Section 1: Management's Discussion and Analysis

MISSION AND ORGANIZATIONAL STRUCTURE

Mission

The mission of the United States Armed Forces is to:

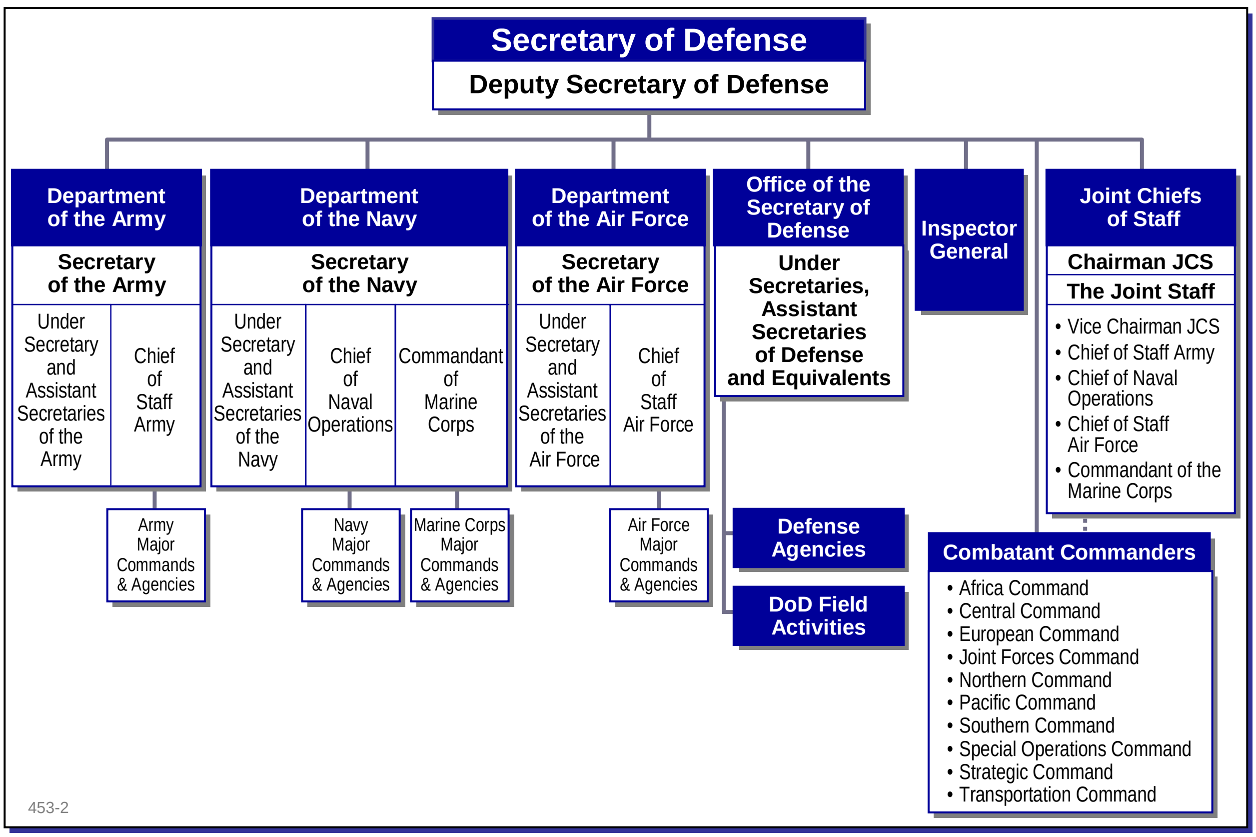
- Defend the United States.
- Deter aggression and coercion in critical regions.
- Swiftly defeat aggression in overlapping major conflicts while preserving for the President the option to call for a decisive victory in one of those conflicts, including the possibility of regime change or occupation.
- Conduct a limited number of smaller-scale contingency operations.

Organization

The Department of Defense is America's oldest, largest, most complex, and most successful organization. Since the creation of America's first army in 1775, DoD has evolved to become a global presence of nearly 3 million individuals, in more than 146 countries, and dedicated to defending the United States by deterring and defeating aggression and coercion in critical regions. The DoD works for America's Chief Executive Officer, the President; the Board of Directors, Congress; and the Nation's shareholders, the American people. As do all successful organizations, DoD embraces the core values of leadership, professionalism, and technical knowledge. Its employees are dedicated to duty, integrity, ethics, honor, courage, and loyalty.

Figure 1-1 shows how the Department is structured.

Figure 1-1. Department of Defense Organizational Structure



The Secretary of Defense 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 a bureau 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 the military operations.

The Military Departments include Active Duty, Reserve, and National Guard forces. Active Duty forces are full-time duty military service members. The Reserves, when ordered to active duty by Congress, support the active forces. They are an extension of the active duty personnel and perform similarly when called into service. The Reserves are also relied upon to conduct counter-drug operations, provide disaster aid, and perform other peacekeeping 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 under the control of the appropriate DoD Military Department. The Guard and Reserve are recognized as indispensable and integral parts of the Nation's defense from the earliest days of a conflict.

U.S. service members exit a C-130 Hercules aircraft at Ali Air Base in Iraq. The aircraft transports personnel and cargo throughout the theater.

