

# Department of Defense



## Performance and Accountability Report

# Highlights

Fiscal Year 2006







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Message from the Deputy Secretary of Defense



**DEPUTY SECRETARY OF DEFENSE**

1010 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1010

November 15, 2006

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

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

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

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

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

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

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

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





## Overview

The Department of Defense Fiscal Year (FY) 2006 Performance and Accountability Report (PAR) provided the President, Congress, other Federal departments and agencies, and the American public an overview of the Department's financial condition and performance status. Essentially, the PAR is equivalent to the private sector's annual report to their stockholders, supplemented with an assessment of program performance. The report covered the 12-month period ending September 30, 2006. The PAR, in its entirety, can be found at [www.dod.mil/comptroller/par](http://www.dod.mil/comptroller/par).

***Performance & Accountability Highlights.*** This Document is an overall summary of the Department's performance and financial information for FY 2006. It highlights the Department's FY 2006 annual performance goals and results. In addition, it provides financial highlights for FY 2006 and a statement on the limitations of the financial statements; management assurances over internal controls, summaries of the Department's progress in

implementing the Financial Improvement and Audit Readiness Plan, its Enterprise Transition Plan initiative, and the President's Management Agenda objectives. The document concludes with a discussion of potential future effects of current events and conditions facing the Department in 2007 and beyond.

We welcome your feedback regarding the content of this report. To comment on the content of this report, please email us at [DoDPAR@osd.mil](mailto:DoDPAR@osd.mil), or write to:

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You may also view this highlights document at [www.dod.mil/comptroller/par](http://www.dod.mil/comptroller/par).





## Year in Review



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

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

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

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

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



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



## Year in Review .....

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



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

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

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

security responsibilities are increasingly being turned over to Iraqi forces.

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

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



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



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

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

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

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





**Executive Summary** .....

**Mission and Organizational Structure**

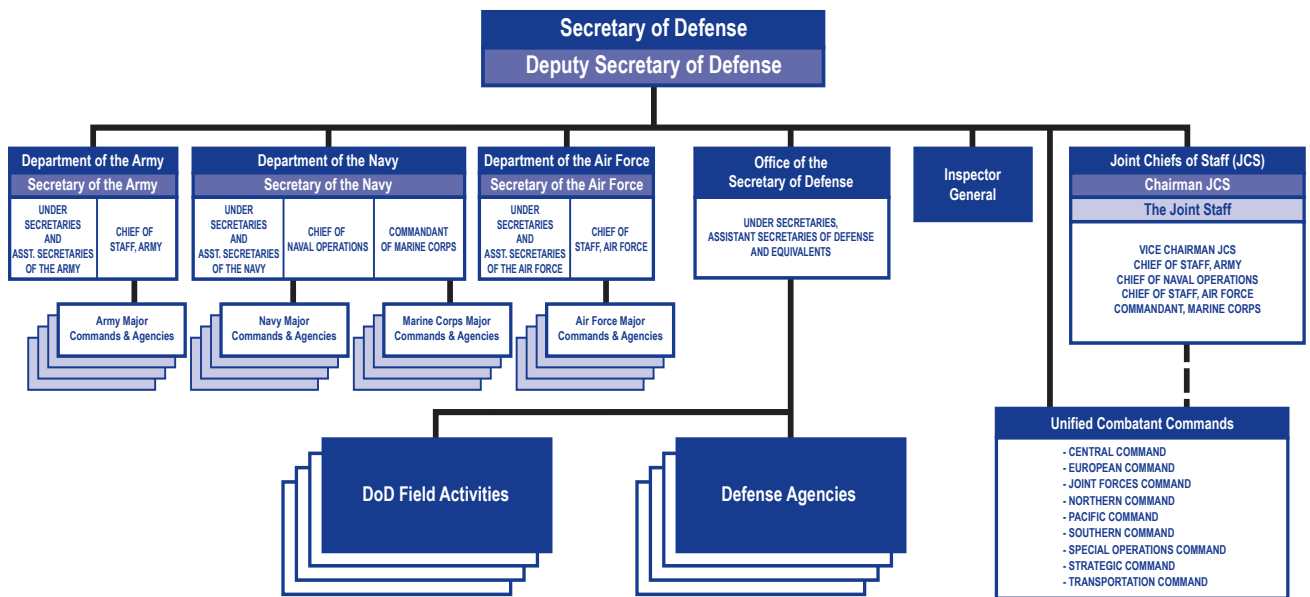
The mission of the Department of Defense is to provide the military forces needed to deter war and to protect the security of our country. The Department is America’s largest, busiest, and most successful organization. Since the creation of America’s first army in 1775, the Department and its predecessor organizations have evolved into a global presence of 3 million individuals, stationed in more than 140 countries, that are dedicated to defending the United States by deterring and defeating aggression and coercion in critical regions. The Department embraces the core values of leadership, professionalism, and technical knowledge. Its employees are dedicated to duty, integrity, ethics, honor, courage, and loyalty. The chart below shows how the Department is structured.

**The Secretary and the Office of the Secretary** .....

The Secretary of Defense and the Office of the Secretary of Defense are responsible for the formulation and oversight of defense strategy and policy. The Office of the Secretary of Defense supports the Secretary in policy development, planning, resource management, and fiscal and program evaluation.

**Military Departments** .....

The Military Departments consist of the Army, Navy (of which the Marine Corps is a component), and the Air Force. In wartime, the U.S. Coast Guard becomes a special component of the Navy; otherwise, it is part of the Department of Homeland Security. The Military





Departments organize, staff, train, equip, and sustain America's military forces. When the President and Secretary of Defense determine that military action is required, these trained and ready forces are assigned to a Combatant Command responsible for conducting military operations.

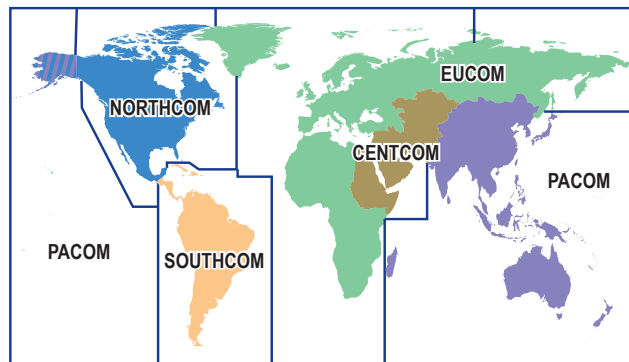
The Military Departments include Active Duty, Reserve, and National Guard forces. Active Duty forces are full-time military Service members. The Reserve, when ordered to active duty by the Congress, supports the Active forces. Reserve forces are an extension of the Active Duty personnel and perform similar jobs when called to active duty. They are also relied on to conduct counter-drug operations, provide disaster aid, and perform other peace-keeping missions. The National Guard has a unique dual mission with both federal and state responsibilities. In peacetime, the Guard is commanded by the governor of each respective state or territory, who can call the Guard into action during local or statewide emergencies, such as storms, drought, or civil disturbances. When ordered to active duty for mobilization or called into federal service for emergencies, units of the Guard are placed under operational control of the appropriate Military Department. The Guard and Reserve forces are recognized as an indispensable and integral part of the Nation's defense from the earliest days of a conflict.

