United States Air Force
Annual Financial Statement 2004






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Annual Financial Statements

Financing the Fight



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SECRETARY OF THE AIR FORCE
WASHINGTON

November 2004

Message from the Secretary of the Air Force

Fiscal Year 2004 saw the Airmen of the United States Air Force consistently rise to ever-greater challenges. Whether conducting operations in Afghanistan, Iraq, over the Homeland or elsewhere, they continued to prove America is home to the greatest air and space force in history.

The dedication shown by our Airmen is rooted in the fact that the Air Force is a team—a team of professionals. Every Airman is part of a cohesive whole. Financial managers are certainly important contributors and enable the efforts of the entire force. If strategic planning is the brain of any successful organization, and a talented workforce the heart, then superb financial management is the lifeblood of a dynamic, world-class enterprise.

I am proud of the Air Force's responsible stewardship of resources. In the past year we launched our Financial Management Strategic Plan, providing a unifying vision for better service, performance, oversight and visibility. Air Force financial management professionals have embraced our continuing adaptation of processes, improving support to all Airmen.

These financial statements illustrate both the success of the Air Force over the past year and our specific financial management success. They comply with the requirements of the Chief Financial Officer Act. The financial information addresses both our General Fund and Working Capital Fund activities.

The Airmen responsible for financial management—Active, Reserve, Guard, and Civilian—are models of leadership and accountability. They are, indeed, "*Financing the Fight*" and providing the best capabilities for the Air Force and for our country.

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC
OFFICE OF THE ASSISTANT SECRETARY

November 2004

Message from the
Assistant Secretary of the Air Force,
Financial Management and Comptroller

I am pleased to report that during Fiscal Year 2004, the Air Force Financial Management professionals continued their outstanding support to ongoing military operations and made great strides in improving our financial management processes and systems throughout the world. Even as the Air Force as a whole responded to the tremendous demands of operations IRAQI FREEDOM and ENDURING FREEDOM, along with other global commitments, our financial managers provided improved support to our warfighters and home stations alike.

One crucial key to this success was the continued implementation of our Strategic Plan, unveiled last October. It effectively links our financial management vision, mission, goals and objectives with those of the Air Force so that we are fully aligned as an enterprise. Further, it focuses our attention on our three most important strategic elements: the warfighter, strategic resourcing and cost management, and information reliability, and integration. The plan has been the foundation of our relentless drive to continually improve our financial services delivery based on performance-based principles.

We have also continued our steady progress in our Transformation imperative across the Air Force. These efforts have matured into a broad program of continuous improvement that is now firmly rooted in the culture of Air Force financial management. I am extremely proud of the way our professionals have embraced the concept of using the best ideas to achieve greater efficiencies and improve our support.

The Fiscal Year 2004 Financial Statements likewise reflects this evolution and efficiency. You will notice it contains a more concise Management Discussion and Analysis section that more effectively summarizes the great achievements of the Air Force over the past year. It also fulfills the requirements of the Chief Financial Officer Act, documents the expenditures devoted to our General Fund and Working Capital Fund (addressed in the accounting statements) and reviews selected performance measures established as part of the Government Performance and Results Act.

America can be proud of the good stewardship of our resources provided by Air Force financial management professionals. They are indeed supporting our nation by "financing the fight" with integrity, selfless service, and excellence.

Financing the Fight


DANGER
EJECTION SEAT
DANGER DANGER
RESCUE

Management Discussion and Analysis

"Our United States Air Force reflects the visions of the founders of airpower. We foster ingenuity in the development of the world's most professional Airmen. We thrive on transitioning new technologies into joint warfighting systems and drive relentlessly toward integration to realize the potential of our air and space capabilities. We are America's Airmen—confident in our capability to provide our Nation with dominance in air and space."

General John Jumper, USAF
Chief of Staff

General Fund

Air Force in Action

Global vigilance, reach, and power—This is the vision of America's Air Force: A vision that continued to be realized during fiscal year 2004. The Air Force proved its ability to produce unprecedented success across the spectrum of conflict, around the world and in space. Continued dominance in this new era requires new thinking and new flexibility. Our Airmen responded with astonishing effectiveness in the Global War on Terrorism, during Operation IRAQI FREEDOM and Operation ENDURING FREEDOM. From a combat controller in the desert to a B-2 crew, our Airmen respond to the challenges of a new era using their skill and innovative technology to respond to insidious and asymmetric threats from terrorists and rogue states.

America's Airmen have adapted leadership, training, and technology to meet today's threat and prepare for tomorrow's. As you will read in this report, we recognize the talents of our Airmen as our greatest resource. We have, therefore, invested in leadership development, training, and education to foster the skills required of a 21st century force. Going a step beyond, we also invested in quality of life for our Airmen and their families to help them cope with the separations and sacrifices we demand of them every day. We have invested in the key technologies that will create an integrated force of intelligence capabilities. We have invested in manned, unmanned, and space technology. But most importantly, we have invested in the training required for our highly-skilled personnel to achieve their fullest potential.

In line with these investments, we have worked to enhance the systems that enable our Airmen to meet the threat now and into the future. While America's adversaries pursue capabilities to compete with our dominance, we are seeking to enhance and expand our capabilities with aircraft, space systems, and technology using transformational advances in air and space systems, and technology to allow us continued dominance.

While our Airmen ensure our quality force, our legacy systems cannot always ensure air and space dominance in future fights. Our systems and platforms must keep pace with our people. We owe it to our dedicated Airmen today, and in the future, to continue these investments. We owe it to them to continue Financing the Fight.

Air Force Organizations

In FY 2004, Air Force active duty members, Air National Guardsmen, Reservists, and civilians responded to unprecedented challenges with unprecedented performance. Calling upon the Air Force Core Values of *"Integrity First – Service Before Self – Excellence In All That We Do,"* Air Force people proved time and time again that they comprise the preeminent air and space power on the planet.

The integrated components of our Air and Space Expeditionary Force were involved in operations including major theater war, homeland security, and humanitarian relief. Air Force people and organizations operated with unprecedented effectiveness and efficiency, all while constantly preparing to face the challenges of the future.

Major Commands, Direct Reporting Units, Field Operating Agencies

The Air Force is organizationally aligned into 9 Major Commands (MAJCOMs, including the Air Force Reserve and Air National Guard), with 13 Field Operating Agencies (FOAs), and four Direct Reporting Units (DRUs).

Major Command (MAJCOM)

MAJCOM is a major subdivision of the Air Force, directly subordinate to Headquarters US Air Force. MAJCOM headquarters are management headquarters and thus have the full range of functional staff. Examples of MAJCOMs are Air Combat Command (ACC), Air Education and Training Command (AETC), and Air Force Materiel Command (AFMC).

Direct Reporting Unit (DRU)

DRU is a subdivision of the Air Force, directly subordinate to the Chief of Staff, US Air Force. A DRU performs a mission that does not fit into any of the MAJCOMs. A DRU has many of the same administrative and organizational responsibilities as a MAJCOM. Examples of DRUs are the Air Force Academy (USAFA), the Air Force Studies and Analysis Agency (AFSAA), and the Air Force Operational Test and Evaluation Center (AFOTEC).

Field Operating Agency (FOA)

FOA is a subdivision of the Air Force, directly subordinate to a Headquarters US Air Force functional manager. An FOA performs field activities beyond the scope of any of the major commands. The activities are specialized or associated with an Air Force-wide mission and do not include functions performed in management headquarters, unless specifically directed by a Department of Defense (DoD) authority. Examples of FOAs are the Air Force Intelligence Analysis Agency (AFIAA), the Air Reserve Personnel Center (ARPC), and the Air Force Services Agency (AFSA).

Fiscal Year 2004 Results

Budget by Appropriation Categories

Six major appropriation categories comprised the Air Force FY 2004 budget, as follows:

- Operations and Maintenance (O&M): Pays the salaries and benefits of civilian employees and other day-to-day operating costs (e.g., fuel, spare parts).
- Military Personnel (MILPERS): Finances the salaries and benefits of uniformed personnel.
- Procurement (PROC): Funds Air Force investment in major systems.
- Research, Development Test and Evaluation (RDT&E): Funds system development.
- Military Contruction (MILCON): Pays for facilities construction.

- Military Family Housing (MFH): Provides for the operation, maintenance, and construction of housing units.

Performance Measures: Quality People

Education and Training

Training is a vital part of the Air Force mission, instructing new Airmen and retraining Airmen on the fundamentals of their career areas and the detailed tasks they will face. For example, the 65-day Security Force Apprentice course and the 79-day Security Force Officer course teach Airmen all aspects of their multi-faceted career field missions—missions they will perform around the globe.

This year saw the worldwide connection of Air Force Education Centers through a web-based system called Air Force Virtual Education Center (AFVEC). AFVEC is available through the Air Force Portal and offers a wide array of on-line capabilities to empower the students to actively participate in all aspects of their education—view their education record, apply for Tuition Assistance, schedule a counseling or testing appointment, and view their Community College of the Air Force degree progress. Each Education Center uses the Air Force Automated Education Management System (AFAEMS) to manage military members' complete education record, now the official system of record for Air Force Voluntary Education data.

The Community College of the Air Force offers numerous courses leading to an associate degree and at the close of FY 2004 had awarded a total of 254,900 degrees.

The newest Joint Professional Military Education (JPME) course, the Joint Advanced Warfighting School, or JAWS for short, began August 2004 at Norfolk Navy Base for eight select Air Force officers. JAWS was designed to produce graduates from all the Services able to create campaign-quality concepts, employ all elements of national power, accelerate transformation and succeed as joint force operational and strategic planners and commanders. JAWS will educate six Majors and two Lt Colonels this year. Graduates will receive single phase Joint PME credit (phase I & II) upon program completion.

In a move to explore alternative methods for completing in-residence enlisted PME, active duty technical sergeants enrolled in the unique Air National Guard Satellite Non-

Commissioned Officer (ANG SatNCO) Academy at Andrews AFB, Maryland. This hybrid approach to the traditional in-residence course allows students to attend NCO PME two evenings a week for fifteen weeks, completing the final two weeks at the McGhee-Tyson ANG NCO Academy, Knoxville, Tennessee. NCOs with unique duty or personal circumstances benefit as they remain at home station while meeting their PME requirement. Nearly a decade old, the ANG SatNCOA Program has been validated by the College for Enlisted PME and Community College of the Air Force as equivalent to the Air Force NCO Academy in-residence school. The SatNCOA program leverages satellite broadcast technologies to present interactive lessons through two-way audio and one-way video live feeds, moderated by in-classroom instructors. Students are joined by others participating from geographically-separated sites. Working on the job while concurrently enrolled in the course, both Air National Guard and active duty NCOs agree on the practicality of immediately putting into practice lessons learned from leadership, management, and communications discussions.

Rated Retention

A special subset of the retention challenge is maintaining the health of the rated force in order to preserve the warfighting capability of the Air Force. The Air Force boasts the world's most efficient and talented support force, combined with technologically superior, integrated air and space systems. However, retention of skilled pilots, navigators, and Air Battle Managers (ABMs) remains crucial to accomplishing operational missions.

Further, at a cost of several million dollars to train and season, a veteran pilot is the Air Force's most expensive personnel asset. Prior to September 11, 2001, a strong economy coupled with unprecedented airline hiring contributed to a shortage of 1,239 pilots—9% below the requirement by the end of FY 2001. In FY 2002 the pilot shortfall dropped to 690 pilots, 5% below the requirement. By the end of FY 2003, the pilot shortfall was 323 pilots, 2% below the requirement. This trend has continued through FY 2004 with a predicted surplus of approximately 300 pilots by the end of the year. This inventory increase is attributable to the decline in airline pilot hiring, combined with the positive retention effects of Air Force initiatives such as Aviator Continuation Pay (ACP), in addition to the Permanent Rated Recall and Retired Rated Recall programs. However, pilots with the right skills and experience will still be in short supply due to low production in the mid-1990s. In FY 2004, the pilot long-term bonus "take rate" (our best indicator of pilot retention trends) is approximately 65%. This is a substantial increase from a 47% "take rate" in FY 2002 and only a 30% "take rate" in FY 2001. While airline

hiring by the major airlines has shrunk following September 11th (from nearly 4,000 new hires in FY 2001 to 518 in FY 2003), two important points need to be considered: 1) that during lean economic times, the airlines tend to hire a greater percentage of former military pilots (up to 75%), and 2) that the long-range forecast of airline hiring shows increases in the coming years due to an increase in airline pilot retirements beginning in 2005. Even so, as FY 2004 draws to a close, there are still 8,936 major airline pilots on furlough. As such, the outlook on pilot retention is improving, but will continue to be a significant issue for the long-term health of Air Force warfighting capability.

Until the bonus was offered to navigators in FY 2003, 30% of the navigator force was retirement eligible in the following two years and nearly half could have retired within four years. Now, as a result of the FY 2003 and FY 2004 navigator ACP program, over half of those navigators accepted bonus agreements, cutting the retirement eligible pool by 50%. The bonus influenced navigators to stay in the service longer and provided relief for HQ staff pilot shortfalls (HQ level staff manning raised overall to 90%, while pilot-rated staff positions were manned at 79%). ABM shortfalls were no less acute as ABM inventory was estimated to be approximately 11% short of requirements. ABMs are a resource critical to Air Force warfighting capabilities as they

operate in low-density/high-demand missions and aircraft (AWACS, JSTARS, and GTACS). The ABM bonus has been a great success with an aggressive "take rate" of approximately 73% for FY 2004. As a result, the ABM ACP has accelerated ABM inventory wellness by three full years.

Overall, the Air Force's integrated focus on retention initiatives will continue to emphasize long-term health of the rated force. Initiative options include: increasing active duty service commitments, increasing compensation, managing operations tempo, and enhancing quality of life programs.

Operational Performance

Air Force Flying Hour Program

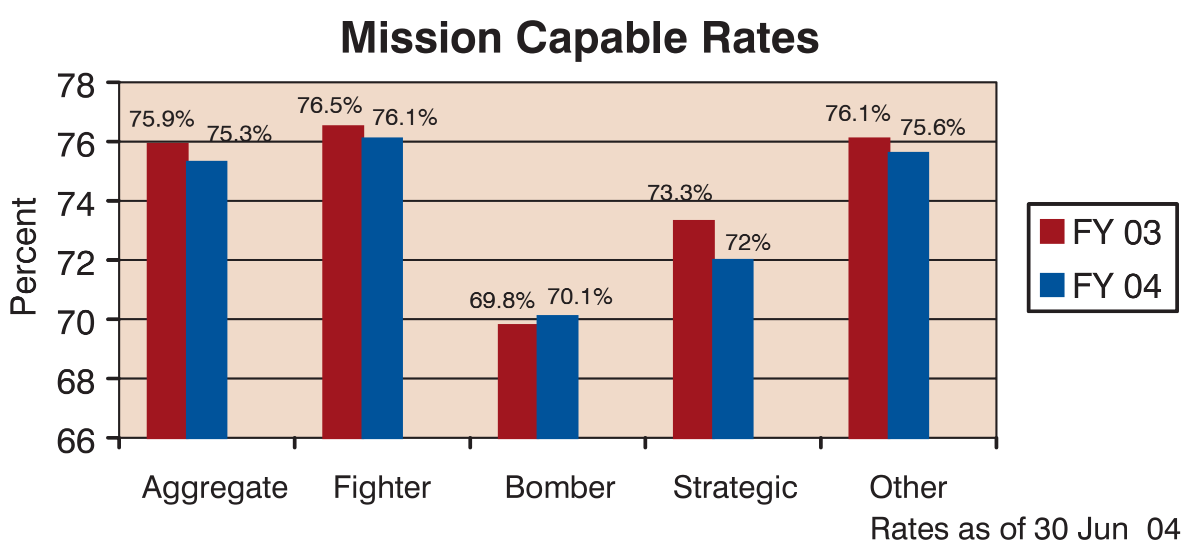
The Air Force Flying Hour Program was developed to provide training opportunities to prepare units to support their mission to the warfighting commanders. The execution of the President's Budget (PB) Flying Hour Program is impacted by contingency operations support, maintenance issues, fact-of-life impacts, aircraft flight operations suspensions, aircraft delivery delays, weapons system retirements, and approved program changes. Though the execution of the Flying Hour Program does not define unit readiness, it can be a forward indicator of possible readiness issues.

The MAJCOMs determine the reasons for execution deviation and required course of action. These evaluations provide insight to possible future-year requirements.

As of 30 June 2004, the Air Force executed 77.4% of the PB Flying Hour Program and is projected to exceed the PB for the full year. Flying Hour Program execution hours include active Air Force, Congressional-funded O&M hours. They do not include incrementally funded contingency support hours, Transportation Working Capital Fund hours, foreign national reimbursable training hours, Special Operations hours or RDT&E.

Weapon System Performance Metrics

The Air Force uses a variety of metrics to gauge the performance of its weapon systems and organizations. Metrics are barometers for measuring the effectiveness of our organizational structures, our training, manpower and equipment levels, quality of spare parts, maintenance actions, and a variety of other indicators of our ability to provide mission-ready weapon systems to the warfighter. Chief among these performance metrics are Mission Capable rates, Not-Mission Capable rates, Cannibalization rates, and engine and supply measures.



Mission Capable Rates

Mission Capable rates are perhaps the best-known yardstick for measuring the readiness of Air Force aircraft. Mission Capable rates reflect the percentage of aircraft, by fleet, capable of performing at least one of its assigned missions. As of 30 June 2004, the aggregate Mission Capable rate was 75.3%, a slight decrease from the FY 2003 rate of 75.9%. This rate is based on a combined Mission Capable rate of A/O-10, B-1, B-2, B-52, C-141, C-130, RC-135, C-5, C-17, E-3, F-15, F-15E, F-16, F-117, HC-130, KC-10, KC-135, HH-60, RQ-1, and U-2 aircraft, categorized into Fighter, Bomber, Strategic, and Other. The C-130 and RC-135 were added to the aggregate fleet for FY 2004, which accounts for some of the rate change from FY 2003.

Non-Mission Capable Rates

Total Non-Mission Capable for Maintenance (TNMCM) is a measure of a maintenance organization's ability to fix aircraft quickly and accurately and Total Non-Mission Capable for Supply (TNMCS) measures spare parts availability. The FY 2004 aggregate fleet TNMCM rate, as of 30 June 04, rose slightly from 19.3% to 20.1%. The 30 June 04 TNMCS rate was 10.4%, representing the fifth consecutive year of improving supply rates, and the lowest TNMCS rate since FY 1994.

Other Key Metrics

Air Force weapon system performance measures for FY 2004 provide a snapshot of the tremendous efforts of the logistics community to support and provide combat-capable forces that are organized, trained, and equipped to provide efficient and effective combat and combat support efforts across the full spectrum of military operations.

Cannibalization (CANN) rates reflect the number of cannibalization actions that occur per 100 sorties for a particular weapon system. The FY 2004 aggregate CANN rate, as of 30 June 04, dropped 19% from the FY 2003 rate. The FY 2004 rate of 6.5 CANNs per 100 sorties represents the lowest CANN rate since FY 1994.

Engine Not Mission Capable-Supply (ENMCS), the key measure of engine and aircraft readiness rates for Air Force engines, dropped from 10.1% to 8.5%, the second consecutive year of improvement, and the lowest rate in the past six years. Major improvements in ENMCS were seen in engines powering fighter, bomber, and strategic airlift aircraft. Engine-time-on-wing (ETOW) rates, a key measure

of durability of the aircraft fleet, improved for the fighter and bomber groups, while declining 10% for engines powering strategic airlift aircraft. ETOW rates for engines powering the F-15E, B-1, and A-10 reached their highest levels recorded since FY 1998. The number of War-Ready Engines returned to pre-war levels as of June 2004. Investments in engine modifications, spare parts, and reliability-centered maintenance continued to pay "quality" dividends for our engine fleet throughout FY 2004.

Aircraft Mission Capable rates are but one indicator of enhanced weapon system readiness. Programmed depot maintenance and fleet modernization activities are also critical to maintaining mission-ready aircraft. The Air Force strives to make continual improvements in business practices designed to increase the efficiency and effectiveness of our depot maintenance programs.

Financing the Fight

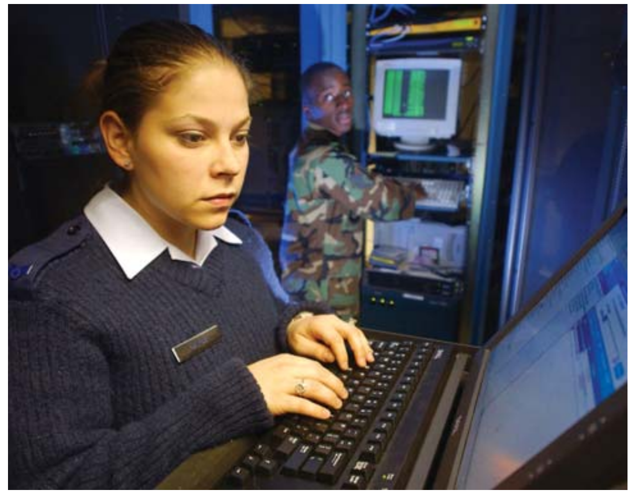
Financial Management Transformation

Air Force Financial Management (FM) envisions an Air Force operating at peak effectiveness and efficiency with every dollar striking the correct balance among supporting the mission, maintaining the infrastructure, and taking care of our people. We will achieve that vision by providing Air Force leaders with accurate, relevant, and timely information to make the right strategic choices while making existing operations more effective and efficient. In addition, we see Airmen resolving pay issues without a trip to Finance, with access to face-to-face support when needed.

In October 2003, we created a roadmap that translates the vision into concrete, actionable, and measurable steps. It integrates ongoing transformation initiatives into the strategy and communicates priorities, focuses efforts, and serves as a filter to help determine where to invest time, people, and resources.

The strategic goals outlined in the plan are:

1. Become a partner in strategic Air Force decisions.
2. Recruit, prepare, and retain a well-trained and highly educated professional team for today and tomorrow.



3. Make processes efficient and effective to produce accurate and relevant financial information complemented by sophisticated decision support.
4. Reduce our cost structure by employing leading-edge technologies that continuously streamline financial management processes and increase capabilities.
5. Provide our customers with world-class financial services.

Translating these goals into strategy led to three distinct strategic themes:

Warfighter Support: We will remain an expeditionary-focused workforce trained and prepared to support deployed forces.

Strategic Resourcing and Cost Management: We will link strategy to measurable improvements in effectiveness and efficiency.

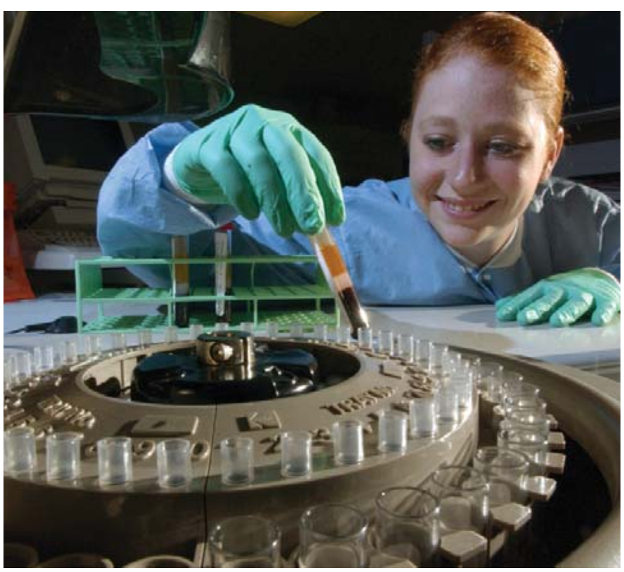
Information Reliability and Integration: We will provide relevant, timely, accurate, and reliable information to support decision-making.

FM Transformation is our catalyst to achieving the FM vision. In 2004, FM Transformation Initiatives resulted in:

Increasing funds available at base level by implementing new systems such has Wide Area Workflow and transforming processing of financial documents and oversight of transactions.

Improving customer services by increasing capabilities in MyPay and LeaveWeb systems. We also provided easier access to those systems by strategically deploying kiosks closer to where our customers work, eliminating wasted transient time between duty locations, and finance offices.

Supporting the deployed environment and delivering tools to the Combat Comptroller. Transformation initiatives in this arena reduced cycle time of financial transactions from days to hours by establishing a central processing site for deployed financial transactions. Transformation eliminated shipping and document storage while achieving near-real-time system input. In addition, we expanded the ATM system so our deployed forces have better access to manage banking needs. Finally, military paper check conversion processing and the eCASHTOOL Web site provide deployed financial managers with better financial tools to get their jobs done quickly and accurately



and significantly reduced loss of funds due to non-sufficient fund checks or closed accounts.

Strengthening partnerships among our community, personnel, logisticians, planners, programmers, and accounting services is a critical element of FM transformation. Effective collaboration among these groups is necessary as our processes, systems, and policies are integrated. Integrated transformation initiatives resulted in cross-functional re-engineering of processes, partnerships on pay and service delivery, and collaboration on a number of E-Gov initiatives.

Improving communications and learning within the FM Workforce continues to be a key transformational initiative of Air Force Financial Management. The FM Knowledge Management leverages web tools to share information, train the workforce, and share best practices—a key enabler to transforming our workforce into the next century.

Our transformation efforts don't stop there. We are focused on moving forward by prioritizing key initiatives and providing high-quality, less costly, customer-focused service delivery through use of the web and call center technology. We also want to continue providing relevant and reliable information, supporting decision making, and achieving unqualified audit opinions. We are working to promote cost and performance management, a government-wide goal of the President's Management Agenda, by incorporating activity costs into our business management systems, beginning with functional feeder systems and ultimately in an Air Force-wide cost accounting system. Finally, through performance-based budgeting we want to integrate strategy, performance, and metrics into the programming, budgeting, and execution process, targeting decisions that allow us to evaluate outcomes against established targets. Transforming financial management leads the way for the financial management community to continue to Finance the Fight!

Air Force Working Capital Fund

Air Force Materiel Command (AFMC) supports Air Force warfighters and operations via four major business areas that operate as revolving funds, i.e., providers charge users for the goods and services provided. AFMC accounts for

more than 95 percent of Working Capital Fund (WCF) revenue and expense activity (excluding the Transportation Working Capital Fund, which is managed by the United States Transportation Command). The WCF consists of three functions: Supply Management, Depot Maintenance, and Information Services. These functions, referred to as activity groups, supply singular goods and services to Air Force and DoD customers. Supply Management provides managers expedited repair, replenishment, and inventory control for spare parts and associated logistics support services to fulfill Air Force needs during war and peacetime. Depot Maintenance provides economical and responsive repair, overhaul, and modification of aircraft, missiles, engines, other major end items, and their associated components. The Information Services business area provides for the maintenance and development of automated information systems for information-related activities of the Air Force and DoD, along with certain other Government agencies.

WCFs allow the Air Force to accomplish the following:

- Ensure readiness through reduced support costs, stabilized rates, and customer service
- Provide flexibility to adjust customer support needs in response to real-world situtations
- Focus management attention on net results, including costs and performance
- Identify the total cost of providing support products and services
- Establish strong customer/provider relationships

Sustained Exceptional Logistics Support to the Warfighter

AFMC personnel consistently step forward showing their dedication toward a common goal—supporting the warfighter. Year after year, AFMC men and women diligently strive to ensure America's warfighters have the capabilities required to carry out the mission. Warfighter sustainment experts work around the clock to get mission-critical parts to our deployed people around the globe. The mindset is that there is nothing more important than those flying the mission, including those who keep the aircraft flying.

For the fourth straight year, the Air Force has shown improvement across major readiness indicators. The right application of management involvement was needed to produce these results, including direct shipments from vendors to warfighters and finding the fastest transportation routes. Aggressive work and coordination among AFMC, Air Mobility Command, and commercial carriers led to this success.

Supply Chain Managers (SCMs) continued to provide outstanding spares support to the warfighters across the board. Collaboration with upstream suppliers and the Defense Logistics Agency (DLA) drove significant reductions in Customer Wait Time (CWT), improving aircraft availability. Implementation of the Customer Oriented Leveling Technique (COLT) drove significant reductions in customer wait time for consumable spares to depot maintenance. COLT uses DLA data to optimally set consumable stock levels. Now deployed at all three AFMC depots, COLT is directly responsible for reducing CWT from a high of eight days in 2001 down to three days in 2004. Similar efforts for reparable items continued to reap improvements in other areas. In FY 2004, aircraft awaiting parts hit an all-time low of 1.7M hours, down from the FY 2000 level of 6.0M hours.

Improving mission capable rates for aircraft and engines was not the only way AFMC enhanced Air Force combat power. Since the end of FY 2000, Depot Maintenance has

increased the number of aircraft in the hands of the warfighter by reducing flowdays and improving on-time performance. Currently, on-time performance is at an all time high, meeting or exceeding schedule commitments more than 90 percent of the time, while maintaining high quality standards. More than 99 percent of our engines are produced defect-free and components average only three defects for every hundred produced. FY 2004 aircraft production was on target (445 produced of 445 scheduled). War Readiness Engine status is the best it's ever been. Most engine levels are at or above 100 percent. Depot Maintenance, in concert with the Supply Chain Managers, has worked to provide each of the operating commands with the required materiel so that mission accomplishment is guaranteed.

AFMC continues to be the premier Air Force Information Technology (IT) center that provides market-leading IT solutions that support our warfighters. During FY 2004, AFMC was able to upgrade a system to operate as a web-based asset visibility tool in a five-week period. This request revolutionized the way the Air Force and other military and civilian groups use the vast repository of supply and transformation data. To support our Security Forces, a mobile computing solution was developed which uses Personal Computing Assistants. Also, a Web-based Mission Capable Asset Sourcing System (WebMASS) was developed for our warfighters. This project was specifically designed to help deployed users work Mission Capable support in low bandwidth environments. It also allows the elimination of the requirement to deploy a specialist to establish Standard Base Supply System (SBSS) connectivity in the deployment environment.

AFMC people have risen to the challenges of supporting ongoing Global War on Terrorism operations as they continue to do for Operation Noble Eagle. Simply by doing the critical work of supply, maintenance, and logistics better and faster, AFMC dramatically improved support to Air Force warfighters.

Supply Management Activity Group

The Supply Management Activity Group (SMAG) provides policy, guidance, and resources to meet Air Force needs for spare parts. SMAG manages approximately two million items including weapon systems spare parts, medical/dental supplies and equipment, and items used for non-weapon systems applications. Materiel procured from vendors held in inventory is for sale to authorized customers.

SMAG consists of four divisions: the Materiel Support Division (MSD), General Support Division (GSD), Medical/Dental Division, and the United States Air Force Academy Cadet Issue Division. AFMC manages MSD and GSD. Headquarters United States Air Force manages the Medical/Dental Division and Air Force Academy Cadet Issue Division. Since the onset of FY 2002, Headquarters Defense Logistics Agency/Defense Energy Service Center assumed management of the Fuels Division.

MSD is responsible for Air Force-managed, depot-level reparable spare parts, and some consumable spares. The principal products of MSD are serviceable spare parts and assemblies unique to Air Force weapon systems.

The Retail Operations of the WCF are comprised of the General Support, Medical Dental, and United States Air Force Academy Divisions. Although each division operates independently, all purchase large quantities of commodities in order to sell small quantities directly to the ultimate consumer (supporting the warfighter). Large bulk buys allow the Air Force to take advantage of the economies of scale and achieve significant cost savings. Additionally, each division concentrates its efforts in a specific area of expertise.

The GSD items support installation maintenance and administrative functions, field and depot maintenance of aircraft and other systems. GSD supports more than 150 Air Force installations throughout the world.

The Surgeon General of the Air Force is responsible for the overall management of the Medical/Dental Division. This peacetime operating authority provides the effective support necessary to maintain established norms in the health

care of USAF active military, retirees, and family members. The war reserve materiel (WRM) requirement of this division is to provide medical supplies and equipment vital to support forces in combat and contingency operations.

The United States Air Force Academy Cadet Issue Division finances the purchase of uniforms, uniform accessories, and computers for sale to cadets. The division's customer base includes more than 4,000 cadets who receive distinctive uniforms procured from a number of domestic manufacturing contractors.

Customers, Products, and Services

In addition to the management of various inventories, the SMAG provides a wide range of logistics support services, including requirements forecasting, item introduction, cataloging, provisioning, procurement, repair, technical support, data management, item disposal, distribution management, and transportation. SMAG provides this support to a variety of customers. The supply business also provides initial provisioning support to the Air Force Acquisition Executive.

SMAG Transformation Initiatives

The SMAG is implementing a major redesign of the spares supply process through a set of initiatives designed to improve support to the warfighter. These initiatives will result in a fundamental reshaping of the internal management processes and data systems used on a daily basis to buy, repair, and distribute the thousands of different items needed to maintain weapon systems in a Mission Capable status. Five primary initiatives address key areas of opportunity within the spares process.

- Purchasing and Supply Chain Management (PSCM)—When implemented, PSCM will integrate purchasing and supply processes into a single end-to-end process that spans the Air Force supply system, reducing supply chain operating costs and improving warfighter readiness.

- Weapon System Supply Chain Management (WS SCM)—WS SCM utilizes the private sector and sister services best practice of creating a supply chain manager position that reports directly to the "CEO" or the Air Force equivalent, System Program Director (SPD). It integrates the weapon system supply chain to maximize spares support to achieve weapon system availability.

- Logistics Enterprise Architecture (LOGEA)—LOGEA is an initiative to develop a single authoritative strategic map of future Logistics business practices, systems, and organizations. It is a single authoritative source that defines operating and systems models, aligns business and IT initiatives, and provides a vehicle to ensure transformation coordination across the Air Force and outside the Air Force.

- Advanced Planning System (APS)—APS aims to improve the process of translating warfighter needs into executable logistics system support plans and schedules. By emphasizing collaboration with customers and suppliers, it seeks to optimize activities and resources across the Air Force supply chain.

- FY 2004 Metrics Way Ahead—HQ AFMC/LG recognizes Aircraft Availability (AA) as the organizational focus and is implementing a new approach to the FY 2004 Supply Performance Metrics. Metrics that show a high correlation to AA, known as Performance Measures, will be formally reported. These measures include Mission Capable hours and CWT.

Customer Support Performance Measures

Mission Capable hours and CWT allow managers to assess quality of spares support provided and plan corrective action when needed. Mission Capable hours are accrued in a given month for items affecting mission capability that are on backorder. For every day during the month the requisition is unfilled, 24 hours are assigned to the requisition. CWT measures the average time elapsed between issuance of a customer order and satisfaction of that order, including the wait time between the retail supply issue and delivery to the base customer—expressed in days.

Financial performance measures

SMAG measures financial performance based on the Net Operating Result (NOR) for MSD and GSD. The NOR is the difference between revenue and expenses, i.e., a bottom-line profit and loss indicator. The NOR objective of an activity group is to break even over a two-year budget cycle. Setting rates that effectively offset the prior year net profit or loss accomplishes this objective. Revenues are amounts earned as a result of normal operations and usually result from sale of, or reimbursements for, goods and services provided to DoD activities, other federal government agencies, and the public. Expenses are the use of resources during an accounting period in carrying out the DoD's mission. They occur from rendering services, delivering or producing goods, or carrying out other mission related activities and relate to normal operating activities. Also used is Unit Cost Target (UCT), a limitation imposed by the Office of the Under Secretary of Defense (Comptroller) on the annual operating budget (AOB), restricting obligations to a percentage of gross sales. The AOB is the funding document providing the authority to incur costs. The UCT is determined by dividing costs by sales. A definition for costs is an obligation (excluding initial and capital expenses) and credit returns.

Depot Maintenance Activity Group

The Depot Maintenance Activity Group (DMAG) repairs systems and spare parts which support the warfighter in peacetime and provide sustainment to combat forces in wartime. In peacetime, DMAG enhances readiness by efficiently and economically repairing, overhauling, and modifying aircraft, engines, missiles, components, and software to meet the warfighter demands. During wartime or contingencies, the group shifts to surge repair operations and realigns capacity to support the warfighter's immediate needs.

Customers, Products, and Services

DMAG provides major overhaul and repair of systems and spare parts while striving to meet or exceed required standards for quality, timeliness, and cost. Both the AFMC depots and contract operations accomplish these goals.

Depot maintenance supports a variety of customers including the Air Force Major Commands, Air National Guard (ANG), Air Force Reserve Command (AFRC), SMAG, and other customers. In addition to supporting the warfighter with depot level repair of weapon systems, DMAG provides storage, reclamation, and regeneration for equipment not currently used by the active forces of all military services. This work is done at the Aerospace Maintenance and Regeneration Center at Davis-Monthan AFB, Arizona. Contract depot maintenance is transitioning to be financed directly by the using commands, the Supply Management Activity Group, and other customers.

The DMAG has two principal objectives. The first objective is to provide organic depot repair capability for fielded and emerging weapon systems, so that warfighters have the mission-essential equipment. Secondly, DMAG's intent is to ensure the ability to rapidly respond to those warfighter requirements driven by contingency operations. To accomplish this, short and long term strategies must be used. The depot maintenance strategic plan guides the DMAG to have the right workload capacity and capability to meet depot maintenance: (a) peacetime support, (b) surge, and (c) core requirements.

To better support the services that DMAG provides to its customers, an integrated suite of systems, Depot Maintenance Accounting and Production Systems (DMAPS), provides improved financial, production and material functionality in support of the warfighter's needs for quality organic depot maintenance. This includes improved financial management and reporting for organic depot maintenance activities, including substantial compliance with legislative requirements, such as the Chief Financial Officers (CFO) Act. The DMAPS suite of systems became fully functional in FY 2004.



Transformation Initiatives

The future financials framework being developed through the Air Force logistics transformation effort will be a centrally-managed approach for both provider (AFMC) and customer (MAJCOMs) funds, utilizing the WCF financing mechanism to enhance cost awareness and provide flexibility. On the provider side, the MSD and DMAG financial management operations will be merged focusing on cost and output. In this simplified structure, MSD and DMAG will no longer recursively pass costs between each other through sales prior to establishing a price to the ultimate customer.

The Depot Maintenance Reengineering and Transformation (DMRT) initiatives include improvements to the budgeting process. This is to be accomplished in part by using predictive modeling and statistical techniques to develop portions of the budgets. The model will also consider a reduction of manual effort currently required to prepare the workload baseline for the budgets.

Customer Support Performance Measures

Customer Support Performance Measures for DMAG consist primarily of Production Performance Measures which are used to assess cost, schedule, and quality of the DMAG output. These are designed to achieve accountability at the appropriate depot maintenance level, the Depot Maintenance Manager. Customer Support Performance Measures monitor progress toward DMAG goals.

DMAG produced aircraft in a more time-responsive manner and at a cost below the targeted amount. The Due Date Performance (ability of the depot to produce aircraft according to schedule) improved significantly compared to a year ago and reached a command high of 93% (3% above goal) in May of 2004. The depot performance of Air Logistics Centers (ALCs) continues to have a direct impact on the warfighter's ability to meet worldwide missions.

Financial Performance Measures

Financial Performance Indicators assess the financial performance of the DMAG. These indicators are designed to achieve accountability at the appropriate level and also measure compliance with DMAG budget objectives. An aggressive cost management focus has improved DMAG's ability to achieve a target Net Operating Result (NOR)—a key budget objective. This will help to minimize growth in future sales rates.

Information Services Activity Group

Information Services Activity Group (ISAG) provides technological support for 250 information systems, from development of leading-edge technologies to the maintenance and modification of older legacy systems. ISAG offers comprehensive support to its customers, including the development, maintenance, integration, and sustainment of combat support information systems.

ISAG was established to develop and maintain automated information systems for the Air Force, DoD, and other Government agencies. Two Air Force entities act as one information technology provider activity under the command of the Air Force Materiel Command, Electronic Systems Center (ESC), at Hanscom Air Force Base (AFB), Massachusetts. The two entities are the Materiel Systems Group (MSG), located at Wright-Patterson AFB, Ohio, and the Standard Systems Group (SSG) located at Maxwell AFB-Gunter Annex, Alabama.

Customers, Products, and Services

ISAG provides information products and services via two business lines—the IT solutions line (rate based) and the commercial information technology (surcharge) line.

The IT solutions business line develops, acquires, and sustains automated information systems in two target markets: 1) AFMC-level supply management and depot maintenance information systems, and 2) Air Force-wide, standardized support systems. This includes a 24-hour, seven-day help desk for customers to call for hardware and software support. The ISAG provides service based on service-level agreements (SLAs) with known customers which specify how many direct billable hours of service per year will be sold to the customer and at what cost per billable hour.

The commercial information technology business line provides computer hardware, software, peripheral equipment, and related services to the Department of the Air Force, other agencies including DoD, and private parties (as authorized by law) through its web-based "Virtual Superstore" called "AFWay." A small surcharge is embedded into the price of the items, on equipment, and services sold. Thousands of customers across the Air Force and DoD enjoy one-stop shopping from the on-line catalog of computer and computer-related products and services.

ISAG Transformation Initiatives

In response to changes in Air Force structure and operations, technology, and customer needs, and to take better advantage of industry core competencies, the ISAG is reshaping itself to meet future information technology requirements for the warfighter. The end result is an organization that is more net-centric, building an object-oriented skills base, and concentrating on architecture, integration, and independent testing to assure top performance and interoperability in the systems deployed to our warfighters. One key in this reshaping involves releasing military positions to be used in other warfighting roles as well as partnering with industry providers for the development of systems while leveraging our unparalleled acquisition and engineering expertise.

Customer Support Performance Measures

The current method of measuring ISAG financial performance is by the NOR, the difference between revenue and expenses. Revenue is earned through the sale of direct billable labor hours at the ISAG composite rate, direct reimbursements for pass-through contract efforts and extraordinary expenses (e.g., mission-unique travel, equipment, and supplies), and the collection of commercial information technology surcharges. Expenses (costs of operations) measure the resources consumed in filling customer orders. These costs include labor and non-labor expenses, both direct and overhead.

Cash Management

DoD cash management policy recommends maintaining the minimum cash balance necessary to meet both operational requirements and disbursements in support of the capital program. Cash generated from operations is the primary means of maintaining adequate cash levels.

