United States Air Force

Annual Financial Statement

Working Capital Funds

Fiscal Year 2000

Working Capital Funds

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DEPARTMENT OF THE AIR FORCE
HEADQUARTERS AIR FORCE MATERIEL COMMAND
WRIGHT-PATTERSON AIR FORCE BASE, OHIO 45433-5001

February 2001

Message from the Commander, Air Force Materiel Command

FY2000 was a most challenging year. Through extraordinary Y2K efforts, we began the new millennium with virtually no disruption to the Command's 186 legacy systems.[1] Additionally, by September 2000 we had successfully transferred 4.3 million hours[2] of Depot Maintenance Workload from two closing Air Logistics Centers to the locations where it would be accomplished in the future. Our FY2001 budget includes the planned transfer of the Air Force Fuels Division to the Defense Logistics Agency.

On a less positive note, the year's financial performance was disappointing. The cost of transferring the workload from the two closing Air Logistics Centers coupled with ever-increasing costs of maintaining and supplying a fleet of aging aircraft significantly exceeded our budget estimates and drove a loss to the bottom line. In FY2001, our priorities will continue to focus on increasing the readiness of Air Force systems while we work a number of initiatives to reduce and contain our costs.

Among these initiatives is our continuing efforts to provide meaningful and timely financial information to our managers through auditable financial statements. We're improving our Depot Maintenance contract and organic financial systems and have established a full-time project management office to adopt commercial-like accounting practices for the Supply Management Activity Group (SMAG).

It is very important to note that while net operating results were down on the financial side, the SMAG, the Depot Maintenance Activity Group (DMAG), and the Information Services Activity Group (ISAG) achieved a majority of the performance goals set for FY2000. This is significant considering the breadth and depth of the worldwide support these activities provided to the Air Force. Overall, support to the warfighter was excellent.

Realizing the Air Force Vision of Global Vigilance, Reach and Power ensures FY2001 will be another year filled with challenges and opportunities. AFMC stands poised to do our part in meeting those challenges by providing increased warfighter support at a reasonable cost.

LESTER L. LYLES
General, USAF
Commander

[1]Source: Systems Compliance Database, formerly Air Force Automated Systems Inventory (AFASI)

[2]Source: FY02 Budget Estimate Submission (BES)

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1130

OFFICE OF THE ASSISTANT SECRETARY

February 2001

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

I am pleased to present the Air Force Working Capital Funds financial statement for Fiscal Year 2000. This statement fulfills the requirements of the Chief Financial Officers Act and portions of the requirements of the Government Performance and Results Act.

The statement displays the financial and performance measures associated with the three major business areas that our Working Capital Funds encompass—supply, depot maintenance, and information systems. The three major business areas successfully met most of their financial goals in FY2000 and achieved many of their target performance goals. The business activities that are included in our working capital funds delivered spare parts and made other contributions in support of continuing operations for KFOR in the Balkans.

We also made progress in improving financial management in the working capital funds in FY2000. We produced more timely financial reports for managers during FY2000, who made wider use of the Keystone system that provides supply managers with valuable data on revenues and expenses. We made further progress on operating capability of a major new depot accounting and production system called the Depot Maintenance Accounting and Production System (DMAPS). This system will comply with the Chief Financial Officers Act, and more importantly will provide the managers of our depots with timely data on the actual cost of repairing systems.

The working capital funds are also excellent examples of GPRA in action in the Air Force. The Government Performance and Results Act (GPRA) requires that managers establish performance measures, set goals using those measures, and then use the measures and goals for day-to-day management as well as for year-end reporting. Consistent with the requirements of GPRA, this statement compares year-end results to our goals using the same measures that senior managers regularly employ to judge the health of our working capital funds.

The Air Force takes its responsibility for stewardship of the public funds seriously. We are therefore strongly committed to improvement in all aspects of financial management.

JAMES R. SPEER
Acting Assistant Secretary of the Air Force
(Financial Management and Comptroller)

Overview

Air Force Foundations

Mission

The mission of the U.S. Air Force is to defend the United States through aerospace power.

Vision 2020

America's Air Force—Global Vigilance, Reach, and Power.

Core Values

- Integrity First
- Service Before Self
- Excellence in All We Do

Core Competencies

- Aerospace Superiority
- Global Attack
- Rapid Global Mobility
- Precision Engagement
- Information Superiority
- Agile Combat Support

Air Force Working Capital Fund

The Air Force Materiel Command (AFMC) accounts for more than 95 percent of Air Force Working Capital Fund (AFWCF) revenue and expense activity (excluding the transportation working capital fund, which is managed by the U.S. Transportation Command). The AFWCF business areas support major Air Force goals and mission-essential tasks by providing inventory management for spare parts and associated logistics support services to fulfill Air Force needs during war and peace. Depot maintenance provides economical and responsive repair, overhaul, and modification of aircraft, missiles, engines, other major end items, and associated components, and the information services business area provides for the maintenance and development of automated information systems for the Air Force, Department of Defense (DoD), and other government agencies.

Air Force Working Capital Fund Concept

"Working capital funds are revolving funds within DoD that finance organizations that are intended to operate like commercial businesses. Income (or budgetary resources) derived from the sale of goods and services is then used to finance the Defense Working Capital Fund (DWCF) business areas' continuing operations without fiscal year limitations. Unlike profit-oriented commercial businesses, DWCF businesses strive to reach break-even prices charged to customers. Revenue from customers sustains the full cost and the continuous cycle of DWCF business operations.

These business units sell goods or services to internal DoD customers at a price necessary to recover the total cost incurred to provide those goods and services. Working capital fund business units finance their operations with cash from the revolving fund; the revolving fund is then replenished by payments from the business units' customers."

—Defense Systems Management College[1]

Working capital funds (WCFs) allow the Air Force to:

- Establish strong customer/provider relationships
- Identify the total cost of providing support products and services
- Focus management attention on net results, including costs and performance
- Ensure readiness through reduced support costs, stabilized rates, and customer service.

[1]Source: DSMC Acquisition Logistics Guide—Life Cycle Costs (LCC), www.dsmc.dsm.mil/educdept/lmdeptresources/papers/chap13.doc and DSMC Financial Management Terms, www.dsmc.dsm.mil/courses/crsdesc/bcf-103/fmtermstn.doc.

Air Force Working Capital Fund Activity Groups

The AFWCF is managed primarily through the following activity groups:

Supply Management Activity Group

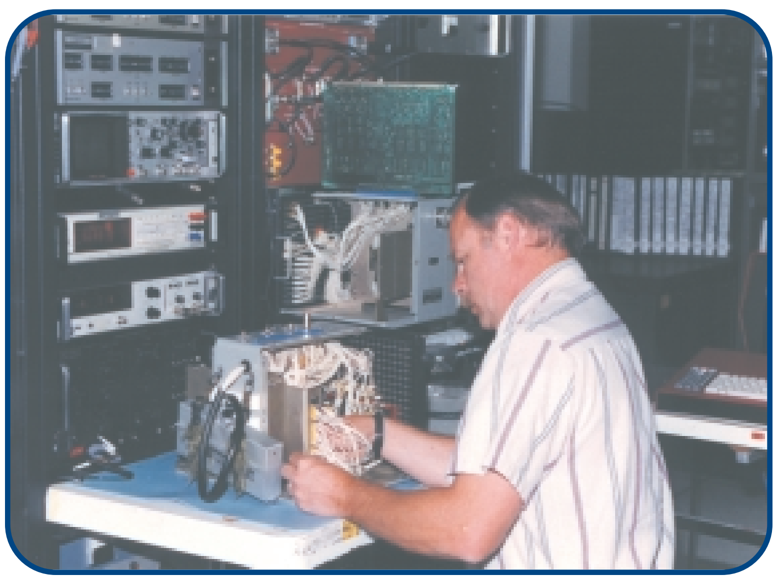
The Supply Management Activity Group (SMAG) was established to provide inventory management for spare parts and associated logistics support services to fulfill USAF needs during war and peace. SMAG manages approximately 2 million items, including weapon systems spare parts, fuel, medical/dental supplies and equipment, and items used for non-weapon systems applications. Materiel is procured from vendors and held in inventory for sale to authorized customers. SMAG acquires and repairs inventories using funds received from prior sales. The activity group pays operating costs using revenue from sales. SMAG consists of five divisions that collectively provide the above-mentioned services. The five divisions are the Materiel Support Division (MSD), General Support Division (GSD), Fuels Division, Medical/Dental Division, and Air Force Academy Cadet Issue Division.

Depot Maintenance Activity Group

The Depot Maintenance Activity Group (DMAG) was established to provide economical and responsive repair, overhaul, and modification of aircraft, missiles, engines, other major end items, and associated components. DMAG provides a wide range of specialized services to DoD as well as other U.S. and foreign agencies. Both AFMC depots and contract operations provide repair and overhaul services. Depot maintenance operates on funds received from the sale of its services.

Information Services Activity Group

The Information Services Activity Group (ISAG) was established to maintain and develop automated information systems for specific Air Force, DoD, and other government agencies. Central design activities (CDAs) develop and implement new applications, maintain and modify existing programs, provide training and documentation, and

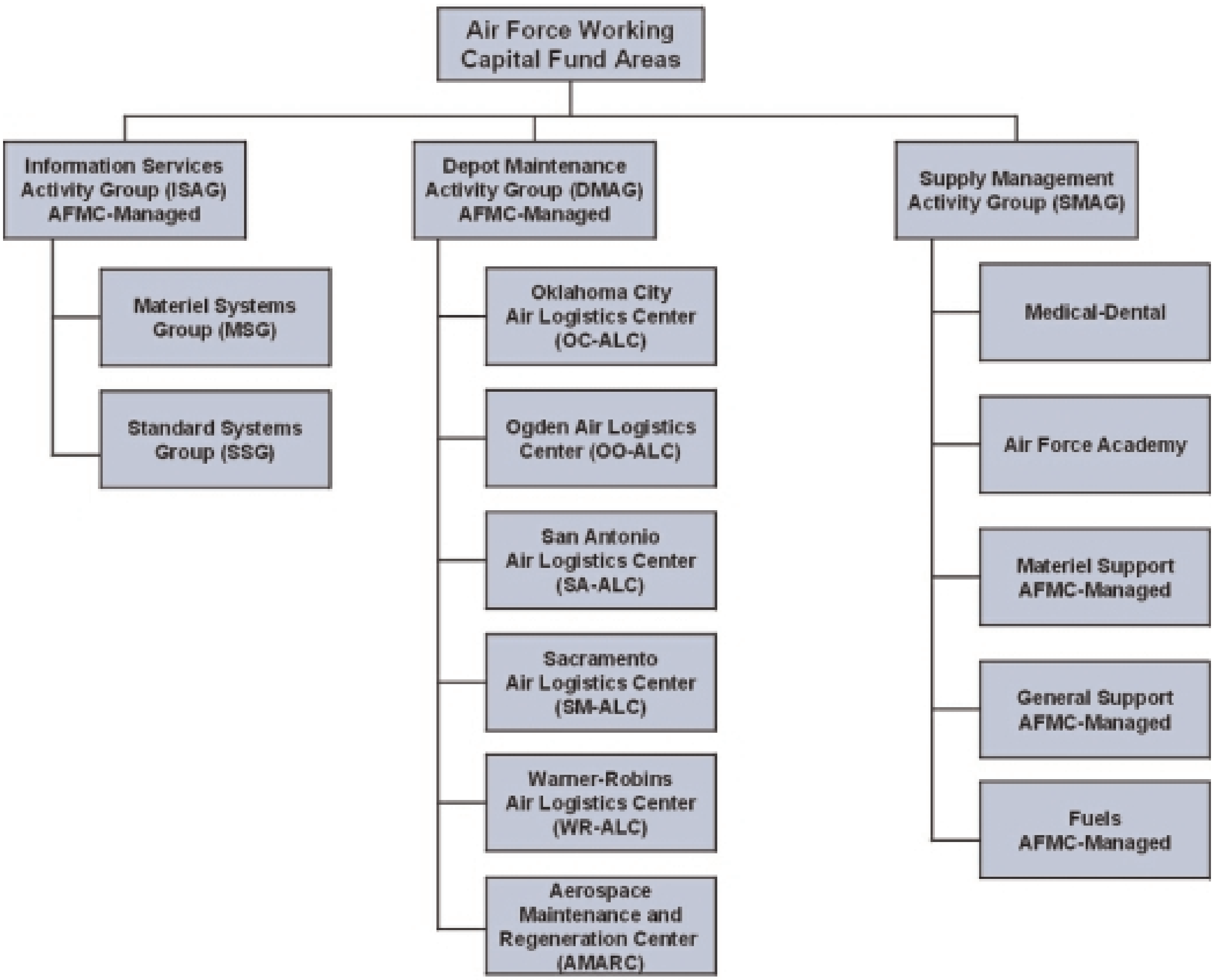


customize off-the-shelf software based on their customers' specific needs.

Mission Impact

The impact of AFWCF support on Air Force mission capability may be gauged by the trends reflected in key operational and financial business performance indicators (BPIs). These indicators also are the key measure to assess performance under the Government Performance and Results Act (GPRA). Key operational BPIs include the following:

- **MSD Retail Issue Effectiveness**—The percentage of occasions on which Base Supply is able to issue a serviceable part after an order is placed, regardless of stock level authorizations.
- **MSD Retail Stockage Effectiveness**—The percentage of occasions on which Base Supply is able to issue a serviceable part that it is authorized to stock.



- **DMAG Depot Maintenance Aircraft Delivery Performance**—The percentage of aircraft delivered from depot maintenance on or before negotiated delivery dates.

Key financial BPIs measure the effectiveness of AFWCF resource management. Typical measures are as follows:

- **Net Operating Results (NOR)**—NOR is calculated by taking the difference between revenue and expenses. It is a bottom-line profit and loss indicator.
- **Unit Cost Target (UCT)**—A target performance indicator measuring projected resources consumed versus projected output. Actual unit cost is measured against target unit cost.

Policies and Procedures

Activity group operations are based on policies and procedures that remain in effect from the establishment of the AFWCF.

Funding Authority

The Office of Under Secretary of Defense (Comptroller) (OUSD(C)), through the Assistant Secretary of the Air Force, Financial Management and Comptroller (SAF/FM), provides activity groups their annual cost authority. Unit cost targets have been developed to provide standards for managing cost per unit of output. UCTs are established during the budget process by dividing the projected total program/product cost by the projected units of measurable output. Capital investment targets are specified to support replacement and modernization of equipment and other capital assets through the budget, obligation, and procurement processes.