### Chairman of the Joint Chiefs of Staff

The Chairman of the Joint Chiefs of Staff is the principal military advisor to the President, the National Security Council, and the Secretary of Defense. The Chairman assists the President and the Secretary in providing for the strategic direction of the Armed Forces, including operations conducted by the Commanders of the Combatant Commands. As part of this responsibility, the Chairman also assists in the preparation of strategic plans and helps to ensure that plans conform to available resource levels projected by the Secretary of Defense.

### Combatant Commands

Combatant Commands are responsible for conducting the Department's missions around the world. The Army, Navy, Air Force, and Marine Corps supply forces to these Commands.



Five Commands have specific mission objectives for their geographic area of responsibility, as shown in the map above:

- U.S. European Command (USEUCOM) is responsible for activities in Europe, Greenland, Russia, and most of Africa.
- U.S. Central Command (USCENTCOM) is responsible for the Middle East, eastern Africa, and several of the former Soviet republics. This Command is primarily responsible for conducting Operation Enduring Freedom in Afghanistan and Operation Iraqi Freedom.
- U.S. Pacific Command (USPACOM) is responsible for China, South and Southeast Asia, Australia, and the Pacific Ocean.
- U.S. Southern Command (USSOUTHCOM) is responsible for Central and South America, and the Caribbean.
- U.S. Northern Command (USNORTHCOM) is responsible for North America including Canada and Mexico.

In addition, four Commands have specified worldwide mission responsibilities focused on a particular function(s):



## Executive Summary

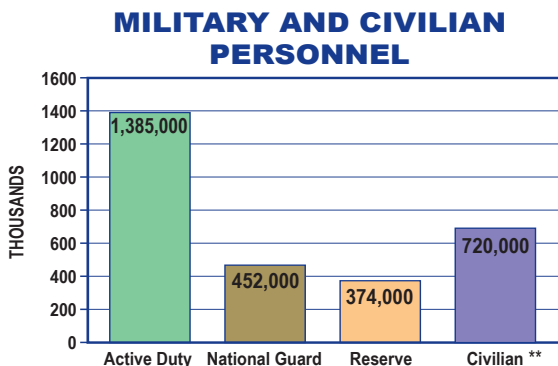
- U.S. Strategic Command provides global deterrence capabilities and synchronizes Department efforts to combat weapons of mass destruction worldwide.
- U.S. Special Operations Command leads, plans, synchronizes and, as directed, executes global operations against terrorist networks.
- U.S. Transportation Command moves military equipment, supplies, and personnel around the world in support of operations.
- U.S. Joint Forces Command develops concepts for joint warfighting.

## Defense Agencies and the Department Field Activities

Defense Agencies and the Department Field Activities provide support services commonly used throughout the Department. For instance, the Defense Finance and Accounting Service provides accounting services, contractor and vendor payments, and payroll services; and the Defense Logistics Agency provides logistics support and supplies to all Department activities.

## Resources

To provide Americans with the highest level of national security, the Department employs nearly 1.4 million men and women on Active Duty, almost 826,000 in the Reserve and National Guard, and approximately 720,000 civilians. Together, these men and women work daily to protect U.S. interests around the world.



\*\* Source: Defense Civilian Personnel Data System, as of September 30, 2006.

The Department's worldwide infrastructure includes nearly 600,000 facilities (buildings, structures, and utilities) located at more than 3,700 sites around the world, and nearly 30 million acres. To protect the security of the United States, the Department uses approximately 250,000 vehicles, 13,000 aircraft, and 500 oceangoing vessels.

## Analysis of Financial Statements and Stewardship Information

The Department's six principal financial statements include a consolidated Balance Sheet along with statements of: Net Cost; Net Position; Budgetary Resources; Financing; and Custodial Activity. These statements reflect the combined financial posture of the Department and include both the proprietary (federal accounting standards) and budgetary resources of the Department.

The Department's financial management environment is complex and diverse. Its FY 2006 financial statements included \$1.4 trillion in assets and nearly \$2 trillion in liabilities. In FY 2006, the Department obtained an audit opinion on the Department-wide financial statements and its nine major reporting components, which include the Military Retirement Fund, the Medicare-Eligible Retiree Health Care Fund, the U.S. Army Corps of Engineers, and the general funds and working capital funds for the Army, Air Force, and Navy.

Of those, only the Military Retirement Fund received an unqualified audit opinion, meaning that the financial statements are presented fairly, in all material respects. The Military Retirement Fund accounts for 15 percent of the Department-wide assets and 49 percent of the liabilities.

The Medicare-Eligible Retiree Health Care Fund, which accounts for 6 percent of the Department's



assets and 28 percent of its liabilities, received a qualified opinion, which means that except for certain conditions, the financial statements meet the standards for an unqualified opinion as described above.

Overall, the Department (to include the remaining seven major reporting components) expects to receive a disclaimer of opinion from its auditor for FY 2006, which means the financial statements are not auditable.

The Department prepares statements for many of its smaller entities that are rolled into the overall consolidated financial statements and identified as "Other Defense Organizations." Some of these smaller entities are subject to audit each year. Five organizations within this group achieved unqualified audit opinions in FY 2006: the Defense Finance and Accounting Service, the Defense Contract Audit Agency, the Defense Commissary Agency, the Chemical Biological Defense Program, and the Defense Threat Reduction Agency. In addition, at the Department-wide level, the Department received favorable audit reviews for the third consecutive year on three significant financial statement items in FY 2006: (1) Investments, (2) Federal Employees' Compensation Act Liabilities, and (3) Appropriations Received.

As a result of its financial improvement efforts, 15 percent of the Department's assets and 49 percent of its liabilities received clean audit results in FY 2006. A summary of results is provided below.

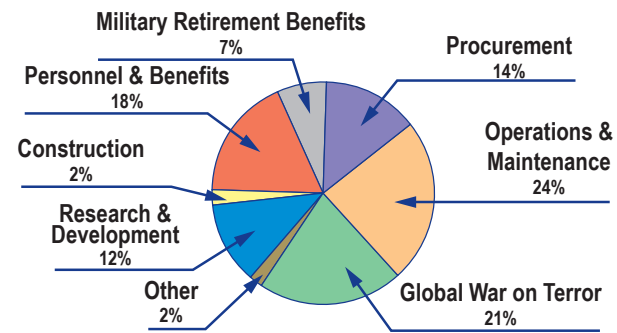
### Financial Analysis

In general, the financial statements of the Department show that the short-term financial outlook of the Department is stable. While needing to address priorities and seek supplementary funds from Congress due primarily to the Global War on Terror, the mission of the Department is being achieved. Short-term financial indicators reveal the Department's ability to satisfy immediate objectives while the long-term

financial outlook is impacted primarily by future military retirement benefits.

During FY 2006, the Department received \$594.7 billion in appropriations from the Congress and invested budget resources in the following general areas, as shown in the chart below. The Department, the federal government's single largest agency, receives more than half the discretionary amount of the federal budget.

### FY 2006 Budget Allocation



As a result of these investments in people, infrastructure, operations, and technologies, the Department continues to defend the national interests. For example, during FY 2006 the Department reduced the foothold of terrorism, assisted in establishing the Iraqi government, provided humanitarian aid for victims of natural disasters, and continued improving financial accountability.

The complete picture of the Department's financial information shows several trends and insights into the financial health of the organization.