U.S. Air Force photo by Tech. Sgt. Sabrina Johnson May 2008

Chairman of the Joint Chiefs of Staff

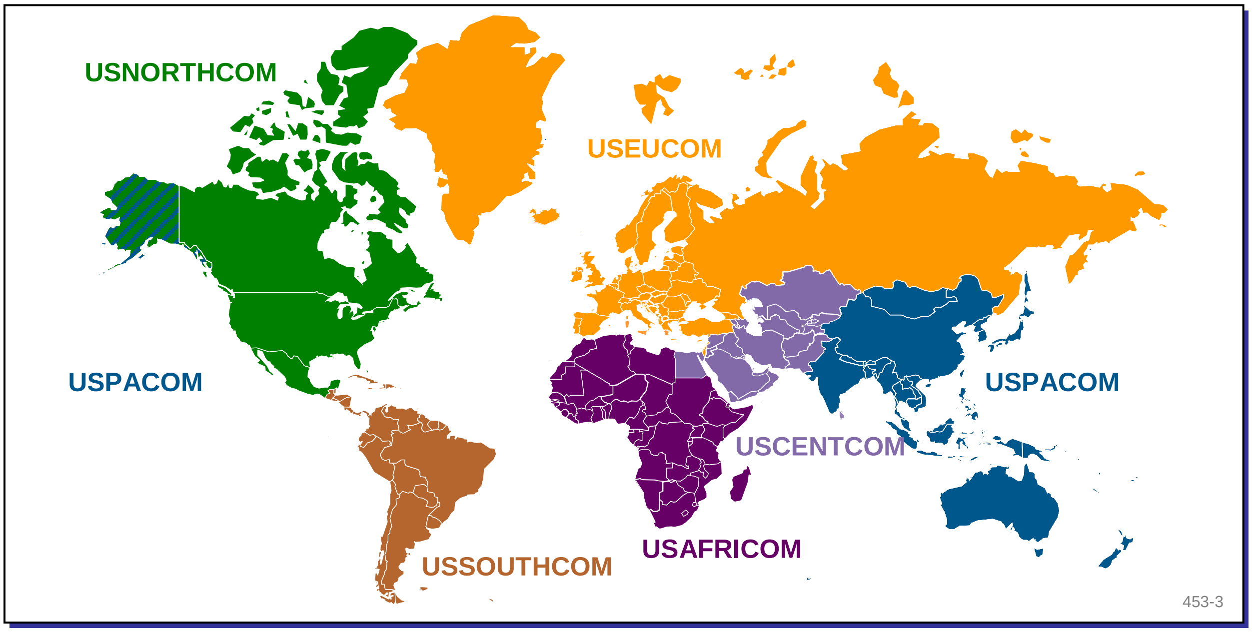
The Chairman of the Joint Chiefs of Staff is the principal military advisor to the President, the National Security Council, and the Secretary of Defense. The Chairman assists the President and the Secretary in providing for the strategic direction of the Armed Forces, including operations conducted 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

The 10 Combatant Commands are responsible for conducting DoD missions around the world (Figure 1-2). The Army, Navy, Air Force, and Marine Corps supply forces to these Commands.

The 10th Combatant Command, U.S. Africa Command (USAFRICOM), officially established in October 2008, assumed responsibility from three existing Combatant Commands to cover all of Africa, with the exception of Egypt. The focuses of USAFRICOM's missions are diplomatic, economic, and humanitarian aid, aimed at prevention of conflict, rather than at military intervention.

Figure 1-2. Geographic Combatant Commands



Six of these Commands have specific mission objectives for their geographic areas of responsibility:

- U.S. European Command (USEUCOM) is responsible for activities in Europe, Greenland, and Russia.
- U.S. Central Command (USCENTCOM) is responsible for the Middle East, several of the former Soviet republics, and Egypt. This Command is primarily responsible for conducting Operation Enduring Freedom in Afghanistan and Operation Iraqi Freedom.
- U.S. Pacific Command (USPACOM) is responsible for Northeast, South, and Southeast Asia, as well as Oceania.
- 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.
- U.S. Africa Command (USAFRICOM) is responsible for all of Africa, with the exception of Egypt.

Four Commands have worldwide mission responsibilities, each focused on a particular function:

- U.S. Strategic Command is responsible for providing global deterrence capabilities and synchronizing DoD efforts to combat weapons of mass destruction worldwide.
- U.S. Special Operations Command is responsible for leading, planning, synchronizing and, as directed, executing global operations against terrorist networks.
- U.S. Transportation Command is responsible for moving military equipment, supplies, and personnel around the world in support of operations.
- U.S. Joint Forces Command is responsible for developing future concepts for joint warfighting.

Elementary school children in Damerdjog, pose for U.S. Marines with the 8th Provisional Security Company deployed to Camp Lemonier, Djibouti, conduct a civil affairs visit to their school.

U.S. Air Force photo by Staff Sgt. Samuel Rogers – September 2008

Defense Agencies and Defense Field Activities

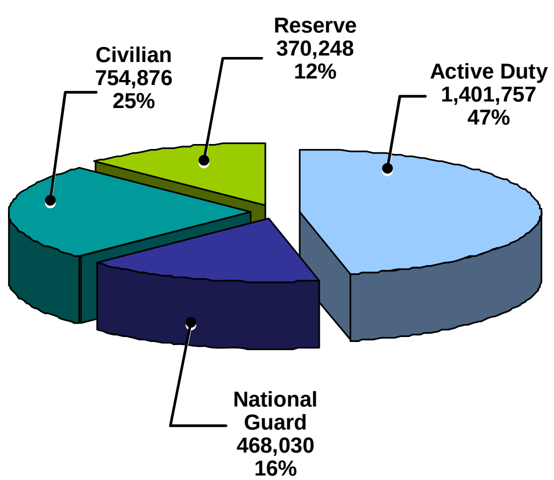
Defense Agencies and DoD Field Activities provide support services commonly used throughout the Department. For example, the Defense Finance and Accounting Service provides accounting services, contractor and vendor payments, and payroll services; and the Defense Logistics Agency provides logistics support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

Resources

Nearly half of the Department's workforce comprises men and women on active duty. To provide Americans with the highest level of national security, the Department employs 1,401,757 men and women on active duty, and 838,278 in the Reserve and National Guard, and 754,876 civilians (Figure 1-3).

The Department's worldwide infrastructure includes nearly 545,000 facilities (buildings, structures, and utilities) located at more than 5,400 sites around the world, on more than 29 million acres. To protect the security of the United States, the Department uses approximately 11,532 aircraft, and 639 ships.

Figure 1-3. Staffing for FY 2008



As of September 30, 2008

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ANALYSIS OF FINANCIAL STATEMENTS

Financial Analysis

The Department's financial statements are presented in Section 2: Financial Information. Preparing these statements is part of the Department's goal to improve financial management and provide information to assess performance and allocate resources. The Department's management is responsible for the integrity of the financial information presented in these financial statements.

The financial statements have been prepared to report the financial position and results of operations. These statements were prepared from the books and records of the Department in accordance with U.S. generally accepted accounting principles (USGAAP) to the extent possible, the Office of Management and Budget (OMB) Circular No. A-136, "Financial Reporting Requirements," and the "DoD Financial Management Regulation."