Effective cash management is directly dependent on the availability of accurate and timely data on cash levels and operational results. Cash levels should be maintained to cover at least 7 to 10 days of operational costs as well as cash adequate to meet six months of capital disbursements.

Cash management efforts continue to focus on analyzing data and developing tools to identify changes in cash and forecast future needs for cash. Monthly, AFMC prepares a statement of sources and uses of cash, which is used to identify areas of cash increases and drains and to monitor performance to the recommended policy. Our continued focus on cash management has led to improved balances in FY 2004.

Fiscal Year 2004
Annual Financial Statements

Limitations of the Financial Statements

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

While the statements have been prepared from the books and records of the entity, in accordance with the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

To the extent possible, the financial statements have been prepared in accordance with federal accounting standards. At times, the Department is unable to implement all elements of the standards due to financial management systems limitations. The Department continues to implement system improvements to address these limitations. There are other instances when the Department's application of the accounting standards is different from the auditor's application of the standards. In those situations, the Department has reviewed the intent of the standard and applied it in a manner that management believes fulfills that intent.

The statements should be read with the realization that they are for a component of the United States Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation that provides resources to do so.

The Federal Accounting Standards Advisory Board (FASAB) amended the Statement of Federal Financial Accounting Standard No. 6 to require the capitalization and depreciation of military equipment (formerly known as National Defense Property, Plant and Equipment) for fiscal years (FY) 2004 and beyond, and encouraged early implementation. Accordingly, the Department began the process of developing and reporting values for these assets in notes to the Balance Sheet, beginning in FY 2003.

General Fund

Principal Statements

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Consolidated Balance Sheet—General Fund

As of September 30, 2004 and 2003 ($ in Thousands)

	2004 Consolidated	2003 Consolidated
1. ASSETS (Note 2)		
A. Intra-governmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	$ 60,547,709	$ 59,714,038
b. Non-Entity Seized Iraqi Cash	0	0
c. Non-Entity-Other	53,290	52,503
2. Investments (Note 4)	711	712
3. Accounts Receivable (Note 5)	689,871	541,429
4. Other Assets (Note 6)	443,939	339,093
5. Total Intra-governmental Assets	$ 61,735,520	$ 60,647,775
B. Cash and Other Monetary Assets (Note 7)	$ 311,323	$ 147,926
C. Accounts Receivable (Note 5)	978,883	772,500
D. Loans Receivable (Note 8)	0	772,500
E. Inventory and Related Property (Note 9)	51,340,248	51,815,831
F. General Property, Plant and Equipment (Note 10)	117,954,430	112,786,130
G. Investments (Note 4)	0	0
H. Other Assets (Note 6)	10,809,588	9,912,151
2. TOTAL ASSETS	$ 243,129,992	$ 236,082,313
3. LIABILITIES (Note 11)		
A. Intra-governmental:		
1. Accounts Payable (Note 12)	$ 1,900,411	$ 1,413,940
2. Debt (Note 13)	0	0
3. Environmental Liabilities (Note 14)	0	0
4. Other Liabilities (Note 15 and Note 16)	1,726,480	1,623,905
5. Total Intra-governmental Liabilities	$ 3,626,891	$ 3,037,845
B. Accounts Payable (Note 12)	$ 7,707,163	$ 7,080,909
C. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,163,442	1,262,267
D. Environmental Liabilities (Note 14)	7,387,187	8,110,403
E. Loan Guarantee Liability (Note 8)	0	0
F. Other Liabilities (Note 15 and Note 16)	4,602,505	4,520,888
G. Debt Held by Public	0	0
4. TOTAL LIABILITIES	$ 24,487,188	$ 24,012,312
5. NET POSITION		
A. Unexpended Appropriations (Note 18)	$ 49,660,670	$ 50,742,317
B. Cumulative Results of Operations	168,982,134	161,327,684
6. TOTAL NET POSITION	$ 218,642,804	$ 212,070,001
7. TOTAL LIABILITIES AND NET POSITION	$ 243,129,992	$ 236,082,313

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

Consolidated Statement of Net Cost—General Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

		2004 Consolidated		2003 Consolidated
1. Program Costs				
A. Intra-governmental Gross Costs		28,909,864		26,846,664
B. (Less: Intra-governmental Earned Revenue)		-5,002,246		-3,986,411
C. Intra-governmental Net Costs	$	23,907,618	$	22,860,253
D. Gross Costs With the Public		96,505,988		99,803,267
E. (Less: Earned Revenue From the Public)		-1,724,336		-836,158
F. Net Costs With the Public	$	94,781,652	$	98,967,109
G. Total Net Cost	$	118,689,270	$	121,827,362
2. Cost Not Assigned to Programs		0		0
3. (Less: Earned Revenue Not Attributable to Programs)		0		0
4. Net Cost of Operations	$	118,689,270	$	121,827,362

The accompanying notes are an integral part of the financial statements. See notes 1 and 19.

Consolidated Statement of Changes in Net Position—General Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	2004 Consolidated	2003 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
1. Beginning Balances	$ 161,327,684	$ 47,443,218
2. Prior Period Adjustments (+/-)		
2.A. Prior Period Adjustments - Restated (+/-)	0	0
2.B. Beginning Balance, Restated	161,327,684	47,443,218
2.C. Prior Period Adjustments - Not Restated (+/-)	0	122,475,076
3. Beginning Balances, as adjusted	161,327,684	169,918,294
4. Budgetary Financing Sources:		
4.A. Appropriations received	0	0
4.B. Appropriations transferred-in/out (+/-)	0	0
4.C. Other adjustments (rescissions, etc) (+/-)	0	0
4.D. Appropriations used	124,686,986	113,384,126
4.E. Nonexchange revenue	8,827	0
4.F. Donations and forfeitures of cash and cash equivalents	2,171	9,096
4.G. Transfers-in/out without reimbursement (+/-)	671,000	0
4.H. Other budgetary financing sources (+/-)	0	-678,772
5. Other Financing Sources:		
5.A. Donations and forfeitures of property	0	0
5.B. Transfers-in/out without reimbursement (+/-)	311,130	-110,688
5.C. Imputed financing from costs absorbed by others	663,607	632,992
5.D. Other (+/-)	0	0
6. Total Financing Sources	126,343,721	113,236,754
7. Net Cost of Operations (+/-)	118,689,270	121,827,362
8. Ending Balances	$ 168,982,135	$ 161,327,686
UNEXPENDED APPROPRIATIONS		
1. Beginning Balances	$ 50,742,317	$ 39,543,850
2. Prior Period Adjustments (+/-)		
2.A. Prior Period Adjustments - Restated (+/-)	0	0
2.B. Beginning Balance, Restated	50,742,317	39,543,850
2.C. Prior Period Adjustments - Not Restated (+/-)	0	0
3. Beginning Balances, as adjusted	50,742,317	39,543,850
4. Budgetary Financing Sources:		
4.A. Appropriations received	125,480,665	124,225,931
4.B. Appropriations transferred-in/out (+/-)	-454,456	2,179,806
4.C. Other adjustments (rescissions, etc) (+/-)	-1,420,870	-1,823,145
4.D. Appropriations used	-124,686,986	-113,384,126
4.E. Nonexchange revenue	0	0
4.F. Donations and forfeitures of cash and cash equivalents	0	0
4.G. Transfers-in/out without reimbursement (+/-)	0	0
4.H. Other budgetary financing sources (+/-)	0	0
5. Other Financing Sources:		
5.A. Donations and forfeitures of property	0	0
5.B. Transfers-in/out without reimbursement (+/-)	0	0
5.C. Imputed financing from costs absorbed by others	0	0
5.D. Other (+/-)	0	0
6. Total Financing Sources	-1,081,647	11,198,466
7. Net Cost of Operations (+/-)		
8. Ending Balances	$ 49,660,670	$ 50,742,316

The accompanying notes are an integral part of the financial statements. See notes 1 and 20.

Combined Statement of Bugetary Resources—General Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	2004 Combined	2003 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
1. Budget Authority:		
1a. Appropriations received	$ 125,483,786	$ 124,235,723
1b. Borrowing authority	0	0
1c. Contract authority	0	0
1d. Net transfers (+/-)	-29,394	1,888,215
1e. Other	0	0
2. Unobligated balance:		
2a. Beginning of period	9,189,946	6,066,510
2b. Net transfers, actual (+/-)	245,938	291,591
2c. Anticipated Transfers Balances	0	0
3. Spending authority from offsetting collections:		
3a. Earned	0	0
1. Collected	8,117,605	7,802,547
2. Receivable from Federal sources	317,565	-322,918
3b. Change in unfilled customer orders	0	0
1. Advance received	188,072	213,465
2. Without advance from Federal sources	-109,981	472,167
3c. Anticipated for the rest of year, without advances	0	0
3d. Transfers from trust funds	0	0
3e. Subtotal	8,513,261	8,165,261
4. Recoveries of prior year obligations	1,431,079	1,955,959
5. Temporarily not available pursuant to Public Law	0	0
6. Permanently not available	-1,437,653	-1,806,362
7. Total Budgetary Resources	$ 143,396,963	$ 140,796,897
STATUS OF BUDGETARY RESOURCES		
8. Obligations incurred:		
8a. Direct	$ 129,913,273	$ 123,375,566
8b. Reimbursable	4,447,386	8,231,386
8c. Subtotal	134,360,659	131,606,952
9. Unobligated balance:		
9a. Apportioned	8,072,566	8,320,595
9b. Exempt from apportionment	2,709	2,573
9c. Other available	-1	-1
10. Unobligated Balances Not Available	961,030	866,778
11. Total, Status of Budgetary Resources	$ 143,396,963	$ 140,796,897
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
12. Obligated Balance, Net - beginning of period	$ 50,541,583	$ 41,822,195
13. Obligated Balance transferred, net (+/-)	0	0
14. Obligated Balance, Net - end of period:		
14a. Accounts receivable	-1,476,612	-1,159,047
14b. Unfilled customer order from Federal sources	-827,393	-937,374
14c. Undelivered orders	42,309,792	42,168,646
14d. Accounts payable	11,505,411	10,469,360
15. Outlays:		
15a. Disbursements	131,752,381	120,782,356
15b. Collections	-8,305,678	-8,016,013
15c. Subtotal	123,446,703	112,766,343
16. Less: Offsetting receipts	-115,376	-156,704
17. Net Outlays	$ 123,331,327	$ 112,609,639

The accompanying notes are an integral part of the financial statements. See notes 1 and 21.

Combined Statement of Financing—General Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	2004 Combined	2003 Combined
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ 134,360,658	$ 131,606,952
2. Less: Spending authority from offsetting collections and recoveries (-)	-9,944,341	-10,121,221
3. Obligations net of offsetting collections and recoveries	124,416,317	121,485,731
4. Less: Offsetting receipts (-)	-115,376	-156,704
5. Net obligations	124,300,941	121,329,027
Other Resources		
6. Donations and forfeitures of property	0	0
7. Transfers in/out without reimbursement (+/-)	311,130	-110,688
8. Imputed financing from costs absorbed by others	663,607	632,992
9. Other (+/-)	0	0
10. Net other resources used to finance activities	974,737	522,304
11. Total resources used to finance activities	125,275,678	121,851,331
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 (-)	201,266	-8,331,143
12b. Unfilled Customer Orders	78,091	685,633
13. Resources that fund expenses recognized in prior periods	-896,088	0
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	115,376	9,106
15. Resources that finance the acquisition of assets	-16,068,394	-19,120,713
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 (-)	0	0
16b. Other (+/-)	-311,130	110,688
17. Total resources used to finance items not part of the net cost of operations	-16,880,879	-26,646,429
18. Total resources used to finance the net cost of operations	108,394,799	95,204,902
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	137,700	478,344
20. Increase in environmental and disposal liability	0	-344,161
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
22. Increase in exchange revenue receivable from the the public (-)	0	0
23. Other (+/-)	53,205	14,770
24. Total components of Net Cost of Operations that will require or generate resources in future periods	190,905	148,953
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	9,847,705	13,282,864
26. Revaluation of assets or liabilities (+/-)	-938,081	1,641,043
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0	0
27b. Cost of Goods Sold	0	0
27c. Operating Material & Supplies Used	3,919,002	0
27d. Other	-2,725,063	11,549,603
28. Total components of Net Cost of Operations that will not require or generate resources	10,103,563	26,473,510
29. Total components of net cost of operations that will not require or generate resources in the current period	10,294,468	26,622,463
30. Net Cost of Operations	118,689,267	121,827,365

The accompanying notes are an integral part of the financial statements. See notes 1 and 22.

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General Fund

Footnotes to the Principal Statements

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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 the Air Force, as required by the "Chief Financial Officers (CFO) Act of 1990," expanded by the "Government Management Reform Act (GMRA) of 1994," and other appropriate legislation. The financial statements have been prepared from the books and records of the Air Force in accordance with the "Department of Defense (DoD) Financial Management Regulation," the Office of Management and Budget (OMB) Bulletin No. 01-09, "Form and Content of Agency Financial Statements," and, to the extent possible, Federal generally accepted accounting principles (Federal GAAP). The accompanying financial statements account for all resources for which the Air Force is responsible, although information relative to classified assets, programs, and operations has been either excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified. The Air Force's financial statements are in addition to the financial reports prepared by the Air Force pursuant to OMB directives that are used to monitor and control the Air Force's use of budgetary resources.

The Air Force is unable to implement fully all elements of Federal GAAP and OMB Bulletin No. 01-09 due to limitations in its financial and nonfinancial processes and feeder systems. Reported values and information for the Air Force's major asset and liability categories are derived largely from nonfinancial feeder systems, such as inventory and logistics systems. These systems were designed to support reporting requirements that focussed on maintaining accountability over assets and on reporting the status of federal appropriations rather than on preparing financial statements in accordance with Federal GAAP. As a result, the Air Force currently cannot implement every aspect of Federal GAAP and OMB Bulletin No. 01-09. The Air Force continues to implement process and system improvements that address the limitations of its financial and nonfinancial feeder systems.

In addition, the Air Force needs to improve documentation, user access, separation of duty, and oversight controls over the travel pay process. Also, the Air Force continues to enter a material number of unsupported accounting entries because financial and non-financial feeder systems continue to lack sufficient customer-identification information to accurately process eliminations. This issue was disclosed in the DoD Agency-wide Note 1 and is addressed in the Air Force's plan to obtain a favorable opinion by FY 2007.

A more detailed explanation of these financial statement elements is provided in the applicable note.

1.B. Mission of the Reporting Entity

The United States Air Force was created on September 18, 1947, by the National Security Act of 1947. The National Security Act Amendments of 1949 established the DoD and made the Air Force a department within the DoD. The overall mission of the Air Force is to defend the United States through control and exploitation of air and space.

The Air Force incorporates internal controls, reconciliations, management by exception reports, and other management-control information into its accounting systems. When possible, the financial statements are presented on the accrual basis of accounting, as required by federal accounting standards.

The accounts used to prepare the financial statements are categorized as either entity or non-entity. Entity accounts consist of resources that are available for use in the operations of the entity. The Air Force is authorized to decide how to use resources in entity accounts or may be legally obligated to use these resources to meet entity obligations. Non-entity accounts, on the other hand, consist of assets that are held by an entity but that are not available for use in the operations of the entity.

Following is a list of Air Force account numbers and titles (all accounts are entity accounts unless otherwise noted):

Air Force Account Number	Title
57 * 0704	Military Family Housing (O&M and Construction), Air Force
57 * 0740	Military Family Housing (Construction), Air Force
57 * 0745	Military Family Housing (O&M), Air Force
57 * 0810	Environmental Restoration, Air Force
57 * 1999	Unclassified Receipts and Expenditures, Air Force
57 * 3010	Aircraft Procurement, Air Force
57 * 3011	Procurement of Ammunition, Air Force
57 * 3020	Missile Procurement, Air Force
57 * 3080	Other Procurement, Air Force
57 * 3300	Military Construction, Air Force
57 * 3400	Operation and Maintenance (O&M), Air Force
57 * 3500	Military Personnel, Air Force
57 * 3600	Research, Development, Testing, and Evaluation (RDT&E), AF
57 * 3700	Personnel, Air Force Reserve
57 * 3730	Military Construction, Air Force Reserve
57 * 3740	Operation and Maintenance (O&M), Air Force Reserve
57 * 3830	Military Construction, Air National Guard
57 * 3840	Operation and Maintenance (O&M), Air National Guard
57 * 3850	Personnel, Air National Guard
57 X 5095	Wildlife Conservation, etc., Military Reservations, Air Force
57 X 8418	Air Force Cadet Fund
57 X 8928	Air Force General Gift Fund
57 * 3XXX	Budget Clearing Accounts
57 * 6XXX (Non-entity)	Deposit Fund Accounts

1.C. Appropriations and Funds

The Air Force's appropriations and funds are used to fund and to report how resources have been used in the course of executing the Air Force's missions. The Air Force's appropriations and funds are divided into the following categories:

- General funds are used for financial transactions arising under congressional appropriations and include personnel, oper ation and maintenance, research and development, procurement, and construction accounts.
- Working Capital Fund (revolving fund) activities are reported in a separate set of audited financial statements and related footnotes.
- Trust funds represent the receipt and expenditure of funds held in trust by the Air Force for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.
- Special funds account for Air Force receipts earmarked for specific purposes.

- Deposit funds are generally used to (1) account for unidentified remittances, or (2) hold assets for which the Air Force is acting as an agent or a custodian or whose distribution is awaiting legal determination.

1.D. Basis of Accounting

The Air Force generally records transactions on a budgetary basis and not an accrual accounting basis as is required by Federal GAAP. For FY 2004, the Air Force's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Air Force's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of Federal GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by Federal GAAP.

The Air Force has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with all elements of Federal GAAP. One such action is the current revision of the Air Force's accounting systems to record transactions based on the United States Government Standard General Ledger (USSGL).

Until all of the Air Force's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by Federal GAAP, some of Air Force's financial data will be based on budgetary transactions (obligations, disbursements, and collections) and nonfinancial feeder systems and then be adjusted for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities. For example, much of the data on the Statement of Net Cost (SoNC) is based on obligations and disbursements and may not represent all accrued costs. However, when possible, the Air Force's financial statements are presented on the accrual basis of accounting as required.

In addition, the Air Force identifies programs based upon the major appropriation groups provided by Congress. The Air Force is reviewing available data and attempting to develop a cost-reporting methodology that balances the need for cost information as required by 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

Financing sources for general funds are primarily provided through congressional appropriations received on both an annual and a multi-year basis. When authorized, these appropriations are supplemented by revenues generated by sales of goods or services through a reimbursable order process. The Air Force recognizes revenue as a result of costs incurred or services performed on behalf of other federal agencies and the public. Revenue is recognized when earned under the reimbursable order process.

The Air Force does not include non-monetary support provided by U.S. Allies for common defense and mutual security in its list of other financing sources that appears in the Statement of Financing. Agreements between the U.S. and some foreign countries include both direct and indirect sharing of the costs that each country incurs in support of the same general purpose. Examples of such countries include those that have a mutual or reciprocal defense agreement with the U.S. and those where U.S. troops are stationed or the U.S. fleet is serviced. The DoD is reviewing this type of financing and cost reduction in order to establish accounting policies and procedures to identify which, if any, of these costs are appropriate for disclosure in the DoD and Air Force financial statements in accordance with Federal GAAP. Recognition of support provided by host nations would affect both financing sources and recognition of expenses.

1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses during the period in which they were incurred. However, because the Air Force's financial and nonfinancial 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, and environmental liabilities. Expenditures for capital and other long-term assets are not recognized as expenses in the Air Force's operations until depreciated, in the case of Property, Plant, and Equipment (PP&E), or consumed, in the case of Operating Materials and Supplies (OM&S). Net increases or decreases in unexpended appropriations are recognized as constituting a change in the net position. Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made.

Operating expenses were adjusted as a result of the elimination of balances between DoD Components. See Note 19.I, Intra-governmental Expenses and Revenue, for disclosure of adjustment amounts.

1.G. Accounting for Intra-governmental Activities

The Air Force, as an agency of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial transactions applicable to the Air Force as though the agency were a stand-alone entity.

The Air Force's proportionate share of public debt and related expenses of the federal government are not included in the financial statements. Debt issued by the federal government and the related costs are not apportioned to federal agencies. The Air Force's financial statements, therefore, do not report any portion of the 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 budget 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.

The Air Force's civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), while military personnel are covered by the Military Retirement System (MRS). The Air Force funds a portion of the civilian and military pensions. Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. Reporting civilian pensions under CSRS and FERS retirement systems is the responsibility of the Office of Personnel Management (OPM). The Air Force recognizes an imputed expense for the portion of civilian employee pensions and other retirement benefits funded by the OPM in the SoNC and recognizes corresponding imputed revenue from the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

To prepare reliable financial statements, transactions occurring between components or activities within the Air Force must be eliminated. However, the Air Force, as well as the rest of the federal government, cannot accurately identify all intra-governmental transactions by customer. The Defense Finance and Accounting Service (DFAS) is responsible for eliminating transactions between components or activities of the Air Force. Since FY 1999, seller entities within the DoD have provided 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 have been adjusted to recognize unrecorded costs and accounts payable. Intra-Air Force balances were then eliminated.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the DoD and other federal agencies. In September 2000, the FMS issued the "Federal Intra-governmental Transactions Accounting Policies and Procedures Guide." The DoD was not able to fully implement the policies and procedures in this guide related to reconciling intra-governmental assets, liabilities, revenues, and expenses for nonfiduciary transactions. The Air Force, however, was able to implement the policies and procedures contained in the "Intra-governmental Fiduciary Transactions Accounting Guide," as updated by the "Federal Intra-governmental Transactions Accounting Policies and Procedures Guide" (October 2002) for reconciling intra-governmental transactions. These transactions include or pertain 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, and benefit program transactions with the OPM.

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 DoD has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit to the U.S. Government. Customers may be required to make payments in advance.

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

The Air Force's financial resources are maintained in U.S. Treasury accounts. The majority of cash collections, disbursements, and adjustments are processed worldwide at the DFAS, Military Services, and the United States Army Corps of Engineers (USACE) disbursing stations, as well as at the Department of State financial service centers. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers, and deposits.

In addition, the DFAS sites and USACE Finance Center submit reports to the Department of the Treasury, providing information at the appropriation level 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 maintained in the Treasury's system. Differences between the Air Force's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled. Material disclosures are provided at Note 3. Also disclosed at Note 3 are differences between accounting offices' detail-level records and Treasury's FBWT accounts - specifically, differences caused by in-transit disbursements and unmatched disbursements (where the specific disbursement has not been recorded in the appropriate accounting offices' detail-level records).

1.J. Foreign Currency

The Air Force conducts a significant portion of its operations overseas. The Congress established a special account to handle gains and losses from foreign currency transactions for the following five general fund appropriations: O&M, military personnel, military construction, family housing operation and maintenance, and family housing construction. Gains and losses are computed as the variance between the exchange rate current 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 adjustment to the original obligation amount at the time of payment. These currency fluctuations are not identified separately. See Note 7 for material disclosures.

1.K. Accounts Receivable

As presented in the balance sheet statement, accounts receivable include 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 DoD 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. See Note 5 for material disclosures.

1.L. Loans Receivable. As Applicable

Not applicable.

1.M. Inventories and Related Property

Effective October 1, 2002, Statement of Federal Financial Accounting Standards No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," revises accounting principles for military equipment (previously referred to as National Defense Property, Plant, and Equipment). This standard renames National Defense PP&E to military equipment, classifies military equipment as general property, plant, and equipment, and requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. Likewise, military equipment (previously referred to as National PP&E) also includes items which are now classified as Operating Materials and Supplies (OM&S).

Implementation of the new accounting principles requires the adjustment of the October 1, 2002, OM&S balance to recognize the investment, accumulated depreciation, and net book value of military equipment that previously had been expensed. This adjustment is discussed further in Note 9.

The related property portion of the amount reported on the Inventory and Related Property line includes OM&S. The OM&S are reported at approximate historical cost using Standard Price (SP). The Air Force uses the SP method because its OM&S systems were designed for material management rather than for accounting. The systems provide accountability and visibility over inventory items. They do not maintain the historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Neither can they directly produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). The DoD is transitioning to a Moving Average Cost methodology for valuing inventory that, when fully implemented, will allow the Air Force to comply with SFFAS No. 3.

SFFAS No. 3 distinguishes between "inventory held for use" and "inventory held in reserve for future use." There is no management or valuation difference between the two USSGL accounts. Further, the DoD manages only military or government-specific material under normal conditions. Items commonly used in and available from the commercial sector are not managed in DoD material-management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The DoD holds material based on military need and support for contingencies. Therefore, the Air Force does not attempt to account separately for items held for current or future use.

Related property includes OM&S and stockpile materials. The OM&S, including munitions not held for use, are valued at SP. Ammunition and munitions are treated as OM&S. In general, the Air Force uses the consumption method of accounting for OM&S, expensing material when it is issued to the end user.

In FY 2002, the DoD implemented a new policy to account for condemned material (only) as Excess, Obsolete, and Unserviceable. The net value of condemned material is zero because the costs of disposal are greater than the potential scrap value. Material that can be potentially redistributed (presented in previous years as Excess, Obsolete, and Unserviceable) is included in the Held for Use or Held for Repair categories, according to its condition.

In addition, past audit results identified uncertainties about the completeness and existence of quantities used to produce the reported values. Material disclosures related to inventory and related property are provided at Note 9.

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

Investments in U.S. Treasury securities are reported at cost, determined as the net of unamortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment, using the effective interest rate method or other method if similar results are obtained. The Air Force's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, provision is not made for unrealized gains or losses on these securities. Related earnings are allocated to appropriate Air Force activities to be used in accordance with the directions of the donor. See Note 4 for material disclosures.

The Air Force invests in both marketable and nonmarketable securities. Marketable securities are investments trading on a public market. The two types of nonmarketable securities are par value and market-based intra-governmental securities. The Bureau of Public Debt issues nonmarketable, par value intra-governmental securities. Nonmarketable, market-based intra-governmental securities mimic marketable securities but are not traded publicly. See Note 4 for material disclosures.

1.O. General Property, Plant, and Equipment

Effective October 1, 2002, Statement of Federal Financial Accounting Standards No. 23, Eliminating the Category National Defense Property, Plant, and Equipment, revises accounting principles for military equipment (previously referred to as National Defense Property, Plant, and Equipment). This standard renames National Defense Property, Plant, and Equipment to military equipment, classifies military equipment as general property, plant, and equipment, and requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades.

Before this change in accounting principles, the acquisition costs for military equipment were classified as National Defense PP&E and were expensed in the period incurred. Implementation of this new accounting principle required the DoD to adjust the October 1, 2002, General PP&E balance to recognize the investment, accumulated depreciation, and net book value of military equipment that previously had been expensed. As discussed further in Note 10, General PP&E, the adjustment was based on data provided by the Bureau of Economic Analysis at the Department of Commerce.

General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the DoD capitalization threshold of $100,000. Also, improvement costs over the DoD capitalization threshold of $100,000 for General PP&E are required to be capitalized. All General PP&E assets, other than land, are depreciated on a straight-line basis. Land is not depreciated.

When it is in the best interest of the government, the Air Force provides contractors with government property necessary to complete contract work. The Air Force owns or leases this property, or the contractor purchases the property directly for the government under the terms of the contract. When the value of contractor-procured General PP&E exceeds the DoD capitalization threshold, such PP&E must be included in the value of General PP&E reported on the Air Force's balance sheet. The DoD is developing new policies and a contractor-reporting process that will provide appropriate General PP&E information for future financial statement purposes. Accordingly, the Air Force currently reports only government property in the possession of contractors maintained in the Air Force real property systems.

To bring the Air Force into fuller compliance with federal accounting standards, the DoD has issued new property accountability and reporting regulations that require DoD Component property systems information on all property furnished to contractors. This and other DoD-proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards.

See Note 10 for material disclosures.

1.P. Advances and Prepayments

Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as an asset on the balance sheet. Advances and prepayments are recognized as expenditures and expenses when the related goods and services are received.

1.Q. Leases

Generally, lease payments are for the rental of equipment vehicles and operating facilities and are classified as either capital or operating leases. When a lease essentially is equivalent to an installment purchase of property (a capital lease), the Air Force records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The Air Force records the amounts as the lesser of the following two values: (1) the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor), or (2) the asset's fair value. The Air Force deems the use of estimates for these costs as adequate and appropriate due to the relatively low dollar value of capital leases. Imputed interest is necessary to reduce net minimum lease payments to present value calculated at the incremental borrowing rate at the inception of the leases. Leases that do not transfer substantially all of the benefits or risks of ownership are classified as operating leases and are expensed over the period of the lease.

1.R. Other Assets

The Air Force conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the Air Force provides financing payments. One type of financing payment for real property is based on the percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction-in-progress and reported on the General PP&E line and in Note 10, General PP&E, Net. In addition, based on the Federal Acquisition Regulation, the Air Force makes financing payments under fixed price contracts not based on percentage of completion. The Air Force reports these financing payments as advances or prepayments in the Other Assets line item. The Air Force treats these payments as advances or prepayments because the Air Force becomes liable only after the contractor delivers the goods. If the contractor does not deliver a satisfactory product, the Air Force is not obligated to reimburse the contractor, and the contractor is liable to repay the Air Force for the full amount of the advance.

The DoD has completed a review of the applicable federal accounting standards; public laws on contract financing; Federal Acquisition Regulation Parts 32, 49, and 52; and the OMB guidance in 5 Code of Federal Regulations Part 1315, "Prompt Payment." The DoD has concluded that SFFAS No. 1 does not address fully or adequately the subject of progress payment accounting and is considering what action is appropriate.

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss to the Air Force. The uncertainty will be resolved when one or more future events occur or fail to occur. A contingency is recognized as a liability when a past event or exchange transaction has occurred, a future loss is probable, and the amount of loss can be reasonably estimated. Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but where there is at least a reasonable possibility that a loss or additional loss will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The Air Force's loss contingencies arising as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft and vehicle accidents, medical malpractice, property or environmental damages, and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for the Air Force's assets and are classified as either environmental or nonenvironmental. The recognition of an anticipated environmental disposal liability commences when the asset is placed into service, consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment." Based upon the Air Force's policies and consistent with SFFAS No. 5, "Accounting for Liabilities of Federal Government," a nonenvironmental disposal liability is recognized for an asset when management makes a decision to dispose of the asset. The DoD has agreed to the recognition of the nonenvironmental disposal liability for nuclear-powered assets when the asset is placed in service. Such amounts are developed in conjunction with and are not easily identifiable separately from environmental disposal costs. Material disclosures are provided at Notes 14 and 15.

1.T. Accrued Leave

Civilian annual leave and military leave balances that have been accrued and not used prior to the balance sheet date are reported as liabilities. The liability reported at the end of the fiscal year reflects current pay rates.

1.U. Net Position

Net Position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent (1) amounts of authority that are not obligated and that have not been rescinded or withdrawn, and (2) amounts that are obligated but for which legal liabilities for payments have not been incurred.

Cumulative results of operations represent the difference between expenses and losses and financing sources (including appropriations, revenue, and gains) since the inception of an activity. Beginning with FY 1998, the results have 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 facilities that are located overseas and that have been obtained through various international treaties and agreements negotiated by the Department of State. The DoD purchases overseas capital assets with appropriated funds, but 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. These fixed assets are subject to loss in the event treaties are not renewed or other agreements are not reached that allow for the continued use by the DoD Components. Therefore, if the U.S. can no longer use foreign bases because treaties or other agreements have been terminated, losses will be recorded for the value of any nonretrievable capital assets after negotiations between the U.S. and the host country determine the amount to be paid the U.S. for such capital investments.

1.W. Comparative Data

The Financial Statements and accompanying Notes to the Financial Statements report the financial position and results of operations for FY 2004. Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet and/or greater than 10 percent between FY 2003 and FY 2004 are explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

The Air Force 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 or services not yet delivered.

1.Y. Problem Disbursements

Problem disbursements represents disbursements of Air Force funds reported by a disbursing station to the Department of Treasury but have not yet been precisely matched against the specific source obligation. The problem disbursement arises when the various contracting, disbursing, and accounting systems fail to match the data necessary to properly account for the transaction in all the applicable accounting systems.

As of August 31, 2004	Sept 2002	Sept 2003	Sept 2004	Decrease/Increase from FY03 to FY04
(Amounts in dollars and cents)				
1. Total Problem Disbursements, Absolute Value				
Unmatched Disbursements (UMDs)	11,685,153.31	7,812,773.99	161,630,191.14	153,817,417.15
Negative Unliquidated Obligations (NULOs)	10,232,414.81	12,436,285.89	9,791,889.12	-2,644,396.77
2. Total In-transit Disbursements, Net	$ 1,320,627,184.94	$ 1,111,273,999.65	$ 1,065,326,018.79	$ -45,947,980.86

The Air Force had a $151,173 thousand increase in problem disbursements and a $45,948 thousand decrease in in-transit disbursements. The Defense Finance and Accounting Service has efforts underway to address system shortcomings, to resolve all previous problem disbursements, and to process all in-transit disbursements. The amount of unmatched disbursements (UMD) over 180 days old is $1,867 thousand, negative unliquidated disbursements (NULOs) is $0.00, and in-transit disbursements is $26,363 thousand. The amount over 120 days old for UMDs is $2,028 thousand, NULOs is $0.00 and for in-transit disbursements is $24,342 thousand. The current absolute value of in-transit disbursements is $1,738,773 thousand.

Note 2. Non-entity Assets

As of September 30	2004	2003
(Amounts in thousands)		
1. Intra-governmental Assets		
A. Fund Balance with Treasury	$ 53,290	$ 52,503
B. Investments	0	0
C. Accounts Receivable	48,685	-2,580
D. Other Assets	0	0
E. Total Intra-governmental Assets	$ 101,975	$ 49,923
2. Non-Federal Assets		
A. Cash and Other Monetary Assets	$ 311,323	$ 147,926
B. Accounts Receivable	238,158	289,787
C. Loans Receivable	0	0
D. Inventory & Related Property	0	0
E. General PP&E	0	0
F. Investments	0	0
G. Other Assets	559	125,940
H. Total Non-Federal Assets	$ 550,040	$ 563,653
3. Total Non-Entity Assets	$ 652,015	$ 613,576
4. Total Entity Assets	$ 242,477,977	$ 235,468,737
5. Total Assets	$ 243,129,992	$ 236,082,313

Other Information

Relevant Information for Comprehension

Non-entity Assets are assets that are held by an entity but that are not available for use in the operations of the entity. Non-Federal Other Assets classes are advances to contractors and outstanding travel advances. The Non-entity Fund Balance with Treasury asset class represents amounts in Air Force deposit and suspense accounts that are not available for Air Force use. Non-entity Accounts Receivables, both when collected, go to the Department of the Treasury as miscellaneous receipts. The Non-entity Non-Federal Accounts Receivable amount also includes interest receivables on aged debt. Non-entity Cash and Other Monetary Assets represent disbursing officers' cash and undeposited collections as reported on the Statement of Accountability. These assets are held by the Air Force disbursing officers as agents of the Treasury.

Fluctuations

The fluctuations on lines 2A and 2G are due to the FY 2004 reporting of advances to contractors as reflected on the SF 1219, Statement of Accountability, as Cash and Other Monetary Assets instead of Advances in accordance with revised OSD guidance.

The decrease of $51,628 thousand in Non-Federal Accounts Receivable, line 2B, can be attributed to a decrease in Air Force Active Duty Accounts Receivable.

	Sep 2004	Sep 2003	$ Change
A/R Government before Eliminations	<$10,383>	$2,580	<$7,803>
Less Intra AF Eliminations	$48,388	$5,161	$43,227
Total	$38,005	$2,581	$35,424

Intra-governmental Receivables fluctuations on line 1.C is due to eliminations activity and the actual increase since September 2003 was for $7,803 thousand. It is caused by an increase in Air Force eliminations. There was a change in procedure this quarter in which unidentified trading partners are no longer allocated to other government agencies but instead are identified as solely Air Force, pending further research.

Note 3.A. Fund Balance with Treasury

As of September 30	2004	2003
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	$ 60,559,736	$ 59,726,905
B. Revolving Funds	0	0
C. Trust Funds	9,212	3,942
D. Other Fund Types	32,051	35,694
E. Total Fund Balances	$ 60,600,999	$ 59,766,541
2. Fund Balances Per Treasury Versus Agency:		
A. Fund Balance per Treasury	$ 61,497,801	$ 59,766,541
B. Fund Balance per Air Force	60,600,999	59,766,541
3. Reconciling Amount	$ 896,802	$ 0

Other Information Related to Fund Balance with Treasury

Fluctuations

The increase of $5,270 thousand in the Trust Fund balance was mainly attributable to Cadet Fund increases. Cadet Fund Accounts Payable increases of $4,431 thousand were due to recent contracts for computers and uniforms. The Cadet Fund other services performed resulted in a net increase of $1,178 thousand due mainly to delays in reimbursement to the 34th Training Wing for Laundry and other services performed. The delays in reimbursement were due to the Fiscal Services Office relocation.

The Other Fund Types decrease of $3,643 thousand is related to a decrease of $3,642 thousand in the Military Airlift Command receipt account. These accounts hold proceeds from revenue traffic, except special mission flights, and other revenue traffic collections which are reimbursable to appropriations, tax payments due to the United States or Foreign Governments, unearned transportation or taxes refunded, and transportation charges due other carriers in connection with traffic revenue collected by MAC.

The reconciling amount is the preclosing of Miscellaneous Receipt Accounts and Cancelling Account balances on the entity records and not on the Treasury Trial Balance.

Air Force Cadet Fund—The Cadet Fund is a revolving trust fund account maintained for the benefit of the U.S. Air Force Academy cadets. The appropriation was funded at its inception. From that point forward, the fund was to be self-sufficient. Collections are received at least equal to any disbursements, and the account revolves funds through the disbursement and collection process with no requirement for additional appropriated funding. The Cadet Fund is an X-year account, meaning there is no time limit on obligations.

Check Issue Discrepancy—DFAS is in the process of collecting information for all check-issue data that are unsupportable because (1) records have been lost during deactivation of disbursing offices, (2) the Treasury may not assist in research efforts for transactions older than 1 year, or (3) corrections were processed for transactions that Treasury removed from the check-comparison report. Transactions that have no supporting documentation due to one of the preceding situations shall be provided to the Department of the Treasury with a request to remove them from the Treasury Check Comparison Report. The vast majority of the remaining check issue discrepancies result from timing differences between the Air Force and the Department of the Treasury for processing checks. The DoD does not require that Treasury remove any amounts from the check-issue comparison report since the check-issue report balance was $0. Further, no empirical evidence has been presented that demonstrates that check issue discrepancies adversely affect the FBWT.

Note Reference

See Note Disclosure 1.I., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing funds with the U.S. Treasury.

Note 3.B. Disclosures Related to Suspense/Budget Clearing Accounts

As of September 30	2002	2003	2004	Decrease/ Increase from FY 2003 - 2004
(Amounts in thousands)				
Account				
F3875	$ -391,552	$ -364,737	$ -357,705	$ 7,032
F3880	-1,327	-2,343	-3,803	-1,460
F3882	-12,555	-16,526	-20,956	-4,430
F3885	254,516	8,785	14,989	6,204
F3886	0	0	0	0
Total	$ -150,918	$ -374,821	$ -367,475	$ 7,346

The Air Force continues to make a concerted effort to reduce balances in the suspense and budget clearing accounts and to establish an accurate and consistent use of these accounts. The information presented indicates the reductions (with the exceptions noted below) that the Air Force has achieved in the various suspense/budget clearing accounts.

The increase in account F3875 from September 2003 to September 2004 is due to many variables. They are all placed in various suspense accounts such as Agricultural/Grazing Leases and Withheld FICA/FITW Medicare Taxes for Military that are collected in and released at various times.

The decrease in account F3880 from September 2003 to September 2004 is due to Recertified Check Payments which are credits from the Treasury for cancelled checks not yet being put back into the original appropriations and 1081 completion.

Suspense account F3882 was first utilized in the 1st Quarter of FY 2003 to accommodate the Military Thrift Saving Plan that came into existence in October 2002. The ($4,429) thousand variance is a result of a timing difference. The National Finance Center posts amounts into each member's account, and they are consolidated and posted to the Treasury before the Air Force can post the amounts in the military accounting system in the following month.

The increase in account F3885 from September FY 2003 to September FY 2004 is due to IPAC transactions received during the last business day of the month. The funds are placed in a suspense account until they can be researched and assigned a valid appropriation, which will fluctuate from one reporting period to another depending upon the amount processed to the Treasury at that time.

Under the authority of Section 1009 of Public Law 107-314, "Clearance of Certain Transactions Recorded in Treasury Suspense Accounts and Resolution of Certain Check Issue Discrepancies," the Suspense Budget Clearing Account wrote-off $408 thousand net and $9,142 thousand absolute from the suspense accounts. The impact on the financial statements of writing this off was that this net amount was no longer in suspense.

Note 4. Investments

As of September 30	2004					2003
	Cost	Amortization Method	Amortized (Premium/ Discount)	Investments, Net	Market Value Disclosure	Investments, Net
(Amounts in thousands)						
1. Intra-governmental Securities:						
A. Marketable	$ 0		$ 0	$ 0	$ 0	$ 0
B. Non-Marketable, Par Value	0		0	0	0	0
C. Non-Marketable, Market-Based	712		-1	711	719	712
D. Subtotal	$ 712		$ -1	$ 711	$ 719	$ 712
E. Accrued Interest	$ 0			$ 0	$ 0	$ 0
F. Total Intragovernmental Securities	$ 712		$ -1	$ 711	$ 719	$ 712
2. Other Investments:	$ 0			$ 0	N/A	$ 0

Other Information

Fluctuations

Air Force Gift Fund cash donations that are not going to be used in the immediate future to fund donor-designated projects are invested in marketable securities with the Department of the Treasury. Increases and decreases in the investment cost amount reflect the changes in those investments.