Rates

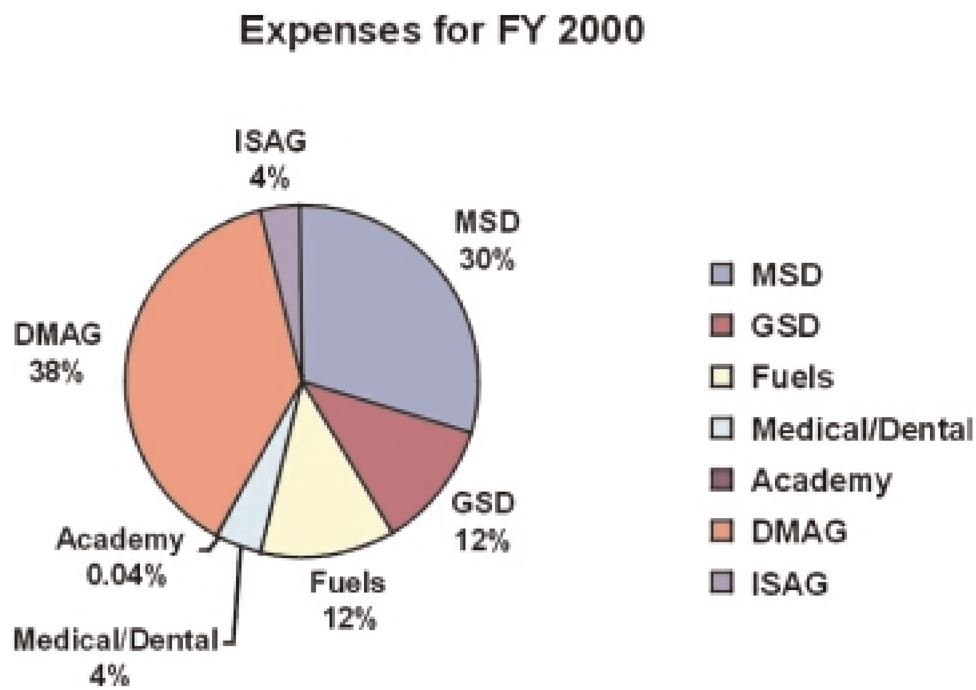
Rates are established to recoup full costs and are adjusted for prior year gains or losses. These rates are stabilized during the year of execution. The scope of costs paid by AFWCF activities and passed to customers in rates and prices have been refined to represent the full costs of goods and services more accurately.

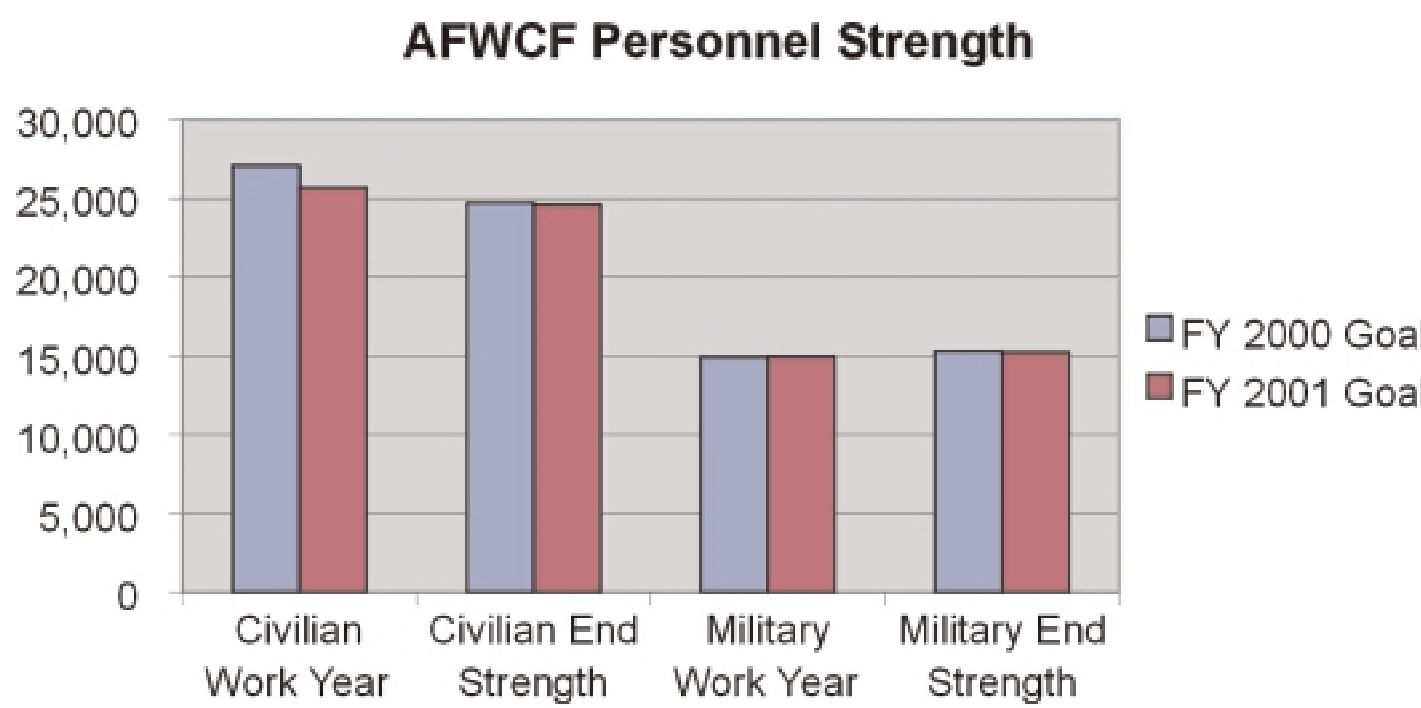
Summary of Working Capital Funds

FY00 Goal	MSD	GSD	Fuels	Med-Dent	Academy	DMAG	ISAG
NOR	($52.1M)	($1.1M)	($3.2M)	$0.0M	$0.0M	($26.9M)	($11.1M)
Revenue	$4,373.6M	$1,945.2M	$1,813.4M	$602.4M	$7.0M	$5,173.7M	$516.4M
Expenses	$4,425.7M	$1,946.3M	$1,816.6M	$602.4M	$7.0M	$5,200.6M	$527.5M

FY00 Results	MSD	GSD	Fuels	Med-Dent	Academy	DMAG	ISAG
NOR	($184.5M)	$92.8M	($39.5M)	$11.3M	$0.0M	($109.0M)	($11.2M)
Revenue	$4,224.8M	$1,793.4M	$1,786.7M	$613.9M	$5.8M	$5,273.8M	$524.3M
Expenses	$4,409.3M	$1,700.6M	$1,826.2M	$602.6M	$5.8M	$5,704.5M	$535.5M

FY01 Goal	MSD	GSD	Fuels	Med-Dent	Academy	DMAG	ISAG
NOR	$24.1M	($63.4M)	$0.1M	$0.0M	$0.0M	$162.8M	$0.8M
Revenue	$4,382.6M	$1,800.6M	$2,788.4M	$626.2M	$5.3M	$5,884.3M	$538.1M
Expenses	$4,358.5M	$1,864.0M	$2,788.3M	$626.2M	$5.3M	$5,721.5M	$537.3M


Expenses for FY 2000
ISAG 4%
MSD 30%
DMAG 38%
GSD 12%
Academy 0.04%
Fuels 12%
Medical/Dental 4%
MSD
GSD
Fuels
Medical/Dental
Academy
DMAG
ISAG


AFWCF Personnel Strength
30,000
25,000
20,000
15,000
10,000
5,000
0
Civilian Work Year
Civilian End Strength
Military Work Year
Military End Strength
FY 2000 Goal
FY 2001 Goal

Overview

Supply Management Activity Group

Mission Statement

The mission of the Supply Management Activity Group (SMAG) is to provide policy, guidance, and resources to meet Air Force needs for spare parts during war and peace. SMAG manages approximately 2 million items, including weapon systems spare parts, fuels, medical/dental supplies and equipment, and items used for non-weapon systems applications. Materiel is procured from vendors and held in inventory for sale to authorized customers.

SMAG consists of five divisions: the Materiel Support Division (MSD), General Support Division (GSD), Fuels Division, Medical/Dental Division, and Air Force Academy Cadet Issue Division. The Air Force Materiel Command (AFMC) manages the MSD, GSD, and Fuels divisions. Air Force Headquarters (HQ USAF) manages the Medical/Dental and Air Force Academy Cadet Issue divisions.

MSD is responsible for Air Force-managed depot-level reparable spare parts and consumable spares. MSD's principal products are serviceable spare parts and assemblies unique to Air Force weapon systems. The sale of reparable parts composes about 90 percent of total sales. The remainder consists of sales of nonreparable or consumable items within the MSD. Although most consumable items have been transferred to the Defense Logistics

Agency (DLA) for management, items designated as weapon system-critical remain on the AFMC product list.

GSD items support installation maintenance and administrative functions, field and depot maintenance of aircraft, ground and airborne communication and electronic systems, and other sophisticated systems and equipment. These items also include individual clothing items issued to new recruits; organizational clothing items, such as firemen's protective overgarments; and air crew helmets and chemical warfare protective overgarments. GSD supports 80 Air Force installations throughout the world.

Aviation, ground, and missile fuels categories comprise the Fuels Division. Aviation and ground fuels categories support the Air Force, Air National Guard (ANG), Air Force Reserve Command (AFRC), and other DoD and government agencies, commercial enterprises, and foreign governments. The missile fuels category supports the National Aeronautics and Space Administration (NASA), Air Force space launch programs, and commercial space launch programs, in addition to the customers named above.

The Surgeon General of the Air Force is responsible for overall management of the Medical/Dental Division. This peacetime operating authority provides effective support necessary to maintain established norms in the health care of Air Force active military, retirees, and dependents. The division's war reserve materiel (WRM) requirement is to provide medical supplies and equipment vital to support forces in combat and contingency operations.

The 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 parts management, the Supply Management Mission Area (SMMA) provides a wide range of logistics support services, to include requirements forecasting, item introduction, cataloging, provisioning, procurement, repair, technical support, data management, item disposal, distribution management, and transportation. SMMA provides support to a variety of customers. For FY

2000, the customer base consisted primarily of the following:

- Air Force Major Commands (MAJCOM) (58 percent of sales)
- AFMC depot maintenance and contractors (18 percent of sales)
- Air National Guard and Air Force Reserves (17 percent of sales)
- Other military services within DoD, other federal agencies, and foreign military sales (FMS) (7 percent of sales).

All customers pay for supply services at the same full cost recovery rate. In addition to providing normal resupply, the supply business also provides initial provisioning support to the Air Force Acquisition Executive. The SMMA consists of a Direct Budget Authority (DBA) and SMAG.

Performance Measures

Supply Management Highlights

SMAG experienced continued improvements in most of its customer support and financial metrics during FY 2000. The activity group met or exceeded most of its FY 2000 goals for the key business performance indicators (BPIs) shown in the table below.

Due in large part to the SMMA's continued supply chain manager (SCM) initiatives, constraints analysis programs (CAP), contract repair process (CRP), and depot repair enhancement program (DREP), SMAG continued to improve its war-fighting support. The mission area's SCM initiatives are aimed at integrating key business processes that support the flow of products, information, and money to improve the efficiency of the supply pipeline. The CAP is an ongoing study of the major constraints that prevent optimum support. Its purpose is to identify, isolate, and correct the constraints that hamper support. The purpose of the CRP and DREP is to enhance the repair capability of both

MSD Business Performance Indicators (BPIs)			
Customer Support BPI	FY 2000 Goal	FY 2000 Result	FY 2001 Goal
Issue Effectiveness (IE)	60 percent	59.18 percent	63 percent
Stockage Effectiveness (SE)	70 percent	69.89 percent	72 percent
Logistics Response Time (LRT)	38 days	36.8 days	36 days
Backorder Reduction	300,000 units	263,026 units	238,200 units

organic depot and contract repair facilities by determining the best use of people, parts, and funds to fill demands.

The activity group experienced continued reduction of its backorders and logistics response times while meeting its financial goals during FY 2000. The FY 2000 SMAG highlights include:

Backorders—SMAG's impressive backorder reduction trend continued. The activity group reduced the number of MSD backorder units from 373,700 to 263,026 in FY 2000.

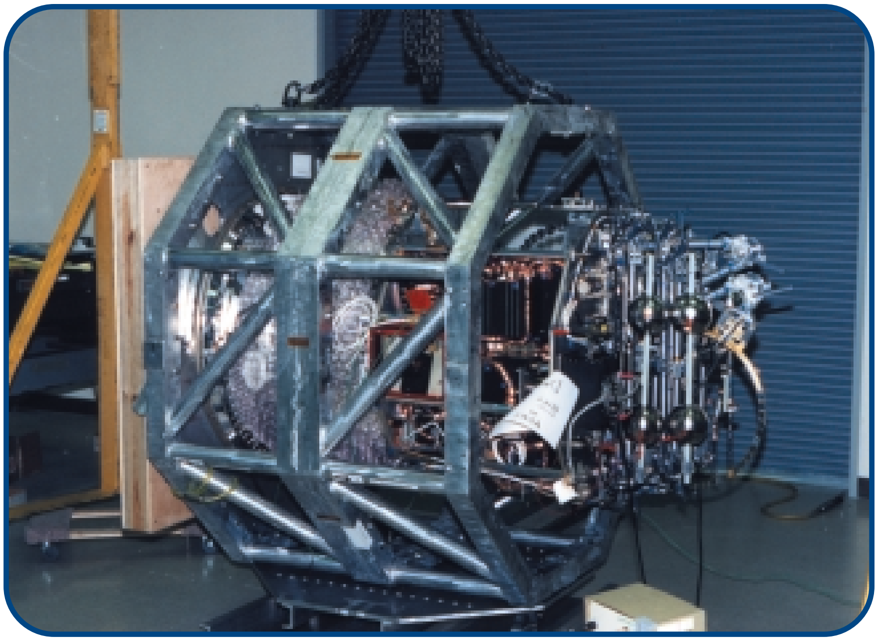
Logistics Response Time (LRT)—SMAG continued to increase the speed at which it satisfied MSD backorders, reducing the activity group's overall logistics response time from 41 days to 36.8 days in FY 2000.

Financial Success—Collectively, SMAG met its FY 2000 goals for unit cost target and net operating result, with each division meeting its target.

SCM Tool Development—In FY 2000, SMAG continued to develop and refine its web-based tools to assist SCMs and Air Force and FMS customers in tracking performance.

- The Backorder Analysis and Reporting Tool (BART), a Microsoft Access-based tool developed by KPMG Consulting, provides front-end query and report capability for backorder data. This database houses D035A (Item Manager Wholesale Requisition Process) data. BART allows an SCM to monitor his or her progress in reducing backorders and to identify inefficiencies in the supply pipeline.

  Issue effectiveness indicates the ability of Base Supply to issue a serviceable part when any demand is placed. Stockage effectiveness examines how often Base Supply fills an authorized base stock level or demand.



▲ In addition to BART, the Issue and Stockage Effectiveness Tool (ISET), developed by the Sacramento Air Logistics Center (SM-ALC) in FY 1999, was web-enabled in FY 2000 through a contract with the Air Force Logistics Management Agency (AFLMA). ISET retains all the drill-down capability of the original tool, and increases its capability by storing more issue effectiveness/stockage effectiveness data. ISET allows an SCM to identify by National Stock Number (NSN) those items that are below desired support targets. Once identified, the SCM can work with key personnel or organizations in the supply chain to remedy any problems.

SCM-based Target Setting—Acknowledging that each SCM manages unique items with particular supply chain issues, problems, and concerns, the AFMC and Logistics Business Board (LBB) tasked each SCM to set their own targets for each of the four operational BPIs tracked by SMAG. In May 2000, each SCM developed their own targets for MSD backorders, LRT, issue effectiveness, and stockage effectiveness. In turn, AFMC Logistics (AFMC/LG) rolled up these individual targets to set new Air Logistics Center (ALC) and AFMC strategic targets through FY 2006.

Materiel Support Division Issue and Stockage Effectiveness

MSD fell just short of its issue and stockage effectiveness goals by 0.82 percent and 0.11 percent, respectively, for FY 2000. MSD's issue effectiveness for FY 2000 was 59.18 percent. The division missed its goal of 60 percent by 0.82 percent. MSD's stockage effectiveness for FY 2000 was 69.89 percent. The division missed its goal of 70 percent by 0.11 percent.