For FY 2008, 5 of the 33 reporting entities are projected to receive unqualified audit opinions. Additionally, Medicare-Eligible Retiree Health Care Fund and U.S. Army Corps of Engineers are projected to receive a qualified opinion in FY 2008. The Components are listed in Figure 1-4. At the Departmentwide level, favorable reviews were received for the fourth consecutive year on three financial statement line items in FY 2008: (1) Investments, (2) Federal Employees' Compensation Act Liabilities, and (3) Appropriations Received.

Budgetary Resources. The Statement of Budgetary Resources presents total resources of $1.1 trillion that was available to the Department during FY 2008 and the

Figure 1-4. Projected Audit Opinions

DoD Reporting Entity	Audit Opinions
Defense Commissary Agency	Unqualified
Defense Contract Audit Agency	Unqualified
Defense Finance and Accounting Service	Unqualified
Military Retirement Fund	Unqualified
Office of the Inspector General	Unqualified
Medicare-Eligible Retiree Health Care Fund	Qualified
U.S. Army Corps of Engineers	Qualified (1)

(1) Out-of-cycle audit opinion

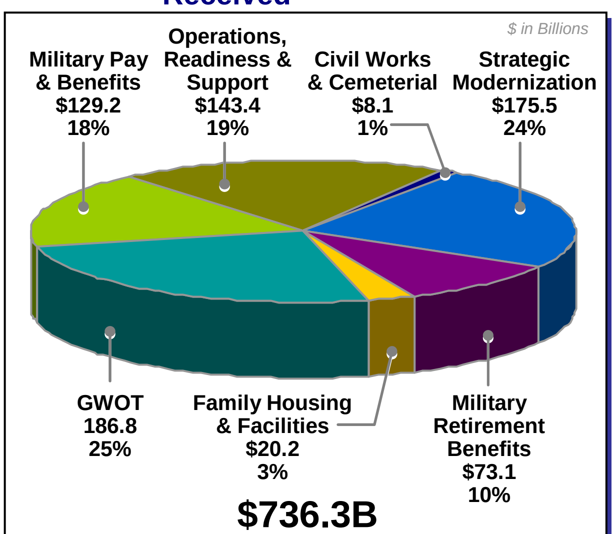
453-18

status at the end of the period. It presents the relationship between budget authority and outlays, and reconciles obligations to total outlays.

The Department's total resources primarily consist of carried forward budget authority of $112.0 billion for unfilled commitments from FY 2007 and received additional appropriations of $736.4 billion in FY 2008 to support the Global War on Terror (GWOT), train and equip our warfighters, and ensure broad national security priorities are met. Figure 1-5 displays appropriations received by program.

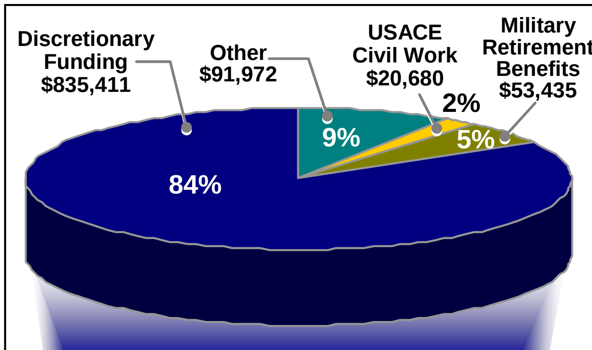
Most ($1.0 trillion or 91%) of the total budgetary resources for FY 2008 were spent or reserved for specific purposes. The remaining resources relate to receipt of multi-year appropriations and supplemental funding that were received late in the fiscal year with insufficient time to fully obligate and outlay. The Department's total FY 2008 obligations incurred are in support of present and future initiatives such as establishing the Africa Command (AFRICOM), building partnership capacity with foreign partners, realigning the ballistic missile defense sites in Europe, and strengthening cyberspace security. Obligations incurred presented in Figure 1-6 are shown separate between mandatory and discretionary funding.

Figure 1-5. FY 2008 Appropriations Received



Amounts include DoD direct appropriations and funds appropriated for military retiree health and pension benefits.

Figure 1-6. FY 2008 Obligations Incurred

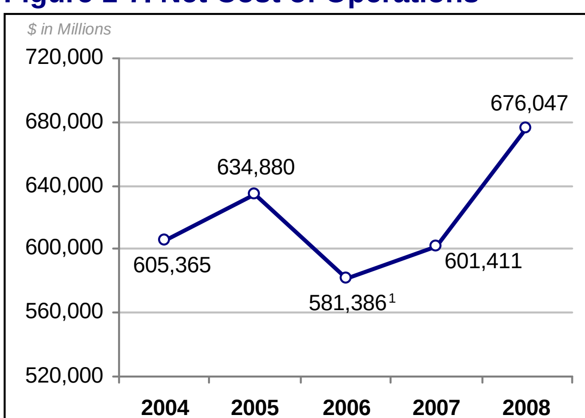


Discretionary Funding	
Military Pay & Benefits	145,550
Family Housing & Facilities	19,859
Operations, Readiness & Support	427,001
Strategic Modernization	243,001
Total	**835,411**

Net Cost of Operations. The Statement of Net Cost presents the net cost of operations which represents the difference between the costs incurred less earned revenue. This is essentially equivalent to outlays displayed on the Statement of Budgetary Resources less capitalized asset purchases plus accrued liabilities and accounts payable. Differences between budgetary resources and net cost generally arise from timing of cost recognition.

The majority of funding used to cover cost is received through congressional appropriations and reimbursement for the provision of goods or services to other federal agencies. The Department's net cost of operations during FY 2008 totaled $676.0 billion. This represents an increase of $74.6 billion, or 12 percent from last year (Figure 1-7).

Figure 1-7. Net Cost of Operations



[1] *Security Assistance Program is not included*

The Military Retirement Benefits accounted for the majority of the FY 2008 increase in cost. This increase is due largely to the growth in actuarial liabilities that resulted from a reduction in the interest rate assumption that affects the value of investments available to pay benefits.

Also contributing to the increase in net cost are the operation and maintenance costs for base operations support related to troop readiness and increased requirements of GWOT.

