

Department of Defense
Agency Wide
CONSOLIDATED BALANCE SHEET
As of December 31, 2005 and 2004

| | 2006 Consolidated | 2005 Consolidated |
|--|-------------------------------------|-------------------------------------|
| | <hr/> | <hr/> |
| 1. ASSETS (Note 2) | | |
| A. Intragovernmental: | | |
| 1. Fund Balance with Treasury (Note 3) | | |
| a. Entity | \$ 322,759,233,240.50 | \$ 575,205,010,153.27 |
| b. Non-Entity Seized Iraqi Cash | 57,715,612.99 | 139,231,227.90 |
| c. Non-Entity-Other | 615,654,181.92 | 676,279,542.28 |
| 2. Investments (Note 4) | 313,022,057,671.99 | 267,525,689,382.53 |
| 3. Accounts Receivable (Note 5) | 3,029,567,320.38 | 2,092,345,708.10 |
| 4. Other Assets (Note 6) | 1,315,571,597.11 | 1,070,578,231.12 |
| 5. Total Intragovernmental Assets | <hr/> \$ 640,799,799,624.89 | <hr/> \$ 846,709,134,245.20 |
| B. Cash and Other Monetary Assets (Note 7) | \$ 1,901,778,598.72 | \$ 2,185,027,093.06 |
| C. Accounts Receivable (Note 5) | 8,077,406,476.41 | 6,477,888,481.05 |
| D. Loans Receivable (Note 8) | 101,322,075.25 | 70,736,172.60 |
| E. Inventory and Related Property (Note 9) | 228,895,689,967.54 | 210,322,780,095.88 |
| F. General Property, Plant and Equipment (Note 10) | 465,385,968,560.39 | 443,109,222,753.42 |
| G. Investments (Note 4) | 772,100,130.00 | 478,764,630.00 |
| H. Other Assets (Note 6) | 23,976,023,503.09 | 25,208,465,944.61 |
| 2. TOTAL ASSETS | <hr/> <hr/> \$ 1,369,910,088,936.29 | <hr/> <hr/> \$ 1,534,562,019,415.82 |
| 3. LIABILITIES (Note 11) | | |
| A. Intragovernmental: | | |
| 1. Accounts Payable (Note 12) | \$ 2,355,693,577.55 | \$ 2,319,199,631.50 |
| 2. Debt (Note 13) | 500,648,543.12 | 602,765,282.24 |
| 3. Other Liabilities (Note 15 & 16) | 10,490,259,029.85 | 10,569,124,561.58 |
| 4. Total Intragovernmental Liabilities | <hr/> \$ 13,346,601,150.52 | <hr/> \$ 13,491,089,475.32 |
| B. Accounts Payable (Note 12) | \$ 27,496,003,151.67 | \$ 25,610,212,785.14 |
| C. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17) | 1,736,057,866,413.76 | 1,569,705,005,356.96 |
| D. Environmental and Disposal Liabilities (Note 14) | 65,908,836,837.05 | 64,251,518,112.80 |
| E. Loan Guarantee Liability (Note 8) | 41,977,948.38 | 44,765,030.64 |
| F. Other Liabilities (Note 15 & Note 16) | 30,188,868,176.28 | 30,475,741,694.19 |
| 4. TOTAL LIABILITIES | <hr/> \$ 1,873,040,153,677.66 | <hr/> \$ 1,703,578,332,455.05 |
| 5. NET POSITION | | |
| A. Unexpended Appropriations - Earmarked Funds (Note 23) | \$ 259,029.32 | \$ 0.00 |
| B. Unexpended Appropriations - Other Funds | 311,394,642,530.97 | 543,771,166,858.36 |
| C. Cumulative Results of Operations - Earmarked Funds | (1,177,163,348,583.32) | 0.00 |
| D. Cumulative Results of Operations - Other Funds | 362,638,382,281.66 | (712,787,479,897.59) |
| 6. TOTAL NET POSITION | <hr/> \$ (503,130,064,741.37) | <hr/> \$ (169,016,313,039.23) |
| 7. TOTAL LIABILITIES AND NET POSITION | <hr/> <hr/> \$ 1,369,910,088,936.29 | <hr/> <hr/> \$ 1,534,562,019,415.82 |

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CONSOLIDATED STATEMENT OF NET COST

For the periods ended December 31, 2005 and 2004

| | 2006 Consolidated | 2005 Consolidated |
|---|-------------------------------------|------------------------------------|
| 1. Program Costs | | |
| A. Gross Costs | \$ 127,362,346,878.46 | \$ 122,593,604,675.25 |
| B. (Less: Earned Revenue) | (18,074,270,948.97) | (27,869,157,649.50) |
| C. Net Program Costs | <u>\$ 109,288,075,929.49</u> | <u>\$ 94,724,447,025.75</u> |
| 2. Cost Not Assigned to Programs | 0.00 | 0.00 |
| 3. (Less: Earned Revenue Not Attributable to Programs) | 0.00 | 0.00 |
| 4. Net Cost of Operations | <u><u>\$ 109,288,075,929.49</u></u> | <u><u>\$ 94,724,447,025.75</u></u> |

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CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended December 31, 2005 and 2004

| | 2006 Consolidated | 2005 Consolidated |
|---|-------------------------|-------------------------|
| CUMULATIVE RESULTS OF OPERATIONS | | |
| 1. Beginning Balances | \$ (870,682,621,884.00) | \$ (745,441,240,189.41) |
| 2. Prior Period Adjustments: | | |
| 2.A. Changes in accounting principles (+/-) | 0.00 | 0.00 |
| 2.B. Corrections of errors (+/-) | 0.00 | 0.00 |
| 3. Beginning balances, as adjusted | (870,682,621,884.00) | (745,441,240,189.41) |
| 4. Budgetary Financing Sources: | | |
| 4.A. Appropriations received | | |
| 4.A.1 Earmarked funds | 0.00 | 0.00 |
| 4.A.2 All other funds | 0.00 | 0.00 |
| 4.B. Appropriations transferred-in/out (+/-) | 0.00 | 0.00 |
| 4.C. Other adjustments (rescissions, etc.) (+/-) | 0.00 | 0.00 |
| 4.D. Appropriations used | | |
| 4.D.1 Earmarked Funds | 900,623.50 | 0.00 |
| 4.D.2 All other Funds | 165,426,278,766.38 | 125,480,541,022.30 |
| 4.E. Nonexchange revenue | | |
| 4.E.1 Earmarked funds | 478,136,976.91 | 0.00 |
| 4.E.2 All other funds | 4,983,029.96 | 382,345,719.36 |
| 4.F. Donations and forfeitures of cash and cash equivalents | | |
| 4.F.1 Earmarked funds | 5,107,585.87 | 0.00 |
| 4.F.2 All other funds | 0.00 | 6,629,071.90 |
| 4.G. Transfers-in/out without reimbursement (+/-) | 223,985,650.34 | 1,942,464,205.81 |
| 4.H. Other budgetary financing sources (+/-) | | |
| 4.H.1 Earmarked funds | 605,484.10 | 0.00 |
| 4.H.2 All other funds | (171,280,265.89) | (1,609,464,722.13) |
| 5. Other Financing Sources: | | |
| 5.A. Donations and forfeitures of property | | |
| 5.A.1 Earmarked funds | 0.00 | 0.00 |
| 5.A.2 All other funds | 10,506.00 | 112,000.00 |
| 5.B. Transfers-in/out without reimbursement (+/-) | (76,000.00) | (11,524.99) |
| 5.C. Imputed financing from costs absorbed by others | 1,063,516,235.68 | 1,175,414,528.13 |
| 5.D. Other (+/-) | 1,322,384,014.75 | 177,017.19 |
| 6. Total Financing Sources | | |
| 6.A. Earmarked funds | 779,510,806.98 | 0.00 |
| 6.B. All other funds | 167,575,041,800.62 | 127,378,207,317.57 |
| 7. Net Cost of Operations (+/-) | | |
| 7.A. Earmarked funds | 6,120,489,868.90 | 0.00 |
| 7.B. All other funds | 106,076,407,156.36 | 94,724,447,025.75 |
| 8. Net Change | | |
| 8.A. Earmarked funds | (5,340,979,061.92) | 0.00 |
| 8.B. All other funds | 61,498,634,644.26 | 32,653,760,291.82 |
| 9. Ending Balances | | |
| 9.A. Earmarked funds | (1,177,163,348,583.32) | 0.00 |
| 9.B. All other funds | 362,638,382,281.66 | (712,787,479,897.59) |

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CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended December 31, 2005 and 2004

| | 2006 Consolidated | 2005 Consolidated |
|---------------------|--------------------------------|--------------------------------|
| 10. Total all funds | \$ <u>(814,524,966,301.66)</u> | \$ <u>(712,787,479,897.59)</u> |

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CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended December 31, 2005 and 2004

| | 2006 Consolidated | 2005 Consolidated |
|---|-----------------------|-----------------------|
| UNEXPENDED APPROPRIATIONS | | |
| 1. Beginning Balances | \$ 271,493,675,950.17 | \$ 243,813,788,091.23 |
| 2. Prior Period Adjustments: | | |
| 2.A. Changes in accounting principles (+/-) | 0.00 | 0.00 |
| 2.B. Corrections of errors (+/-) | 0.00 | 0.00 |
| 3. Beginning balances, as adjusted | 271,493,675,950.17 | 243,813,788,091.23 |
| 4. Budgetary Financing Sources: | | |
| 4.A. Appropriations received | | |
| 4.A.1 Earmarked funds | 100,000.00 | 0.00 |
| 4.A.2 All other funds | 205,642,987,000.00 | 428,241,126,932.46 |
| 4.B. Appropriations transferred-in/out (+/-) | (15,324,000.00) | (549,268,671.00) |
| 4.C. Other adjustments (rescissions, etc) (+/-) | (299,358,000.00) | (2,253,938,472.03) |
| 4.D. Appropriations used | | |
| 4.D.1 Earmarked Funds | (900,623.50) | 0.00 |
| 4.D.2 All other Funds | (165,426,278,766.38) | (125,480,541,022.30) |
| 4.E. Nonexchange revenue | | |
| 4.E.1 Earmarked funds | 0.00 | 0.00 |
| 4.E.2 All other funds | 0.00 | 0.00 |
| 4.F. Donations and forfeitures of cash and cash equivalents | | |
| 4.F.1 Earmarked funds | 0.00 | 0.00 |
| 4.F.2 All other funds | 0.00 | 0.00 |
| 4.G. Transfers-in/out without reimbursement (+/-) | 0.00 | 0.00 |
| 4.H. Other budgetary financing sources (+/-) | | |
| 4.H.1 Earmarked funds | 0.00 | 0.00 |
| 4.H.2 All other funds | 0.00 | 0.00 |
| 5. Other Financing Sources: | | |
| 5.A. Donations and forfeitures of property | | |
| 5.A.1 Earmarked funds | 0.00 | 0.00 |
| 5.A.2 All other funds | 0.00 | 0.00 |
| 5.B. Transfers-in/out without reimbursement (+/-) | 0.00 | 0.00 |
| 5.C. Imputed financing from costs absorbed by others | 0.00 | 0.00 |
| 5.D. Other (+/-) | 0.00 | 0.00 |
| 6. Total Financing Sources | | |
| 6.A. Earmarked funds | (800,623.50) | 0.00 |
| 6.B. All other funds | 39,902,026,233.62 | 299,957,378,767.13 |
| 7. Net Cost of Operations (+/-) | | |
| 7.A. Earmarked funds | 0.00 | 0.00 |
| 7.B. All other funds | | |
| 8. Net Change | | |
| 8.A. Earmarked funds | (800,623.50) | 0.00 |
| 8.B. All other funds | 39,902,026,233.62 | 299,957,378,767.13 |
| 9. Ending Balances | | |
| 9.A. Earmarked funds | 259,029.32 | 0.00 |
| 9.B. All other funds | 311,394,642,530.97 | 543,771,166,858.36 |

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CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended December 31, 2005 and 2004

| | 2006 Consolidated | 2005 Consolidated |
|----------------------------|------------------------------|------------------------------|
| 10. Total all funds | \$ <u>311,394,901,560.29</u> | \$ <u>543,771,166,858.36</u> |

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended December 31, 2005 and 2004

| | 2006 Combined | 2005 Combined |
|--|-----------------------------------|-----------------------------------|
| | <hr/> | <hr/> |
| BUDGETARY FINANCING ACCOUNTS | | |
| BUDGETARY RESOURCES: | | |
| 1. Unobligated balance, brought forward, October 1 | \$ 68,589,487,818.32 | \$ 293,956,869,248.72 |
| 2. Recoveries of prior year unpaid obligations | 9,535,394,970.63 | 24,651,925,689.01 |
| 3. Budget authority | | |
| 3.A. Appropriation | 504,926,752,978.75 | 477,729,007,315.28 |
| 3.B. Borrowing authority | 0.00 | 0.00 |
| 3.C. Contract authority | 60,424,307,584.01 | 43,824,157,236.02 |
| 3.D. Spending authority from offsetting collections | | |
| 3.D.1 Earned | | |
| 3.D.1.a. Collected | 37,009,013,704.24 | 34,504,183,476.80 |
| 3.D.1.b. Change in receivables from Federal sources | (95,596,169.57) | 637,697,124.02 |
| 3.D.2 Change in unfilled customer orders | | |
| 3.D.2.a. Advance received | 290,640,774.53 | 501,330,293.50 |
| 3.D.2.b. Without advance from Federal sources | 9,728,076,179.72 | 16,143,410,808.74 |
| 3.D.3. Anticipated for rest of year, without advances | 38,956,433,143.57 | 27,785,480,684.37 |
| 3.D.4. Previously unavailable | 0.00 | 0.00 |
| 3.D.5. Expenditure transfers from trust funds | 0.00 | 0.00 |
| 3.E. Subtotal | <hr/> 651,239,628,195.25 | <hr/> 601,125,266,938.73 |
| 4. Nonexpenditure transfers, net, anticipated and actual | 215,260,522.00 | 23,325,900,680.93 |
| 5. Temporarily not available pursuant to Public Law | (281,210,657,359.76) | (10,000,000.00) |
| 6. Permanently not available | (13,661,118,958.10) | (9,886,235,010.57) |
| 7. Total Budgetary Resources | <hr/> <hr/> \$ 434,707,995,188.34 | <hr/> <hr/> \$ 933,163,727,546.82 |

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Agency Wide
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended December 31, 2005 and 2004

| | 2006 Combined | 2005 Combined |
|---|-------------------------------------|-------------------------------------|
| Status of Budgetary Resources: | | |
| 8. Obligations incurred: | | |
| 8.A. Direct | \$ 178,709,607,537.19 | \$ 187,822,030,404.68 |
| 8.B. Reimbursable | 43,467,820,993.39 | 50,789,952,837.81 |
| 8.C. Subtotal | <u>222,177,428,530.58</u> | <u>238,611,983,242.49</u> |
| 9. Unobligated balance: | | |
| 9.A. Apportioned | 190,102,721,886.16 | 401,518,491,244.07 |
| 9.B. Exempt from apportionment | 6,007,533,186.95 | 224,563,249,986.50 |
| 9.C. Subtotal | <u>196,110,255,073.11</u> | <u>626,081,741,230.57</u> |
| 10. Unobligated balance not available | 16,420,311,584.65 | 68,470,003,073.76 |
| 11. Total status of budgetary resources | <u><u>\$ 434,707,995,188.34</u></u> | <u><u>\$ 933,163,727,546.82</u></u> |
| Change in Obligated Balance: | | |
| 12. Obligated balance, net | | |
| 12.A. Unpaid obligations, brought forward, October 1 | 300,445,361,172.24 | 282,264,839,033.32 |
| 12.B. Less: Uncollected customer payments from Federal sources, brought forward, October 1 | <u>\$ (54,586,765,275.73)</u> | <u>\$ (49,538,723,232.75)</u> |
| 12.C. Total unpaid obligated balance | <u>245,858,595,896.51</u> | <u>232,726,115,800.56</u> |
| 13. Obligations incurred net (+/-) | <u>\$ 222,177,428,530.58</u> | <u>\$ 238,611,983,242.49</u> |
| 14. Less: Gross outlays | (222,298,545,176.54) | (186,968,907,404.21) |
| 15. Obligated balance transferred, net | | |
| 15.A. Actual transfers, unpaid obligations (+/-) | 0.00 | 0.00 |
| 15.B. Actual transfers, uncollected customer payments from Federal sources (+/-) | <u>0.00</u> | <u>0.00</u> |
| 15.C. Total Unpaid obligated balance transferred, net | <u>0.00</u> | <u>0.00</u> |
| 16. Less: Recoveries of prior year unpaid obligations, actual | <u>(9,535,394,970.63)</u> | <u>(24,651,925,689.01)</u> |
| 17. Change in uncollected customer payments from Federal sources (+/-) | <u>(9,632,480,010.15)</u> | <u>(16,781,107,932.76)</u> |
| 18. Obligated balance, net, end of period | | |
| 18.A. Unpaid obligations | 290,788,849,555.65 | 309,255,989,182.59 |
| 18.B. Less: Uncollected customer payments (+/-) from Federal sources (-) | <u>(64,219,245,285.88)</u> | <u>(66,319,831,165.51)</u> |
| 18.C. Total, unpaid obligated balance, net, end of period | <u>226,569,604,269.77</u> | <u>242,936,158,017.08</u> |
| Net Outlays | | |
| 19. Net Outlays: | | |
| 19.A. Gross outlays | 222,298,545,176.54 | 186,968,907,404.21 |
| 19.B. Less: Offsetting collections | (37,299,654,478.77) | (35,005,513,770.30) |
| 19.C. Less: Distributed Offsetting receipts | <u>(55,417,021,398.08)</u> | <u>(42,121,540,018.29)</u> |
| 19.D. Net Outlays | <u><u>\$ 129,581,869,299.69</u></u> | <u><u>\$ 109,841,853,615.62</u></u> |

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COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended December 31, 2005 and 2004

| | 2006 Combined | 2005 Combined |
|--|-------------------------|-------------------------|
| NONBUDGETARY FINANCING ACCOUNTS | | |
| BUDGETARY RESOURCES | | |
| 1. Unobligated balance, brought forward, October 1 | \$ 35,023,097.64 | \$ 24,520,250.64 |
| 2. Recoveries of prior year unpaid obligations | 0.00 | 0.00 |
| 3. Budget authority | | |
| 3.A. Appropriation | 0.00 | 0.00 |
| 3.B. Borrowing authority | 8,176,995.00 | 3,432,129.00 |
| 3.C. Contract authority | 0.00 | 0.00 |
| 3.D. Spending authority from offsetting collections | | |
| 3.D.1 Earned | | |
| 3.D.1.a. Collected | 9,940,363.09 | 11,206,721.24 |
| 3.D.1.b. Change in receivables from Federal sources | 0.00 | 0.00 |
| 3.D.2 Change in unfilled customer orders | | |
| 3.D.2.a. Advance received | 0.00 | 0.00 |
| 3.D.2.b. Without advance from Federal sources | (8,980,700.00) | 318,315.00 |
| 3.D.3 Anticipated for rest of year, without advances | 4,651,631.33 | 5,135,784.76 |
| 3.D.4 Previously unavailable | 0.00 | 0.00 |
| 3.D.5 Expenditure transfers from trust funds | 0.00 | 0.00 |
| 3.E. Subtotal | 13,788,289.42 | 20,092,950.00 |
| 4. Nonexpenditure transfers, net, anticipated and actual | 0.00 | 0.00 |
| 5. Temporarily not available pursuant to Public Law | 0.00 | 0.00 |
| 6. Permanently not available | 0.00 | (1,912,714.00) |
| 7. Total Budgetary Resources | \$ 48,811,387.06 | \$ 42,700,486.64 |