- The financial results of the Department reflect asset growth of 13 percent over the past 3 years, resulting from an increase in funds available, and investments for long-term liabilities and military equipment.
- Concurrent to the growth in assets, liabilities have increased nearly 15 percent primarily due to the long-term liability increases for military retirement benefits.



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- The Department’s net position increased 16 percent over the past 3 years. This increase is due primarily to the timing of a \$68 billion supplemental appropriation for the Global War on Terror late in the fiscal year. The net position is projected to return to previous levels by the end of FY 2007 as the supplemental appropriation is executed.
- Departmental costs changes over the past 3 years are mainly driven by military retirement benefit costs, Global War on Terror costs, and depreciation expense on military equipment.

### **Long-Term Liabilities Related to Military Retirement Benefits**

Eighty-three percent of long-term military retirement benefit liabilities are not currently funded. The Department has a sound investment strategy to address the military retirement benefits requirement. Based on current projections, unfunded liabilities in the Military Retirement Fund will be fully funded in 2033 and the Medicare-Eligible Retiree Healthcare Fund in 2041.

### **Military Equipment**

The net value of military equipment increased \$21 billion over the past 3 years primarily due to a change in valuation method. The baseline of \$345 billion in book value is now accurately established and the Department is well on its way to improved financial health in this area.

### **Real Property**

The Department’s \$100 billion in real property is an increase in 3 percent over the past 3 years. This is due to efforts to accurately identify and report a complete real property inventory.

### **Environmental Liabilities**

Environmental liabilities of \$68 billion is an increase of 8 percent over the past 3 years. This is due to Departmental efforts to improve estimates and its

environmental liabilities inventory. Future challenges will be affected by the impact of valuations at overseas locations, buried munitions, base closure, cleanup, and enforcement of the standards for asbestos.

## **Improving the Department’s Financial Management** .....

The Financial Improvement and Audit Readiness plan (<http://www.dod.mil/comptroller/FIAR/index.html>) charts financial management transformation for the Department. It provides the construct within which sound financial management can mature and evolve. The Financial Improvement and Audit Readiness (FIAR) plan targets problems arising from weak or nonexistent internal controls, incomplete and inaccurate information, and systems that cannot properly process data and information. Financial management improvement efforts proceed primarily along two tracks:

- Improving the Department’s financial health by streamlining procedures, improving the timeliness and availability of financial information, and capturing more relevant information.
- Preparing the Components for financial statement audits (e.g., testing internal controls).

Fully integrated with other business transformation efforts, the plan ensures accountability and prioritizes financial management improvements. The 3 essential elements—integration, accountability, and prioritization—are interrelated.

The FIAR plan reflects integrated solutions:

- Individual Component financial improvement plans detail corrective actions to accomplish critical milestones in the FIAR plan. For example, the U.S. Army Corps of Engineers’ financial statements are currently under audit. In addition, the Air Force is ready for an audit of its Fund Balance with Treasury and Cash and Other Monetary Assets.



- Systems modifications and solutions managed under the Enterprise Transition Plan ([http://www.dod.mil/dbt/products/sept-06-bea\\_etp](http://www.dod.mil/dbt/products/sept-06-bea_etp)) are closely aligned to FIAR efforts. The Department has thousands of programs and processes ranging from manual processing to computer-based management systems. Few interact with others, most do not meet congressionally-mandated requirements, and many fail to provide the level of reliability, accuracy, and timeliness demanded by today's complex business environment. Systems initiatives and solutions in the Enterprise Transition Plan eventually will provide the Department with effective and efficient Department-wide financial management systems that provide end-to-end tracking of financial transactions and produce fully auditable financial reports.
- The FIAR plan will enable the Department to comply with internal control requirements set forth by the Office of Management and Budget.
- The FIAR plan breaks down the Department's large number of assets and liabilities into auditable segments based on significant lines on the Department's Balance Sheet.

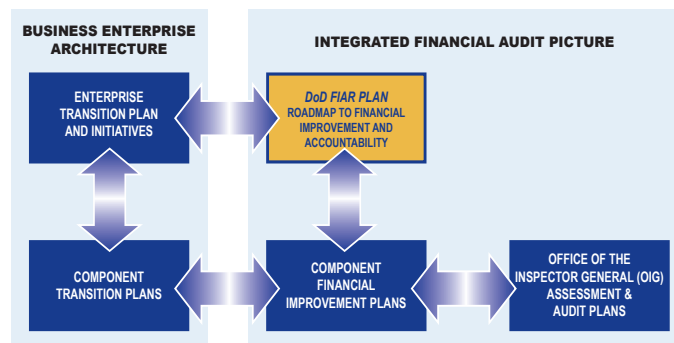
The FIAR plan sets priorities for the Department's financial management improvement efforts. The Department is focusing first on four items that represent 33 percent of its assets and 31 percent of its liabilities. The four focus areas include Military Equipment, Real Property, Medicare-Eligible Retiree Health Care Fund, and Environmental Liabilities. These lines represent some of the more significant Balance Sheet categories.

Finally, the FIAR plan ensures accountability:

- Progress toward completing key milestones is reported monthly to the Defense Business Systems Management Committee, chaired by the Deputy Secretary of Defense.
- Various metrics are used to gauge success.
- Accountability for accomplishing milestones will be included in the performance standards of personnel responsible for implementing the plan.

- Status of financial achievements are reported quarterly to the Office of Management and Budget.

The diagram below shows how the FIAR plan and Enterprise Transition Plan are integrated to focus efforts on improving the Department's financial management.



The financial portion of the Enterprise Transition Plan focuses on Financial Visibility ([http://www.dod.mil/dbt/priorities\\_financial.html](http://www.dod.mil/dbt/priorities_financial.html)), which is defined as having immediate access to accurate and reliable financial information (planning, programming, budgeting, accounting, and cost) in support of financial accountability and audibility, and facilitates effective decision-making throughout the Department. The Department's approach consists of the following key initiatives: Intragovernmental Transactions Initiative, Standard Financial Information Structure, and the U.S. Standard General Ledger.

Intragovernmental transactions involve sales, services, or transfers between two entities of the federal government. Generally accepted accounting principles require the elimination of intragovernmental balances from consolidated financial statements to prevent overstating accounts for intra- or inter-entity activity, or double counting. The Government Accountability Office cited the federal government's inability to adequately account for and reconcile intragovernmental activity and balances as a major impediment to rendering an opinion on the government-wide consolidated financial statements. In FY 2006, the Department developed a set of requirements and initiated a demonstration system



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to enact standard processes, business rules, and data elements. This is the first step towards Department-wide deployment of this initiative to address intragovernmental transactions.

The Standard Financial Information Structure (SFIS) provides a common business language by using standardized terms throughout the Department. The common language ensures consistency in budgeting, accounting, financial reporting, and performance-based management. In FY 2006, the Department created the Standard Financial Information Structure Library ([http://www.dod.mil/dbt/sfis\\_resources.html](http://www.dod.mil/dbt/sfis_resources.html)) to serve as the central repository for maintaining and exposing the Standard Financial Information Structure vocabulary to all Department business systems.

