DEFENSE FINANCE AND ACCOUNTING SERVICE

WORKING CAPITAL FUND

FISCAL YEAR 2008 FINANCIAL REPORT

DECEMBER 2008

Urbach Kahn & Werlin LLP
CERTIFIED PUBLIC ACCOUNTANTS

DEPARTMENT OF DEFENSE
DEFENSE FINANCE AND ACCOUNTING SERVICE
WORKING CAPITAL FUND
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MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2008

In Fiscal Year (FY) 2008, the Defense Finance and Accounting Service (DFAS) continued its endeavor to reform financial management, improve the quality of DFAS products and services, and reduce costs to customers. The DFAS efforts support the President's Management Agenda, the Department of Defense (DoD) transformation initiatives, and the men and women who defend America.

DESCRIPTION OF THE REPORTING ENTITY

The DFAS mission is to direct, approve, and perform finance and accounting activities for DoD. DFAS pays all DoD military and civilian personnel, retirees and annuitants, civilian employees of various federal agencies, major DoD contractors and vendors, and delivers accounting reports and financial information. DFAS employs approximately 11,500 people throughout the United States and in the European and Pacific theaters of operations to serve this purpose. The information in this document, and the accompanying financial statements and footnotes, are the responsibility of DFAS management.

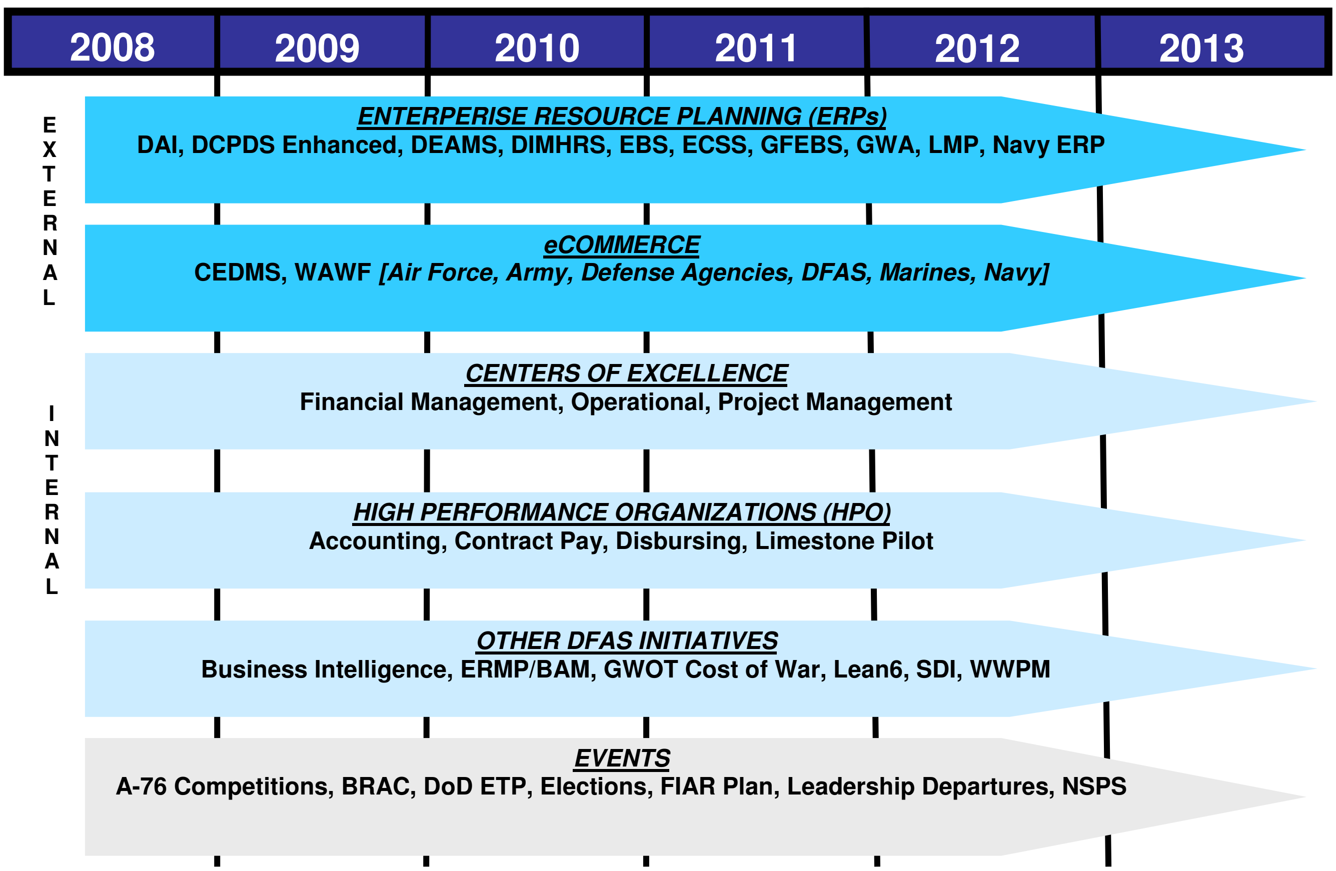
As a Defense Working Capital Fund (WCF) activity, DFAS operates similarly to a private business, obtaining revenue by charging customers fixed prices for its services. DFAS sets its rates annually, 2 years in advance, based on anticipated workload and estimated costs calculated to offset any prior year gains or losses. Unlike private businesses, DFAS has little flexibility to adjust prices in the year of execution, and DFAS operations are subject to DoD, Executive Branch and Legislative Branch oversight.

In FY 2000 through FY 2008, DFAS received unqualified audit opinions on its Working Capital Fund (WCF) financial statements. DFAS has built an effective, accountable management structure with clearly defined, measurable goals. Our progress is charted and regularly reported to our stakeholders. Our programs and initiatives are guided by the Under Secretary of Defense (Comptroller) (USD(C)) and Chief Financial Officer (CFO), and an Audit Committee.

DFAS was generally structured to support Army, Navy, Marine Corps, Air Force, and the Defense Agencies via departmental and field operating networks. Actions implementing the President's Management Agenda have added new customers from outside the DoD, including the Department of Energy, the Department of Veterans Affairs, the Environmental Protection Agency, the Executive Office of the President, and the Department of Health and Human Services.

DFAS's structure is designed to anticipate and meet customers' needs by assigning each major customer a dedicated client executive who fosters effective communications and builds partnerships that enhance customers' mission capabilities. Client Executives ensure the DFAS team understands the unique and diverse needs of each customer.

DFAS is a customer-focused, strategy-based, and metrics-driven organization. The DFAS Strategic Plan drives daily operations to help achieve the Agency's vision of transforming with the Warfighter to remain the trusted financial partner for DoD. In refining its strategy for FY 2008 through 2013, DFAS outlined specific goals and objectives (depicted below) for becoming more customer oriented, shortening response time, improving quality, emphasizing teamwork, enhancing employee growth and satisfaction, and positioning DFAS for the future.



Implementations and Events Expected in the Next Five Years

DFAS has adopted the Balanced Scorecard (BSC) as a management tool for tracking Agency-wide progress toward achieving its strategic objectives. The BSC enables DFAS to translate its strategy into quantifiable measures and targets by bringing together, in a single management report, various aspects of the Agency's competitive agenda: becoming customer oriented, shortening response time, improving quality, emphasizing teamwork, enhancing employee growth and satisfaction, and positioning DFAS for the future. At DFAS, every measure has an executive sponsor and 'measure expert' to champion organizational progress in that area. Using the BSC to make the connection from DFAS's vision and strategic targets to individual performance and standards allows our employees to see how they contribute to corporate goals.

PERFORMANCE GOALS AND OBJECTIVES

DFAS has identified the following goals and objectives that address the critical issues facing our customers and our core capabilities:

FY 2008 through 2013 Strategic Plan Goals:

- Support DoD in prevailing in the Global War on Terror (GWOT)
- Lead transformation of finance and accounting functions throughout DoD
- Perform the DFAS mission at best value for DoD
- Attain operational excellence in finance and accounting services
- Attract, develop, and retain a highly capable workforce with relevant skills and competencies

FY 2008 through 2013 DFAS Objectives:

- Support Customers in the GWOT
- Establish business requirements for DoD transformation initiatives related to finance and accounting activities
- Execute and/or support deployment of DoD transformation initiatives
- Use DFAS resources efficiently and effectively to achieve expected results
- Achieve expected financial results from transformation initiatives
- Optimize processes to meet or exceed industry and government standards
- Increase productivity and deliver products and services on time
- Identify and mitigate risks to improve processes and internal controls
- Raise the level of relevant skills and competencies to meet anticipated needs
- Attract and retain employees with needed skills and competencies

DFAS STRATEGY

MISSION
Direct, approve and perform finance and accounting activities for DoD

VISION
Transforming with the Warfighter to remain the trusted financial partner for DoD

GOALS	OBJECTIVES
	Customer Perspective
Support DoD in prevailing in the Global War on Terror	Support Customers in the Global War on Terror
Lead transformation of finance and accounting functions throughout DoD	Establish business requirements for DoD transformation initiatives related to finance and accounting activities Execute and/or support deployment of DoD transformation initiatives
	Financial Perspective
Perform the DFAS mission at best value for DoD	Use DFAS resources efficiently and effectively to achieve expected results Achieve expected financial results from transformation initiatives
	Internal Perspective
Attain operational excellence in finance and accounting services	Optimize processes to meet or exceed industry and government standards Increase productivity and deliver products and services on time Identify and mitigate risks to improve processes and internal controls
	Learning & Growth Perspective
Attract, develop, and retain a highly capable workforce with relevant skills and competencies	Raise the level of relevant skills and competencies to meet anticipated needs Attract and retain employees with needed skills and competencies

These goals and objectives will allow DFAS's leadership to examine the Agency's business from four important perspectives by providing answers to four basic questions:

- How do our customers see us? (customer perspective)
- What is the impact of strategy execution on bottom-line resource management? (financial perspective)
- Are our processes efficient and effective? (internal perspective)
- Can we continue to improve and create value through the growth of our human capital? (learning and growth/innovation perspective)

The BSC, along with key indicator reports and performance measurement indicators, is used to monitor the overall health of the organization. It provides operational and financial performance indices to effectively and efficiently manage our business operations. Performance objectives in the BSC focus on continued achievement of the DFAS mission to direct, approve and perform finance and accounting activities for DoD. Our Deputy Directors continue to improve BSC reporting under its four perspectives. Success factors for each of its supporting measures are reviewed, compiled and analyzed monthly. Any out-of-tolerance conditions are reported to management, along with a plan of action and milestones, to mitigate the situation.

The BSC indices provide management with real-time information to assist in identifying areas requiring improvement and/or modification. Employees are kept apprised of BSC measures and any corrective actions necessary to achieve established goals. Coupled with an extensive communications effort to ensure employee understanding, the BSC enables DFAS to avoid the perils of improvement in one area at the expense of another through a multidimensional approach to assessing the Agency's overall performance.

The following accomplishments highlight the magnitude of DFAS worldwide operations during FY 2008:

- Processed 154.6 million pay transactions (5.9 million people)
- Made 6.9 million travel payments
- Paid 14.2 million commercial invoices
- Posted 54.5 million general ledger transactions
- Managed military retirement and health benefits funds ($328 billion)
- Made approximately $446 billion in disbursements to pay recipients
- Managed $22.1 billion in foreign military sales (reimbursed by foreign governments)
- Account for 865 active DoD appropriations

TRANSFORMATION AND REORGANIZATION

DFAS focuses on being a trusted partner and a Center of Excellence (COE) for government finance and accounting. To achieve this vision, DFAS is pursuing continuous improvement in the delivery of finance and accounting services in support of the warfighter.