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COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended December 31, 2005 and 2004

| | 2006 Combined | 2005 Combined |
|---|----------------------------------|----------------------------------|
| Status of Budgetary Resources: | | |
| 8. Obligations incurred: | | |
| 8.A. Direct | \$ 2,975,000.00 | \$ 0.00 |
| 8.B. Reimbursable | 0.00 | 0.00 |
| 8.C. Subtotal | <u>2,975,000.00</u> | <u>0.00</u> |
| 9. Unobligated balance: | | |
| 9.A. Apportioned | 1,525,335.32 | 5,545,037.32 |
| 9.B. Exempt from apportionment | 0.00 | 0.00 |
| 9.C. Subtotal | <u>1,525,335.32</u> | <u>5,545,037.32</u> |
| 10. Unobligated balance not available | 44,311,051.74 | 37,155,449.32 |
| 11. Total Status of Budgetary Resources | <u><u>\$ 48,811,387.06</u></u> | <u><u>\$ 42,700,486.64</u></u> |
| Change in Obligated Balance: | | |
| 12. Obligated balance, net | | |
| 12.A. Unpaid obligations, brought forward, October 1 | 446,330,280.81 | 0.00 |
| 12.B. Less: Uncollected customer payments from Federal sources, brought forward, October 1 | <u>\$ (123,710,109.00)</u> | <u>\$ 155,747,457.81</u> |
| 12.C. Total unpaid obligated balance | <u>322,620,171.81</u> | <u>155,747,457.81</u> |
| 13. Obligations incurred net (+/-) | \$ 2,975,000.00 | \$ 0.00 |
| 14. Less: Gross outlays | (26,680,280.81) | 0.00 |
| 15. Obligated balance transferred, net | | |
| 15.A. Actual transfers, unpaid obligations (+/-) | 0.00 | 0.00 |
| 15.B. Actual transfers, uncollected customer payments from Federal sources (+/-) | <u>0.00</u> | <u>0.00</u> |
| 15.C. Total Unpaid obligated balance transferred, net | <u>0.00</u> | <u>0.00</u> |
| 16. Less: Recoveries of prior year unpaid obligations, actual | 0.00 | 0.00 |
| 17. Change in uncollected customer payments from Federal sources (+/-) | 8,980,700.00 | (318,315.00) |
| 18. Obligated balance, net, end of period | | |
| 18.A. Unpaid obligations | 422,625,000.00 | 238,830,280.81 |
| 18.B. Less: Uncollected customer payments (+/-) from Federal sources (-) | <u>(114,729,409.00)</u> | <u>(83,401,138.00)</u> |
| 18.C. Total, unpaid obligated balance, net, end of period | <u>307,895,591.00</u> | <u>155,429,142.81</u> |
| Net Outlays | | |
| 19. Net Outlays: | | |
| 19.A. Gross outlays | (26,680,280.81) | 0.00 |
| 19.B. Less: Offsetting collections | (9,940,363.09) | (11,206,721.24) |
| 19.C. Less: Distributed Offsetting receipts | 0.00 | 0.00 |
| 19.D. Net Outlays | <u><u>\$ (36,620,643.90)</u></u> | <u><u>\$ (11,206,721.24)</u></u> |

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CONSOLIDATED STATEMENT OF FINANCING
For the periods ended December 31, 2005 and 2004

| | 2006 Consolidated | 2005 Consolidated |
|---|-------------------------------------|-------------------------------------|
| | <hr/> | <hr/> |
| Resources Used to Finance Activities: | | |
| Budgetary Resources Obligated | | |
| 1. Obligations incurred | \$ 222,180,403,530.58 | \$ 238,611,983,242.49 |
| 2. Less: Spending authority from offsetting collections and recoveries (-) | (56,468,489,122.64) | (76,450,072,428.31) |
| 3. Obligations net of offsetting collections and recoveries | 165,711,914,407.94 | 162,161,910,814.18 |
| 4. Less: Offsetting receipts (-) | (55,417,021,398.08) | (42,121,540,018.29) |
| 5. Net obligations | <hr/> 110,294,893,009.86 | <hr/> 120,040,370,795.89 |
| Other Resources | | |
| 6. Donations and forfeitures of property | 10,506.00 | 112,000.00 |
| 7. Transfers in/out without reimbursement (+/-) | (76,000.00) | (11,524.99) |
| 8. Imputed financing from costs absorbed by others | 1,063,516,235.68 | 1,175,414,528.13 |
| 9. Other (+/-) | 1,322,384,014.75 | 177,017.19 |
| 10. Net other resources used to finance activities | <hr/> 2,385,834,756.43 | <hr/> 1,175,692,020.33 |
| 11. Total resources used to finance activities | <hr/> \$ 112,680,727,766.29 | <hr/> \$ 121,216,062,816.22 |
| Resources Used to Finance Items not Part of the Net Cost of Operations | | |
| 12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided | | |
| 12a. Undelivered Orders (-) | 8,097,674,314.28 | (39,403,707,942.94) |
| 12b. Unfilled Customer Orders | 10,009,736,254.25 | 16,645,059,417.24 |
| 13. Resources that fund expenses recognized in prior periods | (1,529,969,791.21) | (2,149,958,638.13) |
| 14. Budgetary offsetting collections and receipts that do not affect net cost of operations | 604,394,482.80 | 518,802,279.35 |
| 15. Resources that finance the acquisition of assets | (32,911,774,303.76) | (19,555,931,771.57) |
| 16. Other resources or adjustments to net obligated resources that do not affect net cost of operations | | |
| 16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-) | (10,000,000.00) | (10,000,000.00) |
| 16b. Other (+/-) | (1,290,122,635.31) | (100,475.01) |
| 17. Total resources used to finance items not part of the net cost of operations | <hr/> \$ (17,030,061,678.95) | <hr/> \$ (43,955,837,131.06) |
| 18. Total resources used to finance the net cost of operations | <hr/> \$ 95,650,666,087.34 | <hr/> \$ 77,260,225,685.16 |

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF FINANCING

For the periods ended December 31, 2005 and 2004

| | <u>2006 Consolidated</u> | <u>2005 Consolidated</u> |
|---|-------------------------------------|------------------------------------|
| 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: | | |
| 19. Increase in annual leave liability | 455,187,643.65 | 152,123,612.02 |
| 20. Increase in environmental and disposal liability | 1,217,073,522.48 | 973,164,943.00 |
| 21. Upward/Downward reestimates of credit subsidy expense (+/-) | 0.00 | 0.00 |
| 22. Increase in exchange revenue receivable from the public (-) | (10,809,586.56) | 29,466,667.57 |
| 23. Other (+/-) | 114,811,529.52 | 287,420,301.33 |
| 24. Total components of Net Cost of Operations that will require or generate resources in future periods | <u>1,776,263,109.09</u> | <u>1,442,175,523.92</u> |
| Components not Requiring or Generating Resources: | | |
| 25. Depreciation and amortization | 13,484,603,287.11 | 6,585,701,456.24 |
| 26. Revaluation of assets or liabilities (+/-) | 393,008,282.68 | (2,850,367,650.15) |
| 27. Other (+/-) | | |
| 27a. Trust Fund Exchange Revenue | (7,024,988,410.17) | (6,237,988,441.59) |
| 27b. Cost of Goods Sold | 11,665,660,311.17 | 13,647,646,436.14 |
| 27c. Operating Material & Supplies Used | (2,767,872,112.80) | (519,034,059.06) |
| 27d. Other | (972,118,808.27) | 5,396,088,075.09 |
| 28. Total components of Net Cost of Operations that will not require or generate resources | <u>14,778,292,549.72</u> | <u>16,022,045,816.67</u> |
| 29. Total components of net cost of operations that will not require or generate resources in the current period | <u>\$ 16,554,555,658.81</u> | <u>\$ 17,464,221,340.59</u> |
| 30. Net Cost of Operations | <u><u>\$ 112,205,221,746.15</u></u> | <u><u>\$ 94,724,447,025.75</u></u> |

Department of Defense

Agency Wide

COMBINED STATEMENT OF CUSTODIAL ACTIVITY

For the periods ended December 31, 2005 and 2004

| | 2006 Combined | 2005 Combined |
|---|----------------------------|----------------------------|
| 1.SOURCE OF COLLECTIONS | | |
| A. Deposits by Foreign Governments | \$ 2,585,396,540.94 | \$ 2,312,832,652.34 |
| B. Seized Iraqi Cash | 0.00 | 700.00 |
| C. Other Collections | 0.00 | 0.00 |
| D. Total Cash Collections | <u>\$ 2,585,396,540.94</u> | <u>\$ 2,312,833,352.34</u> |
| E. Accrual Adjustments (+/-) | \$ 0.00 | \$ 0.00 |
| F. Total Custodial Collections | <u>\$ 2,585,396,540.94</u> | <u>\$ 2,312,833,352.34</u> |
| 2.DISPOSITION OF COLLECTIONS | | |
| A. Disbursed on Behalf of Foreign Governments and International Organizations | \$ 2,767,267,203.34 | \$ 2,544,653,772.46 |
| B. Seized Assets Disbursed on behalf of Iraqi People | 3,654,232.40 | 24,199,454.26 |
| C. Increase (Decrease) in Amounts to be Transferred | (181,870,662.40) | (231,821,120.12) |
| D. Collections Used for Refunds and Other Payments | 0.00 | 0.00 |
| E. Retained by The Reporting Entity | 0.00 | 0.00 |
| F. Seized Assets Retained for Support of the Iraqi People | (3,654,232.40) | (24,198,754.26) |
| G. Total Disposition of Collections | <u>\$ 2,585,396,540.94</u> | <u>\$ 2,312,833,352.34</u> |
| 3. NET CUSTODIAL COLLECTION ACTIVITY | <u>\$ 0.00</u> | <u>\$ 0.00</u> |

| | |
|----------------|--|
| Note 1. | Significant Accounting Policies |
|----------------|--|

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the “Chief Financial Officers Act of 1990,” expanded by the “Government Management Reform Act of 1994,” and other appropriate legislation. The financial statements have been prepared from the books and records of the Department in accordance with the “DoD Financial Management Regulation,” Office of Management and Budget Circular No. A-136 (Financial Reporting Requirements), and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the Department is responsible. Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified. Starting in FY 2006, the Department is reporting Earmarked Funds on their financial statements and notes as required in OMB Circular A-136.

The Department is unable to fully implement all elements of GAAP and Office of Management and Budget Circular No. A-136 due to limitations of its financial management processes and systems, and non-financial systems and processes that feed into the financial statements. The Department derives its reported values and information for major asset and liability categories largely from non-financial systems, such as inventory systems and logistics systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The Department continues to implement process and system improvements addressing these limitations. The Department currently has 11 auditor-identified financial statement material weaknesses: (1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Accounting Entries, (4) Fund Balance with Treasury, (5) Environmental Liabilities, (6) General Property, Plant and Equipment, (7) Government Property and material in Possession of Contractors, (8) Inventory, (9) Operating Materials and Supplies, (10) Statement of Net Cost, and (11) Statement of Financing.

1.B. Mission of the Reporting Entity

The National Security Act of 1947 established the Department of Defense. The Department’s mission is to organize, train, and equip armed forces to deter aggression and, if necessary, defeat aggressors against the United States and its allies. Fiscal Year (FY) 2006 is the eleventh year that the Department has prepared audited DoD Agencywide financial statements as required by the Chief Financial Officers Act and Government Management Reform Act. Auditors are required to audit the financial statements of the following stand-alone reporting entities: (1) Army General Fund, (2) Army Working Capital Fund, (3) Navy General Fund, (4) Navy Working Capital Fund (5) Air Force General Fund, (6) Air Force Working Capital Fund, (7) Military Retirement Fund, (8) DoD Medicare-Eligible Retiree Health Care Fund, and (9) U.S. Army Corps of Engineers (Civil Works).

In addition to the nine stand-alone reporting entities, separate columns in the combining/consolidating statements are included with the financial information of the “Other Defense Organizations General Funds” and “Other Defense Organizations Working Capital Funds.” The Office of the Inspector General will not issue separate audit opinions on the statements of the Other Defense Organizations; instead, the financial statements and records of those organizations are included in the audit performed to support the opinion issued on the DoD Agencywide financial statements.

The Department requires the Marine Corps General and Working Capital Fund and the following Defense Agencies to prepare internal stand-alone auditable financial statements: (1) Defense Logistics Agency, (2) Defense Finance and Accounting Service, (3) Defense Information Systems Agency, (4) Defense Contract Audit Agency, (5) Defense Commissary Agency, (6) Defense Security Service, (7) Defense Threat Reduction Agency, (8) Defense Advanced Research Projects Agency, (9) Chemical Biological and Defense

Program, (10) Missile Defense Agency, (11) Services Medical Activity, (12) Tricare Management Activity, and (13) U.S. Special Operations Command.

1.C. Appropriations and Funds

The Department receives its appropriations and funds as general, working capital (revolving), trust, special, and deposit funds. The Components use these appropriations and funds to execute their missions and report on resource usage.

General funds (GF) are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and military construction accounts.

Working capital funds (WCF) receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial startup. The WCF entities provide goods and services on a reimbursable basis. Reimbursable receipts fund ongoing operations and generally are available in their entirety for use without further congressional action.

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

Special fund accounts are used to process government receipts earmarked for a specific purpose.

Deposit funds are used to record amounts held temporarily until ownership is determined. The Department is acting as an agent or a custodian for funds awaiting distribution, for example payroll taxes.

Earmarked Funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. Earmarked funds also have a requirement to account for and report on the receipt, use and retention of revenues and other financing sources that distinguish it from general revenues.

1.D. Basis of Accounting

For FY 2006, the Department's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Department's financial and non-financial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the Department's legacy systems were designed to record information on a budgetary basis.

The Department has undertaken efforts to determine the actions required to bring its financial and non-financial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Standard General Ledger (USSGL). Until all of the Department's financial and non-financial feeder systems and processes are updated to collect and report financial information as required by GAAP, the DoD's financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from non-financial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, the Department identifies program costs based upon the major appropriation groups provided by the Congress. 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 Results Act (GPRA). The Department is in the process of reviewing available data and attempting to develop a cost

reporting methodology that balances the need for cost information required by GPRA and the Statement of Federal Financial Accounting Standard (SFFAS) No. 4, “Managerial Cost Accounting Concepts and Standards for the Federal Government,” with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

The Department receives congressional appropriations as financing sources for general funds on either an annual or multi-year basis. When authorized, these appropriations are supplemented by revenues generated by sales of goods or services. The Department recognizes revenue as a result of costs incurred for goods and services provided to other federal agencies and the public. Full cost pricing is the Department’s standard policy for services provided as required by OMB Circular A-25. The Department recognizes revenue when earned within the constraints of current system capabilities. In some instances, revenue is recognized when bills are issued.

The Department does not include non-monetary support provided by U.S. allies for common defense and mutual security in amounts reported in its Statements of Net Cost and Financing. The U.S. has cost-sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port.

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because the Department’s financial and non-financial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. The Department’s expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses.

1.G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within the Department or between two or more federal agencies. However, the Department cannot accurately identify most of its intragovernmental transactions by customer because DoD’s systems do not track buyer and seller data needed to match related transactions. Seller entities within the Department provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. Intra-DoD intragovernmental balances are then eliminated. Starting in FY 2005, the Department properly eliminates the revenue results from intra-DoD sales of capitalized assets. The Department is developing long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with the existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the Department and other federal agencies. The Treasury Financial Manual Part 2 – Chapter 4700 “Agency Reporting Requirements for the Financial Report of the United States Government,” and the Treasury’s “Federal Intragovernmental Transactions Accounting Policies Guide,” provide guidance for reporting and reconciling intragovernmental balances. While the Department is unable to fully reconcile intragovernmental transactions with all federal partners, the Department is able to

reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DoL), and benefit program transactions with the Office of Personnel Management (OPM). The Department's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debt and its related costs of federal agencies. The DoD's financial statements, therefore, do not report any portion of public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the Department of the Treasury does not allocate such interest costs to the benefiting agencies.

1.H. Transactions with Foreign Governments and International Organizations

Each year, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, the Department has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Payment is required in advance.

1.I. Funds with the U.S. Treasury

The Department's monetary financial resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Services, the U.S. Army Corps of Engineers (USACE), and the Department of State's financial service centers process the majority of the Department's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on check issues, electronic fund transfers, and interagency transfers and deposits.

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account. Differences between the Department's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled.

1.J. Foreign Currency

Cash is the total of cash resources under the control of the DoD, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and non-purchased foreign currencies held in foreign currency fund accounts.

The majority of cash and all foreign currency is classified as nonentity and, therefore, restricted. Amounts reported consist primarily of cash and foreign currency held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange missions. Cash seized during Operation Iraqi Freedom is restricted for use to assist the Iraqi people and support the reconstruction of Iraq.

The Department conducts a significant portion of its operations overseas. The Congress established a special account to capture the gains and losses from foreign currency transactions for five general fund appropriations (operation and maintenance, military personnel, military construction, family housing operation and maintenance, and family housing construction). The gains and losses are computed as the variance between the exchange rate at the date of payment and a budget rate established at the beginning of

each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The Department does not separately identify currency fluctuations.

1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The Department does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies (per the Code of Federal Regulations 4CFR 101).

DoD Components use a variety of techniques for estimating the Allowance for Uncollectible Accounts Receivable from the public. While the exact details differ among the Components, estimates are usually based on either a percentage of actual prior-year write-offs or a percentage of aged accounts receivable from the public.

1.L. Loans Receivable

The Department operates a direct loan and loan guarantee program authorized by the National Defense Authorization Act for FY 1996 Public Law 104-106, Statute 186, Section 2801. The Act includes a series of authorities that allow the Department to work with the private sector to renovate military housing. The Department's goals are to obtain private capital to leverage government dollars, make efficient use of limited resources, and use a variety of private sector approaches to build and renovate military housing faster and at a lower cost to American taxpayers.

The Act also provides the Department with a variety of authorities to obtain private sector financing and expertise to improve military housing. The Department uses these authorities individually or in combination. They include guarantees (both loan and rental); conveyance/leasing of existing property and facilities; differential lease payments; investments (both limited partnerships and stock/bond ownership); and direct loans. In addition, the "Federal Credit Reform Act of 1990" governs all amended direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees.

The Department also operates a loan guarantee program designed to encourage commercial use of inactive government facilities. The revenue generated from property rental offsets the cost of maintaining these facilities.

1.M. Inventories and Related Property

Most of the Department's inventories are currently reported at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, the DoD Components have transitioned, and are continuing to transition, their inventory to the moving average cost method. Upon full implementation, the Department will be compliant with SFFAS No. 3. Approximately 35 percent of the Department's inventory value is now being reported from systems that have transitioned to moving average cost functionality. However, since the on-hand balances which transitioned were not, for the most part, baselined to auditable historical cost, the reported values remain non-compliant with SFFAS No. 3 and GAAP.

The Department manages only military or government-specific materiel under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DoD materiel management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The Department holds materiel based on military need and support for contingencies. Therefore, the Department does not attempt to account separately for “inventory held for sale” and “inventory held in reserve for future sale” based on SFFAS No. 3 definitions.

Related property includes operating materials and supplies (OM&S) and stockpile materials. OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored such as ammunition and engines, are generally recorded using the consumption method and reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the Department uses the purchase method - that is, materials and supplies are expensed when purchased. For FY 2006, the Department expensed significant amounts using the purchase method either because the systems could not support the consumption method or because management deemed that the item was in the hands of the end user.

The Department determined that the recurring high dollar value of OM&S in need of repair is material to the financial statements and requires a separate reporting category. Many high-dollar managed items, such as aircraft engines, are categorized as OM&S rather than military equipment by DoD activities.

The Department recognizes condemned materiel as “Excess, Obsolete, and Unserviceable.” The net value of condemned materiel is zero, because the costs of disposal are greater than the potential scrap value. Potentially redistributable materiel, presented in previous years as “Excess, Obsolete, and Unserviceable,” is included in “Held for Use” or “Held for Repair” categories according to its condition.

Past audits identified uncertainties about the completeness and existence of the reported values of inventory. Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the Department. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. It is more economical to repair than to procure these inventory items. Because the Department often relies on weapon systems and machinery no longer in production, the Department supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Finally, work in process balances include costs related to the production or servicing of items, including direct materiel, direct labor, applied overhead and other direct costs. Work in process also includes the value of finished products or completed services pending the submission of bills to the customer. The work in process designation may also be used to accumulate amounts paid to contractors under cost reimbursable contracts, including amounts withheld from payment to ensure performance, and amounts paid to other government plants for accrued costs of end items of materiel ordered but not delivered. Work in process includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services.

1.N. Investments in U.S. Treasury Securities

The Department reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment using the effective interest rate method or another method obtaining similar results. The Department’s intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities.

The Department invests in both marketable and non-marketable securities. Marketable securities are investments trading on a public market. The two types of non-marketable securities are par value and market-based intragovernmental securities. The Bureau of Public Debt issues non-marketable par value

intragovernmental securities. Non-marketable, market-based intragovernmental securities mimic marketable securities, but are not traded publicly.

The Department's Net Investments are supported by various Trust Funds in each of the reporting entities. These Trust Funds are comprised of the Military Retirement Trust Fund (MRF); Medicare-Eligible Retiree Health Care Fund (MERHCF); Other Defense Organizations General Fund (ODO GF) trust funds; donations (Gift Funds); and the USACE South Dakota Terrestrial Habitat Restoration, Inland Waterways, and Harbor Maintenance Trust Fund accounts.

1.0. General Property, Plant and Equipment

The SFFAS No. 23 establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, and weapons) in federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades for accounting periods beginning after September 30, 2002. The Department uses data from the Bureau of Economic Analysis to calculate a value for military equipment.

General Plant, Property, and Equipment (PP&E) assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of \$100,000, except for the USACE and WCF as discussed below. Also, DoD requires capitalization of improvement costs over the DoD capitalization threshold of \$100,000 to General PP&E. The Department depreciates all General PP&E, other than land, on a straight-line basis.

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of \$15,000, \$25,000, and \$50,000 for FYs 1993, 1994, and 1995, respectively, and an estimated useful life of 2 or more years. General PP&E previously capitalized at amounts below \$100,000 were written off General Fund financial statements in FY 1998. No adjustment was made for WCF assets. These assets remain capitalized and reported on WCF financial statements.