Balance Sheet. The consolidated Balance Sheet presents a status of our financial condition as of September 30, 2008, and displays assets, liabilities and the resulting net position. Figure 1-8 displays asset and liability trends with the difference depicting the Department's net position.

Assets of $1.7 trillion represent amounts that the Department owns and manages. Assets increased $185.9 billion at the end of FY 2008, or 13 percent. This increase is largely attributable to increases in Fund Balance with Treasury (FBWT), Investments, and Military Equipment.

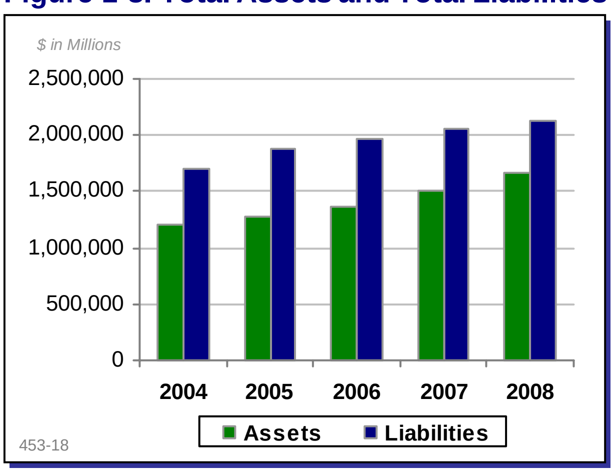
The increase in Fund Balance with Treasury was due to a $73.8 billion increase in appropriated funds primarily in support of the GWOT. The Department was given these appropriations late in the fiscal year with insufficient time to fully obligate and outlay.

The net increase in investments of $60.8 billion is related to expected normal growth to cover unfunded portions of future military retirement and health benefits. Funds not needed to pay current benefits are held in separate trust and special funds and invested in U.S. Treasury securities.

Military Equipment increased $34.0 billion reflecting the receipt of combat vehicles such as Mine Resistant Ambush Protected (MRAP) vehicles, tanks, personnel carriers, other armored vehicles, and trucks, as well as ships and F-22 and C-17 aircraft.

In contrast, the Department has significant unfunded liabilities consisting primarily of actuarial liabilities related to military retirement pension and health care benefits. While the liability presents the Department with a negative financial position, the majority of the unfunded portion will come from annual appropriations outside the Department's budget. The FY 2008 actuarial liability estimate totaled $2.0 trillion of which $1.3 trillion will come from the U.S. Treasury to cover liabilities existing at inception of the programs. Approximately $378.9 billion is currently covered with invested U.S. Treasury securities. Due to the significant growth in liability in recent years, the Board of Actuaries accelerated the liquidation of the initial unfunded liabilities by reducing the amortization period thus increasing the annual contribution amounts from the U.S. Treasury. Figure 1-9 identifies the unfunded portions of liabilities requiring future resources.

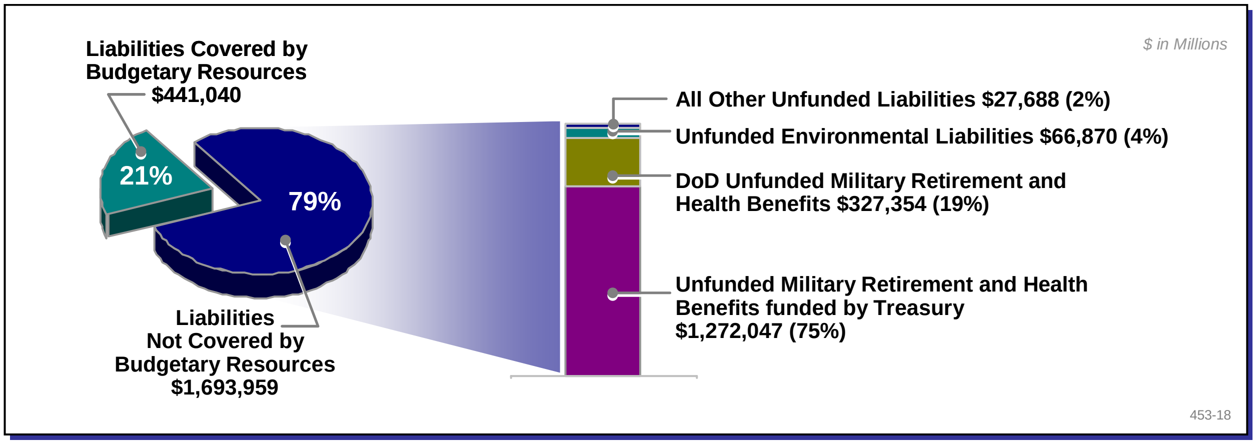
Figure 1-8. Total Assets and Total Liabilities



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 Circular No. A-136 and, to the extent possible, U.S. generally accepted accounting principles (USGAAP). 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

Figure 1-9. Unfunded Liabilities



that they are for a Component of the U.S. Government, a sovereign entity.

The Deputy Secretary of Defense has made financial management improvement and business transformation a priority. He chairs the Defense Business Systems Management Committee, chartered to oversee business transformation, and requires Component heads to demonstrate specific involvement and responsibility by signing their quarterly financial statements. The comprehensive Financial Improvement and Audit Readiness Plan and the Business Transformation Agency's Enterprise Transition Plan drive these improvements.

Financial Improvement and Audit Readiness

The Department initiated the Financial Improvement and Audit Readiness (FIAR) Plan in 2005 to set the course for improving both financial information and audit readiness. The FIAR Plan has three primary goals:

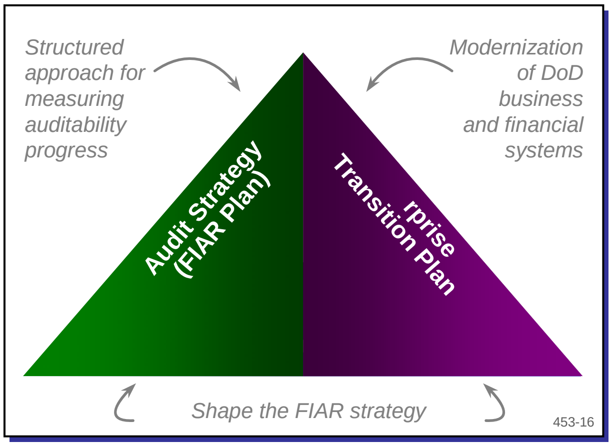
- Improve decision making by providing relevant, accurate, reliable, and timely financial information.
- Sustain improvements through a process of annual assessments and internal control.
- Achieve unqualified audit opinions on DoD annual financial statements.