The DFAS transformation strategy is aligned with the DoD's transformation goals and objectives and with the President's Management Agenda. The DFAS transformation includes proactive planning for the future, emphasis on "best value" solutions, agility to address DoD and customer objectives, and employee participation.

The DFAS transformation strategy leverages and integrates a large, complex portfolio of cross-cutting Agency level Transformation events, while ensuring other business functions have the proper oversight and control. The ultimate objective of the organization is to optimize performance and continue to reduce costs.

With oversight by the Transformation Directorate, Strategic Business Management Deputate (SBM), the Agency continues to integrate plans and project schedules for the major transformation initiatives impacting DFAS during 2008 and beyond. The executive leadership has validated an inventory of approximately 40 initiatives. Project management assessments were completed for each initiative, with the primary goals to validate baseline information and to monitor the achievement of key milestones and project outcomes. In conjunction with the DoD Business Transformation Agency Enterprise Transition Plan, DFAS created an initial Transformation Integrated Master Schedule and governance process to support DFAS management of Transformation costs, schedules, and performance, both individually and across initiatives.

The Transformation Directorate also manages all Base Realignment and Closure (BRAC) 2005 actions for DFAS. BRAC legislation directed DFAS to close 20 sites within the continental United States and Hawaii, realign the functions performed in the Arlington, VA site, except for essential DFAS liaison staff, and migrate the functions into five Enduring Sites in Cleveland, OH; Columbus, OH; Indianapolis, IN; Limestone, ME; and Rome, NY. During FY 2008, DFAS successfully closed six (6) sites, bringing the total number of sites closed since June 2006 to seventeen (17), all on schedule and within budget.

In FY 2008, Charleston, SC; San Diego, CA; Omaha, NE; Pensacola, FL; Rock Island, IL; and Kansas City, KS closed on schedule and within budget. The DFAS provided employee transition options that included paid relocation, priority placement with other agencies, early retirement incentives, and potential private sector employment opportunities. For sites closed in FY 2008, 41 percent of the employees accepted DFAS or other agency employment, 42 percent retired, and 17 percent were separated voluntarily or under Reduction in Force actions.

For all FY 2008 site closures, workload transition to the Enduring Sites occurred while sustaining the quality of customer deliverables. This outcome was achieved through diligent project planning and execution by DFAS personnel and through the use of $129M of BRAC Operations & Maintenance financing utilized in support of DFAS BRAC efforts.

The DFAS will continue its transformation to offer best value to the warfighter, our customers, and the American taxpayer. To assist in accomplishing DFAS's transformation goal, DFAS has developed the following organizational structure:

1. **Principal Deputy Director**
   - Business Intelligence
   - Information & Technology
   - Enterprise Management Services
   - Internal Review
   - Office of General Counsel
   - Chief of Staff
   - Equal Employment Office
   - Human Resources (moved from SBM FY 08)

2. **Operations**
   - Indianapolis
   - Columbus
   - Cleveland
   - Denver
   - Limestone
   - Rome
   - Standards and Compliance (S & C)

3. **Strategic Business Management**
   - Policy and Performance Management
   - Transformation
   - Financial Management Center of Excellence
   - Office of Strategy Management

PRINCIPAL DEPUTY DIRECTOR

Information and Technology

The Information and Technology Directorate (I&T) oversees the DFAS implementation of DoD Information Technology (IT) policy and compliance programs, facilitates an integrated Enterprise Architecture, monitors and evaluates the performance of all information and technology investments, and develops and maintains the Agency's operational, technical, infrastructure, and application systems architectures.

The I&T Directorate oversees the provisioning of telecommunications, computing and software engineering services, manages the agency's information assurance program, and maintains the DFAS infrastructure system (e.g., Enterprise Local Area Network). I&T supports systems development and maintenance while managing the systems which play a critical role in paying our country's military service members and civilians and is improving security for systems such as MyPay in order to protect sensitive data against an increasing number of external attacks. Within I&T, the eSolutions organization was established and is responsible for implementing the agency's electronic commerce strategy with a 90% electronic commerce goal.

Accomplishments/Initiatives:

- I&T continues to play an important role in providing tactical support to the Army and Marine Corps for Operation Iraqi Freedom. Systems and operations support for the Deployable Disbursing System (DDS) is available to the nation's war-fighters 24/7 while we continue to deliver software changes as requested by US soldiers and Marines. The implementation of the Corporate Electronic Document Management System (CEDMS) to the Finance Management companies throughout the Iraqi region eliminates risks associated with soldiers' hand-carrying hard copy documents throughout Theatre. This also allows disbursements to be processed in DDS within 24 hours instead of weekly.

- The Director of I&T led an agency-wide campaign for protecting Personally Identifiable Information (PII) where all agency organizations and their employees conducted PC and workspace reviews to ensure all accessible PII data was protected. An emphasis was placed on Data at Rest (DAR) and use of CREDENT2go encryption software. Controls were applied where vulnerabilities were identified. Furthermore, DFAS is 100% compliant with the DoD requirement to encrypt sensitive unclassified DAR for all laptops and desktops as stated in the DoD Chief Information Officer memo dated July 3, 2007.

- Various organizations within the I&T Directorate continuously review and monitor system security controls. They respond quickly to Joint Task Force for Global Network Operations initiatives, review and enforce data encryption and the secure transfer of files, and enforce the protection of PII. Per DoD instruction (November 28, 2007) to transition from DoD Information Technology Security Certification and Accreditation Process (DITSCAP) to DoD Information Assurance Certification and Accreditation Process (DIACAP), we began implementation and monitoring for DFAS systems. As existing DITSCAP-based accreditations expire, we reaccredit them using the DIACAP vehicle. Additionally, all system managers are required to develop a System Identification Profile which begins the registration process for a DIACAP-based accreditation and which will position systems for future transition to the DIACAP as current accreditation expires.

- The DFAS remains a frontrunner in DoD for implementing required DoD Enterprise Information Assurance (IA) tools such as Host Based Security System. I&T's Computer Network Defense Service Provider (CNDSP) Team has consistently been asked to brief at DISA sponsored IA Tools Working Group Conferences where presentations consist of the state of IA Tools deployment, hardware configurations, server population, general network architecture, scanning methodologies, remediation strategies, significant issues and challenges encountered, best practices, lessons learned and custom workarounds developed. The DFAS CNDSP team continually assists other agencies and DoD components in solving issues not addressed by the industry. The DFAS' implementation of the IA Tools and a sound remediation strategy has resulted in a 98.4% drop in our number of Information Assurance Vulnerability Assessment findings.

- I&T Directorate remains active in successfully migrating workload and equipment to enduring sites as part of BRAC transformation. The DFAS' Charleston and San Diego sites were closed on schedule and within budget with no disruption to customer support or failure to meet agency mission. This was accomplished through meticulous planning and by establishing a solid relationship with Operations to ensure technology changes included Technology Services Organization (TSO) participation. The infrastructure team performs discovery and validation prior to actual teardown and in doing so has contributed to savings through re-use of Enterprise-Wide Local Area Network equipment, laptops and towers. At San Diego, a team of technicians performed removal of data and voice cabling which resulted in a savings of $250,000. As an enduring site, Indianapolis has absorbed five positions, and by the end of FY2008, TSO workload migrations will have occurred for 11 DFAS systems plus the Remedy Customer Contact Center and Rock Island Community Director of Information Management.

- As a result of BRAC and to foster consolidation and improve cost effectiveness, command and control of Marine Corps Total Force System (MCTFS) was assumed by US Marine Corps (USMC) in March, and SMD staff supporting MCTFS was transferred effective in April 2008. This completes the transfer of all resources and functions associated with support of MCTFS and as agreed to by USMC and DFAS.

- I&T Directorate continues to actively support emerging Enterprise Resource Planning (ERP) initiatives by developing interfaces and migration programs between DFAS systems and new ERP systems being developed by various DoD agencies. For example, to minimize the risk of creating new unmatched disbursements, program changes and interface developments for MOCAS must occur in order to facilitate the deployment of DEAMS, DAI, Navy ERP and GFEBS.

- The DFAS has adopted a standard IT proactive audit process to institute a disciplined review and resolution of repeat audit findings on agency system's financial, infrastructure and security requirements. Our goal is to mitigate risk of future audit findings by ensuring similar type weaknesses across our systems are corrected before an audit discovers the same finding again. Proactive audit focuses on areas of compliance such as the Federal Financial Management Improvement Act (FFMIA), Clinger-Cohen Act (CCA) and Information Assurance. Baselines of 2005 and 2006 IT and IT infrastructure findings were developed, and surveys were created using audit findings and recommendations. Survey data has been compiled indicating problem areas requiring resolution. Using a standard process, our next step is to ask managers to prioritize and resolve findings affecting their systems. Options to resolve the finding may include a cost analysis and a risk analysis.

- To foster the Agency's transformation, the Director of I&T made major revisions during FY2007 and 2008 to the DFAS 8430.1-R "Automated Information Systems (AIS)" and the DFAS 8500.1-R, "Information Assurance (IA)." The DFAS 8430.1-R was updated to incorporate Clinger-Cohen Act requirements and to clarify the delineation of duties among organizations. The DFAS 8500.1-R was updated to implement the DIACAP and to move DFAS IT towards the use of stricter IA controls. The DFAS 8500.1-R was published in November 2007, and the DFAS 8400.1-R for DFAS Infrastructure is currently under review. The remaining DFAS IT regulations continue to be reviewed and updated in accordance with the I&T Directorate's annual review process designed to ensure DFAS IT policies evolve with the Agency.

- In accordance with DoD and National Defense Authorization Act requirements to oversee and assess requests for system modernizations, the IT Investment Review Working Group continues to conduct due diligence reviews providing input to the DFAS Executive Steering

Group for investment reviews. I&T has established a standard modernization approval process whereby standard review criteria and instructions are published, and a robust review occurs for all modernization efforts both under and over $1 million. The process involves subject matter experts (SMEs) who review documentation for compliance with requirements such as Clinger-Cohen Act (CCA), FFMIA, Business Enterprise Architecture (BEA), Standard Financial Information Structure (SFIS), Privacy Act and DIACAP. The process also includes an annual review of prior year approvals in order to discuss issues and to evaluate actual costs and schedules. The process was improved this year in that quarterly reviews are now conducted in order to better identify issues earlier in the process. In addition, all Defense Business Systems in DFAS have been entered into the DoD Information Technology Portfolio Repository (DITPR) based on DFAS' own portfolio inventory of such systems maintained in our System Inventory Database (SID).

- The Desktop Management Initiative (DMI) is a DFAS business initiative to provide Managed Desktop Services to DFAS users worldwide and includes a Centralized Help Desk, Standard hardware, Standard Desktop Software, Standard Software Release Procedures across DFAS, Standard ordering processes for DMI items via the Web Ordering System (WOS), Technical Support based on Service Levels, and Industry Best Practice Technologies. It is intended to reduce total cost of desktop and help desk operations by standardizing service and equipment across the enterprise and to improve end user productivity and customer satisfaction. DMI will save DFAS over $8 million dollars over the life of the contract for the cost for the organic support previously provided by DFAS. In addition to the cost savings, DMI provides a daily centralized backup of each users data with a self service restore capability that was not offered previously to DFAS PC users nor is it available today for the non-DMI DFAS population.