The USACE Civil Works General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost exceeds \$25,000. One exception is all buildings and structures related to hydropower projects are capitalized regardless of cost. During 2003, the Corps increased its buildings and structures threshold from \$0 to \$25,000 for all Civil Works appropriations with the exception of Revolving Fund and Power Marketing Agency assets. All Civil Works buildings and structures currently capitalized under \$25,000 (excluding Revolving Fund and Power Marketing Agency) were expensed in FY 2003 and removed from the Corps of Engineers Financial Management System. Beginning in FY 2004 all Civil Works Buildings and Structures under \$25,000 are expensed except for Power Marketing Agency assets.

When it is in the best interest of the government, the Department provides government property necessary to contractors to complete contract work. The Department either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E exceeds the DoD capitalization threshold, it must be reported on the Department's Balance Sheet.

The Department is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Department reports only the government property in the possession of contractors that is maintained in the DoD's property systems. The Department has issued property accountability and reporting regulations that require the DoD components to maintain, in their property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards.

1.P. Advances and Prepayments

The Department records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. In addition, when the Department receives the related goods and services, it recognizes advances and prepayments as expenses.

1.Q. Leases

Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), the Department records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The Department records the amounts as the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. DoD as the lessee receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are charged to expense over the lease term as it becomes payable.

Office space and leases entered into by the Department in support of contingency operations are the largest components of operating leases. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Inter-service Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. Equipment leases have a variety of lease terms, which are not expected to be renewed upon expiration. Other operating leases are generally one-year leases. The Department expects to continue to reduce the level of owned assets while increasing the number of leased assets. The Department will strive to displace commercial leases with more economical GSA leases.

1.R. Other Assets

The Department conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To permit more companies to compete for defense contracts and provide prudent levels of financing on long-term, high-value contracts, the Federal Acquisition Regulations (FAR) authorize the Department to make Contract Financing Payments, which are defined as authorized disbursements of monies to a contractor prior to acceptance of supplies or services. Contract Financing Payments are made in accordance with contract terms and conditions and are typically based on achievement of specific performance milestones or a set percentage applied against the contractor's claimed cost. To protect taxpayer funds paid to the contractor prior to delivery and acceptance, title to the contractor's work vests in the Government in the event of contract nonperformance, termination, bankruptcy, etc. The Department has no obligation or requirement to pay the contractor in excess of those authorized by the contract, nor would such a claim against the Department be enforceable, until delivery and acceptance of a satisfactory product. Upon Government acceptance of the supplies or services, Contract Financing Payments are liquidated and the asset is recognized within the appropriate category on the Balance Sheet.

The Federal Acquisition Regulation allows the Department to make financing payments, under fixed price contracts. The Department reports these financing payments as "Other Assets" because the Department becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the Department is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the Department for the full amount of the advance.

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The DoD recognizes contingencies as liabilities when past events or exchange transactions occur, a future loss is probable and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The Department's loss contingencies arise as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft, ship and vehicle accidents, medical malpractice, property or environmental damages, and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for the Department's assets. This type of liability has two components: non-environmental and environmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Non-environmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon the Department's policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of the Federal Government." The Department recognizes non-environmental disposal liabilities for National Defense PP&E nuclear-powered assets when placed into service. Such amounts are developed in conjunction with, and not easily separately identifiable from, environmental disposal costs.

1.T. Accrued Leave

The Department reports as liabilities civilian annual leave and military leave that has been accrued and not used as of the Balance Sheet date. The liability reported at the end of the accounting period reflects the current pay rates.

1.U. Net Position

Net position consists of unexpended appropriations and cumulative results of operations.

Unexpended Appropriations represent amounts of authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative Results of Operations represent the difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, these results included the cumulative amount of donations and transfers of assets in and out without reimbursement.

1.V. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The Department purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, whereby use of

the foreign bases is prohibited, losses are recorded for the value of any non-retrievable capital assets. This takes place after negotiations between the U.S. and the host country have determined the amount to be paid to the U.S. for such capital investments.

1.W. Comparative Data

Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet or 10 percent from the previous period presented are generally explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

The Department obligates funds to provide goods and services for outstanding orders not yet delivered. The financial statements do not reflect this liability for payment for goods and services not yet delivered.

1.Y. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. In-transit payments are those payments that have been made to other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities' outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

The Department of Defense policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. The majority of the DoD Components reported following this allocation procedure. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities.

| | |
|----------------|-------------------------|
| Note 2. | Nonentity Assets |
|----------------|-------------------------|

| As of December 31 | 2006 | 2005 |
|------------------------------------|-------------------------|-------------------------|
| 1. Intragovernmental Assets | | |
| A. Fund Balance with Treasury | \$ 673,369,794.91 | \$ 815,510,770.18 |
| B. Investments | 0.00 | 0.00 |
| C. Accounts Receivable | 753,952.52 | 9,141,753.71 |
| D. Other Assets | 0.00 | 0.00 |
| E. Total Intragovernmental Assets | \$ 674,123,747.43 | \$ 824,652,523.89 |
| 2. Nonfederal Assets | | |
| A. Cash and Other Monetary Assets | \$ 1,731,557,433.30 | \$ 1,955,040,549.17 |
| B. Accounts Receivable | 5,021,640,268.80 | 4,496,527,406.37 |
| C. Loans Receivable | 0.00 | 0.00 |
| D. Inventory & Related Property | 0.00 | 0.00 |
| E. General PP&E | 0.00 | 0.00 |
| F. Investments | 0.00 | 0.00 |
| G. Other Assets | 156,911,724.36 | 552,407.67 |
| H. Total Nonfederal Assets | \$ 6,910,109,426.46 | \$ 6,452,120,363.21 |
| 3. Total Nonentity Assets | \$ 7,584,233,173.89 | \$ 7,276,772,887.10 |
| 4. Total Entity Assets | \$ 1,362,325,855,762.40 | \$ 1,527,285,246,528.72 |
| 5. Total Assets | \$ 1,369,910,088,936.30 | \$ 1,534,562,019,415.80 |

Nonentity assets are assets for which the Department maintains stewardship accountability and responsibility to report, but are not available for the Department's operation. Intragovernmental assets are carried on the Department of Defense and Treasury books as Deposit Accounts, General Fund Receipt balances, certain Clearing Accounts until transferred to the owning entity, and Foreign Military Sales (FMS) advance deposits. Non-federal assets are posted to the Department's books together with a custodial liability due upon collection.

Fluctuations:Intragovernmental Fund Balance With Treasury

Intragovernmental Fund Balance With Treasury decreased \$142.1 million (17 percent). The decrease was primarily due to disbursing \$81 million of Iraqi seized funds for support of the Iraqi people with no additional collections since the 1st Quarter, FY 05, and the reclassification of Suspense Accounts from Nonentity to Entity assets starting in the 2nd Quarter, FY 05.

Intragovernmental Accounts Receivable

Intragovernmental Accounts Receivable decreased \$8.3 million (92 percent) primarily due to increased management emphasis to liquidate and collect accounts receivable.

Note 3. Fund Balance with Treasury

| As of December 31 | 2006 | 2005 |
|--|-------------------------|-----------------------|
| 1. Fund Balances | | |
| A. Appropriated Funds | \$ 313,728,400,603.62 | \$ 553,681,321,696.41 |
| B. Revolving Funds | 6,848,255,287.58 | 9,376,450,235.84 |
| C. Trust Funds | 683,888,234.93 | 424,953,529.68 |
| D. Special Funds | 301,309,393.24 | 14,634,035.34 |
| E. Other Fund Types | 1,870,749,516.04 | 12,523,161,426.18 |
| F. Total Fund Balances | \$ 323,432,603,035.41 | \$ 576,020,520,923.45 |
| 2. Fund Balances Per Treasury Versus Agency | | |
| A. Fund Balance per Treasury | \$ 188,774,014,461.71 | \$ 573,507,876,180.27 |
| B. Fund Balance per Agency Wide | 323,432,603,035.41 | 576,020,520,923.45 |
| 3. Reconciling Amount | | |
| | \$ (134,658,588,573.70) | \$ (2,512,644,743.18) |

| <u>Reporting Entity</u> <u>(Amounts in millions)</u> | <u>Fund Balance</u> <u>with Treasury</u> <u>FY 2006</u> | <u>Fund Balance per</u> <u>Entity Books</u> <u>FY 2006</u> | <u>Reconciling</u> <u>Amount</u> <u>FY 2006</u> | <u>Reconciling</u> <u>Amount</u> <u>FY 2005</u> |
|---|---|--|---|---|
| Navy GF | \$ 58,106.6 | \$ 94,843.7 | \$ (36,737.1) | \$ 29.0 |
| Air Force GF | 36,138.3 | 73,278.9 | (37,140.6) | 0.0 |
| Army GF | 54,487.5 | 93,738.7 | (39,251.2) | 0.0 |
| ODO GF | 32,130.7 | 53,581.7 | (21,451.0) | (1,026.5) |
| Corps of Engineers | 6,402.8 | 6,481.7 | (78.9) | (1,547.4) |
| MERHCF | 5.0 | 5.0 | 0.0 | 0.0 |
| MRF | 26.2 | 26.2 | 0.0 | 0.0 |
| Air Force WCF | 350.9 | 1,179.6 | (828.7) | 219.1 |
| Army WCF | 370.7 | 370.7 | 0.0 | 0.0 |
| ODO WCF | 428.6 | (400.3) | 828.9 | (186.9) |
| Navy WCF | 326.7 | 326.7 | 0.0 | 0.0 |
| Total | \$ 188,774.0 | \$ 323,432.6 | \$ (134,658.6) | \$ (2,512.7) |

Analysis of Reconciling Amounts

The Department of Defense (DoD) shows a reconciling net difference of \$134.7 billion with the Department of the Treasury, which is comprised of:

- (\$36.7) billion, for the Navy General Fund (GF), is primarily due to Continuing Resolution Authority (CRA) for (\$36.8) billion recorded on accounting records of the Navy GF, but not reported by the Department of the Treasury (Treasury). This reconciling issue is also offset by receipt accounts deposited with the Treasury for \$44.6 million that were not available to the Department of the Navy.
- (\$37.1) billion, for the Air Force GF, is primarily due to CRA of (\$37.1) billion recorded on accounting records of the Air Force GF, but not reported by the Treasury.

- (\$39.3) billion, for the Army General Fund, is due to CRA that was recorded on accounting records of the Army GF, but not reported by the Treasury.
- (\$21.5) billion, for the Other Defense Organizations (ODO) GF, primarily consists of the net of the positive reconciling difference for the DoD component level accounts offset by the aggregated negative reconciling difference of approximately 50 defense agencies and organizations. The reconciling difference is also attributed to CRA reported by defense organizations, but not reported by the Treasury.
- (\$78.9) million, for the US Army Corps of Engineers, consists of parent account allocations for the reporting of trust funds (Inland Waterways and Harbor Maintenance) for the Bureau of Public Debt that are not reported by the Treasury.
- (\$828.7) million, for the Air Force Working Capital Fund (WCF), represents the Fund Balance with Treasury (FBWT) for the United States Transportation Command, which is reported to the Treasury as part of the Air Force WCF fund balance. The accounting for these funds is actually performed within the Financial Statements of ODO WCF. For financial reporting, the FBWT for the ODO WCF is adjusted downward to reconcile with the Air Force WCF.

Other Information Related to Fund Balance with Treasury

The Army GF includes \$34.7 million in Vested Iraqi Cash. This cash represents frozen Iraqi deposits in the United States and is vested in accordance with the International Emergency Economic Powers Act, Section 1701, and is used in support of the Iraqi people. The Army has collected \$1.7 billion in Vested Iraqi Cash and has disbursed \$1.7 billion benefiting the Iraqi people as follows:

| | <u>(\$ in millions)</u> |
|--|-------------------------|
| Collected | \$1,724.1 |
| Disbursed | |
| Iraqi Salaries | \$1,184.8 |
| Repair/Reconstruction/Humanitarian Assistance | \$ 147.8 |
| Iraqi Ministry Operations (Ministry of Finance, Defense, etc.) | <u>\$ 356.8</u> |
| Total Disbursed | <u>\$1,689.4</u> |
| Remaining Funds | <u>\$ 34.7</u> |

Fluctuations

Fund Balance with Treasury decreased by a net of \$252.4 billion (44%) attributable primarily to a \$240.0 billion reduction in funding due to operating under a Continuing Resolution Authority (CRA) for the 1st quarter, FY 2006 reporting.

Status of Fund Balance with Treasury

| As of December 31 | 2006 | 2005 |
|---|-------------------------|------------------------|
| 1. Unobligated Balance | | |
| A. Available | \$ 146,606,237,117.71 | \$ 575,417,819,448.68 |
| B. Unavailable | 9,640,872,356.37 | 68,438,972,314.44 |
| 2. Obligated Balance not yet Disbursed | \$ 608,462,012,558.25 | \$ (66,586,560,152.10) |
| 3. Nonbudgetary FBWT | \$ 7,249,718,445.00 | \$ 0.00 |
| 4. NonFBWT Budgetary Accounts | \$ (449,489,202,635.56) | \$ 0.00 |
| 5. Total | \$ 322,469,637,841.77 | \$ 577,270,231,611.02 |

The Status of Fund Balance with Treasury consists of unobligated and obligated balances. These balances reflect the budgetary authority remaining for disbursements against current or future obligations. In addition, the Status of Fund Balance with Treasury includes various accounts that affect either budgetary reporting or Fund Balance with Treasury, but not both.

Unobligated Balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated Balance is classified as available or unavailable and is associated with appropriations expiring at fiscal year end that remain available only for obligation adjustments until the account is closed.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received or services that have not been performed.

Non-Budgetary Fund Balance with Treasury (FBWT) includes entity and nonentity Fund Balance with Treasury accounts which do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

Non-FBWT Budgetary Accounts include budgetary accounts that do not affect Fund Balance with Treasury, such as contract authority, borrowing authority and investment accounts. This category reduces the Status of Fund Balance with Treasury.

Fluctuations

These fluctuations are primarily due to the FY 2006 Continuing Resolution Authority and a further breakout of this note to comply with recently published Office of Management and Budget Circular A-136, to more closely reconcile the budgetary and proprietary aspect of Fund Balance with Treasury with the President's Budget. Specifically, the last categories (Line 3 and 4) have been added starting 4th Quarter FY 2005. In addition, various accounts previously reported on Lines 1 and 2 have been transferred to Lines 3 and 4 and new accounts have been added.

Disclosures Related to Suspense/Budget Clearing Accounts

| As of December 31 | 2004 | 2005 | 2006 | (Decrease)/ Increase from FY 2005 - 2006 |
|-------------------|-----------------------|-------------------|-------------------|--|
| Account | | | | |
| F3875 | \$ 51,967,186.10 | \$ 589,259,738.92 | \$ 809,808,227.67 | 220,548,488.75 |
| F3880 | (7,576,791.48) | 20,305,514.27 | 11,475,682.09 | (8,829,832.18) |
| F3882 | (39,795,245.49) | 26,228,663.78 | 83,279,316.19 | 57,050,652.41 |
| F3885 | (1,008,859,187.27) | (221,442,070.16) | (345,519,163.86) | (124,077,093.70) |
| F3886 | 197,103.83 | 7,462,998.26 | 8,862,387.62 | 1,399,389.36 |
| Total | \$ (1,004,066,934.31) | \$ 421,814,845.07 | \$ 567,906,449.71 | 146,091,604.64 |

A description of the suspense and budget clearing accounts and their respective balances follows:

Account F3875 reported a positive balance of approximately \$809.8 million that represents the Department's clearing account. Account F3885, which includes the Interfund/Intragovernmental suspense transactions, reported a negative balance of approximately (\$345.5) million. Account F3886 has a positive balance of approximately \$8.9 million represented by the (payroll) Thrift Savings Plan suspense. These three suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation.

The F3880 suspense account reported a positive balance of approximately \$11.5 million. This amount represents the balance of Treasury checks that (1) have either been lost by the payee and need to be reissued, (2) have never been cashed by the payee, or (3) have been cancelled by the Treasury and need to be transferred to the original appropriation.

The F3882 suspense account reported a positive balance of approximately \$83.3 million. This account was established for the Uniformed Services Thrift Savings Plan in FY 2002. The amounts in this account represent a timing difference between the posting of the Thrift Savings Plan deductions by the United States Department of Agriculture National Finance Center and the posting of these same amounts in the military accounting systems in the following month.

| |
|--|
| Disclosures Related to Problem Disbursements and In-Transit Disbursements |
|--|

| As of December 31 | 2004 | 2005 | 2006 | (Decrease)/ Increase from FY 2005 to 2006 |
|---|---------------------|----------------------|---------------------|---|
| 1. Total Problem Disbursements, Absolute Value | | | | |
| A. Unmatched Disbursements (UMDs) | \$ 1,406,351,180.14 | \$ 1,235,825,469.20 | \$ 2,183,243,969.00 | \$ 947,418,499.80 |
| B. Negative Unliquidated Obligations (NULO) | 239,059,638.70 | 164,358,715.00 | 250,164,573.00 | 85,805,858.00 |
| 2. Total In-transit Disbursements, Net | \$ 5,283,632,717.73 | \$ 10,043,913,690.16 | \$ 4,939,942,849.00 | \$ (5,103,970,841.16) |

The DoD reported \$2.2 billion (absolute value) in Unmatched Disbursements (UMD), which is an increase of \$947.4 million over amounts reported last year. A UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

The DoD reported \$250.2 million (absolute value) in Negative Unliquidated Obligations (NULOs), which is an increase of \$85.8 million over amounts reported last year. A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The DoD reported \$4.9 billion (net) for In-transits, which is a decrease of \$5.1 billion under amounts reported last year. The In-transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

| | |
|----------------|---|
| Note 4. | Investments and Related Interest |
|----------------|---|

| As of December 31 | 2006 | | | | |
|--|------------------------------|---------------------|----------------------------------|------------------------------|------------------------------|
| | Par Value / Cost | Amortization Method | Unamortized (Premium) / Discount | Investments, Net | Market Value Disclosure |
| 1. Intragovernmental Securities | | | | | |
| A. Nonmarketable, Market-Based | \$ 276,595,515,564.60 | Effective Interest | \$ 33,149,061,831.55 | \$ 309,744,577,396.15 | \$ 311,108,797,800.67 |
| B. Accrued Interest | 3,277,480,275.84 | | | 3,277,480,275.84 | 3,277,477,917.99 |
| C. Total Intragovernmental Securities | <u>\$ 279,872,995,840.44</u> | | <u>\$ 33,149,061,831.55</u> | <u>\$ 313,022,057,671.99</u> | <u>\$ 314,386,275,718.66</u> |
| 2. Other Investments | | | | | |
| A. Total Investments | \$ 772,100,130.00 | Effective Interest | \$ 0.00 | \$ 772,100,130.00 | N/A |

| As of December 31 | 2005 | | | | |
|--|------------------------------|---------------------|----------------------------------|------------------------------|------------------------------|
| | Par Value / Cost | Amortization Method | Unamortized (Premium) / Discount | Investments, Net | Market Value Disclosure |
| 3. Intragovernmental Securities | | | | | |
| A. Nonmarketable, Market-Based | \$ 255,678,908,578.28 | Effective Interest | \$ 8,695,720,165.72 | \$ 264,374,628,744.00 | \$ 273,378,380,190.54 |
| B. Accrued Interest | 3,151,060,638.53 | | | 3,151,060,638.53 | 3,151,060,638.53 |
| C. Total Intragovernmental Securities | <u>\$ 258,829,969,216.81</u> | | <u>\$ 8,695,720,165.72</u> | <u>\$ 267,525,689,382.53</u> | <u>\$ 276,529,440,829.07</u> |
| 4. Other Investments | | | | | |
| A. Total Investments | \$ 478,764,630.00 | Effective Interest | \$ 0.00 | \$ 478,764,630.00 | N/A |

The amortization method used for non-marketable, market-based securities is effective interest. Other Investments represent limited partnerships, entered into on behalf of the U.S. Government by the Army and Navy in support of the Military Housing Privatization Initiative authorized by Public Law 104-106, Stat. 186, on February 11, 1996. These investments do not require market value disclosure.

Intragovernmental Securities

Net Investments increased \$45.4 billion (17 percent) in non-marketable, market-based securities. This increase is primarily due to positive cash flows of \$32.0 billion for the Medicare-Eligible Retiree Health Care Fund (MERHCF), \$13.0 billion for the Military Retirement Fund, and \$0.4 billion for the Inland Waterways, Harbor Maintenance, and South Dakota Terrestrial Wildlife Habitat Restoration Trust Funds. The MERHCF positive cash flow is primarily due to the Military Services and other Uniformed Services not making normal cost payments monthly in FY 2006. Instead, Treasury makes one lump sum payment for normal cost on behalf of the contributors for the entire year at the beginning of the year which increased investments in the first quarter.

