.

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- The Defense Commissary Agency (DeCA) is responsible for providing an efficient and effective worldwide system of commissaries for the resale of groceries and household supplies at the lowest practical price (consistent with quality) to members of the Military Services, their families, and other authorized patrons, while maintaining high standards for quality, facilities, products, and service.
- The Defense Contract Audit Agency (DCAA) is responsible for performing all contract audits for the DoD, and providing accounting and financial advisory services regarding contracts and subcontracts to all DoD Components responsible for procurement and contract administration.
- The Defense Finance and Accounting Service (DFAS) is the accounting firm of the DoD, responsible for providing accurate, comprehensive, and timely financial and accounting information.
- The Defense Information Systems Agency (DISA) is a Combat Support Agency responsible for planning, engineering, developing, testing and supporting acquisition, implementation, operation and maintenance of information systems for command, control, communications (C3) and information systems that serve the needs of the NCA under all conditions of peace and war.
- The Defense Intelligence Agency (DIA) is a Combat Support Agency that serves as the Nation's primary manager and producer of foreign military intelligence.
- The Defense Security Service (DSS) conducts all Personnel Security Investigations (PSIs) for DoD Components and, when appropriate, also conducts PSIs for other U.S. Government activities.
- The Defense Legal Services Agency (DLSA) provides legal advice and services for the Defense Agencies, DoD Field Activities, and other assigned organizations.
- The Defense Logistics Agency (DLA) is a Combat Support Agency providing worldwide logistics support for the missions of the Military Departments and the Unified Combatant Commands under conditions of peace and war.
- The Defense Threat Reduction Agency (DTRA) is charged to reduce the threat to the United States and its allies from nuclear, biological, chemical (NBC), conventional and special weapon; to support the U.S. nuclear deterrent; and to provide technical support on weapons of mass destruction (WMD) matters to the DoD components.
- The Defense Security Cooperation Agency (DSCA) serves as the DoD focal point and clearinghouse for the development and implementation of security assistance plans and programs.
- The National Imagery and Mapping Agency (NIMA) is a Combat Support Agency which provides timely, relevant, and accurate imagery, imagery intelligence, and geospatial information in support of the national security objectives of the United States.
- The National Security Agency/Central Security Service (NSA/CSS) is a Combat Support Agency responsible for centralized coordination, direction, and

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performance of highly specialized intelligence functions in support of U.S. Government activities.

DoD Field Activities.

The DoD Field Activities are established by the Secretary of Defense, under the provisions of Title 10, United States Code, to perform selected support and service functions of a more limited scope than Defense Agencies.

- The American Forces Information Service: (1) advises and acts for the Assistant to the Secretary of Defense (Public Affairs) in managing DoD internal information programs; (2) develops policies, guidelines, and standards for the management of DoD visual information activities and programs; (3) develops policies, guidelines, and standards for the management of Armed Forces Radio and Television Service (AFRTS) outlets and activities; and (4) provides joint-interest print, radio, film, and television materials for use in the internal information programs of the Military Departments and other DoD organizations.
- The Defense Medical Programs Activity is designed to help support the resources planning, programming, budgeting, execution, program review and evaluation of the Defense Unified Medical Program; and the information systems development and management, facility planning, programming, budgeting, and review requirements of the Military Health Services System.
- The Defense Prisoner of War/Missing in Action Office provides centralized management of prisoner of war/missing in action affairs within the DoD.
- The Defense Civilian Personnel Management Service provides civilian personnel policy support, functional information management, and centralized administration of common civilian personnel management services to the DoD Components and their activities.
- The DoD Education Activity serves as the principal staff advisor on all Defense education matters relative to overseas, domestic, and continuing adult and post-secondary education activities and programs.
- The Tricare Support Office administers civilian health and medical programs for retirees, and for spouses and children of active duty, retired, and deceased members of the Uniformed Services.
- The Office of Economic Adjustment serves as the principal staff advisor on economic adjustment, joint land use studies, and intergovernmental coordination program matters.
- The Washington Headquarters Services provides administrative and operational support to specified DoD activities in the National Capital Region.

PROGRAM PERFORMANCE DURING FISCAL YEAR 1999

A summary of significant indicators of financial results and financial condition is included in each of the DoD reporting entity financial statements. The individual financial statements for DoD reporting activities identify and discuss material changes and significant trends in financial results or condition of the funds and appropriations they receive.

The Department has established many financial performance goals.

Goal: To reduce the number of noncompliant accounting and finance systems.

One goal is to reduce the number of noncompliant accounting and finance systems. In this regard, the Department has embarked upon a major streamlining of its accounting and finance systems. The elimination of noncompliant financial systems represents the largest single reform of financial management systems in the history of the Department.