One of the requirements of the Federal Financial Management Improvement Act is that agencies' financial systems comply substantially with the U.S. Standard General Ledger at the transaction level. This means that agencies must conform to the Department of the Treasury's standards for recording transactions of the federal government accounting process. In FY 2006, the Department implemented an online U.S. Standard General Ledger Library in the Business Enterprise Architecture. This library breaks down the Department of the Treasury's general guidance into detailed transaction sets that link to specific business events, a capability that will facilitate standard account transaction postings using Standard Financial Information Structure data elements across the Department.

Based on these integrated plans, the Department made great progress in improving financial management in FY 2006. The Department completed nearly 80 percent of its Enterprise Transition Plan milestones and during fourth quarter, FY 2006 completed 94 percent of its FIAR Plan milestones. The Department's progress has not gone unrecognized. The Office of Management and Budget elevated the Department's progress rating for Improved Financial Performance under the President's Management

Agenda to green. While progress is green, the Department remains red in status and remains on the Government Accountability Office's high risk list. The Government Accountability Office has issued two consecutive reports citing important business systems modernization progress, and the Comptroller General also has acknowledged publicly the Department's progress and approach.

## Limitations of the Financial Statements .....

*The principal financial statements have been prepared to report the financial position and results of operations of the Department of Defense, pursuant to the requirements of 31 U.S.C. 3515(b). The statements are prepared from accounting records of the Department in accordance with OMB Bulletin A-136 and to the extent possible generally accepted accounting principles. The statements, in addition to the financial reports, are used to monitor and control budgetary resources which are prepared from the same records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.*

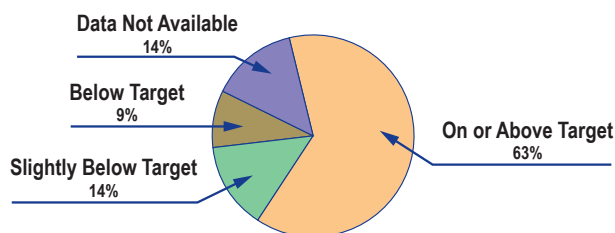
Financial Statement Highlights (Dollars in Millions)	2006	2005 Restated
<b>At End of Year:</b>		
<b>Condensed Balance Sheet Data:</b>		
Cash and Other Monetary Assets	\$ 2,199.8	\$ 2,072.7
Fund Balance with Treasury	327,138.3	290,657.1
Investments and Related Interest	300,351.0	263,972.8
Accounts Receivable, Net	10,791.5	8,906.8
Inventory and Related Property, Net	231,823.2	222,573.3
General Property, Plant and Equipment, Net	465,439.5	452,541.4
Loans Receivable	191.7	75.6
Other Assets	29,118.3	25,341.2
<b>Total Assets</b>	<b>\$ 1,367,053.3</b>	<b>\$ 1,266,140.9</b>
Accounts Payable	\$ 28,870.7	\$ 30,633.4
Debt	382.1	467.1
Other Liabilities	44,388.3	41,136.2
Military Retirement and Other Federal Employment Benefits	1,815,769.5	1,736,057.8
Environmental and Disposal Liabilities	69,985.1	65,027.6
Loan Guarantee Liability	36.8	41.1
<b>Total Liabilities</b>	<b>\$ 1,959,432.5</b>	<b>\$ 1,873,363.2</b>
Unexpended Appropriations	307,709.4	271,493.6
Cumulative Results of Operations	(900,088.6)	(878,715.9)
<b>Total Net Position</b>	<b>(592,379.2)</b>	<b>(607,222.3)</b>
<b>Total Liabilities and Net Position</b>	<b>\$ 1,367,053.3</b>	<b>\$ 1,266,140.9</b>
<b>For the Year:</b>		
Total Cost	\$ 629,736.4	\$ 680,086.6
Total Earned Revenue	(48,350.3)	(45,207.1)
<b>Net Cost of Operations</b>	<b>\$ 581,386.1</b>	<b>\$ 634,879.5</b>



## Performance Objectives, Goals, and Results

During FY 2006, the Department established four strategic goals, each with supporting performance measures and key milestones. Overall, the Department achieved good progress with 77% slightly below, at or above target as shown in the following graph.

### FY 2006 Summary of Performance Results



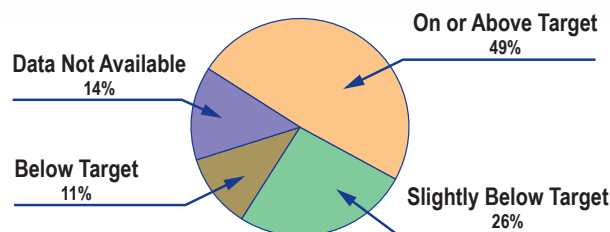
The goals and results for selected measures are presented in the following charts showing the Department's success in achieving its objectives in that area.

### Strategic Goal 1: Balance Force Management Risk

The Department's first strategic goal is to balance the risk of force management. It focuses on recruiting, retaining, training, and equipping America's military forces. Key components address issues such as the total strength of the Armed Forces, the number and educational level of Active and Reserve recruits, the ability of the Department to attract and retain critical skills, efforts to close the pay gap with the private sector for enlisted personnel, and the quality of health care provided to Service members and their families.

The graph below shows the results of FY06 performance for Strategic Goal #1.

### FY 2006 Results Achieved



FY 2006 highlights:

- A challenging recruiting year—all Active Components met their annual targets, however, 4 of 6 Reserve Components fell short of their annual targets. The Department met or exceeded the desired educational and aptitude levels.
- High retention rates—the Marine Corps met its annual target.
- Closed the pay gap to within 3 percent between military enlisted and comparable civilian pay.
- Broke the 90 percent threshold for the first time on overall satisfaction with health care appointments, exceeding the goal of 89 percent. Satisfaction with the Military Health Plan has risen 10 percent since FY 2002.
- The recruitment and retention of Service members in critical skill areas improved.

### Strategic Goal 2: Balance Operational Risk

This goal focuses on achieving and maintaining operational superiority. Key goal components address issues such as incorporating lessons learned, effective real-time plans and operations, and integrating joint operations. By FY 2009, the Department will have a networked capability to seamlessly produce, update, and transition plans through crisis situations. The Department refers to this capability as "Net-Centricity." Net-centricity will allow all DoD users and mission partners to share the information they need, at the time they need it, and in a form they can understand. It





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will provide information security and protect it from those who should not access it. Net-centricity will be achieved through a networked environment (including infrastructure, systems, processes, and people) that will enable a 21st Century approach to warfighting and business operations.

The Department is on or above target on all metrics for the *Balance Operational Risk* strategic goal. FY 2006 results indicate significant progress toward:

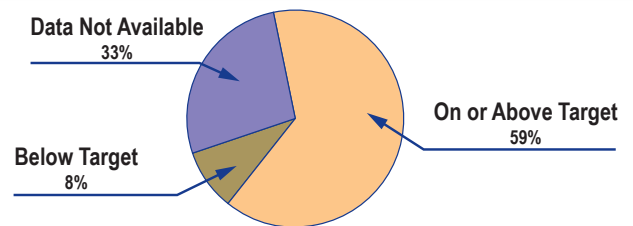
- Implementing the Global Force Management Data Initiative to monitor and provide comprehensive insight into U.S. forces that are available worldwide, enabling the Department to allocate the right forces for specific missions, at the right place and time.
  - Adaptive Planning to produce war and contingency plans that are more timely and responsive to the current security environment.
  - Analytic Agenda Products that guide analysis through a set of common scenarios and data.
- Expanding the lessons learned program Department-wide. This includes incorporating the lessons learned from Operation Iraqi Freedom, the Department's response to Hurricane Katrina, and other recent actions.
- Continuing transformation to the joint force model to eliminate military "stovepipes" by seamlessly combining the Armed Forces' capabilities necessary to address a situation or event. The Capstone Concept for Joint Operations provides a broad description of how the future joint force will operate across the range of military operations 8 to 20 years in the future.