Other Investments

Other Investments increased \$293.3 million (61 percent) from new investments in limited partnerships by the Army (\$148.3 million) and Navy (\$145.0 million) in support of military housing. A summary of the Department's total investments in these limited partnerships follows.

| Installation | Q1 FY 2005 Balance | Month Invested | New Investments | Month Invested | Q1 FY 2006 Total |
|--------------------------------------|-----------------------|----------------|--------------------|-------------------|---------------------|
| Camp Lejeune | | | 83.2 | Dec-05 | \$83.2 |
| Beaufort/Paris ISL/Quantico | \$97.1 | Oct-03 | | | 97.1 |
| Ft. Polk, Louisiana | 53.6 | Dec-04 | | | 53.6 |
| Ft. Campbell, Kentucky | 52.2 | Jan-04 | 7.9 | Mar-05 | 60.1 |
| Ft. Hood, Texas | 52.0 | Nov-01 | | | 52.0 |
| Ft. Bragg, North Carolina | 49.4 | Dec-03 | | | 49.4 |
| 29 Palms/Kansas City | | | 45.9 | Dec-05 | 45.9 |
| Ft. Stewart, Georgia | 37.4 | Feb-02 | | | 37.4 |
| Ft. Bliss, Texas | | | 38.0 | Dec-05 | 38.0 |
| South Texas, Texas | 29.4 | Feb-02 | | | 29.4 |
| Oahu, Hawaii | 25.0 | May-04 | | | 25.0 |
| New Orleans Naval Complex, Louisiana | 23.1 | Oct-01 | | | 23.1 |
| San Diego, California | 20.9 | Jun-03 | | | 20.9 |
| Yuma Naval Air Station | 18.7 | Dec-04 | | | 18.7 |
| Everett NAS, Washington | 12.2 | Dec-00 | | | 12.2 |
| Kingsville NAS, Texas | 4.3 | Dec-00 | | | 4.3 |
| Ft. Hamilton, New York | 2.2 | May-04 | | | 2.2 |
| Ft. Detrick, Maryland | 1.3 | Sep-04 | | | 1.3 |
| Ft. Sam Houston, Texas | | | 6.6 | Jun-05 | 6.6 |
| Pacific Northwest | | | 15.9 | Mar-05 | 15.9 |
| Ft. Eustis, Virginia | | | 14.8 | Apr-05 | 14.8 |
| Ft. Drum, New York | | | 52.0 | Jun-05 | 52.0 |
| Ft. Leonard Wood, Missouri | | | 29.0 | Sep-05 | 29.0 |
| | \$478.8 | | 293.3 | | \$772.1 |

Other Disclosures

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds (or name/s of fund/s). The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to the Department of Defense as evidence of its receipts. Treasury securities are an asset to the Department of Defense and a liability to the U.S. Treasury. Because the Department of Defense and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Governmentwide financial statements. U.S. Treasury securities provide the Department of Defense with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the Department of Defense requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures. For additional information on earmarked funds, see Note 23.

| | |
|----------------|----------------------------|
| Note 5. | Accounts Receivable |
|----------------|----------------------------|

| As of December 31 | 2006 | | | 2005 |
|--|----------------------|--|--------------------------|--------------------------|
| | Gross Amount Due | Allowance For Estimated Uncollectibles | Accounts Receivable, Net | Accounts Receivable, Net |
| 1. Intragovernmental Receivables | \$ 3,029,567,320.38 | N/A | \$ 3,029,567,320.38 | \$ 2,092,345,708.10 |
| 2. Nonfederal Receivables (From the Public) | \$ 8,396,546,965.08 | \$ (319,140,488.67) | \$ 8,077,406,476.41 | \$ 6,477,888,481.05 |
| 3. Total Accounts Receivable | \$ 11,426,114,285.46 | \$ (319,140,488.67) | \$ 11,106,973,796.79 | \$ 8,570,234,189.15 |

FluctuationsIntragovernmental Accounts Receivable

Intragovernmental accounts receivable increased \$937.4 million (45%). This was primarily due to increased support provided to the Federal Emergency Management Agency (FEMA) for hurricane relief efforts in the Gulf Coast.

Nonfederal Accounts Receivable

Nonfederal accounts receivable increased \$1.6 billion (25%). This was due to the Navy's reclassification of \$549.6 million currently not collectible receivables to collectible receivables in 1st Quarter Fiscal Year 2006, an increase of \$300 million for sales to the Foreign Military Sales Trust Fund, and management's increased emphasis on properly reporting accounts receivable.

| Agency Wide Accounts Receivable Aging | | |
|--|------------|------------|
| Nondelinquent | Federal | Nonfederal |
| Current | \$ 2,569.7 | \$ 1,610.4 |
| Noncurrent | \$ 6.4 | \$ 1,719.9 |
| Delinquent | | |
| 1 to 30 days | \$ 263.2 | \$ 199.6 |
| 31 to 60 days | \$ 43.7 | \$ 77.3 |
| 61 to 90 days | \$ 33.5 | \$ 103.8 |
| 91 to 180 days | \$ 35.8 | \$ 204.7 |
| 181 days to 1 year | \$ 28.4 | \$ 186.4 |
| Greater than 1 year and less than or equal to 2 years | \$ 39.6 | \$ 859.7 |
| Greater than 2 years and less than or equal to 6 years | \$ 8.3 | \$ 195.5 |
| Greater than 6 years and less than 10 years | \$ 0.9 | \$ 626.8 |
| Greater than 10 years | \$ - | \$ 2,612.5 |
| Total | \$ 3,029.7 | \$ 8,396.6 |

The Department is actively pursuing collection on the delinquent accounts receivable.

| | |
|----------------|---------------------|
| Note 6. | Other Assets |
|----------------|---------------------|

| As of December 31 | 2006 | 2005 |
|--|-----------------------------|-----------------------------|
| 1. Intragovernmental Other Assets | | |
| A. Advances and Prepayments | \$ 1,315,571,597.11 | \$ 1,070,578,231.12 |
| B. Total Intragovernmental Other Assets | \$ 1,315,571,597.11 | \$ 1,070,578,231.12 |
| 2. Nonfederal Other Assets | | |
| A. Outstanding Contract Financing Payments | \$ 21,451,332,692.89 | \$ 21,815,404,255.81 |
| B. Other Assets (With the Public) | 2,524,690,810.20 | 3,393,061,688.80 |
| C. Total Nonfederal Other Assets | \$ 23,976,023,503.09 | \$ 25,208,465,944.61 |
| 3. Total Other Assets | <u>\$ 25,291,595,100.20</u> | <u>\$ 26,279,044,175.73</u> |

Fluctuations

Total Other Assets Decreased \$987.4 million (4 percent).

Intragovernmental Other Assets

Advances and Prepayments increased \$245 million (23 percent). This increase is primarily attributed to the improved visibility in identifying and recording government advances to the Department of Commerce, Interior, Homeland Security, and the National Aeronautics and Space Administration that are procuring goods and services for the Department of Defense.

| | |
|----------------|---------------------------------------|
| Note 7. | Cash and Other Monetary Assets |
|----------------|---------------------------------------|

| As of December 31 | 2006 | 2005 |
|---|----------------------------|----------------------------|
| 1. Cash | \$ 1,460,709,160.02 | \$ 1,861,720,443.78 |
| 2. Foreign Currency (Nonpurchased) | 441,069,438.70 | 323,306,649.28 |
| 3. Total Cash, Foreign Currency, & Other Monetary Assets | <u>\$ 1,901,778,598.72</u> | <u>\$ 2,185,027,093.06</u> |

Fluctuation and/or Abnormalities

Cash and Other Monetary Assets decreased \$283.2 million (13 percent). This decrease is primarily due to reducing the amount of cash held by disbursing officers by using the International Treasury Services, and reclassifying Advances to Contractors for research and development to Other Assets.

Other Information

The majority of cash and all foreign currency are classified as nonentity and their use is restricted. Approximately \$1.3 billion in cash and \$441.1 million in foreign currency are restricted.

Note 8. Direct Loan and/or Loan Guarantee Programs

As of December 31

Direct Loan and/or Loan Guarantee Programs The entity operates the following direct loan and/or Loan guarantee program(s)

- Military Housing Privatization Initiative
- Armament Retooling & Manufacturing Support Initiative

The Federal Credit Reform Act of 1990 governs all amended direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees.

Direct loans are reported at the net present value of the following projected cash flows:

- Loan disbursements;
- Repayments of principal; and
- Payments of interest and other payments over the life of the loan after adjusting for estimated defaults, prepayments, fees, penalties and other recoveries.

Loan guarantee liabilities are reported at the net present value. The cost of the loan guarantee is the net present value of the following estimated projected cash flows:

- Payments by the Department to cover defaults and delinquencies, interest subsidies, or other payments; offset by
- Payments to the Department including origination and other fees, penalties, and recoveries.

Military Housing Privatization Initiative

The Military Housing Privatization Initiative (MHPI) includes both Direct Loan and Loan Guarantee Programs. The Department obtains private sector capital to leverage government dollars. The Department provides protection against specific risks, such as base closure or member deployment, for the private sector partner. The Loan Guarantee Program is authorized by the National Defense Authorization Act for FY 1996, Public Law (P.L.) 104-106 Statute 186, Section 2801.

Armament Retooling and Manufacturing Support Initiative

The Armament Retooling and Manufacturing Support Initiative (ARMS), Title 10 USC 4551-4555, is a Loan Guarantee Program designed to encourage commercial use of the Army's Inactive Ammunition Plants through many incentives for businesses willing to locate to a government ammunition production facility. The production capacity of these facilities is greater than current military requirements; however, this capacity may be needed by the military in the future. The revenues from the property rental are used to pay for the operation, maintenance and environmental cleanup at the facilities. The resulting savings in overhead costs lower the production cost of the goods manufactured and fund environmental cleanup at no cost to the government.

| |
|---|
| Direct Loans Obligated After FY 1991 |
|---|

| As of December 31 | 2006 | 2005 |
|---|--------------------------|-------------------------|
| Loan Programs | | |
| 1. Military Housing Privatization Initiative | | |
| A. Loans Receivable Gross | \$ 172,395,426.53 | \$ 141,457,962.87 |
| B. Interest Receivable | 3,765,369.22 | 0.00 |
| C. Foreclosed Property | 0.00 | 0.00 |
| D. Allowance for Subsidy Cost (Present Value) | (74,838,720.50) | (70,721,790.27) |
| E. Value of Assets Related to Direct Loans | \$ 101,322,075.25 | \$ 70,736,172.60 |
| 2. Total Loans Receivable | \$ 101,322,075.25 | \$ 70,736,172.60 |

Subsidy costs are recognized when direct loans are disbursed to borrowers and are re-estimated each year as of the date of the financial statements. The allowance for subsidy cost is the difference between the outstanding principal of the loans and the present value of their net cash flows. The increase in the allowance for subsidy is due to an increase in subsidy expense related to one new direct loan disbursed during 1st Quarter, FY 2006 for Elmendorf Air Force Base, Alaska. Interest subsidy amortization is the net of interest revenue and interest expense. The subsidy amortization represents the difference between net borrowing from Treasury and gross loans receivable. For additional information, see the Schedule for Reconciling Subsidy Cost Allowance Balances for Post-1991 Direct Loans.

Gross direct loans for the MHPI program from inception consists of the following:

| | (in millions) |
|--|------------------------|
| Dyess Air Force Base, Texas | \$ 28.9 |
| Elmendorf Air Force Base, Alaska | 79.0 |
| Lackland Air Force Base, Texas | 10.3 |
| Robins Air Force Base, Georgia | 22.3 |
| Camp Pendleton Marine Corps Base, California | 29.4 |
| Kingsville Air Force Base, Texas | <u>2.5</u> |
| Total Loans Receivable Gross | \$ <u>172.4</u> |

| |
|---|
| Total Amount of Direct Loans Disbursed |
|---|

| As of December 31 | 2006 | 2005 |
|--|-------------------------|----------------|
| Direct Loan Programs | | |
| 1. Military Housing Privatization Initiative | \$ 31,000,000.00 | \$ 0.00 |
| 2. Total | \$ 31,000,000.00 | \$ 0.00 |

The Department disbursed one new direct loan of \$31.0 million during 1st Quarter, FY 2006 for the phase two portion of the Elmendorf Air Force Base, Alaska. The demand for direct loans by private developers varies from year to year depending upon the progression of planned construction and renovation, and upon economic factors unrelated to the operations of the Department of Defense.

Subsidy Rate for Direct Loans

| As of December 31 | Interest Differential | Defaults | Fees and other Collections | Other | Total |
|--|-----------------------|----------|----------------------------|-------|--------|
| Direct Loan Programs | | | | | |
| 1. Military Housing Privatization Initiative | 24.17% | 9.78% | 0.00% | 0.00% | 33.95% |

Subsidy rates pertain to the loan agreements contracted during the current fiscal year. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans disbursed in the current year could result from disbursement of loans from both current and prior-year loan agreements.

Schedule for Reconciling Subsidy Cost Allowance Balances for Post 1991 Direct Loans

| As of December 31 | 2006 | 2005 |
|---|------------------|------------------|
| 1. Beginning Balance of the Subsidy Cost Allowance | \$ 65,858,020.50 | \$ 70,721,790.27 |
| 2. Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component | | |
| A. Interest Rate Differential Costs | \$ 5,580,000.00 | \$ 0.00 |
| B. Default Costs (Net of Recoveries) | 3,400,700.00 | 0.00 |
| C. Fees and Other Collections | 0.00 | 0.00 |
| D. Other Subsidy Costs | 0.00 | 0.00 |
| E. Total of the above Subsidy Expense Components | \$ 8,980,700.00 | \$ 0.00 |
| 3. Adjustments | | |
| A. Loan Modifications | \$ 0.00 | \$ 0.00 |
| B. Fees Received | 0.00 | 0.00 |
| C. Foreclosed Property Acquired | 0.00 | 0.00 |
| D. Loans Written Off | 0.00 | 0.00 |
| E. Subsidy Allowance Amortization | 0.00 | 0.00 |
| F. Other | 0.00 | 0.00 |
| G. Total of the above Adjustment Components | \$ 0.00 | \$ 0.00 |
| 4. Ending Balance of the Subsidy Cost Allowance before Re-estimates | \$ 74,838,720.50 | \$ 70,721,790.27 |
| 5. Add or Subtract Subsidy Re-estimates by Component | | |
| A. Interest Rate Re-estimate | \$ 0.00 | \$ 0.00 |
| B. Technical/Default Reestimate | 0.00 | 0.00 |
| C. Total of the above Reestimate Components | \$ 0.00 | \$ 0.00 |
| 6. Ending Balance of the Subsidy Cost Allowance | \$ 74,838,720.50 | \$ 70,721,790.27 |

Subsidy Expense

The total subsidy expense increase of \$9.0 million (100 percent) relates to one new direct loan disbursed in 1st Quarter, FY 2006 for Elmendorf Air Force Base, Alaska.

Defaulted Guaranteed Loans from Post FY 1991 Guarantees

| As of December 31 | 2006 | 2005 |
|--|---------|---------|
| Loan Guarantee Program(s) | | |
| 1. Military Housing Privatization Initiative | | |
| A. Defaulted Guaranteed Loans Receivable, Gross | \$ 0.00 | \$ 0.00 |
| B. Interest Receivable | 0.00 | 0.00 |
| C. Foreclosed Property | 0.00 | 0.00 |
| D. Allowance for Subsidy Cost (Present Value) | 0.00 | 0.00 |
| E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net | \$ 0.00 | \$ 0.00 |
| 2. Armament Retooling & Manufacturing Support Initiative | | |
| A. Defaulted Guaranteed Loans Receivable, Gross | \$ 0.00 | \$ 0.00 |
| B. Interest Receivable | 0.00 | 0.00 |
| C. Foreclosed Property | 0.00 | 0.00 |
| D. Allowance for Subsidy Cost (Present Value) | 0.00 | 0.00 |
| E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net | \$ 0.00 | \$ 0.00 |
| 3. Total Value of Assets Related to Defaulted Guaranteed Loans Receivable | \$ 0.00 | \$ 0.00 |

The Department had no defaulted guaranteed loans as of December 31, 2005.

Guaranteed Loans Outstanding

| As of December 31 | Outstanding Principal of Guaranteed Loans, Face Value | Amount of Outstanding Principal Guaranteed |
|--|---|---|
| Guaranteed Loans Outstanding | | |
| 1. Military Housing Privatization Initiative | \$ 551,320,000.00 | \$ 551,320,000.00 |
| 2. Armament Retooling & Manufacturing Support Initiative | \$ 26,996,345.89 | \$ 24,196,460.20 |
| 3. Total | \$ 578,316,345.89 | \$ 575,516,460.20 |
| 2006 | | |
| New Guaranteed Loans Disbursed | | |
| 1. Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 |
| 2. Armament Retooling & Manufacturing Support Initiative | \$ 739,852.83 | \$ 692,822.09 |
| 3. Total | \$ 739,852.83 | \$ 692,822.09 |
| 2005 | | |
| New Guaranteed Loans Disbursed | | |
| 1. Military Housing Privatization Initiative | \$ 165,000,000.00 | \$ 165,000,000.00 |
| 2. Armament Retooling & Manufacturing Support Initiative | \$ 0.00 | \$ 0.00 |
| 3. Total | \$ 165,000,000.00 | \$ 165,000,000.00 |

The Guaranteed Loans Outstanding for the MHPI program as of the 1st Quarter, FY 2006 consists of the following:

| Guarantees | FY06 (in millions) | Default Rate |
|---------------------------------------|-----------------------|--------------|
| Robins Air Force Base, Georgia | \$ 25.6 | 6% |
| Fort Carson, Colorado | 144.3 | 3% |
| Kirtland Air Force Base, New Mexico | 74.0 | 5% |
| Wright Patterson Air Force Base, Ohio | 65.0 | 6% |
| Elmendorf Air Force Base, Alaska | 48.0 | 6% |
| Lackland Air Force Base, Texas | 29.4 | 6% |
| Fort Polk, Louisiana | 165.0 | 6% |
| | \$ 551.3 | |

Liabilities for Post FY 1991 Loan Guarantees, Present Value

| As of December 31 | 2006 | 2005 |
|--|-------------------------|-------------------------|
| Loan Guarantee Program(s) | | |
| 1. Military Housing Privatization Initiative | \$ 29,584,103.06 | \$ 32,412,560.32 |
| 2. Armament Retooling & Manufacturing Support Initiative | 12,393,845.32 | 12,352,470.32 |
| 3. Total | \$ 41,977,948.38 | \$ 44,765,030.64 |

For additional information, see the Schedule for Reconciling Loan Guarantee Liability Balances for Post 1991 Loan Guarantees.

Subsidy Expense for Post FY 1991 Loan Guarantees

As of December 31

| 2006 | Interest Differential | Defaults | Fees | Other | Total |
|---|-----------------------|---------------------------|-----------------------|-------------------|------------------|
| 1. New Loan Guarantees Disbursed: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2005 | Interest Differential | Defaults | Fees | Other | Total |
| 2. New Loan Guarantees Disbursed: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 10,345,500.00 | \$ 0.00 | \$ 0.00 | \$ 10,345,500.00 |
| Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 10,345,500.00 | \$ 0.00 | \$ 0.00 | \$ 10,345,500.00 |
| 2006 | Modifications | Interest Rate Reestimates | Technical Reestimates | Total Reestimates | Total |
| 3. Modifications and Reestimates: | | | | | |
| Military Housing Privatization Initiative | \$ 906,670.74 | \$ 0.00 | \$ 0.00 | \$ 0 | \$ 906,670.74 |
| Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 | 0.00 | 0 | 0.00 |
| Total | \$ 906,670.74 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 906,670.74 |
| 2005 | Modifications | Interest Rate Reestimates | Technical Reestimates | Total Reestimates | Total |
| 4. Modifications and Reestimates: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0 | \$ 0.00 |
| Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 | 0.00 | 0 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| | 2006 | 2005 | | | |
| 5. Total Loan Guarantee: | | | | | |
| Military Housing Privatization Initiative | \$ 906,670.74 | \$ 10,345,500.00 | | | |
| Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 | | | |
| Total | \$ 906,670.74 | \$ 10,345,500.00 | | | |

Expense activity occurs at the point when a new loan guarantee is disbursed. In 1st Quarter, FY 2006, there was a \$9.4 million (91 percent) decrease in subsidy expense. The Department did not disburse any new loan guarantees; as a result, there was no loan subsidy activity. There was an interest accumulation accrual based on the interest receivable on uninvested funds.

Subsidy Rates for Loan Guarantees

| As of December 31 | Interest Supplements | Defaults | Fees and other Collections | Other | Total |
|--|----------------------|----------|----------------------------|-------|-------|
| Loan Guarantee Programs: | | | | | |
| 1. Military Housing Privatization Initiative | 0.00% | 9.65% | 0.00% | 0.00% | 9.65% |
| 2. Armament Retooling & Manufacturing Support Initiative | 0.00% | 3.75% | -1.79% | 0.00% | 1.96% |

The subsidy rates disclosed pertain only to loan agreements made during the current fiscal year. These rates cannot be applied to the guarantees of loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year result from disbursements of loans from both current year loan agreements and prior year(s) loan agreements. The subsidy expense reported in the current year also includes modifications and re-estimates.