ENTERPRISE MANAGEMENT SERVICES

The mission of Enterprise Management Services is:

- To serve as the Agency's risk and financial manager/advisor by providing a comprehensive risk management and resource management program.
- To provide a single point of accountability for DFAS' Enterprise Risk Management (ERM) program to ensure risks are identified, mitigated, and managed.
- To serve as the Agency's CFO. Ensure implementation of CFO requirements and serve as proponent for e-Biz, the Agency's integrated financial management system.
- To serve as the Agency's senior contract official providing procurement services.
- To develop, manage, and direct finance and accounting policy for DFAS (the reporting entity) and develop policy for Agency administrative programs.

Policy and Audit Oversight

The Chief Financial Officer's Advisory (CFOA), under the Policy and Audit Oversight office, manages the Agency's support of the independent audit of the DFAS WCF financial statements. The DFAS has received its ninth consecutive unqualified (clean) audit opinion from our independent auditors. These audits confirmed that DFAS' decision to use Lean6 methodology to correct audit deficiencies and apply the correct resources to resolve aged and erroneous transactions was a step in the right direction. The audit also highlighted the success of DFAS' use of the Balanced Scorecard in achieving operational excellence. The DFAS continues to report on and review metrics that address sound financial management of Undelivered Orders and Accounts Payable.

The FM Toolkit, developed by the CFOA FM Toolkit Team, is located on the DFAS ePortal and was first rolled out in January 2007. The Toolkit has proven itself to be a key asset in past interim and year-end audits when it was continually referred to by the agency's Lead FMs for pertinent information. The Toolkit is a powerful information resource with eight aspects: What's New?; Policies and Procedures; Contacts; Reports; Forms; ePortal projects; and Financial Management Training; and the FM Calendar, on which are posted all the "main events" coming up in the FM arena. Since the beginning of calendar year 2008, the Toolkit has had 96,017 hits from 6,547 different users.

The CFOA FM Toolkit Team was nominated for and won an award from OSD for "Innovative use of Technology to Improve Financial Management" for the development of the Web-based Financial Management Toolkit.

CFOA manages the Tri-Annual Review process for DFAS and in the current FY has instituted improvements to the process for performing these reviews. The COGNOS reports from eBiz, the DFAS accounting system, are used to accomplish the reviews and have been automated so as to retain transactional and contract data from each review period. In addition, Joint Reviews with the DFAS Accounting office, the Corporate Resource Managers and all transaction owners is ongoing and has allowed more focused efforts to improve the outcome of the reviews each reporting cycle.

In addition, CFOA, as the representative of DFAS, the reporting entity, is currently a member of a DoD-wide working group that has been meeting since May of this year. The purpose of this working group is to: (1) understand the Tri-Annual Review tools and processes used by each DoD Component serviced by DFAS; (2) determine the similarities, differences, and common requirements among Components, and (3) facilitate sharing of best business practices across

Components. In August 2008, 15 policy recommendations forthcoming from the working group conference were presented to OUSD(C) Accounting & Finance Policy for their review and consideration.

The Fiscal Services Office (FSO) serves as the functional proponent for DFAS' integrated financial management system (eBiz). FSO also provides Agency oversight and compliance activities for accuracy and timeliness of Program Managers (PMs) and Transactions Processing Activities' (TPA) concerning all financial transactions.

Accomplishments:

- Created an ePortal modular computer-based training course to assist DFAS personnel responsible for entering trading partner information and completing monthly Elimination processes. The error rate was reduced from a peak of 30% to a 4% average over a 7 month period.
- Partnered with financial management personnel in the reduction of aged undelivered orders and accounts payable transactions. Total and aged accounts payable decreased 16% and 61% respectively from June 2007 to June 2008.
- Developed an Agency Aged Accruals monthly report, resulting in an enhanced ability to manage accruals and reduce aged documents.

RISK MANAGEMENT OFFICE

The DFAS established the Risk Management Office (RMO) to oversee the Agency's strategic and integrated approach of embedding risk management techniques into day-to-day operations. The RMO implementation of the DFAS Enterprise Risk Management (ERM) program is through the Strategic Risk Management Office (SRMO) and the Operational Risk Management Office (ORMO).

The SRMO facilitates a risk-based approach to strategic planning as an overall risk portfolio, tolerance for specific risks, and overall risk management capability are key inputs to strategy development and execution planning. In addition, SRMO provides a single point of accountability for the ERM program to insure a sustained and consistent focus on organizational acceptance, ERM process implementation and continuous improvement. The SRMO is responsible for providing the DFAS Director and executive management a comprehensive assessment of risk exposure. To accomplish this, the SRMO ensures the following:

- Development and validation of risk measurement methodologies, valuation methodologies and qualitative and quantitative limits.
- Consistent application throughout the Agency of the ERM program.
- Alignment of DFAS' risk management capabilities with its strategic direction by integrating risk assessment with the strategic planning process.
- Validation that internal controls are in place and operating within the Agency.

The ORMO provides an integrated approach to enterprise operation risk management. The ORMO provides discipline, structure, and increased accountability across the enterprise: streamlines project management processes; provides management with risk and risk mitigation visibility, and enables a culture of continuous process improvement within DFAS.

Strategic Risk Management Office

Accomplishments:

The DFAS is actively implementing an Agency-wide Enterprise Risk Management Program (ERMP). The purpose of the ERMP is to implement a robust, integrated, and highly visible enterprise-wide risk management program to identify, monitor, reduce or eliminate potential weaknesses or potential fraud which may result in financial discrepancies, losses, and workflow inefficiencies and properly mitigate them in a timely manner. The expected outcome is to have a centralized repository of information for proactively monitoring and tracking financial and operational risks, enabling DFAS to improve processes, decrease errors and rework, and reduce costs. This will provide improved product quality to our DFAS customers at less cost. The DFAS achieved several activities and milestones toward the implementation of the ERMP for internal control improvements:

- Issued standard policies, procedures, and methodology for risk management.
- Implemented a dashboard transition tool for capturing ERM implementation progress.
- Implemented a central repository for key process maps and narratives.
- Identified core areas throughout DFAS.
- Identified sub-core areas within the DFAS core areas.
- Identified, validated, and prioritized key processes performed within the core areas, of which 60% have completed process mapping with controls and narratives.
- Launched an "Introduction to Risk Management" web-based training module for training across the Agency, with approximately 9000 of our employees completing this training.
- Conducted a two day Risk Manager class for 800 Agency Risk Managers.
- Completed risk Maturity Surveys.
- Collected and analyzed strategic risks and issues and are actively applying mitigation.

SRMO lead a robust "Check It" awareness campaign:

The Office of the Under Secretary of Defense, Comptroller (OUSD(C)) sponsored the "CHECK IT" campaign to raise awareness about the importance of internal management controls. This year's campaign "Check It Phase II" solicited the "Most Improved Process" within the Department of Defense. The DFAS received recognition from the Deputy Under Secretary of Defense for two process improvements completed in 2007. Check It Phase II emphasized improving internal controls, and also delivering products and services to the warfighter in a way that is effective and efficient.

The DFAS entries receiving Honorable Mentions were:

** Improvement of the Financial Management Improvement Program which cleared $80 million in aged accounts payable and $90 million in aged undelivered orders.

** Accounts receivable tracking and reporting, which reduced delinquent accounts receivable by $2.6 billion.

To meet the challenge of continuous improvements in the area of financial performance, DFAS recognized new technologies must be leveraged to expand the depth and breadth of current business transaction analysis capabilities. The DFAS is improving its ability to detect illegal, improper, or unusual transactions by utilizing real time transaction inspection via Business Activity Monitoring (BAM). Improvements in detection lead to enhanced internal controls, prevention of fraud, waste, and abuse, and significant savings to our customer. DFAS achieved several activities and milestones toward the implementation of the BAM:

- Identified the transaction detection criteria (requirements) in the area of Potential Improper Payments for the Army, Air Force, and Navy.
- Identified the transaction comparison criteria in the area of Navy General Funds Balance with Treasury.
- Reconciled the primary Master Line of Accounting edit tables used in the Navy General Fund Accounting.
- Demonstrated proof of BAM capability to provide transaction assessment, exception identification, automated workflow processing, dashboard reporting, and audit trail.

Operational Risk Management Office

Accomplishments

The DFAS executed a plan to deliver continuous process improvement capability, combining Six Sigma and Lean Transformation tools. This was implemented through individual projects with oversight by Lean6 Black Belts and Green Belts. The initiative includes executing a plan to achieve the Deputy Secretary of Defense goals to train and certify as Black Belts and Green Belts 1% and 5% of the DFAS population, respectively. This initiative will enable the Agency to document and improve processes, eliminate waste, reduce errors, and increase productivity. DFAS achieved several milestones for this initiative:

- Trained 1672 Green Belts
- Trained 86 Black Belts
- Certified 309 Green Belts
- Certified 24 Black Belts
- Completed 225 Lean6 projects, with estimated benefits of more than $180.4 M over 3 years

The Process Mapping initiative supports ERMP by developing and implementing process mapping guidance, and providing training and consultation services to DFAS process owners. This initiative will enable the Agency to document and improve processes and identify and mitigate risks. The DFAS achieved several milestones for this initiative:

- Developed and implemented standard process mapping guidance and templates.
- Developed and delivered a "Process Mapping Tutorial" to train process owners how to map their processes.
- Built and implemented an interim repository to store DFAS process maps.

The DFAS Project Management Center of Excellence (PMCoE) provides for standardization of project management, policies, processes, procedures, and tools throughout DFAS. It promotes a project management culture in DFAS by developing and implementing project management standards, providing consultation services to DFAS Project Managers, and delivering training. This initiative will enable the Agency to manage projects to achieve cost, schedule, and performance objectives. The DFAS achieved several milestones for this initiative:

- Developed and published Project Management standards, templates, and guides
- Provided project management consulting to 18 project managers
- Developed and implemented Earned Value Management methodology.
- Conceived and executed Project Management Career Development Plan – Fast Track.

HUMAN RESOURCES

The Human Resource (HR) Directorate is responsible for establishing and administering Agency-wide civilian personnel policies, programs, and services. HR also is responsible for identifying and providing HR services and products in support of the human capital needs and strategic business goals for improved mission performance.

Accomplishments:

BRAC - Provided onsite and remote transition services to employees impacted by BRAC. Less than 8% of those impacted by BRAC were separated involuntarily. In addition, more than 97% of all employees receiving BRAC services gave HR favorable ratings.

NSPS - NSPS is transforming the way the DoD recruits, retains, rewards, and manages its 700,000 civilians. NSPS provides a flexible, contemporary, market-based and performance-oriented compensation system aimed to enhance the quality, professionalism, and management of the workforce. NSPS links individual performance expectations with the DFAS and DoD overall mission and strategic goals and is a vital tool for aligning the organization with desired results and creating a "line of sight" showing how team, unit, and individual performance can contribute to overall organizational results.

The DFAS has partnered with the NSPS Program Executive Office (PEO) and is actively involved in this deployment initiative by managing a conversion strategy for approximately 760 supervisory employees and 725 non-supervisory employees; DFAS will continue to support the NSPS PEO in its phased implementation strategy of NSPS.