### Strategic Goal 3: Balance Institutional Risk

This goal focuses on efforts to align the Department and its resources to support the warfighter. Key goal components address changing the way the Department conducts its daily business, such as controlling infrastructure costs, improving acquisition processes, and effectively managing its assets.

The chart below shows the performance results for Strategic Goal #3 *Balance Institutional Risk*.

### FY 2006 Results Achieved



FY 2006 highlights include:

- Eliminated 29,245 inadequate housing units for military personnel, exceeding its target of 27,635. Since FY 2002, the percentage of inadequate housing units has dropped nearly one-third, from 59 to 40 percent. This issue is important enough to warrant a stand-alone initiative in the President's Management Agenda; as of September 30, 2006, the Department was rated green on both status and progress.
- Met its target to allocate 42 percent of its budget to infrastructure activities.
- Continued efforts to achieve zero percent acquisition cost growth and reduce the time it takes to acquire major defense items and leverage new technologies.
- Strengthened budget guidance to estimate the direct cost of program priorities.

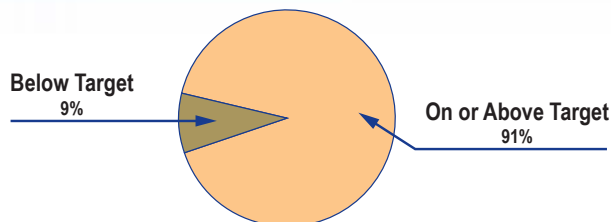
### Strategic Goal 4: Balance Future Challenges Risks

This goal focuses on developing new, leading-edge capabilities to meet the challenges of tomorrow by rapidly converting innovative warfighting concepts from prototypes into fielded capabilities. Key components address defining and acquiring the skills required for the future, experimenting with new warfare concepts, enhancing its intelligence-gathering capabilities, and maintaining the Department's science and technology strengths.



The chart below shows the performance ratings for Strategic Goal #4 *Balance Future Challenges Risk*.

### FY 2006 Results Achieved



FY 2006 highlights include:

- Conducted numerous activities to improve the effectiveness of intelligence in military operations and for overall national security, including information sharing, developing a common human resources system for the intelligence components, and establishing standards for training, tradecraft, technology, architecture and operational tactics, techniques, and procedures.
- Achieved the goals for the Department’s Defense Technology Objectives, which highlight specific technological advancement, the anticipated date the technology will be available, the specific benefits that should result from the technological advancement, and the funding required (and sources) to achieve the new capability.
- Established the Standing Joint Force Headquarters to ensure that in the event of a crisis, a team with the command structure and staff as well as functional and geographic expertise is already in place for rapid reaction with integrated employment of air, land, sea, and information forces.

### Data Quality, Accuracy, and Reliability

To the greatest extent possible, the Department ensures that its performance data is quantifiable and verifiable by implementing internal management controls and responding to recommendations

provided by the Department’s Office of Inspector General, the Government Accountability Office, and others. Performance data for most quantifiable measures are generated as a result of the Department’s operations. Survey satisfaction data is produced from statistically valid surveys. Accuracy measures come from validated automated systems and are reviewed periodically and verified for correctness. New metrics or metrics under development are subject to the same data quality requirements once the metric is established.

The Department recognizes its shortcomings in integrating performance and financial information caused by inadequate financial management systems. To address these problems and provide decision-makers with accurate, timely, and reliable financial data, the Department launched its Financial Improvement and Audit Readiness Plan and Enterprise Transition Plan in 2005. These plans were discussed earlier in this section.

The data in this report are the latest available at time of publication. In many cases, the data for FY 2006 are incomplete because of lengthy reporting cycles. Therefore, several of the results have been projected using partial year data. Incomplete data and projected results are noted for each metric as applicable. The FY 2007 Performance and Accountability Report will include final FY 2006 results and note any significant deviations from targeted and actual results.

### Other Program Evaluations Conducted in FY 2006

The Department’s Office of Inspector General reviewed many of the Department’s programs and activities. These reviews also contain management’s response and plans to address the issues identified in the reports. They may be viewed at <http://www.dodig.osd.mil/>. Click on Publications & Documents, then select Audits under the heading Reports.



## Executive Summary

The Government Accountability Office has reviewed a wide range of the Department's activities. The reports, which contain management's response and plans to address the issues identified in the reports, may be viewed at: <http://www.gao.gov/> Click on Reports and Testimony, select browse by Agency, select Department of Defense, and select date range (October 1, 2005 to September 30, 2006 covers FY 2006).

### Analysis of Systems, Controls, and Legal Compliance

#### Management Assurances

The Federal Managers' Financial Integrity Act (FMFIA) requires federal agencies to assess the effectiveness of internal management controls for program, operational, and administrative areas as well as accounting and financial management. Internal management controls are the organization, policies, and procedures that are considered the tools that help program and financial managers achieve results and safeguard the integrity of their programs. The program strengthens integrity and accountability within programs and operations.

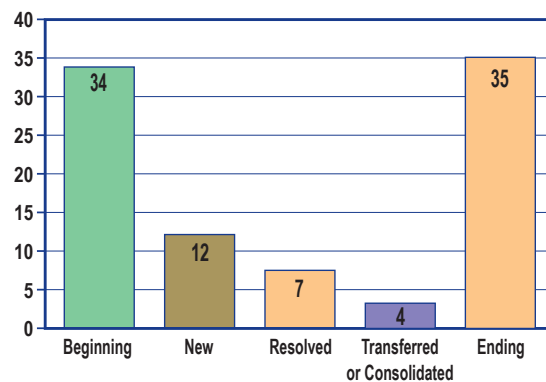
The Department assesses its internal management controls under a formalized program conducted throughout the Department, to include forward deployed units such as the Multi-National Forces - Iraq. Management's philosophy is that effective internal management controls are crucial to all processes and not just financial and accounting processes.

Using assessments from the Office of Management and Budget Circular A-123, Management's Responsibility for Internal Control, the Department prepared the FY 2006 Annual Statement of Assurance, presented on the next page. The Department asserts that all Components have reported to the Secretary of Defense

their individual statements of assurance over internal controls.

The Department uses management-conducted assessments with alternative reviews such as audit results as the primary means of identifying weaknesses. The Department of Defense Office of Inspector General previously identified 11 material weaknesses during its agency-wide audit of the Department's. Seven are covered in the Department's management weaknesses inventory, detailed in Section 4 of the FY06 Performance and Accountability Report.

#### FY 2006 Internal Management Control Material Weaknesses



#### Summary of Material Weaknesses and Corrective Actions

The Department continued an aggressive program of identifying, tracking, and resolving weaknesses in internal controls during FY 2006. Overall, the Department reported 12 new material weaknesses, corrected or consolidated 11, and ended the year with a total of 35, resulting in a net gain of one material weakness over FY 2005.