Schedule for Reconciling Loan Guarantee Liability Balances for Post FY 1991 Loan Guarantees

| As of December 31 | 2006 | 2005 |
|---|------------------|------------------|
| 1. Beginning Balance of the Loan Guarantee Liability | \$ 41,071,277.64 | \$ 34,360,030.64 |
| 2. Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component | | |
| A. Interest Supplement Costs | \$ 0.00 | \$ 0.00 |
| B. Default Costs (Net of Recoveries) | 0.00 | 10,345,500.00 |
| C. Fees and Other Collections | 0.00 | 0.00 |
| D. Other Subsidy Costs | 0.00 | 0.00 |
| E. Total of the above Subsidy Expense Components | \$ 0.00 | \$ 10,345,500.00 |
| 3. Adjustments | | |
| A. Loan Guarantee Modifications | \$ 0.00 | \$ 0.00 |
| B. Fees Received | 0.00 | 59,500.00 |
| C. Interest Supplements Paid | 0.00 | 0.00 |
| D. Foreclosed Property and Loans Acquired | 0.00 | 0.00 |
| E. Claim Payments to Lenders | 0.00 | 0.00 |
| F. Interest Accumulation on the Liability Balance | 906,670.74 | 0.00 |
| G. Other | 0.00 | 0.00 |
| H. Total of the above Adjustments | \$ 906,670.74 | \$ 59,500.00 |
| 4. Ending Balance of the Loan Guarantee Liability before Reestimates | \$ 41,977,948.38 | \$ 44,765,030.64 |
| 5. Add or Subtract Subsidy Reestimates by Component | | |
| A. Interest Rate Reestimate | 0.00 | 0.00 |
| B. Technical/default Reestimate | 0.00 | 0.00 |
| C. Total of the above Reestimate Components | \$ 0.00 | \$ 0.00 |
| 6. Ending Balance of the Loan Guarantee Liability | \$ 41,977,948.38 | \$ 44,765,030.64 |

Subsidy Expense

The subsidy expense components decreased by \$10.3 million due to one loan guarantee disbursed in 1st Quarter, FY 2005. This disbursement caused an increase in subsidy default costs.

Adjustments

The \$800 thousand increase in total adjustments is primarily due to the interest accumulation accrual on uninvested funds for the loan guarantee financing account. The accumulation is interest revenue from the U.S. Treasury.

Administrative Expenses

| As of December 31 | 2006 | 2005 |
|---|----------------|----------------|
| 1. Direct Loans | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 |
| Total | \$ 0.00 | \$ 0.00 |
| 2. Loan Guarantees | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 |
| Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 |

Administrative Expense is limited to separately identified expenses administered to direct and guaranteed loans. The Department of Defense (DoD) does not maintain a separate program to capture the expenses related to direct and guaranteed loans for the MHPI. Administrative Expense for the ARMS is a fee paid to the US Department of Agriculture Rural Business-Cooperative Service (RBS) for administering the loan guarantees under the ARMS, which is a joint program. There were no administrative expenses in FY 2006.

| | |
|----------------|---------------------------------------|
| Note 9. | Inventory and Related Property |
|----------------|---------------------------------------|

| As of December 31 | 2006 | 2005 |
|--|------------------------------|------------------------------|
| 1. Inventory, Net | \$ 80,978,147,091.73 | \$ 67,821,456,818.40 |
| 2. Operating Materials & Supplies, Net | 146,708,096,483.53 | 141,031,655,807.12 |
| 3. Stockpile Materials, Net | 1,209,446,392.28 | 1,469,667,470.36 |
| 4. Total | \$ 228,895,689,967.54 | \$ 210,322,780,095.88 |

Inventory, Net

| As of December 31 | 2006 | | | 2005 | Valuation Method |
|--|------------------------------|-------------------------------|--------------------------|-----------------------------|------------------|
| | Inventory, Gross Value | Revaluation Allowance | Inventory, Net | Inventory, Net | |
| 1. Inventory Categories | | | | | |
| A. Available and Purchased for Resale | \$ 85,990,855,245.62 | \$ (27,557,086,376.52) | 58,433,768,869.10 | \$ 42,977,598,944.01 | LAC,MAC |
| B. Held for Repair | 29,457,133,218.99 | (7,727,340,885.74) | 21,729,792,333.25 | 23,753,878,333.64 | LAC,MAC |
| C. Excess, Obsolete, and Unserviceable | 6,832,443,896.19 | (6,832,443,896.19) | 0.00 | 0.00 | NRV |
| D. Raw Materials | 30,063,604.08 | 0.00 | 30,063,604.08 | 25,274,190.67 | MAC,SP,LAC |
| E. Work in Process | 784,522,285.30 | 0.00 | 784,522,285.30 | 1,064,705,350.08 | AC |
| F. Total | \$ 123,095,018,250.18 | \$ (42,116,871,158.45) | 80,978,147,091.73 | \$ 67,821,456,818.40 | |

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses

SP = Standard Price

AC = Actual Cost

NRV = Net Realizable Value

O = Other

MAC = Moving Average Cost

Generally, there are no restrictions on the use, sale, or disposition of inventory except in the following situations:

- Distributions without reimbursement are made when authorized by Department of Defense directives.
- War reserve material includes fuels and subsistence items that are considered restricted.
- Inventory, with the exception of safety stocks, may be sold to foreign, state and local governments, private parties, and contractors in accordance with the current policies and guidance or at the direction of the President.

General Composition of Inventory

Inventory includes spare and repair parts, clothing and textiles, and fuels held for sale by the Defense Working Capital Funds. Inventory is tangible personal property that is:

- Held for sale, or held for repair for eventual sale;
- In the process of production for sale; or
- To be consumed in the production of goods for sale or in the provision of service for a fee.

Fluctuations

Inventory Available and Purchased for Resale increased \$15.5 billion (36 percent) primarily due to a revaluation of inventory by the Air Force of \$11.3 billion. In 4th Quarter of FY 2005, the Air Force completed conversion of its inventory valuation method from Latest Acquisition Cost to Moving Average Cost. As a result, the allowance for gains and losses account was eliminated. Further information on this revaluation is in Note 19, "Statement of Changes in Net Position."

Operating Materials and Supplies, Net

| As of December 31 | 2006 | | | 2005 | Valuation Method |
|--|------------------------------|------------------------------|------------------------------|------------------------------|------------------|
| | OM&S Gross Value | Revaluation Allowance | OM&S, Net | OM&S, Net | |
| 1. OM&S Categories | | | | | |
| A. Held for Use | \$ 129,929,304,356.23 | \$ 0.00 | \$ 129,929,304,356.23 | \$ 125,089,389,136.24 | SP, LAC |
| B. Held for Repair | 18,263,541,023.89 | (1,484,748,896.59) | 16,778,792,127.30 | 15,942,266,670.88 | SP, LAC |
| C. Excess, Obsolete, and Unserviceable | 2,909,985,494.54 | (2,909,985,494.54) | 0.00 | 0.00 | NRV |
| D. Total | \$ 151,102,830,874.66 | \$ (4,394,734,391.13) | \$ 146,708,096,483.53 | \$ 141,031,655,807.12 | |

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses

SP = Standard Price

AC = Actual Cost

NRV = Net Realizable Value

O = Other

General Composition of Operating Materials and Supplies

Operating Materials and Supplies (OM&S) include spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally managed aircraft engines held for consumption. Generally, there are no restrictions on the use or disposition of operating materials and supplies.

Stockpile Materials, Net

| As of December 31 | 2006 | | | 2005 | |
|--|----------------------------------|------------------------------------|-----------------------------|-----------------------------|---------------------|
| | Stockpile Materials Amount | Allowance for Gains (Losses) | Stockpile Materials, Net | Stockpile Materials, Net | Valuation Method |
| 1. Stockpile Materials Categories | | | | | |
| A. Held for Sale | \$ 1,115,360,624.24 | \$ 0.00 | \$ 1,115,360,624.24 | \$ 1,375,581,701.41 | AC, LCM |
| B. Held in Reserve for Future Sale | 94,085,768.04 | 0.00 | 94,085,768.04 | 94,085,768.95 | AC, LCM |
| C. Total | \$ 1,209,446,392.28 | \$ 0.00 | \$ 1,209,446,392.28 | \$ 1,469,667,470.36 | |

Legend for Valuation Methods:

LAC = Latest Acquisition Cost
 SP = Standard Price
 AC = Actual Cost

NRV = Net Realizable Value
 LCM = Lower of Cost or Market
 O = Other

General Composition of Stockpile Materials

Stockpile materials are strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies. All materials held by the National Defense Stockpile (NDS) are classified as Material Held in Reserve until Congressional action declares the materials are no longer required to be stockpiled, and are available for sale on the open market. When NDS receives authorization to offer materials for sale, NDS removes the materials from Material Held in Reserve and reclassifies them as Materials Held for Sale. Disposals cannot be made from the stockpile except under the following situations: (1) necessary upgrading, refining, or processing; (2) necessary rotation to prevent deterioration; (3) determination as excess with potential financial loss if retained, and (4) as authorized by law. The estimated market price of the stockpile materials held for sale is \$1.5 billion.

| | |
|-----------------|------------------------------|
| Note 10. | General PP&E, Net |
|-----------------|------------------------------|

| As of December 31 | 2006 | | | | | 2005 |
|--|---|-----------------|-------------------------|--|-----------------------|----------------------------|
| | Depreciation/ Amortization Method | Service Life | Acquisition Value | (Accumulated Depreciation/ Amortization) | Net Book Value | Prior FY Net Book Value |
| 1. Major Asset Classes | | | | | | |
| A. Land | N/A | N/A | \$ 10,464,163,784.81 | N/A | \$ 10,464,163,784.81 | \$ 10,315,204,923.72 |
| B. Buildings, Structures, and Facilities | S/L | 20 Or 40 | 164,457,800,334.23 | \$ (96,650,893,491.98) | 67,806,906,842.25 | 67,299,907,394.42 |
| C. Leasehold Improvements | S/L | lease term | 309,702,939.46 | (135,672,876.92) | 174,030,062.54 | 41,525,564.50 |
| D. Software | S/L | 2-5 Or 10 | 7,930,373,163.99 | (4,544,032,358.08) | 3,386,340,805.91 | 2,450,177,769.92 |
| E. General Equipment | S/L | 5 or 10 | 64,004,305,236.46 | (47,528,045,985.83) | 16,476,259,250.63 | 17,735,117,858.09 |
| F. Military Equipment | S/L | Various | 1,219,840,000,000.00 | (873,870,000,000.00) | 345,970,000,000.00 | 325,340,000,000.00 |
| G. Assets Under Capital Lease | S/L | lease term | 630,576,000.13 | (453,576,549.45) | 176,999,450.68 | 202,939,586.81 |
| H. Construction-in- Progress | N/A | N/A | 20,868,729,565.42 | N/A | 20,868,729,565.42 | 19,551,313,285.25 |
| I. Other | | | 63,431,014.02 | (892,215.87) | 62,538,798.15 | 173,036,370.71 |
| J. Total General PP&E | | | \$ 1,488,569,082,038.50 | \$ (1,023,183,113,478.10) | \$ 465,385,968,560.39 | \$ 443,109,222,753.42 |

¹ Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

S/L = Straight Line N/A = Not Applicable

Heritage Assets and Stewardship Land

The Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Standards (SFFAS) 29 "Heritage Assets and Stewardship Land" requires note disclosures for heritage assets and stewardship land. The Department of Defense (DoD) is committed to preserving and accounting for its heritage assets' historical, cultural, educational, or artistic importance. Additionally, DoD has and maintains land not acquired in connection with General PP&E; land donated to the Federal Government; and land previously recorded as public domain.

Heritage Assets, within the Defense Department, consist of buildings and structures, museums, major collections, monuments and memorials, archeological sites and cemeteries, while Stewardship Land consists mainly of mission essential (donated, public domain, executive order) land. The Department, with minor exceptions, uses most of the buildings and structures as part of their every day activities and includes them on the balance sheet as multi-use heritage assets (capitalized and depreciated).

Assets Under Capital Lease

| As of December 31 | 2006 | 2005 |
|--|-------------------|-------------------|
| 1. Entity as Lessee, Assets Under Capital Lease | | |
| A. Land and Buildings | \$ 619,551,791.97 | \$ 574,610,218.91 |
| B. Equipment | 11,024,208.16 | 10,116,848.66 |
| C. Other | 0.00 | 0.00 |
| D. Accumulated Amortization | (453,576,549.45) | (381,787,480.76) |
| E. Total Capital Leases | \$ 176,999,450.68 | \$ 202,939,586.81 |

Assets Under Capital Lease consists primarily of leases for the Section 801 Family Housing Program.

| | |
|-----------------|---|
| Note 11. | Liabilities Not Covered by Budgetary Resources |
|-----------------|---|

| As of December 31 | 2006 | 2005 |
|--|--------------------------------|--------------------------------|
| 1. Intragovernmental Liabilities | | |
| A. Accounts Payable | \$ 0.00 | \$ 5,454,408.69 |
| B. Debt | 14,085,214.11 | 14,804,066.20 |
| C. Other | 6,469,552,550.39 | 5,810,523,780.29 |
| D. Total Intragovernmental Liabilities | \$ 6,483,637,764.50 | \$ 5,830,782,255.18 |
| 2. Nonfederal Liabilities | | |
| A. Accounts Payable | \$ 371,416,900.70 | \$ 570,143,779.98 |
| B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities | 1,416,040,115,670.36 | 1,288,555,745,234.44 |
| C. Environmental Liabilities | 61,532,172,353.43 | 60,838,652,807.75 |
| D. Loan Guarantee Liability | 0.00 | 0.00 |
| E. Other Liabilities | 14,175,766,000.28 | 14,078,004,362.98 |
| F. Total Nonfederal Liabilities | \$ 1,492,119,470,924.80 | \$ 1,364,042,546,185.20 |
| 3. Total Liabilities Not Covered by Budgetary Resources | \$ 1,498,603,108,689.30 | \$ 1,369,873,328,440.40 |
| 4. Total Liabilities Covered by Budgetary Resources | \$ 374,437,044,988.39 | \$ 333,705,004,014.72 |
| 5. Total Liabilities | \$ 1,873,040,153,677.70 | \$ 1,703,578,332,455.10 |

Liabilities Not Covered by Budgetary Resources are those liabilities which are not legally obligated with realized budgetary resources as of the Balance Sheet date.

Intragovernmental Other Liabilities are comprised mainly of \$5.1 billion in Liability for Custodial Accounts Receivable, \$911.9 million in Unfunded Federal Employees Compensation Act Liability, \$259.6 million in Other Unfunded Employment Related Liability and \$152.8 million in Other Accrued Liabilities - Judgment Fund.

Nonfederal Other Liabilities are comprised of \$8.2 billion in Unfunded Liability - Annual Leave, \$2.9 billion in Nonenvironmental Disposal Liabilities, \$2.2 billion in Incurred But Not Reported Medical Claims, \$877.1 million in Contingent Liabilities, \$68.2 million in Capital Lease Liability, \$21.9 million in Other Unfunded Employment Related Liability and (\$70.7) million in Custodial Liability including Iraqi Seized Cash and Development Fund for Iraq.

| | |
|-----------------|-------------------------|
| Note 12. | Accounts Payable |
|-----------------|-------------------------|

| As of December 31 | 2006 | | | 2005 |
|--|-----------------------------|--|-----------------------------|-----------------------------|
| | Accounts Payable | Interest, Penalties, and Administrative Fees | Total | Total |
| 1. Intragovernmental Payables | \$ 2,355,693,577.55 | \$ N/A | \$ 2,355,693,577.55 | \$ 2,319,199,631.50 |
| 2. Nonfederal Payables (to the Public) | 27,494,249,345.83 | 1,753,805.84 | 27,496,003,151.67 | 25,610,212,785.14 |
| 3. Total | <u>\$ 29,849,942,923.38</u> | <u>\$ 1,753,805.84</u> | <u>\$ 29,851,696,729.22</u> | <u>\$ 27,929,412,416.64</u> |

| | |
|-----------------|-------------|
| Note 13. | Debt |
|-----------------|-------------|

| As of December 31 | 2006 | | | 2005 | |
|---|--------------------------|-------------------------|--------------------------|-------------------------|--------------------------|
| | Beginning Balance | Net Borrowing | Ending Balance | Net Borrowing | Ending Balance |
| 1. Agency Debt (Intragovernmental) | | | | | |
| A. Debt to the Treasury | \$ 85,639,244.27 | \$ 26,553,589.78 | \$ 112,192,834.05 | \$ 1,824,917.56 | \$ 87,294,064.46 |
| B. Debt to the Federal Financing Bank | 381,518,390.03 | 6,937,319.04 | 388,455,709.07 | 9,193,500.42 | 515,471,217.78 |
| C. Total Agency Debt | \$ 467,157,634.30 | \$ 33,490,908.82 | \$ 500,648,543.12 | \$ 11,018,417.98 | \$ 602,765,282.24 |
| 2. Total Debt | \$ 467,157,634.30 | \$ 33,490,908.82 | \$ 500,648,543.12 | \$ 11,018,417.98 | \$ 602,765,282.24 |

Debt to the Treasury

The outstanding debt consists of interest and principal payments due to the Treasury. The \$24.9 million (29 percent) increase in Debt to the Treasury consists primarily of a \$26.6 million increase in direct loan borrowings for the Military Housing Privatization Initiative.

Debt to the Federal Financing Bank

Debt owed to the Federal Financing Bank decreased \$127.0 million (25 percent) as a result of the reduction of outstanding debt reported for Maritime Prepositioning Ship loans. As part of the Afloat Prepositioning Force program, the Department of Navy makes loan repayments to the Federal Financing Bank on behalf of ship owners in lieu of capital lease payments to ship owners. Payments are made twice a year, in January and July.

| | |
|-----------------|---|
| Note 14. | Environmental Liabilities and Disposal Liabilities |
|-----------------|---|

| As of December 31 | 2006 | | | 2005 |
|--|----------------------------|-----------------------------|-----------------------------|-----------------------------|
| | Current Liability | Noncurrent Liability | Total | Total |
| 1. Environmental Liabilities-- | | | | |
| Nonfederal | | | | |
| A. Accrued Environmental Restoration (DERP funded) Costs: | | | | |
| 1. Active Installations-- Environmental Restoration (ER) | \$ 1,263,950,298.69 | \$ 8,631,856,092.58 | \$ 9,895,806,391.27 | \$ 10,548,703,318.17 |
| 2. Active Installations--ER for Closed Ranges | 81,636,000.00 | 7,002,822,000.00 | 7,084,458,000.00 | 7,388,214,000.00 |
| 3. Formerly Used Defense Sites (FUDS)--ER | 53,955,000.00 | 4,116,739,000.00 | 4,170,694,000.00 | 4,283,135,000.00 |
| 4. FUDS--ER for Transferred Ranges | 38,735,000.00 | 14,514,844,000.00 | 14,553,579,000.00 | 13,946,019,000.00 |
| B. Other Accrued Environmental Costs (Non-DERP funds) | | | | |
| 1. Active Installations-- Environmental Corrective Action | 43,198,189.98 | 613,734,053.26 | 656,932,243.24 | 547,979,966.53 |
| 2. Active Installations-- Environmental Closure Requirements | 5,113,000.00 | 338,565,594.00 | 343,678,594.00 | 163,498,000.00 |
| 3. Active Installations-- Environ. Response at Active Ranges | 6,491,000.00 | 297,596,000.00 | 304,087,000.00 | 267,632,000.00 |
| 4. Other | 845,695.71 | 560,343,558.30 | 561,189,254.01 | 8,829,627.00 |
| C. Base Realignment and Closure (BRAC) | | | | |
| 1. BRAC Installations-- Environmental Restoration (ER) | 226,729,875.76 | 2,599,426,671.22 | 2,826,156,546.98 | 3,029,050,672.74 |
| 2. BRAC Installations--ER for Transferring Ranges | 20,549,000.00 | 678,780,000.00 | 699,329,000.00 | 535,338,000.00 |
| 3. BRAC Installations-- Environmental Corrective Action | 25,322,672.38 | 178,287,485.78 | 203,610,158.16 | 163,404,442.11 |
| 4. Other | 217,835,714.47 | 197,020,991.14 | 414,856,705.61 | 178,781,000.00 |
| D. Environmental Disposal for Weapons Systems Programs | | | | |
| 1. Nuclear Powered Aircraft Carriers | 0.00 | 6,742,200,000.00 | 6,742,200,000.00 | 6,426,100,000.00 |
| 2. Nuclear Powered Submarines | 91,700,000.00 | 6,103,800,000.00 | 6,195,500,000.00 | 5,694,200,000.00 |
| 3. Other Nuclear Powered Ships | 96,300,000.00 | 236,000,000.00 | 332,300,000.00 | 223,900,000.00 |
| 4. Other National Defense Weapons Systems | 2,300,000.00 | 438,411,701.25 | 440,711,701.25 | 261,136,086.25 |
| 5. Chemical Weapons Disposal Program | 2,218,244,000.00 | 8,153,501,000.00 | 10,371,745,000.00 | 10,425,352,000.00 |
| 6. Other | 54,170,928.53 | 57,832,314.00 | 112,003,242.53 | 160,245,000.00 |
| 2. Total Environmental Liabilities | \$ 4,447,076,375.52 | \$ 61,461,760,461.53 | \$ 65,908,836,837.05 | \$ 64,251,518,112.80 |