Materiel Support Division Logistics Response Time

LRT measures the time from when a customer places an order to the time they receive an AFMC-managed item. With the emergence of an Expeditionary Aerospace Force, which is capable of deploying anywhere in the world at a moment's notice, LRT has become a key BPI for both AFMC and the customer. Tracked monthly by AFMC/LG, LRT data is available to all SCMs through a web site maintained by HQ AFMC/LGIL, and the SCM Analysis Branch. This information can be accessed online at www.afmc-mil.wpafb.af.mil/HQ-AFMC/LG/LSO/lot. A key SCM responsibility is to monitor the four segments of the LRT process to ensure that they fall within acceptable limitations. The four segments are as follows:

- **Requisitioning Processing**—Time from the base's initiation of an order to receipt of the order by the depot
- **Inventory Control Point (ICP) Processing**—Time from the receipt of an order to preparing a part for shipment
- **DLA Pick and Pack**—Time to prepare an item for shipment
- **Transportation Time**—Time to ship an item from the depot to the customer.

In FY 2000, SMAG exceeded its LRT goal of 38 days with a FY 2000 cumulative LRT of 36.8 days. Again, it is the job of the SCM, who is accountable for the health of the supply pipeline for every item, to ensure timely delivery of parts to the customer. To do this, the SCM may be required to develop contracts or service level agreements (SLAs) with suppliers, depot managers, contract repair facilities, commercial shipping companies, single managers, or DLA to find ways to shorten LRT.

Materiel Support Division Backorder Reduction

A backorder is demand for an item that cannot be immediately satisfied from existing inventory. Backorder reductions have become a major HQ AFMC initiative to improve support to the warfighter. AFMC made considerable efforts during FY 2000 to achieve a 30-percent reduction overall throughout the year (from 374,000 units to 263,000 units). This success is due largely to a number of backorder reduction initiatives that ALC implemented, which will continue throughout FY 2001. BART is being used to track SMAG's backorder reduction effort. This tool allows an SCM to analyze backorder trends. Each SCM is encouraged to use BART to identify major drivers of backorder increases by NSN.

Financial Measures

Net Operating Result

The net operating result (NOR) is the difference between revenue and expenses, or a bottom-line profit and loss indicator. The objective of the SMMA is to break even over a two-year budget cycle. This is accomplished by setting rates, which offset the net prior year profit or loss. The MSD NOR for FY 2000 was a $184.5 million loss, $132.4 million below the budgeted NOR loss of $52.1 million. Since MSD is to break even over a two-year budget cycle, the rates were not sufficient to fully recover all costs.

For the General Support Division, the FY 2000 NOR goal was a loss of $1.1 million, but the actual result was a profit of $92.8 million. The increased NOR was driven by higher than planned adjustments for physical inventory and incoming shipment discrepancy gains. Inventory gains resulted from AFMC's effort to reconcile its own D035 system with DLA's Distribution Standard System and to clean up outstanding Received-Not-Billed and Billed-Not-Received transactions at the Air Logistics Centers.

For the Fuels Division in FY 2000, the NOR target was a $3.2 million loss, and the actual result was a $39.5 million loss. The lower NOR was driven by reduced revenue due to under execution of the flying hour program and reduced requirement for the ground fuel and missile fuel programs. Furthermore, the lower NOR can be attributed to fuel costs in excess of the plan.

Unit Cost Target

Unit cost target (UCT) is a limitation imposed by the OUSD(C) on the annual operating budget (AOB), restricting obligations to a percentage of gross sales. The AOB is the funding document that provides the authority to incur costs. The UCT is determined by dividing costs by sales. It also can be described as the ratio of obligations to gross sales. Costs are defined as obligations (excluding initial and capital expenses) and credit returns. Theoretically, SMAG should aim for a unit cost target ratio of one to one, meaning a break-even point where sales equal costs. The FY 2000 MSD actual UCT of 0.985 was programmed and achieved by each Center.

Financial BPIs for SMAG

Financial BPI FY 2000 Goal	MSD FY 2000 Goal	GSD FY 2000 Goal	Fuels FY 2000 Goal	Medical/Dental FY 2000 Goal	Academy FY 2000 Goal
Net Operating Result (NOR)	($52.1M)	($1.1M)	($3.2M)	$0.0M	$0.0M
Revenue	$4,373.6M	$1,945.2M	$1,813.4M	$602.4M	$7.0M
Expenses	$4,425.7M	$1,946.3M	$1,816.6M	$602.4M	$7.0M
Unit Cost Target (UCT)	0.985	1.0	0.998	1.0	1.0

Financial BPI FY 2000 Results	MSD FY 2000 Results	GSD FY 2000 Results	Fuels FY 2000 Results	Medical-Dental FY 2000 Results	Academy FY 2000 Results
Net Operating Result (NOR)	($184.5M)	$92.8M	($39.5M)	$11.3M	$0.0M
Revenue	$4,224.8M	$1,793.4M	$1,786.7M	$613.9M	$5.8M
Expenses	$4,409.3M	$1,700.6M	$1,826.2M	$602.6M	$5.8M
Unit Cost Target (UCT)	0.985	0.988	0.999	1.007	1.004

Financial BPI FY 2001 Goal	MSD FY 2001 Goal	GSD FY 2001 Goal	Fuels FY 2001 Goal	Medical-Dental FY 2001 Goal	Academy FY 2001 Goal
Net Operating Result (NOR)	$24.1M	($63.4M)	$0.1M	$0.0M	$0.0M
Revenue	$4,382.6M	$1,800.6M	$2,788.4M	$626.2M	$5.3M
Expenses	$4,358.5M	$1,864.0M	$2,788.3M	$626.2M	$5.3M
Unit Cost Target (UCT)	0.996	1.0	0.993	1.0	1.0

Efforts to Improve Financial Management

Goals and Initiatives

Inventory Valuation

A predominant driver in DFAS and Air Force reporting differences involves the valuation of MSD's extensive inventory. Currently, the Air Force is using Latest Acquisition Cost (LAC) to value all inventory. To properly record the inventory at historical value on the financial statements, a complex adjustment is made using an approved spreadsheet based on the OSD model. The Air Force has elected to change to the historical method of Moving Average Cost (MAC). The change in method will ensure the inventory value is auditable, as well as provide better management visibility to the SCM. An additional issue the Air Force is addressing is the matching principle for expenses to revenue generated. Under this issue, movement to Federal Accounting Standards Advisory Board (FASAB) Standard 6, capitalized assets, was studied. However, the movement to a different standard did not fully solve the issue and created additional problems that were not acceptable to the Air Force. Standard 6 is no longer an option. The Air Force is now studying the commercial practice of applying an obsolescence or usage factor over time to match the expense to the expected revenue. The proper application of this concept will be addressed throughout FY 2001.

Financial Reporting in Fiscal Year 2001

AFMC's goal is the use of official Accounting Report 1307 accounting data to both budget for and evaluate execution of MSD performance. The Air Force continues to work closely with DFAS to ensure accounting statements are in full compliance with generally accepted accounting principles and plans to achieve CFO Act compliance as expeditiously as possible. Other SMMA FY 2001 goals and objectives can be found in the FY 2001 SMMA Plan at www.scm.wpafb.af.mil and are summarized below:

- Increase issue effectiveness to 63 percent
- Increase stockage effectiveness to 72 percent
- Reduce LRT to 36 days
- Reduce backorders to 238,200 units
- Meet or exceed a NOR of zero
- Hold unit cost increases of SMMA products and services to no more than the rate of inflation
- Determine the FY 2005 SMMA workforce end state
- Size and configure the SMMA infrastructure for the FY 2005 mission
- Improve SMAG forecasting, budgeting, and execution processes.

Overview

Depot Maintenance Activity Group

Mission Statement

The Depot Maintenance Activity Group (DMAG) provides major overhaul and repair of systems and spare parts while striving to meet or exceed required standards for quality, timeliness, and cost. In peacetime, readiness is enhanced by efficiently and economically repairing, overhauling, and modifying aircraft, engines, missiles, components, and software to meet customer demands. During wartime or contingencies, repair operations surge and capacity is realigned to support the warfighter's immediate needs.

Repair and overhaul is accomplished through both the Air Force Materiel Command depots and contract operations. Customers pay for depot maintenance repair when the item is needed. Depot maintenance operates on the funds received through sales of its products and services. Less than 1 percent of the activity group's annual budget comes from funds authorized by Congress.

Customers, Products, and Services

Depot maintenance supports a number of customers. DMAG's single largest customer is the Supply Management Activity Group, which generates approximately 40 percent of their total revenue. The components repaired for supply management replenish spare

parts to the Air Force supply chain. Approximately 55 percent of depot maintenance revenue comes directly from work performed for the major commands, the Air National Guard, and the Air Force Reserve Command. The balance of work comes from other services, government agencies, and foreign countries.

Depot maintenance provides scheduled overhaul for airframes and engines based on a planned timetable for each weapon system. Missiles and ground electronic systems are repaired through scheduled and unscheduled depot maintenance. Individual components routed from the field also are repaired. AFMC depots also provide an extensive software capability to develop or modify software used to operate weapon systems and software designed for diagnostic purposes. Finally, storage, reclamation, and regeneration services are provided for all military services at the Aerospace Maintenance and Regeneration Center (AMARC) at Davis-Monthan Air Force Base, Arizona, for equipment not currently needed by active forces.

Depot Workload Strategy

The nation needs military depot repair and overhaul capability to maintain weapon systems at a reasonable cost with minimum interruptions to Air Force operations. Organic depot maintenance is an important and logical part of depot maintenance capability and provides support for military-unique technologies. The Air Force has developed a depot maintenance strategy that takes advantage of both public- and private-sector sources of depot maintenance repair to supply reliable, flexible, cost-effective, and timely depot maintenance support. Previously, no clear policy existed. In the wake of recent base closures, interest from the private sector to perform depot maintenance has increased. New weapon systems with advanced technologies and alternative repair strategies, such as public/private partnering and teaming, present new challenges to depot maintenance management.

The new depot maintenance strategy has four major facets. First, it supports the needs of the combat forces of today and tomorrow through assured peacetime readiness. Second, it retains a reserve capacity to surge, meeting contingency operations. Next, it provides the best value to taxpayers by allocating work between strong public-and private-sector maintenance capabilities. Allocation occurs through best value assessments and formal competitions. Finally, the strategy complies with all legislative commitments.

The depot maintenance strategy's purpose is to determine how to size the Air Force organic depot maintenance infrastructure. The process defines the necessary capabilities that should be retained by the Air Force and the depot maintenance workload that should be performed by the private sector. By direction of the Secretary of the Air Force, the depot maintenance strategy uses Core Plus to determine the basic size and composition of government depots.

Core depot maintenance, frequently shortened to "core," is the organic depot capability required to assure mission support for the weapon systems/equipment designated for the contingency plan. It encompasses both the depot capability (facilities, equipment, processes, and skills) and the workload required for maintaining the capability. The legislative branch has defined core logistics capabilities in Title 10 of the U.S. Code (U.S.C.), Section 2464. The definition reads:

> "Core logistics capabilities are essential for national defense that are Government-owned and Government operated (including Government personnel and Government-owned and Government-operated equipment and facilities) to ensure effective and timely response to a mobilization, national defense contingency situation, or other emergency requirement."

Core Plus refers to organic depot workloads not required to maintain a core logistics capability. Core Plus work includes public/private competitive awards, best value, last source, foreign military sales, DLA, and repair requirements for other military services and government agencies.

Depots will be right-sized through 2005, maintaining Core Plus through new technology infusion in new weapon system workloads. Existing depot technology will be refreshed with the Capital Purchases Program (CPP), expense dollars, and acquisition program funds. Air Force-acquired commercial derivative equipment will remain as supported by the private sector. Workloads without a clear depot source designation will be assigned by performing a best value assessment (Core Plus). In 1995, the capacity utilization of the five Air Force organic depots was 65 percent. Current targets propose 85 percent as full utilization (given fluctuating demand). With the execution of the Defense Base Realignment and Closure Act of

1990 (Public Law 101-510, Title XXIX, November 9, 1990, as amended) (BRAC-95), the Sacramento Air Logistics Center (SM-ALC) was closed and the workload from the San Antonio Air Logistics Center (SA-ALC) was realigned among other air logistics centers. Through consolidation of the core workloads and winning of non-core workloads, the remaining three depots improved capacity utilization to 90 percent.

As the Air Force modernizes, the future workload mix at the depots will continue to evolve. The distribution of work between the public and private sector will be based on the attributes of mission and work requirements. The Air Force will periodically revisit organic and contract capabilities to determine the logic of maintaining work at particular locations. A corporate depot assignment process will provide the overarching guidance. To implement this strategy, the depot assignment process must be integrated with acquisition strategy panel reviews. This ensures corporate compliance of Air Force depot decisions with all legal constraints. The accomplishment of a biennial review of the depot maintenance strategy substantiates currency with Air Force doctrine and policies. This depot maintenance strategy will enable effective performance of depot maintenance in the most economic manner. Peacetime readiness and wartime sustainability to the Air Force will receive the right workload mix of public- and private-sector depots.

Workload Consolidation

In 1997, core workloads from the two closing depots (San Antonio and Sacramento) began transitioning to Ogden (OO-ALC), Oklahoma City (OC-ALC), and Warner-Robins (WR-ALC) Air Logistics Centers and Tobyhanna Army Depot. By drawing down the AFMC infrastructure from five to three depots, general and administrative costs required to support the original five depots were greatly reduced.

Competition

As discussed previously, once the minimum core capability is established in the organic depots, the remaining non-core workloads will be accomplished in a manner that achieves the best value to the customer. This is achieved through public/private competition of non-core depot workloads. The three major competition packages [San Antonio C-5, Sacramento Composite, and San Antonio Propulsion Business Area (PBA)] are expected to ultimately produce a total savings of 16 percent.

Sources of Maintenance

The depot maintenance environment continues to change in response to a decreasing military force structure, aging weapons systems, and advancing technology. Weapon systems embody new materials and technologies that require new maintenance processes, improvements in reliability, and reductions in maintenance frequency. The net result is a requirement for greater flexibility in addressing both wartime and peacetime workload changes. This flexibility is achieved by employing both organic and contractor repair sources.

Organization of Depots

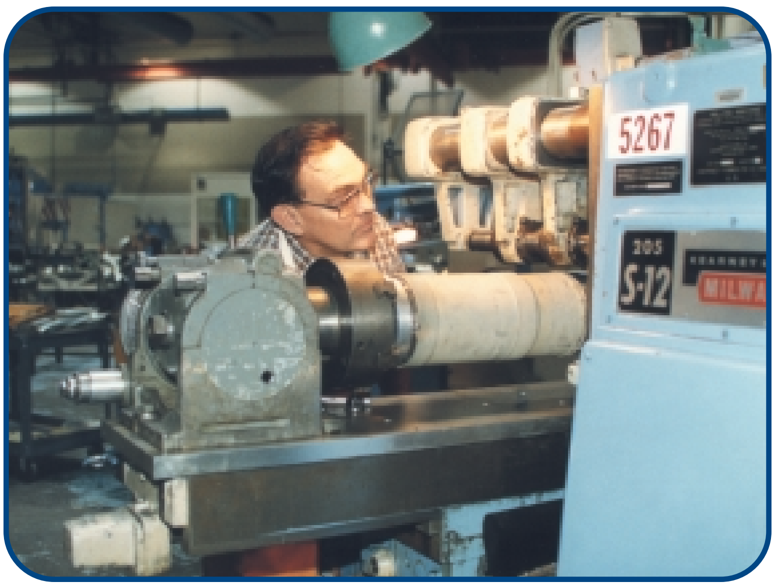
DMAG organic services are provided by three principal ALCs, other service depots, and AMARC at Davis-Monthan Air Force Base, Arizona. Organic depot maintenance sites are as follows:

- Ogden Air Logistics Center (OO-ALC), Ogden, Utah
- Oklahoma City Air Logistics Center (OC-ALC), Oklahoma City, Oklahoma
- Warner-Robins Air Logistics Center (WR-ALC), Robins, Georgia
- Aerospace Maintenance and Regeneration Center (AMARC), Tucson, Arizona.