#### Statement of Assurance over Financial Reporting Process

The Department is using an incremental approach in implementing Circular A-123, Appendix A. At the beginning of FY 2006, the Deputy Secretary



## Annual Assurance Statement



### DEPUTY SECRETARY OF DEFENSE

1010 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1010

November 15, 2006

The management of the Department of Defense remains committed to effective internal management controls, full compliance with established requirements, accurate financial reporting, and proper stewardship. Fortright reporting and prompt resolution of weaknesses are priorities.

For the overall statement of assurance pertaining to functional areas other than financial reporting, the Department can provide a qualified statement of reasonable assurance that internal management controls meet the objectives of the Federal Managers Financial Integrity Act and the Office of Management and Budget Circular A-123 except for the weaknesses listed in Section 4 of this report at Tables IIIa, IIIb, and IV. In addition, the Department is not compliant with system requirements of the Act as described in Section 4 of this report at Table V.

The assessments on the financial reporting areas were conducted in compliance with Circular A-123, Appendix A, under the oversight of the Department's Senior Assessment Team for the following areas.

- Fund Balance with Treasury
- Investments
- Real Property
- Military Equipment
- Federal Employee Compensation Act Liabilities
- Environmental Liabilities
- Medicare-Eligible Retiree Health Care Liabilities
- Appropriations Received

The Department can provide a qualified statement of assurance its internal management controls over financial reporting for the areas listed above, as of June 30, 2006, were operating effectively with the exception of the financial reporting weaknesses listed in Section 4 of this report at Table VI. The Department can provide no assurance outside these areas.

In 2006, the Department identified 12 new weaknesses and reduced the total number of outstanding weaknesses by 11, resulting in 35 outstanding weaknesses. Of the 35 weaknesses, five are classified as financial reporting weaknesses.



## Executive Summary .....

of Defense established a Senior Assessment Team composed of senior leaders as the governing body for the Department's Appendix A implementation. The team defines the scope of the assessments used within the Department, determines the Department's financial reporting weaknesses, and monitors the progress of corrective actions. In addition, certain Components, (based on materiality) were required to establish Senior Assessment Teams that monitor the Component's Appendix A implementation process.

The Department issued guidance at the beginning of FY 2006 that prescribed procedures for conducting flow charts, risk assessments, and control analyses to promote consistency and comparability of data throughout the Department. In addition, the test plan guidance issued in March 2006 prescribed a standardized process for developing test plans, which included universe and sample size determination, independent testing, tolerance levels, and test methods.

The Department is leveraging its Financial Improvement and Audit Readiness (FIAR) plan for Appendix A implementation by using the resources and capabilities already established for the FIAR plan. The FIAR plan is the Department's path to audit readiness and an unqualified audit opinion. It describes major impediments identified by auditors and management and sets milestones for resolving problems affecting the accuracy, reliability, and timeliness of financial information. For process solutions, the plan addresses known major deficiencies and captures work done or to be done by large Components in assessing their weaknesses and developing plans to overcome those weaknesses. The Department will continue to maximize resources by aligning its Appendix A efforts with the FIAR plan.

### Systems .....

The Federal Financial Management Improvement Act requires federal agencies to conform to the U.S. Government Standard General Ledger, comply with

all applicable federal accounting standards, establish financial management systems that meet government-wide standards and requirements, and support full disclosure of federal financial data, including the costs of federal programs and activities.

The Department's Inspector General and the audit agencies within the Military Services have reported on the Department's failure to comply with the Act's requirements. The Department's inability to comply materially with the Act primarily results from structural problems related to legacy accounting systems that do not accurately account for both budgetary and proprietary activities. Quite simply, the Department does not have the systems and accounting structures in place to enable compliance.

To remedy these challenges, the Department of Defense has placed an unprecedented emphasis on reforming its financial management systems and accounting processes. Primarily through the Business Enterprise Architecture and the Enterprise Transition Plan, the Department is identifying the business capabilities and standards at the Department-wide level that will support compliance. The Standard Financial Information Structure and U.S. Standard General Ledger initiatives discussed earlier in this section are major steps toward achieving compliance with the Federal Financial Management Improvement Act.

### Improper Payments Information Act Reporting .....

The Improper Payments Information Act of 2002, as implemented by the Office of Management and Budget, requires federal agencies to review all programs and activities annually and identify those that may be susceptible to significant erroneous payments.

The Department of Defense reports its progress in reducing erroneous payments to both the President and the Congress. The Department's FY 2006 review



did not identify any programs or activities at risk for “significant erroneous payments” in accordance with the Office of Management and Budget’s criteria (i.e., programs with erroneous payments exceeding both \$10 million and 2.5 percent of program payments). During this review, however, the Department noted that civilian, commercial, and travel pay potentially were susceptible to erroneous payments in excess of \$10 million. For FY 2006, the Department reports on three high risk programs: military health benefits, military retirement, and military pay.

In accordance with guidance, the Department calculated statistically-valid estimates of erroneous payments and is implementing plans to reduce them within each of the six programs. Current estimates for FY 2006 improper payments are presented in the table below.

**FY 2006 Estimated Improper Payments**  
Dollars in Millions

Program	Estimated \$	Estimated %
Military Retirement	\$48.8	0.1%
Travel Pay	\$8.0	1.0%
Military Health Benefits	\$140.0	2.0%
Military Pay	\$65.9	0.1%
Civilian Pay	\$62.8	0.1%
Commercial Pay	\$550.0	0.2%

While the Department’s overall improper payment percentage is quite low for the over \$750 billion it pays each year to individuals, contractors, agencies, and other entities, the Department has numerous pre- and post-payment controls in place to minimize and eliminate improper payments.

## Other Management Information, Initiatives, and Issues

### President’s Management Agenda

The President’s Management Agenda has been inculcated throughout the Department and significant progress has been made since implementation. Detailed information is available at <http://www.results.gov>.

The President’s Management Agenda identifies the following five government-wide initiatives:

- Electronic Government (e-Gov)
- Strategic Management of Human Capital
- Competitive Sourcing
- Improved Financial Performance
- Budget and Performance Integration

In addition, the President’s Management Agenda includes the following four program initiatives that apply to the Department:

- Eliminating Improper Payments
- Real Property Management
- Coordination of Department of Veterans Affairs and Department of Defense Programs and Systems
- Privatization of Military Housing

As of September 30, 2006, the Department’s grades were mixed:



## Executive Summary

### Department Scorecard Results

(September 30, 2006)

Government-Wide Initiatives	Status Score	Progress Score
Electronic Government (e-Gov)	R	G
Strategic Management of Human Capital	Y	G
Competitive Sourcing	Y↑	Y↑
Improved Financial Performance	R	G↑
Budget & Performance Integration	Y	G
<b>Program Initiatives</b>		
Eliminating Improper Payments Initiative	Y	G
Real Property Management Initiative	Y↑	Y↓
Coordination of VA and DoD Programs and Systems	Y	Y
Privatization of Military Housing *	G	G
<span>G - SUCCESS</span> <span>Y - MIXED RESULTS</span> <span>R - FAILURE</span>		

Note: ↑↓ Changes in score since FY2005

\* = Results as of June 30, 2006

Following is a brief description of each initiative and actions that the Department has taken toward achieving the President's Management Agenda.