The first FIAR Plan identified financial management improvement priorities, established standard business rules for financial management improvement efforts, and aligned itself with other business transformation efforts (Figure 1-10). This approach has not changed, although the framework upon which the Department structures, plans, and monitors financial management improvement efforts is today more complete. The FIAR Plan structures improvement efforts into incremental and prioritized areas (such as the U.S. Marine Corps). The OUSD(C) plays an active role in overseeing, managing, and monitoring Component improvement efforts through the FIAR Plan.

The Department has made significant progress in achieving the FIAR goals as evidenced by:

- $1.4 trillion, or 37 percent of $3.8 trillion, of the Department's assets and liabilities has received an unqualified audit opinion,

Figure 1-10. Three Pronged Strategy For Transformation



- The TRICARE Management Activity Contract Resource Management organization's $247 billion (7 percent) in assets and liabilities have been validated as audit ready,
- Favorable audit opinions on five reporting entities' FY 2008 financial statements,
- Favorable reviews on three DoD financial statement line items, and
- Audit readiness at the Defense Information Systems Agency, whose FY 2007 financial statements are presently under audit.

In addition, to the above achievements, the Navy, Air Force and Defense Logistics Agency have asserted audit readiness and are sustaining it until their entire financial statements are ready for audit.

Business Transformation Agency

The Department of Defense is fully engaged in business transformation efforts to modernize its processes, systems, and information flows to support 21st century national security requirements. To help guide this undertaking, the Department established the Defense Business Transformation Agency (BTA) and released its first Business Enterprise Architecture (BEA) and Enterprise Transition Plan (ETP) in 2005. Over the past 3 years, the Department has made significant progress, not only in the improvements to business capabilities, but also in the fundamental ways in which it thinks about business operations and the methods to achieve transformation.

Business Enterprise Architecture

The Business Enterprise Architecture (BEA) guides Defense business transformation by providing a common reference for target systems and initiatives. The BEA blueprints business transformation and includes activities, processes, data standards, business rules, system functionality, and technical standards. Six business enterprise priorities define the scope and allow the BEA to evolve in a controlled and consistent fashion:

- Personnel visibility
- Acquisition visibility
- Common supplier engagement
- Materiel visibility
- Real property accountability
- Financial visibility

Enterprise Transition Plan

The Enterprise Transition Plan is the Department's comprehensive plan for implementing the business enterprise architecture. The Department issues a new ETP each September and reports progress each March. The FY 2008 ETP, like the preceding plans, contains milestones and measures for the programs and initiatives that support achievement of the business enterprise priorities. The ETP describes the Department's system initiatives and status of Enterprise Resource Planning (ERP) and other system implementations throughout the Army, Navy, Air Force, and Defense Agencies. This year's ETP also contains performance measures for achieving the business capabilities and their supporting operational activities. This set of performance measures permits the opportunity to baseline performance growth. The Enterprise Transition Plan has become part of the business operations culture of DoD, and is the framework that integrates capabilities across the Department.

Members of Defense Logistics Agency s (DLA) Defense Distribution Deployable Center prepare to load tarps into trucks at FEMA s Hurricane Ike disaster relief staging area on Fort Sam Houston, Texas.
DoD photo by SPC Sean Harp September 2008

PERFORMANCE OBJECTIVES, GOALS, AND RESULTS

DoD Key Performance Outcomes

The President's Management Agenda (PMA) Budget and Performance Integration Initiative, subsequently renamed Performance Improvement Initiative (PII), is focused on re-emphasizing and implementing all statutory provisions of the Government Performance and Results Act (GPRA) of 1993. The PII calls for a Government that is results-oriented, and guided by performance, not process. Since the first quarter of FY 2003, the Department has maintained a "yellow," or satisfactory, rating for overall status of this initiative.

DoD Performance Budget Hierarchy

The Department's performance budget hierarchy is depicted in Figure 1-11. This hierarchy indicates that every level of DoD is accountable for measuring performance and delivering results at multiple tiers of the organization. The DoD investments in systems and other initiatives are aggregated to support strategic objectives at the enterprise-level.

The DoD strategic objectives and performance targets (measures and milestones) are subject to annual refinement based on changes in missions and priorities. Such changes reflect the evolutionary nature of DoD's performance budget and the Department's ensuing efforts to link resource allocation to identifiable and measurable strategic outcomes.

DoD Strategic Plan

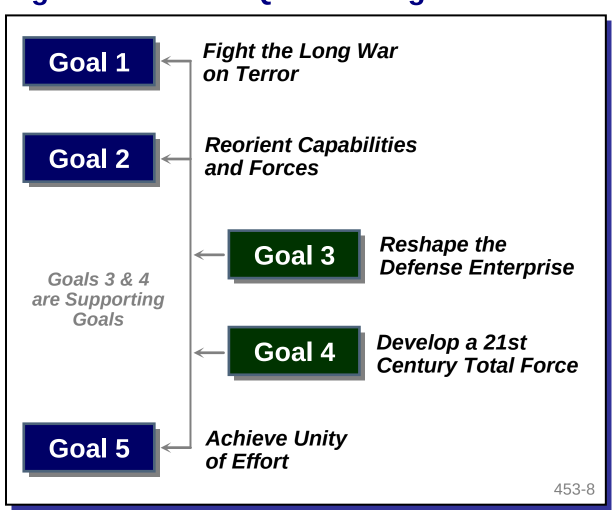
The Quadrennial Defense Review (QDR) constitutes DoD's strategic plan. On February 3, 2006, the Department unveiled its most recent QDR, charting the way ahead for the next 20 years. The QDR report acknowledges that the Department has been and is transforming along a continuum that shifts emphasis from the 20th century to the 21st century. The 2006 QDR was founded on the National Military Strategy, published in May 2004, and the National Defense Strategy, published in March 2005.