Depot Maintenance Manager

The Depot Maintenance Manager (DMM) concept's goal is to achieve accountability at the lowest level in depot maintenance. The DMM is typically the Product Directorate Chief Deputy, normally a Colonel or GM-15, responsible for the daily management of repair, maintenance, and modification of weapon systems and materials assigned to a directorate. This includes management of organic production accomplished within the directorate's Resource Control Centers (RCCs) and contract production managed by the directorate. The DMM may be responsible for production pertaining to multiple weapon systems (e.g., B-1, F-16, C-130) and commodities (e.g., software, avionics, engines, engine accessories). The DMM is responsible for managing all production elements and ensuring compliance with applicable regulatory direction.

Each DMM must ensure that his or her portion of the business area stays within its revenue and expense goals while executing customer requirements. DMMs are responsible for ensuring that schedule and quality goals are met and for identifying, tracking, and controlling costs. DMMs recognize that MAJCOM customer accounts have a specific fund level based on the President's Budget (PB). Cost authority given to AFMC and allocated to the ALCs must match the DMAG PB. DMMs, in coordination with Air Force Materiel Command Headquarters, work with their customers to ensure funding, reprogramming actions, and investment decision/requirement deferrals, or the reprioritization of requirements that support warfighter needs.



If such changes occur and are approved, the DMM must validate, justify, and defend the new growth requirement. DMMs also are responsible for closely monitoring programmed versus unprogrammed funding execution. HQ AFMC, in conjunction with the MAJCOMs, will defend these requirements to Air Force Headquarters for additional or reprioritization of funds. The justification must occur as early in the fiscal year as possible. This does not negate the necessity for the DMMs to accurately forecast budget requirements in the out years to the greatest extent possible.

Contract Repair Process

The Contract Repair Process (CRP), formerly known as Contract Repair Enhancement Program (CREP), is transitioning to contracting standards for repair of exchangeable commodities. The revised vision statement reads:

> "CRP is a contract repair process that responds directly to customer demands while simultaneously reducing inventory, process steps, queue time, and total system operating costs. This environment requires long-term business relationships with contractors to take advantage of innovative ideas and efficient management practices such that customer demands are satisfied using the least resources."

A Materiel Management Team Leader leads Contract Repair Teams, with the Production Management Specialist, Seller, and Procuring Contracting Officers as the core team. CRP requires that middle managers be actively engaged and use their knowledge to identify opportunities to gain additional leverage by combining multiple requirements into corporate contracts.

Providing the contractor with incentives better meets the Air Force's customer demands. Performance-based "delivery on demand" contracts in which the contractor delivers a "serviceable upon receipt" item from a requisition within a specified time period is the leading tenet of CRP. Other tenets include process flow day reduction, rapid transportation, and direct shipment on demand.

Depot Workload Distribution 50/50 Management Process

Title 10 U.S.C. 2466 establishes a limitation of 50 percent on the portion of depot maintenance workload that may be performed by other than government personnel. Depot maintenance work performed under Interim Contractor Support (ICS) and Contract Logistics Support (CLS) contracts also are included in the 50/50 calculation. The Air Force workload distribution and tracking process has experienced significant improvement over the past two years and has become a model for DoD. The Air Force's ability to comply with Section 2466 has been seriously challenged with the award of the BRAC-directed SA-ALC and SM-ALC workload competitions and a general increasing trend toward contract logistics support. A Secretary of the Air Force waiver for Section 2466 compliance was exercised for FY 2000. An integrated process team (IPT), with representation from the Assistant Secretary of the Air Force (Acquisitions) (SAF/AQ), the Air Staff, and HQ AFMC, has been tasked to develop a Section 2466 compliance plan that is expected to feature significant workload shifts and execution targets for all Air Force Defense Acquisition Commanders (DACs) and Program Executive Officers (PEOs). Finally, Air Force logistics and acquisition guidance is now in effect to ensure Air Force corporate consideration of each major decision on Section 2466 compliance.

Service Level Agreements

A service level agreement (SLA) is an agreement between the provider of a service and the customer detailing the type, quantity, cost, and payment for the service to be delivered. The Directorate of Requirements (HQ AFMC/DR) has developed a template for service level agreements (SLAs). The Single Managers (SMs) and Supply Chain Managers (SCMs) are tailoring the templates by program. After these are established and deemed an effective management tool, SLAs between the SMs and DMMs will be developed.

Depot Maintenance Accounting and Production System

AFMC is implementing the Depot Maintenance Accounting and Production System (DMAPS) to bring substantial improvement to financial management and reporting for organic Depot Maintenance Mission Area (DMMA) facilities. It also will provide AFMC with the capability to capture and report actual and planned direct material and direct labor at the task level on a daily basis. The ability to apply overhead and general and administrative expenses on a planned dollar rate per direct labor hour also will be provided. DMMA has the capability to observe production costs on a daily basis at the task level. DMAPS will move AFMC closer to CFO Act and Cost Accounting Standards (CAS) compliance than the current legacy systems allow. Other features include:

- ▲ Incorporates the Defense Industrial Financial Management System (DIFMS)
- ▲ Standard DoD financial reporting system
- ▲ Fully automated billing process
- ▲ Reduction of some legacy systems
- ▲ Consolidated fund control process.

DMAPS impacts all organic DMMA employees and heavily impacts production, material, financial, and customer order/funding processes at the ALCs. It also impacts the DFAS-Denver location.

Production—DMAPS encompasses all organic production processes used by production personnel (planners, mechanics, and supervisors) from opening to closing of a job order number (JON). In addition, all indirect DMMA employees will use the new Time and Attendance System.

Materiel—Principal resources involved in organic DMMA materiel processes include item managers, equipment specialists, materiel planners, and shop floor personnel (to identify and requisition materiel). Other personnel include Depot Repair Enhancement Program production maintenance technicians, and Aircraft Repair Enhancement Program (AREP) forward logistics specialists.

Finance—Participants in this process include management analysts from workloading and the production directorates, as well as analysts from the budget office and cost accounting (cost accumulation and reporting).

Customer Order and Funding—This process touches nearly every ALC activity. It begins with buyer/seller functions (workload negotiation); includes the budget office (data input, rates, and analysis); and ends with cost accounting (cost accumulation and reporting).

DMAPS Program Phases

Phase I (Production)—Production cutover began in July 2000 at OO-ALC and is scheduled for January 2001 at WR-ALC and May 2001 at OC-ALC. Phase I includes the following:

- Time and Attendance (TAA)
- Six Air Force legacy systems
- An integration engine to interface with legacy systems and data.

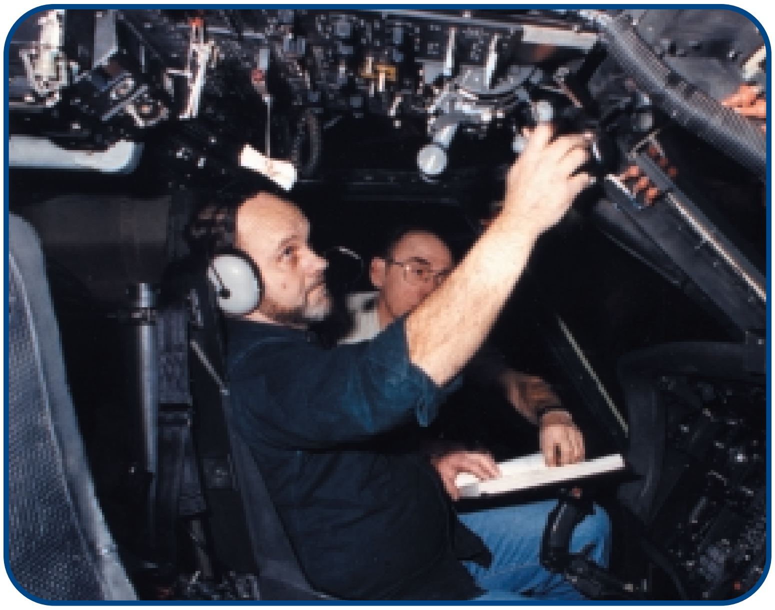
Phase II (Financial and Materiel)—Implementation is scheduled for April 2001 at OO-ALC, October 2001 at WR-ALC, and January 2002 at OC-ALC. Phase II includes the following:

- Defense Industrial Financial Management System (DIFMS)
- NAVAIR Industrial Materiel Management System (NIMMS) Automated Bill of Material (ABOM)
- Twenty-one Air Force legacy systems
- Four DFAS Denver legacy systems
- Air Force and DFAS Denver integration engine to interface with legacy systems and data.

Contract Maintenance Accounting and Production System

The purpose of the Contract Maintenance Accounting and Production System (CMAPS) is to obtain timely and accurate data related to repair, overhaul, modification, software updates, and other types of contracts under the contract portion of the Depot Maintenance Activity Group (Contract DMAG). CMAPS is the production reporting and financial accounting system for Contract DMAG.

CMAPS supports the management of contract maintenance production, government furnished materials/government furnished equipment (GFM/GFE) usage, and funding/accounting visibility to the ALCs and DFAS. The system tracks repair/maintenance work and associated DMAG



funds obligated and expended for labor (contract), materials, and overhead. CMAPS also validates, records, and maintains outstanding orders for GFM to contractors. It also accumulates and processes GFM billing data. General ledger accounting, cost accounting, production costing, financial management, and asset accounting provide financial tracking. Materials and equipment furnished by the government to contractors for use in the repair and testing of end items are tracked through the contractual and interservice repair process by contract work, location, and usage.

CMAPS replaces the G072D, G009, and H075C legacy systems. CMAPS modernizes the information technology and logistical functionality supporting AFMC contract depot maintenance. It streamlines contractor production reporting, meets CFO Act goals, adds GFM management, and is integrated with the command's Agile Logistics initiative. CMAPS standardizes and shares information in the data depot and supports relational database technology on mid-tier, web-based platforms. CMAPS also provides:

- Products and reports to improve inventory and accounting visibility for contract depot maintenance
- GFM management and financial reports
- Reports on contractor authorized use of GFM
- DFAS customer billings and general ledger accounts.

Quality Assurance

An effective quality assurance (QA) program is essential to ensuring the technical compliance of depot products and services. QA helps ensure that products and services conform to all technical requirements and are delivered to the customer at the lowest cost. The quality assurance program includes the following:

- The publication of AFMC Instruction (AFMCI) 21-115, "Depot Maintenance Quality Assurance" (October 19, 1999), provides the policy and procedural guidance that will reinstate an effective program.
- Establishing and staffing the Air Force Materiel Command Headquarters Depot Maintenance Quality (HQ AFMC/LGPQ), in addition to their Product Directorate counterparts, creates the infrastructure necessary for the implementation of QA guidance.
- Center QA manuals and Product Directorate Quality Assurance Plans (QAPs) implement the new policy and procedures at the ALC/center level.

- Yearly task evaluations will ensure that workers are qualified and certified to produce technically compliant products and services.
- The publication, AFMCI 21-132, "Depot Maintenance Technical Compliance Review Procedures" (January 5, 2000), provides annual self-assessment and monthly metrics reviews. These generate feedback to management in four critical areas: technical data and work control documents, personnel qualification and certification, tools and equipment, and process discipline.

Value Engineering

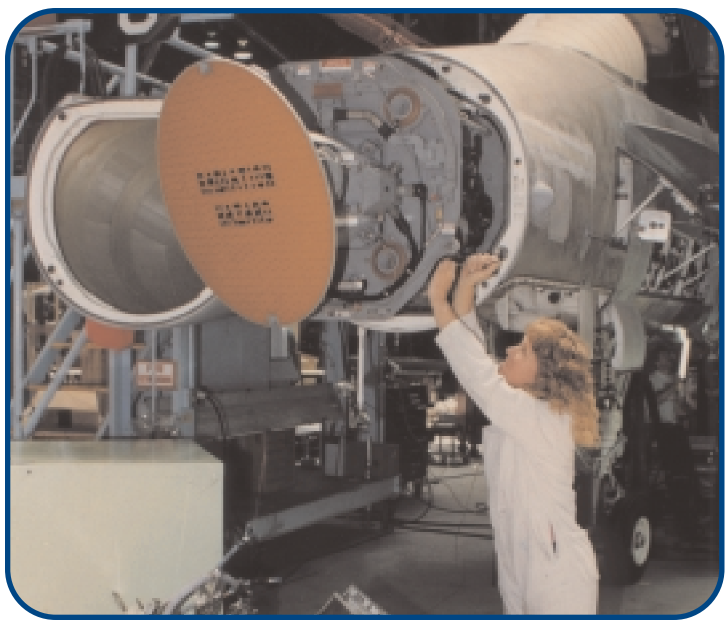
One effective and proven tool for cost reduction is Value Engineering (VE). This approach analyzes systems, facilities, processes, and supplies to achieve the required result at the lowest total cost, while retaining the user performance requirements. Value Engineering is based on questioning the necessity of all functions of a product or process. By performing functional/value and cost/benefit analysis, essential functions are retained and unnecessary functions are eliminated or modified. More information is available in Air Force Policy Directive (AFPD) 63-9, Air Force Instruction (AFI) 63-801, DoD Handbook 4245.8, and in the Principles and Applications of Value Engineering (PAVE) course. Further information on the VE program or availability of the course is available at the Aeronautical Systems Center (ASC) VE web site at www.en.wpafb.af.mil/ve/index.htm.

Performance Measures

DMAG's performance effectiveness is represented by 11 metrics—four financial effectiveness measures and seven performance effectiveness measures.

Mission performance indicators (MPIs) assess cost, schedule, and quality of the DMMA output. These MPIs are designed to achieve accountability at the appropriate depot maintenance level, the DMM. MPIs measure compliance with DMMA objectives. While summary information is reported to HQ AFMC, the centers have the ability to "peel back" the metrics to the shop level. Further MPIs may be developed as additional DMMA strategic plan objectives are approved.

DMAG performance effectiveness measures include: Organic Production Hours, expressed in direct production standard hours (DPSHs), which depict how well DMAG supported its planned production output; Days Held Index (Aircraft), which tracks delivery performance against the initial Aircraft and Missile Maintenance Production Compression Report (AMREP) date; Aircraft Due Date Performance (Command), which portrays



Performance Effectiveness Measures	FY 2000 Goal	FY 2000 Results	FY 2001 Goal
Organic Production Hours (DPSH)	23,941K	22,310K	21,935K
Days Held Index (Aircraft)(yr.)	1.0	1.1	1.0
Aircraft Due Date Performance (Command)	90 percent	67 percent	90 percent
Aircraft Due Date Performance (Maintenance) (New Metric)	N/A	78 percent	100 percent
Total Aircraft Quality Defect Rate*	0.1 defects	0.21 defects	0.1 defects
Engine Quality Rate (New Metric)	N/A	0.21	95 percent
Exchangeable Quality Defect Rate (New Metric)	N/A	0.013	97 percent

**Defects per aircraft produced.*

schedule effectiveness at the command level; Aircraft Due Date Performance (Maintenance), which indicates schedule effectiveness at the depot level; Total Aircraft Quality Defect Rate, which measures the quality of the completed work by the operating unit possessing the aircraft; Engine Quality Rate, which measures the quality of engine production; and Exchangeable Quality Defect Rate, which measures the quality of the completed exchangeables by operating unit.