### Electronic Government (E-Gov)

Goal: To ensure that the federal government's \$60 billion annual investment in information technology (IT) is well spent.

Agencies are working to ensure that all major IT investments and projects are:

- Justified with strong business cases
- Completed within 10 percent of cost, schedule, and performance goals
- Secured properly and data is protected appropriately

The E-Gov initiative emphasizes the customer. The Department takes an active role in several government-wide initiatives, including SmartBUY, the Integrated Acquisition Environment, and various education and training initiatives.

### Strategic Management of Human Capital

Goal: To maintain a competent, motivated, and mission-ready workforce able to respond to emerging threats, now and in the future.

In May 2006, the Department issued its Human Capital Strategic Plan to guide and inform human resource policies, programs, and initiatives. Currently, the Department is re-evaluating and assessing its core mission and critical support occupations by: (1) workforce profile and trends, (2) Components' needs and requirements, and (3) geographical locations to ensure alignment with the capabilities listed in the Quadrennial Defense Review. This assessment will provide specific competency-focused results that will help support current and future workload requirements for the Department.

The Department began implementation of the National Security Personnel System on April 30, 2006, with the conversion of approximately 11,000 employees, supervisors, and managers to the pay band system and new performance management system. Between October 2006 and January 2007, 66,000 employees are projected to be converted to the new system. The Department, however, remains enjoined by decision of the U.S. District Court from implementing the National Security Personnel System labor relations system and appeals process.

### Improved Financial Performance

Goal: To ensure transparency over the Department's finances—having timely and reliable financial information on a regular, recurring basis and using



that information to make informed decisions about agency or program management. Transparency means knowing the costs and results of the Department's programs and operations and being able to judge the best return on investment. Demonstrating fiscal accountability and achieving unqualified financial statements are good first steps. Ultimately, the Department will use more accurate, precise, and timely financial information in its day-to-day management.

A major initiative of improved financial performance is the Financial Improvement and Audit Readiness (FIAR) plan, which has been discussed previously in this document.

### ***Budget and Performance Integration***

Goal: To improve program results and to ensure that performance is routinely considered in funding and management decisions.

During FY 2006, the Department formulated, justified, and defended its FY 2007 budget, which requested \$439.3 billion in discretionary budget authority for FY 2007. The budget supports priorities established by the Secretary to fulfill the President's pledges to defeat global terrorism, restructure America's Armed Forces and global defense posture, develop and field advanced warfighting capabilities, and provide for the welfare of the forces. To develop the FY 2007 budget, the Department continued to implement the new Planning, Programming, Budgeting, and Execution System, refining the second year of the Department's 2-year budget. This process increases the effectiveness of the Department's resource allocation process by linking performance results to programming and budgeting decisions and placing additional emphasis on program execution.

The Department developed and submitted the FY 2006 Emergency Wartime Supplemental Request for funds to finance continuing military operations in Iraq and Afghanistan. The request was formulated, in large part,

by calculating the costs, based on current cost and performance data, for specific performance elements (e.g., the deployment of specific units to the theater) and estimating the associated operational tempo.

In addition, the Department met its goal of using the Program Assessment Rating Tool to assess programs representing 80 percent of its resources in the FY 2007 President's Budget.

### ***Competitive Sourcing***

Goal: To help agencies become more results-oriented and effective through public-private competition subject to Office of Management and Budget Circular A-76, Performance of Commercial Activities.

The Department uses the A-76 process only when it makes military and economic sense to do so. Competition is the driving force within the American economy, resulting in improved quality, reduced cost, and rapid delivery of better products and services. The Department continues to use the process of public-private competition to obtain services clearly identified as commercial to improve support to the warfighter and increase readiness. Alternatives to Circular A-76 are focused primarily on military-to-civilian conversions and high performing organizations, in accordance with section 337 of the National Defense Authorization Act of 2004 (Public Law 108-136). These alternatives also produce significant efficiencies, but the Department does not have systems necessary to quantify such efficiencies.

Public-private competition has produced significant savings for the Department. For competitions conducted between FY 2000 and FY 2006, the Department expects to produce savings (cost avoidance) of nearly \$9.4 billion, regardless of who ultimately wins the competition. During FY 2006, the Department initiated competitions involving more than 7,000 positions with anticipated savings (cost avoidance) of \$150 million.





### ***Real Property Management***

Goal: To help agencies efficiently manage the hundreds of billions of dollars in real property owned by the federal government.

The Department has developed and implemented a comprehensive plan to improve real property management with the ultimate goal of ensuring that the right assets are available, when and where needed, with the capabilities necessary to support the warfighter. Accurately capturing the real property inventory, and continuing to refine the performance measures that monitor how well the Department sustains, restores, and modernizes its facilities, are integral steps necessary to accomplish that goal. The Department's plan to monitor progress, identify and correct deficiencies, and address overall management of its real property includes:

- Increased visibility of assets under management through improved real property inventories.
- Application of requirements models that are based on accurate and auditable commercial benchmarks and tied directly to existing and forecasted assets.
- Standardization of performance targets across the Department through improved planning guidance.
- Implementation of mechanisms for continuous tracking of performance through the programming and budgeting cycle.
- Controlling the size of the Department footprint through incentives and robust demolition and disposal programs, including Base Realignment and Closure decisions.
- An up-to-date asset management plan that includes goals and timelines.
- Achieving full sustainment funding levels to prevent deterioration and loss of service life.
- Reaching a recapitalization rate that matches the expected service life of the assets under management, to prevent loss of effectiveness through obsolescence.

### ***Eliminating Improper Payments***

Goal: To strengthen financial management controls to better detect and prevent improper payments, enabling the Department to better ensure the taxpayer dollar is put to use as Congress intended.

During FY 2006, the Department made over \$700 billion in payments to individuals and a variety of other entities. An improper payment occurs when the funds go to the wrong recipient, the recipient receives the incorrect amount of funds, or the recipient receives payment for an ineligible service. Improper payments also include duplicate payments and payments for products and services not received.

The Department maintains a vigorous review process to identify and prevent duplicate vendor payments and ensure that program dollars are spent as intended. This review process includes pre- and post-payment reviews, continual enhancements to commercial payment systems to detect potential erroneous payments prior to disbursement, post-payment reviews of commercial payments within 180 days of disbursement, and continual review of purchase and travel card payments by the Office of Inspector General.

### ***Privatization of Military Housing***

Goal: To eliminate inadequate family housing and increase the quality of life for Service members and their families.

The Department received green scores on the President's Management Agenda for both status and progress on this initiative. Leveraging the Department's resources with private sector capital revitalizes inadequate housing faster and at a lower lifecycle cost to the taxpayer than traditional construction. Since the end of 2000, when the Department privatized nearly 5,900 housing units,



the Department has privatized almost 142,000 units, and plans to privatize a cumulative total of more than 186,000 units by the end of 2007.