Key accomplishments to date include:

- Converted 1040 employees to NSPS Spirals 1.2 and 1.3
- Trained over 90% of the converting workforce in HR Elements and Performance Management
- Achieved 100% completion rate for Pay Pool Management training

Lean Transformation - The Lean Transformation initiative is DFAS' organizational assessment, development, and planning initiative to transition to an optimized organizational structure. It applies position management standards to the Agency's structure, improves supervisor-to-employee ratios, standardizes full performance levels for positions regardless of location, and builds standard organizations across DFAS at all enduring sites.

The Lean Transformation initiative will decrease costs by improving supervisor-to-employee ratios, standardizing full performance levels for positions regardless of location, and building standard organizations in accordance with lean principles across DFAS. Lean Transformation will achieve savings as a component of HPO and BRAC implementation and will reduce the supervisor ratio from 1 supervisor for every 8 employees to 1 supervisor for every 15 employees by 2010.

Key accomplishments to date include:

- Performed position management reviews of existing structures
- Performed and analyzed results of compensation surveys
- Baselined the lean structure and distributed it to all organizations
- Implemented a deviation process for evaluating and approving changes to the structure
- Developed a database to standardize and track the structures for each organization
- Developed reports to compare the current workforce to the target lean structure; shared these reports with senior leadership and functional managers to identify risk areas and to show progress toward meeting the lean structure
- Partnered with manpower and functional organizations to standardize and share data needed to define, implement, and manage change.
- Developed workforce planning toolkit – a systematic process and tool set to identify/address gaps from workforce needs of today and tomorrow.

Human Capital Strategic Plan - Developed and vetted the 2008-2013 Human Capital Strategic Plan, which establishes the roadmap for how DFAS will address its human capital needs via the establishment of an enterprise-wide human capital governance structure and reporting program, as well as various other human capital focused initiatives, designed to ensure DFAS' workforce readiness.

Competitive Academic Degree Program - The objective of the DFAS Competitive Civilian Academic Degree Program is to enhance the professionalism of the DFAS workforce by increasing the number of employees who have attained a bachelor's or graduate degree in a mission-related field. The program had 27 selections for the program for FY 07, with 56 applications from eligible employees for FY 08.

Employee Certification and Professionalization Initiative – Supported the identification of critical series throughout the Agency and the credentials desired for employees that encumber those positions. Selection and measurement criteria have been developed with uniform guidance on how to credit applicants with these credentials for position openings. In addition, career roadmaps and development opportunities are being marketed to encourage in-house growth of credentialed employees.

Leadership Development - Established framework for developing DFAS leadership through external sources, selecting programs/courses that align with the Office of Personnel Management's (OPM) Executive Core Qualifications. Also, developed cadre approach to developing all DFAS supervisors, beginning with a regular and recurring forum for training and information sharing that focuses on core supervisory competencies.

Succession Management – Developed a succession management database to identify critical leadership positions throughout the Agency, assign potential successors to those positions, and rank those potential successors readiness to assume those critical positions. Thus far, 156 critical positions have been identified, 94% of which have "ready now" successors.

Learning and Development Dashboard - Developed a "one-stop shopping" ePortal tool to provide:

- Complete Visibility of All Training Information
- Access to All Training Actions and Approvals
- Improved Functionality
- Easier Navigation, Action Alerts and Additional Information

Initiatives:

Future goals include:

- Execute a competency management strategy and approach to workforce planning
- Bolster leadership development program with standardized development roadmaps and requirements
- Deploy a cross-functional, human capital governance structure and reporting network to fully assess workforce readiness
- Support and improve future NSPS conversions, enhancing NSPS communication infrastructure.
- Expand marketing and access of Personnel Force Innovation (PFI) Program

OPERATIONS

The Operations mission is to support the warfighting capability of the DoD by paying people and contractors correctly, recording financial events correctly, and producing timely and accurate reports on the financial condition of the DoD.

To achieve the given mission, Operations will continue to improve in paying people and vendors and properly recording and reporting accounting events by:

- Assuring the proper recording of payables and receivables from the entitlement systems into the accounting system, and
- Synchronizing the recording of accounting events with the reporting of the financial condition of the Military Departments and Defense Agencies.
- Standardizing accounting organization structures.
- Consolidating and standardizing disbursing operations by aligning disbursing operations with the Standard Disbursing Initiative and Treasury's Government-wide Accounting implementation.
- Partnering with Strategic Business Management to implement Enterprise Resource Planning systems.
- Providing value added analysis of DFAS operations and DoD financial information.
- Enhancing efficiencies by employing standard end-to-end processes, best practices, and effective risk management controls.
- Increasing focus on transaction-driven general ledger.
- Educating the workforce on the depth and breadth of customers' missions and operations.
- Championing initiatives to assist our customers in obtaining and maintaining unqualified audit opinions.

Accomplishments

In FY 2008, DFAS made progress in several critical operational areas in support of the key strategic targets as we continue to migrate work from DFAS closing sites on schedule. Specific results include:

Wounded Warrior Pay Management Program (WWPMP):

- The purpose of the WWPMP is to improve the accuracy and timeliness of all aspects of pay to Wounded Warriors and their families. The Secretary of Defense stated that "apart from the war itself, this department, and I have no higher priority." The DFAS WWPMP, in concert with the Services, is doing its part to accomplish that mandate. The WWPMP serves as the "hub of the wheel" where pay is concerned and champions initiatives in order to continue improving financial support to our wounded heroes and their families.

- At the Landstuhl Regional Medical Center as well as strategic locations throughout CONUS (e.g., Walter Reed and Brooke Army Medical Centers), the WWPMP works to ensure Wounded Warriors and their family members receive personal, face-to-face support. This includes updating their pay accounts to ensure their pay is correct, assisting in the preparation of travel claims, and providing briefings to members' and their family members.

- The WWPMP team developed and continues to maintain a web-based Army Wounded Warrior database receiving data feeds from finance, medical, and personnel databases. This database enables detailed tracking of Wounded Warriors throughout their continuum of care. Additionally, our central site personnel perform a host of duties including: conducting extensive audits and making associated input to ensure correctness of pay accounts; computation and payment of travel claims; and preparing, submitting, and monitoring remission and waiver packets. The WWPMP has Regional Managers monitoring field sites and providing advice, guidance, and assistance in resolving pay related issues. The WWPMP authored and frequently updates a variety of entitlement booklets and pamphlets, as well as, created and maintains a Wounded Warrior Pay Office Website.

- The WWPMP team along with other DFAS directorates advanced partnerships with other Federal Departments. The WWPMP team:

  - collaborated with the Army's Soldier Family Assistance Centers and Warrior Transition Units to increase pay support;
  - supported the Army's effort for placing Active Army Service Component 1 Soldiers in Community Based Health Care Organizations;
  - facilitated a Memorandum of Agreement between Department of Veterans Affairs and DFAS in order to receive information on Wounded Warriors hospitalized in VA Health facilities;
  - assisted DFAS Indianapolis Disbursing Operations in creating a pilot program for the use of debit cards to issue travel advances;
  - analyzed and provided recommendations on proposed legislative changes and implementing instructions; and
  - coordinated with the special operations community and senior DoD leaders to successfully introduce legislation to the National Defense Authorization Act 2008 improving pay support to wounded warriors by authorizing continuation of specialty and incentive pay for up to one year after medical evacuation from a combat zone when remaining in a hospitalized status.

Global War on Terror (GWOT) Cost of War (CoW) Reporting:

- GWOT CoW reporting improvement is measured in a number of ways; the most significant measure is the President's Management Agenda (PMA) supplemental scorecard. The Office of Management and Budget (OMB) rated the Department's FY 2007 first quarter scorecard red on both status and progress. Today, the FY 2008, 3rd quarter PMA draft ratings by OMB are red on status and green on progress. These ratings are a major performance indicator for measuring status and progress toward the Department's goal of achieving increasing degrees of accuracy, timeliness, traceability, and audibility. Our objective was to achieve green on both status and progress by the end of FY 2008. However, this was not accomplished by the end of FY 2008.

- Following are significant accomplishments achieved in areas of governance, audit and review, business process, information delivery, and theater support.

  - Governance
    - Chartered senior steering group and established GWOT CoW project management office.
    - Established and implemented formal GWOT CoW cost improvement plan.

  - Audit and Review
    - Improved accuracy and quality of audit findings and recommendations.
      - Provided supporting documentation to DoDIG for transactions totaling $1.2B (Nov. 2007).
      - Increased consistency in reporting $1.1B in GWOT medical obligations (May 2008).
      - Reduced error rate of critical out-of-country payment vouchers from 15.88 percent to 1.47 percent.
    - Integrated audit liaison practices into overall operations.
    - Improved effectiveness and efficiency of tracking status, findings, and recommendations of GWOT CoW audits by developing an audit tracking database.

  - Business Process
    - Implemented accuracy and compliance measures.
    - Provided process for qualitative review resulting in greater confidence in reported data.
    - Identified 66 repeatable processes and improved accuracy through standardization.
    - Identified 92 percent of CoW data originated from accounting systems.
    - Created DoD GWOT CoW reporting standard operating procedures.

    - Improved DoD's ability to explain CoW report variances to external customers with 100 percent of variances explainable.
    - Enabled variance analysis of planned versus actual spending.
    - Achieved transparency for Army, Air Force, and Marine Corps accounting transactions.

  - Information Delivery
    - Implemented GWOT CoW extract files for GAO, OMB, and CBO.
    - Implemented GWOT status of funds report.
    - Added inception-to-date activities beginning with FY 2007 funds.
    - Expanded ability to perform ad hoc queries.
    - Established plan to automate CoW reporting.

  - Theater Support
    - Trained finance soldiers in theater.
    - Retrograded vendor payments from Kuwait and Qatar to DFAS Rome
    - Assisted command in closing FY 2006 Iraqi Security Force Fund obligations with $9M unobligated, down from $5.5B.
    - Deployed 11 DFAS personnel in theater to provide finance and accounting support.
    - Supported efforts to clarify definition of prompt payment act in theater.
    - Performed accounting verification at DFAS Rome.

Accounting HPO:

- The Standards and Compliance (S&C) Accounting Mission Area manages the Accounting HPO Initiative. The Accounting HPO is the catalyst for increasing operational efficiencies through reengineering, consolidation and process improvements.

Accomplishments:

- Published an updated Accounting HPO Concept of Operations (CONOPS) (DFAS 5100.9-M);
- Created an Accounting HPO Mission and Function Statement (DFAS 5100.8-M);
- Created the Accounting HPO Instruction (DFAS 7000.10-I) providing standardized Accounting procedural guidance at the five enduring sites;
- Dedicated a full-time senior-level Program Manager to drive further accounting operations efficiencies through reengineering, consolidation, and process improvements;
- Executed plans to implement standard structure, functions, processes, and workload consolidation;

- Improved visibility of accounts payable weaknesses by completing a business lifecycle review of internal controls process flows for 20 entitlement and 27 accounting systems;
- Improved managerial control of accounting processes by implementing the automated Accounting Quality Review (AQR) Dashboard providing an internal control check list of critical processes, reports, and reconciliations;
- Mitigated risks through the identification, documentation, and evaluation of 145-plus core accounting processes;
- Eliminated material weakness and improved the accuracy and timeliness of reported accounts receivable balances by implementing a centralized data collection, analysis and reporting tool allowing for the identification and resolution of delinquent debt;
- Improved efficiency of collections by centralizing and consolidating contractor debt into one system;
- Eliminated material weakness and improved the accuracy of calendar year end tax reporting by reducing invalid tax payer identification numbers; and
- Improved visibility over accounts payable transactions by implementing a monthly self-certification and reconciliation process.