Organic Production Hours

Production hours (planned and actual) are expressed in numbers of DPSH and direct production actual hours (DPAH). This represents the number of labor hours planned and used in the production effort, as negotiated by the system/item management and depot maintenance management groups. DPSHs are allocated by month to cover the anticipated productivity requirements. Management compares monthly actual DPSHs to monthly planned DPSHs to determine efficiencies. Production hours consumed are reviewed in monthly increments and are cumulative.

Results for FY 2000. Planned organic production hours were 23,941,000, while actual organic production hours equaled 22,310,000. Total production hours for the command finished the year below plan by 1.6 million hours or approximately 7 percent under plan. Specific variations are explained according to their commodity group:

- The Aircraft commodity group closed out the year 558,000 hours below plan. Specifically, previously undetected corrosion and extensive structural work on C-135, E-3, and C-5 aircraft slowed production efforts and contributed to the underproduction. Bomber and fighter aircraft production remained steady and on target throughout the year.

- ▲ Exchangeable commodities ran low throughout the year due to transitioning workloads among closing/gaining centers; Propulsion Business Area (PBA) competition, transfer, and startup; and parts shortages affecting avionics, landing gear, and engine module repair at the centers.
- ▲ Software production came in 11,000 hours above target, finishing better than target for the first time in years.

Days Held Index (Aircraft)

The purpose of this metric is to determine the length of time that the depot or depot maintenance contractor possesses aircraft for maintenance or modifications. Total actual flow days divided by total planned flow days yields the index. Acceptable performance is a Days Held Index of less than the Air Force standard of one.

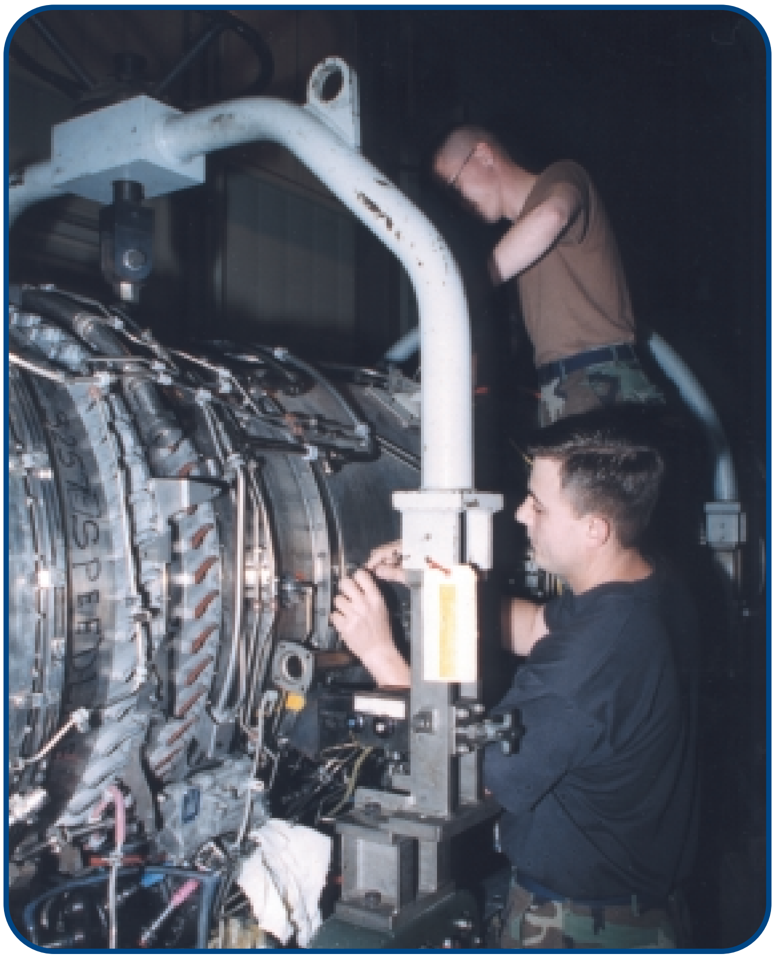
Looking at the days held index for the past 12 months, increases and decreases notwithstanding, the overall trend (variance between planned and actual flowdays) throughout the year was above the standard. This difference between the index and standard is consistent with the Aircraft Due Date Performance measure. This measure indicates the effect of delays in aircraft production for both organic and contracts. Specific delay reasons are discussed with the Aircraft Due Date Performance measure.

Aircraft Due Date Performance (Command)

Aircraft Due Date Performance (Command) measures the ability of air logistics centers and depot maintenance contractors to produce aircraft according to schedule. This includes all factors that may not be within their control (e.g., weather, parts, availability of flight crews, engineering evaluations, etc.). The measure tracks organic and contract aircraft by Mission Design Series (MDS) and measures aircraft produced against either the initial or adjusted schedule, but not both. Aircraft produced early and on time divided by the total aircraft produced equals the due date performance. The thresholds for early, on-time, or late production are as follows:

- ▲ **Early**—produced more than five days prior to scheduled out date
- ▲ **On time**—produced on scheduled out date plus five days
- ▲ **Late**—Produced more that five days after scheduled out date.

Annual production results were 850 aircraft (including aircraft produced at AMARC) produced—190 (22 percent) early, 376 (44 percent) on time, and 284 (33 percent) late. Cumulative aircraft delivery performance averaged 67 percent for the year. Over-and-above maintenance due to extensive structural work (C-135), severe corrosion (C-135, E-3), horizontal stabilizer (C-5), and cracked wing fingers (F-16) were the primary drivers. In addition, post-dock maintenance; functional check flight problems (both on the ground and in the air); parts, manpower, and skill-level imbalances; and fuel problems contributed significantly to delivery problems.



Aircraft Due Date Performance (Maintenance)

Aircraft Due Date Performance (Maintenance) measures the ability of air logistics centers and depot maintenance contractors to produce aircraft according to schedule while factoring out those occurrences which were not within the control of maintenance (e.g., weather, parts, availability of flight crews, engineering evaluations, etc.). With the exception of the aforementioned criteria, this measure is the same as Aircraft Due Date Performance (Command).

Total Aircraft Quality Defect Rate

The Total Aircraft Quality Defect Rate is a record of the number of defects discovered by the owning units of an aircraft returned from Programmed Depot Maintenance (PDM). It is expressed as an average of defects per aircraft produced. Performance is acceptable when the critical or major defects accepted rate is equal to or less than the Air Force standard of 0.1. That is, one defect for every 10 aircraft produced. During FY 2000, the organic and contract work force achieved a rate of 0.21 defects per aircraft.

Engine Quality Rate

The Engine Quality Rate measures the ability of the depot to produce engines that are defect-free for use by customers. This measure shows the long-term quality trend of the engines being delivered to the customer. Engine quality is measured over an 18-month period allowing for the interval between engine completion and quality defect report (QDR) processing and receipt. The engine quality rate (percent accepted defect-free engines produced) is established by dividing accepted defect-free engines produced by total engines produced. The standard used varies and is a weighted standard based on the Type Model Series (TMS) for various engines. The Engine Quality Rate achieved the standard in 10 out of the previous 18 months. The defect rate trend has remained relatively constant over the past 12 months, despite turmoil associated with transitioning repair workload to new locations and facilities.

Exchangeable Quality Defect Rate

The Exchangeable Quality Defect Rate measures the ability of the depot, both organic and contract, to produce components that are defect-free and ready for customer use. This measure also determines the long-term quality trend of the components being delivered to the customer. Exchangeable quality is measured over an 18-month period, allowing for the interval between component completion and QDR processing and receipt. The exchangeable quality rate is determined by dividing total exchangeable defects reported by total exchangeables produced.

The defect rate trend has increased slightly over the past 12 months. This is due in part to transitioning repair workload to new locations and facilities, and training the workforce at the gaining repair facilities to operate the equipment and repair the components. In addition, exchangeable production dropped off during this year of transition. Due to the decrease in production, the exchangeable defect rate is artificially high. The rate is expected to regain customary levels during FY 2001.

Financial Measures

DMAG financial effectiveness measures include net operating result (NOR), which is computed as revenue minus the cost of goods sold (COGS) plus other (includes equipment write-offs and extraordinary items); revenue, which is the income received from customers for goods or services provided by depot maintenance; cost of goods produced, which measures the cost incurred to produce a given quantity and mix of products and/or services; and expense rate, which compares planned and actual cost of goods produced.

Financial Effectiveness Measures	FY 2000 Goal	FY 2000 Results	FY 2001 Goal
Net Operating Result (NOR)	($26.9M)	($109.0M)	$162.8M
Revenue	$5,173.7M	$5,273.8M	$5,884.3M
Expenses	$5,200.6M	$5,704.5M	$5,721.5M
Organic Expense Rate	128.01	146.37	149.80

Net Operating Result

The NOR is the difference between revenue and cost of goods sold (COGS) and other. In business terms, this is the profit or loss from annual operations. The variance of actual NOR from target NOR is one of the most important indicators of the effectiveness of business operations. Revenue and costs are based on work performed. Targets for financial effectiveness are set according to the FY 2000 column of the FY 2001 President's Budget. The DMAG NOR reflects a loss of $109.0 million, which results in $82.1 million less than the targeted NOR loss of $26.9 million.

Revenue

DMAG's total revenue was $100.1 million higher than anticipated ($5,273.8 million vs. $5,173.7 million). Organic revenue is over plan by $70.6 million due to engine and other major end items (OMEI) revenue being over plan. In addition, PBA reimbursement is included in revenue. Contract revenue is $29.5 million over plan, primarily due to exchangeables.

Expenses

This measures the costs incurred during the production of a given quantity and mix of products and services. The total expenses were $503.9 million higher than planned for FY 2000. In support of the workload transition from the closing centers, more work was performed by contract depot maintenance than planned, and more material costs were incurred.

Organic Expense Rate

DMAG uses an organic expense rate instead of a UCT to measure performance. This measures the rate that expenses were consumed in relationship to total production hours. The total expense rate was 14.3 percent ($146.37 million vs. $128.01 million) higher than planned. The materiel expense rate is 18.6 percent over the end-of-year plan due to increased usage and higher-than-expected material inflation. The Air Force is currently performing an analysis to determine how much of the rate change is due to material price changes and how much is due to changes in the consumption of material. The expense rate was 39.9 percent over the end-of-year plan, primarily due to higher usage of contract augmentees than planned to support transition workloads.

Efforts to Improve Financial Management

Goals and Initiatives

DMAG's mission objective for FY 2001 is to meet or exceed the support requirements and expectations of its combat-ready customers. Components and end items must be produced as required by the customers when needed and be delivered where needed, in a timely manner and at a reasonable cost. The following major initiatives commit us to improve the cost- and time-effectiveness of depot business and production practices in Expeditionary Aerospace Force support, weapon systems support, cost reduction, work force management, and infrastructure realignment. These objectives support the Air Force mission essential tasks identified in Air Force Doctrine Document 1-1 Depot Maintenance Business Area (DMBA).

Expeditionary Aerospace Force Objectives

- **Reduce total flow days** for aircraft undergoing depot maintenance by 40 percent by the end of FY 2005 from FY 1998 baseline for both contract and organic repair (1996 baseline for aircraft)
- **Engineer labor standards** to accurately describe changing work requirements
- **Meet end item delivery commitments** 95 percent of the time by the end of FY 2005.

Weapon Systems Support

- Sustain and improve weapon systems by meeting or exceeding specific cost, schedule, safety, and certification commitments by FY 2005
- Establish technically compliant operations across all product lines by FY 2003
- Establish in-process measures ensuring the production of technically compliant products. These metrics are categorized into the following areas:
  - **Technical Data—**Indicate if the technical data in use is current and accurate
  - **Tools and Equipment—**Indicate if the tools and equipment in use are correct and in serviceable condition
  - **Training and Qualification—**Indicate if the maintenance workforce has the technical expertise and is capable of proficient task accomplishment
  - **Task Execution—**Indicate if the maintenance workforce is safely and efficiently executing tasks in accordance with technical data and other directives.

Cost

- **Reduce unit cost of AFMC products and services in real terms** (without inflation) 8 percent from the FY 1998 baseline by FY 2007, while maintaining appropriate performance standards
- **Reduce average customer price** after inflation by 8 percent, from the FY 1998 baseline, by FY 2007
- **Achieve materiel cost savings** by doing the following:
  - Identifying and developing action plans to reduce the causes of backorders and awaiting parts (AWP) that cause constant workaround processes
  - Updating depot maintenance materiel policy

- ✦ Improving bill of material (BOM) accuracy by conducting an audit and implementing recommendations
- ✦ Exploring and implementing prudent use of the International Merchant Purchase Authorization Card (IMPAC)
- ✦ Establishing a command materiel support ability process in partnership with Defense Logistics Agency (DLA) using the Reparability Forecast Model (RFM)
- ✦ Training the workforce in proper BOM management
- ✦ Investigating and implementing prudent prime vendor initiatives
- ✦ Investigating and implementing prudent direct vendor delivery programs

▲ **Strengthen contract depot maintenance management** by doing the following:

- ✦ Developing standardized review and tracking of contracts at the Program Management Specialist (PMS) level
- ✦ Updating pertinent regulations, manuals, and instructions
- ✦ Providing standardized training
- ✦ Determining specific areas of contract depot maintenance for review

▲ **Consolidate core capabilities/technologies** from closing depots to remaining depots by end of FY 2001

▲ **Compete non-Core workload**

▲ **Develop partnerships with industry** to place unused but essential capacity into service

▲ Manage costs each year to ensure that **NOR goals are met without suffering a financial loss**.

Work Force

▲ **Develop a qualified, flexible work force** in sufficient numbers with appropriate employment/skills mix by FY 2005 to support the AFMC FY 2007 Performance and Cost Objectives

▲ **Determine DMAG work force end states** based on FY 2005 DMAG end states to include a strategic, top-level assessment of work force skills, skill levels, and demographics needed in FY 2005

▲ **Apply work force shaping decisions** to individual positions.

Infrastructure

▲ **Support missions and people at AFMC installations** with capital infrastructure that is properly sized, configured, and maintained to enable productive operations and achieve Air Force quality of life standards by FY 2010.

▲ **Plan an investment strategy supporting infrastructure** that will cover current and future requirements:

- ✦ **CPP**—Minor construction, equipment replacement, and software development
- ✦ **New applications of technology**
- ✦ **Military construction** (MILCON)
- ✦ **New systems**

▲ **Plan to continually look at the surge in depot maintenance workload requirements** resulting from wartime operations in determining shortages or excesses in areas of capability classified as Core or Core Plus. Use these results to develop and maintain overall strategies and plans for increasing capacities where needed and for divesting excess capacities.

Overview

Information Services Activity Group

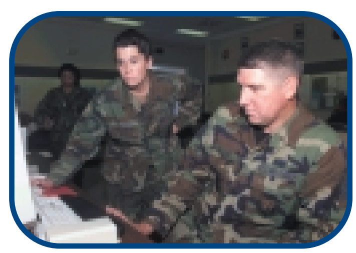
Mission Statement

The Information Services Activity Group's (ISAG's) mission is to develop, acquire, sustain, integrate, modernize, and secure combat support information systems for the Air Force and Department of Defense (DoD) customers.