## Looking Forward: 2007 and Beyond

The 2006 Quadrennial Defense Review shapes the Department's future with a 20-year outlook by linking strategy to defense resources and encompassing four areas that drive capabilities development and force planning:

- Defeating terrorist networks
- Defending the homeland in depth
- Shaping the choices of countries at strategic crossroads
- Preventing hostile state or non-state actors from acquiring or using weapons of mass destruction

The 2006 Quadrennial Defense Review process also looked at all aspects of the Department to include:

- Programs and force size
- The right mix of capabilities
- Enablers such as logistics, space, and intelligence, surveillance, and reconnaissance
- Roles, missions, and organizations
- Manning and balancing the force
- Business practices and processes
- Department authorities

The 2006 Quadrennial Defense Review recognized that the United States is a Nation at war and is building on lessons learned from recent and ongoing operations in Iraq and Afghanistan. Senior Department leaders guided and participated in all aspects of the review to avoid "stove-piping" of issues and resource priorities. The Quadrennial Defense Review includes ideas from other government agencies, industry, allies, and partners. The Department consulted closely with Congress throughout the process.

A cross-cutting theme of the Quadrennial Defense Review is how America might help allies and

partners develop their capacities to confront common security challenges. Experience in the war on terror has underscored the need for a changed defense establishment—one postured both for extended conflict and continuous transformation.

Based on the Quadrennial Defense Review results, the Department's senior leaders decided to refine the capstone force planning construct that translates the Department's strategy into guidance to shape and size military forces. This wartime construct, described in detail in the 2006 Quadrennial Defense Review, makes adjustments to better capture the realities of a long war by:

- Better defining the Department's responsibilities for homeland defense within a broader national framework.
- Giving greater emphasis to the war on terror and irregular warfare activities, including long-duration unconventional warfare, counter-terrorism, counter-insurgency, and military support for stabilization and reconstruction efforts.
- Accounting for, and drawing a distinction between, steady-state force demands and surge activities over multi-year periods.

At the same time, this wartime construct requires the capability to conduct multiple, overlapping wars. It calls for the forces and capabilities needed for deterrence, reflecting a shift from "one-size-fits-all" deterrence toward more flexible capabilities to deter advanced military powers, regional weapons of mass destruction states, or non-state terrorists.

The 2006 Quadrennial Defense Review provided new direction for accelerating the transformation of the Department to focus more on the needs of Combatant Commanders and to develop portfolios of joint capabilities rather than individual "stove-piped" programs. The 2006 Quadrennial Defense Review emphasizes the needs of the Combatant Commanders as the basis for programs and budgetary priorities.



## Executive Summary .....

This environment also places new demands on the Department's Total Force concept. Although the all-volunteer force has been a key to successful U.S. military operations over the past several decades, continued success in future missions is not preordained. The Total Force of Active and Reserve military, civilian, and contractor personnel must continue to develop the best mix of people equipped with the right skills needed by the Combatant Commanders. The Quadrennial Defense Review updates the Department's workforce management policies to guide investments in the force and improve the workforce's ability to adapt to new challenges.

### **The Quadrennial Defense Review and Department's FY 2007 Budget Submission**

The 2006 Quadrennial Defense Review benefited from the change in the legislation mandating the review. By shifting the completion date of the review to coincide with the submission of the President's FY 2007 budget request, the Congress permitted the Department to "front-load" a limited number of initiatives into the budget submission for FY 2007, rather than waiting until the next full budget cycle. This Quadrennial Defense Review recommended a number of adjustments to align defense plans, policies, and programs with the broader strategic direction as "leading edge" measures in the President's Budget request for FY 2007. The Department will develop additional proposals for the FY 2008 budget submission.

Among the key programmatic decisions the Quadrennial Defense Review proposed to launch in FY 2007 are the following:

- Increasing Special Operations Forces by 15 percent and increasing the number of Special Forces Battalions by one-third to strengthen forces to defeat terrorist networks. U.S. Special Operations

Command is establishing the Marine Corps Special Operations Command, an Air Force Unmanned Aerial Vehicle Squadron, and providing an increase of Navy SEAL teams. The Department also is expanding Psychological Operations and Civil Affairs units by 3,700 personnel, a 33 percent increase. Multi-purpose Army and Marine Corps ground forces are increasing their capabilities and capacity to conduct irregular warfare missions.

- Funding a \$1.5 billion initiative over the next 5 years to develop broad-spectrum medical countermeasures against the threat of genetically engineered bio-terror agents. This will strengthen homeland defense and homeland security. Additional initiatives include developing advanced detection and deterrent technologies and facilitating full-scale civil-military exercises to improve interagency planning for complex homeland security contingencies.
- Developing a wider range of conventional and non-kinetic deterrent options while maintaining a robust nuclear deterrent to help shape the choices of countries at strategic crossroads, strengthen deterrence, and hedge against future strategic uncertainty. It will convert a small number of Trident submarine-launched ballistic missiles for use in a conventional prompt global strike. The Department is increasing procurement of unmanned aerial vehicles to improve persistent surveillance, nearly doubling today's capacity. It is developing the next generation long-range strike systems, accelerating projected initial operational capability by almost two decades.
- Expanding its capabilities and forces for addressing the dangers posed by states that possess weapons of mass destruction and the possibility of terrorists gaining control of them. The U.S. Strategic Command is the lead Combatant Command for integrating and synchronizing efforts to combat weapons of mass destruction, providing a focal point for the Department's efforts. The Department also is establishing a deployable Joint Task Force headquarters for weapons of mass destruction



elimination able to provide immediate command and control of forces for executing those missions.

## Aligning Authority and Accountability through Joint Capability Portfolios

Most of the Department's resources are provided to the Military Services. This arrangement can lead to gaps and redundancies within capability areas as individual Service attempts to supply complete warfighting packages rather than organize to depend on capabilities provided by other Military Departments. To optimize the provision of capabilities for the joint warfighter, the Department is working to re-orient its processes around joint capability portfolios. In the acquisition realm, the Department has already instituted several joint capability reviews. These reviews look across major force programs to assess needed investments in specific capability portfolio areas such as integrated air and missile defense, land attack weapons, and electronic warfare.

The Quadrennial Defense Review used this type of portfolio approach to evaluate surveillance capabilities. The Department began by accounting for all of its current and planned surveillance capabilities and programs, which included a transparent review of capabilities at all levels of classification across the entire portfolio of assets. This review enabled decision-makers to make informed choices about how to reallocate resources among previously stove-piped programs to deliver needed capabilities to the joint force more rapidly and efficiently.

The Department is building on these initial efforts to integrate tasks, people, relationships, technologies, and associated resources more effectively across the Department's many activities. By shifting the focus from Service-specific programs to joint capabilities, the Department will be better positioned to understand the implications of investment and resource trade-offs among competing priorities. As a first step, the Department will manage four capability areas using a capability portfolio concept: Joint Command and

Control, Joint Net-Centric Operations, Battlespace Awareness, and Joint Logistics. As the Department learns from experience and gains confidence in this approach, it plans to expand the concept to other capability areas.

## Summary

Without question, reshaping the defense enterprise is difficult. The structures and processes developed over the past half-century were forged in the Cold War. However, the strategic landscape of the 21st century demands excellence across a much broader set of national security challenges. With change comes turmoil, and achieving a desired vision requires determination and perseverance within the Department. Cooperation with the Congress is vital. As the Department emphasizes agility, flexibility, responsiveness and effectiveness in the operational forces, its organizations, processes, and practices are changing to embody these characteristics to support the joint warfighter and America's Commander in Chief.





## WELCOME TO THE DEPARTMENT OF DEFENSE

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