Mechanization of Contract Administration Services (MOCAS):

- MOCAS is the Department's major contract administration and pay entitlement system operated by DFAS and Defense Contract Management Agency. Invoices paid through MOCAS tend to be complex, related to multi-year purchases with high dollar values; e.g., purchase of major weapon systems. During FY 2007, MOCAS processed over 1M invoices and disbursed over $189B. A long-standing challenge with MOCAS has been the inability to recognize and record liabilities for the unpaid amount of goods and services when a government activity accepts title to those goods and services.

- Generally Accepted Accounting Principles (GAAP), referenced in the Statements of Federal Financial Accounting Standards (SFFAS) # 1, require estimating and recording an accounts payable when an entity accepts title to goods but amounts are not available for recording during the accounting period. In FY 2008, DFAS enhanced its newly implemented standard MOCAS monthly estimation process and accompanying database supporting all Military Services and Defense Organizations. These monthly estimates cover liabilities related to multi-funded items and amounts related to the unavailability of the system due to month-end processing. As a result, the Department's financial reports now include approximately $1B of estimates for accounts payable.

Benefits accrued from this improvement are:

- increased accuracy for recognizing liabilities;
- improved cash management for paying liabilities;
- adherence to Federal accounting standards;
- addressing Department audit recommendations; and
- meeting Federal Financial Integrity Act milestone requirement.

Defense Integrated Military Human Resource System (DIMHRS):

The S&C DIMHRS Support Team (DST) is implementing a plan to conduct the DIMHRS validation process for Army implementation. The S&C DST leads the effort to restructure DFAS into a post DIMHRS organizational structure; monitors 143 business process reengineering (BPR) actions; and assists BPR sponsors in meeting key milestones. This team also:

- spearheaded the effort to draft and finalize the Memorandum Of Agreement (MOA) with Army;
- led the headhunting effort for DIMHRS trainers resulting in finding more nominees (400 percent more) for the required training slots thereby ensuring the availability of a cadre of qualified trainers;
- suggested the trainers be used to fill slots for the Systems Acceptance Test (SAT) resulting in trainers with practical hands-on knowledge of DIMHRS;
- provided 2 personnel and 647 test scenarios, covering 46 DFAS and Enterprise BPR actions for SAT;
- provided one resource for Pay Parallel testing (PPT; and
- worked, as a member of the Operational Test Working Group, with Operations to assign Business Function Action Officers (AOs) to each of the 143 BPR actions and developed test scenarios for the operational test.

Defense Travel System (DTS) Training:

The S&C Finance Mission Area is responsible for the overall focus to execute and administer the DTS program for DFAS. Executing this program required:

- Initiating vital training at the five enduring sites for sixty-three classes this year.
- Providing oversight and guidance to 400 Administrators and Approving Officials.
- Training and monitoring over 8,000 potential travelers.
- Conducting annual training to ensure Organizational or Lead Defense Travel Administrators stay abreast of systems changes to enhance awareness and preclude adverse publicity.

Retired and Annuity Pay:

The Retired and Annuity Pay Mission Area continues to refine and test its Continuity of Operations Plan (COOP) processing ensuring all Retirees and Annuitants world-wide will continue to receive support and payments regardless of the location due to a contingency. Over the past 2 years, Retired and Annuity Pay successfully invoked their COOP at their alternate site.

The VA Retro Project:

- A temporary project began in 2005 as a joint effort between DFAS and the DVA to pay eligible retirees and veterans all retroactive entitlements that are payable by either agency in the form of retired pay, Concurrent Retirement and Disability Payment (CRDP), Combat Related Special Compensation (CRSC), or VA disability compensation.
- With the enactment of CRSC and CRDP effective June 1, 2003, and January 1, 2004, retirees and veterans became entitled to concurrent receipt of retired pay and DVA disability compensation in varying amounts and percentages (depending upon which type of compensation a retiree is eligible to receive).
- There were 133,057 VA Retro claims identified as potentially eligible in September 2006.

In order to determine whether a retiree/veteran was due an additional payment, a retiree's retired pay and DVA disability compensation had to be reconciled for the entire retroactive period.

In many cases, the account history had to be reconstructed using various DVA databases, PDF files, and microfiche for the remaining complex accounts that included:

- CRSC and CRDP combination entitlements for veterans with multiple disability percentages and disability codes
- Former spouses' community property interests
- Prior year taxes
- Deaths
- Other unique characteristics, requiring manual processing.

Accomplishments:

DFAS adjudicated all of the original claims by June 8, 2008.

- To adjudicate the more complex claims, the contractor organized its workforce into teams and realigned select quality control personnel to the production floor to ensure each team produced quality payrolls to go to the quality control team.
- Established a production dashboard for performance accountability at every level of the organization.
- At the end of April 2008, the contractor's staff increased from 51 to more than 200 personnel (Over 185 personnel manually working claims daily).
- Applied technology solutions to speed processing of the difficult cases and developed automated tools to assist in more rapid processing of two of the most difficult and challenging categories -- former spouse and open season change cases.

As of July 1, 2008, DFAS had adjudicated all of the original, new, and returning claims.

As of September 2, 2008, DFAS had adjudicated over 299,652 claims and had paid out over $316 million in entitlements.

As of September 30, 2008, DFAS has paid $ 2,427,523,884 in monthly CRSC payments and $7,770,169,248 in monthly CRDP payments since the inception of the programs.

STRATEGIC BUSINESS MANAGEMENT

The SBM Deputate focuses on the Agency strategic goals of operational excellence, on-demand financial information, becoming a Center of Excellence, and attaining a highly professional workforce with indispensable skills and competencies. During FY 2008, DFAS made significant progress in several strategic areas. SBM's mission is to:

- Develop and promulgate DoD and DFAS policy
- Analyze, report, and use performance metrics to drive 'best business practices' and achieve high-quality results
- Integrate and standardize business rules, functional requirements and DFAS Operational Architecture
- Oversee and implement DoD-wide initiatives
- Develop DFAS Strategic Plan and Corporate BSC that links budget to the strategy
- Develop DFAS Human Capital Strategy

- Oversee all DFAS transformation efforts
- Institutionalize Lean6 methodology as the standard for driving and measuring performance
- Support the Military Services in achieving audit readiness

Accomplishments/Initiatives:

During FY 2008, DFAS made significant progress in several areas. Specific results include:

Policy/Strategic Management:

- Published nearly 40 DoD Financial Management Regulation chapters and numerous DoD and DFAS policies.
- Developed a plan to update DoD Financial Management Regulation chapters at least every two years to support the Deputy Secretary of Defense's objective to keep DoD regulations current.
- Updated DFAS's Strategic Plan to more closely link to the DoD's strategic priorities.
- Utilized the FY 2008 BSC to analyze performance, drive best business practices, achieve high-quality results, and accomplish strategic goals.

Expanded DoD-wide cash management tools, such as the International Treasury Services system and FedLine Advantage to improve EFT payments and processing, as well as debit and stored value card programs to reduce the amount of disbursing officer cash on-hand and minimize risk of loss/theft.

Financial Management Center of Excellence (FM COE)

The mission of the FM COE is to develop and integrate standard finance and accounting business practices across the DOD. Utilizing a matrix structure, FM COE is aligning its efforts with the strategic priorities of the Services and working to accelerate system delivery, reduce risks, and optimize the use of resources for providing services. FM COE focuses on reusability, lessons learned, and leveraging best practices.

Accomplishments:

Defense Agencies Initiative (DAI)

DAI represents the Department's effort to extend its solution set for streamlining financial management capabilities, eliminate material weaknesses, and achieve financial statement auditability for the Agencies and Field Activities across the DOD. DFAS is playing a key leadership role in the development and deployment of the DAI solution. DFAS is providing leadership in the areas of requirements definition, system design and compliance testing preparation and execution. DFAS is also supporting other critical areas including interface development, data conversion, data cleansing, test preparation and execution and training.

DFAS Electronic Solutions Strategic Initiatives - E2E eProcurement ERP Standardization

The objective of the DoD E2E eProcurement Interim ERP standardization process is to define the common interfaces across DFAS and the enterprise systems that will facilitate greater interoperability between the financial, acquisition and logistics systems while streamlining and simplifying the deployment process for the ERPs. Additionally, DFAS supports the Enterprise Transition Plan (ETP) emphasizing best value to the war fighter, our customers, and the American taxpayer by implementing E2E capabilities.

Defense Enterprise Accounting Management System (DEAMS)

DEAMS is a web-based, financial management ERP initiative that will transform business and financial management processes and systems to provide accurate, reliable, and timely business information to support effective business decision making for U.S. Transportation Command, U.S. Air Force, and the DFAS. DFAS has partnered with the DEAMS Program Management Office to provide support for all components relating to core financial processes as it pertains to blueprinting, requirements definition, interfaces, testing, training, and implementation strategies.

Defense Integrated Military Human Resource System (DIMHRS)

DIMHRS will provide an integrated, multi-component, personnel and pay system initially supporting the Army and Air Force followed by implementation across the Department of the Navy. It will collect, store, pass, process, report and deliver timely and accurate pay and benefits, through the use of a single, comprehensive record of service. The integration, self-service, and technological enhancements will facilitate more than a 65% reduction in the DFAS military pay staff support (estimate as of April 2007).

DFAS DIMHRS Integration Office (DDIO) Sets New Implementation Strategy for DIMHRS

DDIO continues to utilize the results of the "DFAS After DIMHRS" analysis and the subsequent Business Process Change Review to define the way ahead for the Agency. DDIO remains intimately engaged within this process by facilitating, planning, guiding, and monitoring those involved. In addition, DDIO staff are assigned as Change Agents assisting the internal DFAS, Service led and Enterprise level change teams that have been set up to manage the change. In support, DDIO has developed the Functional Analysis database being used by each of the change teams to record progress and report their weekly status.

Enterprise Business System (EBS)

EBS allows for the successful integration of business processes with a new enterprise business system based on Commercial Off-the-Shelf Software and best business practices, providing an Information Technology foundation, which allows for both continuous process and technology insertion. DFAS is currently providing dedicated support for the SAP software upgrade, which is scheduled to be loaded after FY 08 end of year processing has completed and before FY 09 begins, followed by the planned implementation of additional capabilities and deployments in conjunction with the Enterprise Operational Accounting System (EOAS) and eProcurement initiatives.

General Funds Enterprise Business System (GFEBS)

GFEBS is the U. S. Army web-based, ERP solution that will enable compilation and sharing of accurate, up-to-date resource management data across the Army. It will leverage commercial, off-the-shelf business enterprise software, supply standardized, real time finance data and information, and empower leadership to make strategic business decisions that have a direct and positive impact on the war fighter.

Standard Functional Requirements

One of the DFAS FM COE missions is to develop standard, consistent and effective requirements for DOD Financial and Accounting systems and operations. FM COE completed the initial Functional Requirements for the seven core financial areas. These Functional Requirements are currently being maintained by assessing the impact of BEA and Authoritative Sources changes, and making the related edits to the Functional Requirements. Other functional areas are being evaluated to determine if existing requirements are sufficient for ERP systems development. These functional areas include Audit Trails and System Controls, Budget Authority and Execution, and Field Level Reporting.