| Service Component – Environmental Restoration (Cleanup) Liabilities and Environmental Disposal Liabilities (Amounts in millions) | Army | Navy | Air Force | ODO | Total |
|--|--------------------|--------------------|-------------------|-----------------|--------------------|
| 1. Environmental Liabilities-Nonfederal | | | | | |
| A. Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) funded) Costs: | | | | | |
| 1. Active Installations-Environmental Restoration (ER) | \$ 3,114.9 | \$ 2,618.7 | \$ 3,928.7 | \$ 233.7 | 9,896.0 |
| 2. Active Installations--ER for Closed Ranges | 5,180.0 | 559.6 | 1,344.8 | 0.0 | 7,084.4 |
| 3. Formerly Used Defense Sites (FUDS) –ER | 4,170.7 | 0.0 | 0.0 | 0.0 | 4,170.7 |
| 4. FUDS--ER for Transferred Ranges | 14,553.7 | 0.0 | 0.0 | 0.0 | 14,553.7 |
| B. Other Accrued Environmental Costs (Non-DERP funds) | | | | | |
| 1. Active Installations--Environmental Corrective Action | 379.6 | 29.9 | 135.8 | 111.6 | 656.9 |
| 2. Active Installations--Environmental Closure Requirements | 96.8 | 195.2 | 51.7 | 0.0 | 343.7 |
| 3. Active Installations--Environ. Response at Active Ranges | 304.1 | 0.0 | 0.0 | 0.0 | 304.1 |
| 4. Other | 529.6 | 0.0 | 0.0 | 31.5 | 561.1 |
| C. Base Realignment and Closure (BRAC) | | | | | |
| 1. BRAC Installations--Environmental Restoration (ER) | 523.5 | 1,079.2 | 1,178.5 | 44.9 | 2,826.1 |
| 2. BRAC Installations--ER for Transferring Ranges | 634.1 | 65.2 | 0.0 | 0.0 | 699.3 |
| 3. BRAC Installations--Environmental Corrective Action | 54.1 | 0.0 | 149.5 | 0.0 | 203.6 |
| 4. Other | 188.4 | 0.0 | 226.4 | 0.0 | 414.8 |
| D. Environmental Disposal for Weapon Systems Programs | | | | | |
| 1. Nuclear Powered Aircraft Carriers | 0.0 | 6,742.2 | 0.0 | 0.0 | 6,742.2 |
| 2. Nuclear Powered Submarines | 0.0 | 6,195.5 | 0.0 | 0.0 | 6,195.5 |
| 3. Other Nuclear Powered Ships | 0.0 | 332.3 | 0.0 | 0.0 | 332.3 |
| 4. Other National Defense Weapon Systems | 0.0 | 440.7 | 0.0 | 0.0 | 440.7 |
| 5. Chemical Weapons Disposal Program | 10,371.7 | 0.0 | 0.0 | 0.0 | 10,371.7 |
| 6. Other | 0.0 | 0.0 | 0.0 | 112.0 | 112.0 |
| 2. Total Nonfederal Environmental Liabilities: | \$ 40,101.2 | \$ 18,258.5 | \$ 7,015.4 | \$ 533.7 | \$ 65,908.8 |

Others Category Disclosure Comparative Table

December 31, 2005

Types

(\$ in Millions)

Other Accrued Environmental Costs (Non-DERP funds)

U.S. Army Corps of Engineers Formerly Utilized Sites Remedial Action Program \$ 529.6

Defense Commissary Agency Surcharges \$ 31.5

Total **\$ 561.1**

Base Realignment and Closure

Army Unliquidated Obligations that cannot be identified to a specific program. \$ 188.4

Air Force contractual support for environmental program management at BRAC installations. \$ 226.4

Total **\$ 414.8**

Environmental Disposal for Weapons Systems Programs-Other

National Defense Stockpile –Other Defense Organizations (ODO) \$ 54.2

Other Defense Organization's Environmental Disposal Unliquidated Obligations that cannot be identified to a specific program. \$ 57.8

Total **\$ 112.0**

The Department of Defense (DoD) is required to clean up contamination resulting from past waste disposal practices, leaks, spills, and other potentially harmful activity, which have created a public health or environmental risk. The Department accomplishes this effort in coordination with regulatory agencies, and if applicable, with other responsible parties and current property owners. The Department is also required to recognize closure and post-closure costs for its General Property, Plant, and Equipment (PP&E) and environmental corrective action costs for current operations. Each of the Department's major reporting entities is responsible for tracking and reporting all required environmental information related to environmental restoration costs, other accrued environmental costs, disposal costs of weapons systems, and environmental costs related to the Base Realignment and Closure (BRAC) actions that have taken place in prior years.

The Department uses engineering estimates and independently validated models to estimate environmental liabilities. The models are contained within the Remedial Action Cost Engineering Requirements (RACER) and the Normalization of Data System (NORM). The Department validates the models in accordance with DoD Instruction 5000.61 and primarily uses the models to estimate the liabilities based on data received during a preliminary assessment and initial site investigation. The Department primarily uses engineering estimates after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project.

The DoD has clean up requirements for the Defense Environmental Restoration Program (DERP) sites at active installations, BRAC installations, Formerly Used Defense Sites (FUDS), non-DERP sites at active installations, weapon systems programs, and chemical weapons disposal programs. The DoD follows the Comprehensive Environmental Response, Compensation Liability Act (CERCLA) and the Superfund Amendment and Reauthorization Act (SARA) to clean up DERP-eligible contamination. Non-DERP eligible contamination clean up is performed in accordance with the Resource Conservation and Recovery Act (RCRA). The CERCLA and RCRA require DoD to clean up contamination in coordination with regulatory agencies, current property owners of property damaged by the Department, and third parties that have a partial responsibility for the environmental restoration. Failure to comply with agreements and legal mandates can put DoD at risk of incurring fines and penalties.

The clean up requirements for nuclear-powered aircraft carriers, submarines, and other nuclear ships are based on the significant laws that affect the Department's conduct of environmental policy and regulations. The Atomic Energy Act of 1954, as amended, assures the proper management of source, special nuclear, and byproduct material. As in all cases with nuclear power, the Department coordinates actions with the Department of Energy. The Nuclear Waste Policy Act of 1982 requires all owners and generators of high-level nuclear waste and spent nuclear fuel to pay their respective shares of the full cost of the program. Finally, the Low Level Radioactive Waste Policy Amendments Act of 1986 provides for the safe and efficient management of low-level radioactive waste.

The Chemical Weapons Disposal Program is based on the FY 1986 National Defense Authorization Act (PL 99-145, as amended by subsequent acts) that directed the DoD to destroy the unitary chemical stockpile by April 29, 2004. The current guidelines for destruction are based on the Chemical Weapons Convention treaty. The United States ratified the treaty in April 1997 that required the stockpile of chemical weapons to be destroyed by April 2007, according to the terms outlined. The Army, as Executive Agent within the DoD, provides policy, direction, and oversight for both the Chemical Stockpile Program and the Non-Stockpile Chemical Materiel Project. As such, the Army is responsible for the safe and economical disposal of the U.S. stockpile of lethal and incapacitating chemical warfare agents and munitions.

The estimated total clean up liability for the current operating period is assigned based on the amount of the current year appropriation and unliquidated obligations that will be disbursed within 12 months from the Balance Sheet date. The non-current clean up liability is the portion of the clean up liability that will be disbursed more than 12 months from the Balance Sheet date.

The DoD has not identified any unrecognized portion of the estimated total clean up cost associated with General PP&E. The Department requires the unrecognized clean up cost associated with General PP&E to be disclosed and is working with the Military Departments to ensure this policy is properly implemented.

The Department had changes in estimates resulting from overlooked or previously unknown contaminants, better site characterization with sampling, re-estimation based on different assumptions, and lessons-learned. Environmental liabilities can also change in the future due to changes in laws and regulation, changes in agreements with regulatory agencies, and advances in technology.

The Department is working on processes to disclose: the amount of operating and capital resources disbursed to remediate legacy waste; the unrecognized portion of the estimated costs associated with General PP&E; and changes in estimates due to laws and technology.

In addition to the liabilities reported above, the Army and the United States Army Corps of Engineers (USACE) have additional liabilities that they are unable to estimate. The Army has a liability to take environmental restoration/corrective action for buried chemical munitions and agents but are unable to provide a reasonable estimate of the liability because the extent of the buried chemical munitions are not known. The USACE is conducting a review of all of their assets to identify the extent of the damage caused by hurricanes in 2005 and may identify additional environmental liabilities.

| | |
|-----------------|--------------------------|
| Note 15. | Other Liabilities |
|-----------------|--------------------------|

| As of December 31 | 2006 | | | 2005 |
|---|-----------------------------|----------------------------|-----------------------------|-----------------------------|
| | Current Liability | Noncurrent Liability | Total | Total |
| 1. Intragovernmental | | | | |
| A. Advances from Others | \$ 361,755,308.77 | \$ 0.00 | \$ 361,755,308.77 | \$ 724,375,064.19 |
| B. Deposit Funds and Suspense Account Liabilities | 1,054,471,659.72 | 0.00 | 1,054,471,659.72 | 1,106,090,236.09 |
| C. Disbursing Officer Cash | 1,873,800,609.31 | 0.00 | 1,873,800,609.31 | 1,947,156,586.19 |
| D. Judgment Fund Liabilities | 161,395,240.45 | 0.00 | 161,395,240.45 | 154,515,554.31 |
| E. FECA Reimbursement to the Department of Labor | 909,330,164.68 | 566,059,531.15 | 1,475,389,695.83 | 1,482,977,650.93 |
| F. Other Liabilities | 3,915,929,092.73 | 1,647,517,423.04 | 5,563,446,515.77 | 5,154,009,469.87 |
| G. Total Intragovernmental Other Liabilities | \$ 8,276,682,075.66 | \$ 2,213,576,954.19 | \$ 10,490,259,029.85 | \$ 10,569,124,561.58 |
| 2. Nonfederal | | | | |
| A. Accrued Funded Payroll and Benefits | \$ 7,407,402,211.99 | \$ 9,876,362.91 | \$ 7,417,278,574.90 | \$ 7,382,326,247.68 |
| B. Advances from Others | 1,860,365,515.08 | 0.00 | 1,860,365,515.08 | 1,788,175,658.19 |
| C. Deferred Credits | 11,800,000.00 | 0.00 | 11,800,000.00 | 9,377,164.15 |
| D. Deposit Funds and Suspense Accounts | 221,906,927.36 | 0.00 | 221,906,927.36 | (374,322,463.11) |
| E. Temporary Early Retirement Authority | 335,363.11 | 0.00 | 335,363.11 | 1,650,248.59 |
| F. Nonenvironmental Disposal Liabilities | | | | |
| (1) Military Equipment (Nonnuclear) | 17,752,488.34 | 1,429,988,753.81 | 1,447,741,242.15 | 563,131,599.81 |
| (2) Excess/Obsolete Structures | 53,783,000.00 | 182,114,000.00 | 235,897,000.00 | 767,105,000.00 |
| (3) Conventional Munitions Disposal | 0.00 | 1,318,442,916.98 | 1,318,442,916.98 | 1,284,206,891.00 |
| (4) Other | 0.00 | 0.00 | 0.00 | 0.00 |
| G. Accrued Unfunded Annual Leave | 8,250,766,368.85 | 1,715,597.63 | 8,252,481,966.48 | 8,066,713,407.45 |
| H. Capital Lease Liability | 47,246,294.99 | 212,273,042.19 | 259,519,337.18 | 296,706,025.37 |
| I. Other Liabilities | 8,294,869,120.81 | 868,230,212.23 | 9,163,099,333.04 | 10,690,671,915.06 |
| J. Total Nonfederal Other Liabilities | \$ 26,166,227,290.53 | \$ 4,022,640,885.75 | \$ 30,188,868,176.28 | \$ 30,475,741,694.19 |
| 3. Total Other Liabilities | \$ 34,442,909,366.19 | \$ 6,236,217,839.94 | \$ 40,679,127,206.13 | \$ 41,044,866,255.77 |

Intragovernmental Other Liabilities

Intragovernmental Other Liabilities are comprised primarily of custodial liabilities resulting from accounts receivable for cancelled appropriations and interest, penalties, fines, and administrative fees from the public. The amounts collected cannot be used by DoD and must be distributed to the Department of Treasury.

Nonfederal Other Liabilities

Nonfederal Other Liabilities are primarily comprised of other accrued liabilities, which include incurred but not reported costs. These costs result from medical care provided at nonfederal facilities which have not yet been billed to DoD. Other liabilities also include employer contributions and payroll taxes payable, contingent liabilities, and various other liabilities.

Capital Lease Liability

| As of December 31 | 2006 | | | | 2005 |
|--|--------------------------|------------------------|----------------|--------------------------|--------------------------|
| | Asset Category | | | | |
| | Land and Buildings | Equipment | Other | Total | Total |
| 1. Future Payments Due | | | | | |
| A. 2006 | \$ 105,635,052.93 | \$ 471,967.16 | \$ 0.00 | \$ 106,107,020.09 | \$ 81,966,279.27 |
| B. 2007 | 47,123,104.55 | 1,155,951.00 | 0.00 | 48,279,055.55 | 64,160,637.19 |
| C. 2008 | 43,853,305.76 | 3,972,058.00 | 0.00 | 47,825,363.76 | 54,463,885.57 |
| D. 2009 | 43,853,305.76 | 0.00 | 0.00 | 43,853,305.76 | 44,353,046.76 |
| E. 2010 | 41,295,407.67 | 0.00 | 0.00 | 41,295,407.67 | 43,877,305.76 |
| F. After 5 Years | 37,389,143.94 | 0.00 | 0.00 | 37,389,143.94 | 123,959,972.88 |
| G. Total Future Lease Payments Due | \$ 319,149,320.61 | \$ 5,599,976.16 | \$ 0.00 | \$ 324,749,296.77 | \$ 412,781,127.43 |
| H. Less: Imputed Interest Executory Costs | 64,823,735.71 | 406,223.89 | 0.00 | 65,229,959.60 | 116,075,102.05 |
| I. Net Capital Lease Liability | \$ 254,325,584.90 | \$ 5,193,752.27 | \$ 0.00 | \$ 259,519,337.17 | \$ 296,706,025.38 |
| 2. Capital Lease Liabilities Covered by Budgetary Resources | | | | \$ 191,306,240.76 | \$ 219,385,812.39 |
| 3. Capital Lease Liabilities Not Covered by Budgetary Resources | | | | \$ 68,213,096.42 | \$ 77,320,212.98 |

For the Department of Defense, all leases prior to FY 1992 are funded on an annual basis and subject to the availability of funds. Noncurrent amounts for these leases are shown as not covered by budgetary resources.

Leases originating after FY 1992 are required to be fully funded in the year of their inception. Therefore, budgetary resources show the present value of those lease payments as covered by budgetary resources.

Note 16.

Commitments and Contingencies

Legal Contingencies

The Department is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests. The Department has accrued contingent liabilities for legal actions where the Department's Office of the General Counsel considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. The Department records Judgment Fund liabilities in Note 15, "Other Liabilities" and Note 12, "Accounts Payable." See Notes 15 and 12 for details.

The Department's General Counsel reported 42 legal actions with individual claims greater than the DoD-wide materiality threshold of \$171.4 million for Fiscal Year (FY) 2005. The total claim amount of these 42 actions is approximately \$342 billion. The Department's General Counsel identified 35 of these cases (\$331 billion) as unable to determine the outcome.

Other Commitments and Contingencies

For FY 2005, the materiality threshold for reporting litigation, claims, or assessments was \$171.4 million and remains the same for 1st Quarter, FY 2006. Cases, meeting this threshold, were reported on the Department's legal representation letter for FY 2005. The Department also had a number of potential claims that individually do not meet the \$171.4 million threshold materiality at the DoD-wide level, but do meet individual DoD Component level thresholds. These claims should be disclosed in the Component's financial statements.

| | |
|-----------------|--|
| Note 17. | Military Retirement Benefits and Other Employment Related Actuarial Liabilities |
|-----------------|--|

| As of December 31 | 2006 | | | | 2005 |
|--|--|--------------------------|--|--------------------------------|--------------------------------|
| | Actuarial Present Value of Projected Plan Benefits | Assume Interest Rate (%) | (Less: Assets Available to Pay Benefits) | Unfunded Actuarial Liability | Unfunded Actuarial Liability |
| 1. Pension and Health Benefits | | | | | |
| A. Military Retirement Pensions | \$ 892,111,600,551.72 | 6.25 | \$ (230,439,053,230.48) | \$ 661,672,547,321.24 | \$ 616,328,290,896.52 |
| B. Military Retirement Health Benefits | 296,473,202,000.00 | 6.25 | 0.00 | 296,473,202,000.00 | 221,242,011,000.00 |
| C. Military Medicare-Eligible Retiree Benefits | 537,397,092,000.00 | 6.25 | (87,389,240,933.26) | 450,007,851,066.74 | 443,242,089,255.84 |
| D. Total Pension and Health Benefits | \$ 1,725,981,894,551.70 | | \$ (317,828,294,163.74) | \$ 1,408,153,600,388.00 | \$ 1,280,812,391,152.40 |
| 2. Other | | | | | |
| A. FECA | \$ 6,918,865,000.04 | | \$ (83,040,774.07) | \$ 6,835,824,225.97 | \$ 6,959,049,100.60 |
| B. Voluntary Separation Incentive Programs | 1,495,755,463.00 | 4.0 | (770,502,430.32) | 725,253,032.68 | 770,097,786.81 |
| C. DoD Education Benefits Fund | 1,661,351,399.00 | 5.3 | (1,335,913,375.27) | 325,438,023.73 | 14,207,194.67 |
| D. Total Other | \$ 10,075,971,862.04 | | \$ (2,189,456,579.66) | \$ 7,886,515,282.38 | \$ 7,743,354,082.08 |
| 3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities: | \$ 1,736,057,866,413.70 | | \$ (320,017,750,743.40) | \$ 1,416,040,115,670.40 | \$ 1,288,555,745,234.50 |

Actuarial Cost Method Used: Aggregate entry-age normal method

Assumptions: See Below

Market Value of Investments in Market-based and Marketable Securities: \$311.1 billion

Fluctuations

The unfunded liability for Military Retirement and Other Employment-Related Actuarial Liabilities increased \$127.5 billion (10 percent) and is attributable to an increase of \$166.4 billion (11 percent) in the actuarial liability that was partially offset by an increase of \$38.9 billion in the value of assets available to pay benefits.

Military Retirement Pensions

The unfunded actuarial liability increased \$45.3 billion (7 percent). This increase is attributable to an increase of \$57.5 billion in the actuarial liability that is offset by an increase of \$12.2 billion in the value of assets available to pay benefits. The increase in the actuarial liability is primarily the result of an amendment to the Military Retirement Fund (MRF) Plan established by the National Defense Authorization Act for FY 2005 increasing survivor benefits.

The Military Retirement System is a single-employer, defined benefit plan. Administrative costs of the Fund are not ascertainable. Projected revenues into the Fund, authorized by Public Law 98-94, come from three sources: interest earnings on Fund assets, monthly DoD contributions, and annual contributions from the Treasury Department. The monthly DoD contributions are determined as a percentage (approved by the DoD Retirement Board of Actuaries) of basic pay. The contribution from Treasury is paid into the Fund at the beginning of each fiscal year, and represents the amortization of the unfunded liability for service performed prior to October 1, 1984, as well as the amortization of actuarial gains and losses that have arisen since then. Effective FY 2005, Treasury began making an annual contribution to the Fund that represents the normal cost amount for the new concurrent receipt provisions of the 2004 National

Defense Authorization Act. The Board determines Treasury's contribution and the Secretary of Defense directs the Secretary of Treasury to make the payment.

The long-term economic assumptions for each valuation are set by the DoD Retirement Board of Actuaries. The long-term assumptions for the FY 2004 valuation were 6.25 percent interest, 3.0 percent Consumer Price Index, and 3.75 percent salary increase. The long-term economic assumptions did not change for the FY 2005 valuation. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience. Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year valuation results as reported in the DoD Office of Actuary Valuation of the Military Retirement System. In calculating the FY 2005 roll-forward amount, the following assumptions were used:

| | <u>Inflation</u> | <u>Salary</u> | <u>Interest</u> |
|------------------|----------------------|-------------------------|-----------------|
| Fiscal Year 2005 | 2.7 percent (actual) | 3.5 percent (actual) | 6.25 percent |
| Fiscal Year 2006 | 4.1 percent (actual) | 3.1 percent (estimated) | 6.25 percent |
| Long-Term | 3.0 percent | 3.75 percent | 6.25 percent |

For purposes of the Fund's financial reporting, this roll-forward process is applied annually.

Actuarial Cost Method Used: Aggregate entry-age normal method.