DoD's accounting and finance systems will be compliant when they agree substantially with federal financial management system requirements, applicable federal accounting standards, and the United States Government Standard General Ledger at the transaction level.

The objective of the Department's initiative, however, is not simply to reduce the number of accounting and finance systems. The consolidation, standardization, and modernization of DoD accounting and

finance systems is meant to enable the Department to eliminate its outdated, noncompliant accounting and finance systems and replace them with systems that provide more accurate, timely, and meaningful financial information to decisionmakers. The Department tracks its progress in reducing the number of noncompliant accounting and finance systems through the *DoD Financial Management Improvement Plan*.

Another goal is to achieve unqualified audit opinions on its financial statements. An unqualified audit is an opinion by external auditors that DoD financial statements present fairly, in all material respects, the financial position of the Department as of the date of the statements, as well as the results of departmental operations and cash flows for the year then ended. The auditor's opinion results from the inspection of the Department's financial records to determine compliance with generally accepted accounting standards.

Obtaining unqualified opinions on the Department's financial statements is a difficult challenge. The Department must put in place policies, systems, and practices

Goal: To achieve unqualified audit opinions on the financial statements.

that enable it to produce consolidated, DoD-wide financial statements, plus statements for various organizational elements.

Approximately 80 percent of the information needed to prepare DoD financial

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statements originates in feeder systems that input data into the Department's financial systems. Thus, achieving a clean audit opinion on financial statements is an effort

that involves all DoD functional communities--financial, acquisition, logistics, personnel, medical and others--and is a DoD-wide management challenge.

FINANCIAL MANAGEMENT REFORM

The goal of financial management reform is to ensure that DoD financial management fulfills the information needs of decisionmakers, satisfies statutory requirements, eliminates fraud and waste, and provides superior customer service.

The Department of Defense is continuing the vigorous transformation of its financial management operations, processes, and systems. The goal is to ensure that DoD financial management fulfills the information needs of decisionmakers, satisfies statutory requirements, eliminates fraud and waste, and provides superior customer service. Actions to advance these goals and a comprehensive new concept for financial operations are summarized below. Applicable actions are also available in the Department's Financial Management Improvement Plan available at the following web site: <http://www.dtic.mil/comptroller>

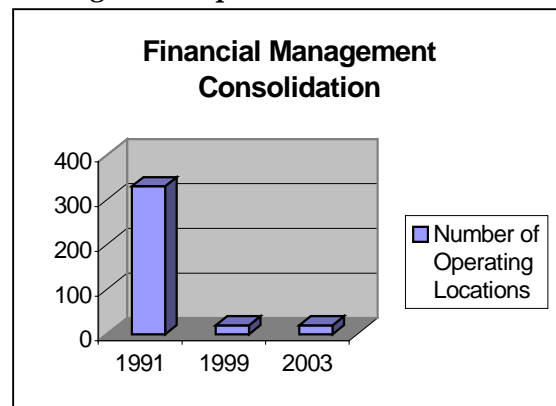
In its financial management, DoD is transitioning from a time when many DoD component organizations had their own pay and accounting systems, most of which were incompatible with each other. Virtually all DoD Component accounting systems were designed to account for how money appropriated by Congress was spent, and did not incorporate generally accepted accounting practices prevalent outside government.

Once fully transformed, the Department's financial management will rely on a minimum number of modernized finance and accounting systems, adhere to government-wide accounting requirements adopted in the last several years, and reap the benefits of substantial compatibility among its financial and nonfinancial systems. DoD decisionmakers will have the

fullest availability of data on costs so that they can allocate resources most wisely. Decisionmakers also will be able to make the best assessment of how well funds are achieving their intended purposes. Finally, more accurate and timely financial services will be provided at lower achievable costs.

CONSOLIDATION OF OPERATIONS AND SYSTEMS

DFAS and the Consolidation of Financial Management Operations

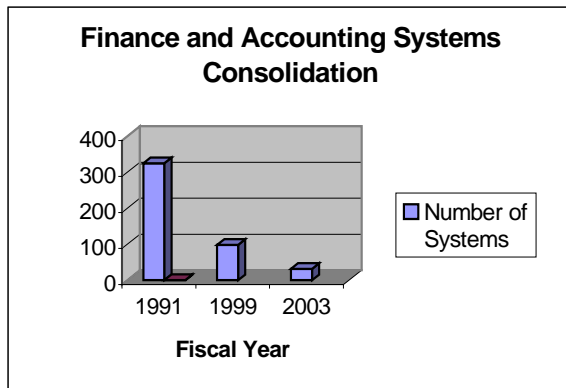


Since its activation in January 1991, the Defense Finance and Accounting Service (DFAS) has been the Department's pivotal agent for financial management improvements. By consolidating over 330 financial management field sites into five DFAS centers and 20 operating locations, the Department has been better able to eliminate redundancy, facilitate standardization, improve and speed up service to customers, and increase productivity. Through consolidation and reform, DFAS

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has generated savings in operating costs totaling about \$1 billion since 1991.