Standard Functional Test Scenarios

The DFAS FM COE completed the first deliverable of standard finance and accounting functional requirements and developed a concept of operations and project plan to write standard test scenarios for standard functional requirements developed. Execution of this plan will result in a shareable repository of standard functional requirements with supporting test scenarios and test script suggestions which can be used in the evaluation of Enterprise and ERP systems.

FINANCIAL CONDITION

The financial statements have been prepared to report the financial position and results of operations for DFAS, pursuant to the requirements of Title 31, United States Code, Section 3515(b).

While the statements have been prepared from the books and records of the entity in accordance with accounting principles generally accepted in the United States of America and the formats prescribed by the OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

DFAS's financial condition is sound. DFAS received consecutive unqualified opinions on its financial statements from an independent Certified Public Accounting firm in FY 2000 through FY 2008.

Additional information about DFAS performance, programs and systems can be found on our Web site at http://www.dod.mil/dfas.

DEPARTMENT OF DEFENSE
DEFENSE FINANCE AND ACCOUNTING SERVICE
WORKING CAPITAL FUND
BALANCE SHEETS
AS OF SEPTEMBER 30, 2008 AND 2007
Amounts in Thousands

	2008	2007
ASSETS		
Intragovernmental:		
Collections and Disbursements Clearing Account (Note 1e)	$ -	$ -
Accounts Receivable	43,408	9,188
Total Intragovernmental	43,408	9,188
With the Public:		
Accounts Receivable	1,005	675
General Property, Plant and Equipment (Note 2)	475,364	566,407
Other Assets	209	58
TOTAL ASSETS	**$ 519,986**	**$ 576,328**
LIABILITIES		
Intragovernmental:		
Accounts Payable	$ 32,690	$ 41,309
Other Liabilities (Note 3)	14,181	13,734
Total Intragovernmental	46,871	55,043
With the Public:		
Accounts Payable	58,486	63,462
Actuarial FECA Liability (Notes 4 and 5)	38,591	38,245
Accrued Payroll and Benefits (Note 3)	98,258	93,355
TOTAL LIABILITIES	**242,206**	**250,105**
NET POSITION		
Cumulative Results of Operations	277,780	326,223
TOTAL NET POSITION	**277,780**	**326,223**
TOTAL LIABILITIES AND NET POSITION	**$ 519,986**	**$ 576,328**

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF DEFENSE
DEFENSE FINANCE AND ACCOUNTING SERVICE
WORKING CAPITAL FUND
STATEMENTS OF NET COST
FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 2008 AND 2007
Amounts in Thousands

	2008	2007
PROGRAM COSTS		
Gross Costs	$ 1,576,027	$ 1,596,142
Less: Earned Revenue	(1,495,995)	(1,503,823)
NET COST OF OPERATIONS (Note 9)	**$ 80,032**	**$ 92,319**

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF DEFENSE
DEFENSE FINANCE AND ACCOUNTING SERVICE
WORKING CAPITAL FUND
STATEMENTS OF CHANGES IN NET POSITION
FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 2008 AND 2007
Amounts in Thousands

	2008	2007
Cumulative Results of Operations		
Beginning Balances	**$ 326,223**	**$ 410,579**
Financing Sources		
Transfers-In/Out Without Reimbursement	(42,498)	(69,042)
Imputed Financing Sources (Note 6)	71,674	82,294
Donations and forfeitures of property	1,138	-
Other	1,275	(5,289)
Total Financing Sources	**31,589**	**7,963**
Net Cost of Operations	**(80,032)**	**(92,319)**
ENDING BALANCES	**$ 277,780**	**$ 326,223**

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF DEFENSE
DEFENSE FINANCE AND ACCOUNTING SERVICE
WORKING CAPITAL FUND
STATEMENTS OF BUDGETARY RESOURCES
FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 2008 AND 2007
Amounts in Thousands

	2008	2007
BUDGETARY RESOURCES		
Unobligated Balance, Beginning of Period	$ 13,616	$ 91,207
Recoveries of Prior Year Unpaid Obligations	42,853	72,066
Budget Authority:		
Contract Authority	26,633	28,793
Spending Authority from Offsetting Collections:		
Earned:		
Collected	1,468,340	1,538,675
Change in Receivables from Federal Sources	33,078	(30,821)
Change in Unfilled Customer Orders:		
Without Advance from Federal Sources	(572)	(62,472)
Subtotal Budget Authority	1,527,479	1,474,175
Nonexpenditure transfers, net	738	-
Permanently Not Available	(45,024)	(91,303)
Total Budgetary Resources	**$ 1,539,662**	**$ 1,546,145**
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred - Reimbursable	$ 1,514,054	$ 1,532,529
Unobligated Balance - Apportioned	25,608	13,616
Total Status of Budgetary Resources	**$ 1,539,662**	**$ 1,546,145**
CHANGE IN OBLIGATED BALANCE		
Obligated Balance, Net - Beginning of Period	$ 222,589	$ 155,772
Obligations Incurred, Net	1,514,054	1,532,529
Less: Gross Outlays	(1,444,730)	(1,486,938)
Less: Recoveries of Prior Year Unpaid Obligations	(42,853)	(72,066)
Change in Uncollected Customer Payments from Federal Sources	(32,506)	93,292
Subtotal	$ 216,554	$ 222,589
Obligated Balance, Net - End of Period:		
Unpaid Obligations	285,715	259,244
Less: Uncollected Customer Payments from Federal Sources	(69,161)	(36,655)
Total, Unpaid Obligated Balance, Net, End of Period	**$ 216,554**	**$ 222,589**
Net Outlays:		
Gross Outlays	$ 1,444,730	$ 1,486,938
Less: Offsetting Collections	(1,468,340)	(1,538,675)
Net Outlays	**$ (23,610)**	**$ (51,737)**

The accompanying notes are an integral part of the financial statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Defense Finance and Accounting Service (DFAS), a component of the Department of Defense (DoD), was established in 1991 by the Secretary of Defense to reduce the cost of DoD finance and accounting operations and to reform financial management throughout DoD. The mission of DFAS is to direct, approve, and perform finance and accounting activities for DoD.

DFAS accounts consist of resources that DFAS has the authority to use, or where management is legally obligated to use funds to meet its obligations. Through the Working Capital Fund (WCF) DFAS pays all DoD military and civilian personnel, retirees and annuitants, civilian employees of various federal agencies, major DoD contractors and vendors, and delivers accounting reports and financial information. DFAS employs approximately 12,000 people throughout the United States and in the European and Pacific theaters of operations to serve this purpose. DFAS has seventeen installation-level finance and accounting operations sites throughout the world.

Through the WCF, DFAS operates similarly to a private business, obtaining revenue by charging customers fixed prices for its services. DFAS sets its rates annually, 2 years in advance, based on anticipated workload and estimated costs calculated to offset any prior year gains or losses. Unlike private businesses, DFAS has little flexibility to adjust prices in the year of execution, and DFAS operations are subject to DoD, Executive Branch and Legislative Branch oversight. DFAS' programs and initiatives are guided by the Under Secretary of Defense Comptroller, Chief Financial Officer, and an Audit Committee.

DFAS also manages the operations of a General Fund and the Base Realignment and Closure Fund. The accompanying financial statements do not include the activities of those operations. The accompanying financial statements represent only the Working Capital Fund activities of DFAS and all remaining references to DFAS throughout these notes to the financial statements relates to WCF accounting activity.

B. Basis of Presentation

The accompanying financial statements have been prepared to report the financial position, net cost and changes in net position of the DFAS WCF, together with budgetary resources and a reconciliation of net cost to budgetary obligations as required by the Chief Financial Officer's (CFO) Act of 1990 and amended by the Government Management Reform Act (GMRA) of 1994, and are in accordance with accounting principles generally accepted in the United States of America (GAAP). GAAP for Federal financial reporting entities recognize the Federal Accounting Standards Advisory Board (FASAB) as the standards-setting body designed to establish these principles for these entities. The financial statements have been prepared from the books and records of DFAS in accordance with the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, and the DoD Financial Management Regulation (DoD FMR) Volume 6B, when applicable, as summarized in these notes.

C. Basis of Accounting

Transactions are recorded on an accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is exchanged. Under the budgetary basis, however, funds availability is recorded based upon legal considerations and constraints. As a result, certain line items on the proprietary financial statements may not equal similar line items on the budgetary financial statements.

D. Revenues and Other Financing Sources

Revenue is recognized when earned and services have been rendered. Revenue is generated by sales of accounting and finance services to the DFAS customers through a reimbursable order process. The majority of services rendered by DFAS are provided to other DoD agencies.

E. Collections and Disbursements Clearing Account

The DFAS WCF does not have a separate Fund Balance with Treasury (FBWT) account. Instead, a collections and disbursements clearing account is maintained by DFAS to account for its collections and disbursements activity.

The Defense Working Capital Fund (DWCF) is subdivided at the Department of Treasury (Treasury) into five sub-numbered Treasury accounts. It is at the sub-numbered account level that the FBWT exists for the DWCF. DFAS' WCF and nine other DWCF activities operate under one Defense sub-numbered Treasury account. As a result, DFAS does not have an individually identifiable balance. The collections, disbursements, and cash transfers applicable to DFAS' operations are recorded in DFAS' financial records during the fiscal year. The collections and disbursements and current-year cash transfers are recorded as financing sources transferred out without reimbursement via cumulative results of operations to the DWCF sub-numbered Treasury account at year-end.

F. Accounts Receivable

Intragovernmental Accounts Receivable consists of amounts due from other DoD and other Federal agencies for reimbursable work performed on behalf of DFAS' customers. An allowance for uncollectible accounts was not established for Intragovernmental Accounts Receivable because amounts due from other Federal agencies are deemed to be fully collectible. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience to derive a percentage of prior year write-offs and a percentage of aged receivables due from the public.

G. General Property, Plant and Equipment

General Property, Plant and Equipment (PP&E) are carried at historical acquisition cost plus capitalized improvements. General PP&E assets are capitalized at cost if the acquisition is $100,000 or more except for real property that was revised to $20,000 in FY 2006 and has a useful life of two or more years. All General PP&E is depreciated based on the historical cost using the straight-line method over the estimated useful lives of the assets, which range from 2 to 40 years. Normal repairs and maintenance are charged to expense as incurred.

Title 10, United States Code, prohibits DoD agencies from owning property. Therefore, DoD has implemented the recognition criteria of Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant and Equipment*, to report the financial position of its member agencies. As implemented by DoD regulations, ownership of an asset is not a prerequisite to asset recognition. DoD FMR Volume 4, Chapter 6, states that legal ownership usually, but not always, is the determinant factor when determining which DoD component recognizes a particular General PP&E asset for accounting and reporting purposes in financial statements. Asset recognition may also be based on the “Preponderance of Use” principle. This concept recognizes that member DoD agencies that gain the most benefit by virtue of space usage should capitalize the asset as General PP&E on their balance sheet.