Market Value of Investments in Market-Based and Marketable Securities: \$219.6 billion

(Amounts in millions)

| | <u>FY 2005</u> |
|--|--------------------|
| Actuarial Liability as of 9/30/04 | \$834,582.1 |
| Expected Normal Cost for FY 05 | 14,857.2 |
| Plan Amendment Liability | 25,835.9 |
| Assumption Change Liability | 4,904.2 |
| Expected Benefit Payments for FY 05 | (38,704.4) |
| Interest Cost for FY 05 | 51,427.5 |
| Actuarial (gains)/losses due to changes in trend assumptions | <u>(790.9)</u> |
| Actuarial Liability as of 09/30/05 | <u>\$892,111.6</u> |
| Change in Actuarial Liability | <u>\$57,529.5</u> |

Military Retirement Health Benefits (MRHB)

The unfunded liability for the Military Retirement Health Benefits increased \$75.2 billion (34 percent). In FY 2005, there was a significant actuarial loss attributable to medical cost experience; this loss is included in "Actuarial (gains)/losses due to other factors" in the table below. Other (gains)/losses in this line include new population data, other actuarial experience being different from assumed and actuarial assumption changes other than the change in trend assumptions.

Change in MRHB Actuarial Liability

(Amounts in millions)

| | |
|---|-------------------|
| Actuarial Liability as of 09/30/04 (DoD pre-Medicare + all uniformed services Medicare cost-basis effect) | \$221,242 |
| Expected Normal Cost for FY05 | 7,686 |
| Expected Benefit Payments for FY05 | (7,718) |
| Interest Cost for FY05 | 13,827 |
| Actuarial (gains)/losses due to other factors | 20,323 |
| Actuarial (gains)/losses due to changes in trend assumptions | <u>41,113</u> |
| Actuarial Liability as of 09/30/05 (DoD pre-Medicare + all uniformed services Medicare cost-basis effect) | <u>*\$296,473</u> |
| Change in Actuarial Liability (millions) | <u>\$ 75,231</u> |

*MRHB Actuarial Liability is comprised of the following components:

| | |
|---|------------------|
| Tricare Management Activity (TMA) Actuarial Liability as of 9/30/05 | \$201,500 |
| Service Medical Activity (SMA) Actuarial Liability as of 9/30/05 | <u>94,973</u> |
| Total MRHB Actuarial Liability | <u>\$296,473</u> |

Note: The distribution above of the actuarial liability for MRHB between the TMA and SMA components differs from the distribution reported in the 2005 Performance and Accountability Report. The distribution above reflects the accurate distribution between the two components, which was calculated during first quarter 2006. The overall total MRHB liability is unchanged.

Actuarial Cost Method Used for SMA/TMA consolidated Liability: Aggregate Entry-Age Normal

Assumptions in Calculation of DHP Liability:

Interest Rate: 6.25 %

Medical Trend

| | |
|--|---|
| Medicare Inpatient: | 3.2 % from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Medicare Outpatient: | 5.6 % from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Medicare Prescriptions (Direct Care): | 10.0 % from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Medicare Prescriptions (Purchased Care): | 15.2 % from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Non-Medicare Inpatient (Direct Care): | 6.1 % from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Non-Medicare Outpatient (Direct Care): | 6.25 % from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Non-Medicare Prescriptions (Direct Care): | 7.5 % from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Non-Medicare Inpatient (Purchased Care): | 13.5 % from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Non-Medicare Outpatient (Purchased Care): | 14.9 % from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Non-Medicare Prescriptions (Purchased Care): | 15.1% from FY04 to FY05, ultimate rate of 6.25% in 2029. |

Other Information

The SMA/TMA consolidated liability includes pre-Medicare liabilities for the Department of Defense (DoD), plus a cost-basis effect related to the direct care portion of Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2005 liability was:

| | |
|--|----------------------|
| | (Amount in millions) |
| DoD | \$295,962 |
| Coast Guard | \$453 |
| Public Health Service | \$54 |
| National Oceanic and Atmospheric Administration (NOAA) | <u>\$4</u> |
| Total | <u>\$296,473</u> |

The cost-basis effect is approximately \$22.3 billion as of September 30, 2005, and arises because liabilities for direct care in the total MRHB liability are valued at a higher cost basis than they are in the Medicare Eligible Retiree Health Care Fund (MERHCF) liability. As of September 30, 2005, the SMA/TMA consolidated liability represents DoD pre-Medicare liabilities for direct care benefits plus DoD pre-Medicare liabilities for purchased care benefits for MTF Prime enrollees plus the direct-care cost-basis effect for Medicare liabilities for all Uniformed Services.

Medicare-Eligible Retiree Benefits

The MERHCF unfunded actuarial liability increased \$6.8 billion (2 percent). This increase is attributable to an increase of \$33.3 billion in the actuarial liability that is offset by an increase of \$26.5 billion in the value of assets available to pay benefits.

Changes in MERHCF Actuarial Liability

| | |
|--|-----------------------|
| | (Amounts in millions) |
| Actuarial Liability as of 09/30/04 (all uniformed services Medicare) | \$504,073.8 |
| Expected Normal Cost for FY05 | 10,613.8 |
| Expected Benefit Payments for FY05 | (6,546.9) |

| | |
|--|--------------------------|
| Interest Cost for FY05 | 31,629.8 |
| Actuarial (gains)/losses due to other factors | (14,902.7) |
| Actuarial (gains)/losses due to changes in trend assumptions | <u>12,529.3</u> |
| Actuarial Liability as of 09/30/05 (all uniformed services Medicare) | <u>\$537,397.2</u> |
| Change in Actuarial Liability | <u><u>\$33,323.3</u></u> |

Assumptions in Calculation of MERHCF Liability

Interest Rate: 6.25%

Medical Trend

| | |
|--|--|
| Medicare Inpatient: | 3.2% from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Medicare Outpatient: | 5.6% from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Medicare Prescriptions (Direct Care): | 10.0% from FY04 to FY05, ultimate rate of 6.25% in 2029. |
| Medicare Prescriptions (Purchased Care): | 15.2% from FY04 to FY05, ultimate rate of 6.25% in 2029. |

The MERHCF liability includes Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2005, liability was:

(Amounts in millions)

| | |
|-----------------------|---------------------|
| DoD | \$526,082.5 |
| Coast Guard | 10,176.7 |
| Public Health Service | 1,067.0 |
| NOAA | 71.0 |
| Total | <u>\$ 537,397.2</u> |

FY 2005 Service contributions to the MERHCF were:

(Amounts in millions)

| | |
|-----------------------|--------------------|
| DoD | \$10,220.0 |
| Coast Guard | 236.7 |
| Public Health Service | 32.1 |
| NOAA | 1.5 |
| Total | <u>\$ 10,490.3</u> |

Assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience. Claims cost assumptions for direct care were based on actual experience; assumptions for purchased care were developed from industry-based cost estimates adjusted to approximate the military retired population.

Projected revenues into the Medicare Eligible Retiree Health Care Fund, authorized by Chapter 56 of Title 10, United States Code, come from three sources: interest earnings on Fund assets, annual Uniformed Services "normal cost" contributions, and annual contributions from the Treasury Department. Prior to October 1, 2006, the normal cost contributions by the Services were paid monthly at a per-capita amount (approved by the DoD Medicare Eligible Retiree Health Care Board of Actuaries) times actual end strength. Beginning in FY 2006 the normal cost is paid annually at the beginning of the fiscal year by the Treasury, from amounts appropriated to the Military Services, and is calculated at the approved rate times the budgeted force strengths. The contribution from Treasury is also paid into the Fund at the beginning of each fiscal year and represents the amortization of the unfunded liability for service performed prior to October 1, 2002, as well as the amortization of actuarial gains and losses that have arisen since then. The Board determines Treasury's contribution, and the Secretary of Defense directs the Secretary of Treasury to make the payment.

The actuarial liability reported above does not include \$762.2 million in incurred but not reported liabilities as of September 30, 2005. These liabilities are disclosed in the Liabilities Not Covered and Covered by Budgetary Resources note, and the Other Liabilities note.

Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year's results. For purposes of the Fund's financial reporting, this process is applied annually.

Actuarial Cost Method Used for MERHCF Liability: Aggregate Entry-Age Normal

Market Value of Investments in Market-Based and Marketable Securities: \$86.5 billion

Federal Employees Compensation Act (FECA)

The unfunded liability for FECA decreased 2 percent.

Assumptions

The liability for future workers' compensation (FWC) benefits 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 liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

| | |
|-----------------------|-------|
| Year 1 | 4.53% |
| Year 2 | 5.02% |
| Year 3 and thereafter | 5.02% |

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2005 were also used to adjust the methodology's historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections for various charge back years (CBY) were as follows:

| <u>CBY</u> | <u>COLA</u> | <u>CPIM</u> |
|------------|-------------|-------------|
| 2006 | 3.33% | 4.09% |
| 2007 | 2.93% | 4.01% |
| 2008 | 2.40% | 4.01% |
| 2009+ | 2.40% | 4.01% |

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on three tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments; (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year calculated for the current projection to the liability-payment ratio calculated for the prior projection; and (3) a comparison of the incremental paid losses (the medical component in particular) in CBY 2005 (by injury cohort) to the average pattern observed during the prior three charge back years.

Voluntary Separation Incentive Programs (VSI)

The unfunded actuarial liability decreased \$44.8 million (6 percent) as a result of a decrease of \$97.7 million in the actuarial liability and a decrease of \$52.9 million in the value of assets available to pay benefits.

The VSI program was established by Public Law 102-190. The intent of this program is to reduce the number of military personnel on active duty. This plan was offered to personnel with a minimum of six years of service who do not qualify for retirement. The incentive payments are spread over a period equivalent to twice the years of active service. The annual payment is based on 2.5 percent of the person's basic pay at the time they leave service multiplied by the number of years of service. The September 30, 2005, VSI Actuarial Present Value of Projected Plan Benefits (Actuarial Liability) was calculated at an assumed annual interest rate of 4 percent.

Since the VSI program is discontinued for new takers, each year the Actuarial Liability is expected to decrease with benefit outlays, and increase with interest cost. In the absence of (1) actuarial gains and losses, and (2) assumption changes, a decrease of \$94 million in the Actuarial Liability was expected during FY 2005. The September 30, 2005, Actuarial Liability includes changes due to experience, which resulted in a net gain of \$3 million. This reflects the new population on which the September 30, 2005, Actuarial Liability is based, as well as other economic experience being different than assumed.

No new accruals were posted for the 1st Quarter, FY 2006. The Present Value of Projected Plan Benefits (Actuarial Liability) for the VSI Fund, as of September 30, 2005, is \$1.5 billion. It has been calculated as in prior years; namely, as the present value, as of September 30, 2005, of all remaining VSI payments.

Market Value of Investments in Market-based and Marketable Securities: \$635 million.

DoD Education Benefits Fund

The \$311.2 billion increase in the DoD Education Benefits unfunded actuarial liability is the combined result of a \$406.8 billion increase in the actuarial present value of plan benefits, offset by an increase of \$95.6 billion in the value of assets available to pay benefits.

The Education Benefits Fund was established by Public Law 98-525. The program is designed to accumulate funds for the Educational Assistance program, to promote the recruitment and retention of members for the All-Volunteer Forces program and the Total Force Concept of the Armed Forces, and aid in the readjustment of members of the Armed Forces to civilian life after separation from military service. A new educational benefit was added for mobilized reservists under Chapter 1607 of Title 10.

The addition of the new benefit for mobilized reservists, the inclusion of National-Call-to-Service benefits under Chapter 510 of Title 10, a change in interest rates and modeling, more complete experience, and an additional year of new entrants all combined to yield the significant increase in the actuarial liability.

Market Value of Investments in Market-based and Marketable Securities: \$1.0 billion

| | |
|-----------------|---|
| Note 18. | General Disclosures Related to the Statement of Net Cost |
|-----------------|---|

| Intragovernmental Costs and Exchange Revenue | | |
|--|-------------------------------|-------------------------------|
| As of December 31 | 2006 | 2005 |
| 1. Intragovernmental Costs | \$ 6,497,093,394.24 | \$ 6,908,407,625.02 |
| 2. Public Costs | 120,865,253,484.22 | 115,685,197,050.23 |
| 3. Total Costs | \$ 127,362,346,878.46 | \$ 122,593,604,675.25 |
| 4. Intragovernmental Earned Revenue | \$ (7,738,528,841.17) | \$ (20,516,883,170.10) |
| 5. Public Earned Revenue | (7,426,921,012.03) | (7,352,274,479.40) |
| 6. Total Earned Revenue | \$ (15,165,449,853.20) | \$ (27,869,157,649.50) |
| 7. Net Cost of Operations | \$ 112,196,897,025.26 | \$ 94,724,447,025.75 |

General Disclosures Related to the Statement of Net Cost

This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

For General Funds, the amounts presented in the Statement of Net Cost are based on obligations and disbursements and therefore may not, in all cases, accrue actual costs. While the Department's Working Capital Funds generally record transactions on an accrual basis, the systems do not always capture actual costs in a timely manner. As such, information presented in the Statement of Net Cost 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, accounts payable and environmental liabilities.

Fluctuations**Intragovernmental Earned Revenue**

Intragovernmental Earned Revenue decreased \$12.7 billion (62 percent) due primarily to overstating the 1st Quarter, FY 2005 revenue. In 1st Quarter, FY 2005, the Department reported the Treasury's annual contribution to the DoD Medicare-Eligible Retiree Health Care Fund (MERHCF) as revenue and should have reported it as internal DoD revenue and eliminated it from the DoD's financial statements. The error was corrected in 2nd Quarter, FY 2005 and subsequent periods.

| | |
|-----------------|--|
| Note 19. | Disclosures Related to the Statement of Changes in Net Position |
|-----------------|--|

| As of December 31 | 2006 | | 2005 | |
|--|-------------------------------------|------------------------------|-------------------------------------|------------------------------|
| | Cumulative Results of Operations | Unexpended Appropriations | Cumulative Results of Operations | Unexpended Appropriations |
| 1. Prior Period Adjustments | | | | |
| Increases (Decreases) to Net Position Beginning Balance | | | | |
| A. Changes in Accounting Standards | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| B. Errors and Omissions in Prior Year Accounting Reports | 0.00 | 0.00 | 0.00 | 0.00 |
| C. Total Prior Period Adjustments | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2. Imputed Financing | | | | |
| A. Civilian CSRS/FERS Retirement | \$ 362,281,557.48 | \$ 0.00 | \$ 415,141,266.58 | \$ 0.00 |
| B. Civilian Health | 640,562,937.00 | 0.00 | 648,808,401.00 | 0.00 |
| C. Civilian Life Insurance | 6,079,828.48 | 0.00 | 16,853,232.83 | 0.00 |
| D. Judgment Fund | 54,591,912.72 | 0.00 | 94,611,627.72 | 0.00 |
| E. IntraEntity | 0.00 | 0.00 | 0.00 | 0.00 |
| F. Total Imputed Financing | \$ 1,063,516,235.68 | \$ 0.00 | \$ 1,175,414,528.13 | \$ 0.00 |

Imputed Financing

The amounts the Department of Defense remits to the Office of Personnel Management by and for employees covered by the Civil Service Retirement System, the Federal Employees' Retirement System, the Federal Employees' Health Benefits program, and the Federal Employees' Group Life Insurance program do not fully cover the government's cost to provide these benefits. An imputed cost is recognized as the difference between the government's cost of providing these benefits to employees and DoD's contributions for them. The Office of Personnel Management provides cost factors for the computation of imputed financing costs, and their inclusion in the Department's financial statements.

Fluctuations**Cumulative Results of Operations**

Budgetary Financing Sources, Appropriations Used increased \$39.9 billion (32 percent). The increase is largely due to a change in process whereby normal cost payments to the Military Retirement and Medicare-Eligible Retiree Health Care Funds are made lump sum at the beginning of the fiscal year. Prior to FY 2006 these payments were made in incremental amounts on a monthly basis.

Other Budgetary Financing Sources, Other increased by \$1.4 billion (89 percent) due to a correction in the treatment of reconciling adjustments. Due to system deficiencies, the Department is unable to fully reconcile budgetary and proprietary

trial balances and must make adjustments. Prior to fourth quarter, FY 2005, these adjustments were being reflected incorrectly on this line. These adjustments are now correctly reflected as Other Financing Sources, Other.

Other Financing Sources, Other increased by \$1.3 billion due to the adjustments to reconcile budgetary and proprietary trial balances discussed above.

Unexpended Appropriations

Budgetary Financing Sources, Appropriations Received, Budgetary Financing Sources, Appropriations Transferred-In/Out, and Budgetary Financing Sources Other all reflected significant decreases due to funding reductions resulting from the Continuing Resolution Authority during first quarter FY 2006.

Other Disclosures

Statement of Federal Financial Accounting Standards Number 27, "Identifying and Reporting Earmarked Funds," effective for reporting years after FY 2005, required that the Department of Defense modify the Statement of Changes in Net Position. The Federal Accounting Standards Advisory Board determined that restatement of prior comparative balances would not be allowed. In order to meet the requirement, additional lines were added to separately display earmarked funds in all categories required for both the Cumulative Results of Operations and the Unexpended Appropriations sections of the statement.

There is a difference of \$299.2 billion between Appropriations Received that are reported on the Statement of Changes in Net Position (\$205.7 billion) and Appropriations Received in the Statement of Budgetary Resources (\$504.9 billion). The difference is due to the Continuing Resolution Authority and to a duplication of appropriations received by the DoD Trust Funds. Appropriations received by the Trust Funds are duplicated in the Statement of Budgetary Resources but not in the Statement of Changes in Net Position. See Note 20, "Disclosures Related to the Statement of Budgetary Resources," for further disclosures.

| | |
|-----------------|--|
| Note 20. | Disclosures Related to the Statement of Budgetary Resources |
|-----------------|--|

| As of December 31 | 2006 | 2005 |
|--|-----------------------|-----------------------|
| 1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period | \$ 267,079,577,144.97 | \$ 271,906,766,366.24 |
| 2. Available Borrowing and Contract Authority at the End of the Period | 75,044,683,031.27 | 61,450,533,965.22 |

The Net Amount of Budgetary Resources Obligated for Undelivered Orders decreased \$4.8 billion (2 percent) primarily due to the Continuing Resolution Authority in FY 2006.

Available Borrowing and Contract Authority increased \$13.6 billion (22 percent) primarily due to the receipt of additional obligation authority on a greater amount of war related activities as well as higher petroleum prices.

Budgetary Financing, Budgetary Resources section of the Statement of Budgetary Resources (SBR) reflects a decrease of \$498.4 billion (53 percent) primarily due to the Continuing Resolution Authority in FY 2006.

The Nonbudgetary Financing, Budgetary Resources section of the SBR reflects an increase of \$6.1 million (14 percent). This section of the SBR reports activity for the Military Housing Privatization Initiative. This fluctuation was primarily due to financing costs associated with a new direct loan at Elmendorf Air Force Base, Alaska.

Permanent Indefinite Appropriations

The Department of Defense received the following permanent indefinite appropriations:

- Department of the Army General Gift Fund (10 USC 2601(b)(1))
- Department of the Navy General Gift Fund (10 USC 2601(b)(2))
- Department of the Air Force General Gift Fund (10 USC 2601 (b)(3))
- Foreign National Employees Separation Pay Account, Defense (10 USC 1581)
- United States Naval Academy Gift and Museum Fund (10 USC 6973-4)
- Ship Stores Profits, Navy (10 USC 7220, 31 USC 1321)
- Midshipmen's Store (10 USC 6971B)
- Burdensharing Contributions Account (10 USC 2350j)
- Forest Program (10 USC 2665)
- Department of Defense Base Closure Account (BRAC 10 USC 2687 note)
- Medicare Eligible Retiree Health Care Fund (10 USC 1111)
- Military Retirement Fund (10 USC 1461)
- Education Benefits Fund (10 USC 2006)
- Reserve Mobilization Income Insurance Fund (RII) (10 USC 12528)
- Host Nation Support for U.S. Relocation Activities (10 USC 2350k)
- National Defense Sealift Fund (10 USC 2218)
- Environmental Restoration, Navy (10 USC 2702)
- Hydraulic Mining Debris Reservoir (33 USC 683)
- Maintenance and Operation of Dams and Other Improvements of Navigable Waters (16 USC 810(a))
- Payments to States (33 USC 701c-3)
- Wildlife Conservation (16 USC 670-670f)
- Ainsworth Bequest (IAW 31 USC 1321)

Reconciliation Differences

There is a difference of \$14.6 billion between the contract and borrowing authority reported on line 2 (\$75 billion) in the table above and the amount reported for Available Borrowing and Contract Authority on the SBR (\$60.4 billion). Line 2 reports current-year activity as well as carry-forward amounts for both categories of authority. The SBR only reports current-year activity for these categories.

The Department of the Treasury issues annual warrants to pay amortized payments for the unfunded actuarial liabilities of the Military Retirement Fund (MRF) and Medicare-Eligible Retiree Health Care Fund (MERHCF). This amount is credited and expended from the Other Defense Organization General Fund to the MRF and MERHCF in accordance with the Office of Management and Budget (OMB) guidance. The OMB is aware of, and approves of, this duplicate reporting. As a result, \$42.1 billion is duplicated in Appropriations Received on the SBR.