Relevant Information for Comprehension

The Air Force Gift Fund was established to control and account for the disbursement and use of monies donated to the Air Force along with the interest received from the investment of such donations. The related earnings are allocated to appropriate Air Force activities to be used in accordance with the directions of the donor. These funds are recorded as Non-Marketable Market Based U.S. Treasury Securities, which are not traded on any security exchange but which mirror the prices of marketable securities with similar terms.

Note Reference

See Note Disclosure 1.N., Investments in U.S. Treasury, for additional Air Force policies governing investments in U.S. Treasury securities.

Note 5. Accounts Receivable

As of September 30	2004			2003
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intra-governmental Receivables:	$ 689,871	N/A	$ 689,871	$ 541,429
2. Non-Federal Receivables (From the Public):	$ 1,101,661	$ -122,778	$ 978,883	$ 772,500
3. Total Accounts Receivable:	$ 1,791,532	$ -122,778	$ 1,668,754	$ 1,313,929

The total allowance method is determined at the Air Force departmental level. These department-level amounts are derived as follows: For closed-years receivables and deferred debts in litigation, an allowance rate of 50 percent results in an estimated allowance of $62,999 thousand. Interest allowance of

$2,160 thousand is calculated using an average percent of write-offs to outstanding public accounts receivable over a five-year period starting with FY 2000 data. For Air Force entity receivables, the allowance is computed each year based on the average percent of write-offs to outstanding public accounts receivable for the last five years resulting in an estimated allowance of $57,619 thousand.

Other information

Relevant Information for Comprehension

As presented on the Consolidated Balance Sheet, accounts receivable include reimbursements receivable and refunds receivable such as out-of-service debts (amounts owed by former service members), contractor debt, and unused travel tickets. It also includes net interest receivables per Department of Defense (DoD) Financial Management Regulation (FMR) Vol. 6B guidance. Canceled accounts receivable is reported as non-entity receivables because these amounts are deposited into a Treasury Department miscellaneous receipt account when collected. Reconciliation between Report on Receivables Due from the Public and the balance sheet was accomplished. The differences between the balance sheet (line 1C) and Treasury Report on Receivables (TROR) Due from the Public (line 7) include the allowance for estimated receivables that will be uncollected of $122,778 thousand and undistributed collections of $379,869 thousand. Undistributed collections are prorated between public and intra-governmental receivables on the balance sheet based on the percentages of distributed receivables. This reconciliation is performed to ensure that the financial statements are in agreement with the public receivables reported to the Department of the Treasury.

Accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Air Force was unable to reconcile intra-governmental accounts receivable balances with its trading partners. Through the ongoing Business Management Modernization Program, the Department intends to develop long-term systems improvements that will capture the data necessary to perform reconciliation.

Allocation of Undistributed Collections

The DoD policy is to allocate supported undistributed collections between federal and non-federal categories based on the percentage of Federal and Non-federal Accounts Receivable. Unsupported undistributed collections should be recorded in the United States Standard General Ledger (USSGL) account 2400, Liability for Deposit Funds, Clearing Accounts and Undeposited Collections. The Air Force follows this allocation procedure.

Fluctuations

Intra-governmental accounts receivable before eliminations increased by $318,523 thousand from September 2003. The increase on the financial statement of $148,444 thousand is after intra-governmental Air Force eliminations.

	Sep 2004	Sep 2003	$ Change
A/R Government before Eliminations	$1,251,491	$ 932,969	$ 318,523
Less Intra AF Eliminations	$ 561,620	$ 391,541	$ 170,079
Total	$ 689,872	$ 541,428	$ 148,444

(Both columns reflect data in thousands)

Intra-governmental accounts receivable increased $148,444 thousand since September 2003. increase due larger spending authority earned in the O&M and RDT&E appropriations. The O&M increase was due to a concerted effort, in August and September 2004, at the Major Command level to properly code the reimbursable transactions in the accounting system to better reflect the total amount of goods and services provided to other DoD organizations. The RDT&E increase was a product of an OMB $2 Billion increase to spending authority (Reimbursable Budget Authority) resulting in a larger amount of goods and services provided to other DoD agencies. Also, intra-governmental accounts receivables due from the U.S. Transportation Command increased $159,190 thousand from September 2003.

Public accounts receivable increased $206,383 thousand from September 30, 2003.

Allowance of estimated uncollectibles (decrease)	<$155,405>
MOCAS debts (decrease)	<$215,311>
MDMR debts (increase)	$351,273
Base-level reporting (increase)	$225,826
Total increase	$206,383

The breakout above is as follows:

Decreases: (a) A decrease of $155,405 thousand was the result of more emphasis on writing off uncollectible debts; (b) The remaining decrease of $215,311 thousand was a result of increased emphasis of debts collected in Mechanization of Contract Administration Services (MOCAS).

Increases: (a) An increase of $351,273 thousand was a result of accounts receivable reported by the Monthly Debt Management Report (MDMR), off-line contract debts; (b) The remaining $225,826 thousand increase results from public accounts receivables reported on the Air Force field sites base-level accounting systems and off-line receivables consolidated at the Denver center.

Note Reference

See Note Disclosure 1.K., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing Accounts Receivable.

Note 6. Other Assets

As of September 30	2004	2003
(Amounts in thousands)		
1. Intra-governmental Other Assets:		
A. Advances and Prepayments	$ 443,939	$ 339,093
B. Other Assets	0	0
C. Total Intra-governmental Other Assets	$ 443,939	$ 339,093
2. Non-Federal Other Assets:		
A. Outstanding Contract Financing Payments	$ 10,705,720	$ 9,645,299
B. Other Assets (With the Public)	103,868	266,852
C. Total Non-Federal Other Assets	$ 10,809,588	$ 9,912,151
3. Total Other Assets:	$ 11,253,527	$ 10,251,244

Other Information Related to Other Assets:

Fluctuations

Advances and Prepayments on line 1.A. increased $104,846 thousand from September 2003. Amounts are recorded based on elimination data as provided by Air Force trading partners. The increase is primarily attributable to recording government advances from either seller side actuals or an estimation technique for level 1 partners. Prior to FY 2004, level 1 government advances were not included.

The comparison of FY 2004 to FY 2003 for Advances and Prepayments (in thousands):

	FY 2004	FY 2003
Government advances before accrual	56	56
Accruals to match seller data	491,860	721,477
	491,916	721,533
Less intra Air Force eliminations	47,977	382,440
Reported advances and prepayments	443,939	339,093

Outstanding Contract Financing Payments increased $1,060,421 thousand, or 11 percent, when compared with FY 2003. The increase is attributed to additional progress payments made for the F-22 as it experiences increased production and an increase in the allowable percentage of progress payments for new fixed price contracts.

Relevant Information for Comprehension

Other Assets

The $103,868 thousand on line 2.B. is composed of $94,590 thousand in travel advances and $9,278 thousand in other advances to contractors.

Advances to the contractor as reported on the SF 1219, Statement of Accountability, are payments as part of an advance-payment pool agreement with Massachusetts Institute of Technology or other nonprofit institutions. Advance-payment pool agreements are used for the financing of cost-type contracts with nonprofit educational or research institutions for experimental or research and development work when several contracts or a series of contracts require financing by advance payments. These amounts for 2003 and prior were reported as other assets. In accordance with revised guidance, these advances are now reported on line 1.B on the balance sheet.

Outstanding Contract Financing Payments

The Air Force reports as advances and prepayment all outstanding financing payments for fixed-price contracts that are not based on percentage or stage of completion. Under the contract terms, the Air Force 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 Air Force is not obligated to reimburse the contractor for its cost, and the contractor is liable to repay the Air Force for the full amount of the outstanding contract finance payments.

Note Reference

See Note Disclosure 1.R., Significant Accounting Policies, for additional discussion on financial reporting requirements and Department of Defense policies governing other assets.

Note 7. Cash and Other Monetary Assets

As of September 30	2004	2003
(Amounts in thousands)		
1. Cash	$ 303,142	$ 136,195
2. Foreign Currency (non-purchased)	8,181	11,731
3. Other Monetary Assets	0	0
4. Total Cash, Foreign Currency, & Other Monetary Assets	$ 311,323	$ 147,926

- Cash—includes the total of cash resources under the control of the Air Force, including coin, paper currency, negotiable instruments, and amounts on deposit in banks and other financial institutions. Cash available for agency use should include petty cash funds and cash held in revolving funds that will not be transferred into the U.S. Government General Fund.
- Foreign Currency—consists of the total U.S. dollar equivalent of nonpurchased foreign currencies held in foreign currency fund accounts.
- Other Monetary Assets—includes gold, special drawing rights, and U.S. Reserves in the International Monetary Fund. This category is principally for use by the Department of the Treasury.

Other Information Pertaining to Entity Cash & Other Monetary Assets:

Fluctuations

Advances to Contractors under the University Pool Agreements of $147,780 thousand, as reported on the SF 1219, Statement of Accountability, are now reflected as a component of Total Cash, Foreign Currency and Other Monetary Assets. This allows Total Accountability as reflected on the SF 1219 to mirror line 1.B of the Balance Sheet in accordance with OSD guidance. Advance-payment pool agreements are used for the financing of cost-type contracts with nonprofit educational or research institutions for experimental or research and development work when several contracts or a series of contracts require financing by advance payments. These amounts for 2003 and prior were reported as other assets. In accordance with revised guidance, these advances are now reported on line 1.B on the balance sheet. In accordance with revised guidance these advances are now reported on line 1.B on the balance sheet. The remaining variance can be attributed to changing requirements of the disbursing officers to carry out their paying, collecting and foreign currency exchange functions. In reviewing the Cash and Foreign Currency asset classes for the past 9 quarters (March 2003 and June 2003 were excluded since they were anomalies due to unique requirements in support of Operation Iraqi Freedom), the average level for both has been $171,000 thousand (excluding the Advances to Contractors as state above).

Relevant Information for Comprehension

The amounts reported for the Cash and Foreign Currency asset classes consist primarily of cash held by disbursing officers to carry out their paying, collecting, and foreign-currency accommodation exchange mission. The primary source of the amounts reported is the Standard Form 1219, Statements of Accountability, reported by the Department of Defense (DoD) disbursing officers.

The amount reported for the Foreign Currency asset class is valued using the Department of Treasury Prevailing Rate of Exchange, the most favorable rate available to the U.S. Government when acquiring foreign currency to make official disbursements and to provide currency for exchange of U.S. dollars for troops.

Note Reference

See Note Disclosure 1.J., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing foreign currency.

Note 8. Direct Loan and/or Loan Guarantee Programs

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

Other Information:

Not applicable.

Note 9. Inventory and Related Property

As of September 30	2004	2003
(Amounts in thousands)		
1. Inventory, Net (Note 9.A.)	$ 0	$ 0
2. Operating Materials & Supplies, Net (Note 9.B.)	51,340,248	51,815,831
3. Stockpile Materials, Net (Note 9.C.)	0	0
4. Total	$ 51,340,248	$ 51,815,831

Note 9.A. Inventory, Net

Not applicable.

Note 9.B. Operating Materials and Supplies (OM&S), Net

As of September 30	2004			2003	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in thousands)					
1. OM&S Categories:					
A. Held for Use	$ 39,347,759	$ 0	$ 39,347,759	$ 38,860,094	
B. Held for Repair	11,992,489	0	11,992,489	12,955,737	
C. Excess, Obsolete, and Unserviceable	955,660	-955,660	0	0	
D. Total	$ 52,295,908	$ -955,660	$ 51,340,248	$ 51,815,831	

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

Fluctuations

In FY 2004, condition codes were built into the ICBM logistics management system which made it possible to break out by condition code those assets that were considered to be held for repair from assets considered to be excess, obsolete and unserviceable. In FY 2003, uninstalled motors were reported at Latest Acquisition Cost while in FY 2004 they are being reported at Moving Average Cost. Also, many of the old uninstalled missile motors reported in FY 2003 as excess have been refurbished and are now being reported as "held for use" and some motors have been destroyed. The effect has been a reduction of $1,102,268 thousand in missile motors. A $92,539 thousand reduction in munitions (CAS) is the result of of excess and obsolete assets being destroyed by the Army, or being eliminated through the DRMO process. An additional $60,279 thousand reduction in FIABS munitions was caused by duplicate data reflected in the 4th Quarter FY 2003 numbers that was subsequently corrected in FY 2004.

Information related to OM&S

General Composition of OM&S

OM&S include spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally managed aircraft engines.

Balances

In addition to the account balances shown in Table 9.B., the federal accounting standard requires disclosure of the amount of OM&S held for future use. Except for an immaterial amount of munitions, the Air Force is not holding any items for future use.

Decision Criteria for Identifying the Category to Which OM&S Items Are Assigned

Managers determine which items are more costly to repair than to replace. Items retained for management purposes are coded "condemned." The net value of these items is zero and is shown as Excess, Obsolete, and Unserviceable.

The category Held for Use includes all issuable materials and is coded within each supply or inventory system as condition codes A – D.

The category Excess, Obsolete, and Unserviceable includes all material assigned condition codes H, P, and S.

The Category Held for Repair relates to impaired assets and includes all other condition codes as defined by the Military Standard Transaction Reporting and Accounting Procedures Manual (DoD 4000.25-2-M).

Changes in the Criteria for Identifying the Category to Which OM&S Items Are Assigned

As stated above, the category Held for Use includes all issuable material, and the category Held for Repair includes all economically reparable material. Before FY 2002, the Department of Defense (DoD) categorized potentially redistributable material, regardless of condition, as Excess, Obsolete, and Unserviceable.

To date, the Air Force has only implemented one system to report "moving average cost," the DoD-approved methodology for reporting historical cost within any of the supply or inventory accounting systems for OM&S. Consequently, most OM&S assets are valued at standard price, with an allowance for Excess, Obsolete, and Unserviceable. Under current DoD policy, no allowance is made for serviceable ready-to-issue items (category Held for Use). An allowance equal to 100 percent of standard price, however, is made for the category Excess, Obsolete, and Unserviceable. This allowance results in a net book value of zero, which is considered appropriate because the items are coded condemned and, therefore, have no intrinsic value to the Air Force. The category Held for Repair represents suspended, unserviceable (but reparable) items which have a value to the Air Force but whose value is less than that of the Held for Use items and greater than that of the Excess, Obsolete and Unserviceable items. To date, the Office of the Secretary of Defense has not provided sufficient guidance to the Air Force on the methodology for computing an allowance for the Held for Repair category; therefore, Held for Repair is reported at full standard price.

Government-Furnished Material (GFM) and Contractor-Acquired Material (CAM)

Generally, the value of the Air Force's GFM and CAM in the hands of contractors is not included in the OM&S values reported above. The DoD is presently reviewing its process for reporting these amounts in an effort to determine the appropriate accounting treatment and the best method to collect and report required information quarterly without duplicating information already in other logistics systems.

Operating Materials and Supplies Value

The OM&S data reported on the financial statements are derived from logistics systems designed for material management purposes. These systems do not maintain the historical cost data necessary to comply with the valuation requirements of the Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property." In addition, while these logistics systems provide management information on the accountability and visibility over OM&S items, they do not directly support the categorization of OM&S as Held for Use, Held in Reserve for Future Use, Held for Repair, or Excess, Obsolete, and Unserviceable. The DoD manages only military or government-specific material under normal circumstances. Material includes material held due to operational economies. Similarly, material held for use includes material held due to a managerial determination that it should be retained to support departmental contingencies. All OM&S assets are valued at standard price, with an allowance for Excess, Obsolete, and Unserviceable.

Items commonly used in and available from the commercial sector are not managed in the DoD material management activities. Further, unlike the commercial sector, the DoD operational cycles based on national need are irregular. In addition, the military risks associated with stock-out positions (e.g., weapon systems that are not mission capable due to lack of supplies) are totally different from a commercial activity's risk of losing sales. Therefore, the Department does not attempt to account separately for items held for current or future use.

In general, the Air Force is using the consumption method of accounting for OM&S, since OM&S is defined in the SFFAS No. 3 as material that has not yet been issued to the end user. Once issued, the material is expensed. As stated above, current financial and logistics systems cannot fully support the consumption method. According to federal accounting standards, the consumption method of accounting should be used to account for OM&S unless (1) the amount of OM&S is not significant,

(2) OM&S are in the hands of the end-user for use in normal operations, or (3) it is cost-beneficial to expense OM&S when purchased (purchase method).

Note Reference

See Note Disclosure 1.M., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing inventory and related property.

For a regulatory discussion of OM&S, see DoD Financial Management Regulation, Volume 6B, Chapter 10, paragraph 101107.

Other Air Force Disclosures

The Air Force provided only minimal OM&S accounting data that can be used to prepare the financial statements. In most cases, the data provided consisted of only beginning and ending balances for each of the asset accounts Held for Use; Excess, Obsolete, Unserviceable; and Held for Repair. In other cases, the data provided consisted of only beginning balances and serviceable and unserviceable ending balances. Without the required additional data (acquisitions, transfers in, amounts consumed, transfers out, trading partner data, etc), the Defense Finance and Accounting Service (DFAS) could only report the net change between prior-period ending balances and the values reported as current-period ending balances. Although the required additional data are available in some Air Force supply systems, the DFAS General Fund accounting system was not developed to receive and translate the transaction codes to report the data. To correct this problem, DFAS is making changes to some accounting systems and implementing standard interfaces between the Air Force feeder systems and the accounting systems.

Although the Air Force OM&S systems, in most cases, capture some trading partner data at the transaction level, no electronic interfaces exist between the Air Force OM&S feeder systems and the DFAS accounting systems for reporting the data for all items transferred to and from other DoD and federal agencies. Consequently, intra-governmental transactions (trading partner data) could not be reconciled. The Air Force and DFAS are currently developing processes, methodologies and standard electronic interfaces that will allow intra-governmental transactions to be reported monthly to the General Accounting and Finance System - Rehost.

Note 9.C. Stockpile Materials, Net

Not applicable.

Note 10. General Property, Plants, and Equipment (PP&E), Net

As of September 30	2004					2003
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in thousands)						
1. Major Asset Classes:						
A. Land	N/A	N/A	$ 431,607	N/A	$ 431,607	$ 416,974
B. Buildings, Structures, and Facilities	J	20 or 40	42,478,002	$ -24,311,083	18,166,919	17,266,526
C. Leasehold Improvements	S/L	lease term	0	0	0	0
D. Software	S/L	2-5 or 10	23,806	-24	23,782	23,782
E. General Equipment	S/L	5 or 10	19,419,138	-12,674,764	6,744,374	92,367,308
F. Military Equipment	S/L	various	300,790,000	-211,730,000	89,060,000	0
G. Assets Under Capital Lease [1]	S/L	lease term	409,498	-246,439	163,059	188,025
H. Construction-in-Progress	N/A	N/A	3,364,351	N/A	3,364,351	2,523,416
I. Other			338	0	338	99
J. Total General PP&E			$ 366,916,740	$ -248,962,310	$ 117,954,430	$ 112,786,130

[1] Note 15.B for additional information on Capital Leases

Legend for Valuation Methods:

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

Other Information

Fluctuations

The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards No. 23, “Eliminating the Category National Defense Property, Plant and Equipment,” in May 2003. This standard, which became effective for accounting periods after September 30, 2002, establishes Generally Accepted Accounting Principles (GAAP) for valuing and reporting military equipment (e.g., aircraft, satellites, and intercontinental ballistic missiles) in federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades.

The Department of Defense has determined that it is not practicable at this time to accumulate sufficient information from internal records to value military equipment in accordance with GAAP. The Department is currently working to revise its accounting processes and systems to support the informational needs of management and compliance with GAAP. In the interim, the Department will base the value of military equipment for financial statement presentation purposes on data provided by the Bureau of Economic Analysis (BEA) at the Department of Commerce.

The AF, during FY 04, in the category of general PP&E (support equipment), had an increase of approximately $1.3 billion over FY 03. This was due in part to an increase of approximately $533 million that did not pass the edit checks (SBSS to AFEMS) and were reported and depreciated manually by DFAS. In addition, the AF had an increase in general PP&E in AFEMS due to an increase in support equipment acquisitions of approximately $1 billion. Then, the AF had a decrease in medical equipment acquisitions of about $169 million as a result of DMLSS not loading assets that had a net book value of zero, which understated the amount of assets on hand.

The data provided by the BEA consists of investment and net book value data for 84 groups of equipment such as aircraft, ships, and combat vehicles. The Department adjusts BEA data to eliminate equipment items (such as spares, munitions, and inventory items) that are not accounted for as military equipment. Such items are accounted for and reported as Inventory and Related Property.

BEA uses Department of Defense budget, expenditure, and delivery data to calculate the Department's annual investment in equipment, after recognizing any equipment transfers or war losses. BEA recently revised its Fiscal Year 2003 estimate. Previous BEA estimates were based, in part, on projections because source data was not available. The revised estimate for Fiscal Year 2003 is based on updated and more complete source data. Further, the revised estimate reflects changes in the methods and data BEA uses to project the investment in, and depreciation of, military equipment resulting from BEA's 2003 Comprehensive Revision of the National Income and Product Accounts. A major factor in the reduction of the acquisition value of military equipment included in the updated estimate was new data that showed that governments purchased a smaller proportion of the domestic supply of software than had previously been estimated.

The value of the BEA data provided by the DoD to the Air Force for inclusion in the financial statements for the 4th Quarter, 2004 amounted to approximately $300,790,000 thousand less accumulated depreciation of $211,730,000 thousand for a net realized book value of $89,060,000 thousand.

The overall increase in General Property, Plant and Equipment is $5,168,299 thousands of, which is Military Equipment, derived from BEA data, which are approximately $3,400,000 thousands. The remaining difference of $1,768,299 thousand represents general increases in equipment and construction-in-progress.

The Construction-in-Progress on line 1.H. increased $840,935 thousand since September 2003 due to an increase in construction projects started and not completed.

The Other asset class on line 1.I. increased by $239 thousand since September 2003. The Other category represents the timing factor inherent in timber harvesting. The timber markets, driven by supply and demand, are volatile and fluctuate. Timber sale contracts are awarded at irregular intervals, with some contracts held back until the market improves. Similarly, when buyers pay for just the timber they cut, they may hold off when markets are bad and cut more when markets are good. Weather conditions also influence the flow of timber and revenue.

Relevant Information for Comprehension

Personal property in the Air Force consists of General Equipment, Automated Data Processing (ADP) hardware and software, Medical Equipment, Special Tools and Test Equipment (ST/STE) and Military Equipment.

Other Air Force Disclosures

For the 4th Quarter, FY 2004 reports, the Air Force used FY 2002 ending data for (ST/STE). The FY 2002 values were used because the two systems previously used to report ST/STE have been turned off and are scheduled to be replaced by Air Force Equipment Management System (AFEMS) in FY 2005.

For the 4th Quarter, FY 2004 reports, the Air Force used a special extract from AFEMS to identify the General PP&E assets that had not passed the required edit checks (e.g. missing historical cost, acquisition dates or serial numbers). The dollar value of these assets exceeded $3 billion and were not initially included in the financial statements. Therefore, DFAS used the extract data and depreciated these assets and included the cost plus depreciation in the financial statements. The Air Force is currently working this data exception problem to assure that all assets are properly recorded and depreciated in future financial statements. The value of the Air Force internal use software reported for 4th Quarter FY 2004 is the same dollar value that was reported in previous financial statements. On prior reporting cycles, the Air Force used a rudimentary manual process to collect these values, however this process is no longer considered reliable. The Air Force is working this issue and estimate that a systematic process will be established to both capture and report internal used software in FY 2005. The value of the Air Force's General PP&E real property in the possession of contractors is included in the values reported above for the Major Asset Classes of Land and Buildings, Structures, and Facilities. The value of General PP&E personal property (Major Asset Classes of Software and Equipment) does not include all of the General PP&E above the DoD capitalization threshold in the possession of contractors. The net book amount of such property is immaterial in relation to the total General PP&E net book value. In accordance with a strategy approved by the OMB, the General Accounting Office, and the Inspector General, DoD, the Department is developing new policies and a contractor-reporting process to capture General PP&E information for future reporting purposes in compliance with GAAP.

Note Reference

See Note Disclosure 1.O., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing PP&E.

Note 10.A. Assets Under Capital Lease

As of September 30	2004	2003
(Amounts in thousands)		
1. Entity as Lessee, Assets Under Capital Lease:		
A. Land and Buildings	$ 408,540	$ 408,540
B. Equipment	408,540	958
C. Other	0	0
D. Accumulated Amortization	-246,439	-221,473
E. Total Capital Leases	$ 163,059	$ 188,025

Description of Lease Arrangements

The Air Force is the lessee in twelve capital leases. Eleven leases are for military family housing acquired through Section 801 Family Housing Program, and one is for a piece of medical equipment. The leased items are capitalized and reported as an asset when the costs of the items exceed the capitalization threshold. Leased items not meeting the capitalization threshold are expensed. All leases originating prior to FY 1992 are funded on a fiscal-year basis. Six of the current military family housing leases originated before FY 1992.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2004	2003
(Amounts in thousands)		
1. Intra-governmental Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Debt	0	0
C. Environmental Liabilities	0	0
D. Other	682,737	699,256
E. Total Intra-governmental Liabilities	$ 682,737	$ 699,256
2. Non-Federal Liabilities		
A. Accounts Payable	$ 473,152	$ 0
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,163,442	1,262,268
C. Environmental Liabilities	6,876,461	7,560,554
D. Loan Guarantee Liability	0	0
E. Debt Held by Public	0	0
F. Other Liabilities	2,721,503	2,922,241
G. Total Non-Federal Liabilities	$ 11,234,558	$ 11,745,063
3. Total Liabilities Not Covered by Budgetary Resources	$ 11,917,295	$ 12,444,319
4. Total Liabilities Covered by Budgetary Resources	$ 12,569,893	$ 11,567,996
5. Total Liabilities	$ 24,487,188	$ 24,012,315

Other Information

Liabilities Not Covered and Covered by Budgetary Resources - These are liabilities that are not considered covered by realized budgetary resources as of the balance sheet date. Budgetary resources include the following:

- New budget authority
- Spending authority from offsetting collections (credited to an appropriation or fund account)
- Recoveries of unexpired budget authority through downward adjustments of prior-year obligations
- Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior-year balances during the year
- Borrowing authority or permanent indefinite appropriations that have been enacted and signed into law as of the balance sheet date, provided that the Office of Management and Budget (OMB) can apportion the resources with out first meeting a contingency or without additional action by the Congress.

Liabilities Covered by Budgetary Resources

These are resources the reporting entity incurred that are covered by realized budget resources as of the balance sheet date. Budgetary resources encompass not only new budget authority but also other resources available to cover liabilities for specified purposes in a given year. Available budgetary resources include the following:

- New budget authority
- Spending authority from offsetting collections (credited to an appropriation or fund account)
- Recoveries of unexpired budget authority through downward adjustments of prior-year obligations
- Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior-year balances during the year
- Borrowing authority or permanent indefinite appropriations that have been enacted and signed into law as of the balance sheet date, provided that the OMB can apportion the resources without first meeting a contingency or without additional action by the Congress.

Fluctuations and Abnormalities

Accounts Payable—Cancelled Appropriations increased 100 percent, when compared with FY 2003. The increase is due to a change in the USSGL crosswalk. USSGL 2960, Accounts Payable from Cancelled Appropriations, is now reported on the Accounts Payable lines of the Balance Sheet instead of Other Liabilities.

Information Related to Liabilities Not Covered by Budgetary Resources

Other Liability Disclosures

Other Intra-governmental Liabilities Not Covered by Budgetary Resources consists of $101,737 thousand in judgement fund liabilities, $304,420 thousand in Federal Employees' Compensation Act (FECA) reimbursement to the Department of Labor, $25,823 thousand in unemployment compensation liabilities, $3,329 thousand in education benefit liabilities, and $250,757 thousand in custodial liabilities.

Other Nonfederal Liabilities Not Covered by Budgetary Resources consists of $91,980 thousand in nonenvironmental disposal liabilities, $47,224 thousand in capital lease liabilities, $308,765 thousand in contingent liabilities, $2,272,599 thousand in accrued annual leave liabilities for military and civilians, and $934 thousand in accrued interest liability.

Note Reference

For Additional Line Item discussion, see:

- Note 12, Accounts Payable
- Note 13, Debt
- Note 14, Environmental Liabilities and Disposal Liabilities
- Note 15, Other Liabilities
- Note 16, Commitments and Contingencies
- Note 17, Military Retirement Benefits and Other Employment Related Actuarial Liabilities

Note 12. Accounts Payable

As of September 30	2004			2003
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intra-governmental Payables:	$ 1,900,411	N/A	$ 1,900,411	$ 1,413,940
2. Non-Federal Payables (to the Public):	$ 7,707,163	$ 0	$ 7,707,163	$ 7,080,910
3. Total	$ 9,607,574	$ 0	$ 9,607,574	$ 8,494,850

Other Information:

The Intra-governmental Payables category consists of amounts owed to other federal agencies for goods or services ordered and received but not yet paid for. Interest, penalties, and administrative fees are not applicable to intra-governmental payables. The Nonfederal Payables (to the Public) category consists of payments to nonfederal governmental entities

Fluctuations

The fluctuation associated with Intra-governmental accounts payable is the direct result of the elimination process which requires the accrual of accounts payable to agree with Air Force trading partner seller data. The increase is primarily attributable to recording level 1 accounts payable based on actual seller side data provided by the agency or using an estimation technique for those agencies that did not provide actuals. Buyer side adjustments for FY 2004 were significantly higher than for previous periods. Air Force accrued $2,034,149 thousand in FY 2004 compared to $1,054,040 thousand in FY 2003.

Intra-governmental Eliminations

For the majority of intra-agency sales, the Air Force's feeder and the DFAS accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Air Force was unable to reconcile intra-governmental accounts payable to the related intra-governmental accounts receivable that generated the payable. The DoD and Air Force intend to develop 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 intra-governmental transactions is so large that after-the-fact reconciliation cannot be accomplished with the current or foreseeable resources. The DoD summary-level seller accounts receivables were compared to the Air Force accounts payable. An adjustment was posted to the Air Force accounts payable based on the comparison with the accounts receivable of the DoD components providing goods or services to the Air Force.

Comparison prior to eliminations:

	Sep 2004	**Sep 2003**	**$ Change**
Intra-governmental accounts payable			
before eliminations	$ 2,462,030	$ 1,805,481	$ 656,549
Less Intra-Air Force eliminationss	$ 561,620	$ 391,541	$ -170,079
Total	**$ 1,900,410**	**$1,413,940**	**$ 486,470**

(All data in thousands)

Allocation of Undistributed Disbursements

The DoD policy is to allocate supported undistributed disbursements between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable. Unsupported undistributed disbursements should be recorded in the United States Standard General Ledger account 2120, Disbursements in Transit. The Air Force followed this allocation policy.

Note Reference

See Note Disclosure 1.G., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing accounting for intra-governmental activities.

Note 13. Debt

Not Applicable

Other Information

Note Reference

See Note Disclosure 1.G., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing accounting for Intra-governmental Activities, Public Debt.

Note 14. Environmental Liabilities and Disposal Liabilities

As of September 30	2004			2003
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
1. Environmental Liabilities – Non Federal				
A. Accrued Environmental Restoration (DERP funded) Costs:				
1. Active Installations—Environmental Restoration (ER)	$ 382,368	$ 3,842,847	$ 4,225,215	$ 4,901,889
2. Active Installations—ER for Closed Ranges	15,000	1,329,856	1,344,856	838,172
3. Formerly Used Defense Sites (FUDS)—ER	0	0	0	0
4. FUDS—ER for Transferred Ranges	0	0	0	0
B. Other Accrued Environmental Costs (Non-DERP funds)				
1. Active Installations—Environmental Corrective Action	0	182,385	182,385	204,341
2. Active Installations—Environmental Closure Requirements	6,177	106,106	112,283	66,454
3. Active Installations—Environ.Response at Active Ranges	0	0	0	0
4. Other	0	0	0	0
C. Base Realignment and Closure (BRAC)				
1. BRAC Installations—Environmental Restoration (ER)	132,134	1,247,513	1,379,647	1,908,999
2. BRAC Installations—ER for Transferring Ranges	0	0	0	0
3. BRAC Installations—Environmental Corrective Action	13,677	129,124	142,801	139,956
4. Other	0	0	0	0
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0	0	0	0
2. Nuclear Powered Submarines	0	0	0	0
3. Other Nuclear Powered Ships	0	0	0	0
4. Other National Defense Weapons Systems	0	0	0	50,592
5. Chemical Weapons Disposal Program	0	0	0	0
6. Other	0	0	0	0
2. Total Environmental Liabilities:	$ 549,356	$ 6,837,831	$ 7,387,187	$ 8,110,403

Other Information Related to Environmental Liabilities

Fluctuations

Accrued Environmental Restoration Costs (Defense Environmental Restoration Program [DERP]-funded) Active Installations – Environmental Restoration decreased $676,673 thousand, or 14 percent, when compared with FY 2003. This decrease is in line with an 11 percent decline in sites and a lower actual inflation rate than originally estimated, so existing site costs did not increase as fast as in prior years. Strict management program reviews early in FY 2004 led to better control of costs and the net closure of approximately 289 sites during the year.

Accrued Environmental Restoration Costs (DERP-funded) Active Installations – Environmental Restoration for Closed Ranges increased $506,684 thousand, or 60 percent, when compared with FY 2003. The total number of all sites at September 30, 2003 was 260. The comparable number of sites for September 30, 2004 was 292, which indicates the increase expected. However, this total number of sites includes sites that are closed, as well as active sites. The operation closed 52 sites during FY 2004, which leaves active sites at 240 as of September 30, 2004. The number of active sites at September 30, 2003 was 210. Because of the relatively new nature of the munitions response reporting for closed ranges and expected growth in sites, the Air Force believes this liability will continue to grow significantly for several years.

Other Accrued Environmental Costs (Non-DERP funds) Active Installations – Environmental Corrective Action decreased $21,956 thousand, or 11 percent, when compared with FY 2003. Resource Conservation and Recovery Act (RCRA) corrective action sites are defined by the Environmental Protection Agency as Solid Waste Management Units (SWMU). SWMUs

are not determined in a scientific manner and may arise from any indication of potential pollution. Therefore, there are a high number of SWMUs. Superficial investigation generally leads to the conclusion that there is no significant pollution at the SWMU. The amount of the liability fluctuates greatly from year-to-year as further investigation results in significant changes in cost estimates. These changes result from the additional information gained in each step of the cleanup process and the relatively few sites that actually require significant cleanup costs.

Other Accrued Environmental Costs (Non-DERP funds) Active Installations – Environmental Closure Requirements increased $45,829 thousand, or 69 percent, when compared with FY 2003. The increase is due to a change in the amortization computation for Underground Storage Tanks (USTs) and Landfills. Amortization of USTs is now based on the year the facility is placed in service instead of the planned year for closure. Additionally, the inventory of Landfills and USTs has expanded as reporting continues to improve. Likewise, units reported have moved to the use of the Remedial Action Cost Engineering and Requirements System (RACER) as the estimating tool, which changes the cost estimates from previous periods. The Air Force expects continued increase in the liability for closures as the inventory of facilities with a liability continues to increase and cost estimates are changed to the verified, validated, and approved cost methodology of RACER. During FY 2005, the liability for Treatment, Storage, and Disposal Facilities (TSDFs) is expected to increase significantly as the amortization computation is changed to the year the facility was placed in service instead of the planned closure year.

Base Realignment and Closure (BRAC) Installations – Environmental Restoration decreased $529,352 thousand, or 28 percent, when compared with FY 2003. The decrease is due to a new cost estimating and reporting policy being used by the active Air Force. In the past, site cost estimates were run until the duration of the remediation, for example, FY 2300. This policy was changed to 25 years of Remediation Action Operation (RA-O) with a 5 year Long Term Monitoring (LTM) cost estimate that means the site cost estimate would be cut-off by FY 2034.

Optimization of existing systems contributed to the decrease. This is a systematic approach for evaluating and improving site remediation processes by reducing risk and enhancing system performance, minimizing both short and long term costs, assessing decision logic to reach site cleanup goals, and accelerating site closure. Also, a portion of the cost reduction is due to privatization, in which the government cleanup function has been converted to the private sector. Additionally, the FY 2003 ending liability balance for Environmental Restoration was in error. $139,956 thousand of Environmental Corrective Action requirements were added to the Environmental Restoration line as well as being reported on the Environmental Corrective Action line. The new ending Environmental Restoration balance includes the correction, contributing to the reported decrease.

Environmental Disposal for Weapons Systems Programs - Other National Defense Weapons Systems decreased $50,592 thousand, or 100 percent, when compared with FY 2003. The decrease is due to a policy change during FY 2004 that transferred accounting responsibility for all disposal costs to the Department of the Army for inclusion in their financial statements. The Air Force no longer reports this activity.

General Disclosures

Accrued Environmental Restoration Costs (DERP-funded) Active Installations – Environmental Restoration and Other Accrued Environmental Costs (Non-DERP funds) Active Installations – Environmental Corrective Action

Environmental cleanup liabilities are incurred in connection with the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and the Resource Conservation and Recovery Act (RCRA). Cost estimates are performed using the RACER unless there is a historic comparable project, a specific bid, or an independent government cost estimate for the project. The liability amount is composed of the sum of several stages of activity and not necessarily contained in a single estimate or contract.

The change in environmental cleanup liability during a reporting period is comprised of revaluations of the cost-to-complete cleanup of sites that existed at the beginning of the period plus the cost-to-complete cleanup for new sites introduced during the reporting period, less amounts expensed in the program during the reporting period. The beginning environmental cleanup liability plus the cost-to-complete new sites added during the period plus or minus changes in cost-to-complete estimates (revaluations) during the period is equal to the ending environmental cleanup liability for the period. Because the DERP is accounted for as a totally self-contained program, all direct and indirect costs of the program are captured and reported.

Non-DERP, non-BRAC environmental cleanup liabilities represent corrective actions required under RCRA law. These environmental cleanup liabilities are estimated in the same manner as DERP environmental cleanup liabilities. The change in non-DERP, non-BRAC environmental cleanup liabilities during a reporting period is comprised of revaluations of the cost-to-complete for sites that existed at the beginning of the period plus the cost-to-complete for new sites added during the reporting period less amounts expensed during the period. Because the non-DERP, non-BRAC environmental cleanup activity is part of general funding achieved using 3400 appropriation funds, there is no special accounting for the costs of the entire program. Therefore, the costs captured for the non-DERP, non-BRAC environmental cleanup reflect only direct costs. Because this program was not tracked and appropriated specifically, there was no accounting specific to this program. Expense codes for this program were established in 1999 and implemented in FY 2000. Therefore, the expense portion of the estimate has no significant history. Because of the lack of expense history for the program, there is no reliable data for estimating the current portion of the non-DERP, non-BRAC environmental cleanup liability. It is believed that the current portion of the environmental cleanup liability in this area is relatively small and not material in the classification of liabilities. Because the non-DERP non-BRAC environmental cleanup liabilities are only estimated between 1 July and 1 September of each year, there is no significant change other than at fiscal yearend for non-DERP non-BRAC environmental liabilities. On less than an annual basis the only change to the liability estimate in this area is the amount recorded as expensed during the reporting period.

Included in the environmental restoration liability for active installations are 27 sites that represent building demolition and debris removal costs of approximately $56,500 thousand at September 30, 2004. Building demolition and debris removal costs represent a mixture of environmental and nonenvironmental costs that are not separated due to their joint nature.

Accrued Environmental Restoration Costs (DERP funded) Active Installations – Environmental Restorations for Closed Ranges

The environmental cleanup of military ranges is governed by the Military Munitions Rule in 40 CFR 266.201. Environmental cleanup liabilities on ranges refer only to munitions related activities. Other actions are captured under the DERP, BRAC, and non-DERP, non-BRAC environmental cleanup categories. Additionally, environmental cleanup liabilities are reported only for closed ranges. As of September 30, 2002, the Air Force had 509 ranges, of which 268 were considered operational ranges. The environmental cleanup liability is reported only for closed ranges that numbered 260 as of September 30, 2003 (236 closed, 18 transferred, and 6 transferring).

Environmental cleanup areas within a closed range are referred to as Munitions Response Areas (MRAs). As studies are done to find munitions- related contamination on closed ranges, the number of sites is expected to rise. As of September 30, 2003, there were 210 active areas on closed ranges resulting in an estimated environmental cleanup liability of $838,172 thousand, increasing to 240 active areas with an estimated cost of $1,344,856 thousand by September 30, 2004. As investigations progress, the number of sites will increase to reflect specific areas of pollution. The Air Force expects the number of sites reported to increase as pollution is discovered and sites are defined in areas less than the total boundary of the closed range. For example, one closed range of 100 acres may become three sites: one of five acres with pollution A, one of 15 acres with pollution B, and the remaining 80 acres with no pollution found. Thus, one closed range can become three sites, each with its own cost-to-complete cleanup estimate. The sum of the sites' costs-to-complete cleanup becomes the envi-

ronmental cleanup liability for closed ranges. The environmental cleanup for closed ranges is in its infancy, and the total liability is expected to increase significantly over the coming years as investigations progress. Current policy is to investigate all closed ranges by the end of 2007.

Although there are no stated standards for the environmental cleanup of closed ranges, the Air Force has implemented studies to determine the extent of pollution from munitions. It is expected that there will be significant changes in range cleanup standards that eventually will be applied on a case-by-case basis for munitions-response requirements.

As investigations progress, it is expected the environmental cleanup liability for closed ranges will increase materially. The liability for environmental cleanup will reflect direct costs. Also, the lack of expense history for range environmental cleanup makes it impossible to estimate current liabilities reliably for some time. The current liability reflects the amount contained in the President's Budget that shows the expected activity for the next fiscal year.

Other Accrued Environmental Costs (Non-DERP funds) Active Installations – Environmental Closure Requirements

Environmental closure liabilities are incurred under RCRA with the cost-to-complete closure reported for RCRA facilities. Cost estimates are prepared under assumptions of a clean close, as defined in the RCRA law and estimated using RACER in the absence of a specific contract cost or bid. The specific facilities reported cover landfills, Underground Storage Tanks (USTs), and Treatment, Storage and Disposal Facilities (TSDFs).