H. Contingencies and Commitments

DFAS is a party in various administrative proceedings, legal actions, and claims brought against it. In the opinion of DFAS management and legal counsel, the ultimate resolution of these proceedings, actions, and claims will not materially affect the financial position or results of operations of DFAS. The DFAS recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

I. Federal Employee Compensation Benefits

Workers’ Compensation is comprised of two components: (1) the accrued liability which represents monies owed for claims incurred through the current fiscal year; and (2) the actuarial liability for approved compensation cases beyond the current year.

The Federal Employees’ Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for DFAS employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by DFAS.

Future workers’ compensation estimates were generated from an application of actuarial procedures developed by DOL to estimate the liability for FECA benefits. The liability for future workers' compensation benefit includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined utilizing historical benefit payment patterns related to a specific period to estimate the ultimate payments related to the period.

J. Pensions, Other Retirement Benefits, and Other Post-Employment Benefits

Each employing Federal agency is required to recognize its share of the cost and imputed financing of providing pension and post-retirement health benefits and life insurance to its employees, effective with fiscal years beginning after September 30, 1996, as required by SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. Factors used in calculation of these pension and post-retirement health and life insurance benefit expenses were provided by the Office of Personnel Management (OPM) financial management letters regarding cost factors for pension and other retirement benefits expense.

DFAS civilian employees participate in the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS), while military personnel are covered by the Military Retirement System (MRS). Employees and personnel covered by FERS and MRS also have varying coverage under Social Security. DFAS funds a portion of the civilian and military pensions. The assets, funded actuarial liability, and unfunded actuarial liability for the military personnel are reported in the DoD Military Retirement Fund. The actuarial liability for the military retirement health benefits is recognized in the DoD Agency-wide statements.

K. Annual, Sick and Other Accrued Leave

Military and civilian leave is accrued as earned and the accrued amounts are reduced for actual leave taken and increased for leave earned. The balances for accrued leave are adjusted monthly to reflect changes. The balances for military and civilian leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Sick and other types of non-vested leave are expensed as taken. To the extent budget resources are not available to fund annual leave earned but not taken; funding will be obtained from future financing sources.

L. Interest on Late Payments

DFAS, on occasion, incurs interest penalties on late payments. All such interest penalties are paid to the respective vendor in accordance with the guidelines mandated by the Prompt Payment Act, Public Law, 97-177, as amended.

M. Use of Estimates

The preparation of financial statements requires management to make certain estimates and assumptions that affect the reported amount of assets and liabilities, at the date of the financial statements, and the amount of revenues and costs reported during the period. Actual results could differ from those estimates.

Amounts in Thousands

NOTE 2. GENERAL PROPERTY, PLANT AND EQUIPMENT, NET

As of September 30, 2008:	**Acquisition Cost**	**Accumulated Depreciation**	**Net Book Value**	**Useful Life (in years)**
Buildings, Structures and Facilities	$ 122,908	$ 35,703	$ 87,205	20 to 40
Leasehold Improvements	121,114	31,042	90,072	Lease term
Equipment	278,073	245,955	32,118	5 to 10
Internal-Use Software	1,269,117	1,050,036	219,081	2 to10
Construction/Development In-Progress:				
Equipment	17,710	-	17,710	N/A
Software	28,998	-	28,998	N/A
Other	1,392	1,212	180	N/A
Total General PP&E, Net	**$ 1,839,312**	**$ 1,363,948**	**$ 475,364**	**-**
As of September 30, 2007:				
Buildings, Structures and Facilities	$ 187,455	$ 72,079	$ 115,376	20 to 40
Leasehold Improvements	121,933	25,660	96,273	Lease Term
Equipment	283,068	250,494	32,574	5 to 10
Internal-Use Software	1,250,500	989,282	261,218	2 to 10
Construction/Development In-Progress:				
Equipment	16,636	-	16,636	N/A
Software	44,142	-	44,142	
Other	1,551	1,363	188	N/A
Total General PP&E, Net	**$ 1,905,285**	**$ 1,338,878**	**$ 566,407**	**-**

As assets in construction or development are deemed ready for use, the value of the asset is transferred into the appropriate asset account and depreciation commences.

NOTE 3. OTHER LIABILITIES

As of September 30, 2008:	**Current**	**Non-current**	**Total**
Intragovernmental Other Liabilities:			
Workers' Compensation	$ 3,907	$ 4,849	$ 8,756
Employer Contributions and Payroll Taxes	5,425	-	5,425
Total Intragovernmental Other Liabilities	9,332	4,849	14,181
Other Liabilities With the Public - Accrued Payroll and Benefits	98,258	-	98,258
Total Other Liabilities	**$ 107,590**	**$ 4,849**	**$ 112,439**

Amounts in Thousands

NOTE 3. OTHER LIABILITIES (CONTINUED)

As of September 30, 2007:	**Current**	**Non-current**	**Total**
Intragovernmental Other Liabilities:			
Workers' Compensation	$ 4,099	$ 5,060	$ 9,159
Employer Contributions and Payroll Taxes	4,575	-	4,575
Total Intragovernmental Other Liabilities	8,674	5,060	13,734
Other Liabilities With the Public - Accrued Payroll and Benefits	93,355	-	93,355
Total Other Liabilities	**$ 102,029**	**$ 5,060**	**$ 107,089**

NOTE 4. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Intragovernmental:	**2008**	**2007**
Workers' Compensation	$ 8,756	$ 9,159
Total Intragovernmental	8,756	9,159
With the Public:		
Actuarial FECA Liability	38,591	38,245
Unfunded Compensatory Time and Credit Leave Liability	3,935	4,037
Total With the Public	42,526	42,282
Total Liabilities Not Covered by Budgetary Resources	51,282	51,441
Total Liabilities Covered by Budgetary Resources	190,924	198,664
Total Liabilities	**$ 242,206**	**$ 250,105**

NOTE 5. UNFUNDED ACTUARIAL LIABILITY

	2008	**2007**
Workers' Compensation	$ 38,591	$ 38,245
Total Actuarial Liability	**$ 38,591**	**$ 38,245**

Amounts in Thousands

NOTE 5. UNFUNDED ACTUARIAL LIABILITY *(CONTINUED)*

The liability for future workers' compensation benefit (FECA) includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The Department of Labor provides an estimated actuarial liability for future workers' compensation benefits. DFAS' reported FECA liability is based on the DoD-Wide allocation worksheet, the bills received, and applicable charge back reports.

NOTE 6. IMPUTED FINANCING SOURCES

	2008	2007
Civilian Retirement	$ 18,407	$ 23,989
Civilian Health	49,608	55,386
Civilian Life Insurance	132	133
Building Space	3,527	2,786
Total Imputed Financing Sources	**$ 71,674**	**$ 82,294**

NOTE 7. LEASES

DFAS has no capitalized leases. All DFAS leases are operating leases for rent, where DFAS is the lessee. The Consumer Price Index was used for future year projections as increases to the lease rental amounts.

After the Base Realignment and Closure (BRAC) 2005 announcement, DFAS formed a Transformation and BRAC organization which put together a list of sites closing and the projected dates of closure. These sites and projected closure dates were all approved by the Office of the Secretary of Defense. Based on the projected DFAS sites closing, anticipated operating lease costs have been reduced based on the closure date.

The dollar amount of DFAS' operating lease commitments for future years consisted of the following at September 30, 2008:

Fiscal Year	
2009	$ 29,257
2010	30,501
2011	32,081
2012	33,814
2013	36,597
After 2013	40,216
Total	**$ 202,466**

Amounts in Thousands

NOTE 8. CONTINGENCY

There is a legal action pending against the DFAS relating to a contract dispute with a public vendor. Management intends to vigorously contest the claim. Even though management believes, based on information provided by legal counsel, that a loss for this claim is unlikely, an immaterial amount has been included in Accounts Payable with the Public at September 30, 2008.

NOTE 9. INTRAGOVERNMENTAL COSTS AND EXCHANGE REVENUE

	2008	2007
Intragovernmental Costs	$ 474,658	$ 500,345
Public Costs	1,101,369	1,095,797
Total Costs	$ 1,576,027	$ 1,596,142
Intragovernmental Earned Revenue	$ (1,495,396)	$ (1,501,948)
Public Earned Revenue	(599)	(1,875)
Total Earned Revenue	$ (1,495,995)	$ (1,503,823)
Net Cost of Operations	**$ 80,032**	**$ 92,319**

Intragovernmental costs and revenue are related to transactions made between two reporting entities within the Federal Government. Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

The Statement of Net Cost represents the net cost of programs and/or organizations that the Federal Government supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The Department's current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act. The Department is in the process of reviewing available data and developing a cost reporting methodology as required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government."

The Department's Working Capital Funds generally record transactions on an accrual basis. As such, information presented is based on budgetary obligations, disbursements, and collection transactions, as well as non-financial feeder systems, adjusted to record known accruals for major items such as payroll expenses and accounts payable.

Amounts in Thousands

NOTE 10. STATEMENT OF BUDGETARY RESOURCES RECONCILIATION

Under OMB Circular A–11, *Preparing, Submitting, and Executing the Budget*, Federal agencies are to report budgetary information in the Statement of Budgetary Resources based on budget terminology, definitions, and guidance issued. OMB Circular A–11 also states that the information on the Statement of Budgetary Resources should be consistent with budget execution information reported in the President's Budget. Additionally, per SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, agencies are to provide financial statement footnote disclosure to explain significant differences between amounts presented in the Statement of Budgetary Resources and amounts described as actual in the President's Budget. Since DFAS is a component of the DoD rather than a separate Federal agency as envisioned by OMB requirements, these analyses are difficult; however, an analysis of information reported in the Statement of Budgetary Resources and the information reported in the September 30, 2008 Report on Budget Execution (SF–133) was performed. This analysis identified immaterial differences related to Unpaid Obligations due to DFAS adjustments, primarily related to additional accruals being posted to the financial statements.

NOTE 11. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

	2008	2007
RESOURCES USED TO FINANCE ACTIVITIES		
Budgetary Resources Obligated:		
Obligations Incurred	$ 1,514,054	$ 1,532,529
Less: Spending Authority from Offsetting Collections and Recoveries	(1,543,700)	(1,517,448)
Net Obligations	(29,646)	15,081
Other Resources:		
Donations and Forfeitures of Property	1,138	-
Transfers In/Out Without Reimbursement	(42,498)	(69,042)
Imputed Financing Sources	71,674	82,294
Other	537	(5,289)
Total Resources Used to Finance Activities	**1,205**	**23,044**
RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but Not Yet Provided:		
Undelivered Orders	(35,253)	(3,936)
Unfilled Customer Orders	(572)	(62,472)
Resources that Fund Expenses Recognized in Prior Periods	(505)	(4,726)
Resources that Finance the Acquisition of Assets	(22,520)	(29,635)
Other	40,823	74,331
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	**(18,027)**	**(26,438)**
Total Resources Used to Finance the Net Cost of Operations	**$ (16,822)**	**$ (3,394)**

Amounts in Thousands

NOTE 11. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET (CONTINUED)

COMPONENTS OF THE NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD		
Components Requiring or Generating Resources in Future Period:		
Increase in Annual Leave Liability	$ -	$ 507
Other	346	2,666
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	346	3,173
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	92,063	103,031
Revaluation of Assets or Liabilities	6,612	(10,689)
Other	(2,167)	198
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	**96,508**	**92,540**
Total Components of Net Cost of Operations That Will Not Require or Generate Resources In the Current Period	**96,854**	**95,713**
NET COST OF OPERATIONS	**$ 80,032**	**$ 92,319**

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202–4704

December 22, 2008

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/ CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Endorsement of the Unqualified Opinion on the FY 2008 Defense Finance and Accounting Service Working Capital Fund Financial Statements (Report No. D-2009-038)

The Chief Financial Officers Act of 1990, as amended, requires the DoD Office of Inspector General (OIG) to audit the DoD Agency-wide financial statements. Financial data from the Defense Finance and Accounting Service (DFAS) Working Capital Fund (WCF) is included in the DoD Agency-wide financial statements. DoD Financial Management Regulation 7000.14-R requires audited DFAS WCF financial statements. For FY 2008, DFAS contracted with Urbach Kahn & Werlin LLP (UKW) to audit the DFAS WCF financial statements. UKW has been performing the annual DFAS WCF financial statement audit since FY 2002. FY 2008 is the first year that the DoD OIG served as the Contracting Officer's Representative and provided oversight of the annual audit of the DFAS WCF financial statements.