The ISAG provides technological support for all levels of information systems, from developing leading-edge technologies to maintaining and modifying older legacy systems. It offers comprehensive support to its customers, including developing, maintaining, integrating, and sustaining their combat support information systems.

ISAG enhances readiness during war and peace by sustaining global combat support information systems, which provide information to combat forces where and when they need it, thus improving the forces' response capability.

Two Air Force activities act as one central design activity (CDA) under Air Force Materiel Command's Electronic Systems Center (ESC) at Hanscom Air Force Base, Massachusetts. The two activities are the Materiel Systems Group (MSG), at Wright-Patterson Air Force Base, Ohio, and the Standard Systems Group (SSG), at Maxwell Air Force Base–Gunter Annex, Alabama.



Customers, Products, and Services

ISAG provides, through the CDA, information products and services via two business lines. The product support business line provides the development and operational sustainment of automated information and communications systems on existing hardware and software platforms for AFMC-level logistics support systems and Air Force base-level standard support systems. This includes a 24-hour, seven-day help desk for field users to call for hardware and software systems support. This business line also provides automated information and communications systems requirement analysis, system design, development, testing, integration, implementation support, and documentation services on mainframe, mid-tier, and personal computer hardware/software platforms for Air Force and DoD customers using the Software Engineering Institute Capability Maturity Model processes.

The Commercial Information Technology Product Area Directorate (CITPAD) business line provides other authorized information system services or products through the acquisition and operation of the CITPAD commodity contracts for the Air Force and other DoD agencies.

ISAG may furnish these products or services to other agencies and private parties, as authorized by law. These services are authorized to be provided by organic or contract sources.

The product support business line provides CDA services based on service level agreements (SLAs) with known customers and on the sale of direct billable hours. However, the CITPAD business line provides goods and services (e.g., personal computers and local area network hardware and services, including installations worldwide) to thousands of individual customers across the Air Force and DoD, making SLAs and the use of direct billable hours impractical.

Instead, the CITPAD portion of ISAG contributes to the overall revenue of the organization through the collection of a surcharge on orders for equipment and services required by the users of the contracts or blanket purchase agreements (BPAs).

As previously mentioned, ISAG operates in two major locations, each with slightly different market sectors. MSG, headquartered at Wright-Patterson Air Force Base, Ohio, with two operating locations at the Oklahoma City Air Logistics Center (OC-ALC) and the Ogden Air Logistics Center (OO-ALC), has historically concentrated on depot management information systems. SSG, headquartered at Maxwell Air Force Base–Gunter Annex, Alabama, has focused on flight line management information systems.

Performance Measures

Deficiency Reports and Software Releases

Software deficiency reports (DIREPs) are one measure of the quality of software produced. Software releases are software components issued to fix DIREPs and to incorporate minor enhancements as part of sustainment. Priority 1 DIREPs (emergency calls) and priority 2 DIREPs (routine calls) are quantitative measurements reported monthly. The number of priority 1 and priority 2 DIREPs per 100,000 lines of code are identified, reported monthly, and corrected, and the corrective action is provided as feedback to ISAG developers and customers.

ISAG's FY 2000 performance is as follows:

- **Software Releases**—88 percent on time
- **Priority 1 Deficiency Reports**—61 percent closed within 48 hours
- **Priority 2 Deficiency Reports**—57 percent closed within 45 days.

These performances were all within the acceptable limitations endorsed by AFMC.

Earned Value Management

Earned Value Management (EVM) is a management tool that allows customer and software factory/contractor program managers to have visibility into technical, cost, and schedule progress on their projects. An earned value management system ensures that program managers are provided with cost and schedule performance data that:

- Relates time-phased budgets to specific contract tasks and/or statements of work
- Indicates work progress
- Properly relates cost, schedule, and technical accomplishments
- Is valid, on time, and auditable
- Supplies managers with information at a practical level of summarization
- Is derived from the same internal earned value management systems the contractor uses to manage the contract.

Initial implementation of EVM on ISAG software programs began in May 1998. The FY 2000 ISAG cost variance and schedule variance were better than the standard of 13 percent for the entire fiscal year.

Financial Measures

Financial Performance Measures	ISAG FY 2000 Goal	ISAG FY 2000 Results	ISAG FY 2001 Goal
Net Operating Result (NOR)	($11.1M)	($11.2M)	$0.8M
Revenue	$516.4M	$524.3M	$538.1M
Cost of Operations	$527.5M	$535.5M	$537.3M

Net Operating Result

The primary indicator of ISAG financial effectiveness is net operating result (NOR), which is computed as revenue minus cost of operations. A $11.1 million loss was set for the FY 2000 NOR to achieve a zero accumulated operating result (AOR) by FY 2001. ISAG recorded a NOR loss of $11.2 million in FY 2000.

Revenue

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 CITPAD surcharge revenue. The variance in revenue of $7.9 million is driven by an unplanned Oracle and Gold license purchase in FY 2000.

Cost of Operations

For ISAG, cost of operations measures the resources consumed in filling customer orders. These costs include labor and non-labor expenses, both direct and overhead. As stated above, this higher cost is driven by an unplanned Oracle and Gold license purchase in FY 2000.

Efforts to Improve Financial Management

Goals and Initiatives

CDA will provide mission support services to the Air Force and other customers in a multitude of functional areas, including supply, maintenance, financial management, medical, transportation, munitions, logistics, plans, contracting, and military justice. To do so most efficiently and effectively, the following strategic initiatives have been developed to reduce costs and keep the work force trained to remain competitive through FY 2007. AFMC objectives for the Expeditionary Aerospace Force, weapon systems, cost, work force, and infrastructure are supported by the seven ISAG initiatives that have been developed:

- Objective 1: Meet or exceed commitments
- Objective 2: Improve customer satisfaction
- Objective 3: Protect information systems
- Objective 4: Meet NOR and AOR targets
- Objective 5: Optimize work force
- Objective 6: Improve communications
- Objective 7: Properly size capital infrastructure.

Overview

Cash Management

The Air Force Working Capital Fund ended FY 2000 with $542.6 million in cash. The FY 2000 revised, end-of-year budget projection was $456.2 million. The cash increase was largely due to cash infusions in support of operational losses. A summary of cash changes includes the following:

- The Depot Maintenance Activity Group cash balance decreased $81 million in FY 2000. This decrease can be attributed to declining organic revenue coupled with increasing expenses for operating material and supplies.
- The Fuel Division cash balance decreased $88.1 million in FY 2000. This decrease was primarily the result of a cash transfer to the Materiel Support Division.

- The General Support Division cash balance decreased $33.1 million in FY 2000. This decrease was the result of a cash transfer to MSD.
- The MSD cash balance increased $417.8 million in FY 2000. To better manage the cash accounts, AFWCF approved a $403.6 million cash adjustment. Air Force Materiel Command is working to identify and correct the cash balance discrepancy in the MSD repair process.

The DoD cash management policy recommends maintaining the minimum cash balance necessary to meet both operational and disbursement requirements in support of the capital program. Cash generated from operations is the primary means of maintaining adequate cash levels. The ability to generate cash is dependent on setting rates to recover full costs to include prior year losses, accurately projecting workloads, and meeting established operational goals.

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 at seven to 10 days of operational cost and cash adequate to meet six months of capital disbursements. The recommended cash range for FY 2000 was $638.3 million (seven days) and $921.4 million (10 days). The amount of cash ending the fiscal year was not adequate to meet the standards set by the Office of the Secretary of Defense.

Cash management efforts continue to focus on analyzing data and developing tools to identify changes in cash. Although the data currently available is outdated for current needs, accuracy has been improving. AFMC has completed a statement of sources and uses of cash in FY 2000 and has implemented use of the statements to identify areas of cash increases and drains. Work continues on identifying and correcting the processes that are causing cash drains.

Working Capital Funds

The financial statements have been prepared to report the financial position and results of operations for the entity, pursuant to the requirements of the 31 U.S.C. 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 Air Force is unable to implement all elements of the standards due to financial management systems limitations. The Air Force continues to implement system improvements to address these limitations. There are other instances when the Air Force's application of the accounting standards is different from the auditor's application of the standards. In those situations, the Air Force 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 U.S. Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation that provides resources to do so.

Working Capital Funds

Principal Statements

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

As of September 30, 2000
($ in Thousands)

Assets (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$	214,627
Accounts Receivable (Note 5)		729,449
Other Assets (Note 6)		65,592
Total Intragovernmental Assets	$	1,009,668
Cash and Other Monetary Assets (Note 7)	$	102
Accounts Receivable (Note 5)		73,578
Inventory and Related Property (Note 9)		17,310,658
General Property, Plant and Equipment (Note 10)		1,255,368
Other Assets (Note 6)		790,490
Total Assets	$	20,439,864
Liabilities (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$	192,597
Other Liabilities (Note 15 & Note 16)		25,379
Total Intragovernmental Liabilities	$	217,976
Accounts Payable (Note 12)	$	201,906
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)		198,890
Other Liabilities (Note 15 and Note 16)		3,346,456
Total Liabilities	$	3,965,228
Net Position		
Unexpended Appropriations (Note 18)	$	63,971
Cumulative Results of Operations		16,410,665
Total Net Position	$	16,474,636
Total Liabilities and Net Position	$	20,439,864

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

For the year ended September 30, 2000
($ in Thousands)

Program Costs		
Intragovernmental	$	6,093,205
With the Public		7,256,718
Total Program Cost	$	13,349,923
(Less: Earned Revenue)		(11,548,149)
Net Program Costs	$	1,801,774
Net Costs of Operations	$	1,801,774

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

See notes 1 and 19.

For the year ended September 30, 2000
($ in Thousands)

Net Cost of Operations	$ 1,801,777
Financing Sources (other than exchange revenues)	
Imputed Financing (Note 20)	107,034
Transfers - in	229,402
Transfers - out	(378,445)
Other	389,788
Total Financing Sources (other than Exchange Revenues)	$ 347,779
Net Results of Operations	$ (1,453,998)
Prior Period Adjustments (Note 20)	(1,419,599)
Net Change in Cumulative Results of Operations	$ (2,873,597)
Change in Net Position	$ (2,873,597)
Net Position-Beginning of the Period	19,348,233
Net Position-End of the Period	$ 16,474,636

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

See notes 1 and 20.

For the year ended September 30, 2000
($ in Thousands)

Budgetary Resources		
Budget Authority	$	384,498
Unobligated Balance - Beginning of Period		512,188
Net Transfers Prior-Year Balance, Actual		207,900
Spending Authority from Offsetting Collections		14,763,644
Adjustments		(777,284)
Total Budgetary Resources	$	15,090,946
Status of Budgetary Resources		
Obligations Incurred	$	15,035,345
Unobligated Balances - Available		55,601
Total, Status of Budgetary Resources	$	15,090,946
Outlays		
Obligations Incurred	$	15,035,345
Less: Spending Authority from Offsetting Collections and Adjustments		(14,763,644)
Obligated Balance, Net - Beginning of Period		2,806,547
Less: Obligated Balance, Net - End of Period		(2,791,001)
Total Outlays	$	287,247

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

See notes 1 and 21.

For the year ended September 30, 2000
($ in Thousands)

Obligations and Nonbudgetary Resources	
Obligations Incurred	$ 15,035,345
Less: Spending Authority from Offsetting Collections and Adjustments	(14,763,644)
Financing Imputed for Cost Subsidies	107,034
Transfers-In (Out)	1,092,348
Total Obligations as Adjusted and Nonbudgetary Resources	$ 1,471,083
Resources That Do Not Fund Net Cost of Operations	
Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Received or Provided (Increases)/Decreases	$ 290,667
Change in Unfilled Customer Orders	(126,261)
Costs Capitalized on the Balance Sheet - (Increases)/Decreases	(28,939)
Financing Sources that Fund Costs of Prior Periods	(206,522)
Total Resources That Do Not Fund Net Costs of Operations	$ (71,055)
Components of Costs of Operations That Do Not Require or Generate Resources	
Depreciation and Amortization	$ 146,122
Loss on Disposition of Assets	56,739
Total Costs That Do Not Require Resources	$ 202,861
Financing Sources Yet to be Provided	$ 198,890
Net Cost of Operations	$ 1,801,779

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

See notes 1 and 22.

As of September 30, 2000
($ in Thousands)

		Depot Maintenance		Supply Management		Information Services
ASSETS (Note 2)						
Intragovernmental:						
Fund Balance with Treasury (Note 3)	$	391,908	$	(263,812)	$	66,114
Accounts Receivable (Note5)		723,706		414,645		47,071
Other Assets (Note 6)		55,847		18,462		2
Total Intragovernmental Assets	$	1,171,461	$	169,295	$	113,187
Cash and Other Monetary Assets (Note 7)	$	0	$	24	$	78
Accounts Receivable (Note 5)		43,303		146,021		1
Inventory and Related Property (Note 9)		1,757,060		15,553,467		131
General Property, Plant and Equipment (Note 10)		1,018,661		163,261		32,938
Other Assets (Note 6)		132,649		657,824		17
TOTAL ASSETS	$	4,123,134	$	16,689,892	$	146,352
LIABILITIES (Note 11)						
Intragovernmental:						
Accounts Payable (Note 12)	$	158,754	$	488,866	$	950
Other Liabilities (Note 15 & Note 16)		30,652		2,725		721
Total Intragovernmental Liabilities	$	189,406	$	491,591	$	1,671
Accounts Payable (Note 12)	$	54,231	$	332,780	$	7,910
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)		173,671		16,196		9,023
Other Liabilities (Note 15 and Note 16)		2,892,368		318,961		133,663
TOTAL LIABILITIES	$	3,309,676	$	1,159,528	$	152,267
NET POSITION						
Unexpended Appropriations (Note 18)	$	0	$	63,971	$	0
Cumulative Results of Operations		813,458		15,466,393		(5,915)
TOTAL NET POSITION	$	813,458	$	15,530,364	$	(5,915)
TOTAL LIABILITIES AND NET POSITION	$	4,123,134	$	16,689,892	$	146,352

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

See notes 1 and 21.

Transportation	Component Level	Combined Total	Intra-Entity Eliminations	Consolidated Total
$ 9,631	$ 10,786	$ 214,627	$ 0	$ 214,627
(1)	(1)	1,185,420	455,971	729,449
0	0	74,311	8,719	65,592
$ 9,630	$ 10,785	$ 1,474,358	$ 464,690	$ 1,009,668
$ 0	$ 0	$ 102	$ 0	$ 102
617	(116,364)	73,578	0	73,578
0	0	17,310,658	0	17,310,658
40,508	0	1,255,368	0	1,255,368
0	0	790,490	0	790,490
$ 50,755	$ (105,579)	$ 20,904,554	$ 464,690	$ 20,439,864
$ 0	$ (2)	$ 648,568	$ 455,971	$ 192,597
0	0	34,098	8,719	25,379
$ 0	$ (2)	$ 682,666	$ 464,690	$ 217,976
$ 1,002	$ (194,017)	$ 201,906	$ 0	$ 201,906
0	0	198,890	0	198,890
1,464	0	3,346,456	0	3,346,456
$ 2,466	$ (194,019)	$ 4,429,918	$ 464,690	$ 3,965,228
$ 0	$ 0	$ 63,971	$ 0	$ 63,971
48,289	88,440	16,410,665	0	16,410,665
$ 48,289	$ 88,440	$ 16,474,636	$ 0	$ 16,474,636
$ 50,755	$ (105,579)	$ 20,904,554	$ 464,690	$ 20,439,864

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

See notes 1 and 21.