Disposal liabilities are presented as an accrued amount for the life of the RCRA facilities, and the total liability is presented in the year-end narrative. The accounting standard requires full cost be recognized for closure liability. Closure liabilities recognized by the Air Force cover only direct costs. No cost accounting exists to determine indirect closure costs. This is not considered material in the cost estimates because indirect costs incurred would not happen for at least 20 years and, in many cases, far beyond 20 years. The present value of such costs would be negligible in recognition of closure liabilities.

There are no material changes in environmental closure liabilities on less than an annual basis because revaluation and addition of new sites occurs in the last quarter of the year in preparation for the budget process. Because environmental closure liabilities are estimated in the last quarter of the year, new closure sites recognized in the last quarter of the year and no accounting process to capture environmental closure expenses, there is no material change in environmental closure liabilities on less than an annual basis. The total amortized annual portion of the liability estimate is recognized in the fiscal yearend liability, therefore, there is no change in the amortized liability amount on a quarterly basis. There is no value to the amortization of the estimated liability more frequently than annually because there is no cash impact for such recognition and there is no funding requirement in connection with the liability amortization. Because the function does not generate any revenues it is not essential to match costs against revenues to establish net income.

The environmental closure liability for landfills is based on the proportion of the landfill used as of the reporting date. This estimate includes the cost of capping the fill, as well as 30 years of monitoring required by federal regulations.

Reporting of landfill closure liability is not in conformance with the accounting standard. The standard would recognize all future costs regardless of timing. The Air Force recognizes only the initial closure. A landfill cap typically requires replacement every 20 to 40 years. An estimation of current costs based on all future costs, regardless of timing, would result in an infinite liability. This result would be meaningless and not the intent of the standard. Therefore, the Air Force reports only the cost of the initial cap required to close a landfill. The Air Force believes this reporting is more meaningful. The present value of the future caps (those after the initial cap) would be negligible.

UST closure liabilities are based on an assumed life of 20 years and two years of monitoring with closure costs estimated for a clean close. (Clean close is defined in the federal regulations.) TSDF closure liabilities are based on an assumed life of 30 years. Disposal costs include two years of monitoring with closure costs estimated for a clean close.

The unamortized and amortized liability amount is disclosed below. The amortized liability is the amount recognized on the financial statements.

FY 2004
(amounts in thousands)

	Unamortized	***Amortized***
TSDFs	$18,193	$5,361
Landfills	$204,590	$64,822
USTs	$59,229	$42,100
Total	**$282,012**	**$112,283**

Base Realignment and Closure (BRAC) Installations – Environmental Restoration and Environmental Corrective Action

The Air Force Real Property Agency (AFRPA) estimates a $1,522,448 thousand total environmental liability as of September 30, 2004. This amount includes all cleanup requirements to meet applicable laws and regulatory requirements and to transfer property. However, this amount does not include Land Use Control/Institutional Control costs beyond system operations associated with property transfer. Cost estimates are assigned to current operating periods using RACER.

Reporting of Estimates

Our financial statements are prepared in accordance with Federal Generally Accepted Accounting Principles. These accounting principles require us to make certain estimates, judgments, and assumptions that we believe are reasonable based upon information available to us at the time. These estimates, judgments, and assumptions can affect the reported amounts of environmental liabilities as of the date of the financial statements.

Our financial statements would be affected to the extent there are material differences between these estimates and actual results. In many cases, the accounting treatment of a particular transaction is specifically dictated by the Department of Defense (DoD) Financial Management Regulations (FMRs) and does not require management's judgment in its application. There also are areas in which management judgment in selecting any available alternative could produce a materially different result.

Note Reference

For regulatory discussion on environmental liabilities, see DoD FMR, Volume 6B, Chapter 10, Paragraph 1016 and Volume 4, Chapters 13 and 14.

Note 15.A. Other Liabilities

As of September 30	2004			2003
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
1. Intra-governmental:				
A. Advances from Others	$ 664,325	$ 0	$ 664,325	$ 145,290
B. Deferred Credits	0	0	0	0
C. Deposit Funds and Suspense Account Liabilities	23,508	0	23,508	23,503
D. Resources Payable to Treasury	0	0	0	0
E. Disbursing Officer Cash	311,323	0	311,323	273,536
F. Nonenvironmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
(4) Other	0	0	0	0
G. Accounts Payable—Cancelled Appropriations	0	0	0	0
H. Judgement Fund Liabilities	43	101,737	101,780	252,091
I. FECA Reimbursement to the Department of Labor	135,509	168,912	304,421	304,751
J. Capital Lease Liability	0	0	0	0
K. Other Liabilities	321,123	0	321,123	624,734
L. Total Intra-governmental Other Liabilities	$ 1,455,831	$ 270,649	$ 1,726,480	$ 1,623,905
2. Non-Federal:				
A. Accrued Funded Payroll and Benefits	$ 1,589,124	$ 0	$ 1,589,124	$ 1,289,522
B. Advances from Others	71,763	0	71,763	68,038
C. Deferred Credits	0	0	0	0
D. Loan Guarantee Liability	0	0	0	0
E. Liability for Subsidy Related to Undisbursed Loans	0	0	0	0
F. Deposit Funds and Suspense Accounts	30,199	0	30,199	29,181
G. Temporary Early Retirement Authority	304	1,199	1,503	5,143
H. Nonenvironmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	30,280	61,700	91,980	70,689
(3) Conventional Munitions Disposal	0	0	0	5,880
(4) Other	0	0	0	0
I. Accounts Payable—Cancelled Appropriations	0	0	0	445,939
J. Accrued Unfunded Annual Leave	2,272,599	0	2,272,599	2,152,619
K. Accrued Entitlement Benefits for Military Retirees and Survivors	0	0	0	0
L. Capital Lease Liability	32,900	202,736	235,636	263,801
M. Other Liabilities	934	308,767	309,701	190,076
N. Total Non-Federal Other Liabilities	$ 4,028,103	$ 574,402	$ 4,602,505	$ 4,520,888
3. Total Other Liabilities:	$ 5,483,934	$ 845,051	$ 6,328,985	$ 6,144,793

Other Information Pertaining to Other Liabilities

Intra-governmental Fluctuations

The $609,675 thousand increase in Advances from Others on Line 1.A. in comparison with FY 2003 is due to the timing of the receipt and execution of orders mainly in the Research, Test and Development (RDT&E) classified program, causing variations in the year-end balances.

The $37,787 thousand increase in Disbursing Officer Cash on Line 1.E. is attributed to the reduction of requirements that have subsided in asociation with Operation Iraqi Freedom, with has returning to pre-war levels.

The decrease on Line 1.K is due to the reduction of custodial liability in the recording of off-line receivables.

The decrease in Judgement Fund liabilities of $150,510 thousand result from contractor claims under the Contract Disputes Act on Air Force contracts that have been adjudicated by a court or a board in favor of the contractor. Initially, Treasury pays the monetary awards to the contractor. The Air Force must subsequently reimburse the Treasury's Judgement Fund for the amount that was paid to the contractors. The amount reported as the total Judgement Fund liability is the amount owed as of September 30, 2004. This amount includes approximately $42 thousand owed for Judgement Fund liabilities that resulted because of the Notification and Federal Employee Antidiscrimination and Retaliatory Act of 2002. This amount can change daily and can fluctuate substantially due to new billings by the Treasury and payments made to the Treasury by DFAS and the U.S. Army Corps of Engineers on behalf of the Air Force.

Other Liabilities

The amount of $321,124 thousand represents $41,216 thousand in government contributions for employee benefits, $25,823 thousand in unfunded unemployment compensation liabilities, $250,756 thousand in custodial liabilities, and $3,329 thousand in DoD education benefit liabilities.

Non-Federal Fluctuations

Accrued Funded Payroll and Benefits increased $299,602 thousand, or 23 percent, when compared with FY 2003. The change is due to the increase in the number of military personnel when Air Force Reserve and Air National Guard military personnel were activated in support of the war effort.

The Temporary Early Retirement Authority (TERA) liabilities decrease of $3,640 thousand is due to the termination of the program in FY 2002.

Nonenvironmental Disposal Liabilities – Excess/Obsolete Structures increased $21,291 thousand, or 30 percent, when compared with FY 2003. The increase is attributable to the recently completed housing market analysis that better defined the Air Force's surplus, inadequate housing inventory. Modifications in future year demolition strategy account for the change in disposal liability.

Nonenvironmental Disposal Liabilities – Conventional Munitions Disposal decreased $5,880 thousand, or 100 percent, when compared with FY 2003. The decrease is due to a policy change during FY 2004 that transferred accounting responsibility for all disposal costs to the Department of the Army for inclusion in their financial statements. The Air Force no longer reports this activity.

Accounts Payable – Cancelled Appropriations decreased $445,939 thousand, or 100 percent, when compared with FY 2003. The decrease is due to a change in the U.S. Standard General Ledger (USSGL) crosswalk. USSGL 2960, Accounts Payable from Cancelled Appropriations, is now reported on the Accounts Payable lines of the Balance Sheet instead of Other Liabilities.

The increase in contingent liabilities of $106 thousand is attributed to the win/loss settlement of case(s) and the associated dollar value.

The change in Capital Lease Liability is due to a decrease in leases held by the Air Force in FY04.

Non-Federal

Other Liabilities

The amount of $309,700 thousand represents legal contingencies of $308,766 thousand and accrued interest liability of $934 thousand.

The recorded estimated probable liability amount of $13,550 thousand has been included in the accompanying financial statements for open contractor claims greater than $100,000 and neither under appeal nor in litigation. In addition to the con-

tractor claims under appeal and the open contractor claims for an amount greater than $100,000, the Air Force was party to numerous other contractor claims in amounts less than $100,000 per claim. These claims are a routine part of the contracting business and are typically resolved through mutual agreement between the contracting officer and the contractor. Because of the routine nature of these claims, no requirement exists for a consolidated tracking mechanism to record the amount of each claim, the number of open claims, or the probability of the claim being settled in favor of the claimant. The potential liability arising from these claims in aggregate would not materially affect the operations or financial condition of the Air Force. A reasonably possible liability is estimated at $5,669 thousand and is not included in the reported amount.

The total estimated probable liability for claims and litigation against the Air Force handled by the Civil Law and Litigation Directorate, as of September 30, 2004, was valued at $284,526 thousand and has been included in the accompanying financial statements. As of June 30, 2004, the Air Force was party to 3,548 claims and litigation actions. This liability dollar amount recorded in the financial statements is an estimate based on the weighted average payout rate for the previous three years. A reasonably possible liability is estimated at $246,008 thousand and is not included in the reported amount. Neither past payments nor the current contingent liability estimate provides a basis for accurately projecting the results of any individual lawsuit or claim. It is uncertain that claims will ever accrue to the Air Force. In addition, many claims and lawsuits, even if successful, will not be paid out of Air Force Funds.

As of September 30, 2004, the Air Force was party to 62 contract appeals before the Armed Services Board of Contract Appeals (ASBCA). The probable amount of loss from contractor claims of $10,689 thousand has been included in the financial statements. The contractor claims involve unique circumstances, which are considered by the ASBCA in formulating decisions on the cases. Such claims are funded primarily from Air Force appropriations. A reasonably possible liability is estimated at $115,624 thousand and is not included in the reported amount.

Other Disclosures

Intra-governmental Reconciliation for Fiduciary Transactions with the Department of Labor (DoL) and the Office of Personnel Management (OPM):

With respect to the major fiduciary balances with the DoL and the OPM, the Air Force was able to reconcile with the OPM and the DoL. During these reconciliations, immaterial differences were identified.

Note 15.B. Capital Lease Liability

As of September 30	2004				2003
	Asset Category				
	Land and Buildings	Equipment	Other	Total	Total
(Amounts in thousands)					
1. Future Payments Due:					
A. 2004	$ 45,433	$ 0	$ 0	$ 45,433	$ 45,600
B. 2005	45,152	0	0	45,152	45,475
C. 2006	42,056	0	0	42,056	45,152
D. 2007	38,978	0	0	38,978	42,056
E. 2008	38,502	0	0	38,502	38,978
F. After 5 Years	115,278	0	0	115,278	165,138
G. Total Future Lease Payments Due	$ 325,399	$ 0	$ 0	$ 325,399	$ 382,399
H. Less: Imputed Interest Executory Costs	89,761	0	0	89,761	118,597
I. Net Capital Lease Liability	$ 235,638	$ 0	$ 0	$ 235,638	$ 263,802
2. Capital Lease Liabilities Covered by Budgetary Resources:				$ 188,413	$ 299,510
3. Capital Lease Liabilities Not Covered by Budgetary Resources:				$ 47,224	$ 82,679

Other Information

The Air Force is the lessee in eleven capital leases for family housing. Six of the military housing leases were awarded prior to FY 1992 and are funded on a FY basis.

Note 16. Commitments and Contingencies

Disclosures Related to Commitments and Contingencies

Relevant Information for Comprehension

The Commitments and Contingencies consist of the following reasonably possible liabilities:

Contractual Actions:

Contractor Claims		$5,669 Thousand
Appeals before Armed Services Board of Contract Appeals (ASBCA)		$115,624 Thousand
		$121,293 Thousand
Claims and Litigation from Civil Law:		$246,008 Thousand
	Total	**$367,301 Thousand**

Note Reference

See Note Disclosure 1.S., Significant Accounting Policies, for additional discussion on financial reporting requirements and Department of Defense policies governing Contingencies and Other Liabilities.

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

As of September 30	2004				2003
	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
(Amounts in thousands)					
1. Pension and Health Benefits:					
A. Military Retirement Pensions	$ 0		$ 0	$ 0	$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Benefits	$ 0		$ 0	$ 0	$ 0
2. Other:					
A. FECA	$ 1,163,442		$ 0	$ 1,163,442	$ 1,262,267
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. *[Enter Program Name}*	0		0	0	0
E. Total Other	$ 1,163,442		$ 0	$ 1,163,442	$ 1,262,267
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$ 1,163,442		$ 0	$ 1,163,442	$ 1,262,267

Military Retirement Pensions—Assumptions

The portion of the military retirement benefits actuarial liability applicable to the Department of the Air Force is reported on the financial statements of the Military Retirement Fund.

Military Retirement Health Benefits—Assumptions

Health benefits are funded centrally at the Department of Defense (DoD) level. As such, the portion of the health benefits actuarial liability that is applicable to the Air Force is reported only on the DoD Agency-wide financial statements.

Federal Employees' Compensation Act (FECA)—Assumptions and Actuarial Cost Method Used

The Air Force's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the Air Force at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the Office of Management and Budget's (OMB's) economic assumptions for 10-year U.S. Treasury notes and bonds. Cost-of-Living Adjustments (COLAs) and medical inflation factors are also applied to the calculation of projected future benefits. Interest rate assumptions utilized for discounting were as follows::

2004
4.883% in Year 1
5.235% in Year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. These factors 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 (CBYs) are as follows:

CBY	COLA	CPIM
2005	2.03%	4.14%
2006	2.73%	3.96%
2007	2.40%	3.98%
2008	2.40%	3.99%
2009+	2.40%	4.02%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on two tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments, and (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.

Note Reference

For regulatory discussion on "Military Retirement Benefits and Other Employment Related Actuarial Liabilities," see DoD Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1019.

Note 18. Unexpended Appropriations

As of September 30		2004		2003
(Amounts in thousands)				
1. Unexpended Appropriations:				
A. Unobligated, Available	$	3,284,541	$	8,323,168
B. Unobligated, Unavailable		2,194,414		1,571,907
C. Unexpended Obligations		44,181,715		40,847,242
D. Total Unexpended Appropriations	$	49,660,670	$	50,742,317

Other Information Pertaining to Unexpended Appropriations

Relevant Information for Comprehension

Unexpended Obligations reported as a component of Unexpended Appropriations include both Undelivered Orders-Unpaid and Undelivered Orders-Paid only for direct appropriated funds. This amount is distinct from Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Received line of the Statement of Financing, which includes the change during the fiscal year in Unexpended Obligations against Budget Authority from all sources.

An adjustment is reflected in line 1.C., Unexpended Obligations, to balance Note 18 to Unexpended Appropriations reflected on the balance sheet. The discrepancy is due to problems in the classification of the Direct vs reimbursable attribute for budgetary accounts. Further analysis and corrective action will be accomplished during FY 2005.

Note 19.A. General Disclosures Related to the Statement of Net Cost

Disclosures Related to the Statement of Net Cost

Statement of Net Cost

The Consolidated Statement of Net Cost (SoNC) in the federal government is unique because its principles are based on understanding the net cost of programs and/or organizations that the federal government supports through appropriations or other means. 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.

Reporting Entities

The amounts presented in the SoNC are based on obligations and disbursements and therefore may not in all cases report actual accrued costs. The Air Force generally records transactions on a cash basis and not an accrual basis as is required by Federal Generally Accepted Accounting Principles (GAAP). Therefore, the Air Force systems do not capture actual costs. As such, information presented in the SoNC is based on budgetary obligations, disbursements, and collection transactions, as well as non-financial feeder systems; the information is then adjusted to record known accruals for major items such as payroll expenses, accounts payable, and environmental liabilities.

Fluctuations and Abnormalities

Treasury changed the Statement of Net Cost mapping for FY 2004. Other Gains (USSGL 7190) was moved from Gross Costs with the Public to Earned Revenue from the Public. Additionally, amounts previously recorded in FY 2003 as Other Gains have been ruled as immaterial prior period adjustments that should have been recorded as Other Expenses Not Requiring Budgetary Resources (USSGL 6790).

Intra-governmental Earned Revenue 25 percent increase is due to larger spending authority earned in the O&M and RDT&E appropriations. The O&M increase was due to a concerted effort, in August and September 2004, at the Major Command level to properly code the reimbursable transactions in the accounting system to better reflect the total amount of goods and services sold to other DoD organizations. The RDT&E increase was a product of an OMB $2 Billion increase to spending authority (Reimbursable Budget Authority) resulting in a larger amount of goods and services sold to other DoD agencies.

The 106 percent increase in Earned Revenue from the Public is due to two factors. First, reporting of GLA 7190, Other Gains, to this line is a change for FY 2004. Previously, 7190 was included in Gross Cost. This account includes an increase in Other Gains on assets resulting from events other than the disposition of assets. Also GLA 7190 was used to adjust transfer-in balances when the amounts of intra-governmental transfers-out reported by the transferring entity are more than was accounted for on AF books.

Note 19.B. Gross Cost and Earned Revenue by Budget Functional Classification

Not applicable.

Note 19.C. Gross Cost to Generate Intra-governmental Revenue and Earned Revenue (Transactions with Other Federal-Non-DoD-Entities) by Budget Functional Classification

Not applicable.

Note 19.D. Imputed Expenses

As of September 30	2004	2003
(Amounts in thousands)		
1. Civilian (e.g.,CSRS/FERS) Retirement	$ 244,900	$ 254,229
2. Civilian Health	393,519	338,180
3. Civilian Life Insurance	1,316	1,249
4. Military Retirement Pension	0	0
5. Military Retirement Health	0	0
6. Judgment Fund	23,872	39,334
7. Total Imputed Expenses	$ 663,607	$ 632,992

Other Information

Fluctuations

The Civilian Health imputed expense increased $55,339 thousand, or 16 percent, when compared with FY 2003. The major factor contributing to this fluctuation is an increase in the cost factors computed by the Office of Personnel Management (OPM).

The Judgement Fund imputed expense decrease of $15,462 thousand is due to a decline in the number of Air Force lawsuits requiring payment by the Department of Treasury.

Information Related to Imputed Expenses

The total Civilian Retirement imputed expense of $244,900 thousand is comprised of $219,009 thousand for the Civil Service Retirement System (CSRS) and $25,891 thousand for the Federal Employees' Retirement System (FERS).

The imputed expenses are equal to the imputed revenue recognized on the Statement of Changes in Net Position and disclosed in detail in Note 20.

Note 19.E. Benefit Program Expenses

Not applicable.

Note 19.F. Exchange Revenue

Disclosures Related to the Exchange Revenue:

Exchange Revenue arises when a government entity provides goods and services to the public or to another government for a price, or earned revenue. Exchange revenue includes most user charges other than taxes, i.e., regulatory user charges.

Goods and services provided through reimbursable programs to the public or to another U.S. Government entity (intra-Air Force, intra-DoD or other federal entity) is provided at cost. Such reimbursable sales are reported as earned revenues. Costs are equal to the amount reported as earned. Since FY 2000, sales to the Foreign Military Trust Fund and related cost of sales have been reclassified as nonfederal transactions with the public, rather than as intra-governmental transactions as in prior years.

Note 19.G. Amounts for Foreign Military Sales (FMS) Program Procurements from Contractors

Disclosures Related to Amounts for FMS Program Procurements from Contractors

Not applicable.

Note 19.H. Stewardship Assets

Disclosures Related to Stewardship Assets

Stewardship assets include Heritage Assets, Stewardship Land, Nonfederal Physical Property, and Investments in Research and Development. The current-year costs of acquiring, constructing, improving, reconstructing, or renovating heritage assets; costs of acquiring stewardship land; and costs to prepare stewardship land for its intended use are required to be recognized and disclosed in the SoNC or the notes. Such costs, if any, are not separately identifiable and are not believed to be material.

Note 19.I. Intra-governmental Revenue and Expense

Disclosures Related to Intra-governmental Revenue and Expense:

Intra-governmental Revenue

The Air Force's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Air Force was unable to reconcile intra-governmental revenue balances with its trading partners. The DoD intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliation. The volume of intra-governmental transactions is so large that after-the-fact reconciliation cannot be accomplished with the existing or foreseeable resources.

Intra-governmental Operating Expenses

The Air Force's operating expenses were adjusted based on a comparison between the Air Force's accounts payable and the DoD Summary-level seller accounts receivables. An adjustment was posted to accounts payable and operating expenses to reflect unrecognized accounts payable and operating expenses.

Note 19.J. Suborganization Program Costs

Not applicable.

Note 20. Disclosures Related to the Statement of Changes in Net Position

As of September 30	Cumulative Results of Operations 2004	Unexpended Appropriations 2004	Cumulative Results of Operations 2003	Unexpended Appropriations 2003
(Amounts in thousands)				
1. Prior Period Adjustments Increases/Decreases to Net Position Beginning Balance:				
A. Changes in Accounting Standards	$ 0	$ 0	$ 122,475,076	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	0	0	0	0
C. Other Prior Period Adjustments	0	0	0	0
D. Total Prior Period Adjustments	$ 0	$ 0	$ 122,475,076	$ 0
2. Imputed Financing:				
A. Civilian CSRS/FERS Retirement	$ 244,900	$ 0	$ 254,229	$ 0
B. Civilian Health	393,519	0	338,180	0
C. Civilian Life Insurance	1,316	0	1,249	0
D. Military Retirement Pension	0	0	0	0
E. Military Retirement Health	0	0	0	0
F. Judgment Fund	23,872	0	39,334	0
G. Total Imputed Financing	$ 663,607	$ 0	$ 632,992	$ 0

Other Information

Relevant Information for Comprehension

The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards No. 23, Eliminating the category National Defense Property, Plant and Equipment, in May 2003. This standard requires the capitalization and depreciation of the cost of military equipment. This information was included in the statements through a prior-period adjustment.

Imputed Financing

The amounts remitted to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System (CSRS), the Federal Employees' Retirement System (FERS), the Federal Employees Health Benefits Program (FEHB), and the Federal Employees Group Life Insurance Program (FEGLI) do not fully cover the U.S. 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 the employees and contributions made by and for them. The OPM provides the cost factors to Defense Finance and Accounting Service (DFAS) for computation of imputed financing cost. DFAS provides the costs to the Office of the Under Secretary of Defense (Personnel and Readiness) (OUSD [P&R]) for validation. Approved imputed costs are provided to the reporting components for inclusion in their financial statements.

The total Civilian Retirement imputed financing of $244,900 thousand is comprised of $219,009 thousand for the CSRS and $25,891 thousand for the FERS.

The imputed revenue is equal to the imputed expense recognized in the Statement of Net Cost and disclosed in detail in Note 19D.

Note 21. Disclosures Related to the Statement of Budgetary Resources

As of September 30 (Amounts in thousands)	2004	2003
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 42,905,248	$ 42,556,665
2. Available Borrowing and Contract Authority at the End of the Period	0	0

Other Information Related to the Statement of Budgetary Resources

The amount of direct obligations incurred and apportioned under category A is $74,410,933 thousand, category B is $55,500,271 thousand, and exempt is $2,069 thousand. For reimbursable obligations incurred and apportioned, category A is $1,100,885 thousand, category B is $3,346,500 thousand, and exempt is $0.

Unexpended Obligations presented in the SBR includes Unexpended Obligations for both direct and reimbursable funds. The Department of Defense has not fully implemented the U.S. Standard General Ledger (USSGL) in all operational accounting systems.

The statement does not include any amounts for which the Department of Treasury is willing to accept corrections to canceled appropriation amounts, in accordance with the Statement of Federal Financial Accounting Standards No.1.

Adjustments in funds that are temporarily not available pursuant to public law and those that are permanently not available (included in the Adjustments line on the SBR) are not included in the Spending Authority from Offsetting Collections and Adjustments line of the SBR or the Spending Authority for Offsetting Collections and Adjustments line of the Statement of Financing.

Due to accounting system deficiencies, the proper amount of intra-agency eliminations for this statement cannot be determined. Accounting systems currently do not provide or capture data needed for obligations incurred and recoveries of prior year obligations in accordance with the Office of Management and Budget Circular A-11, “Instructions on Budget Execution,” requirements. Although the Defense and Accounting Service-Denver (DFAS-DE) developed an alternative methodology to calculate these items, the auditors and DFAS-DE concur that this methodology also distorts the obligation figures. As a result, the amount of distortion cannot be reliably determined and may or may not be material.

Note 22. Disclosures Related to the Statement of Financing

Disclosures Related to the Statement of Financing

The objective of the Statement of Financing is to reconcile the difference between budgetary obligations and the net cost of operations reported. It is presented as combined or combining statements rather than consolidated statements due to intragovernmental transactions not being eliminated. Due to limitations in the Department of the Air Force’s financial system,

budgetary data are not in agreement with proprietary expenses and assets capitalized. Differences between budgetary and proprietary data constitute a previously identified deficiency.

Note 1A and Note 1F provide additional detail.

Other Information Related to the Statement of Financing

Components Requiring or Generating Resources in Future Period, Other consists of $56,454 thousand in closed-year liabilities and $(3,249) thousand in DoD education benefit liabilities. Components Not Requiring or Generating Resources, Other, consists of $(191,867) thousand in bad debt expense, $(584,699) thousand in Other Expenses not Requiring Budgetary Resources, and $(1,948,496) thousand in Cost Capitalization Offset.

The components and amount of liabilities not covered by budgetary resources are disclosed in Note 11, Liabilities Not Covered by Budgetary Resources.

Intra-entity transactions have not been eliminated because the statements are presented as combined and combining.

Budgetary data are not in agreement with Proprietary Expenses and Asset Capitalized. This causes a difference between Net Cost on the Statement of Net Cost and on the Statement of Financing. The amount on the "Resources that finance the acquisition of assets" line has been adjusted $28,258 thousand to resolve differences.

Note 23. Disclosures Related to the Statement of Custodial Activity

Not applicable.

Note 24.A. Other Disclosures

As of September 30	2004				2003
(Amounts in thousands) B. Future Payments Due:	Land and Buildings	Equipment	Other	Total	Total
Fiscal Year					
2005	$ 113	$ 0	$ 114,821	$ 114,934	$ 1,399
2006	55	0	117,117	117,172	738
2007	63	0	119,460	119,523	458
2008	84	0	121,849	121,933	87
2009	98	0	124,286	124,384	85
After 5 Years	195	0	0	195	87
Total Future Lease Payments Due	$ 608	$ 0	$ 597,533	$ 598,141	$ 2,854

ENTITY AS LESSEE—Operating Leases

Fluctuations and Abnormalities

The increase in the Other Lease Category costs from FY03Q4 and FY04Q4 is due to a dramatic increase in the number of high-cost leases entered into by the Air Force (AF) in support of contingency operations in SWA/Afghanistan and AMC's efforts to convert their administrative support fleet to GSA leases. The bulk of the spike in lease costs for SWA and Afghanistan was the result of Air Combat Command (ACC) continuous effort to accomplish vehicle validation visits at all deployed locations, increased OPSTEMPO, and continued fluidity with build up of steady state operating locations. ACC expects continued significant quarterly changes in SWA commercial leases until a more stable environment is realized. Additionally, our GSA lease cost figures may continue to increase because as more alternative fuels become available, the AF is moving to GSA leases for general purpose Alternative Fueled Vehicles. We expect GSA lease costs will stabilize by the end of FY05 unless we have significant operational increase or changes in environmental laws affecting Federal fleets. The increase in the Land and Buildings Category cost between FY07 and FY11 is due to an additional 1700 family housing units for USAF-Europe. The Air Force has no leases in the Equipment Category and does not anticipate any in the future.

Definitions

- Lessee—A person or entity who receives the use and possession of leased property (e.g. real estate or equipment) from a lessor in exchange for a payment of funds.
- Operating Lease—A lease which does not transfer substantially all the benefits and risk of ownership. Payments should be charged to expense over the lease term as it becomes payable.

Land and Buildings Leases consist of:

- Description of Leases: The figures represent operating leased facilities in the U.S. and overseas applicable to active Air Force, Air Force Reserve and Air Force National Guard.

Equipment Leases consist of:

- Description of Leases: Operating leases for medical equipment are one-year leases with four option years. Each year, facilities must specifically exercise the option to continue the lease. The operating leases contain an option to purchase allow the government to purchase the equipment a fair market value at the end of the lease period.

Other Leases consist of:

- Description of Leases: Operating Leases for Motor Vehicles are essentially one to three-year leases funded in appropriation 3400 (O&M). As the out-year estimates indicate, the Air Force expects to continue to reduce the level of owned assets, while increasing the number of operational leases from commercial and GSA sources. The Air Force will continue to displace commercial leases in favor of IFMS (General Services Administration) leases because IFMS leases are typically more economical. Also, the commercial lease costs in support of operations in Iraq and Afghanistan have increased significantly and our estimations are that it will be at least another year before we see stabilization in our commercial lease costs.

Note 24.B. Other Disclosures

Undistributed Collections and Disbursements: Accounts receivable and payable are adjusted for undistributed collections and disbursements. These transactions represent the Air Force's in-float (undistributed) collections and disbursements for transactions that were reported by a disbursing station but not recorded by the appropriate accountable station. Undistributed amounts are prorated by appropriation based on the percentage of distributed government and public receivables and payables.

Canceled Balances: All unliquidated balances associated with closed accounts have been canceled in accordance with Public Law 101-510. Canceled accrued expenditures unpaid are reflected in the financial statements as unfunded liabilities. Canceled undelivered orders outstanding are not included in the financial statements; however, these orders may result in future expenditures.

General Fund

Consolidating and Combining Statements

Consolidating Balance Sheet—General Fund

As of September 30, 2004 and 2003 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard
ASSETS (Note 2)			
Intra-governmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 57,691,648	$ 909,269	$ 1,946,792
Non-Entity Seized Iraqi Cash	0	0	0
Non-Entity-Other	53,290	0	0
Investments (Note 4)	711	0	0
Accounts Receivable (Note 5)	959,581	112,322	179,587
Other Assets (Note 6)	56	0	0
Total Intra-governmental Assets	$ 58,705,286	$ 1,021,591	$ 2,126,379
Cash and Other Monetary Assets (Note 7)	$ 311,323	$ 0	$ 0
Accounts Receivable (Note 5)	953,472	9,285	16,126
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property (Note 9)	46,607,419	693,550	4,039,279
General Property, Plant and Equipment (Note 10)	113,134,711	1,059,098	3,760,621
Investments (Note 4)	0	0	0
Other Assets (Note 6)	10,787,653	5,336	16,599
TOTAL ASSETS	$ 230,499,864	$ 2,788,860	$ 9,959,004
LIABILITIES (Note 11)			
Intra-governmental:			
Accounts Payable (Note 12)	$ 523,132	$ 46,248	$ 82,481
Debt (Note 13)	0	0	0
Environmental Liabilities (Note 14)	0	0	0
Other Liabilities (Note 15 and Note 16)	1,770,504	1,803	2,150
Total Intra-governmental Liabilities	$ 2,293,636	$ 48,051	$ 84,631
Accounts Payable (Note 12)	$ 6,216,413	$ 154,602	$ 238,396
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	834,997	121,955	206,490
Environmental Liabilities (Note 14)	7,387,187	0	0
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	4,466,857	55,927	79,721
Debt Held by Public	0	0	0
TOTAL LIABILITIES	$ 21,199,090	$ 380,535	$ 609,238
NET POSITION			
Unexpended Appropriations (Note 18)	$ 49,486,289	$ 803,393	$ 1,787,049
Cumulative Results of Operations	159,814,485	1,604,932	7,562,717
TOTAL NET POSITION	$ 209,300,774	$ 2,408,325	$ 9,349,766
TOTAL LIABILITIES AND NET POSITION	$ 230,499,864	$ 2,788,860	$ 9,959,004

Component Level	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
$ 0	$ 60,547,709	$ 0	$ 60,547,709	$ 59,714,038
0	0	0	0	0
0	53,290	0	53,290	52,503
0	711	0	711	712
-561,619	689,871	0	689,871	541,429
443,883	443,939	0	443,939	339,093
$ -117,736	$ 61,735,520	$ 0	$ 61,735,520	$ 60,647,775
$ 0	$ 311,323	$ 0	$ 311,323	$ 147,926
0	978,883	0	978,883	772,500
0	0	0	0	0
0	51,340,248	0	51,340,248	51,815,831
0	117,954,430	0	117,954,430	112,786,130
0	0	0	0	0
0	10,809,588	0	10,809,588	9,912,151
$ -117,736	$ 243,129,992	$ 0	$ 243,129,992	$ 236,082,313
$ 1,248,550	$ 1,900,411	$ 0	$ 1,900,411	$ 1,413,940
0	0	0	0	0
0	0	0	0	0
-47,977	1,726,480	0	1,726,480	1,623,905
$ 1,200,573	$ 3,626,891	$ 0	$ 3,626,891	$ 3,037,845
$ 1,097,752	$ 7,707,163	$ 0	$ 7,707,163	$ 7,080,909
0	1,163,442	0	1,163,442	1,262,267
0	7,387,187	0	7,387,187	8,110,403
0	0	0	0	0
0	4,602,505	0	4,602,505	4,520,888
0	0	0	0	0
$ 2,298,325	$ 24,487,188	$ 0	$ 24,487,188	$ 24,012,312
$ -2,416,061	$ 49,660,670	$ 0	$ 49,660,670	$ 50,742,317
0	168,982,134	0	168,982,134	161,327,684
$ -2,416,061	$ 218,642,804	$ 0	$ 218,642,804	$ 212,070,001
$ -117,736	$ 243,129,992	$ 0	$ 243,129,992	$ 236,082,313

Consolidating Statement of Net Cost—General Fund

For the periods ended September 30, 2004 and 2003 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard
Program Costs			
A. Military Personnel	0		
Intra-governmental Gross Costs	$ -3,201	$ 46,772	$ 275,635
(Less: Intra-governmental Earned Revenue)	-288,373	-5,856	-21,120
Intra-governmental Net Costs	$ -291,574	$ 40,916	$ 254,515
Gross Costs With the Public	26,499,285	1,191,146	2,017,930
(Less: Earned Revenue From the Public)	-94,079	3	-12,475
Net Costs With the Public	$ 26,405,206	$ 1,191,149	$ 2,005,455
Total Net Cost	$ 26,113,632	$ 1,232,065	$ 2,259,970
B. Operation and Maintenance	0		
Intra-governmental Gross Costs	$ 14,295,821	$ 698,044	$ 1,893,086
(Less: Intra-governmental Earned Revenue)	-3,557,430	-303,209	-524,737
Intra-governmental Net Costs	$ 10,738,391	$ 394,835	$ 1,368,349
Gross Costs With the Public	23,228,346	1,734,741	3,502,356
(Less: Earned Revenue From the Public)	-502,304	-6,321	-135,839
Net Costs With the Public	$ 22,726,042	$ 1,728,420	$ 3,366,517
Total Net Cost	$ 33,464,433	$ 2,123,255	$ 4,734,866
C. Procurement	0		
Intra-governmental Gross Costs	$ 652,495	$ 0	$ 0
(Less: Intra-governmental Earned Revenue)	-265,408	0	0
Intra-governmental Net Costs	$ 387,087	$ 0	$ 0
Gross Costs With the Public	27,231,988	0	0
(Less: Earned Revenue From the Public)	-401,470	0	0
Net Costs With the Public	$ 26,830,518	$ 0	$ 0
Total Net Cost	$ 27,217,605	$ 0	$ 0
D. Research, Development, Test & Evaluation	0		
Intra-governmental Gross Costs	$ 791,689	$ 0	$ 0
(Less: Intra-governmental Earned Revenue)	-2,553,633	0	0
Intra-governmental Net Costs	$ -1,761,944	$ 0	$ 0
Gross Costs With the Public	20,987,117	0	0
(Less: Earned Revenue From the Public)	-174,458	0	0
Net Costs With the Public	$ 20,812,659	$ 0	$ 0
Total Net Cost	$ 19,050,715	$ 0	$ 0
E. Military Construction/Family Housing	0		
Intra-governmental Gross Costs	$ 196,768	$ 601	$ 3,483
(Less: Intra-governmental Earned Revenue)	781	0	0
Intra-governmental Net Costs	$ 197,549	$ 601	$ 3,483
Gross Costs With the Public	217,498	91,367	276,538
(Less: Earned Revenue From the Public)	0	0	0
Net Costs With the Public	$ 217,498	$ 91,367	$ 276,538
Total Net Cost	$ 415,047	$ 91,968	$ 280,021
F. Other	0		
Intra-governmental Gross Costs	$ 10,764	$ 0	$ 0
(Less: Intra-governmental Earned Revenue)	0	0	0
Intra-governmental Net Costs	$ 10,764	$ 0	$ 0
Gross Costs With the Public	3,547	0	0
(Less: Earned Revenue From the Public)	-11,010	0	0
Net Costs With the Public	$ -7,463	$ 0	$ 0
Total Net Cost	$ 3,301	$ 0	$ 0
G. Total Program Costs	0		
Intra-governmental Gross Costs	$ 15,944,336	$ 745,417	$ 2,172,204
(Less: Intra-governmental Earned Revenue)	-6,664,063	-309,065	-545,857
Intra-governmental Net Costs	$ 9,280,273	$ 436,352	$ 1,626,347
Gross Costs With the Public	98,167,781	3,017,254	5,796,824
(Less: Earned Revenue From the Public)	-1,183,321	-6,318	-148,314
Net Costs With the Public	$ 96,984,460	$ 3,010,936	$ 5,648,510
Total Net Cost	$ 106,264,733	$ 3,447,288	$ 7,274,857
Cost Not Assigned to Programs	0	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0	0
Net Cost of Operations	$ 106,264,733	$ 3,447,288	$ 7,274,857

The accompanying notes are an integral part of the financial statements. See notes 1 and 19.

Component Level	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
	$ 319,206	$ 0	$ 319,206	$ 720,365
	-315,349	0	-315,349	-342,368
	$ 3,857	$ 0	$ 3,857	$ 377,997
	29,708,361	0	29,708,361	28,348,890
	-106,551	0	-106,551	-147,296
	$ 29,601,810	$ 0	$ 29,601,810	$ 28,201,594
	$ 29,605,667	$ 0	$ 29,605,667	$ 28,579,591
	$ 16,886,951	$ 0	$ 16,886,951	$ 15,259,669
	-4,385,376	0	-4,385,376	-3,730,957
	$ 12,501,575	$ 0	$ 12,501,575	$ 11,528,712
	28,465,443	0	28,465,443	27,571,579
	-644,464	0	-644,464	-525,209
	$ 27,820,979	$ 0	$ 27,820,979	$ 27,046,370
	$ 40,322,554	$ 0	$ 40,322,554	$ 38,575,082
	$ 652,495	$ 0	$ 652,495	$ 2,669
	-265,408	0	-265,408	-214,765
	$ 387,087	$ 0	$ 387,087	$ -212,096
	27,231,988	0	27,231,988	35,414,003
	-401,470	0	-401,470	-13,188
	$ 26,830,518	$ 0	$ 26,830,518	$ 35,400,815
	$ 27,217,605	$ 0	$ 27,217,605	$ 35,188,719
	$ 791,689	$ 0	$ 791,689	$ 976,052
	-2,553,633	0	-2,553,633	-2,356,078
	$ -1,761,944	$ 0	$ -1,761,944	$ -1,380,026
	20,987,117	0	20,987,117	19,273,993
	-174,458	0	-174,458	-138,222
	$ 20,812,659	$ 0	$ 20,812,659	$ 19,135,771
	$ 19,050,715	$ 0	$ 19,050,715	$ 17,755,745
	$ 200,852	$ 0	$ 200,852	$ 146,489
	781	0	781	0
	$ 201,633	$ 0	$ 201,633	$ 146,489
	585,403	0	585,403	1,240,859
	0	0	0	0
	$ 585,403	$ 0	$ 585,403	$ 1,240,859
	$ 787,036	$ 0	$ 787,036	$ 1,387,348
$ 10,047,907	$ 10,058,671	$ 0	$ 10,058,671	$ 9,741,420
2,516,739	2,516,739	0	2,516,739	2,657,757
$ 12,564,646	$ 12,575,410	$ 0	$ 12,575,410	$ 12,399,177
-10,475,871	-10,472,324	0	-10,472,324	-12,046,057
-386,383	-397,393	0	-397,393	-12,243
$ -10,862,254	$ -10,869,717	$ 0	$ -10,869,717	$ -12,058,300
$ 1,702,392	$ 1,705,693	$ 0	$ 1,705,693	$ 340,877
$ 10,047,907	$ 28,909,864	$ 0	$ 28,909,864	$ 26,846,664
2,516,739	-5,002,246	0	-5,002,246	-3,986,411
$ 12,564,646	$ 23,907,618	$ 0	$ 23,907,618	$ 22,860,253
-10,475,871	96,505,988	0	96,505,988	99,803,267
-386,383	-1,724,336	0	-1,724,336	-836,158
$ -10,862,254	$ 94,781,652	$ 0	$ 94,781,652	$ 98,967,109
$ 1,702,392	$ 118,689,270	$ 0	$ 118,689,270	$ 121,827,362
0	0	0	0	0
0	0	0	0	0
$ 1,702,392	$ 118,689,270	$ 0	$ 118,689,270	$ 121,827,362

The accompanying notes are an integral part of the financial statements. See notes 1 and 19.