Unqualified Auditor's Opinion. We agree with the UKW unqualified opinion on the FY 2008 DFAS WCF Financial Statements. However, we cannot endorse UKW's opinion on the FY 2007 financial results presented on the FY 2008 DFAS WCF Financial Statements because we did not perform oversight of the UKW FY 2007 audit. UKW reported that the DFAS WCF financial statements present fairly, in all material respects, the financial position of the DFAS WCF as of September 30, 2008 and 2007, and its net cost of operations, changes in net position, and budgetary resources for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Report on Internal Control. We agree with the UKW Report on Internal Control over Financial Reporting and on Compliance and Other Matters. UKW did not identify any material internal control weaknesses. UKW, in planning and performing their audit, considered the DFAS WCF internal control over financial reporting as a basis for designing audit procedures. UKW did not express an opinion on internal control.

Report on Compliance with Laws and Regulations. We further agree with the UKW Report on Compliance with Laws and Regulations. UKW performed tests to determine whether management administered the DFAS WCF in compliance with certain provisions of laws and regulations. UKW identified no reportable instances of noncompliance with financial reporting related Federal laws or regulations or Office of Management and Budget (OMB) guidance. Noncompliance with these laws, regulations, and guidance could have a direct and material effect on the determination of financial statement amounts. OMB Bulletin No. 07-04, as amended, requires that auditors report test results if they identify noncompliance with certain provisions of laws and regulations.

Audit Responsibilities. We were responsible for obtaining reasonable assurance that the basic financial statements were presented fairly and free of material misstatement, in conformity with accounting principles generally accepted in the United States of America.

To fulfill our oversight responsibilities of UKW audit work, we complied with the following: "Government Auditing Standards" issued by the Comptroller General of the United States; OMB Bulletin No. 07-04, as amended; and the "GAO/PCIE Financial Audit Manual," July 2008. Specifically, we evaluated the nature, timing, and extent of the work; monitored progress throughout the audit; reviewed documentation prepared by UKW; met with UKW partners and staff members; reviewed the key judgments; met with DFAS officials; performed independent tests of the accounting records; and performed other procedures appropriate to the circumstances.

UKW formed their opinion on the basic financial statements taken as a whole. Because the required supplementary information is not part of the basic financial statements, UKW did not audit that information and did not express an opinion on it.

We appreciate the courtesies extended to the audit team. Please direct questions to Mr. Jack L. Armstrong at (317) 510-4801 extension 274 or Mr. Ted R. Paulson at (317) 510-4801 extension 271.

Patricia A. Marsh

Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

Attachment

INDEPENDENT AUDITOR'S REPORT

Inspector General of the Department of Defense,
Chair of Audit Committee and Director of the
Defense Finance and Accounting Service

In our audit of the Working Capital Fund (WCF) of the Defense Finance and Accounting Service (DFAS), a component of the United States Department of Defense, for Fiscal Year (FY) 2008 we found:

- The DFAS WCF financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;
- No material weaknesses in internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations;
- Significant progress has been made in FY 2008 on the control deficiency condition noted in the FY 2007 Independent Auditor's Report and, accordingly, that matter is no longer considered to be a significant deficiency.
- No instances of noncompliance with the Federal Financial Management Improvement Act of 1996 (FFMIA);
- No instances of noncompliance with laws and regulations.

The following sections discuss in more detail: (1) these conclusions, (2) our conclusions on Management's Discussion and Analysis and other supplementary information, (3) our audit objectives, scope and methodology, and (4) agency comments and evaluation.

OPINION ON FINANCIAL STATEMENTS

The accompanying financial statements including the accompanying notes present fairly, in all material respects, in conformity with accounting principles generally accepted in the United States, DFAS' assets, liabilities, and net position as of September 30, 2008 and 2007; and net costs; changes in net position and budgetary resources for the years then ended.

CONSIDERATION OF INTERNAL CONTROL

In planning and performing our audit, we considered DFAS' internal control over financial reporting, with respect to the WCF, as a basis for designing our auditing procedures and to comply with the Office of Management and Budget (OMB) audit guidance for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of DFAS' internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be material weaknesses or other significant deficiencies. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

We did, however note other matters involving internal control and its operation that are not considered significant deficiencies, but are communicated in a separate management letter to DFAS management.

SYSTEMS' COMPLIANCE WITH FFMIA REQUIREMENTS

Under the Federal Financial Management Improvement Act of 1996 (FFMIA), we are required to report whether the financial management systems used by DFAS, with respect to the WCF, substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger (SGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

The objective of our audit was not to provide an opinion on compliance with FFMIA. Accordingly, we do not express such an opinion. However, our work disclosed no instances in which DFAS' financial management systems, with respect to the WCF, did not substantially comply with Federal financial management systems requirements, Federal accounting standards or the SGL at the transaction level.

COMPLIANCE WITH LAWS AND REGULATIONS

Our tests of DFAS' compliance with selected provisions of laws and regulations, with respect to the WCF, for FY 2008 disclosed no instances of noncompliance that would be reportable under United States Government Auditing Standards or OMB audit guidance. However, the object of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

STATUS OF PRIOR YEAR'S CONTROL DEFICIENCY

As required by *Government Auditing Standards* and OMB Bulletin No. 07-04, we have reviewed the status of DFAS' corrective actions with respect to the findings and recommendations included in the prior year's Independent Auditor's Report dated October 30, 2007. The prior year audit report noted a control deficiency related to improving internal controls over the recording of accounts payable and undelivered orders. DFAS management has implemented substantial changes to its procedures and, accordingly, the prior year control deficiency is no longer considered a significant deficiency for purposes of this report.

CONSISTENCY OF OTHER INFORMATION

DFAS Management's Discussion and Analysis (MD&A), referenced in the Table of Contents, is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The introductory information, performance information and appendixes listed in the table of contents are presented for additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

OBJECTIVES, SCOPE AND METHODOLOGY

DFAS management is responsible for (1) preparing the WCF financial statements in conformity with accounting principles generally accepted in the United States, (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA), are met, (3) ensuring that DFAS' financial management systems, with respect to the WCF, substantially comply with FFMIA requirements, and (4) complying with other applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether the WCF financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States. We are also responsible for: (1) obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit, (2) testing whether DFAS' financial management systems, with respect to the WCF, substantially comply with the three FFMIA requirements, (3) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the WCF financial statements and laws for which OMB audit guidance requires testing, and (4) performing limited procedures with respect to certain other information appearing in the MD&A.

In order to fulfill these responsibilities, we (1) examined on a test basis, evidence supporting the amounts and disclosures in the financial statements, (2) assessed the accounting principles used and significant estimates made by management, (3) evaluated the overall presentation of the financial statements, (4) obtained an understanding of DFAS and its operations, (including safeguarding of assets), compliance with laws and regulations (including execution of transactions in accordance with budget authority), (5) tested relevant internal controls over financial reporting, and compliance, and evaluated the design and operating effectiveness of internal control, (6) considered the design of the process for evaluating and reporting on internal control and financial management systems under FMFIA, (7) tested whether DFAS' financial management systems, with respect to the WCF, substantially complied with the three FFMIA requirements, and (8) tested compliance with selected provisions of certain laws and regulations.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

We did not test compliance with all laws and regulations applicable to DFAS. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the financial statements and those required by OMB audit guidance that we deemed applicable to DFAS' financial statements for the fiscal year ended September 30, 2008. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We performed our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to the financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and OMB guidance.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on a draft of this report (Exhibit I), DFAS management and its Audit Committee concurred with the facts and conclusions in our report.

****

This report is intended solely for the information and use of DFAS' management, the Department of Defense (DOD), the DOD Office of Inspector General, OMB, the Government Accountability Office, and the U.S. Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

Urbach Kahn & Werlin LLP

Arlington, Virginia
November 12, 2008

EXHIBIT I

DEPARTMENT OF DEFENSE
DEFENSE FINANCE AND ACCOUNTING SERVICE
COMMENTS FROM DFAS MANAGEMENT AND ITS
AUDIT COMMITTEE ON FY 2008
INDEPENDENT AUDITOR'S REPORT
November 12, 2008

DEFENSE FINANCE AND ACCOUNTING SERVICE
ARLINGTON
1851 SOUTH BELL STREET
ARLINGTON, VA 22240-5291

November 6, 2008

Mr. Sal P. Ercolano, Jr., CPA, CGFM
Partner
Clifton Gunderson LLP
4250 N. Fairfax Dr
Arlington, VA 22203

Dear Mr. Ercolano:

This letter is in response to the draft Independent Auditor's Report on the Fiscal Year 2008 DFAS Working Capital Fund Financial Statements that you submitted on October 30, 2008. I concur with this draft Auditor's Report as written with no comments.

Please extend my thanks to your staff for the outstanding integrity, professionalism and diligence exhibited these last nine months. This report is concise and definitive as to the areas requiring our attention in the coming year.

The DFAS Financial Management Improvement Plan (FMIP) Team will address any conditions you identified over this past year and we look forward to the FMIP Team's continual updates as it addresses the issues.

My point of contact is Mr. Craig Fitzgibbons, (317) 510-1258 or e-mail at craig.fitzgibbons@dfas.mil.

Sincerely,

T McKay

Teresa A. McKay
Director

www.dfas.mil
Your Financial Partner @ Work

GSA

U.S. General Services Administration

November 6, 2008

Mr. Sal P. Ercolano, Jr., CPA, CGFM
Partner
Clifton Gunderson LLP
4250 N. Fairfax Dr
Arlington, VA 22203

Dear Mr. Ercolano:

This letter is in response to the draft Independent Auditor's Report on the Fiscal Year 2008 DFAS Working Capital Fund Financial Statements that you submitted on October 30, 2008. We concur with this draft Auditor's Report as written with no comments.

Please extend our thanks to your staff for the outstanding integrity, professionalism and diligence exhibited these last nine months. This report is concise and definitive as to the areas requiring our attention in the coming year.

The DFAS Financial Management Improvement Plan (FMIP) Team will address any conditions you identified over this past year and we look forward to the FMIP Team's continual updates as it addresses the issues.

Again, our utmost gratitude to you and your staff and we look forward to receiving the final FY 2008 DFAS Financial Statements Audit Report.

Sincerely,

Kathleen M. Turco

Kathleen M. Turco
Chairman
DFAS Audit Committee

1800 F Street, NW
Washington, DC 20405-0002
www.gsa.gov