Consolidation of Finance and Accounting Systems



DFAS manages two types of DoD financial management systems, finance and accounting. Finance systems process payments to the Department's military and civilian personnel, retirees, annuitants, and vendors and contractors. Accounting systems record, accumulate, and report financial activity.

As of October 1999, 98 finance and accounting systems were operating, down from 324 in 1991. Finance systems have been reduced to 15, with a goal of only nine by FY 2003. Accounting systems are down to 83, with a goal of 22 or fewer by FY 2003.

These consolidations achieve genuine benefits. For example, in bringing into a single system all of DoD's one million civilian payroll accounts, 26 separate systems were eliminated and 348 payroll offices closed. In 1999, a typical civilian payroll technician handled over 2,100 accounts, compared to 380 accounts in 1991.

Expanding Competition to Improve Services and Reduce Cost

DoD financial managers are participating in the Administration's effort to use competition within the government and with the private sector to improve support services and save money. In 1996, DFAS began selecting certain finance and accounting functions to be considered for competitive sourcing. DFAS has identified a number of its operations as available for competition and has committed to study over 6,000 positions during the next five years.

STRENGTHENING INTERNAL CONTROLS

Internal Controls, Information Assurance, and Fraud Detection

To strengthen internal controls and elevate fraud awareness, DFAS is improving its processes by implementing a single standard general ledger; an integrated database for finance and accounting functions; and automated measures for costs, performance, and other outputs. These actions will provide a single, consistent set of policies and procedures for financial transactions, as well as safeguards for the verification and preservation of assets. DFAS and other DoD organizations also continue to implement information assurance programs and fraud detection and protection measures. Efforts include better controls to reduce vulnerability and improved employee fraud awareness training.

Eliminating Problem Disbursements

A critical DoD challenge has been reducing problem disbursements. These occur when expenditures have not been or cannot be reconciled with official accounting records. Once totaling \$34.3 billion, DoD problem disbursements have

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Since 1994, DoD problem disbursements have been reduced by nearly 84 percent.

been reduced to \$5.5 billion as of September 1999. Virtually all expenditures connected with these problem disbursements were proper and made only after a Department official confirmed that the subject goods or services were received and that payment was in accordance with a valid contract. Despite this, DoD has extensive efforts underway to improve its disbursement process. Prevalidation, the procedure of matching a disbursement to an obligation before (rather than after) a payment is made, has helped to reduce problem disbursements. Thresholds for applying prevalidation are being gradually lowered until all payments are prevalidated.

The Department also is implementing the Defense Cash Accountability System (DCAS), through which disbursement voucher data will be collected electronically under one central system and distributed electronically for posting to accounting systems. The DCAS is expected to reduce the DoD disbursing cycle from over 90 days to just two days.

Implementing New Federal Accounting Standards

The Department is taking aggressive action to implement new federal accounting standards. This requires overhauling DoD-wide management information processes and requires both a long-term and short-term strategy.

The long-term strategy is, through reengineering or replacement, to ensure that

DoD financial systems can implement new federal accounting standards and that they interface with the Department's other financial systems, as well as the nonfinancial systems that feed data to them. Only 20 percent of the information needed for sound financial management originates in systems under the control of DoD's financial community. The remainder comes from nonfinancial feeder systems most notably from acquisition, logistics, medical, and personnel systems. It is an enormous challenge to upgrade those feeder systems to produce the needed information and to improve their interfaces with DoD financial systems, especially since the primary purpose of nonfinancial systems is to support U.S. military forces and people, not to produce financial data.

In the short-term, the Department is developing interim methodologies to achieve acceptable results in its major accounts sufficient to support a favorable opinion on DoD financial statements. For example, the Department has hired respected private accounting firms to assist in the valuation of its property and in the development of new procedures on accountability. The Department also is working with the audit community to develop more detailed policy guidance to assist DoD Components in identifying and reporting information needed for better financial statements. Interim actions likewise are being advanced to overcome gaps or problems in current information flows. All these actions are being done in partnership with the Office of Management and Budget, General Accounting Office (GAO), and IG, DoD.

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ADOPTING BEST BUSINESS PRACTICES

A critical aspect of the Department's financial management reform is to exploit successful business practices from both the private and government sectors. The goal is to make DoD business practices simpler, more efficient, and less prone to error.

Our goal is to make DoD business practices simpler, more efficient, and less prone to error.