Consolidating Statement of Changes in Net Position—General Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 152,136,711	$ 1,595,916	$ 7,595,057
Prior Period Adjustments - Restated (+/-)	0	0	0
Beginning Balance, Restated	152,136,711	1,595,916	7,595,057
Prior Period Adjustments - Not Restated (+/-)	0	0	0
Beginning Balances, as adjusted	152,136,711	1,595,916	7,595,057
Budgetary Financing Sources:			
Appropriations received	0	0	0
Appropriations transferred-in/out (+/-)	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0
Appropriations used	112,007,930	3,418,963	7,171,317
Nonexchange revenue	8,827	0	0
Donations and forfeitures of cash and cash equivalents	2,171	0	0
Transfers-in/out without reimbursement (+/-)	671,000	0	0
Other budgetary financing sources (+/-)	0	0	0
Other Financing Sources:			
Donations and forfeitures of property	0	0	0
Transfers-in/out without reimbursement (+/-)	588,973	37,340	71,200
Imputed financing from costs absorbed by others	663,607	0	0
Other (+/-)	0	0	0
Total Financing Sources	113,942,508	3,456,303	7,242,517
Net Cost of Operations (+/-)	106,264,733	3,447,288	7,274,857
Ending Balances	$ 159,814,486	$ 1,604,931	$ 7,562,717
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 48,066,969	$ 956,002	$ 2,046,631
Prior Period Adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0	0	0
Beginning Balance, Restated	48,066,969	956,002	2,046,631
Prior Period Adjustments - Not Restated (+/-)	0	0	0
Beginning Balances, as adjusted	48,066,969	956,002	2,046,631
Budgetary Financing Sources:			
Appropriations received	114,855,435	3,582,508	7,042,722
Appropriations transferred-in/out (+/-)	-115,191	-267,364	-71,901
Other adjustments (rescissions, etc) (+/-)	-1,312,994	-48,790	-59,086
Appropriations used	-112,007,930	-3,418,963	-7,171,317
Nonexchange revenue	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0
Transfers-in/out without reimbursement (+/-)	0	0	0
Other budgetary financing sources (+/-)	0	0	0
Other Financing Sources:			
Donations and forfeitures of property	0	0	0
Transfers-in/out without reimbursement (+/-)	0	0	0
Imputed financing from costs absorbed by others	0	0	0
Other (+/-)	0	0	0
Total Financing Sources	1,419,320	-152,609	-259,582
Net Cost of Operations (+/-)			
Ending Balances	$ 49,486,289	$ 803,393	$ 1,787,049

The accompanying notes are an integral part of the financial statements. See notes 1 and 20.

Component Level	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
$ 0	$ 161,327,684	$ 0	$ 161,327,684	$ 47,443,218
0	0	0	0	0
0	161,327,684	0	161,327,684	47,443,218
0	0	0	0	122,475,076
0	161,327,684	0	161,327,684	169,918,294
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
2,088,776	124,686,986	0	124,686,986	113,384,126
0	8,827	0	8,827	0
0	2,171	0	2,171	9,096
0	671,000	0	671,000	0
0	0	0	0	-678,772
0	0	0	0	0
-386,383	311,130	0	311,130	-110,688
0	663,607	0	663,607	632,992
0	0	0	0	0
1,702,393	126,343,721	0	126,343,721	113,236,754
1,702,392	118,689,270	0	118,689,270	121,827,362
$ 1	$ 168,982,135	$ 0	$ 168,982,135	$ 161,327,686
$ -327,285	$ 50,742,317	$ 0	$ 50,742,317	$ 39,543,850
0	0	0	0	0
-327,285	50,742,317	0	50,742,317	39,543,850
0	0	0	0	0
-327,285	50,742,317	0	50,742,317	39,543,850
0	125,480,665	0	125,480,665	124,225,931
0	-454,456	0	-454,456	2,179,806
0	-1,420,870	0	-1,420,870	-1,823,145
-2,088,776	-124,686,986	0	-124,686,986	-113,384,126
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
-2,088,776	-1,081,647	0	-1,081,647	11,198,466
$ -2,416,061	$ 49,660,670	$ 0	$ 49,660,670	$ 50,742,316

The accompanying notes are an integral part of the financial statements. See notes 1 and 20.

Combining Statement of Budgetary Resources—General Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	Air Force Active	Air Force Reserve
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 114,858,556	$ 3,582,508
Borrowing authority	0	0
Contract authority	0	0
Net transfers (+/-)	125,871	-192,964
Other	0	0
Unobligated balance:		
Beginning of period	8,661,900	162,910
Net transfers, actual (+/-)	429,938	-74,400
Anticipated Transfers Balances	0	0
Spending authority from offsetting collections:		
Earned	0	0
Collected	7,198,945	259,901
Receivable from Federal sources	230,989	53,249
Change in unfilled customer orders	0	0
Advance received	188,077	0
Without advance from Federal sources	-109,846	50
Anticipated for the rest of year, without advances	0	0
Transfers from trust funds	0	0
Subtotal	7,508,165	313,200
Recoveries of prior year obligations	1,304,731	56,209
Temporarily not available pursuant to Public Law	0	0
Permanently not available	-1,329,777	-48,790
Total Budgetary Resources	$ 131,559,384	$ 3,798,673
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 119,492,619	$ 3,366,775
Reimbursable	3,487,131	308,877
Subtotal	122,979,750	3,675,652
Unobligated balance:		
Apportioned	7,894,840	34,944
Exempt from apportionment	2,709	0
Other available	0	0
Unobligated Balances Not Available	682,085	88,077
Total, Status of Budgetary Resources	$ 131,559,384	$ 3,798,673
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	$ 47,752,881	$ 887,527
Obligated Balance transferred, net (+/-)	0	0
Obligated Balance, Net - end of period:		
Accounts receivable	-1,172,373	-114,923
Unfilled customer order from Federal sources	-827,056	-50
Undelivered orders	43,105,532	675,121
Accounts payable	8,005,704	226,101
Outlays:		
Disbursements	120,194,950	3,667,422
Collections	-7,387,022	-259,901
Subtotal	112,807,928	3,407,521
Less: Offsetting receipts	-115,376	0
Net Outlays	$ 112,692,552	$ 3,407,521

The accompanying notes are an integral part of the financial statements. See notes 1 and 21.

Air National Guard	Component Level	2004 Combined	2003 Combined
$ 7,042,722	$ 0	$ 125,483,786	$ 124,235,723
0	0	0	0
0	0	0	0
37,699	0	-29,394	1,888,215
0	0	0	0
365,136	0	9,189,946	6,066,510
-109,600	0	245,938	291,591
0	0	0	0
0	0	0	0
658,759	0	8,117,605	7,802,547
33,327	0	317,565	-322,918
0	0	0	0
-5	0	188,072	213,465
-185	0	-109,981	472,167
0	0	0	0
0	0	0	0
691,896	0	8,513,261	8,165,261
70,139	0	1,431,079	1,955,959
0	0	0	0
-59,086	0	-1,437,653	-1,806,362
$ 8,038,906	$ 0	$ 143,396,963	$ 140,796,897
$ 7,053,879	$ 0	$ 129,913,273	$ 123,375,566
651,378	0	4,447,386	8,231,386
7,705,257	0	134,360,659	131,606,952
142,782	0	8,072,566	8,320,595
0	0	2,709	2,573
-1	0	-1	-1
190,868	0	961,030	866,778
$ 8,038,906	$ 0	$ 143,396,963	$ 140,796,897
$ 1,901,175	$ 0	$ 50,541,583	$ 41,822,195
0	0	0	0
-189,316	0	-1,476,612	-1,159,047
-287	0	-827,393	-937,374
1,437,060	-2,907,921	42,309,792	42,168,646
365,685	2,907,921	11,505,411	10,469,360
7,890,009	0	131,752,381	120,782,356
-658,755	0	-8,305,678	-8,016,013
7,231,254	0	123,446,703	112,766,343
0	0	-115,376	-156,704
$ 7,231,254	$ 0	$ 123,331,327	$ 112,609,639

The accompanying notes are an integral part of the financial statements. See notes 1 and 21.

Combining Statement of Financing—General Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	Air Force Active	Air Force Reserve
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 122,979,750	$ 3,675,652
Less: Spending authority from offsetting collections and recoveries (-)	-8,812,896	-369,410
Obligations net of offsetting collections and recoveries	114,166,854	3,306,242
Less: Offsetting receipts (-)	-115,376	0
Net obligations	114,051,478	3,306,242
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	588,973	37,340
Imputed financing from costs absorbed by others	663,607	0
Other (+/-)	0	0
Net other resources used to finance activities	1,252,580	37,340
Total resources used to finance activities	115,304,058	3,343,582
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered Orders (-)	-2,228,506	112,671
Unfilled Customer Orders	78,231	50
Resources that fund expenses recognized in prior periods	-862,836	-11,266
Budgetary offsetting collections and receipts that do not affect net cost of operations	115,376	0
Resources that finance the acquisition of assets	-15,956,828	-15,952
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0	0
Other (+/-)	-588,973	-37,340
Total resources used to finance items not part of the net cost of operations	-19,443,536	48,163
Total resources used to finance the net cost of operations	95,860,522	3,391,745
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	127,062	3,244
Increase in environmental and disposal liability	0	0
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
Increase in exchange revenue receivable from the the public (-)	0	0
Other (+/-)	52,756	315
Total components of Net Cost of Operations that will require or generate resources in future periods	179,818	3,559
Components not Requiring or Generating Resources:		
Depreciation and amortization	9,601,433	45,074
Revaluation of assets or liabilities (+/-)	-547,355	-1,625
Other (+/-)		
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	0	0
Operating Material & Supplies Used	3,791,424	28,284
Other	-2,621,109	-19,751
Total components of Net Cost of Operations that will not require or generate resources	10,224,393	51,982
Total components of net cost of operations that will not require or generate resources in the current period	10,404,211	55,541
Net Cost of Operations	106,264,733	3,447,286

The accompanying notes are an integral part of the financial statements. See notes 1 and 22.

Air National Guard	Component Level	2004 Combined	2003 Combined
$ 7,705,256	$ 0	$ 134,360,658	$ 131,606,952
-762,035	0	-9,944,341	-10,121,221
6,943,221	0	124,416,317	121,485,731
0	0	-115,376	-156,704
6,943,221	0	124,300,941	121,329,027
0	0	0	0
71,200	-386,383	311,130	-110,688
0	0	663,607	632,992
0	0	0	0
71,200	-386,383	974,737	522,304
7,014,421	-386,383	125,275,678	121,851,331
228,325	2,088,776	201,266	-8,331,143
-190	0	78,091	685,633
-21,986	0	-896,088	0
0	0	115,376	9,106
-95,614	0	-16,068,394	-19,120,713
0	0	0	0
-71,200	386,383	-311,130	110,688
39,335	2,475,159	-16,880,879	-26,646,429
7,053,756	2,088,776	108,394,799	95,204,902
7,394	0	137,700	478,344
0	0	0	-344,161
0	0	0	0
0	0	0	0
134	0	53,205	14,770
7,528	0	190,905	148,953
201,198	0	9,847,705	13,282,864
-2,718	-386,383	-938,081	1,641,043
0	0	0	0
0	0	0	0
99,294	0	3,919,002	0
-84,203	0	-2,725,063	11,549,603
213,571	-386,383	10,103,563	26,473,510
221,099	-386,383	10,294,468	26,622,463
7,274,855	1,702,393	118,689,267	121,827,365

The accompanying notes are an integral part of the financial statements. See notes 1 and 22.

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General Fund

Required Supplementary Stewardship Information

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National Defense Property, Plant and Equipment

The Federal Accounting Standards Advisory Board (FASAB) revised the Statement of Federal Financial Accounting Standards No. 6 to require the capitalization and depreciation of military equipment (formerly National Defense Property, Plant and Equipment/ND PP&E) for fiscal years 2004 and beyond and encouraged early implementation.

HERITAGE ASSETS
For Fiscal Year Ended September 2004

	Measurement Quantities	As Of 10/1/2003	Additions	Deletions	As Of 9/30/2004
Museums	Each	18	0	0	18
Monuments & Memorials	Each	151	2	0	153
Cemeteries	Sites	39	0	0	39
Archeological Sites	Sites	1,685	0	0	1,685
Buildings & Structures	Each	4,074	0	0	4,074
Major Collections	Each	4	0	0	4

1. Museums

The Air Force Museum, located at Wright-Patterson Air Force Base, Ohio, houses the main collection of historical artifacts that are registered as historical property in the USAF Museum System. The other 17 Air Force museums are considered Air Force Field Museums or Heritage Centers, which also contain items of historical interest; some however, are specific to the general locality.

All remaining museums and Heritage Centers are reported in acceptable condition.

2. Monuments and Memorials

The memorials and monuments reported above, except for 28, are all located at the Air Force Academy in the Air Gardens and Honor Court. Most of these monuments and memorials honor specific individuals or cadet wings for various accomplishments. The remaining 28 memorials, all with costs that exceed $100,000, are located on various Air Force bases throughout the United States. All are reported in acceptable condition.

3. Cemeteries

The Air Force has administrative and curatorial responsibilities for 39 cemeteries on its bases. The cemeteries are maintained by the bases and are in good condition.

4. Archeological Sites

As of 30 September 2004, the AF has 1,685 archeological sites listed on, or eligible for, the National Register. The AF has 9,779 potentially eligible archeological sites, and 2,464 non-eligible archaeological sites. Neither is listed on this report. The numbers of archaeological sites will increase yearly as the AF completes surveys in compliance with the National Historic Preservation Act. The number of archaeological sites on AF managed lands is reported each year in the Report to Congress on Federal Archaeological Activities (FY03 report submitted March 04). The identified sites are maintained in an acceptable condition.

5. Buildings and Structures

The Air Force currently considers 4,074 buildings and structures as heritage assets. Most of these buildings and structures are considered Multi-use Heritage Assets, and as such, have been reported as general property, plant, and equipment on the

Balance Sheet. The buildings and structures are maintained by each base civil engineering group and are considered to be in good condition.

6. Major Collections

The Air Force has four significant or major collections consisting of: (a) the Air Force Art Collection, and (b) three collections at the Air Force Academy containing historical items and memorabilia as well as distinctive works of art. The curators for all major collections reported the contents to be in good condition. They further added that almost all of the materials are protected in an environment suitable for long-term storage. The overall condition of the collections in the museums is good; items are displayed and protected in accordance with the standards of Air Force Instruction 84-103, USAF Museum System.

STEWARDSHIP LAND
For Fiscal Year Ended September 2004 (Acres in Thousands)

(a) Land Use	(b) As of 10/1/2003	(c) Additions	(d) Deletions	(e) As of 9/30/2004
1. Mission	7,728	0	0	7,728
2. Parks & Historic Sites	0	0	0	0
Totals	7,728	0	0	7,728

The Air Force has 7,728 acres of mission-essential land under their administration. Lands purchased by the Air Force with the intent to construct buildings or facilities are considered general PP&E and are reported on the balance sheet. All stewardship lands, as reported, are in acceptable condition, based on designated use.

NONFEDERAL PHYSICAL PROPERTY
Yearly Investment in State and Local Governments
For Fiscal Years 2000 through 2004 ($ in Millions)

Categories	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Funded Assets:					
National Defense Mission Related	$6.80	$20.20	$21.30	$11.31	$18.30
Total	$6.80	$20.20	$21.30	$11.31	$18.30

The Air National Guard investments in non-federal physical property are strictly through the Military Construction Cooperative Agreements (MCCAs). These agreements involve the transfer of money only and allow joint participation with States, Counties, and Airport Authorities for construction or repair of airfield pavements and facilities required to support the flying mission assigned at these civilian airfields.

Investment values included in this report are based on Nonfederal Physical Property outlays (expenditures). Outlays are used because current DoD systems are unable to capture and summarize costs in accordance with the Federal Accounting Standards requirements.

INVESTMENTS IN RESEARCH AND DEVELOPMENT
Yearly Investment in Research and Development
For Fiscal Years 2000 through 2004 ($ in Millions)

Categories	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
1. Basic Research	$206	$203	$208	$141	$326
2. Applied Research	577	637	666	510	886
3. Development					
Advanced Technology Development	554	545	492	399	1,074
Advanced Component Development and Prototypes	899	1,237	884	1,065	2,003
System Development and Demonstration	4,251	3,279	3,194	2,903	4,390
Research, Development, Test and Evaluation Management Support	768	777	769	597	1,000
Operational Systems Development	7,096	7,295	7,225	7,864	10,612
Totals	$14,351	$13,973	$13,438	$13,479	$20,291

Basic Research is the systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications, processes, or products in mind. Basic Research involves the gathering of a fuller knowledge or understanding of the subject under study. Major outputs are scientific studies and research papers.

Applied Research is the systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met. It is the practical application of such knowledge or understanding for the purpose of meeting a recognized need. This research points toward specific military needs with a view toward developing and evaluating the feasibility and practicability of proposed solutions and determining their parameters. Major outputs are scientific studies, investigations, and research papers, hardware components, software codes, and limited construction of, or part of, a weapon system to include nonsystem specific development efforts.

Development takes what has been discovered or learned from basic and applied research and uses it to establish technological feasibility, assessment of operability, and production capability. Development is comprised of five stages defined below:

1. Advanced Technology Development is the systematic use of the knowledge or understanding gained from research directed toward proof of technological feasibility and assessment of operational and producibility rather than the development of hardware for service use. Employs demonstration activities intended to prove or test a technology or method.

2. Advanced Component Development and Prototypes evaluates integrated technologies in as realistic an operating environment as possible to assess the performance or cost reduction potential of advanced technology. Programs in this phase are generally system specific. Major outputs of Advanced Component Development and Prototypes are hardware and software components, or complete weapon systems, ready for operational and developmental testing and field use.

3. System Development and Demonstration concludes the program or project and prepares it for production. It consists primarily of preproduction efforts, such as logistics and repair studies. Major outputs are weapon systems finalized for complete operational and developmental testing.

4. RDT&E Management Support is support for installations and operations for general research and development use. This category includes costs associated with test ranges, military construction maintenance support for laboratories, operations and maintenance of test aircraft and ships, and studies and analysis in support of the R&D program.

5. Operational Systems Development is concerned with development projects in support of programs or upgrades still in engineering and manufacturing development, which have received approval for production, for which production funds have been budgeted in subsequent fiscal years.

The following are representative program examples for each of the above major categories:

Basic Research—The Air Force supported basic researchers have developed a method to produce gallium nitride material for use in improved semiconductor devices. This advance could enable improved electronics that can perform in harsh environments. Possible applications include: remote-sensing platforms; displays and indicators based on light-emitting diodes; laser diodes for optical data storage; and sensor and detector surveillance systems, such as the solar-blind shield and biological agent detectors.

Air Force supported basic researchers have discovered a new method of improving digital signal processing through holography. These holographic systems are able to record fast events that occur on the nanosecond timescale. This advance could lead to significant improvements in our capability to track and identify enemy aircraft and missile threats.

Applied Research—The AF's Applied Research program is developing technologies to support the air and space force of the future. Development of electronic components and subsystems for use in shallow-depth phased-array radar antennas for persistent intelligence, surveillance, and reconnaissance and time-sensitive strike capabilities. Such phased-array antennas, at 1/5 the cost of conventional antennas, could have direct application to advanced unmanned aerial vehicles and fighter aircraft. Wireless Intrusion Detection System sensors for information assurance were designed, developed, and field-tested. This program opens the door for secure operation of military wireless networks based on this widely available and cost-effective technology.

Advanced Technology Development—The AF's Advanced Technology Development program demonstrates, in a realistic operational environment, integrated sets of technology to prove military worth and utility. The first example was when the AF and the Defense Advanced Research Projects Agency conducted a successful jettison release of a weapon from a Boeing X-45A Joint Unmanned Combat Air System (J-UCAS) over the Precision Impact Range Area (PIRA) at Edwards Air Force Base, CA. It is an aviation first for a UAV to release from an internal weapons bay. Secondly, AFRL also demonstrated a 330 Gigahertz detector that operates at frequencies billions of times faster than the blink of an eye. This technology will be used to produce compact solid-state circuits operating at Terahertz frequencies. Likely technology application would be to enable a new generation of sensors to enhance homeland security. Completed the final transition of the very successful Laser Infrared Countermeasures Fly-out Experiment demonstration with a final risk reduction live fire missile test at Tonopah National Test Range, Nevada. This test showed conclusively that Closed Loop Infrared Countermeasures jamming techniques provide a robust capability against a wide variety of infrared missiles, including proliferated Man Portable Air Defense Systems.

Developed a custom-molded, noise-attenuating earplug that enables seamless voice communications to and from radios, while electronically passing all outside environmental sounds to the operator at safe levels.

Demonstration and Validation (Advanced Component Development and Prototypes)—The Air Force's Advanced Component Development and Prototypes (ACD&EP) programs are comprised of system specific advanced technology integration efforts accomplished in an operational environment to help expedite transition from the effort: In FY04 the Air Force successfully demonstrated Fighter Aircraft Command and Control Enhancement (FACE). FACE provides an improved, beyond-line-of-sight (BLOS) command and control link with fighter aircraft by integrating Iridium telephone communications equipment with existing aircraft communications equipment. BLOS capability has traditionally been provided by low-density, high-demand airborne platforms acting as communications relays. FACE provides relief for these overworked assets, while allowing combatant commanders to maintain positive control of the battle space. FACE, which has been approved for

deployment to Afghanistan through the Air Force's Rapid Response Process, has the potential for extensive use in virtually any Area of Responsibility, including Homeland Defense.

In FY04, the joint DARPA/Air Force program office awarded Falcon contracts (other transaction agreements administered by DARPA) for the development and demonstration of key technologies. The small responsive launch vehicle portion (four contracts) is proceeding toward a FY05 down select (to one or more contractors) with a launch no later than FY07 while the hypersonic test vehicle portion (one contract) is also working toward a FY07 launch. The ultimate goal of this technology demonstration program is to demonstrate and validate key technologies leading to residual capability and follow-on operational systems.

In FY04, the Air Force awarded contracts for Space Based Radar (SBR) for up-front, in-depth, system engineering, focused concept-specific, risk-reduction activities, and alternative concept-exploration activities leading to the System Requirements Review. The SBR program will provide day/night, all-weather global surface moving target indications (MTI), synthetic aperture radar (SAR) and high-resolution terrain information (HRTI) capabilities from a space-based platform. The ultimate goal is a FY15 first launch.

Engineering and Manufacturing Development—The Air Force's System Demonstration and Engineering Development (SD&ED) efforts are development projects which have not received approval for full-production. Examples of Air Force SD&ED efforts are: (1) The Space Based Infrared System Increment 1 Mission Control Station (MCS) achieved initial operational capability on 18 December 2001. The MCS consolidates Defense Support Program operations at Buckley AFB, Colorado, reducing manpower by 58% and operations and maintenance costs by 25%. Subsequent upgrades to the MCS throughout fiscal year 2002 resulted in closure of the Air-Land Enhanced Reconnaissance and Targeting ALERT ground station on 25 September 2002, consolidating all space-based strategic and theater missile warning operations, realizing additional manpower and Operations and Maintenance funds savings. (2) Another example, the F/A-22 Raptor program continues development and low-rate production of the Air Force's next generation air dominance fighter. Designed to penetrate enemy airspace and achieve a first look, first kill capability against multiple targets, the F/A-22's combination of stealth, supercruise, maneuverability, and integrated avionics, coupled with improved supportability, represents an exponential leap in warfighting capabilities and allows for the full realization of operational concepts that are vital to the 21st century Air Force. Initial operational capability is planned for December 2005. The F/A-22 has been in Engineering and Manufacturing Development (EMD) since 1991 and is currently meeting or exceeding all key performance parameters.

Significant program accomplishments in fiscal year 2004 include:

- Completion of Fatigue Testing through 2.68 lifetimes. Static test unit disassembled for study
- Commencement of Initial Operational Test and Evaluation. Open air and simulator testing phase is complete with the remainder of the effort focused on analysis and reporting the data
- Completion of multiple supersonic AMRAAM and AIM-9 missile shots, along with the first-ever JDAM drop
- The exceeding of over 3,100 flight test missions, logging in over 6,900 hours on the EMD aircraft fleet

The F-35 Joint Strike Fighter (JSF) program is developing a family of strike fighter aircraft for the Air Force, Navy, Marine Corps and our allies, with maximum commonality among the variants to minimize life cycle costs. The Air Force Conventional Takeoff and Landing (CTOL) variant will be a multi-role, primary air-to-ground aircraft to replace the F-16 and A-10 and complement the F/A-22. In addition, the Air Force recently announced the intent to buy the Short Takeoff and Vertical Landing (STOVL) variant to provide dedicated close air support from austere bases. While the F/A-22 will establish air dominance, the F-35—with its combination of stealth, large internal payloads and multi-spectral avionics—will provide persistent stealth and precision engagement to the future battlespace. The F-35 has been in System Development and

Demonstration since 2001. In March 2004, the USD (AT&L) approved a program restructure to address design maturity issues. As a result of this restructure, the F-35 is still projected to meet or exceed all key performance parameters.

Significant program accomplishments in fiscal year 2004 include:

- Service acquisition oversight transition from the Navy to the Air Force
- Completion of the Air System Design Integration and Maturity Review (DIMR)
- Pratt & Whitney F135 First Engine to Test
- General Electric F136 First Engine to Test

Additionally, the program continued the International Commonality Effort to identify an ORD compliant configuration for international partners that maximizes commonality with the U.S. baseline program consistent with National Disclosure Policy. The B-1B Defensive System Upgrade Program (DSUP) was canceled in December 2002 due to repeated cost and schedule overruns. However, the Air Force continued to improve the B-1B's effectiveness through integration of new computers and advanced conventional weapons. Combined Developmental and Operational Testing (DT/OT) for the new computers was completed in July, and dedicated operational testing completed in December 2002. Testing showed the computers met or exceeded all key performance parameters and they were approved for full-rate production in April 2003. Combined DT/OT flight test JSOW and JASSM Integration (JJI) was completed on the B-1. The JJI-modified B-1 was determined to be operationally effective and suitable. The weapon system experienced no JJI component failures during OT&E. This weapon integration added significant operational capabilities to the B-1.

In August 2004, the Space Based Infrared System (SBIRS) program delivered its first space payload for integration with a classified host satellite. The SBIRS payload includes an infrared sensor, which will operate in Highly Elliptical Orbit (HEO).

In FY04, the Air Force awarded contracts for Transformational Satellite Communications System (TSAT) space segment development and continued technology development for the next-generation communication satellite. The TSAT program will develop key technologies such as laser communications, internet-like communications protocols, and methods of dynamically allocating communications capability among users. The ultimate goal is a FY13 first launch of a transformational satellite.

The Counter Communications Systems first system was delivered in December 2003. Air Force Space Command declared initial capability on Sept. 24, 2004, after the final two systems were delivered. The Counter Communications Systems (CCS) is operated by the 76th Space Control Squadron at Peterson AFB, CO, and is a transportable ground-based system that denies adversary satellite communications through reversible, non-destructive methods.

Research, Development, Test and Evaluation Management Support—The Air Force's Research, Development, Test, and Evaluation (RDT&E) Management Support efforts include projects directed toward support of installation or operations required for general research and development use. Included would be test ranges, military construction, maintenance support of laboratories, operation and maintenance of test aircraft and ships, and studies and analyses in support of the research and development program. Example of Air Force RDT&E management support is: The Major Test and Evaluation Investment program, which funds the planning, improvements and modernization for three national asset test centers having over $10 billion of unique test facilities/capabilities operated and maintained by the Air Force for the Department of Defense (DoD) test and evaluation missions, and available to others having a requirement for their unique capabilities. The test capabilities and facilities are operated and maintained by the Air Force for the DoD test and evaluation missions, and are available to others having a requirement for their unique capabilities. Many efforts are contained within this program, but two examples are the Propulsion Wind Tunnel Upgrade at Arnold Engineering Development Center. This effort replaces outdated data acquisition, processing, and control systems and drive motors. A second example is the Threat Simulator Development

program, which supports many of the AF Electronic Warfare Test Processes. Current projects focus on improved Low Radar Cross Section threat modeling and simulation, and enhanced infrared and radio frequency countermeasures testing.

Operational Systems Development—The Air Force's operational system efforts include projects in support of development acquisition programs or upgrades in System Demonstration and Development (SDD). Examples of operational systems development are: The AIM-9X Short Range Missile (SRM) completed its OPEVAL on 29 August 2003. After 22 live fire tests, 177 sorties, and 2,300 captive flight hours, the AIM-9X was found to be "Operationally Effective and Suitable." The program beat its Initial Operational Capability (IOC) by six months in November 2003. In addition, Milestone III was completed and Full-Rate Production was approved with the first full-rate production lot (Lot 5) to be awarded in 1QFY05. Finally, platform integration efforts for the F-16 and F-18E/F remain on track.

The Phase 3 (AIM-120C-7) effort completed System Demonstration and Development (SDD) in May 2004 and is ready to begin Operational Test (OT). The AIM-120C-7 provides a major upgrade over the AIM-120C-6 guidance section, particularly the use of circular processor cards over previously used rectangular cards. These cards provide significant space savings within the missile for added capability in addition to providing greater processing power.

AMRAAM Phase 4 builds on the AIM-120C-7 capability and is progressing well on track. This new AIM-120D missile will add a GPS/INU and a two-way Data Link to enhance accuracy and control, and thus, increasing weapon effectiveness. In addition, the AIM-120D will have increased range and third party targeting which expands the HOBS launch envelope. The SDD contract was awarded in December 2003 and initial systems integration testing of the Proof of Design (POD) missile began in September 2004.

The Joint Direct Attack Munition Program successfully completed operational testing of the MK-82 500lb JDAM on the B-2A providing an operational capability to the warfighter to drop 80 JDAMs, each targeted to a separate point, from a single aircraft, on a single sortie. JDAM also successfully completed operational testing of the MK-82 on the F-16 (Block 25-30) accelerating an additional capability to the warfighter in support of ongoing operations.

The SAASM/Anti-Jam development effort, a 27-month effort that commenced in FY03 and continues through FY05, will provide JDAM the capability to decrease vulnerability to crypto compromise and spoofing as well as enhanced anti-jam performance. All JDAMS delivered starting in FY06 and beyond will be SAASM capable. JDAMs delivered in FY06 will be anti-jam capable. The program has successfully completed one captive carriage and four guided releases using SAASM hardware. Anti-jam testing will begin in early FY05.

The JDAM program successfully completed in record time the certification of a non-standard fuze/warhead combination to further minimize JDAM MK-82 collateral damage concerns in support of F-16 units for ongoing operations. This capability provided the warfighter the ability to use the FMU-139 fuze with the BLU-109 penetrator warhead to both enable detonation at impact (rather than after penetration as they normally do with the FMU-143 fuze) and have the smaller fragmentation pattern of the BLU-109, further minimizing the risk of collateral damage.

The Small Diameter Bomb (SDB) program will increase the number of kills per platform or sortie (x4) while achieving required effects by improving accuracy and reducing collateral damage over current inventory weapons. SDB is an incremental development weapon program that entered a 36-month System Development and Demonstration (SDD) of its first increment in FY04. The first Increment of SDB will attack fixed and stationary targets using anti-jam/SAASM Inertial Navigation System (INS)/Global Positioning Satellite (GPS) aided by a very wide area differential GPS solution and standoff capability. The program has successfully completed seven free flight events. The program is working towards a MS C decision in April 05 with LRIP scheduled for May 05. The SDB will provide transformational capability to the Air Force by increasing loadout per weapon station on multiple platforms, reducing sorties and minimizing collateral damage.

The Air Force Space program achieved seven successful launches of military satellites, utilizing Titan, Atlas & Delta to launch DMSP F-16, NRO, UHF-11, GPS IIR-10, DSP-22, GPS IIR-11 and GPS IIR-12.

The Air Force continues to develop the Family of Advanced Beyond Line of Sight Terminals (FAB-T) to provide robust, secure, strategic and tactical global communications for nuclear and conventional forces. This family of terminals will provide transformational communications via connectivity to Advanced EHF satellites (AEHF), Wideband Gapfiller Satellites (WGS), and the future Transformational Satellite Communications System (TSAT). Future increments of this terminal will provide laser communications in conjunction with optical capabilities on TSAT to deliver data in excess of one GB per second, as well as a new multi-band antenna that will enable aircraft to have simultaneous connectivity to multiple satellites via a phased array construct. This capability will allow the Air Force to reduce the costs of integrating multiple antennas to communicate with different satellite constellations.

In FY04, the Air Force awarded a contract for the Space Based Space Surveillance (SBSS) pathfinder satellite. The SBSS pathfinder program will design, build, launch and operate this single satellite with a visible sensor payload, as well as build and operate a ground segment to support initial satellite operations. The SBSS Pathfinder will detect and track objects in Earth orbit, contributing to timely space situation awareness, and is scheduled to launch in late 2007.

In FY04, the Air Force awarded a contract to begin architecture development for the Orbital Deep Space Imager (ODSI). The ODSI program will deploy a satellite constellation for reconnaissance of objects in deep space in support of overall battlespace awareness. The first ODSI launch is scheduled for FY12.

General Fund

Required Supplementary Information

Disaggregated Statement of Budgetary Resources—General Fund

For years ended September 30, 2004 and 2003 ($ in Thousands)

	Other	Research, Development, Test & Evaluation	Operation and Maintenance
BUDGETARY RESOURCES			
1. Budget Authority:			
1a. Appropriations received	$ 387,428	$ 20,540,054	$ 39,682,758
2b. Borrowing authority	0	0	0
1c. Contract authority	0	0	0
1d. Net transfers (+/-)	-382,470	-50,686	556,232
1e. Other	0	0	0
2. Unobligated balance:			
2a. Beginning of period	2,787	2,006,444	859,909
2b. Net transfers, actual (+/-)	0	0	745,680
2c. Anticipated Transfers Balances	0	0	0
3. Spending authority from offsetting collections:			
3a. Earned	0	0	0
1. Collected	11,241	2,743,842	4,619,439
2. Receivable from Federal sources	-232	-17,883	380,438
3b. Change in unfilled customer orders	0	0	0
1. Advance received	0	230,101	0
2. Without advance from Federal sources	0	36,014	-167,905
3c. Anticipated for the rest of year, without advances	0	0	0
3d. Transfers from trust funds	0	0	0
3e. Subtotal	11,009	2,992,074	4,751,144
4. Recoveries of prior year obligations	0	70,735	525,757
5. Temporarily not available pursuant to Public Law	0	0	0
6. Permanently not available	-1,837	-248,689	-495,338
7. Total Budgetary Resources	$ 16,917	$ 25,309,932	$ 46,626,142
STATUS OF BUDGETARY RESOURCES			
8. Obligations incurred:			
8a. Direct	2,684	20,538,300	40,674,543
8b. Reimbursable	11,010	2,772,784	4,560,162
8c. Subtotal	13,694	23,311,084	45,234,705
9. Unobligated balance:			
9a. Apportioned	515	2,848,059	103,541
9b. Exempt from apportionment	2,709	0	0
9c. Other available	0	0	0
10. Unobligated Balances Not Available	0	-849,211	1,287,897
11. Total, Status of Budgetary Resources	$ 16,918	$ 25,309,932	$ 46,626,143
Relationship of Obligations to Outlays:			
12. Obligated Balance, Net – beginning of period	$ 2,294	$ 7,153,485	$ 18,257,328
13. Obligated Balance transferred, net (+/-)	0	0	0
14. Obligated Balance, Net – end of period:			
14a. Accounts receivable	-3	-222,989	-1,166,513
14b. Unfilled customer order from Federal sources	0	-375,942	-304,380
14c. Undelivered orders	-2,907,685	7,614,135	15,670,520
14d. Accounts payable	2,914,984	857,802	2,617,891
15. Outlays:			
15a. Disbursements	8,924	22,502,697	45,936,224
15b. Collections	-11,241	-2,973,943	-4,538,611
15c. Subtotal	-2,317	19,528,754	41,397,613
16. Less: Offsetting receipts	0	0	0
17. Net Outlays	$ -2,317	$ 19,528,754	$ 41,397,613

Procurement	Military Personnel	Military Construction/ Family Housing	2004 Combined	2003 Combined
$ 32,748,086	$ 29,823,154	$ 2,302,306	$ 125,483,786	$ 124,235,723
0	0	0	0	0
0	0	0	0	0
-2,810	-142,431	-7,229	-29,394	1,888,215
0	0	0	0	0
4,766,061	565,628	989,116	9,189,946	6,066,510
4,998	-406,010	-98,730	245,938	291,591
0	0	0	0	0
0	0	0	0	0
267,130	476,734	-781	8,117,605	7,802,547
10,064	-54,822	0	317,565	-322,918
0	0	0	0	0
38,799	0	0	188,072	213,465
21,909	1	0	-109,981	472,167
0	0	0	0	0
0	0	0	0	0
337,902	421,913	-781	8,513,261	8,165,261
248,956	581,701	3,931	1,431,079	1,955,959
0	0	0	0	0
-508,384	-139,066	-44,338	-1,437,653	-1,806,362
$ 37,594,809	$ 30,704,889	$ 3,144,275	$ 143,396,963	$ 140,796,897
33,121,531	33,449,486	2,126,729	129,913,273	123,375,566
286,806	-3,183,376	0	4,447,386	8,231,386
33,408,337	30,266,110	2,126,729	134,360,659	131,606,952
4,062,315	45,794	1,012,342	8,072,566	8,320,595
0	0	0	2,709	2,573
0	0	0	-1	-1
124,157	392,984	5,203	961,030	866,778
$ 37,594,809	$ 30,704,888	$ 3,144,274	$ 143,396,963	$ 140,796,897
$ 20,565,944	$ 2,148,716	$ 2,413,816	$ 50,541,583	$ 41,822,195
0	0	0	0	0
-55,973	-31,134	0	-1,476,612	-1,159,047
-147,070	-2	0	-827,393	-937,374
19,324,782	26,362	2,581,679	42,309,792	42,168,646
3,235,611	1,810,517	68,606	11,505,411	10,469,360
31,336,002	30,082,204	1,886,330	131,752,381	120,782,356
-305,930	-476,734	781	-8,305,678	-8,016,013
31,030,072	29,605,470	1,887,111	123,446,703	112,766,343
0	-115,376	0	-115,376	-156,704
$ 31,030,072	$ 29,490,094	$ 1,887,111	$ 123,331,327	$ 112,609,639

General Property, Plant, and Equipment
Real Property Deferred Annual Sustainment and RestorationTables
As of September 30, 2004 ($ in thousands)

Table 12-3	Annual Sustainment FY 2004			
Property Type	1. Required	2. Appropriated	3. Executed	4. Difference
Buildings, Structures, and Utilities	2,406,443	2,124,700	1,751,123	$550,966

Notes

1. FY04 O&M Sustainment Required is based on Facilities Sustainment Model (FSM) 04 requirements (per request of OUSD(AT&L) to use draft DoD Financial Management Regulation, Volume 6B, Chapter 12, dated Oct 2003). O&M requirements are less the MILPERS contribution (49%).

2. FY04 O&M Sustainment Actuals come from SAF/FMBOO using the CRIS database. The numbers are not certified DFAS numbers and are subject to change. Certifed numbers for FY04 obligations are not expected until mid-November.

3. MFH Deferred Sustainment is based upon a combination of historical expenditures for day-to-day maintenance and condition assessment surveys for MFH real property maintenance by contract. These requirements are part of the 2002 Family Housing Master Plan.

4. Table 12-3 does not include NAF sustainment funding information because their systems are not able to capture the requested data for the NAF program. AFSVA and AF/ILVF are working to be able to provide the requested information for the FY05 Financial Statement.

5. FY04 RDT&E Sustainment data comes from AF/TER using the CRIS database to provide the Actual funds and Integrated Budget Documentation and Execution System (IDECS) database to provide the Required funds for RDT&E facility sustainment. FY04 was the first time RDT&E sustainment data was separated from the general T&E support funds. The budgeted funding for T&E facility sustainment is planned to increase in FY05 and FY06.

Table 12-4	Annual Deferred Sustainment Trend			
Property Type	FY 2001	FY 2002	FY 2003	FY 2004
Buildings, Structures, and Utillities	368,470	808,628	417,112	$550,966

Notes

1. Obligations and expenditures for RDT&E Sustainment and Restoration & Modernization (SRM) funding before FY04 are not available.

Table 12-5	Restoration & Modernization Requirements		
Property Type	**End FY 2003**	**End FY 2004**	**Change**
Buildings, Structures, and Utilities	$28,400,000	41,500,000	$13,100,000

Notes

1. Before FY04, the Air Force did not maintain data on the cost to C1 for all facilities. The FY03 Installations' Readiness Report (IRR) highlighted cost to C2 but id not include the total AF backlog. Therefore, the FY03 R&M requirements for Table 12-5 use the total R&M Operation and Maintenance (O&M) requirement projected for each year, non-Military Family Housing (MFH), and MFH MILCON requirements to C2 from the FY02 IRR. The FY04 R&M requirements are the FY03 IRR Costs to C1. Because the annual R&M requirements shown in Table 12-5 are calculated differently, they provide a statistically irrelevant "apples to oranges" comparison.

a. FY03 Requirements: FY02 IRR Costs to C2 breakdown is: $12.5B MILCON, $5.1B for Family Housing, and $2.9 MILCON for Transportation Working Capital Fund, Defense Logistics Agency, Non-Appropriated Funds, RDT&E (Research, Development, Test, and Evaluation), Medical, other non-O&M facilities. The total FY03 O&M R&M backlog is $7.9B. FY03 R&M MILCON numbers include new footprint. New footprint is an essential element of our IRR requirements. It provides the facilities necessary to effectively support our installations' mission.

b. FY04 Requirements: FY03 IRR Costs to C1 breakdown is: $15.0B MILCON (excluding new footprint), $5.3B new footprint MILCON, $5.6B for Family Housing, $3.4B Host Nation, $0.6B DLA, and $2.2B MILCON for Transportation Working Capital Fund, Non-Appropriated Funds, RDT&E (Research, Development, Test, and Evaluation), Medical, other non-O&M facilities. The total FY04 O&M R&M backlog is $8.7B, and the total MFH O&M R&M backlog is $0.8B.