Figure 1-11. Department of Defense Performance Budget Hierarchy

The QDR acknowledges that everything done in the Department must contribute to joint warfighting capability. Its purpose is to provide the U.S. with strong, sound, and effective warfighting capabilities.

The 2006 QDR was the first contemporary defense review to coincide with an ongoing major conflict. Consequently, (Figure 1-12) Strategic Goal 1 focuses on the ongoing

Figure 1-12. 2006 QDR Strategic Goals



major conflict and extended stabilization campaigns in Iraq and Afghanistan. At the same time, the 2006 QDR recognized that the Department needed to recast its view of future warfare through the lens of a long duration and globally-distributed conflict. Therefore, Strategic Goal 2 focuses on reorienting the Armed Forces to deter and defend against transnational terrorists around the world. Strategic Goal 5 recognizes that DoD cannot meet today's complex challenges alone. This goal recognizes integrated security cooperation and strategic communication as additional tool sets the Combatant Commanders may use to fight wars. Together, these three goals encompass the Department's warfighting missions. Strategic Goals 3 and 4 focus on developing a Total Force and reshaping the defense infrastructure, respectively, in ways that better support the warfighter. These supporting goals enable accomplishment of the Department's primary goals, Strategic Goals 1, 2, and 5.

FY 2008 Performance Plan

The Department also established a task force and Senior Review Group (SRG) in January 2007 to develop a limited number of strategic objectives and performance targets at the joint- or enterprise-level. The task force and SRG included representatives from each OSD Principal Staff, the Joint Staff, and the Military Departments. As a result of their efforts, 17 supporting strategic objectives and 51 enterprise-level performance targets were developed for FY 2008.

FY 2008 Key Performance Outcomes:

The following tables show key, unclassified strategic objectives and performance measures, and targeted results for FY 2008. The tables are organized by QDR Strategic Goal, and Strategic Objective. Performance Measures are also provided for each strategic objective and are numbered respectively.

The DoD expects to meet or exceed most of its key outcomes for FY 2008. Actual year-end results for these same key outcomes will be addressed in the Department's FY 2008 Citizen's Report.

Strategic Goal 1: Fight the Long War on Terror

Since 2001, the Department has been engaged in developing the forces and capabilities of Iraq and Afghanistan in fighting the long war on terror. Two key outcomes focused on training Iraqi and Afghan Security Forces and were identified as primary indicators for transitioning the security of these two nations to the Iraqi and Afghan governments. By the end of FY 2008, the Department expects to have trained 529,000 Iraqi Security Forces (ISF) and 152,000 Afghan National Security Forces (ANSF).

STRATEGIC GOAL 1: FIGHT THE LONG WAR ON TERROR				
Strategic Objective 1.1:	**Conduct a large-scale, potentially long-duration irregular warfare campaign that includes counterinsurgency, security stability, transition, and reconstruction operations.**			
Performance Measures	**Strategic Plan Long-term Performance Targets**	**Annual Performance Targets/Results**		
		FY 2007 Target	FY 2007 Results	FY 2008 Target
1.1-1a: Cumulative number of Iraqi Security Forces (ISF) trained.	1.1-1a: By FY 2009, DoD will train 588,000 Iraqi Security Forces (ISF).	365,000	439,700	529,000
1.1-1b: Cumulative number of Afghan National Security Forces (ANSF) trained.	1.1-1b: By FY 2009, DoD will train 162,000 Afghan National Security Forces (ANSF).	112,000	124,700	152,000

Strategic Goal 2: Reorient Capabilities and Forces

Four key performance outcomes are most reflective of the Department's goal to reorient its capabilities and forces. Two outcomes reflect new DoD capabilities that have been established to assist in mitigating attacks on the U.S. personnel, facilities, and key assets. Two other outcomes focus on converting Army force structure to modular designs, as primary indicators for the most significant transformation of the Army in a generation.

STRATEGIC GOAL 2: REORIENT CAPABILITIES AND FORCES				
Strategic Objective 2.1:	**Deter or defeat direct attacks to the U.S. homeland and its territories and contribute toward the nation's response to the management of Weapons of Mass Destruction (WMD) or catastrophic event; Improve ability to respond to Chemical, Biological, Radiological, Nuclear, and Explosive (CBRNE) attacks and improve the capability of interagency partners to contribute to our nation's security.**			
Performance Measures	**Strategic Plan Long-term Performance Targets**	**Annual Performance Targets/Results**		
		FY 2007 Target	FY 2007 Results	FY 2008 Target
2.1-1: Number of National Guard Weapons of Mass Destruction –Civil Support Teams (WMD-CSTs) certified.	2.1-1: By FY 2007, 55 National Guard Weapons of Mass Destruction-Civil Support Teams (WMD-CSTs) will be certified.	55	55	55
2.1-2: Number of National Guard Chemical, Biological, Radiological, Nuclear, and High-Yield Explosive (CBRNE) Enhanced Response Force Packages (CERFPs) trained.	2.1-2: By FY 2008, 17 National Guard Chemical, Biological, Radiological, Nuclear, and High-Yield Explosive (CBRNE) Enhanced Response Force Packages (CERFPs) will be trained for WMD or other catastrophic responses.	12	12	17
Strategic Objective 2.2:	**Deter and defend against transnational terrorists attacks and globally distributed aggressors and shape the choices of countries at strategic crossroads, while postured for a second, nearly simultaneous campaign.**			
2.2-4a: Number of Army Brigades Combat Teams (BCTs) converted to a modular design and available to meet military operational demands.	2.2-4a: By FY 2013, 76 modular Army Brigade Combat Teams (BCTs) will be available to meet military operational demands.	35	35	38
2.2-4b: Number of Army Multi-functional and Functional Support (MFF) brigades converted to a modular design and available to meet military operational demands.	2.2-4b: By FY 2013, 227 modular Army Multi-functional and Functional Support (MFF) brigades will be available to meet military operational demands.	144	144	187

Strategic Goal 3: Reshape the Defense Enterprise

Five key performance outcomes are identified as representative samples of the Department's reshaping goal. The first outcome, average customer wait time, has been used by the DoD logistics community to improve joint warfighting support. The second key outcome under this goal reflects a reduction in the number of inadequate military family housing units in the continental United States in order to improve the quality of life for service members and their families. The third and fourth outcomes demonstrate an increase in DoD's financial audit readiness—a significant step in improving financial stewardship to the American taxpayer. The final performance outcome shows how the Department's inventory of information technology systems are faring against information assurance standards.