Contractor Payments and Audits

To improve its contract payment process, the Department now allows for the submission of vouchers (requests for payment) directly to DFAS by approved contractors. Previously, such vouchers had to be reviewed by the Defense Contract Audit Agency (DCAA) prior to being submitted to DFAS. This reform saves substantial staff and processing time without putting accountability at risk, as DCAA continues to provide oversight through periodic reviews. The DCAA is continuing to minimize costs without jeopardizing accountability by reducing its level of audit hours devoted to low risk contractors (i.e., those with good audit histories and no more



than \$10 million of annual reimbursable contracts). Such contractors are subject to audit only once every three years on a sampling basis. Additionally, to speed up audits and expedite the closeout of contracts, DCAA has begun concurrent auditing for contractors with good internal controls. By auditing transactions soon after they occur rather than after the end of the contractor's fiscal year, DCAA's work can be completed sooner, overhead rates settled more quickly, and contracts closed faster.

Improving the Exchange of Financial Information

DFAS is promoting the paperless exchange of financial information through a variety of initiatives.

- Electronic document management (EDM) and World Wide Web applications are enabling on-line, real-time access to documents needed to perform bill paying and accounting operations. Under this process, contracts, government bills of lading, and payment vouchers can be stored in an electronic file and shared among DFAS activities. Another application eliminates the printing of reports by converting them into an electronic format for on-line analysis, reconciliation, and reporting. EDM technology also is being used to enhance the control and management of documents needed for bill paying operations, regardless of the format of the document, as well as to link directly to DoD pay systems.
- Electronic funds transfer (EFT) is being used extensively to reduce the cost of disbursements. Over 98 percent of DoD civilian employees and military members paid by the Department have their pay

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directly deposited into their accounts. The direct deposit participation rate for travel payments now is up to 94 percent. In FY 1999, EFT accounted for about 90 percent (\$63 billion) of the total contract dollars disbursed by the Department.

- Electronic Data Interchange (EDI) is being used by DFAS to send remittance information directly to vendors. Currently DFAS is processing EDI contracts and contract modifications into its finance and accounting systems. DFAS also has implemented a Web-based invoicing system, which provides industry with an economical method to submit electronic invoices.
- Through its Joint Electronic Commerce Program Office, the Department has fielded the Web-based Central Contractor Registration (CCR), a single database of basic business information from contractors that want to do business with DoD. CCR provides all DoD procurement and payment offices with a single source of valid and reliable contractor data. The CCR capability also helps DFAS capture required data up front, enabling it to exchange EDI and pay via EFT.

Travel Reengineering

The Department continues to reengineer its management of travel by DoD personnel. The goal is a more efficient, customer-

The goal of travel reengineering is a more efficient, customer-oriented travel system that fully supports DoD requirements.

oriented travel system that fully supports DoD requirements. Procedures have been simplified and refined as a result of extensive analysis and the conduct of pilots in various operating environments. New DoD travel policies include expanded use of EFT to process travel settlements and greater use of a government-sponsored, contractor-issued travel card to pay for all official travel expenses.

Digital Signature

To help achieve the goal of paperless contracting, DoD leaders --working with the Departments of Commerce and Energy and the General Accounting Office (GAO) developed a software specification that creates a digital signature that is compliant with federal standards. This initiative is being piloted and eventually will be available to all DoD personnel via a chip-enabled common access card.

Information Infrastructure

The DFAS Corporate Information Infrastructure (DCII) is being implemented to help modernize DFAS finance and accounting systems and to establish the information environment needed to support future DoD financial activities. DCII will support the use of common standard data for the collection, storage, and retrieval of financial information, and simplify and standardize DoD finance and accounting transactions. DCII also will integrate DFAS migratory and legacy systems, as well as feeder systems of DoD components. Included in DCII is an ambitious effort to standardize and share acquisition data. This will greatly improve the interactions between DoD procurement systems and the financial systems that process and account for the associated payments.

LIMITATION OF THE FINANCIAL STATEMENTS

- The financial statements have been prepared to report the financial position and results of operations for the entity, pursuant to the requirements of 31 U.S.C. 3515(b).
- While the statements have been prepared from the books and records of the entity, in accordance with the formats prescribed by the Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary resources of the Department.
- To the extent possible, the financial statements have been prepared in accordance with accounting standards recommended by the Federal Accounting Standards Advisory Board (FASAB) and revised by OMB. At times, the Department is unable to fully implement every aspect of every the standard due to the limitations of current financial management systems. The Department continues to implement system improvements to address such limitations. In some instances, although the Department has reviewed the intent of the standard and applied the standard in a manner that management believes is consistent with and fulfills the intent of the standard, the auditors interpret the standard differently.
- The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides the resources to do so.