Real Property Condition Information

The readiness of Air Force facilities is assessed using the IRR. The IRR assigns C-ratings ranging from C-4 (worst) to C-1 (best) facilities aggregated in nine facility classes. The FY03 IRR identified that 59 percent of Air Force facility classes were rated C-4 or C-3. Facility clases rated as having significant (C-3) or major (C-4) deficiences preclude satisfactory mission accomplishment.

Military Equipment
Deferred Maintenance Amounts
As of September 30, 2004 (Amounts in Thousands)

Major Type	
1. Aircraft	$11,000
2. Ships	$0
3. Missiles	$85,000
4. Combat Vehicles	$0
5. Other Weapon Systems	$136,000
Subcategories as required	$0
Total	$232,000

The figures presented are actual deferred maintenance amounts for FY04. The figures include Active Air Force, Air National Guard, and the Air Force Reserve.

Schedule, Part A DoD Intra-governmental Asset Balances ($ in thousands)	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Executive Office of the President	11		$ -9			
Department of Agriculture	12		$ 816			
Department of Commerce	13		$ 292			$ 10,835
Department of the Interior	14		$ 700			$ 114,361
Department of Justice	15		$ 5,709			$ 1,177
Navy General Fund	17		$ 4,792			
United States Postal Service	18		$ 121			
Department of State	19		$ 25,313			
Department of the Treasury	20	$ 60,600,999	$ 1,246		$ 712	$ 62
Army General Fund	21		$ 14,203			$ 2,880
Office of Personnel Management	24		$ 2			
Social Security Administration	28		$ 1			
Library of Congress	3					$ 920
Smithsonian Institution	33					$ 22
Department of Veterans Affairs	36		$ 239			
Government Printing Office	4					$ 31
General Service Administration	47		$ 642			
National Science Foundation	49		$ 5,491			$ 1,813
Central Intelligence Agency	56		$ 516			
Federal Emergency Management Agency	58		$ 536			
Environmental Protection Agency	68		$ 226			$ 2,386
Department of Transportation	69		$ 28,745			$ 58,821
Homeland Security	70					$ 50
Agency for International Development	72		$ 1,335			
Small Business Administration	73					$ 848
Department of Health and Human Services	75		$ 14			
National Aeronautics and Space Administration	80		$ 11,021			$ 16,180
National Archives and Records Administration	88		$ 50			
Department of Energy	89		$ 3,163			$ 2,872
Department of Education	91		$ 33			
US Army Corps of Engineers	96		$ 55			
Other Defense Organizations General Funds	97		$ 120,458			$ 172
Other Defense Organizations Working Capital Funds	97-4930		$ 387,873			$ 1,969
Army Working Capital Fund	97-4930.001		$ 749			$ -442
Navy Working Capital Fund	97-4930.002		$ 1,507			
Air Force Working Capital Fund	97-4930.003		$ 74,035			$ 228,984
The General Fund of the Treasury	99		$ 0			

Schedule, Part B DoD Intra-governmental entity liabilities ($ in thousands)	Treasury Index	Accounts Payable	Debts/ Borrowings From Other Agencies	Other
Executive Office of the President	11	$		$ 196,761
Department of Agriculture	12	$ 351		
Department of Commerce	13	$ 565		$ 33,744
Department of the Interior	14	$ 1,935		$ 33
Department of Justice	15	$ 1,009		
Department of Labor	16	$ 67,065		$ 330,244
Navy General Fund	17	$ 15,358		$ 75,516
Department of State	19	$ 6,788		
Department of the Treasury	20	$ 107,861		$ 175,194
Army General Fund	21	$ 155,513		$ 15,155
Office of Personnel Management	24	$ 2,782		$ 41,216
Federal Communications Commission	27	$ 30		
Social Security Administration	28	$ 7		$ 1,505
Library of Congress	3	$ 336		
Nuclear Regulatory Commission	31	$ 29		
Smithsonian Institution	33	$ 30		
Department of Veterans Affairs	36	$ 9,852		
Government Printing Office	4	$ 601		
General Service Administration	47	$ 262,986		$ 41,274
National Science Foundation	49	$ 868		
Federal Labor Relations Authority	54	$ 1		
Tennessee Valley Authority	64	$ 1,882		
Environmental Protection Agency	68	$ 69		$ 0
Department of Transportation	69	$ 23,667		$ 595
Homeland Security	70	$ 1,645		
Agency for International Development	72	$ 7,851		$ 286
Small Business Administration	73	$ 36		
Department of Health and Human Services	75	$ 388		
National Aeronautics and Space Administration	80	$ 29,539		$ 263,608
Department of Energy	89	$ 14,193		$ 53,115
US Army Corps of Engineers	96	$ 43		
Other Defense Organizations General Funds	97	$ 37,775		$ 3,333
Other Defense Organizations Working Capital Funds	97-4930	$ 617,597		$ -45
Army Working Capital Fund	97-4930.001	$ 19,595		
Navy Working Capital Fund	97-4930.002	$ 60,640		$ 0
Air Force Working Capital Fund	97-4930.003	$ 451,525		$ 0
The General Fund of the Treasury	99			$ 494,947
DoD Medicare-Eligible Retiree Health Care Fund				$ 0

Schedule, Part C DoD Intra-governmental revenue and related costs ($ in thousands)	Treasury Index	Earned Revenue
Executive Office of the President	11	$ 829,012
Department of Agriculture	12	$ 369
Department of Commerce	13	$ 1,163
Department of the Interior	14	$ 1,965
Department of Justice	15	$ 15,971
Navy General Fund	17	$ 199,799
United States Postal Service	18	$ 345
Department of State	19	$ 28,800
Department of the Treasury	20	$ 1,305
Army General Fund	21	$ 129,602
Office of Personnel Management	24	$ 1
Social Security Administration	28	$ 97
Nuclear Regulatory Commission	31	$ -2
Department of Veterans Affairs	36	$ 908
General Service Administration	47	$ 2,566
National Science Foundation	49	$ 54,043
Central Intelligence Agency	56	$ 1,977
Federal Emergency Management Agency	58	$ 489
Environmental Protection Agency	68	$ 501
Department of Transportation	69	$ 55,831
Agency for International Development	72	$ 37,910
Department of Health and Human Services	75	$ 93
National Aeronautics and Space Administration	80	$ 78,148
National Archives and Records Administration	88	$ 25
Department of Energy	89	$ 19,733
Department of Education	91	$ 127
US Army Corps of Engineers	96	$ 954
Other Defense Organizations General Funds	97	$ 1,711,234
Other Defense Organizations Working Capital Funds	97-4930	$ 1,312,211
Army Working Capital Fund	97-4930.001	$ 1,722
Navy Working Capital Fund	97-4930.002	$ 19,355
Air Force Working Capital Fund	97-4930.003	$ 301,785
The General Fund of the Treasury	99	$ -59,893
DoD Medicare-Eligible Retiree Health Care Fund		$ 194,208

Schedule, Part E DoD Intra-governmental Non-exchange Revenues (& in thousands)	Treasury Index	Transfers In	Transfers Out
Navy General Fund	17		$ -2,809
Army General Fund	21	$ 9,386	$ 44,393
Other Defense Organizations General Funds	97	$ 343,362	
Other Defense Organizations Working Capital Funds	97-4930	$ 451,000	
Air Force Working Capital Fund	97-4930.003	$ 220,000	$ 34

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General Fund

Audit Opinion

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

November 8, 2004

MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Air Force General Funds Fiscal Year 2004 Principal Financial Statements (Report No. D-2005-014)

The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires Federal agency Inspectors General, appointed under the Inspector General Act of 1978, as amended, to audit their respective agencies' financial statements or determine that "an independent external auditor" should conduct such audits. Pursuant to this statutory authority, the undersigned Inspector General assumed responsibility for auditing the accompanying Consolidated Balance Sheet as of September 30, 2004 and 2003, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, the Combined Statement of Financing for the fiscal years then ended.

The financial statements are the responsibility of Air Force management. The Air Force is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Fiscal Year 2004 financial statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us that previously identified material weaknesses in internal control and instances of noncompliance with laws and regulations continue to affect the current period. As a result of those conditions, management acknowledged that the financial data reported in the financial statements were unreliable. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Inspector General of the Department of Defense to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. These material weaknesses also affect the reliability of certain information contained in the annual financial statements—much of

which is taken from the same data sources as the principal financial statements.[1] As described above, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

Summary of Internal Control

In planning our audit, we considered Air Force internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance. However, previously identified reportable conditions,[2] all of which are material, continued to exist in the following areas:

- Financial Management Systems;
- Operating Materials and Supplies;
- General Property, Plant, and Equipment;
- Environmental Liabilities;
- Statement of Net Cost;
- Statement of Financing:
- Intragovernmental Transactions; and
- Other Accounting Entries.

A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance that are material in relation to the financial statements would be prevented or detected on a timely basis. Our internal control work would not necessarily disclose all material weaknesses. See the Attachment for additional details on material internal control weaknesses.

Summary of Compliance With Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged, and prior audits confirm, that instances of noncompliance continue to exist. The Assistant Secretary of the Air Force (Financial Management and Comptroller)

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[1] The annual financial statements include the principal financial statements, management discussion and analysis, consolidating and combining financial statements, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

[2] Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

"A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." —Constitution of the United States, Article I, Section 9

acknowledged to us that critical financial management feeder systems of the Air Force do not comply substantially with the Federal Financial Management Improvement Act of 1996. Therefore, we did not determine whether the Air Force was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) are met; and
- complying with applicable laws and regulations.

We provided a draft of this report to the Air Force. Air Force officials concurred with the facts and conclusions in the report.

Joseph E. Schmitz
Inspector General
Department of Defense

Paul J. Granetto, CPA
Assistant Inspector General
Defense Financial Auditing Service

Attachment:
As stated

"A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." —Constitution of the United States, Article I, Section 9

Report on Internal Control and Compliance With Laws and Regulations

Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting because management acknowledged that previously identified reportable conditions, all of which are material, continue to exist. The following financial management deficiencies are indications of material weaknesses in internal control that may adversely affect any decision by the Air Force that is based, in whole or in part, on information that is inaccurate because of these deficiencies. Financial information reported by the Air Force also may contain misstatements resulting from these deficiencies.

Financial Management Systems. The Air Force financial management systems do not substantially comply with Federal financial management systems requirements.

The Air Force had not implemented the U.S. Government Standard General Ledger (USSGL) at the transaction level. For details, see Note 1.D to the financial statements.

The Air Force is unable to implement fully all elements of generally accepted accounting principles (GAAP) and Office of Management and Budget (OMB) Bulletin No. 01-09, "Form and Content of Agency Financial Statements," because of limitations in financial management processes and systems, including nonfinancial feeder systems and processes. For details, see Note 1.A to the financial statements.

The Air Force generally records transactions on a cash (budgetary) basis and not on an accrual basis as required by GAAP. The amounts presented in the Consolidated Statement of Net Cost are based on budgetary obligations and disbursements and collection transactions, and are adjusted to record known accruals for major items and known imputed expenses. For details, see Note 1.D to the financial statements.

Operating Materials and Supplies. The Air Force does not record operating materials and supplies balances derived from logistics systems at historical cost in conformance with Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property." Furthermore, the Air Force does not strictly follow the consumption method in accounting for operating materials and supplies. In addition, the operating materials and supplies amount on the Balance Sheet does not include all contractor-controlled, Government-furnished material in the financial records. For details, see Note 9.B to the financial statements.

General Property, Plant, and Equipment (PP&E). The Department of Defense has not reported the cost of military equipment in accordance with GAAP because of an absence of detailed cost information for military equipment acquired over many decades. For details, see Note 10 to the financial statements.

Attachment

Environmental Liabilities. Material uncertainties exist related to environmental cleanup liabilities because of incomplete documentation for cleanup costs. For details, see Note 14 to the financial statements.

Statement of Net Cost. The Air Force does not accumulate cost information as required by GAAP. The Air Force identifies costs in the Consolidated Statement of Net Cost based on the major appropriation groups funded by Congress instead of being based on major programs and activities as set forth in SFFAS No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government." For details, see Note 1.D to the financial statements.

Statement of Financing. The objective of the Statement of Financing is to reconcile the difference between budgetary obligations and the net cost of operations reported. It is presented as combined or combining statements rather than consolidated statements because of intragovernmental transactions not being eliminated. Because of limitations in the Air Force financial system, budgetary data are not in agreement with proprietary expenses and assets capitalized. For details, see Note 22 to the financial statements.

Intragovernmental Transactions. The Air Force cannot accurately identify all intragovernmental transactions by customer and cannot be assured that transactions occurring between entities within DoD, or between two or more Federal agencies, are eliminated.

The Air Force was unable to reconcile intragovernmental accounts receivable or accounts payable balances, or reconcile intragovernmental revenue balances with its trading partners. For details, see Notes 5, 12, and 19 to the financial statements.

Other Accounting Entries. The Air Force continues to enter a material number of unsupported accounting entries because financial and non-financial feeder systems continue to lack sufficient customer identification information to accurately process eliminations. For details, see Note 1.A to the financial statements.

Compliance With Laws and Regulations

Management is responsible for compliance with existing laws and regulations related to financial reporting. Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether the Air Force was in compliance with selected provisions of all applicable laws and regulations related to financial reporting. Our objective was not to, and we do not, express an opinion on compliance with applicable laws and regulations.

The Air Force is required by the Federal Financial Management Improvement Act of 1996 to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable GAAP, and the USSGL at the transaction level. The Air Force acknowledged that many of its critical financial management feeder systems do not comply substantially with Federal financial management systems requirements, Federal accounting standards, and the USSGL at the transaction level. Therefore, we did not perform tests of compliance for these requirements.

Audit Disclosures

The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us on February 27, 2004, that Air Force financial management systems do not comply substantially with Federal financial management systems requirements, GAAP, and the USSGL at the transaction level. These deficiencies in Air Force critical financial feeder systems limited its ability to present information accurately and in conformance with GAAP.

We did not perform audit work related to provisions of the laws and regulations identified in OMB Bulletin Number 01-02, "Audit Requirements for Federal Financial Statements," October 16, 2000, Appendix C, "General Laws."

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance because previous audit reports contained recommendations for corrective actions.

Attachment

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Working Capital Fund

Principal Statements

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Consolidated Balance Sheet—Working Capital Fund

As of September 30, 2004 and 2003 ($ in Thousands)

	2004 Consolidated	2003 Consolidated
1. ASSETS (Note 2)		
A. Intra-governmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	$ 1,051,110	$ 732,842
b. Non-Entity Seized Iraqi Cash	0	0
c. Non-Entity-Other	0	0
2. Investments (Note 4)	0	0
3. Accounts Receivable (Note 5)	576,396	605,077
4. Other Assets (Note 6)	10	3
5. Total Intra-governmental Assets	$ 1,627,516	$ 1,337,922
B. Cash and Other Monetary Assets (Note 7)	$ 0	$ 0
C. Accounts Receivable (Note 5)	103,111	167,764
D. Loans Receivable (Note 8)	0	0
E. Inventory and Related Property (Note 9)	21,025,528	22,524,996
F. General Property, Plant and Equipment (Note 10)	1,197,683	1,329,629
G. Investments (Note 4)	0	0
H. Other Assets (Note 6)	788,966	380,362
2. TOTAL ASSETS	$ 24,742,804	$ 25,740,673
3. LIABILITIES (Note 11)		
A. Intra-governmental:		
1. Accounts Payable (Note 12)	$ 256,763	$ 231,725
2. Debt (Note 13)	0	0
3. Environmental Liabilities (Note 14)	0	0
4. Other Liabilities (Note 15 and Note 16)	243,131	345,437
5. Total Intragovernmental Liabilities	$ 499,894	$ 577,162
B. Accounts Payable (Note 12)	$ 497,471	$ 88,984
C. Military Retirement Benefits and Other Employment-Related	238,729	275,132
D. Actuarial Liabilities (Note 17)		
E. Environmental Liabilities (Note 14)	0	0
F. Loan Guarantee Liability (Note 8)	0	0
G. Other Liabilities (Note 15 and Note 16)	1,616,321	1,891,851
H. Debt Held by Public	0	0
4. TOTAL LIABILITIES	$ 2,852,415	$ 2,833,129
5. NET POSITION		
A. Unexpended Appropriations (Note 18)	$ 0	$ 0
B. Cumulative Results of Operations	21,890,389	22,907,544
6. TOTAL NET POSITION	$ 21,890,389	$ 22,907,544
7. TOTAL LIABILITIES AND NET POSITION	$ 24,742,804	$ 25,740,673

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

Consolidated Statement of Net Cost—Working Capital Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	2004 Consolidated	2003 Consolidated
1. Program Costs		
A. Intra-governmental Gross Costs	$ 5,399,793	$ 5,448,310
B. (Less: Intra-governmental Earned Revenue)	-11,888,462	-13,317,788
C. Intra-governmental Net Costs	$ -6,488,669	$ -7,869,478
D. Gross Costs With the Public	8,674,787	8,224,828
E. (Less: Earned Revenue From the Public)	-891,419	-393,889
F. Net Costs With the Public	$ 7,783,368	$ 7,830,939
G. Total Net Cost	$ 1,294,699	$ -38,539
2. Cost Not Assigned to Programs	0	0
3. (Less: Earned Revenue Not Attributable to Programs)	0	0
4. Net Cost of Operations	$ 1,294,699	$ -38,539

The accompanying notes are an integral part of the financial statements. See notes 1 and 19.

Consolidated Statement of Changes in Net Position—Working Capital Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	2004 Consolidated	2003 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
1. Beginning Balances	$ 11,537,088	$ 11,593,865
2. Prior Period Adjustments (+/-)		
2.A. Prior Period Adjustments - Restated (+/-)	11,370,456	11,370,456
2.B. Beginning Balance, Restated	22,907,544	22,964,321
2.C. Prior Period Adjustments - Not Restated (+/-)	699,393	-55,128
3. Beginning Balances, as adjusted	23,606,937	22,909,193
4. Budgetary Financing Sources:		
4.A. Appropriations received	0	0
4.B. Appropriations transferred-in/out (+/-)	0	0
4.C. Other adjustments (rescissions, etc) (+/-)	0	0
4.D. Appropriations used	0	23,956
4.E. Nonexchange revenue	0	0
4.F. Donations and forfeitures of cash and cash equivalents	0	0
4.G. Transfers-in/out without reimbursement (+/-)	-580,900	0
4.H. Other budgetary financing sources (+/-)	0	0
5. Other Financing Sources:		
5.A. Donations and forfeitures of property	0	0
5.B. Transfers-in/out without reimbursement (+/-)	34	-209,350
5.C. Imputed financing from costs absorbed by others	159,017	145,206
5.D. Other (+/-)	0	0
6. Total Financing Sources	-421,849	-40,188
7. Net Cost of Operations (+/-)	1,294,699	-38,539
8. Ending Balances	$ 21,890,389	$ 22,907,544
UNEXPENDED APPROPRIATIONS		
1. Beginning Balances	$ 0	$ 0
2. Prior Period Adjustments (+/-)		
2.A. Prior Period Adjustments - Restated (+/-)	0	0
2.B. Beginning Balance, Restated	0	0
2.C. Prior Period Adjustments - Not Restated (+/-)	0	0
3. Beginning Balances, as adjusted	0	0
4. Budgetary Financing Sources:		
4.A. Appropriations received	0	23,956
4.B. Appropriations transferred-in/out (+/-)	0	0
4.C. Other adjustments (rescissions, etc) (+/-)	0	0
4.D. Appropriations used	0	-23,956
4.E. Nonexchange revenue	0	0
4.F. Donations and forfeitures of cash and cash equivalents	0	0
4.G. Transfers-in/out without reimbursement (+/-)	0	0
4.H. Other budgetary financing sources (+/-)	0	0
5. Other Financing Sources:		
5.A. Donations and forfeitures of property	0	0
5.B. Transfers-in/out without reimbursement (+/-)	0	0
5.C. Imputed financing from costs absorbed by others	0	0
5.D. Other (+/-)	0	0
6. Total Financing Sources	0	0
7. Net Cost of Operations (+/-)	0	0
8. Ending Balances	$ 0	$ 0

The accompanying notes are an integral part of the financial statements. See notes 1 and 20.

Combined Statement of Budgetary Resouces—Working Capital Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	2004 Combined	2003 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
1. Budget Authority:		
1a. Appropriations received	$ 0	$ 23,956
1b. Borrowing authority	0	0
1c. Contract authority	684,378	-35,575
1d. Net transfers (+/-)	0	0
1e. Other	0	0
2. Unobligated balance:		
2a. Beginning of period	607,130	305,847
2b. Net transfers, actual (+/-)	-580,900	-125,000
2c. Anticipated transfers balances	0	0
3. Spending authority from offsetting collections:		
3a. Earned	0	0
1. Collected	17,824,823	17,643,264
2. Receivable from Federal sources	-186,398	83,803
3b. Change in unfilled customer orders	0	0
1. Advance received	-173,221	-371,890
2. Without advance from Federal sources	-733,915	200,583
3c. Anticipated for the rest of year, without advances	0	0
3d. Transfers from trust funds	0	0
3e. Subtotal	16,731,289	17,555,760
4. Recoveries of prior year obligations	3,180	2,027
5. Temporarily not available pursuant to Public Law	0	0
6. Permanently not available	-36,669	-119,535
7. Total Budgetary Resources	$ 17,408,408	$ 17,607,480
STATUS OF BUDGETARY RESOURCES		
8. Obligations incurred:		
8a. Direct	$ 2,027	$ 23,956
8b. Reimbursable	17,271,941	16,976,393
8c. Subtotal	17,273,968	17,000,349
9. Unobligated balance:		
9a. Apportioned	134,440	607,132
9b. Exempt from apportionment	0	0
9c. Other available	0	-1
10. Unobligated Balances Not Available	0	0
11. Total, Status of Budgetary Resources	$ 17,408,408	$ 17,607,480
Relationship of Obligations to Outlays:		
12. Obligated Balance, Net - beginning of period	$ 3,317,312	$ 3,504,176
13. Obligated Balance transferred, net (+/-)	0	0
14. Obligated Balance, Net - end of period:		
14a. Accounts receivable	-958,783	-1,145,183
14b. Unfilled customer order from Federal sources	-3,265,470	-3,999,386
14c. Undelivered orders	6,610,227	6,166,726
14d. Accounts payable	2,370,008	2,295,155
15. Outlays:		
15a. Disbursements	16,752,435	16,900,798
15b. Collections	-17,651,602	-17,271,374
15c. Subtotal	-899,167	-370,576
16. Less: Offsetting receipts	0	0
17. Net Outlays	$ -899,167	$ -370,576

The accompanying notes are an integral part of the financial statements. See notes 1 and 21.

Combined Statement of Financing—Working Capital Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	2004 Combined	2003 Combined
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ 17,273,968	$ 17,000,349
2. Less: Spending authority from offsetting collections and recoveries (-)	-16,734,467	-17,557,786
3. Obligations net of offsetting collections and recoveries	539,501	-557,437
4. Less: Offsetting receipts (-)	0	0
5. Net obligations	539,501	-557,437
Other Resources		
6. Donations and forfeitures of property	0	0
7. Transfers in/out without reimbursement (+/-)	33	-209,350
8. Imputed financing from costs absorbed by others	159,017	145,206
9. Other (+/-)	0	0
10. Net other resources used to finance activities	159,050	-64,144
11. Total resources used to finance activities	698,551	-621,581
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 (-)	-951,116	-468,106
12b. Unfilled Customer Orders	-907,137	-171,307
13. Resources that fund expenses recognized in prior periods	-36,403	0
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	0	0
15. Resources that finance the acquisition of assets	-2,686,199	1,006,802
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 (-)	0	0
16b. Other (+/-)	-34	0
17. Total resources used to finance items not part of the net cost of operations	-4,580,889	367,389
18. Total resources used to finance the net cost of operations	-3,882,338	-254,192
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		
20. Increase in environmental and disposal liability	0	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
22. Increase in exchange revenue receivable from the the public (-)	0	0
23. Other (+/-)	0	0
24. Total components of Net Cost of Operations that	0	27,382
will require or generate resources in future periods	0	27,382
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	259,260	185,805
26. Revaluation of assets or liabilities (+/-)	-5,660,357	2,466
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0	0
27b. Cost of Goods Sold	5,866,525	0
27c. Operating Material & Supplies Used	325,585	0
27d. Other	4,386,024	0
28. Total components of Net Cost of Operations that will not require or generate resources	5,177,037	188,271
29. Total components of net cost of operations that will not require or generate resources in the current period	5,177,037	215,653
30. Net Cost of Operations	1,294,699	-38,539

The accompanying notes are an integral part of the financial statements. See notes 1 and 22.

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Working Capital Fund

Footnotes to the Principal Statements

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 United States Air Force Working Capital Fund (AFWCF), as required by the "Chief Financial Officers (CFO) Act of 1990," expanded by the "Government Management Reform Act (GMRA) of 1994," and other appropriate legislation. The financial statements have been prepared from the books and records of the AFWCF in accordance with "Department of Defense Financial Management Regulation (DoDFMR)," the Office of Management and Budget (OMB) Bulletin No. 01-09, "Form and Content of Agency Financial Statements" and to the extent possible Federal Generally Accepted Accounting Principles (GAAP). The accompanying financial statements account for all resources for which the AFWCF is responsible except that information relative to classified assets, programs, and operations. This information has been excluded from the statements or otherwise aggregated and reported in such a manner that is no longer considered classified. The AFWCF's financial statements are in addition to the financial reports that are prepared by the United States Air Force pursuant to OMB directives to monitor and control the Air Force's use of budgetary resources.

The AFWCF is unable to implement all elements of Federal GAAP and the OMB Bulletin No. 01-09, due to limitations of its financial management processes and systems, including nonfinancial feeder systems and processes. Reported values and information for the AFWCF's major asset and liability categories are derived largely from nonfinancial feeder systems, such as inventory systems and logistic systems. These systems were designed to support reporting requirements focusing on maintaining accountability over assets and reporting the status of federal appropriations, rather than preparing financial statements in accordance with Federal GAAP. The AFWCF continues to implement process and system improvements addressing the limitations of its financial and nonfinancial feeder systems. A more detailed explanation of these financial statement elements is provided in the applicable footnote.

The AFWCF continues to enter material amounts of unsupported accounting entries. Financial and nonfinancial feeder systems continue to lack sufficient customer identification necessary to accurately process eliminations. The issue has been addressed as part of the Air Force plan for obtaining a favorable opinion by FY 2007. This was also disclosed in the DoD Agency-wide Note 1.

1.B. Mission of the Reporting Entity

The United States Air Force was created on September 18, 1947 by the National Security Act of 1947. The National Security Act Amendments of 1949 established the DoD and made the Air Force a department within the DoD. The overall mission of the DoD is to organize, train, and equip armed forces to deter aggression and if necessary, defeat aggressors of the United States and its allies. The overall mission of the Air Force is to defend the United States through control and exploitation of air and space.

The stock and industrial revolving fund accounts were created by the National Security Act of 1947, as amended in 1949 and codified in Title 10, U.S.C., Section 2208. The revolving funds were established as a means to more effectively control the cost of work performed by the DoD. The DoD began operating under the revolving fund concept as early as July 1, 1951.

1.C. Appropriations and Funds

The Air Force's funds are divided into the general, working capital (revolving funds), trust, special, and deposit funds. These appropriations and funds are used to fund and report how the resources have been used in the course of executing the Air Force's missions.

Working Capital Funds receive their initial working capital through an appropriation or a transfer of resources from existing appropriations or funds, and use those capital resources to finance the initial cost of products and services. Financial resources to replenish the initial working capital and to permit continuing operations are generated by the acceptance of customer orders. The Defense Working Capital Fund (DCWF) operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision making process. The activities provide goods and services on a reimbursable basis. Receipts derived from operations generally are available in their entirety for use without further congressional action.

Air Force systems are not transaction driven for budgetary accounts. Therefore, in some cases proprietary and statistical accounts are used to develop the Report on Budget Execution (SF133) and Statement of Budgetary Resources for reporting budgetary data.

Supply Management

The Air Force Stock Funds were established within the DoD under 10 U.S.C. 2208, as described in DoD Financial Management Regulation 7000.14-R, to finance inventories of supplies. Most inventories of supplies are financed by use of a stock fund. Exceptions include an item financed with a procurement appropriation or when financing by other means has been deemed to be more economical and efficient. A stock fund operates as a revolving fund acquiring inventories with funds received from prior sales to customers.

There are four active business activities in the Supply Management Activity Group (SMAG). They are Materiel Support Division (MSD), General Support Division (GSD), Medical-Dental Division, and Academy Division. In FY 2001, the Fuels Division was taken over by the Defense Energy Support Center; therefore, all activity within the Fuels Division is residual. Troop Support is also a residual activity.

Depot Maintenance

The Air Force Depot Maintenance Activity Group (DMAG) performs manufacturing, development, and test work as well as aviation maintenance. Primarily supporting Air Force organizations, DMAG also supports other DoD components, government agencies, and foreign governments. The DMAG environment is rapidly changing. Weapons systems embodying new material and technologies require new maintenance processes, while improvements in reliability reduce the frequency of maintenance for many items. The net result requires flexibility in addressing both wartime and peacetime workload changes. The DMAG achieves this flexibility by employing the unique strengths of organic (in-house) and contractor repair resources.

Transportation

The unique transportation responsibilities of the Air Mobility Command (AMC) include the executive travel mission and operation of other operational support aircraft, the air weather service, AMC training, AMC base operations, tanker operations, and other miscellaneous AMC functions. The Air Force Transportation Defense Business Operations Fund (DBOF) was established during FY 1993 and discontinued in FY 1995 in accordance with the DWCF improvement plan. Only residual accounting remains.

Air Force Working Capital Fund Component

The purpose of the Air Force Component Activity is to provide an activity within the AFWCF to record transactions that cannot be identified to a specific business area. The January 21, 1997 memorandum "Policy and Procedures for Cash Management Working Capital Funds (DWCF)" established the "Component Level Adjustment" column. Additional DFAS-Arlington memorandums provided specific and detailed instructions and procedures to maintain accountability for fund balances with Treasury.

Additional DFAS-Arlington memorandums provided specific and detailed instructions and procedures to maintain accountability for fund balances with Treasury.

Operations of the activities within the AFWCF are based on policies and procedures that include:

(1) Funding Authority. Prior to FY 1992, industrial fund activities were not issued funding documents. Activities now receive obligation authority for customer orders from the Air Force Deputy Assistant Secretary, Budget (SAF/FMB). The total costs that can be incurred are a function of the cost goals applied to the actual customer funded workload.

(2) Minor Construction Funding. Minor construction projects that cost $100,000 or more, but less than $300,000, are funded through a separate section of the capital budget, and depreciated over a 20-year period.

(3) Software Development Costs. Policy and procedures have been changed to move the development costs of new software that meets capitalization requirements to the capital budget. Software is to be amortized after release.

(4) Capital Budgeting. Activity group budgets are segregated into operating and capital budgets. Any investment in equipment, software, minor construction and other management improvements that meet capitalization requirements are funded through the capital budget and the cost is depreciated or amortized over the relevant life cycle.

(5) Asset Capitalization and Depreciation. The assets of the industrial and stock funds were transferred to the DBOF and subsequently to the AFWCF. Capital assets, excluding land, which exceed a unit cost of $100,000 or more are subject to depreciation. In addition, capital assets previously capitalized using the established thresholds for prior years will continue to be depreciated if depreciation was being recorded prior to the increase to the $100,000 threshold.

(6) Rates and Prices. All Air Force activity groups within the WCF are expected to set their rates and prices based upon full cost recovery, ensuring that cost reductions made by an activity will be passed on to the customers. Rates and prices normally will not change during the year of execution, but occasionally change based on certain world situations. If there is a need for a price change in Depot Maintenance, the authority is requested from HQ Air Force Material Command.

The FY 2004, AFWCF operations encompassed three activity groups: Supply Management, Depot Maintenance, and Information Services. These activity groups use their resources to finance the initial cost of products or services for activities of the United States Government, primarily those of the DoD. Work is generated by the acceptance of customer orders from ordering activities.

1.D. Basis of Accounting

The AFWCF generally records transactions on an accrual accounting basis as is required by Federal GAAP. However, some of the Air Force's financial and nonfinancial feeder systems and processes are not designed to collect and record financial information on the full accrual accounting basis. The AFWCF has undertaken efforts to determine the actions required to bring all of its financial and nonfinancial feeder systems and processes into compliance with all elements of Federal GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Government Standard General Ledger (USSGL). Until such time that all of the processes are updated to collect and report financial information as required by Federal GAAP, some of the AFWCF's financial data will be based on budgetary transactions (obligations, disbursements, and collections) and nonfinancial feeder systems. For example, most of information presented on the Statement of Net Cost is based on accrued costs. However, some of this information is based on obligations and disbursements.

Under the accrual method revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting is accomplished through unique general ledger accounts to facilitate compliance with legal and internal control requirements associated with the use of federal funds. However, the cash

basis of accounting may be followed if the reported activity and amounts are not materially significant. In addition to the accrual basis of accounting, Depot Maintenance also uses the full absorption accounting principal. During FY 1996, DFAS-DE, SAF/FMB, and OSD/FM jointly agreed on the use of this principal by Depot Maintenance. This principal requires that overhead costs such as depreciation and bad debt expenses are included in the cost of services sold. The effect of known intrafund transactions is eliminated.

The Air Force uses several service unique general ledger structures plus data converted from the Defense Business Management System (DBMS). The financial statements depicted are derived from supply, maintenance, and accounting records, utilizing the Air Force service and DBMS unique general ledger structures. The activity groups' general ledger accounts are "cross-walked" to the USSGL chart of accounts to produce the financial statements.

In addition, the Air Force identifies programs based upon the major appropriation groups provided by Congress. The Air Force 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 the SFFAS No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements readable.

The asset accounts used to prepare the statements are categorized as either entity or non-entity. Entity assets consist of resources that the agency has the authority to use, or where management is legally obligated to use funds to meet entity obligations. Non-entity assets are assets that are held by an entity that are not available for use in the operations of the entity.

Material disclosures are provided at Note 10.

1.E. Revenues and Other Financing Sources

The Under Secretary of Defense (Comptroller) directed, per memorandum dated January 1992, all of the services to use the percentage of completion accounting method to recognize revenue and expenses. The DoD 7000.14-R, Financial Management Regulation, Chapter 11B, January 1995, also prescribes this method of accounting.

Each working capital activity group recognizes revenue in the following manner:

Supply Management

Air Force Supply Management revenue is recognized at the time of sale under constructive delivery terms (normally when an item is released from inventory or delivered to the customer). Foreign Military Sales transactions also require proof of shipment before revenue is recognized. Generally, Supply Management's revenue consists of sales at standard prices less sales returns. Sales of Materiel Support Division items are at exchange price. The Medical-Dental division and the Air Force Academy Store add surcharges to their billings rather than include a surcharge in the standard price. Intradivision Supply Management sales have been eliminated. Cash discounts and interfund retail stock loss allowances are reported as additional revenue.

Depot Maintenance

Revenue recognition for Organic DMAG is the percentage of completion method now that the Depot Maintenance Accounting and Production System (DMAPS) is fully operational at all three ALCs.

Revenue recognition for Contract DMAG is based on the number of units produced times the Unit Sales Price (USP) and does not recognize IRR at this time.

Information Services

The Information Services Activity Group (ISAG), as a service type organization, recognizes revenue in one of two ways based on the service level agreement between the customer and the provider. ISAG uses either the completed contract method or the percentage of completion method.

1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the Air Force's financial and nonfinancial 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, and environmental liabilities. Expenditures for capital and other long-term assets are not recognized as expenses in the AFWCF's operations until depreciated in the case of property, plant, and equipment (PP&E) or consumed in the case of operating materials and supplies (OM&S). Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made. Operating expenses were adjusted as a result of the elimination of balances between the DoD Components. Net increases or decreases in unexpended appropriations are recognized as a change in net position. See Note 19.I, Intra-governmental Expenses and Revenue, for disclosure of adjustment amounts.

1.G. Accounting for Intra-governmental Activities

The Air Force, as an agency of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Air Force as though the agency was a stand-alone entity.

The Air Force's proportionate share of public debt and related expenses of the federal government are not included. Debt issued by the federal government and the related costs are not apportioned to the federal agencies. The Air Force's financial statements, therefore, do not report any portion of the 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 the DoD facilities is obtained through budget 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.

The Air Force's civilian employees participate in the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS), while military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. The AFWCF funds a portion of the civilian and military pensions. Reporting civilian pension information under the CSRS and FERS retirement systems is the responsibility of the Office of Personnel Management (OPM). The AFWCF recognizes an imputed expense for the portion of civilian employee pensions and other retirement benefits funded by the OPM in the Statement of Net Cost, and recognizes corresponding imputed revenue in the Statement of Changes in Net Position.

To prepare reliable financial statements, transactions occurring between components or activities within the DoD or between two or more federal agencies must be eliminated. However, the Air Force, as well as the rest of the federal government, cannot accurately identify all intra-governmental transactions by customer. The Defense Finance and Accounting Service (DFAS) is responsible for eliminating transactions between the components or activities of the AFWCF. For FY 1999 and beyond, seller entities within the Department provided 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 have been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD intra-governmental balances were then eliminated.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the Department and other federal agencies. In September 2000, the FMS issued the "Federal Intra-governmental Transactions Accounting Policies and Procedures Guide." The DoD was not able to fully implement the policies and procedures in this guide related to reconciling intra-governmental assets, liabilities, revenues, and expenses for nonfiduciary transactions. The Air Force was able to implement the policies and procedures contained in the "Intra-governmental Fiduciary Transactions Accounting Guide," as updated by the "Federal Intra-governmental Transactions Accounting Policies and Procedures Guide," for reconciling intra-governmental transactions pertaining to investments in federal securities, borrowings from the United States (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 OPM.

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 AFWCF 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. Customers may be required to make payments in advance.

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

The AFWCF's financial resources are maintained in U.S. Treasury accounts. The majority of cash collections, disbursements, and adjustments are processed worldwide at the Defense Finance and Accounting Service (DFAS), Military Services and U.S. Army Corps of Engineers (USACE) disbursing stations, as well as the Department of State financial service centers. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on check issues, electronic funds transfers, 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 maintained in the Treasury's system. Differences between the AFWCF's recorded balance in the FBWT account and Treasury's FBWT sometimes result and are subsequently reconciled.

Fund Balances with Treasury are maintained at the AFWCF corporate business area today. In 1992, when the Defense Business Operating Fund was established, the FBWT was moved from the Air Force level to the DoD level. In 1996, the DWCF was established and the FBWT was moved back to the Air Force level. However, allocations of FBWT were at a lower level than the level transferred out. The cash balance had been maintained at 10 days worth of cash, but what was allocated back was 3 days worth of cash. The days are based on the average of cash needed to pay vendors. The fund has been "under funded" since that time.

Material disclosures are provided at Note 3. Differences are caused by in-transit disbursements and unmatched disbursements, which are not recorded in the accounting offices' detail-level records.

1.J. Foreign Currency

Not applicable.

1.K. Accounts Receivable

As presented on the Balance Sheet, accounts receivable includes accounts receivables, claims receivables, and refunds receivable from other Federal entities or from nonfederal entities. Allowances for loss on accounts receivable due from nonfederal entities are based upon analysis of collection experience by fund type. The AFWCF does not recognize an allowance for loss on accounts receivable amounts from another Federal agency. Claims against another federal agency are to be resolved between the agencies. If the claim cannot be resolved by the agencies involved, it should be referred to the General Accounting Office. Only Supply Management allows for allowance for loss accounts receivable based upon analysis of historical data from prior year accounts receivable balances, write-offs, and collection policy.

Material disclosures are provided at Note 5.

1.L. Loans Receivable. As Applicable

Not applicable.

1.M. Inventories and Related Property

Inventory for the AFWCF is all held in the Supply Management Activity Group (SMAG) except for work-in-process inventory which is in the Depot Management Activity Group. Prior to fiscal year 2004 the majority of the SMAG inventory was reported at approximate historical cost based on Latest Acquisition Cost (LAC), adjusted for holding gains and losses. In fiscal year 2004 approximately 50% of the Supply Management Activity Group inventory changed from the LAC method and began using a Moving Average Cost (MAC) method of valuation. This allowed SMAG to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property" for that percentage of the inventory. The remaining 50% of the SMAG inventory is managed in the Standard Base Supply System using the LAC method for valuation and will be changed to MAC valuation beginning in fiscal year 2005. The conversion to MAC included programming changes for the SMAG accounting system to convert from the Air Force General Ledger (AFGL) to the United States Standard General Ledger (USSGL) for supply accounting.

Under the LAC method of inventory valuation gains and losses resulting from valuation changes for inventory items were recognized and reported in the Statement of Net Cost and included in the calculation of Cost of Goods Sold. To calculate the allowances for gain or loss on inventories, DFAS Denver prepared an inventory worksheet monthly for each fund code within the SMAG. SFFAS No. 3, "Accounting for Inventory and Related Property," directs that using a historical cost valuation method does not require an allowance for holding gains and losses account. Additionally, SFFAS No. 3 provides for either the direct or allowance method to be used in valuing inventory held for repair. Therefore the change to a historical costing method also included the elimination of the allowance for holding gains and losses, revaluation of all inventories to a historical basis and the creation of an allowance for repairs. The implementation of Moving Average Cost for 50% of SMAG inventories in fiscal year 2004 eliminated the need for the gains and losses allowance account for that portion of the inventory and has been credited against a prior period. Inventory held for repair is now valued at MAC with an allowance for repair equal to the latest repair cost.