For the year ended September 30, 2000
($ in Thousands)

	Total	Intra-Entity Eliminations	Consolidated Total
Program Costs			
A. Depot Maintenance			
Intragovernmental	$ 2,342,165	$ (1,436,619)	$ 905,546
With the Public	3,410,535	0	3,410,535
Total Program Cost	$ 5,752,700	$ (1,436,619)	$ 4,316,081
(Less: Earned Revenue)	(5,268,108)	2,349,891	(2,918,217)
Net Program Costs	$ 484,592	$ 913,272	$ 1,397,864
B. Supply Management			
Intragovernmental	$ 7,567,107	$ (2,427,421)	$ 5,139,686
With the Public	3,345,200	0	3,345,200
Total Program Cost	$ 10,912,307	$ (2,427,421)	$ 8,484,886
(Less: Earned Revenue)	(9,619,769)	1,359,091	(8,260,678)
Net Program Costs	$ 1,292,538	$ (1,068,330)	$ 224,208
C. Information Services			
Intragovernmental	$ 47,974	$ (1)	$ 47,973
With the Public	500,983	0	500,983
Total Program Cost	$ 548,957	$ (1)	$ 548,956
(Less: Earned Revenue)	(524,312)	155,058	(369,254)
Net Program Costs	$ 24,645	$ 155,057	$ 179,702
D. Total Program Costs			
Intragovernmental	$ 9,957,246	$ (3,864,041)	$ 6,093,205
With the Public	7,256,718	0	7,256,718
Total Program Cost	$ 17,213,964	$ (3,864,041)	$ 13,349,923
(Less: Earned Revenue)	(15,412,189)	3,864,040	(11,548,149)
Net Program Costs	$ 1,801,775	$ (1)	$ 1,801,774
Net Costs of Operations	$ 1,801,775	$ (1)	$ 1,801,774

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

See notes 1 and 19.

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

For the year ended September 30, 2000
($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
Net Cost of Operations	$ 484,593	$ 1,292,538	$ 24,646
Financing Sources (other than exchange revenues)			
Imputed Financing (Note 20)	92,384	9,262	5,388
Transfers - in	0	0	0
Transfers - out	(228,445)	(65,841)	0
Other	0	370,987	18,801
Total Financing Sources (other than Exchange Revenues)	$ (136,061)	$ 314,408	$ 24,189
Net Results of Operations	$ (620,654)	$ (978,130)	$ (457)
Prior Period Adjustments (Note 20)	(24,547)	(1,389,014)	4
Net Change in Cumulative Results of Operations	$ (645,201)	$ (2,367,144)	$ (453)
Change in Net Position	$ (645,201)	$ (2,367,144)	$ (453)
Net Position-Beginning of the Period	1,458,659	17,897,508	(5,462)
Net Position-End of the Period	$ 813,458	$ 15,530,364	$ (5,915)

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

See notes 1 and 20.

Transportation	Component Level	Combined Total	Intra-Entity Eliminations	Consolidated Total
$ 0	$ 0	$ 1,801,777	$ 0	$ 1,801,777
0	0	107,034	0	107,034
0	295,243	295,243	65,841	229,402
(150,000)	0	(444,286)	(65,841)	(378,445)
0	0	389,788	0	389,788
$ (150,000)	$ 295,243	$ 347,779	$ 0	$ 347,779
$ (150,000)	$ 295,243	$ (1,453,998)	$ 0	$ (1,453,998)
(6,042)	0	(1,419,599)	0	(1,419,599)
$ (156,042)	$ 295,243	$ (2,873,597)	$ 0	$ (2,873,597)
$ (156,042)	$ 295,243	$ (2,873,597)	$ 0	$ (2,873,597)
204,331	(206,803)	19,348,233	0	19,348,233
$ 48,289	$ 88,440	$ 16,474,636	$ 0	$ 16,474,636

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

See notes 1 and 20.

For the year ended September 30, 2000
($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
BUDGETARY RESOURCES			
Budget Authority	$ 76,178	$ 308,320	$ 0
Unobligated Balance - Beginning of Period	(14,026)	49,826	319,439
Net Transfers Prior-Year Balance, Actual	(7,488)	276,948	0
Spending Authority from Offsetting Collections	5,199,938	9,030,648	533,105
Adjustments	0	(775,300)	(1,984)
Total Budgetary Resources	$ 5,254,602	$ 8,890,442	$ 850,560
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred	$ 5,368,129	$ 8,865,023	$ 796,880
Unobligated Balances - Available	(113,527)	25,419	53,680
Total, Status of Budgetary Resources	$ 5,254,602	$ 8,890,442	$ 850,560
OUTLAYS			
Obligations Incurred	$ 5,368,129	$ 8,865,023	$ 796,880
Less: Spending Authority from Offsetting Collections and Adjustments	(5,199,938)	(9,030,648)	(533,105)
Obligated Balance, Net - Beginning of Period	599,126	2,431,630	(216,634)
Less: Obligated Balance, Net - End of Period	(693,816)	(2,146,288)	(20,509)
Total Outlays	$ 73,501	$ 119,717	$ 26,632

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

See notes 1 and 21.

Transportation	Component Level	Combined Total
$ 0	$ 0	$ 384,498
156,950	(1)	512,188
(150,000)	88,440	207,900
(47)	0	14,763,644
0	0	(777,284)
$ 6,903	$ 88,439	$ 15,090,946
$ 5,313	$ 0	$ 15,035,345
1,590	88,439	55,601
$ 6,903	$ 88,439	$ 15,090,946
$ 5,313	$ 0	$ 15,035,345
47	0	(14,763,644)
(1,275)	(6,300)	2,806,547
(8,041)	77,653	(2,791,001)
$ (3,956)	$ 71,353	$ 287,247

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

See notes 1 and 21.

For the year ended September 30, 2000
($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
OBLIGATIONS AND NONBUDGETARY RESOURCES			
Obligations Incurred	$ 5,368,129	$ 8,865,023	$ 796,880
Less: Spending Authority from Offsetting Collections and Adjustments	(5,199,938)	(9,030,648)	(533,105)
Financing Imputed for Cost Subsidies	92,384	9,262	5,388
Transfers-In (Out)	664,338	253,600	0
Total Obligations as Adjusted and Nonbudgetary Resources	$ 924,913	$ 97,237	$ 269,163
RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS			
Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Received or Provided (Increases)/Decreases	$ 228,655	$ 297,715	$ (236,453)
Change in Unfilled Customer Orders	(160,589)	29,736	4,592
Costs Capitalized on the Balance Sheet - (Increases)/Decreases	(847,162)	819,665	(27,445)
Financing Sources that Fund Costs of Prior Periods	0	0	0
Total Resources That Do Not Fund Net Costs of Operations	$ (779,096)	$ 1,147,116	$ (259,306)
COMPONENTS OF COSTS OF OPERATIONS THAT DO NOT REQUIRE OR GENERATE RESOURCES			
Depreciation and Amortization	$ 108,367	$ 31,988	$ 5,767
Loss on Disposition of Assets	56,739	0	0
Total Costs That Do Not Require Resources	$ 165,106	$ 31,988	$ 5,767
FINANCING SOURCES YET TO BE PROVIDED	$ 173,671	$ 16,196	$ 9,023
NET COST OF OPERATIONS	$ 484,594	$ 1,292,537	$ 24,647

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

See notes 1 and 22.

Transportation	Component Level	Combined Total
$ 5,313	$ 0	$ 15,035,345
47	0	(14,763,644)
0	0	107,034
0	174,410	1,092,348
$ 5,360	$ 174,410	$ 1,471,083
$ 750	$ 0	$ 290,667
0	0	(126,261)
(6,110)	32,113	(28,939)
0	(206,522)	(206,522)
$ (5,360)	$ (174,409)	$ (71,055)
$ 0	$ 0	$ 146,122
0	0	56,739
$ 0	$ 0	$ 202,861
$ 0	$ 0	$ 198,890
$ 0	$ 1	$ 1,801,779

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

See notes 1 and 22.

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

Working Capital Funds

Footnotes to the Principal Statements

Note 1—Significant Accounting Policies

A. Basis of the 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 (WCF), as required by the Chief Financial Officers (CFOs) 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 WCF in accordance with "Department of Defense Financial Management Regulation" (DoDFMR), the Office of Management and Budget (OMB) Bulletin No. 97-01, "Form and Content of Agency Financial Statements" and to the extent possible, generally accepted accounting principles. The Air Force WCF financial statements are in addition to the financial reports also prepared by the United States Air Force pursuant to OMB directives that are used to monitor and control the Air Force's use of budgetary resources.

The Air Force WCF is unable to implement all elements of generally accepted accounting principles (GAAP) and OMB Bulletin No. 97-01 due to limitations of its financial management processes and systems, including nonfinancial feeder systems and processes. Reported values and information for the Air Force WCF major asset and liability categories are derived largely from nonfinancial feeder systems, such as inventory systems and logistic systems. These were designed to support reporting requirements focusing on maintaining accountability over assets and reporting the status of federal appropriations rather than applying the current emphasis of business-like financial statements. As a result, the Air Force WCF cannot currently implement every aspect of GAAP and the OMB Bulletin No. 97-01. The Air Force WCF continues to implement process and system improvements addressing the limitations of its financial and nonfinancial feeder systems.

There are other instances when the Air Force WCF has reviewed the intent of the standard and applied it in a manner consistent with the standard, but the auditors interpret the standard differently. Financial statement elements impacted include financing payments under fixed price contracts, operating materials and supplies (OM&S), and disposal liabilities.

A more detailed explanation of these financial statement elements is discussed in the applicable footnote.

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 Department of Defense (DoD) and made the Air Force a department within DoD. The overall mission of the Department 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. Fiscal year (FY) 2000 represents the fifth year that the Department will prepare and have audited, DoD

Agency-wide financial statements as required by the CFO Act and the GMRA.

In support of these objectives, 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 DoD. The DoD began operating under the revolving fund concept as early as July 1, 1951.

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

The accompanying financial statements account for all resources for which the Air Force Working Capital Fund is responsible except that information relative to classified assets, programs, and operations has been excluded from the statement or otherwise aggregated and reported in such a manner that it is no longer classified.

When possible, the financial statements are presented on the accrual basis of accounting as required by federal financial accounting standards. For fiscal year (FY) 2000, the Air Force Working Capital Fund's financial management systems are unable to meet all of the requirements for full accrual accounting. Efforts are underway to bring the Department of Defense's (DoD) systems into compliance with all elements of generally accepted accounting principles and OMB Bulletin No. 97-01.

C. Budgets and Budgetary Accounting

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 in the course of executing the Air Force's missions.

Revolving funds receive their initial working capital through an appropriation or a transfer of resources from existing appropriations of 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 ("the Fund") 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 proprietary accounts are used to develop the Report on Budget Execution, SF133 and Statement of Budgetary Resources for reporting budgetary data. Implementation of the CSMAS and DCD systems will result in budgetary data that is transaction-driven.

Supply Management

The Air Force Stock Funds were established within the DoD under 10 U.S.C. 2208, as described in DoD Directives 7420.13 and 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 more economical and efficient. A stock fund operates as a revolving fund acquiring inventories with funds received from prior sales to customers.

There are now five active business activities in the Supply Management Activity Group (SMAG). They are: Materiel Support Division (MSD), General Support Division (GSD), Medical-Dental Division, Fuels Division (including aviation, ground, missile and cost of operations fuels), and Academy Division. Troop Support is a residual activity.

Depot Maintenance

The Air Force Depot Maintenance activity group performs manufacturing, development and test work as well as aviation maintenance. Primarily in support of Air Force organizations, it also supports other DoD components, government agencies, and foreign governments. Due to a decreased force structure and technology advances, the Depot Maintenance 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 a great flexibility in addressing both wartime and peacetime workload changes. The Air Force Depot Maintenance activity group achieves this flexibility by employing the unique strengths of organic (in house) and contractor repair sources.

Base Support

1999 was the final year audited financial statements and footnotes were prepared for this business activity. Effective September 30, 1999 all remaining residual activity was transferred to the Supply Management Activity Group. The Air Force Base Support activity group consisted of residual accounting for the Laundry and Dry Cleaning Service, the Air Force commissary, and the San Antonio Real Property Maintenance Agency (SARPMA). The Laundry and Dry Cleaning Service provided laundry and dry cleaning and other textile services to the government, DoD, and other authorized activities and individuals worldwide using government-owned facilities. Primary customers were medical facilities serving Army, Marine, Navy, and Air Force installations. In FY 1995, the Laundry and Dry Cleaning Service was removed from the Defense Business Operations Fund (DBOF) and returned to the Air Force to be funded with Air Force O&M appropriations, except for accounting of residual unliquidated balances. The Air Force Commissary was decapitalized as a working capital fund and capitalized under the Defense Commissary Agency (DeCA). SARPMA was disestablished in 1989. Like laundry and dry cleaning, only residual accounting for unliquidated balances remains.

Transportation

Air Mobility Command's (AMC's) Air Force unique transportation responsibilities 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 unique transportation DBOF was established during FY 1993 and disestablished in FY 1995 in accordance with the Defense Working Capital Fund (DWCF) improvement plan. Only residual accounting of unliquidated balances remains.

Information Services—Air Force Central Design Activities

The Air Force Central Design Activities (CDAs) provide software design, development, maintenance, and technical support services. As of October 1, 1995, the Air Force CDA business area transferred to the DBOF. This transfer complied with PBD 433 in expanding the Information Services Business Area. Transfer procedures were set forth in DFAS-HQ/AB memo of May 3, 1995. The Central Design Activities included the Standard Systems Group and the Materiel Systems Group. Prior to this transfer, the CDAs were funded by Air Force Operations and Maintenance funds. During FY 1996, DFAS-Denver provided only interim accounting support because the CDAs accounting support was in transition to the Industrial Fund Accounting System (IFAS) and subsequent transfer to the Pensacola Operating Location. In FY 1997, the CDAs went on-line with IFAS and all financial reports, including the CFO Statements, are prepared at DFAS Cleveland and forwarded to DFAS Denver for inclusion with Air Force WCF statements.

United States Transportation Command (USTC)

For Audited Financial Statements (AFS) only, USTC is not reported with Air Force Working Capital Funds. In fiscal year 1998, the Office of the Under Secretary of Defense, Chief Financial Officer, directed DFAS to report USTC statements with Other Defense Organizations Working Capital Fund Consolidated statements. The USTC remains part of the Air Force Budget operations for all other financial reporting.

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

- Funding Authority—Prior to FY 1992, industrial fund activities were not issued funding documents. Activities now receive their 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.
- Minor Construction Funding—Policy and procedures have been changed to fund minor construction projects costing $100,000 or more, but less than $300,000, through a separate section of the capital budget and depreciate them over a 20 year period.
- Software Development Costs—Policy and procedures have been changed to move the development costs of new software meeting the time and cost thresholds (2 years or more and $100,000 or more) to the capital budget. Software releases will be amortized after release.

- Capital Budgeting—Activity group budgets are segregated into operating and capital budgets. Any investment in equipment, software, or minor construction, and other management improvements costing $100,000 or more with a useful life of 2 years or greater, are funded through the capital budget and their costs depreciated/amortized over the relevant life cycle.
- Asset Capitalization and Depreciation—The assets of the industrial and stock funds were transferred to DBOF and subsequently to WCF. The 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 established thresholds for prior years will continue to be depreciated if depreciation was being recorded prior to the increase to the $100,000 threshold.
- Rates and Prices—All Air Force activity group areas in 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 will not change during the year of execution.