STRATEGIC GOAL 3: RESHAPE THE DEFENSE ENTERPRISE				
Strategic Objective 3.3:	**Implement improved logistics operations to support joint warfighting priorities.**			
Performance Measures	**Strategic Plan Long-term Performance Targets**	**Annual Performance Targets/Results**		
		FY 2007 Target	FY 2007 Results	FY 2008 Target
3.3-1: Average customer wait time.	3.3-1: Beginning in FY 2007, DoD will reduce average customer wait time to 15 days.	15	17	15
Strategic Objective 3-4:	**Maintain capable, efficient, and cost-effective installations to support the DoD workforce.**			
3.4-4a: Number of inadequate family housing units in CONUS.	3.4-4a: By FY 2009, DoD will eliminate all inadequate family housing in the continental United States (CONUS).	0	13,242	2,959
Strategic Objective 3.5:	**Improve financial management and budget and performance integration to support strategic decisions and provide financial stewardship to the taxpayer.**			
3.5-1a: Percent of audit-ready assets.	3.5-1a: By 2017, DoD will demonstrate that 100 percent of assets have achieved audit readiness.	18%	15%	23%
3.5-1b: Percent of audit-ready liabilities.	3.5-1b: By 2017, DoD will demonstrate that 100 percent of liabilities have achieved audit readiness.	49%	50%	51%
Strategic Objective 3.6:	**Make information available on a network that people depend on and trust.**			
3.6-2: Percent of applicable information technology (IT) and National Security Systems (NSS) programs that are FISMA-compliant.	3.6-2: By FY 2013, 95 percent of applicable information technology (IT) and National Security Systems (NSS) programs in the IT Repository will be FISMA-compliant.	90% or >	87.1%	90% or >

Strategic Goal 4: Develop a 21st Century Total Force

Four key performance outcomes are focused on sustaining the capacity of the All-Volunteer Force to prevail in the Global War on Terror. Two outcomes assess DoD active and reserve component end-strength at levels not less than those prescribed by the Secretary of Defense for mission accomplishment. A third outcome measures how well the Military Health Service identifies significant medical conditions that would affect the availability of Service members to deploy. This goal's final key outcome measures the Department's ability to support the Combatant Commanders across the full spectrum of operations by providing combat units trained in joint warfighting doctrine.

STRATEGIC GOAL 4: DEVELOP A 21ST CENTURY TOTAL FORCE				
Strategic Objective 4.1:	**Ensure an "All Volunteer" military force is available to meet the steady-state and surge activities of the DoD.**			
Performance Measures	**Strategic Plan Long-term Performance Targets**	**Annual Performance Targets/Results**		
		FY 2007 Target	FY 2007 Results	FY 2008 Target
4.1-1a: Percent variance in Active component end strength.	4.1-1a: For each fiscal year, the DoD Active component end strength must not be less than (NLT) and not to exceed (NTE) three percent above the SECDEF prescribed end strength for that fiscal year.	NLT authorized /NTE +3% above SECDEF prescribed end strength	+.9% above SECDEF prescribed end strength	NLT authorized/ NTE +3% above SECDEF prescribed end strength
4.1-1b: Percent variance in Reserve component end strength.	4.1-1b: For each fiscal year, the DoD Reserve component end strength will not vary by more than two percent from the SECDEF prescribed end strength for that fiscal year.	+/-2% from SECDEF prescribed end strength	-1.7% below SECDEF prescribed end strength	+/-2% from SECDEF prescribed end strength
4.1-2: Percent of deployable Armed Forces without any deployment- limiting medical condition.	4.1-2: By FY 2010, DoD will sustain the percent of deployable Armed Forces without any deployment-limiting medical condition to equal to or greater than 92 percent.	>87% of deployable Armed Forces	85% of deployable Armed Forces	>90% of deployable Armed Forces
Strategic Objective 4.4:	**Improve workforce skills to meet mission requirements.**			
4.4-2: Percent of deployed combat units receiving joint training in Joint National Training Center (JNTC) - accredited programs prior to arriving in theater.	4.4-2: By FY 2012, 80 percent of deployed combat units will participate in joint training at JNTC-accredited programs prior to arriving in theater.	Not available	70% of units trained	72% or greater of units trained

Strategic Goal 5: Achieve Unity of Effort

This goal focuses on building the capacity of international partners in fighting the Global War on Terror by improving access to equipment, technology, and training. A single key outcome provides for an increase in the number of various technological and security reviews of goods and services proposed for transfer to international partners.

STRATEGIC GOAL 5: ACHIEVE UNITY OF EFFORT				
Strategic Objective 5.1:	**Build capacity of international partners in fighting the war on terror.**			
Performance Measures	**Strategic Plan Long-term Performance Targets**	**Annual Performance Targets/Results**		
		FY 2007 Target	FY 2007 Results	FY 2008 Target
5.1-1: Annual number of Technology Security Actions (TSAs) processed.	5.1-1: Beginning in FY 2007, DoD will increase the number of reviews of relevant technologies involving transfers to international partners by two percent per year.	102,059	116,017	118,337

ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

Management Assurances

The Department's management is committed to addressing DoD weaknesses, as identified in evaluations and assessments of its management systems, controls, and processes. The DoD's overall goal is to improve its operations by focusing on ensuring effective internal controls, systems conformance with federal requirements, and the ability to produce accurate, timely, and reliable financial and performance data for reporting.

Federal Managers' Financial Integrity Act

The Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires agencies to establish internal controls and financial systems that ensure the integrity and protection of federal programs and operations. In addition, FMFIA requires the head of each agency to provide an annual assurance statement outlining what the agency has done to meet this requirement, including details of remaining material weaknesses. OMB Circular A-123, "Management's Responsibility for Internal Control" provides specific requirements to agencies for conducting management's assessments of internal controls. For FMFIA reporting results, see Section 3: Other Accompanying Information.