The MERHCF, MRF, and Education Benefits report Appropriations Received for contributions paid by the Army, Navy, and Air Force. The Military Departments also include these amounts in Appropriations Received. As a result, \$14.0 billion is duplicated on the SBR.

Intraentity Transactions

The SBR includes intraentity transactions because the statements are presented as combined and combining.

Direct Obligations – Apportionment Categories

| Reporting Entity | Category A (\$millions) | Category B (\$millions) | Exempt from Apportionment (\$millions) | Totals (\$millions) |
|---|----------------------------|----------------------------|--|------------------------|
| Army General Fund | \$43,457.3 | \$351.1 | | \$43,808.4 |
| Navy General Fund - see disclosure | 15,756.9 | 14,843.5 | | 30,600.4 |
| Air Force General Fund | 20,743.5 | 10,372.8 | \$0.2 | 31,116.5 |
| US Army Corps of Engineers | 1,444.3 | | 7 | 1,451.3 |
| Military Retirement Fund | 10,010.8 | | | 10,010.8 |
| Medicare-Eligible Retiree Health Care Fund | 2,365.8 | | | 2,365.8 |
| Other Defense Organizations – General Fund | 57,689.2 | 28.2 | 126.6 | 57,844.0 |
| Other Defense Organizations – Working Capital Fund | 1,512.4 | | | 1,512.4 |
| Totals | \$152,980.2 | \$25,595.6 | \$133.8 | \$178,709.6 |

Reimbursable Obligations – Apportionment Categories

| Reporting Entity | Category A (\$millions) | Category B (\$millions) | Exempt from Apportionment (\$millions) | Totals (\$millions) |
|---|----------------------------|----------------------------|--|------------------------|
| Army General Fund | \$3,206.8 | \$538.4 | | \$3,745.2 |
| Navy General Fund - see disclosure | | 1,479.1 | \$1,872.3 | 3,351.4 |
| Air Force General Fund | 815.9 | 656.2 | | 1,472.1 |
| Army Working Capital Fund | | 3,752.5 | \$1,900.0 | 5,652.5 |
| Navy Working Capital Fund | | 5,772.8 | | 5,772.8 |
| Air Force Working Capital Fund | | 3,782.0 | | 3,782.0 |
| US Army Corps of Engineers | 3,846.4 | | 0.1 | 3,846.5 |
| Other Defense Organizations – General Fund | 888.8 | | | 888.8 |
| Other Defense Organizations – Working Capital Fund | 14,956.7 | | | 14,956.7 |
| Totals | \$23,714.6 | \$15,981.0 | \$3,772.4 | \$43,468.0 |

Due to system limitations, the Navy General Fund could not categorize obligations. Therefore, all of Navy’s direct and reimbursable obligations are reported in the above table as Category “A.”

NOTE:

1. Category “A” relates to appropriations for a specific period of time (e.g., Military Personnel appropriation).
2. Category “B” relates to appropriations for a specific project (e.g., Military Construction appropriation).

| | |
|-----------------|--|
| Note 21. | Disclosures Related to the Statement of Financing |
|-----------------|--|

Due to the Department's financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. The difference between budgetary and proprietary data is a previously identified deficiency. To bring the Statement of Financing into balance with the Statement of Net Cost, the following adjustments (absolute value) were made:

| | |
|--|----------------|
| Resources That Finance the Acquisition of Assets | \$ 8.6 billion |
| Other Components Not Requiring or Generating Resources | \$ 1.1 billion |

The following Statement of Financing lines are presented as combined instead of consolidated due to intra-agency budgetary transactions not being eliminated:

- Obligation Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Net Obligations
- Undelivered Orders
- Unfilled Orders.

Resources Used to Finance Activities

Offsetting Receipts increased \$13.3 billion due primarily to a change in policy that requires upfront annual contributions rather than monthly contributions for the Medicare-Eligible Retiree Health Care Fund (MERHCF), and increased contributions to the MERHCF and the Military Retirement Fund.

Other Resources – Other increased \$1.3 billion primarily due to a change in accounting procedures requiring Components to include non-exchange gains and losses necessary to reconcile the proprietary and budgetary accounts previously not mapped to this line.

Resources Used to Finance Items not Part of the Net Cost of Operations

Resources That Finance the Acquisition of Assets increased \$13.4 billion due primarily to a revision of military equipment projections provided by the Bureau of Economic Analysis (BEA), Department of Commerce. See Note 10 for further disclosure on military equipment.

Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations decreased by \$1.3 billion primarily due to a change in accounting procedures requiring Components to include non-exchange gains and losses necessary to reconcile the proprietary and budgetary accounts previously not mapped to this line.

Components not Requiring or Generating Resources

Depreciation and amortization increased \$6.9 billion due primarily to the revision of military equipment projections provided by the Bureau of Economic Analysis (BEA), Department of Commerce.

| | |
|-----------------|---|
| Note 22. | Disclosures Related to the Statement of Custodial Activity |
|-----------------|---|

The Statement of Custodial Activity displays current year collections and disbursements for three custodial accounts: Foreign Military Sales, Development Fund for Iraq, and Seized Assets. Funds held in a custodial activity are only used for the stated purposes and are not available for the Department's use.

Foreign Military Sales (FMS)

Current year Deposits by Foreign Governments into the FMS Trust Fund are \$2.6 billion and disbursements on Behalf of Foreign Governments and International Organizations equal \$2.8 billion.

Under authority of the Arms Export and Control Act, the FMS Trust Fund receives collections from foreign governments that are dedicated specifically to FMS purchases. Funds collected into the Trust Fund are in advance of the performance of services or sale of articles. These advance collections constitute a fiduciary relationship with the countries and are outside the federal budget.

FMS neither recognizes nor reports revenue. The only exception is cost clearing accounts, which are reflected in all other principle financial statements. Since various DoD Components actually perform the services and sell the articles, recognition of revenue and expense occurs in the financial statements of the applicable DoD Components.

Development Fund for Iraq (DFI)

The DFI is for urgent humanitarian assistance, reconstruction, and other projects carried out for the benefit of the Iraqi people. In the current year, there were \$16.3 million in disbursements by the Multi-National Force-Iraq with no additional deposits. Some of the disbursements for FY 2005 were incorrectly classified, but the misclassification was corrected in FY 2006 which caused negative disbursements on some of the lines.

| | (Amounts in Millions) | |
|---|---------------------------|--------------------------------------|
| | During FY 2006 | Cumulative from Inception |
| Source of Collections | | |
| Deposits By Foreign Governments | 0 | 136.0 |
| Disposition of Collections | | |
| Security and Law Enforcement | 0.0 | .8 |
| Electric Sector | 14.6 | 38.9 |
| Oil Infrastructure | 0.0 | .5 |
| Water Resources and Sanitation | 8.5 | 15.1 |
| Transportation and Telecommunications | (0.2) | 5.0 |
| Roads, Bridges and Construction | 0.2 | 4.4 |
| Health Care | 0.0 | 2.8 |
| Private Sector Development | 0.4 | 4.2 |
| Education, Refugees, Human Rights, and Governance | (7.2) | 27.3 |
| Total Disbursed on Behalf of Foreign Governments | 16.3 | 99.0 |
| Retained for Future Support of Foreign Governments (Note) | (16.3) | 37.0 |
| Total Disposition of Collections | <u>\$ 0</u> | <u>136.0</u> |
| Net Custodial Collection Activity | <u>\$ 0</u> | <u>\$ 0</u> |

Note – Reported on Statement of Custodial Activity under Disposition of Collections, Increase (Decrease) in Amounts to be Transferred.

Seized Assets

During Operation Iraqi Freedom, the U.S. Government seized assets from the former Iraqi Government that are used in support of the Iraqi people. As of December 31, 2005, \$57.7 million of seized monetary assets remain to be disbursed in support of the Iraqi people as shown in the table below.

| | (Amount in Millions) | |
|--|---------------------------|--------------------------------------|
| | During FY 2006 | Cumulative from Inception |
| Source of Collections | | |
| Seized Iraqi Cash | \$ 0.0 | \$ 927.2 |
| Disposition of Collections | | |
| Iraqi Salaries | \$ 0.0 | \$ 30.8 |
| Repair/Reconstruction/Humanitarian Assistance | 3.7 | 498.7 |
| Iraqi Ministry Operations (Ministry of Finance, Defense, etc.) | 0 | 264.7 |
| Fuel/Supplies | <u>0</u> | <u>75.3</u> |
| Total Disbursed on behalf of Iraqi People | \$ 3.7 | \$ 869.5 |
| Retained for Future Support of the Iraqi People | <u>(3.7)</u> | <u>57.7</u> |
| Total Disposition of Collections | \$ 0 | \$ 927.2 |
| Net Custodial Collection Activity | <u>\$ 0</u> | <u>\$ 0</u> |

| | |
|-----------------|------------------------|
| Note 23. | Earmarked Funds |
|-----------------|------------------------|

| | | | | |
|---|-----|--------|-----------------------|-----------------------|
| BALANCE SHEET As of December 31 | | | | |
| | MRF | MERHCF | Other Earmarked Funds | Total Earmarked Funds |

ASSETS

| | | | | |
|----------------------------------|------------------------------|-----------------------------|----------------------------|------------------------------|
| Fund balance with Treasury | \$ 26,182,327.92 | \$ 5,000,000.00 | \$ 1,424,413,043.63 | \$ 1,455,595,371.55 |
| Investments | 220,435,717,171.79 | 87,475,115,343.02 | 5,111,186,296.55 | 313,022,018,811.36 |
| Accounts and Interest Receivable | 25,709,468.51 | 9,376,178.82 | 985,377,161.31 | 1,020,462,808.64 |
| Other Assets | 0.00 | 0.00 | 819,204,471.02 | 819,204,471.02 |
| Total Assets | \$ 220,487,608,968.22 | \$ 87,489,491,521.84 | \$ 8,340,180,972.51 | \$ 316,317,281,462.57 |

LIABILITIES and NET POSITION

| | | | | |
|---|------------------------------|-----------------------------|----------------------------|------------------------------|
| Military Retirement Benefits and Other Employment Related Actuarial Liabilities | \$ 892,111,600,551.72 | \$ 537,397,092,000.00 | \$ 0.00 | \$ 1,429,508,692,551.70 |
| Other Liabilities | 3,435,013,297.63 | 1,036,033,600.94 | 1,332,689,938.89 | 5,803,736,837.46 |
| Unexpended Appropriations | 0.00 | 0.00 | 259,029.32 | 259,029.32 |
| Cumulative Results of Operations | (703,738,589,897.85) | (477,301,652,715.10) | 3,876,894,029.63 | (1,177,163,348,583.30) |
| Total Liabilities and Net Position | \$ 191,808,023,951.50 | \$ 61,131,472,885.84 | \$ 5,209,842,997.84 | \$ 258,149,339,835.18 |

STATEMENT OF NET COST

| | | | | |
|---|----------------------------|----------------------------|--------------------------|----------------------------|
| Program Costs | \$ 10,011,839,246.17 | \$ 1,288,141,608.08 | \$ 345,956,614.57 | \$ 11,645,937,468.82 |
| Less Earned Revenue | (3,850,524,170.43) | (1,646,544,259.80) | (25,866,135.24) | (5,522,934,565.47) |
| Net Program Costs | \$ 6,161,315,075.74 | \$ (358,402,651.72) | \$ 320,090,479.33 | \$ 6,123,002,903.35 |
| Less Earned Revenues Not Attributable to Programs | 0.00 | 0.00 | 0.00 | 0.00 |
| Net Cost of Operations | \$ 6,161,315,075.74 | \$ (358,402,651.72) | \$ 320,090,479.33 | \$ 6,123,002,903.35 |

STATEMENT OF CHANGES IN NET POSITION

| | | | | |
|--------------------------------------|--------------------------------|--------------------------------|----------------------------|----------------------------------|
| Net Position Beginning of the Period | \$ (697,577,274,822.11) | \$ (477,660,055,366.82) | \$ 3,416,020,320.35 | \$ (1,171,821,309,868.60) |
| Net Cost of Operations | 6,161,315,075.74 | (358,402,651.72) | 320,090,479.33 | 6,123,002,903.35 |
| Other Nonexchange Revenue | 0.00 | 0.00 | 781,223,217.93 | 781,223,217.93 |
| Change in Net Position | \$ (6,161,315,075.74) | \$ 358,402,651.72 | \$ 461,132,738.60 | \$ (5,341,779,685.42) |
| Net Position End of Period | \$ (703,738,589,897.85) | \$ (477,301,652,715.10) | \$ 3,877,153,058.95 | \$ (1,177,163,089,554.00) |

The earmarked fund schedule is shown as consolidated. All intra-DoD activity between earmarked funds and non-earmarked funds has been eliminated from the schedule, which may cause differences between the individual stand-alone statements for the Department's earmarked fund accounts.

The Statement of Federal Financial Accounting Standards (SFFAS) 27, "Identifying and Reporting Earmarked Funds," requires the disclosure of earmarked funds separately from all other funds on the Statement of Changes in Net Position and Balance Sheet. Funds must meet three criteria to be classified as earmarked, including a statute committing use of specifically identified revenues for designated purposes, explicit authority to retain the revenues, and a requirement to account and report on the revenues. The Department of Defense (DoD) earmarked funds are either special or trust funds and use both receipt and expenditure accounts to report activity to the Department of the Treasury. There have been no changes in legislation during or subsequent to this reporting period that significantly changed the purposes of any of the following funds.

Military Retirement Fund (MRF), 10 United States Code (USC) 1461. The MRF accumulates funds in order to finance, on an actuarially sound basis, the liabilities of the Department of Defense (DoD) military retirement and survivor benefit programs. Financing sources for the MRF are interest earnings on Fund assets, monthly DoD contributions, and annual contributions from the Treasury. The monthly DoD contributions are determined as a percentage of basic pay. The contribution from Treasury represents the amortization of the unfunded liability for service performed prior to October 1, 1984, as well as the amortization of actuarial gains and losses that have arisen since then. The Treasury annual contribution also includes the normal cost amount for the concurrent receipt provisions of the 2004 National Defense Authorization Act.

Medicare Eligible Retiree Health Care Fund (MERHCF), 10 USC 1111. The MERHCF accumulates funds to finance, on an actuarially sound basis, liabilities of the DoD and the uniformed services health care programs for specific Medicare-eligible beneficiaries. The MERHCF was authorized by Public Law 106-398. Financing sources for the MERHCF are provided primarily through an annual actuarial liability payment from Treasury, annual contribution(s) from the Military Services and other Uniformed Services (US Coast Guard, the National Oceanic and Atmospheric Administration, and the US Public Health Service), and interest earned from the Fund's investments.

Other Earmarked Funds

Special Recreation Use Fees, 16 USC 4061-6a note. The U. S. Army Corps of Engineers (USACE) is granted the authority to charge and collect fair and equitable Special Recreation Use Fees at campgrounds located at lakes or reservoirs that are under the jurisdiction of the USACE. Types of allowable fees include, but are not limited to, daily use fees, admission fees, recreational fees, annual pass fees, and other permit type fees. The receipts are used for the operation and maintenance of the recreational sites.

Hydraulic Mining in California, Debris, 33 USC 683. Operators of hydraulic mines through which debris flows in part or in whole to a body restrained by a dam or other work erected by the California Debris Commission are required to pay an annual tax as determined by the Commission. Taxes imposed under this code are collected and then expended under the supervision of the USACE and the direction of the Department of the Army. The funds are used for repayment of funds advanced by the federal government or other agency for construction, restraining works, settling reservoirs, and for maintenance.

Payments to States, Flood Control Act of 1954, 33 USC 701c-3. Seventy-five percent of all funds received and deposited from the leasing of lands acquired by the United States for flood control, navigation and allied purposes, including the development of hydroelectric power, are returned to the state on which the property is located. The USACE collects lease receipts into a receipt account. Funds are appropriated for the amount of receipts the following fiscal year.

Maintenance and Operation of Dams and Other Improvements of Navigable Waters, 16 USC 803(f), 810. The USC states, "all proceeds from any Indian reservation shall be placed to the credit of the Indians of such reservation." However, the codes also states, "all other charges arising from licenses" except those charges established by the Commission for purpose of administrative reimbursement shall be paid to the Treasury from which specific allocations will be made. From the specific allocations, 50 percent of charges from "all other licenses" is reserved and appropriated as a special fund in the Treasury to be expended under the direction of the Secretary of the Army in the maintenance, operation/improvement of dams and other navigation structures that are owned by the United States or in construction, maintenance, or operation of headwater or other improvements of navigable waters of the United States.

Fund for Non-Federal Use of Disposal Facilities (for dredged material), 33 USC 36, 2326a. Any dredged material disposal facility under the jurisdiction of, or managed by, the Secretary of the Army (Secretary) may be used by a nonfederal interest if the Secretary determines that such use will not reduce the availability of the facility for project purposes. Fees may be imposed to recover capital, operation and maintenance costs associated with such use. Any monies received through collection of fees under this law shall be available to the Secretary, and shall be used by the Secretary, for the operation and maintenance of the disposal facility from which the fees were collected.

South Dakota Terrestrial Wildlife Habitat Restoration Trust Fund, Public Law 106-53, 113 Stat. 388. Yearly transfers are made from the General Fund of the Treasury to the Trust Fund for investment purposes. Investment activity is managed by the Bureau

of Public Debt (BPD). The BPD purchases and redeems nonmarketable market-based securities issued by the BPD. Investments include one-day certificates, bonds and notes. When the fund reaches the aggregate amount of \$108 million, withdrawals may be made by the USACE for payment to the State of South Dakota. The state uses the payments to fund the annually scheduled work for wildlife habitat restoration.

Coastal Wetlands Restoration Trust Fund, 104 Stat. 4778; 4788 and Coastal Wetlands Planning, Protection and Restoration Act, 16 USC 3951-3956. The USACE, along with the Environmental Protection Agency, and the Fish and Wildlife Service is granted the authority to work with the State of Louisiana to develop, review, evaluate, and approve a plan to achieve a goal of "no net loss of wetlands" in coastal Louisiana. The USACE is also responsible for allocating funds among the named Task Force members. Federal contributions are established at 75 percent of project costs or 85 percent if the State has an approved Coastal Wetlands Conservation Plan.

Rivers and Harbors Contributed and Advance Funds, 33 USC 60, 701h, 702f, 703. This establishes funding to construct, improve, and maintain levees, water outlets, flood control, debris removal, rectification and enlargement of river channels, etc. in the course of flood control and river/harbor maintenance. Whenever any state or political subdivision offers to advance funds for a flood control project duly adopted and authorized by law, the Secretary of the Army may in his discretion, receive such funds and expend them in the immediate prosecution of such work.

Inland Waterways Trust Fund, Public Law 95-502, 33 USC 1081, 1802. This law made the Inland Waterways Trust Fund available for USACE expenditures for navigation, construction, and rehabilitation projects on inland waterways. The investment activity is managed by the BPD.

Harbor Maintenance Trust Fund, 100 Stat. 4269-4270 and 26 USC 9505. The USACE Civil Works mission is funded by the Energy and Water Developments Appropriations Act. The Water Resources Development Act of 1986 was implemented to cover a portion of USACE operations and maintenance costs for deep draft navigation.

Foreign National Employees Separation Pay Account Trust Fund. This is used to make payments from amounts obligated by the Secretary of Defense that remain unexpended for separation pay for foreign national employees of the DoD. This does not apply to foreign national employees' separation funded by Foreign Military Sales administrative funds.

| | |
|-----------------|--------------------------|
| Note 24. | Other Disclosures |
|-----------------|--------------------------|

| | | | | |
|-------------------|------------------------|-----------|-------|-------|
| As of December 31 | 2006 Asset Category | | | |
| | Land and Buildings | Equipment | Other | Total |

**1. ENTITY AS LESSEE-
Operating Leases**

Future Payments Due

Fiscal Year

| | | | | | | | | |
|---------------|----|----------------|----|------------|----|----------------|----|----------------|
| 2006 | \$ | 175,235,411.01 | \$ | 157,392.00 | \$ | 135,762,466.00 | \$ | 311,155,269.01 |
| 2007 | | 187,790,616.06 | | 0.00 | | 138,477,716.00 | | 326,268,332.06 |
| 2008 | | 204,145,307.48 | | 0.00 | | 141,247,270.00 | | 345,392,577.48 |
| 2009 | | 218,085,352.32 | | 0.00 | | 144,072,215.00 | | 362,157,567.32 |
| 2010 | | 216,609,593.60 | | 0.00 | | 146,953,660.00 | | 363,563,253.60 |
| After 5 Years | | 192,893,380.68 | | 0.00 | | 149,892,733.00 | | 342,786,113.68 |

**Total Future Lease
Payments Due**

| | | | | | | | | |
|--|----|------------------|----|------------|----|----------------|----|------------------|
| | \$ | 1,194,759,661.15 | \$ | 157,392.00 | \$ | 856,406,060.00 | \$ | 2,051,323,113.15 |
|--|----|------------------|----|------------|----|----------------|----|------------------|