Related property includes operating materials and supplies (OM&S) and stockpile materials. The OM&S including munitions not held for sale are valued at standard purchase price. The department uses the consumption method of accounting for OM&S for the most part, expensing material when it is issued to the end user. Where current systems cannot fully support the consumption method, the AFWCF uses the purchase method, expensed when purchased.

Material disclosures related to inventory and related property are provided at Note 9.

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

Not applicable.

1.O. General Property, Plant, and Equipment

General property, plant, and equipment (PP&E) assets are capitalized at historical acquisition cost plus capitalized improvements, when an asset has a useful life of two or more years, and when the acquisition cost equals or exceeds the DoD capi-

talization threshold of $100,000. Also, improvement costs over the DoD capitalization threshold of $100,000 for General PP&E are required to be capitalized. All General PP&E, other than land, is depreciated using the straight-line method. Land is not depreciated.

Prior to FY 1996, General PP&E with 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 was capitalized. These assets remain capitalized and are reported on WCF financial statements. General PP&E previously capitalized at amounts below $100,000 were written off General Fund financial statements in FY 1998.

When it is in the best interest of the government, the Air Force provides government property necessary to complete contract work to contractors. Such property is either owned or leased by the Air Force, or 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, the items should be included in the value of General PP&E reported on the Air Force's Balance Sheet. The AFWCF recently completed a study that indicates that the value of General PP&E that meets the capitalization requirement and is in the possession of contractors is not material to the Department's financial statements. Regardless, the AFWCF 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 Air Force currently reports only the government property in the possession of contractors that is maintained in the Air Force's property systems.

For entities operating as business type activities (WCFs), all PP&E used in the performance of their mission is categorized as General PP&E, whether or not it meets the definition of any other PP&E categories. National Defense PP&E, Heritage Assets and Stewardship Land owned or maintained on a WCF installation are reported in the Supplemental Stewardship Report of the applicable military department.

Material disclosures are provided at Note 10.

1.P. Advances and Prepayments

Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as an asset on the Balance Sheet. Advances and prepayments are recognized as expenditures and expenses when the related goods and services are received.

1.Q. Leases

Not applicable.

1.R. Other Assets

The AFWCF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that these long-term contracts can cause, the AFWCF provides financing payments. One type of financing payment that the AFWCF makes is for real property, and is based upon a percentage of completion. In accordance with SFFAS No 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported on the General PP&E line and in Note 10, General PP&E, Net. In addition, based on the provision of the Federal Acquisition Regulations, the AFWCF makes financing payments under fixed price contracts that are not based on a percentage of completion. The AFWCF reports these financing payments as advances or prepayments in the "Other Assets" line item. The AFWCF treats these payments as advances or prepayments because the AFWCF 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 AFWCF is not obligated to reimburse the contractor for its costs, and the contractor is liable to repay the AFWCF for the full amount of the advance. The AFWCF has completed a review of all applicable federal accounting standards, applicable public laws on contract financing, Federal Acquisition

Regulation Parts 32, 49, and 52 and the OMB guidance in Code 5 of Federal Regulations Part 1315, "Prompt Payment." The AFWCF has concluded that SFFAS No. 1 does not fully or adequately address the subject of progress payment accounting and is considering what further action is appropriate.

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss to the AFWCF. The uncertainty will be resolved when one or more future events occur or fail to occur. A contingency is recognized as a liability when a past event or exchange transaction has occurred, a future loss is probable, and the amount of loss 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 that a loss or an additional loss will be incurred. Examples of loss contingencies include the collectability of receivables, pending or threatened litigation, possible claims and assessments. The AFWCF's loss contingencies arising are events such as aircraft, ship and vehicle accidents, medical malpractice, property or environmental damages, and contractual disputes.

1.T. Accrued Leave

Civilian annual leave and military leave that have been accrued and not used as of the balance sheet date are reported as liabilities. The liability reported at the end of the fiscal year 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, which are unobligated and have not been rescinded or withdrawn, and amounts obligated but for which legal liabilities for payments have not been incurred.

Cumulative results of operations for the AFWCF represent the excess of revenues over expenses, less refunds to customers, and returns to the U.S. Treasury since fund inception.

1.V. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings and other facilities that are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. The DoD capital assets located overseas are purchased with appropriated funds, however the host country retains the title to the land and any improvements. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. These fixed assets are subject to loss in the event treaties are not renewed or the AFWCF does not reach agreements that allow for the continued use. Therefore, in the event treaties or other agreements are terminated and the use of foreign bases is not allowed the losses will be recorded for the value of any nonretrievable capital assets. Negotiations between the United States and the host country determine the amount to be paid the United States for such capital investments.

1.W. Comparative Data

Not applicable.

1.X. Unexpended Obligations

The AFWCF records obligations for goods and services that have been ordered but not yet received. No liability for payment has been established in the financial statements because goods/services have yet to be delivered.

1.Y. Problem Disbursements

Problem disbursements represent disbursements of Air Force Working Capital funds reported by a disbursing station to the Department of Treasury that have not yet been precisely matched against the specific source obligation. The problem disbursements arise when the various contracting, disbursing, and accounting systems fail to match the data necessary to properly account for the transaction in all the applicable accounting systems.

As of August 31, 2004	Sept 2002	Sept 2003	Sept 2004	Decrease/Increase from FY03 to FY04
(Amounts in dollars and cents)				
1. Total Problem Disbursements, Absolute Value				
Unmatched Disbursements (UMDs)	2,548,304.11	2,813,110.98	4,712,851.72	1,899,740.74
Negative Unliquidated Obligations (NULOs)	11,615,822.46	6,497,624.92	4,255,145.38	-2,242,479.54
2. Total In-transit Disbursements, Net	$ 537,627,452.62	$ 464,048,716.87	$ 415,521,508.49	$ -48,527,208.38

The Air Force Working Capital fund had a $342.7 thousand decrease in problem disbursements and $48,527.2 thousand decrease in in-transit disbursements. Defense Finance and Accounting Service has efforts underway to improve the systems and to resolve all previous problem disbursements and to process all in-transit disbursements. The amount over 180 days old for UMD is $175.9 thousand, for NULO is $0.00, and for in-transit is $1,752.1 thousand. The amount over 120 days old for UMD is $103.14, for NULO is $0.00, and for in-transit is $8,641.4 thousand. The current absolute value of in-transit disbursements is $502,975.7 thousand.

Note 2. Non-entity Assets

As of September 30	2004	2003
(Amounts in thousands)		
1. Intra-governmental Assets		
A. Fund Balance with Treasury	$ 0	$ 0
B. Investments	0	0
C. Accounts Receivable	0	0
D. Other Assets	0	0
E. Total Intra-governmental Assets	$ 0	$ 0
2. Non-Federal Assets		
A. Cash and Other Monetary Assets	$ 0	$ 0
B. Accounts Receivable	0	0
C. Loans Receivable	0	0
D. Inventory & Related Property	0	0
E. General PP&E	0	0
F. Investments	0	0
G. Other Assets	0	0
H. Total Non-Federal Assets	$ 0	$ 0
3. Total Non-Entity Assets	$ 0	$ 0
4. Total Entity Assets	$ 24,742,804	$ 25,740,673
5. Total Assets	$ 24,742,804	$ 25,740,673

Asset accounts are categorized as either entity or non-entity. Entity accounts consist of resources that are available for use in the operations of the entity. The Air Force is authorized to decide how to use resources in entity accounts. The Air Force may be legally obligated to use these resources to meet entity obligations. Non-entity accounts, on the other hand, consist of assets that are held by an entity but are not available for use in the operations of the entity.

The Air Force Working Capital Fund does not have any non-entity assets.

Note 3.A. Fund Balance with Treasury

As of September 30		2004		2003
(Amounts in thousands)				
1. Fund Balances				
A. Appropriated Funds	$	0	$	0
B. Revolving Funds		1,051,110		732,842
C. Trust Funds		0		0
D. Other Fund Types		0		0
E. Total Fund Balances	$	1,051,110	$	732,842
2. Fund Balances Per Treasury Versus				
A. Fund Balance per Treasury	$	1,703,858	$	2,475,046
B. Fund Balance per AFWCF		1,051,110		732,842
3. Reconciling Amount	$	652,748	$	1,742,204

The reconciling amount on line 3 above represents $652,746.5 thousand for the United States Transportation Command (USTC), which is reported at the Department of the Treasury as part of the Air Force Working Capital Fund (AFWCF). However, for the purposes of Audited Financial Statements (AFS), USTC is included with the Other Defense Organizations (ODO) reporting, which is separate from the AFWCF. Therefore, USTC cash is not included on the AFWCF AFS statements.

Fluctuations and Abnormalities

Fund Balance with Treasury increased $318,268.2 thousand in FY 2004. The increase can be attributed to three primary factors. First, the Supply Management Activity Group (SMAG) and the Depot Maintenance Activity Group (DMAG) both had increases in fund balances from the prior year, which is attributed to favorable financial performance. Net operating results for the two business areas, before elimination and AFS required adjustments, totaled $619,075.5 thousand, which represents a source of cash. Secondly, a $343,635.1 thousand increase to the fund balance is attributed to favorable balance sheet performance. This increase was the result of the collection of an additional $94,327.7 thousand in accounts receivable over the prior year, coupled with an increase in accounts payable in the amount of $249,307.4 thousand. These increases are discussed in Note 5 and Note 12, respectively. Overall, the increase to cash was $962,710.6 thousand, which was offset by a mandated cash pull totaling $578,400.0 thousand, accounting for an overall increase of $384,310.6 thousand. The remaining decrease of $66,042.4 thousand can be attributed to normal business fluctuations in other areas of the Working Capital Fund.

Note Reference

See Note Disclosure 1.1, Significant Accounting Policies, for additional discussion on financial reporting requirements and Department of Defense policies governing funds with the U.S. Treasury.

Note 3.B. Disclosures Related to Suspense/Budget Clearing Accounts

Not applicable.

Note 4. Investments

Not applicable.

Note 5. Accounts Receivable

As of September 30	2004			2003
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intra-governmental Receivables:	$ 576,396	N/A	$ 576,396	$ 605,077
2. Non-Federal Receivables (From the Public):	$ 103,189	$ -78	$ 103,111	$ 167,764
3. Total Accounts Receivable:	$ 679,585	$ -78	$ 679,507	$ 772,841

Other information

Fluctuations

Non-federal receivables decreased $64,653.4 thousand. The amount consists of a decrease in the Supply Management Activity Group (SMAG) which is offset by an increase in the Depot Maintenance Activity Group (DMAG). SMAG had a decrease of $78,283.4 thousand, which is attributed to two factors. At the end of FY 2003, accounts receivable deliveries suspense were reclassified from other assets to non-federal receivables. Deliveries suspense are receivables from sales transactions to foreign governments. While the original transaction is recorded at the standard rates, foreign policy often dictates the actual amount to be collected from the foreign government. Once the amount is determined, the billing is processed. In FY 2004 it was determined that the amount should be reported in other assets until the billing occurs and the receivable is established. The reclassification resulted in a decrease of $117,903.1 thousand. The decrease is offset by an increase of $19,810.1 thousand, which is the result of reclassification of unsupported undistributed collections to U. S. Standard General Ledger (USSGL) account 2400. In FY 2003, the unsupported undistributed collections were netted with the unsupported undistributed disbursements; therefore there was no impact on receivables. The remaining increase in SMAG can be attributed to a $18,023.1 thousand reclassification of receivables from intra-governmental to non-federal for foreign military sales receivables that were previously recorded incorrectly. The DMAG increase of $12,997.8 thousand is primarily attributed to an uncollected demand letter to Boeing for an overpayment of approximately $8,456.4 thousand on a KC-135 contract. The letter is currently under dispute by Boeing. The remaining fluctuations are a result of normal business operations.

Information Related to Accounts Receivables

Allowance Method

The SMAG uses an allowance method based on historical data for non-federal receivables. The Depot Maintenance and the Information Services Activity Groups generally use the direct write-off method for uncollectible accounts.

Allocation of Undistributed Collections

The Department of Defense (DoD) policy is to allocate supported undistributed collections between federal and non-federal categories based on the percentage of federal and non-federal accounts receivable. Unsupported undistributed collections are recorded in USSGL account 2400, Liability For Deposit Funds, Clearing Accounts, and Undeposited Collections. The Air Force Working Capital Fund (AFWCF) followed this allocation procedure, applying $(2,980.0) thousand in undistributed collections to accounts receivable and recording $18,913.2 thousand of unsupported undistributed to USSGL account 2400.

Elimination Adjustments

Accounts receivable within the AFWCF have been eliminated for statement presentation purposes. The total value of the receivables that were eliminated on these financial statements is $341,080.9 thousand.

The Air Force accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Air Force was unable to reconcile intra-governmental accounts receivable balances with its trading partners. Through the ongoing Business Management Modernization Program, the Department intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations.

Receivables over 180 Days

The Air Force has $13,643.1 thousand intragovernment receivables and $18,488.3 thousand non-federal receivables over 180 days. Processes have been implemented to closely monitor the delinquent receivables and to refer them to the appropriate entity for resolution.

Note Reference

See Note Disclosure 1.K., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing accounts receivable.

Note 6. Other Assets

As of September 30	2004	2003
(Amounts in thousands)		
1. Intra-governmental Other Assets:		
A. Advances and Prepayments	$ 10	$ 3
B. Other Assets	0	0
C. Total Intra-governmental Other Assets	$ 10	$ 3
2. Non-Federal Other Assets:		
A. Outstanding Contract Financing Payments	$ 0	$ 0
B. Other Assets (With the Public)	788,966	380,362
C. Total Non-Federal Other Assets	$ 788,966	$ 380,362
3. Total Other Assets:	$ 788,976	$ 380,365

Other Information Related to Other Assets:

Fluctuations and Abnormalities

Intra-governmental other assets (Line 1)

The $7.3 thousand increase to intra-governmental other assets is caused by an increase in unearned revenue reported by seller side data. The unearned revenue is reported as advances in the Supply Management Activity Group (SMAG).

Non-federal other assets (Line 2)

The $408,604.7 thousand increase in non-federal other assets consists of a $27,389.9 thousand decrease in the Depot Maintenance Activity Group (DMAG) and a $435,994.6 thousand increase in SMAG.

For DMAG, the decrease in advances is largely due to the phaseout of Contract DMAG. The increase in other assets is due to the unallocated labor and material expenditures account. This account is used to record expenditures that can not be identified to a specific job order number. The Air Logisitics Centers have been notified of the increase and will continue to research the issue. The remaining increases or decreases for DMAG's advances and other assets are a result of normal operations.

For SMAG, the $246,139.0 thousand increase in advances was largely due to paid intransits from vendors that were reported in FY 2003 as inventory. In FY 2004 this was corrected to be reported as non-federal advances. For FY 2003 the ending balance of paid intransits was $278,486.9 thousand. The $189,855.9 thousand increase in other assets is due to two events. The first is due to other assets accounts receivable deliveries suspense that were reported in FY 2003 as accounts receivables for 4th Quarter only. During 1st Quarter, FY 2004 this error was corrected and the transactions are properly recorded as other assets. For FY 2003 the ending balance of the account was $117,903.1 thousand. The second event is an increase of $71,780.0 thousand in returns to vendors pending credit. The Materiel Support Division is continuing its research the reason for the increase. The remaining increases or decreases for SMAG's advances and other assets are a result of normal operations.

Non-Federal Other Assets (in Thousands)

Types of Asset	**2004**	**2003**
SMAG – Advances and Prepayments to Contractors	$374,443	$128,304
DMAG – Advances and Prepayments to Contractors	7,044	38,899
SMAG – Other Assets	401,543	211,688
DMAG – Other Assets	5,936	1,471
Total Non-Federal Other Assets	**$788,966**	**$380,362**

Note Reference

See Note Disclosure 1.R., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing other assets.

Note 7. Cash and Other Monetary Assets

As of September 30	2004	2003
(Amounts in thousands)		
1. Cash	$ 0	$ 0
2. Foreign Currency (non-purchased)	0	0
3. Other Monetary Assets	0	0
4. Total Cash, Foreign Currency, and Other Monetary Assets	$ 0	$ 0

Other Information Pertaining to Entity Cash and Other Monetary Assets

Definitions

Cash—The total of cash resources under the control of the Working Capital Fund, including coin, paper currency, purchased foreign currency, negotiable instruments, and amounts on deposit in banks and other financial institutions. Cash available for agency use should include petty cash funds and cash held in revolving funds that will not be transferred into the U.S. Government General Fund.

Foreign Currency—The total U.S. dollar equivalent of non-purchased foreign currencies held in foreign currency fund accounts. Non-purchased foreign currency is limited to the Treasury Index 97X7000 fund account (formerly called FT accounts).

Other Monetary Assets—included gold, special drawing rights, and U.S. Reserve in the International Monetary Fund. This category is principally for use by the Department of Treasury.

Note Reference

See Note Disclosure 1.J., Significant Accounting Policies, for additional discussion on financial reporting requirements and Department of Defense (DoD) policies governing foreign currency.

For regulatory discussion on other assets, see the DoD Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1009.

Note 8. Direct Loan and/or Loan Guarantee Programs

Not applicable.

Note 9. Inventory and Related Property

As of September 30	2004	2003
(Amounts in thousands)		
1. Inventory, Net (Note 9.A.)	$ 20,492,890	$ 21,869,635
2. Operating Materials and Supplies, Net (Note 9.B.)	532,638	655,361
3. Stockpile Materials, Net (Note 9.C.)	0	0
4. Total	$ 21,025,528	$ 22,524,996

Note 9.A. Inventory, Net

As of September 30	2004			2003	
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	Valuation Method
(Amounts in thousands)					
1. Inventory Categories:					
A. Available and Purchased for Resale	$ 22,004,327	$ -11,311,957	$ 10,692,370	$ 15,118,285	LAC/O/MAC
B. Held for Repair	13,419,021	-4,088,513	9,330,508	6,057,706	LAC/O/MAC
C. Excess, Obsolete, and Unserviceable	753,522	-753,522	0	0	
D. Raw Materials	0	0	0	0	
E. Work in Process	470,012	0	470,012	693,644	AC
F. Total	$ 36,646,882	$ -16,153,992	$ 20,492,890	$ 21,869,635	

Legend for Valuation Methods:	
Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses	NRV = Net Realizable Value
SP = Standard Price	O = Other
AC = Actual Cost	

Restrictions of Inventory Use, Sale, or Disposition

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

(1) Distributions without reimbursement are made when authorized by Department of Defense (DoD) directives.

(2) War Reserve Material includes fuels and subsistence items that are considered restricted.

(3) Inventory, with the exception of safety stocks, may be sold to foreign, state and local governments, private parties, and contractors in accordance with current policies and guidance or at the direction of the President.

Other Information

Definitions

Inventory available and purchased for resale includes consumable spare and repair parts as well as repairable items owned and managed by the Department. Material available and purchased for resale includes material held due to a managerial determination that it should be retained to support military or national contingencies.

Inventory held for repair is damaged inventory that requires repair to make it suitable for sale. Many of the inventory items are more economical to repair than to procure. In addition, 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.

Excess, obsolete, and unserviceable inventory consists of scrap materials or items that cannot be economically repaired and are awaiting disposal. Potentially reusable material, presented in previous years as excess, obsolete, and unserviceable, is included in the held for use or held for repair categories, according to its condition.

Work in process balances include costs related to the production or servicing of items, including direct material, 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 the amount paid to a contractor under cost-reimbursable contracts, including the amount withheld from payment to ensure performance and the amount paid to other government plants for accrued costs of end-items of material ordered but not delivered.

Fluctuations

Inventory decreased $1,376,744.7 thousand due to the following factors.

Gross inventory values for the Supply Management Activity Group (SMAG) had an increase of $845,962.5 thousand after FY 2003 was restated. Two events caused the increase for SMAG. First was an increase of $1,124,449.4 thousand (5.5% of total net inventory) that is a result of normal operations. The second event was a change in the accounting for intransit inventory and caused a decrease of $278,486.9 thousand to inventory available and purchased for resale. In FY 2003 paid intransit from vendors were recorded in the inventory available and purchased for resale account. In FY 2004 this was corrected and is now recorded in the advance account in the other assets line. See Note 6 for further details. Each category related to SMAG did have fluctuations however, these were related to the movement of inventory from the category of available and purchased for resale to the category of held for repair and the recent population of the excess, obsolete and unserviceable inventory category. Work in process (WIP) had a decrease of $223,632.5 thousand. The continuing phase out of Contract Depot Maintenance Activity Group (DMAG) operations resulted in a decrease of WIP of $178,621.2 thousand. DMAG had a decrease of $45,011.3 thousand. This is attributed to the clean-up of problematic invoices that resulted from the DMAPS/DIFMS implementation. Once the bills were able to be processed, the associated WIP was relieved.

The revaluation allowance values increased $1,999,074.7 thousand, which leads to the decrease in total inventory. In FY 2004 SMAG changed its inventory valuation method for the portions of its General and Materiel Support Divisions that are reported by FIABS. The new inventory method is Moving Average Cost. The change impacted total inventory by an increase in the amount of $11,370,455.9 thousand. This adjustment was processed as a prior period adjustment, and the FY 2003 total inventory has been restated by this amount. The original FY 2003 inventory amount was $10,499,179.0 thousand.

General Composition of Inventory

Inventory includes spare and repair parts, clothing and textiles, fuels, and ammunition. Inventory is tangible personal property that is (1) held for sale or held for repair for eventual sale, (2) in the process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee.

The category inventory held for repair consists of damaged material that requires repair to make it usable. Excess inventory is condemned material that must be retained for management purposes. The category held for sale includes all issuable material. The category held for repair includes all economically reparable material. Work in process includes depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services. The U.S. Standard General Ledger does not include a separate work in process account unrelated to sales. Inventory is assigned to categories based on guidance in the DoD Financial Management Regulation, Volume 11B.

Note Reference

See Note Disclosure 1.M., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing inventory and related property.

Note 9.B. Operating Materials and Supplies (OM&S), Net

As of September 30	2004			2003	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in thousands)					
1. OM&S Categories:					
A. Held for Use	$ 532,638	$ 0	$ 532,638	$ 655,361	
B. Held for Repair	0	0	0	0	
C. Excess, Obsolete, and Unserviceable	0	0	0	0	
D. Total	$ 532,638	$ 0	$ 532,638	$ 655,361	

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

Other Information

Fluctuations

The OM&S category held for use (Line 1A) decreased $122,723.3 thousand for the following reasons. A decrease of $85,624.9 thousand is a result of the phase out of Contract DMAG operations. A decrease of $26,505.6 thousand can be attributed to the write off of obsolete floating stock, coupled with the clean up of the unmatched OM&S accounts for Organic DMAG. The remaining fluctuations are a result of normal operations.

General Composition of Operating Materials and Supplies

OM&S include spare and repair parts. The OM&S data reported on the financial statements are derived from logistics systems designed for material management purposes, i.e. accountability and visibility. The reported balances from these systems are not recorded at historical cost, in conformance with the valuation requirements in the Statement of Federal Financial Accounting Standard (SFFAS) No. 3, "Accounting for Inventory and Related Property." Instead, the Air Force uses standard price to value OM&S without computing unrealized holding gains or losses. Furthermore, past audit results have led to uncertainties pertaining to the completeness and existence of the OM&S quantities used to derive the balances reported in the financial statements.

For the most part, DMAG uses the consumption method of accounting for OM&S, since OM&S is defined in the SFFAS No. 3 as material which has not yet been issued to the end user. Once issued, the material is expensed. As stated above, current financial and logistics systems cannot fully support the consumption method. According to federal accounting standards, the consumption method of accounting should be used to account for OM&S unless (1) the amount of OM&S is not significant, (2) OM&S are in the hands of the end user for use in normal operations, or (3) it is cost-beneficial to expense OM&S when purchased (purchase method). The DoD, in consultation with its auditors, is (1) developing specific criteria for determining when OM&S amounts are not significant for the purpose of using the consumption method, (2) developing functional requirements for feeder systems to support the consumption method, (3) identifying feeder systems that are used to manage OM&S items, and (4) developing plans to revise those systems to support the consumption method. For FY 2004, the department reported significant amounts using the purchase method either because the systems could not support the consumption method or because management deems that the item is in the hands of the end user.

Note Reference

See Note Disclosure 1.M., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing Inventory and related property.

Note 9.C. Stockpile Materials, Net

Not applicable

Note 10. General Property, Plant, and Equipment (PP&E), Net

As of September 30	2004						2003
	Depreciation/ Amortization Method	Service Life	Acquisition Value		(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in thousands)							
1. Major Asset Classes:							
A. Land	N/A	N/A	$ 0		N/A	$ 0	$ 0
B. Buildings, Structures, and Facilities	S/L	20 or 40	809,196	$	-559,967	249,229	235,804
C. Leasehold Improvements	S/L	lease term	0		0	0	0
D. Software	S/L	2-5 or 10	978,030		-608,565	369,465	809,852
E. General Equipment	S/L	5 or 10	2,044,958		-1,493,532	551,426	227,317
F. Military Equipment	S/L	various	0		0	0	0
G. Assets Under Capital Lease [1]	S/L	lease term	0		0	0	0
H. Construction-in-Progress	N/A	N/A	27,563		N/A	27,563	27,884
I. Other			0		0	0	28,772
J. Total General PP&E			$ 3,859,747	$	-2,662,064	$ 1,197,683	$ 1,329,629

[1] Note 15.B for additional information on Capital Leases

Legend for Valuation Methods:

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

Other Information

Fluctuations and Abnormalities

The decrease of $28,772.2 thousand in other property, plant and equipment is caused by an incorrect general ledger account used during FY 2003. In FY 2004 the correct general ledger account of general equipment was used. Acquisition values for software and general equipment only increased 3 percent, however depreciation values caused fluctuations for the net book value. The fluctuation in depreciation is caused by a change made in General Accounting and Finance System – Rehost (GAFS-R). In FY 2003, $377,348.7 thousand was erroneously reported as general equipment accumulated depreciation. In FY2004 it was correctly reported as software accumulated depreciation. Since software can depreciate faster than general equipment, the amount of overall depreciation has therefore increased. Additional increases or decreases represent normal operations and do not exceed the 10 percent threshold.

Information Related to General PP&E, Net

Real property reported by the Automated Civil Engineering System (ACES) and personal property reported by the Air Force Equipment Management System (AFEMS) and the Information Processing Management System (IPMS) has not been validated and reconciled to reported figures received by Defense Finance and Accounting Service (DFAS) from the field activities. However, the Depot Maintenance ALCs and Aerospace Maintenance and Regeneration Center (AMARC) use the ACES to capture the costs of real property based on preponderance of use for each building. They use the straight-line method for

recording depreciation maintained on spreadsheets in place of the ACES schedule. The accounting entries are recorded directly into the field-level trial balances.

Any Working Capital Fund Special Tools and Special Test equipment in the possession and control of the Air Force are reported in the Air Force General Fund financial statements.

The value of Air Force General PP&E real property in the possession of contractors is included in the value reported above for the Major Asset Classes of Land and Buildings, Structures, and Facilities. The value of General PP&E personal property (Major Asset Classes of Software and Equipment) does not include all of the General PP&E in the possession of contractors that is above the Department of Defense (DoD) capitalization threshold. The net book amount of such property is immaterial in relation to the total General PP&E net book value. In accordance with a strategy approved by the Office of Management and Budget, the General Accounting Office, and the Inspector General, DoD, the Department is developing new policies and a contractor-reporting process to capture General PP&E information for future reporting purposes in compliance with generally accepted accounting practices.

Past audit results have identified uncertainties as to whether all General PP&E assets in the possession or control (existence) of the Department are properly and accurately recorded in the system (completeness).

Note Reference

See Note Disclosure 1.N., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing General PP&E.

Note 10.A. Assets Under Capital Lease

Not applicable.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2004	2003
(Amounts in thousands)		
1. Intra-governmental Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Debt	0	0
C. Environmental Liabilities	0	0
D. Other	0	0
E. Total Intra-governmental Liabilities	$ 0	$ 0
2. Non-Federal Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	238,729	275,132
C. Environmental Liabilities	0	0
D. Loan Guarantee Liability	0	0
E. Debt Held by Public	0	0
F. Other Liabilities	0	0
G. Total Non-Federal Liabilities	$ 238,729	$ 275,132
3. Total Liabilities Not Covered by Budgetary Resources	$ 238,729	$ 275,132
4. Total Liabilities Covered by Budgetary Resources	$ 2,613,686	$ 2,557,997
5. Total Liabilities	$ 2,852,415	$ 2,833,129

Other Information

Fluctuations and Abnormalities

The amounts recorded on line 2B represent the Federal Employees Compensation Act (FECA) actuarial liabilities provided by the Department of Labor. The $36,402.5 thousand decrease is due to a decrease in the number of employees.

Definitions

Liabilities Not Covered and Covered by Budgetary Resources – These are liabilities that are not considered covered by realized budgetary resources as of the balance sheet date. Budgetary resources include the following:

- New budget authority
- Spending authority from offsetting collections (credited to an appropriation or fund account)
- Recoveries of unexpired budget authority through downward adjustments of prior-year obligations
- Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior-year balances during the year
- Borrowing authority or permanent indefinite appropriations that have been enacted and signed into law as of the bal ance sheet date, provided that the Office of Management and Budget (OMB) can apportion the resources without first meeting a contingency or without additional action by the Congress.

Liabilities Covered by Budgetary Resources

These are resources the reporting entity incurred that are covered by realized budget resources as of the balance sheet date. Budgetary resources encompass not only new budget authority but also other resources available to cover liabilities for specified purposes in a given year. Available budgetary resources include the following:

- New budget authority
- Spending authority from offsetting collections (credited to an appropriation or fund account)
- Recoveries of unexpired budget authority through downward adjustments of prior-year obligations
- Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior-year balances during the year
- Borrowing authority or permanent indefinite appropriations that have been enacted and signed into law as of the bal ance sheet date, provided that the OMB can apportion the resources without first meeting a contingency or without additional action by the Congress.

Note Reference

For additional line item discussion, see:

- Note 8, Direct Loans and/or Loan Guarantee Programs
- Note 12, Accounts Payable
- Note 13, Liabilities Not Covered and Covered by Budgetary Resources

- Note 14, Environmental Restoration Liabilities and Environmental Disposal Liabilities
- Note 15, Other Liabilities
- Note 16, Commitments and Contingencies
- Note 17, Military Retirement Benefits and Other Employment Related

Note 12. Accounts Payable

As of September 30	2004			2003
	Accounts Payable	Interest, Penalties, and Administrative	Total	Total
(Amounts in thousands)				
1. Intra-governmental Payables:	$ 256,763	N/A	$ 256,763	$ 231,725
2. Non-Federal Payables (to the Public):	$ 497,471	$ 0	$ 497,471	$ 88,984
3. Total	$ 754,234	$ 0	$ 754,234	$ 320,709

Other Information

Definition

Intra-governmental payables consist of amounts owed to other federal agencies for goods or services ordered and received but not yet paid for. Interest, penalties, and administrative fees are not applicable to intra-governmental payables. Non-federal payables (to the public) are payments to non-federal entities.

Fluctuations and Abnormalities

Intra-governmental payables increased by $25,033.7 thousand. An increase of $80,841.3 thousand is attributed to the Supply Management Activity Group (SMAG). SMAG is reporting increased accounts payable to the US Army and US Navy that the Air Force Material Command is currently researching. The increase is offset by the elimination adjustments processed to match the accounts receivables as reported by other government agencies.

Non-federal payables increased by $408,487.9 thousand. The Supply Management Activity Group (SMAG) accounted for $419,095.5 thousand of the increase, which is offset by normal operations in the remaining business areas. An increase of $206,458.6 thousand is attributed to a change in allocation method regarding undistributed disbursements. In FY 2003, the undistributed was allocated to non-federal payables, which decreased the total payables reported. In FY 2004, the undistributed was all allocated to intragovernmental payables due to systems changes. The change in allocations did not affect the intragovernmental payable balance as the undistributed was eliminated within the AFWCF. The remaining increase of $202,029.3 thousand is attributable to an increase in expense volume in September 2004 in comparison to September 2003. Expenses incurred in one month are generally paid in the subsequent month, resulting in the subsequent increase in accounts payable at the end of September 2004.

Undistributed Disbursements

Undistributed disbursements consist of the difference between (1) disbursements/collections recorded at the transaction level to a specific obligation, payable, or receivable in the activity field records, and (2) those disbursements/collections reported by the U.S. Treasury via the reconciled DD1329 and DD1400. The total undistributed disbursement amounts displayed in this note should agree with the undistributed amounts reported on accounting reports (SF 133/(M) 1002/(M) 1307). In-transit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to each entity's outstanding accounts payable balance at year-end. Accounts payable were adjusted downward in the amount of $644,649.2 thousand for these payments.

Allocation of Undistributed Disbursements

The Department of Defense (DoD) policy is to allocate supported undistributed disbursements between intragovernmental and non-federal categories based on the percentage of intragovernmental and non-federal accounts payable. Unsupported undistributed disbursements should be recorded in U.S. Standard General Ledger account (USSGLA) 2120, Disbursements in Transit. The AFWCF followed this allocation policy reporting $67,014.5 thousand in USSGLA 2120.

Intragovernmental Eliminations

For the majority of intra-agency sales, the AFWCF accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the AFWCF was unable to reconcile intragovernmental accounts payable to the related intragovernmental accounts receivable that generated the payable. Elimination adjustments are made at the consolidated business activity level instead of at the fund-code level, resulting in less distortion of the actual payable amounts.

The DoD intends to develop 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 reconciliations cannot be accomplished with the existing or foreseeable resources.

Note Reference

See Note Disclosure 1.G., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing accounting for intragovernmental activities.

Note 13. Debt

Not applicable.

Note 14. Environmental Liabilities and Disposal Liabilities

Not applicable.

Note 15.A. Other Liabilities

As of September 30	2004			2003
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
1. Intra-governmental:				
A. Advances from Others	$ 234,529	$ 0	$ 234,529	$ 339,302
B. Deferred Credits	0	0	0	0
C. Deposit Funds and Suspense Account Liabilities	0	0	0	0
D. Resources Payable to Treasury	0	0	0	0
E. Disbursing Officer Cash	0	0	0	0
F. Non-environmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
(4) Other	0	0	0	0
G. Accounts Payable—Cancelled Appropriations	0	0	0	0
H. Judgement Fund Liabilities	0	0	0	0
I. FECA Reimbursement to the Department of Labor	0	0	0	0
J. Capital Lease Liability	0	0	0	0
K. Other Liabilities	8,602	0	8,602	6,135
L. Total Intra-governmental Other Liabilities	$ 243,131	$ 0	$ 243,131	$ 345,437
2. Non-Federal:				
A. Accrued Funded Payroll and Benefits	$ 135,633	$ 0	$ 135,633	$ 161,111
B. Advances from Others	15,256	0	15,256	5,542
C. Deferred Credits	0	0	0	0
D. Loan Guarantee Liability	0	0	0	0
E. Liability for Subsidy Related to Undisbursed Loans	0	0	0	0
F. Deposit Funds and Suspense Accounts	18,913	0	18,913	-22
G. Temporary Early Retirement Authority	0	0	0	0
H. Non-environmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
(4) Other	0	0	0	0
I. Accounts Payable—Cancelled Appropriations	0	0	0	0
J. Accrued Unfunded Annual Leave	0	0	0	0
K. Accrued Entitlement Benefits for Military Retirees and Survivors	0	0	0	0
L. Capital Lease Liability	0	0	0	0
M.Other Liabilities	1,446,519	0	1,446,519	1,725,220
N. Total Non-Federal Other Liabilities	$ 1,616,321	$ 0	$ 1,616,321	$ 1,891,851
3. Total Other Liabilities:	$ 1,859,452	$ 0	$ 1,859,452	$ 2,237,288

Other Information Pertaining to Other Liabilities

Fluctuations and Abnormalities

Line 1.A—Intra-governmental advances from others decreased due largely to the decrease in the Depot Maintenance Activity Group (DMAG) Contract progress billings. Contract DMAG is phasing out of the Working Capital Fund (WCF).

Line 1.K—The other intra-governmental liabilities increase represents employee benefits that are payable to the Office of Personnel Management (OPM). Liabilities fluctuate based on staffing levels and participation in benefit programs by employees.

Line 2.A—The decrease in accrued funded payroll and benefits is a result of fewer days accrued in FY 2004. In FY 2003, there were nine days of accrued payroll and benefits and in FY 2004 there were four days.

Line 2.B—The increase of advances from others is caused by DMAG. This increase is largely due to a problem with the billing of public workload. DMAG receives advances from the public. This is recorded as a liability until the work is completed and the revenue can be reported as earned. Since DMAG was unable to process the bills for work that was completed, the advances from others amount was not moved to earned revenue from the public. The Air Logistics Centers are aware of the issue and are working to resolve it. The remaining fluctuations are a result of normal operations.

Line 2.F—The fluctuation represents unsupported undistributed collections, for which guidance was issued to reclassify to deposit funds and suspense accounts. In FY 2003 the reclassification was not prepared for the Supply Management Activity Group (SMAG). If the reclassification has been prepared the amount would have little fluctuation from the amount processed in FY 2004.

Information Related to Other Liabilities (Line 2.M)

As of Septemb 30		FY2004		FY 2003
DMAG/Information Services Activity Group (ISAG) – Progress Billings		0		1
DMAG – WIP Accrued Expenses	$	1,377,793	$	1,616,599
SMAG – Future Purchase - Foreign Military Sales	$	29,049	$	62,521
SMAG – Other Accrued Liabilities	$	4,140	$	10,630
Component – Reclass of Abnormal Non-Federal Accounts Receivable	$	35,537	$	35,469
Total	$	1,446,519	$	1,725,220

DMAG work in process accrued expenses has decreased as a result of the removing Contract DMAG from the Working Capital Funds, which has resulted in a decline in material, labor, and overhead cost accruals.

SMAG other liabilities related to foreign military sales consist of money that various countries have deposited with the SMAG as a buy-in on future purchases they plan to make under the foreign military sales program. These funds are considered a liability as the funds are returned if the countries do not make future purchases. Revenue is not recognized on these transactions until the purchase takes place. The decrease in this account is caused by some foreign governments canceling agreements.

The Component other liability is related to an abnormal non-federal accounts receivable amount. The amount was abnormal because of Undistributed Collections. FACTS I will not accept an abnormal balance in non-federal accounts receivable; therefore, the amount was reclassified as a non-federal other liability.

Note Reference

See Note Disclosure 1.S., Significant Accounting Policies, for additional discussion on financial reporting requirements and Department of Defense policies governing contingencies and other liabilities.

Note 15.B. Capital Lease Liability

Not applicable.

Note 16. Commitments and Contingencies

Not applicable.

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

As of September 30	2004				2003
	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
(Amounts in thousands)					
1. Pension and Health Benefits:					
A. Military Retirement Pensions	$ 0		$ 0	$ 0	$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Benefits	$ 0		$ 0	$ 0	$ 0
2. Other:					
A. FECA	$ 238,729		$ 0	$ 238,729	$ 275,132
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. *[Enter Program Name}*	0		0	0	0
E. Total Other	$ 238,729		$ 0	$ 238,729	$ 275,132
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$ 238,729		$ 0	$ 238,729	$ 275,132

Other Information Pertaining to Military Retirement Benefits and Other Employment-Related Actuarial Liabilities

Fluctuations and Abnormalities

The decrease of FECA is due to the decrease in total employees in FY 2004.

Federal Employee's Compensation Act (FECA)

The Air Force Working Capital Fund's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the Air Force at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns related to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Cost-of-Living Adjustments (COLAs) and medical inflation factors are also applied to the calculation of projected future benefits.

Interest rate assumptions utilized for discounting are as follows:

2002	2003	2004
5.20% in year 1	3.84% in year 1	4.883% in year 1
5.20% in year 2 and thereafter	4.35% in year 2 and thereafter	5.235% in year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for workers' compensation benefits, wage inflation factors (COLAs) and medical inflation factors (Consumer Price Index Medical or CPIMs) were applied to the calculation of projected future benefits. These factors 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 (CBYs) are as follows:

CBY	COLA	CPIM
2005	2.03%	4.14%
2006	2.73%	3.96%
2007	2.40%	3.98%
2008	2.40%	3.99%
2009+	2.40%	4.02%

The model's resulting projections were analyzed to ensure that the estimates were reliable. The analysis was based on two tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in actual payments, and (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 ration calculated for the prior projection.

Actuarial data and percentages are only updated at the end of the fiscal year; therefore, amounts referenced in this note are the balances at September 30, 2004 and September 30, 2003.

Note Reference

For regulatory discussion on "Military Retirement Benefits and Other Employment Related Actuarial Liabilities," see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1019.

Note 18. Unexpended Appropriations

Not applicable.

Note 19.A. General Disclosures Related to the Statement of Net Cost

Fluctuations and Abnormalities

Intra-governmental Earned Revenue

Intra-governmental revenue had a decrease of $1,429,325.2 thousand, which represents a 10.73 percent decrease. A portion of the decrease is attributed to the implementation of the General Accounting and Finance System - Rehost in FY 2004. For the Supply Management Activity Group (SMAG), in FY 2003 a portion of other income was erroneously reported as intra-governmental and in FY 2004 this error was corrected. It is currently reported as non-federal instead. The phase out of Contract Depot Maintenance Activity Group (DMAG) contributes significantly to the decrease in intra-governmental revenue. The Air Force Working Capital Fund is in the process of discontinuing to contract out Depot operations, therefore the related revenues are decreasing. Any remaining fluctuations are a result of normal operations.

Earned Revenue from the Public

Earned revenue from the public had an increase of $497,530.1 thousand. The increase is largely attributed to the implementation of the General Accounting and Finance System - Rehost in FY 2004. For SMAG, in FY 2003 a portion of other income was erroneously reported as intra-governmental and in FY 2004 this error was corrected. It now reported as non-federal. The remaining fluctuation is a result of normal operations.