ANNUAL ASSURANCE STATEMENT

DEPUTY SECRETARY OF DEFENSE
1010 DEFENSE PENTAGON
WASHINGTON, DC 20301-1010

November 17, 2008

The Department of Defense's (DoD) leadership is committed to establishing and maintaining effective internal management controls and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). The Department aggressively reduced material weaknesses by 85 percent—from 116 material weaknesses in Fiscal Year 2001 to 17 in Fiscal Year 2008 and we continue to work towards zero weaknesses. By instituting a senior-level review, the Department is attempting to accelerate the correction and eliminate remaining material weaknesses. Details of these material weaknesses are available in Section 3, Other Accompanying Information.

As part of a Department-wide evaluation and assessment of internal management controls, the DoD provides qualified reasonable assurance that objectives of the FMFIA over non-financial operations have been achieved. The Department conducted its assessment on the effectiveness of internal controls over financial reporting, according to the Office of Management and Budget's Circular No. A-123, Appendix A, *Management's Responsibility for Internal Control*. This evaluation determined that, while measurable progress is being made, as of June 30, 2008, the Department cannot provide reasonable assurance that internal management controls over financial reporting are effective. As of the date of this report, the Department's financial systems are not in substantial compliance with the Federal Financial Management Improvement Act.

The Department continues to achieve positive results by:

- Increasing awareness on the importance of establishing and maintaining effective internal management controls through the "*Check It*" campaign challenge.
- Emphasizing internal management control program responsibility, and providing training throughout DoD to include deployed troops.
- Ensuring senior management attention to internal management controls.
- Focusing on responsible planning to resolve financial reporting and systems weaknesses through the Department's Financial Improvement and Audit Readiness and Enterprise Transition Plans.

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act (FFMIA) requires certain federal agencies, including DoD, to report on conformance with Federal Financial Management System Requirements, Federal Accounting Standards, and the U.S. Standard General Ledger at the transaction level.

The Department's Inspector General and the audit agencies within the Military Services have reported on the Department's noncompliance with the Act's requirements. The Department's non-compliance is largely due to the legacy financial management systems in use by the Department's Components. These systems, for the most part, do not comply with the wide range of requirements for systems compliance and, therefore, do not provide the necessary assurances to rely on information contained either in the core financial system or in the mixed systems that provide source transactional information. The Business Enterprise Architecture is the Department's blueprint providing the business rules and controls for complying with the Act's requirements. The Financial Improvement and Audit Readiness Plan and the Enterprise Transition Plan provide the approach and plan for reaching unqualified audit opinions and FFMIA compliance.

Improper Payments Information Act Reporting

The Improper Payments Information Act (IPIA) of 2002, as implemented by OMB Circular A-123, Appendix C, "Requirements for Effective Measurement and Remediation of Improper Payments," requires federal agencies to review their programs and activities, and identify those susceptible to significant improper payments. The National Defense Authorization Act (PL 107-107) established the requirement for government agencies to carry out cost-effective programs for identifying and recovering overpayments made to contractors, also known as "recovery auditing." The OMB established specific

Shiite pilgrims walk across Sarafiyah Bridge on their way to the Kadhamiyah shrine in Baghdad, Iraq. The bridge was destroyed last year by insurgents and reopened to traffic in early 2008

DoD photo by Staff Sgt. Lorie Jewell, U.S. Army July 2008

reporting requirements for agencies with programs that possess a significant risk of improper payments and for reporting on the results of recovery auditing activities. For FY 2008 IPIA reporting results, see Section 3: Other Accompanying Information.

OTHER MANAGEMENT INFORMATION, INITIATIVES, AND ISSUES

Looking Forward: Challenges for 2008 and Beyond

The 2006 Quadrennial Defense Review (QDR) provided new direction for accelerating the transformation of the Department to focus more on the needs of Combatant Commanders and to better develop joint capabilities rather than individual, parallel programs. The QDR was designed to serve as a catalyst to spur the Department's continuing adaptation and reorientation to a joint force that is more agile, more rapidly deployable, and more capable against the wider range of threats.

The essence of capabilities-based planning is to identify capabilities that adversaries could employ and capabilities that could be available to the United States, then evaluate their interaction, rather than over-optimize the joint force for a limited set of threat scenarios.

The goal is to manage the Department increasingly through the use of joint capability portfolios. Doing so should improve the Department's ability to meet the needs of the President and Combatant Commanders.

Moving toward a more "demand-driven" approach reduces program redundancy, improves joint interoperability, and streamlines acquisition and budgeting processes. The Department is continuing to shift from stovepiped vertical programs to more transparent and horizontally-integrated programs. Just as the U.S. forces operate jointly, DoD recognized that horizontal integration must become an organizing principle for the Department's investment and enterprisewide functions. These reforms will not occur overnight, and care must be taken not to weaken what works effectively during the transition to a more cross-cutting approach. However, the complex strategic environment of the 21st century demands greater integration of forces, organizations and processes, and closer synchronization of actions.

Aligning Authority and Accountability through Joint Capability Portfolios

Most of the Department's resources are provided through the Military Services. This arrangement can lead to both gaps and redundancies within capability areas as each Service attempts to supply a complete warfighting package rather than organize to depend on capabilities provided by other Military Departments. To optimize capabilities for the joint warfighter, the Department is working to reorient 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 QDR used such a portfolio approach to evaluate surveillance capabilities. The Department began by accounting for all of its current and planned surveillance capabilities and programs. This included a transparent review of capabilities at all levels of classification. Viewing capabilities across the entire portfolio of assets enabled decision-makers to make informed choices about how to reallocate resources among previously stovepiped 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 should 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, Joint Logistics, and Battlespace Awareness. As lessons are learned, the Department will expand this approach to other capability areas.

Summary

Reshaping the Defense enterprise is a difficult task. The structures and processes developed over the past half-century were forged during the Cold War and are strengthened by success. However, the strategic landscape of the 21st century demands excellence across a broader set of national security challenges. With change comes turmoil, and achieving a desired vision requires determination and perseverance within the Department and, more importantly, in cooperation with Congress. As the Department emphasizes agility, flexibility, responsiveness, and effectiveness in the operational forces, the Department's organizations, processes, and practices must change to embody these characteristics and maximize support to the joint warfighter and the Commander in Chief.