Information Related to the Statement of Net Cost

Statement of Net Cost

The Consolidated SoNC in the federal government is unique because its principles are based on understanding the net cost and/or organizations that the federal government supports through appropriations or other means. 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.

Working Capital Funds

While the Air Force Working Capital Fund (AFWCF) generally records transactions on an accrual basis as is required by generally accepted accounting principles, the systems do not always capture actual costs. Information presented on the SoNC is primarily based on budgetary obligations, disbursements, or collection transactions, as well as information from nonfinancial feeder systems.

Note 19.B. Gross Cost and Earned Revenue by Budget Functional Classification

Not applicable.

Note 19.C. Gross Cost to Generate Intra-governmental Revenue and Earned Revenue (Transactions with Other Federal-Non-DoD-Entities) by Budget Functional Classification

Relevant Information for Comprehension

The Air Force's accounting systems do not capture cost data in a manner that enables the Air Force to determine if the cost was incurred to generate intra-governmental revenue. Therefore, this note could not be completed. The Department is in the process of upgrading its financial and feeder systems and will be addressing this issue. Additionally, the identification of intra-governmental revenue and expenses is a government-wide problem. The Office of Management and Budget and the Department of the Treasury are developing government-wide guidance to enable accurate reporting of intra-governmental transactions.

Note 19.D. Imputed Expenses

As of September 30	2004	2003
(Amounts in thousands)		
1. Civilian (e.g.,CSRS/FERS) Retirement	$ 63,443	$ 64,298
2. Civilian Health	95,320	80,667
3. Civilian Life Insurance	255	241
4. Military Retirement Pension	0	0
5. Military Retirement Health	0	0
6. Judgment Fund	0	0
7. Total Imputed Expenses	$ 159,018	$ 145,206

Other Information

The increase in imputed expenses can be attributed to rising cost of employee benefit programs.

Note 19.E. Benefit Program Expenses

Not applicable.

Note 19.F. Exchange Revenue

Definition

Exchange Revenue arises when a government entity provides goods and services to the public or to another government entity for a price (earned revenue). Exchange revenue includes most user charges other than taxes, i.e., regulatory user charges.

Note 19.G. Amounts for Foreign Military Sales (FMS) Program Procurements from Contractors

Not applicable.

Note 19.H. Stewardship Assets

Not applicable.

Note 19.I. Intra-governmental Revenue and Expense

Information Related to Intra-governmental Revenue and Expense

Intra-governmental Revenue

The AFWCF's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the AFWCF was unable to reconcile intra-governmental revenue balances with its trading partners. The Department intends to develop long-term systems improvements that will include sufficient up-front client edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intra-governmental transactions is so large that such reconciliations cannot be accomplished with the existing or foreseeable resources.

Intra-governmental Operating Expenses

The AFWCF's operating expenses were adjusted based on a comparison between the AFWCF's accounts payable and the DoD summary- level seller accounts receivables. An adjustment was posted to accounts payable and operating expenses to reflect unrecognized accounts payable and operating expenses. The operating expenses of the AFWCF were adjusted upward in the amount of $107,916.5 thousand.

Note 19.J. Suborganization Program Costs

Not applicable.

Note 20. Disclosures Related to the Statement of Changes in Net Position

As of September 30	Cumulative Results of Operations 2004	Unexpended of Appropriations 2004	Cumulative Results Operations 2003	Unexpended Appropriations 2003
(Amounts in thousands)				
1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance:				
A. Changes in Accounting Standards	$ 699,393	$ 0	$ 0	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	11,370,456	0	11,315,328	0
C. Other Prior Period Adjustments	0	0	0	0
D. Total Prior Period Adjustments	$ 12,069,849	$ 0	$ 11,315,328	$ 0
2. Imputed Financing:				
A. Civilian CSRS/FERS Retirement	$ 63,443	$ 0	$ 64,298	$ 0
B. Civilian Health	95,319	0	80,667	0
C. Civilian Life Insurance	255	0	241	0
D. Military Retirement Pension	0	0	0	0
E. Military Retirement Health	0	0	0	0
F. Judgment Fund	0	0	0	0
G. Total Imputed Financing	$ 159,017	$ 0	$ 145,206	$ 0

Other Information

Information Related to the Statement of Changes in Net Position

Prior Period Adjustments. Materiel Support Division inventory valued at LAC was converted to Moving Average Cost historical cost basis valuation on October 1, 2003. This change in inventory valuation method was required by the Office of the Under Secretary of Defense (OUSD) policy. Historical cost does not require an allowance for gains and losses. The change in accounting policy created a prior period adjustment in FY 2004 of $11,604,540.3 thousand for the elimination of the allowance for gains and losses, the establishment of an allowance for repairs and the revaluation of inventory. The amount $699,393.4 thousand represents standard price changes. The table below provides detail by USSGL of the prior period adjustment. In addition, there is an ongoing effort by the OUSD Comptroller regarding the baselining of inventory, which may result in changes in inventory valuation in subsequent periods.

USSGL	Description	Debit	Credit
1521	Serviceable Inventory	$ 82,823,884	
1523	Unserviceable Inventory	3,917,057,191	
1524	Excess, Obsolete & Unserviceable Inventory	3,917,057,191	
1529 1R01	Standard Price Change Loss	663,591,208	
1529 1G01	Standard Price Change Gain		$ 4,851,105,837
Inventory Revaluation to MAC from LAC/Carcass - 1 Oct 2003			
6500	Cost of Goods Sold	$ 4,241,778,398	
1529 3A03	Allowance for Repairs		$ 4,241,778,398
Establish the Allowance for Repairs - 1 Oct 2003			
1521/23/24	Inventory	$ 11,658,804,025	
1529 1001	Inventory – Allowance for Holding Gains & Losses		$ 11,658,804,025
Original Entries into the Inventory Allowance account			
1529	Inventory – Allowance	$ 11,604,540,255	
7401	Prior Period Adjustment – Restated		$ 10,905,146,882
7400	Prior Period Adjustment – Not restated		699,393,373
Adjustment to eliminate the allowance account			

The General Support Division inventory valued at LAC was converted to Moving Average Cost historical cost basis valuation on October 1, 2003. This change in inventory valuation method was required by the Office of the Under Secretary of Defense (OUSD) policy. Historical cost does not require an allowance for gains and losses. The change in accounting policy created a prior period adjustment in FY 2004 of $133,808.6 thousand for the elimination of the allowance for gains and losses and the elimination of the potential excess allowance of $331,500.5 thousand. The table below provides detail by USSGL of the prior period adjustment. The entry was recorded to GLA 7400 in the General Accounting and Finance System - Rehost (GAFS-R). Due to year-end processing problems in GAFS-R, the reclassification to GLA 7401 will be accomplished in the Defense Departmental Reporting System - Audited Financial Statements (DDRS-AFS). In addition, there is an ongoing effort by the OUSD Comptroller regarding the baselining of inventory, which may result in changes in inventory valuation in subsequent periods.

USSGL	Description	Debit	Credit
1521/23/24	Inventory	$ 133,808,567	
1529	Inventory – Allowance		$ 133,808,567
Original Entries into the Inventory Allowance Account			
7110	Loss	$ 331,500,483	
1529	Potential Excess Allowance		$ 331,500,483
Original Entries into Potential Excess Allowance			
1529	Inventory - Allowance	$ 133,808,567	
7401	Prior Period Adjustment – Restated		$ 133,808,567
Adjustment to eliminate the allowance account			
1529	Potential Excess Allowance	$ 331,500,483	
7401	Prior Period Adjustment – Restated		$ 331,500,483
Adjustment to eliminate the allowance account			

Imputed Financing

The amounts remitted to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System, Federal Employee Retirement System, Federal Employees Health Benefits program, and the Federal Employee 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 the employees and contributions made by and for them. The OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for computation of imputed financing cost. Then DFAS provides the costs to the OUSD (Personnel and Readiness) for validation. Approved imputed costs are provided to the reporting components for inclusion in their financial statements.

Note 21. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2004	2003
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 7,117,842	$ 6,166,726
2. Available Borrowing and Contract Authority at the End of the Period	3,839,310	3,191,601

Other Information

Information Related to the Statement of Budgetary Resources

Intra-entity Transactions. The Statement of Budgetary Resources (SBR) does not include intra-entity transactions because the statements are presented as combined and combining.

Apportionment Categories. Office of Management and Budget Bulletin No. 01-09, section 9.27, specifically requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B, and exempt from apportionment. This disclosure should agree with the aggregate of the related information as included in each reporting entity's SF 133 and lines 8A and 8B in the SBR. Category A direct obligations total $2,027.2 thousand, which represents an adjusting entry. Category A reimbursable obligations total $17,271,941.4 thousand. There are no category B or exempt obligations.

Undelivered Orders. Undelivered orders presented in the SBR includes undelivered orders-unpaid for both direct and reimbursable funds.

Spending Authority from Offsetting Collections. Adjustments in funds that are temporarily not available pursuant to Public Law, and those that are permanently not available (included in the "Adjustments" line on the SBR), are not included in the "Spending Authority from Offsetting Collections and Adjustments" line on the SBR or the "Spending Authority for Offsetting Collections and Adjustments" line on the Statement of Financing.

Note 22. Disclosures Related to the Statement of Financing

Other Disclosures

The objective of the Statement of Financing is to reconcile the difference between budgetary obligations and the net cost of operations reported. It is presented as combined or combining statements rather than consolidated statements because intra-governmental transactions are not eliminated. Because of limitations in the Air Force Working Capital Fund's financial system, budgetary data is not in agreement with proprietary expenses and assets capitalized. Differences between budgetary and proprietary data constitute a previously identified deficiency.

Note 1A and Note 1F provide additional detail.

Other Information Related to the Statement of Financing

Statement of Financing Adjustments

Budgetary data is not in agreement with Proprietary Expenses and Assets Capitalized. This causes a difference in Net Cost between the Statement of Net Cost (SoNC) and the Statement of Financing. Line 15 on the Statement of Financing, "Resources that finance the acquisition of assets," is adjusted in order to align the amount of net cost on the Statement of Financing with the amount reported on the (SoNC). Line 15 was adjusted by an absolute value of $1,147,112.4 thousand to balance the report. The adjustment will be researched to determine the cause of the increase over prior reporting periods.

Note 23. Disclosures Related to the Statement of Custodial Activity

Not applicable.

Note 24.A. Other Disclosures

Undistributed Collections and Disbursements

Differences often occur between the time that the Department of the Treasury records cash transactions and the time that the field records transactions in the general ledger. The timing differences are accounted for in the undistributed collection and disbursements accounts, which offset accounts receivable and accounts payable in the accounting records. Undistributed amounts are reconciled monthly to ensure that they are fully supported. Unsupported amounts are reclassifed to General Ledger Accounts 2400 and 2120.

Various categories make up the total undistributed. In-transit items and uncleared interfund transactions represent the majority of the undistributed. The in-transit category consists of transactions that are paid/collected by one entity on behalf of another entity. The transaction is recorded at Treasury in the month of occurrence; however, it generally takes 30-60 days to be distributed to the accountable entity. Interfund transactions are intra-governmental, no-check-drawn transactions that are generated by the billing activity at the end of the month. They are then transmitted to a central location to be distributed to the accountable entity. Since this is an end-of-month process, the accountable entity does not receive the data until the next month. Recons and suspense are also categories of undistributed. Recons are created when the cumulative disbursements and collections reported by the field entities on monthly reports do not equal cumulative amounts generated from current-month transactions. When differences occur between the field-level weekly and monthly reports, the amount is suspensed until anything out-of-balance can be researched and corrected in subsequent months. The suspense category may also contain amounts that are not supported by voucher data but have been reported to Treasury. Once again, this data is researched and corrected. Other miscellaneous posting errors can contribute to undistributed balances, which are identified monthly and corrected at the appropriate location.

Working Capital Fund

Consolidating and Combining Statements

Consolidating Balance Sheet—Working Capital Fund

As of September 30, 2004 and 2003 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
ASSETS (Note 2)			
Intra-governmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 537,530	$ 466,474	$ 30,350
Non-Entity Seized Iraqi Cash	0	0	0
Non-Entity-Other	0	0	0
Investments (Note 4)	0	0	0
Accounts Receivable (Note 5)	411,812	437,397	55,774
Other Assets (Note 6)	0	104,722	0
Total Intra-governmental Assets	$ 949,342	$ 1,008,593	$ 86,124
Cash and Other Monetary Assets (Note 7)	$ 0	$ 0	$ 0
Accounts Receivable (Note 5)	49,520	52,333	641
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property (Note 9)	1,002,650	20,022,878	0
General Property, Plant and Equipment (Note 10)	1,038,003	129,255	30,418
Investments (Note 4)	0	0	0
Other Assets (Note 6)	12,980	775,986	0
TOTAL ASSETS	$ 3,052,495	$ 21,989,045	$ 117,183
LIABILITIES (Note 11)			
Intra-governmental:			
Accounts Payable (Note 12)	$ 259,752	$ 305,197	$ 10,235
Debt (Note 13)	0	0	0
Environmental Liabilities (Note 14)	0	0	0
Other Liabilities (Note 15 and Note 16)	346,651	798	394
Total Intra-governmental Liabilities	$ 606,403	$ 305,995	$ 10,629
Accounts Payable (Note 12)	$ 13,248	$ 465,655	$ 136,792
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	206,663	22,457	9,609
Environmental Liabilities (Note 14)	0	0	0
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	1,510,123	60,540	10,121
Debt Held by Public	0	0	0
TOTAL LIABILITIES	$ 2,336,437	$ 854,647	$ 167,151
NET POSITION			
Unexpended Appropriations (Note 18)	$ 0	$ 0	$ 0
Cumulative Results of Operations	716,058	21,134,398	-49,968
TOTAL NET POSITION	$ 716,058	$ 21,134,398	$ -49,968
TOTAL LIABILITIES AND NET POSITION	$ 3,052,495	$ 21,989,045	$ 117,183

The accompanying notes are an integral part of the financial statements. See notes 1 and 21.

Transportation	Component Level	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
$ 10,223	$ 6,533	$ 1,051,110	$ 0	$ 1,051,110	$ 732,842
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	-1	904,982	328,586	576,396	605,077
0	0	104,722	104,712	10	3
$ 10,223	$ 6,532	$ 2,060,814	$ 433,298	$ 1,627,516	$ 1,337,922
$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
617	0	103,111	0	103,111	167,764
0	0	0	0	0	0
0	0	21,025,528	0	21,025,528	22,524,996
7	0	1,197,683	0	1,197,683	1,329,629
0	0	0	0	0	0
0	0	788,966	0	788,966	380,362
$ 10,847	$ 6,532	$ 25,176,102	$ 433,298	$ 24,742,804	$ 25,740,673
$ 1	$ 10,164	$ 585,349	$ 328,586	$ 256,763	$ 231,725
0	0	0	0	0	0
0	0	0	0	0	0
0	0	347,843	104,712	243,131	345,437
$ 1	$ 10,164	$ 933,192	$ 433,298	$ 499,894	$ 577,162
$ 1,693	$ -119,917	$ 497,471	$ 0	$ 497,471	$ 88,984
0	0	238,729	0	238,729	275,132
0	0	0	0	0	0
0	0	0	0	0	0
0	35,537	1,616,321	0	1,616,321	1,891,851
0	0	0	0	0	0
$ 1,694	$ -74,216	$ 3,285,713	$ 433,298	$ 2,852,415	$ 2,833,129
$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
9,153	80,748	21,890,389	0	21,890,389	22,907,544
$ 9,153	$ 80,748	$ 21,890,389	$ 0	$ 21,890,389	$ 22,907,544
$ 10,847	$ 6,532	$ 25,176,102	$ 433,298	$ 24,742,804	$ 25,740,673

The accompanying notes are an integral part of the financial statements. See notes 1 and 21.

Consolidating Statement of Net Cost—Working Capital Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
Program Costs				
B. Component Level	0			
Intra-governmental Gross Costs	$ 10,166	$ 0	$ 10,166	$ 1
(Less: Intra-governmental Earned Revenue)	0	0	0	1
Intra-governmental Net Costs	$ 10,166	$ 0	$ 10,166	$ 2
Gross Costs With the Public	0	0	0	0
(Less: Earned Revenue From the Public)	0	0	0	0
Net Costs With the Public	$ 0	$ 0	$ 0	$ 0
Total Net Cost	$ 10,166	$ 0	$ 10,166	$ 2
C. Depot Maintenance	0			
Intra-governmental Gross Costs	$ 2,706,901	$ 2,091,148	$ 615,753	$ 1,198,929
(Less: Intra-governmental Earned Revenue)	-6,811,091	-2,950,348	-3,860,743	-4,653,703
Intra-governmental Net Costs	$ -4,104,190	$ -859,200	$ -3,244,990	$ -3,454,774
Gross Costs With the Public	3,940,937	0	3,940,937	4,291,719
(Less: Earned Revenue From the Public)	-168,063	0	-168,063	-199,659
Net Costs With the Public	$ 3,772,874	$ 0	$ 3,772,874	$ 4,092,060
Total Net Cost	$ -331,316	$ -859,200	$ 527,884	$ 637,286
D. Information Services	0			
Intra-governmental Gross Costs	$ 59,464	$ 20	$ 59,444	$ 83,811
(Less: Intra-governmental Earned Revenue)	-708,754	-140,870	-567,884	-475,537
Intra-governmental Net Costs	$ -649,290	$ -140,850	$ -508,440	$ -391,726
Gross Costs With the Public	670,818	0	670,818	589,886
(Less: Earned Revenue From the Public)	-2,865	0	-2,865	0
Net Costs With the Public	$ 667,953	$ 0	$ 667,953	$ 589,886
Total Net Cost	$ 18,663	$ -140,850	$ 159,513	$ 198,160
E. Supply Management	0			
Intra-governmental Gross Costs	$ 7,782,043	$ 3,067,613	$ 4,714,430	$ 4,165,569
(Less: Intra-governmental Earned Revenue)	-9,527,399	-2,067,564	-7,459,835	-8,188,549
Intra-governmental Net Costs	$ -1,745,356	$ 1,000,049	$ -2,745,405	$ -4,022,980
Gross Costs With the Public	4,063,032	0	4,063,032	3,343,049
(Less: Earned Revenue From the Public)	-719,910	0	-719,910	-194,230
Net Costs With the Public	$ 3,343,122	$ 0	$ 3,343,122	$ 3,148,819
Total Net Cost	$ 1,597,766	$ 1,000,049	$ 597,717	$ -874,161
F. Transportation	0			
Intra-governmental Gross Costs	$ 0	$ 0	$ 0	$ 0
(Less: Intra-governmental Earned Revenue)	0	0	0	0
Intra-governmental Net Costs	$ 0	$ 0	$ 0	$ 0
Gross Costs With the Public	0	0	0	174
(Less: Earned Revenue From the Public)	-581	0	-581	0
Net Costs With the Public	$ -581	$ 0	$ -581	$ 174
Total Net Cost	$ -581	$ 0	$ -581	$ 174
G. Total Program Costs	0			
Intra-governmental Gross Costs	$ 10,558,574	$ 5,158,781	$ 5,399,793	$ 5,448,310
(Less: Intra-governmental Earned Revenue)	-17,047,244	-5,158,782	-11,888,462	-13,317,788
Intra-governmental Net Costs	$ -6,488,670	$ -1	$ -6,488,669	$ -7,869,478
Gross Costs With the Public	8,674,787	0	8,674,787	8,224,828
(Less: Earned Revenue From the Public)	-891,419	0	-891,419	-393,889
Net Costs With the Public	$ 7,783,368	$ 0	$ 7,783,368	$ 7,830,939
Total Net Cost	$ 1,294,698	$ -1	$ 1,294,699	$ -38,539
Cost Not Assigned to Programs	0	0	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0	0	0
Net Cost of Operations	$ 1,294,698	$ -1	$ 1,294,699	$ -38,539

The accompanying notes are an integral part of the financial statements. See notes 1 and 19.

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Consolidating Statement of Changes in Net Postition—Working Capital Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 609,469	$ 10,868,004	$ -39,871
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0	11,370,456	0
Beginning Balance, Restated	609,469	22,238,460	-39,871
Prior Period Adjustments - Not Restated (+/-)	0	699,393	0
Beginning Balances, as adjusted	609,469	22,937,853	-39,871
Budgetary Financing Sources:			
Appropriations received	0	0	0
Appropriations transferred-in/out (+/-)	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0
Appropriations used	0	0	0
Nonexchange revenue	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0
Transfers-in/out without reimbursement (+/-)	-358,400	-222,500	0
Other budgetary financing sources (+/-)	0	0	0
Other Financing Sources:			
Donations and forfeitures of property	0	0	0
Transfers-in/out without reimbursement (+/-)	-213	247	0
Imputed financing from costs absorbed by others	133,887	16,564	8,566
Other (+/-)	0	0	0
Total Financing Sources	-224,726	-205,689	8,566
Net Cost of Operations (+/-)	-331,316	1,597,766	18,663
Ending Balances	$ 716,059	$ 21,134,398	$ -49,968
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 0	$ 0	$ 0
Prior period adjustments (+/-)			
Prior Period Adjustments - Restated (+/-)	0	0	0
Beginning Balance, Restated	0	0	0
Prior Period Adjustments - Not Restated (+/-)	0	0	0
Beginning Balances, as adjusted	0	0	0
Budgetary Financing Sources:			
Appropriations received	0	0	0
Appropriations transferred-in/out (+/-)	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0
Appropriations used	0	0	0
Nonexchange revenue	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0
Transfers-in/out without reimbursement (+/-)	0	0	0
Other budgetary financing sources (+/-)	0	0	0
Other Financing Sources:			
Donations and forfeitures of property	0	0	0
Transfers-in/out without reimbursement (+/-)	0	0	0
Imputed financing from costs absorbed by others	0	0	0
Other (+/-)	0	0	0
Total Financing Sources	0	0	0
Net Cost of Operations (+/-)			
Ending Balances	$ 0	$ 0	$ 0

The accompanying notes are an integral part of the financial statements. See notes 1 and 20.

Transportation	Component Level	Combined Total	Eliminations	2004 Consolidated	2003 Consolidated
$ 8,572	$ 90,914	$ 11,537,088	$ 0	$ 11,537,088	$ 11,593,865
0	0	11,370,456	0	11,370,456	11,370,456
8,572	90,914	22,907,544	0	22,907,544	22,964,321
0	0	699,393	0	699,393	-55,128
8,572	90,914	23,606,937	0	23,606,937	22,909,193
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	23,956
0	0	0	0	0	0
0	0	0	0	0	0
0	0	-580,900	0	-580,900	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	34	0	34	-209,350
0	0	159,017	0	159,017	145,206
0	0	0	0	0	0
0	0	-421,849	0	-421,849	-40,188
-581	10,166	1,294,698	-1	1,294,699	-38,539
$ 9,153	$ 80,748	$ 21,890,390	$ 1	$ 21,890,389	$ 22,907,544
$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	23,956
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	-23,956
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
$ 0	$ 0	$ 0	$ 0	$ 0	$ 0

The accompanying notes are an integral part of the financial statements. See notes 1 and 20.

Combining Statement of Budgetary Resources—Working Capital Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations received	$ 0	$ 0	$ 0
Borrowing authority	0	0	0
Contract authority	26,598	656,341	1,439
Net transfers (+/-)	0	0	0
Other	0	0	0
Unobligated balance:			
Beginning of period	483,862	8,991	17,397
Net transfers, actual (+/-)	-358,400	-222,500	0
Anticipated Transfers Balances	0	0	0
Spending authority from offsetting collections:			
Earned	0	0	0
Collected	6,999,114	10,106,978	718,664
Receivable from Federal sources	-166,139	-21,808	1,616
Change in unfilled customer orders	0	0	0
Advance received	-173,221	0	0
Without advance from Federal sources	-531,460	-177,871	-24,584
Anticipated for the rest of year, without advances	0	0	0
Transfers from trust funds	0	0	0
Subtotal	6,128,294	9,907,299	695,696
Recoveries of prior year obligations	0	0	0
Temporarily not available pursuant to Public Law	0	0	0
Permanently not available	0	-36,669	0
Total Budgetary Resources	$ 6,280,354	$ 10,313,462	$ 714,532
STATUS OF BUDGETARY RESOURCES			
Obligations incurred:			
Direct	$ 0	$ 0	$ 0
Reimbursable	6,192,365	10,371,068	710,535
Subtotal	6,192,365	10,371,068	710,535
Unobligated balance:			
Apportioned	87,989	-57,606	3,997
Exempt from apportionment	0	0	0
Other available	0	0	0
Unobligated Balances Not Available	0	0	0
Total, Status of Budgetary Resources	$ 6,280,354	$ 10,313,462	$ 714,532
Relationship of Obligations to Outlays:			
Obligated Balance, Net - beginning of period	$ -4,100	$ 3,377,896	$ 37,442
Obligated Balance transferred, net (+/-)	0	0	0
Obligated Balance, Net - end of period:			
Accounts receivable	-465,342	-471,709	-56,652
Unfilled customer order from Federal sources	-2,064,652	-934,175	-266,643
Undelivered orders	1,355,747	5,056,743	197,737
Accounts payable	1,777,521	552,931	157,780
Outlays:			
Disbursements	6,282,591	9,744,854	738,724
Collections	-6,825,893	-10,106,978	-718,664
Subtotal	-543,302	-362,124	20,060
Less: Offsetting receipts	0	0	0
Net Outlays	$ -543,302	$ -362,124	$ 20,060

The accompanying notes are an integral part of the financial statements. See notes 1 and 21.

Transportation	Component Level	2004 Combined	2003 Combined
$ 0	$ 0	$ 0	$ 23,956
0	0	0	0
0	0	684,378	-35,575
0	0	0	0
0	0	0	0
5,966	90,914	607,130	305,847
0	0	-580,900	-125,000
0	0	0	0
0	0	0	0
0	67	17,824,823	17,643,264
0	-67	-186,398	83,803
0	0	0	0
0	0	-173,221	-371,890
0	0	-733,915	200,583
0	0	0	0
0	0	0	0
0	0	16,731,289	17,555,760
3,180	0	3,180	2,027
0	0	0	0
0	0	-36,669	-119,535
$ 9,146	$ 90,914	$ 17,408,408	$ 17,607,480
$ 2,027	$ 0	$ 2,027	$ 23,956
-2,027	0	17,271,941	16,976,393
0	0	17,273,968	17,000,349
9,146	90,914	134,440	607,132
0	0	0	0
0	0	0	-1
0	0	0	0
$ 9,146	$ 90,914	$ 17,408,408	$ 17,607,480
$ 3,963	$ -97,889	$ 3,317,312	$ 3,504,176
0	0	0	0
-617	35,537	-958,783	-1,145,183
0	0	-3,265,470	-3,999,386
0	0	6,610,227	6,166,726
1,693	-119,917	2,370,008	2,295,155
-293	-13,441	16,752,435	16,900,798
0	-67	-17,651,602	-17,271,374
-293	-13,508	-899,167	-370,576
0	0	0	0
$ -293	$ -13,508	$ -899,167	$ -370,576

The accompanying notes are an integral part of the financial statements. See notes 1 and 21.

Combining Statement of Financing—Working Capital Fund

For the years ended September 30, 2004 and 2003 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations incurred	$ 6,192,365	$ 10,371,068	$ 710,535
Less: Spending authority from offsetting collections and recoveries (-)	-6,128,294	-9,907,298	-695,695
Obligations net of offsetting collections and recoveries	64,071	463,770	14,840
Less: Offsetting receipts (-)	0	0	0
Net obligations	64,071	463,770	14,840
Other Resources			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	-213	247	-1
Imputed financing from costs absorbed by others	133,887	16,564	8,566
Other (+/-)	0	0	0
Net other resources used to finance activities	133,674	16,811	8,565
Total resources used to finance activities	197,745	480,581	23,405
Resources Used to Finance Items not Part of the Net Cost of Operations			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered Orders (-)	-203,832	-769,428	19,546
Unfilled Customer Orders	-704,682	-177,871	-24,584
Resources that fund expenses recognized in prior periods	-32,417	-1,716	-2,270
Budgetary offsetting collections and receipts that do not affect net cost of operations	0	0	0
Resources that finance the acquisition of assets	-136,998	-2,550,744	-8,623
Other resources or adjustments to net obligated resources that do not affect net cost of operations			
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0	0	0
Other (+/-)	213	-247	0
Total resources used to finance items not part of the net cost of operations	-1,077,716	-3,500,006	-15,931
Total resources used to finance the net cost of operations	-879,971	-3,019,425	7,474
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:			
Components Requiring or Generating Resources in Future Period:			
Increase in annual leave liability	0	0	0
Increase in environmental and disposal liability	0	0	0
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0	0
Increase in exchange revenue receivable from the the public (-)	0	0	0
Other (+/-)	0	0	0
Total components of Net Cost of Operations that will require or generate resources in future periods	0	0	0
Components not Requiring or Generating Resources:			
Depreciation and amortization	167,103	83,028	9,129
Revaluation of assets or liabilities (+/-)	35,196	-5,697,620	2,067
Other (+/-)			
Trust Fund Exchange Revenue	0	0	0
Cost of Goods Sold	0	5,866,524	0
Operating Material & Supplies Used	325,585	0	0
Other	20,771	4,365,259	-7
Total components of Net Cost of Operations that will not require or generate resources	548,655	4,617,191	11,189
Total components of net cost of operations that will not require or generate resources in the current period	548,655	4,617,191	11,189
Net Cost of Operations	-331,316	1,597,766	18,663

The accompanying notes are an integral part of the financial statements. See notes 1 and 22.

Transportation	Component Level	2004 Combined	2003 Combined
$ 0	$ 0	$ 17,273,968	$ 17,000,349
-3,180	0	-16,734,467	-17,557,786
-3,180	0	539,501	-557,437
0	0	0	0
-3,180	0	539,501	-557,437
0	0	0	0
0	0	33	-209,350
0	0	159,017	145,206
0	0	0	0
0	0	159,050	-64,144
-3,180	0	698,551	-621,581
2,598	0	-951,116	-468,106
0	0	-907,137	-171,307
0	0	-36,403	0
0	0	0	0
0	10,166	-2,686,199	1,006,802
0	0	0	0
0	0	-34	0
2,598	10,166	-4,580,889	367,389
-582	10,166	-3,882,338	-254,192
0	0	0	0
0	0	0	0
0	0	0	0
0	0	0	0
0	0	0	27,382
0	0	0	27,382
0	0	259,260	185,805
0	0	-5,660,357	2,466
0	0	0	0
0	1	5,866,525	0
0	0	325,585	0
0	1	4,386,024	0
0	2	5,177,037	188,271
0	2	5,177,037	215,653
-582	10,168	1,294,699	-38,539

The accompanying notes are an integral part of the financial statements. See notes 1 and 22.

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Working Capital Fund

Required Supplementary Information

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Schedule, Part A DoD Intra-governmental Asset Balances ($ in thousands)	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Department of Agriculture	12		$ 20			
Department of Commerce	13		$ 2			
Department of the Interior	14		$ 43			
Department of Justice	15		$ 501			
Navy General Fund	17		$ 3,701			
Department of State	19		$ 18			
Department of the Treasury	20	$ 1,051,111	$ 859			
Army General Fund	21		$ 3,637			
Office of Personnel Management	24		$ 6			
General Service Administration	47		$ 5,598			
National Science Foundation	49		$ 998			
General Accounting Office	5		$ 2			
Air Force General Fund	57		$ 451,525			$ 0
Department of Transportation	69		$ 982			
Homeland Security	70		$ 1,048			
Small Business Administration	73		$ 0			
National Aeronautics and Space Administration	80		$ 285			
Department of Energy	89		$ 120			
US Army Corps of Engineers	96		$ 25			
Other Defense Organizations General Funds	97		$ 31,900			
Other Defense Organizations Working Capital Funds	97-4930		$ 60,489			
Army Working Capital Fund	97-4930.001		$ 5,316			$ 10
Navy Working Capital Fund	97-4930.002		$ 9,320			

Schedule, Part B DoD Intra-governmental entity liabilities ($ in thousands)	Treasury Index	Accounts Payable	Debts/ Borrowings From Other Agencies	Other
Unidentifiable Federal Agency Entity (Other than DoD entities)	0			$ 0
Navy General Fund	17			$ 66
Army General Fund	21	$ 876		$ 401
Office of Personnel Management	24			$ 8,602
Air Force General Fund	57	$ 74,035		$ 228,984
National Aeronautics and Space Administration	80			$ 20
Other Defense Organizations General Funds	97	$ 1,734		$ 219
Other Defense Organizations Working Capital Funds	97-4930	$ 171,651		$ 4,742
Army Working Capital Fund	97-4930.001	$ 4,302		$ 78
Navy Working Capital Fund	97-4930.002	$ 4,163		
The General Fund of the Treasury	99			$ 20

Schedule, Part C DoD Intra-governmental revenue and related costs ($ in thousands)	Treasury Index	Earned Revenue
Department of Agriculture	12	$ 20
Department of the Interior	14	$ 58
Department of Justice	15	$ 3,235
Navy General Fund	17	$ 81,341
Department of State	19	$ 287
Department of the Treasury	20	$ 835
Army General Fund	21	$ 20,817
Office of Personnel Management	24	$ 6
General Service Administration	47	$ 82
National Science Foundation	49	$ 12
Securities and Exchange Commission	50	$ 51
Air Force General Fund	57	$ 9,794,922
Department of Transportation	69	$ 3,011
Homeland Security	70	$ 7,823
Small Business Administration	73	$ 3
National Aeronautics and Space Administration	80	$ 1,800
Department of Energy	89	$ 45
US Army Corps of Engineers	96	$ 8
Other Defense Organizations General Funds	97	$ 1,276,159
Other Defense Organizations Working Capital Funds	97-4930	$ 554,837
Army Working Capital Fund	97-4930.001	$ 12,969
Navy Working Capital Fund	97-4930.002	$ 130,141

Schedule, Part E DoD Intra-governmental non-exchange revenues ($ in thousands)	Treasury Index	Transfers In	Transfers Out
Navy General Fund	17		$ 0
Army General Fund	21		$ 350,000
Air Force General Fund	57	$ 34	$ 220,000
Other Defense Organizations Working Capital Funds	97-4930		$ 10,900

Working Capital Fund

Audit Opinion

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

November 8, 2004

MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Air Force Working Capital Fund Fiscal Year 2004 Principal Financial Statements (Report No. D-2005-015)

The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires Federal agency Inspectors General appointed under the Inspector General Act of 1978, as amended, to audit their respective agencies' financial statements or determine that "an independent external auditor" should conduct such audits. Pursuant to this statutory authority, the undersigned Inspector General assumed reponsibility for auditing the accompanying Air Force Working Capital Fund Consolidated Balance Sheet as of September 30, 2004 and 2003, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing for the fiscal years then ended.

The financial statements are the responsibility of Air Force management. The Air Force is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Fiscal Year 2004 financial statements of the Air Force Working Capital Fund because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us that previously identified material weaknesses in internal control and instances of noncompliance with laws and regulations continue to affect the current period. As a result of those conditions, management acknowledged that the financial data reported in the financial statements were unreliable. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Inspector General of the Department of Defense to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. These material weaknesses also affect the reliability of certain information contained in the annual financial statements—much of

"A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." —Constitution of the United States, Article I, Section 9

which is taken from the same data sources as the principal financial statements.[1] As described above, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

Summary of Internal Control

In planning our audit, we considered Air Force internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance. However, previously identified reportable conditions,[2] all of which are material, continued to exist in the following areas:

- Financial Management Systems;
- Operating Materials and Supplies;
- In-Transit Inventory;
- General Property, Plant, and Equipment;
- Statement of Net Cost;
- Statement of Financing;
- Intragovernmental Transactions;
- Other Accounting Entries; and
- Policies and Practices.

A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance that are material in relation to the financial statements would be prevented or detected on a timely basis. Our internal control work would not necessarily disclose all material weaknesses. See the Attachment for additional details on material internal control weaknesses.

Summary of Compliance With Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged,

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[1] The annual financial statements include the principal financial statements, management discussion and analysis, consolidating and combining financial statements, Required Supplementary Information, and Other Accompanying Information.

[2] Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

"A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." —Constitution of the United States, Article I, Section 9

and prior audits confirm, that instances of noncompliance continue to exist. The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us that critical financial management feeder systems of the Air Force do not comply substantially with the Federal Financial Management Improvement Act of 1996. Therefore, we did not determine whether the Air Force was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) are met; and
- complying with applicable laws and regulations.

We provided a draft of this report to the Air Force. Air Force officials concurred with the facts and conclusions in the report.

Joseph E. Schmitz
Inspector General
Department of Defense

Paul J. Granetto, CPA
Assistant Inspector General
Defense Financial Auditing Service

Attachment:
As stated

Report on Internal Control and Compliance With Laws and Regulations

Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly and that assets are safeguarded against misappropriation and abuse. Our purpose was not, and we do not, express an opinion on internal control over financial reporting because management acknowledged that previously identified reportable conditions, all of which are material, continue to exist. The following financial management deficiencies are indications of material weaknesses in internal control that may adversely affect any decision by the Air Force that is based, in whole or in part, on information that is inaccurate because of these deficiencies. Financial information reported by the Air Force also may contain misstatements resulting from these deficiencies.

Financial Management Systems. The Air Force financial management systems do not substantially comply with Federal financial management systems requirements. For details, see Note 1.A to the financial statements.

The Air Force has not fully implemented the United States Government Standard General Ledger (USSGL) at the transaction level. For details, see Note 1.D to the financial statements.

The Air Force is unable to implement fully all elements of generally accepted accounting principles (GAAP) and the Office of Management and Budget (OMB) Bulletin No. 01-09, "Form and Content of Agency Financial Statements," because of limitations in financial management processes and systems. For details, see Note 1.A. to the financial statements.

Air Force systems are not transaction driven for budgetary accounts. Therefore, in some cases proprietary and statistical accounts are used to develop the Report on Budget Execution and Budgetary Resources (SF-133) and Statement of Budgetary Resources for reporting budgetary data. For details, see Note 1.C to the financial statements.

Operating Materials and Supplies. Cost of goods sold and work in process are not recorded in accordance with Statement of Federal Financial Accounting Standard (SFFAS) No. 3, "Accounting for Inventory and Related Property." Instead of using historical costs, the Air Force values operating materials and supplies based on standard prices, and values inventory using latest acquisition cost. In addition, the Air Force does not strictly follow the consumption method to record the use of operating materials and supplies, as current financial and logistics systems cannot fully support it. Further, uncertainties exist regarding the existence and completeness of the quantities used to derive the balances reported in the financial statements for operating materials and supplies. For details, see Note 1.M to the financial statements.

In-Transit Inventory. Air Force supply management systems do not provide sufficient audit trails to confirm and value the in-transit inventory reported as part of inventory held for sale on the Consolidated Balance Sheet.

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General Property, Plant, and Equipment (PP&E). General PP&E values cannot be verified in accordance with SFFAS No. 6, "Accounting for Property, Plant, and Equipment." For details, see Note 10 to the financial statements. In addition, the General PP&E line item on the Balance Sheet does not include all Government-furnished equipment (with values exceeding the capitalization threshold) in the hands of contractors. The Air Force is developing policies and a contractor reporting system so that the Air Force will report appropriate values. For details, see Note 1.O to the financial statements.

Statement of Net Cost. The Air Force does not accumulate cost information as required by GAAP. The Air Force identifies cost in the Consolidated Statement of Net Cost based on the major appropriation groups funded by Congress instead of being based on major programs and activities as set forth in SFFAS No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government." For details, see Note 1.D to the financial statements.

Statement of Financing. The Air Force cannot reconcile budgetary data with proprietary expenses and assets capitalized without making unsupported adjustments to resolve differences. For details, see Note 22 to the financial statements. Additionally, the Air Force prepared the Statement of Financing on a combined basis, instead of the consolidated basis required by OMB Bulletin No. 01-09.

Intragovernmental Transactions. The Air Force cannot accurately identify all intragovernmental transactions by customer. Seller entities within the DoD provided 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 have been adjusted to recognize unrecorded costs and accounts payable. DoD intragovernmental balances were then eliminated. For details, see Note 1.G to the financial statements.

The Air Force cannot reconcile intragovernmental accounts receivable or accounts payable balances, or reconcile intragovernmental revenue balances with its trading partners. For details, see Note 1.G to the financial statements.

Other Accounting Entries. The Air Force continues to enter a material number of unsupported accounting entries because financial and non-financial feeder systems continue to lack sufficient customer identification information to accurately process eliminations. For details, see Note 1.A to the financial statements.

Policies and Practices. Air Force resource managers do not always maintain adequate documentation or use transaction subsidiary ledgers and special journals to support recorded trial balance accounts. Air Force and Defense Finance and Accounting Service personnel do not perform reconciliation and systems validations to verify the accuracy of accounts receivable from foreign military sales, progress payments to contractors, and accounts payable from the Materiel Support Division.

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Compliance With Laws and Regulations

Management is responsible for compliance with existing laws and regulations related to financial reporting. Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether Air Force was in compliance with selected provisions of all applicable laws and regulations related to financial reporting. Our objective was not to, and we do not, express an opinion on compliance with applicable laws and regulations.

The Air Force is required by the Federal Financial Management Improvement Act of 1996 to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable generally accepted accounting principles, and the USSGL at the transaction level. The Air Force acknowledged that its critical financial management feeder systems do not comply substantially with Federal financial management systems requirements, Federal accounting standards, and the USSGL at the transaction level. Therefore, we did not perform tests of compliance for these requirements.

Audit Disclosures

The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us on February 27, 2004, that Air Force financial management systems do not comply substantially with Federal financial management systems requirements, GAAP, and the USSGL at the transaction level. These deficiencies in Air Force critical financial feeder systems limited its ability to present information accurately and in conformance with GAAP.

We did not perform audit work related to the provisions of the laws and regulations identified in OMB Bulletin Number 01-02, "Audit Requirements for Federal Financial Statements," October 16, 2000, Appendix C, "General Laws."

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance because previous audit reports contained recommendations for corrective actions.

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The United States Air Force Annual Financial Statement is available for viewing on the Air Force portal at: https://www.my.af.mil.