The FY 2000 Air Force DWCF operations encompass 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.

D. Basis of Accounting

The Air Force's Working Capital Funds generally record transactions on an accrual accounting basis as is required by 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 Air Force 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 GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Government Standard General Ledger (SGL). Until such time as all of the processes are updated to collect and report financial information as required by GAAP, some of the Air Force's financial data will be based on budgetary obligations, disbursements, collection transactions, and nonfinancial feeder systems. One example is the information presented on the Statement of Net Cost. Most of this information 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 balances are not materially significant. In addition to the accrual basis of accounting, Depot Maintenance also uses the full absorption accounting principle. During

FY 1996, DFAS-DE, SAF/FMB, and OSD/FM jointly agreed on the use of this principle by Depot Maintenance. This means that depreciation and bad debt expenses are included in determining the cost of services sold. The effect of known intra-fund transactions are eliminated.

To the extent that guidance is not provided by the DoD Accounting Manual, DoD Components are allowed to follow other guidance promulgated by the Defense Finance and Accounting Service (DFAS), the General Accounting Office (GAO), the Office of Management and Budget (OMB), the Department of Treasury, the Federal Accounting Standards Advisory Board (FASAB), or the Financial Accounting Standards Board.

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 "crosswalked" 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 from becoming overly voluminous.

E. Revenues and Other Financing Sources

Revenue is recognized according to the percentage of completion method for depot maintenance and ordinance WCF activities. Revenue for supply management WCF activities is recognized when an inventory item is dropped from inventory for sale.

For financial reporting purposes, 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 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 until consumed in the Air Force's operations. Net increases or decreases in unexpended appropriations are recognized as a change in the net position.

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

Supply Management. Air Force Supply Management revenue is recognized at the point of sale under constructive delivery terms (normally dropped from inventory when an item is released from inventory or delivered to the customer). Foreign Military Sales (FMS) transactions additionally require proof of shipment before revenue is recognized. Generally, Supply Management revenue consists of sales at standard prices less sales return. Sales of MSD 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. Intra-division Supply Management Sales have been eliminated. Cash discounts and inter-fund retail stock loss allowances are additional revenue.

Depot Maintenance. The Under Secretary of Defense (Comptroller) directed, per memorandum dated January 1992, all 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. Air Force Depot Maintenance uses a method called incremental revenue recognition that basically agrees with the prescribed method. As Depot Maintenance completes a job order, revenue is recognized by either calculating the hourly sales rate or an end item sales price, depending on the type of workload. Within the Depot Maintenance activity group, organic revenue is generally recognized at job completion; however, the related expenses are accrued monthly. In addition, other contract revenue is based on the percentage-of-completion method augmented with prorations based on activity group policies.

Information Services. The Information Services Activity Group (ISAG) recognizes revenue in one of two ways as a service type organization based on the service level agreement between the customer and the provider. When the effort is priced on a "Level of Effort" basis, the revenue is recognized based on completed units (direct labor hours) times the stabilized rate plus any extraordinary contract costs (contract, program equipment, etc.) incurred by the activity. When the effort is priced on a "Firm Fixed Price" basis, the revenue is recognized each month as a percentage of completion. Operating expenses for activities are recognized in the period incurred. Expenditures for capital and other long-term assets are not recognized as expenses until depreciated.

F. Accounting for Intragovernmental 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 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 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 Air Force funds a portion of the civilian and military pensions. Reporting civilian pension under CSRS and FERS retirement systems is the responsibility of 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 OPM in the Statement of Net Cost; and recognizes corresponding imputed revenue for the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

The Department reports the assets, funded actuarial liability, and unfunded actuarial liability for the military personnel in the Military Retirement Fund (MRF) financial statements. The Department recognizes the actuarial liability for the military retirement health benefits in the Other Defense Organization column of the DoD Agency-wide statements.

To prepare reliable financial statements, transactions occurring between entities 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 intragovernmental transactions by customer. For FYs 1999 and 2000, the Air Force provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side departmental accounting offices and required the adjustment of the buyer-side records to recognize unrecorded costs and accounts payable. Internal DoD intragovernmental balances were then eliminated. In addition, the Air Force implemented the policies and procedures contained in the Intragovernmental Eliminations Task Force's "Intragovernmental Fiduciary Transactions Accounting Guide" for reconciling intragovernmental transactions pertaining to investments in federal securities, borrowings from Treasury and the Federal Financing Bank, Federal Employee Compensation Act transactions with the Department of Labor, and benefit program transactions with the OPM.

Each year, the DoD Components sells assets to foreign governments under the provisions of the Arms Export Control Act of 1976. Under the provision of the Act, the Department has authority to sell defense articles and services to foreign countries, generally at no profit or loss to the U.S. Government. Customers are required to make payments in advance.

G. Funds with the U.S. Treasury and Cash

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 Defense Finance and Accounting Service (DFAS) and Military Service and U.S. Army Corps of Engineers (USACE) disbursing stations, as well as Department of State financial service centers. Each disbursing station prepares monthly reports, which provide information to the U.S. Treasury on check issues, interagency transfers and deposits. In addition, the DFAS centers and the USACE Finance Center submit reports to Treasury, by appropriation, on collections received and disbursements issued. Treasury then records this information to the appropriation

Fund Balance With Treasury (FBWT) account maintained in the Treasury's system. Differences between the Air Force's recorded balance in the FBWT account and Treasury's FBWT often result and are reconciled. Material Disclosures are provided at Note 3.

H. Foreign Currency

Not applicable.

I. Accounts Receivable

As presented in the Balance Sheet statement, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The Department does not recognize an allowance for estimated uncollectible amounts from 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 uncollectible accounts based upon analysis of historical data from prior year accounts receivable balances, write-offs, and collection policy. Material disclosures are provided at Note 5.

J. Loans Receivable

Not Applicable.

K. Inventories and Related Property

Inventories are reported at approximate historical cost based on Latest Acquisition Cost (LAC) adjusted for holding gains and losses. The LAC method is used because inventory data is maintained in logistics systems designed for material management purposes. For the most part, these systems value inventory at selling prices or LAC and reported amounts must be adjusted, using a formula to approximate historical costs.

Within the Materiel Support Division, inventory is valued at either LAC or carcass. Carcass value is calculated within the pricing system and is included in any transaction when needed. Gains and losses that result from valuation changes for inventory items are recognized and reported in the net cost statement and included in the calculation of the cost of goods sold. Only the Supply Management activity group accounts for inventories. To calculate the allowances for gain or loss on inventories, an inventory worksheet is prepared monthly for each fund code within Supply Management Activity Group. Inventory is not applicable to the remaining Air Force activity groups.

The related property portion of the amount reported on the Inventory and Related Property line includes OM&S and stockpile materials. The OM&S are valued at standard purchase price. The Department is using both the purchase and the consumption method of accounting for OM&S, as defined in the SFFAS No. 3. "Accounting for Inventory and Related Property."

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

L. Investments in U.S. Treasury Securities

Not Applicable.

M. General Property, Plant and Equipment (PP&E)

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 2 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 should be capitalized. The Department has contracted with two certified public accounting (CPA) firms to obtain an independent assessment of the validity of the General PP&E capitalization threshold. At the conclusion of the studies, both CPA firms recommended that the Department retain its current capitalization threshold of $100,000. All General PP&E , other than land, is depreciated on a straight-line basis. 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 reported on WCF financial statements.

When it is in the best interest of the government, the Air Force provides to contractors government property necessary to complete contract work. 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, such should be included in the value of General PP&E reported on the Air Force's Balance Sheet. The Department recently completed a study that indicates that the value of General PP&E above the DoD capitalization threshold and not older than the DoD Standard Recovery Periods for depreciation, and that is presently in the possession of contractors, is not material to the Department's financial statements. Regardless, the Department is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Air Force currently reports only 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. Heritage Assets and Stewardship Land under the control of a WCF organization are reported on the Supplemental Stewardship Report of the applicable military department.

Material disclosures are provided at Note 10.

N. Advance 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. Information Services posts payments in advance that are applicable to travel advances. These advances are recognized as expenditures and expenses when the related goods and services are received. Depot Maintenance posted prepayments and deferred charges to intragovernment and with the public. For all the other Air Force activity groups, this area is not applicable.

O. Leases

Not Applicable.

P. 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 these long-term contracts can cause, the Air Force provides financing payments. One type of financing payment that the Air Force makes 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 Air Force makes financing payments under fixed price contracts that are not based on a 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 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 costs and the contractor is liable to repay the Air Force for the full amount of the advance. The Air Force does not believe that the SFFAS No. 1 addresses this type of financing payment. The auditors disagree with the Air Force's application of the accounting standard pertaining to advances and prepayments because they believe that the SFFAS No. 1 is applicable to this type of financing payment.

Q. 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 involve 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 it is probable that the future event or events will confirm the loss or the incurrence of a liability for the reporting entity 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 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, ship and vehicle accidents, medical malpractice, property or environmental damages, and contract disputes.

R. Accrued Leave

Civilian annual leave and military leave are accrued as earned and the accrued amounts are reduced as leave is taken. The balances for annual and military leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken.

S. Net Position

Net Position consists of unexpended appropriations and cumulative result 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 been incurred. Only Supply Management has unexpended appropriations.

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

T. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other facilities, which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. DoD capital assets overseas are purchased with appropriated funds; however, title to land and improvements is retained by the host country. 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 which allow for the continued use by the DoD. Therefore, in the event treaties or other agreements are terminated whereby use of foreign bases is no longer allowed, losses will be recorded for the value of any nonretrievable capital assets after negotiations between the United States and the host country have been concluded to determine the amount to be paid the United States for such capital investments.

U. Comparative Data

The OMB has waived the requirement to present comparative financial statements for FY 2000.

V. Undelivered Orders

The Air Force 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.

Note 2—Assets

As of September 30, 2000

(Amounts in thousands)

Total Entity Assets:	20,439,864
Total Assets:	$ 20,439,864

Note 3—Fund Balance with Treasury

As of September 30, 2000

(Amounts in thousands)

1. Fund Balances:

Revolving Funds		214,627

2. Fund Balances Per Treasury Versus Agency:

A. Fund Balance per Treasury	$	542,600
B. Fund Balance per AF WCF		214,627
C. Reconciling Amount	$	327,973

3. Explanation of Reconciliation Amount: A reconciling amount of ($303.06) in SMAG, FC 64 is being investigated. A transfer of $327,973K represents cash transferred to Other Defense Organizations for United States Transportation Command (USTC). The transfer of USTC is for CFO reporting only. See footnote 1.C.2. paragraphs in the USTC footnotes.

4. Other Information Related to Fund Balance with Treasury: The Fund Balance with Treasury does not include any amounts for which the Department of the Treasury is willing to accept corrections to canceled appropriation accounts, in accordance with SFFAS Number 1, "Accounting for Selected Assets and Liabilities".

The FBWT number for Supply Management is ($263,811,983.81). A negative balance for the Materiel Support Division (MSD) is the primary cause. SAF/FMBMR has provided a disclosure which can be found in the SMAG footnotes.

Fund Balances with Treasury are maintained at the Air Force DWCF 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 Department of Defense level. In 1996, the DWCF was established and the FBWT was given back to the Air Force level. However, the allocation of FBWT was at a lower level than the level transferred out. (The cash balance had been maintained at 10 days worth of cash. 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.

In addition, the policy of full cost recovery was put in place when DBOF was established (1992). At the same time the reparable spares were capitalized into the SMAG from the general funds general ledger. These two changes drove significant changes to the development of surcharge rates now called cost recovery rates. In 1997, the Materiel Support Division was formed as a merger of Reparable Support Division, Systems Support Division and the Cost Of Operations Division. Also, the entire pricing and cost recovery development process was changed as an attempt to improve the process. MSD is the only division of SMAG which includes both the overhead costs and repair costs. Combining this with changing flying hour programs, base closures, and continuing peace keeping missions, means budgeting and pricing for MSD was severely challenged. Each year, since inception, the MSD pricing computation had to be changed to meet the changing missions.

On Line Payment and Collection (OPAC) Differences—Any differences are reported with Air Force General Fund statements.

Check Issue Discrepancy—Any differences are reported with Air Force General Fund statements.

Note 4—Investments

Not Applicable.

Note 5—Accounts Receivable

As of September 30, 2000 (Amounts in thousands)	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
1. Intragovernmental Receivables:	$ 729,449	N/A	$ 729,449
2. Nonfederal Receivables (From the Public):	$ 76,083	$ (2,505)	$ 73,578
3. Total Accounts Receivables:	$ 805,532	$ (2,505)	$ 803,027

4. Allowance method: The Supply Management activity group uses an allowance method based on historical data from prior year accounts receivable balances, write-offs, and collection policy. Review of individual accounts receivable transferred to DFAS-Denver, Debt Management Operations Division, often reveals invalid receivables that the Standard Base Supply System should have posted as an issue without reimbursement, instead of a sale. Depot Maintenance generally uses the direct write-off method for uncollectible accounts.

5. Other information: Intragovernmental Accounts Receivable. 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 intragovernmental accounts receivable balances with its trading partners. The Department 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 reconciliation can not be accomplished with the existing or foreseeable resources.

Guidance was issued by DFAS Arlington to reclassify Foreign Military Sales Trust Fund receivables as public rather than government.

Prior to FY 2000, DMAG sales and services provided to the foreign military sales trust fund were considered intragovernmental for statement preparation and eliminating entry purposes. Beginning with FY 2000, these transactions are now treated as nongovernmental. This change reclassified approximately $9.6 million in accounts receivable and $70.7 million in revenue from governmental to nongovernmental for the FY 2000 statements.

Note 6—Other Assets

As of September 30, 2000

(Amounts in thousands)

1. **Intragovernmental Other Assets**—Advances and Prepayment	$	65,592
2. **Nonfederal Other Assets**—Other Assets (With the Public)		790,490
3. **Total Other Assets:**	$	856,082

4. Other Information Related to Other Assets: The Air Force has reported outstanding financing payments for fixed price contracts as an advance and prepayment, because under the terms of the fixed price contracts, 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 costs and the contractor is liable to repay the Air Force for the full amount of the advance. The Air Force does not believe that the SFFAS No. 1, Accounting for Selected Assets and Liabilities addresses this type of financing payment. The auditors disagree with the Air Force's application of the accounting standard pertaining to advances and prepayments because they believe that the SFFAS No. 1 is applicable to this type of financing payment.

ISAG—All other assets for ISAG represent travel advances of $17,000. ISAG reflects a decrease in Other Assets due to a change in crosswalks. Previously, Other Intragovernmental Assets reflected the values of GLA 1315, Refunds Receivable. For FY 2000 Accounts Receivable correctly includes the amount of Refunds Receivable.

DMAG—Other Assets With the Public, consists of USSGL 1410, Advances to Others, in the amount of $22,456,000 and USSGL 1450, Prepayments, in the amount of $2,617,000.

SMAG—The majority of other assets are reported by five Air Logistics Centers as sales of Materiel Support Division (MSD) assets to foreign governments. These deliveries cannot be billed until each delivery is matched to a proof of shipment within SAMIS. The Other Nonfederal Assets account consists of the following categories and dollar amounts, in thousands:

The total SMAG other assets consists of the following:

- Other assets accounts receivable—deliveries suspense: $475,241,000
- Air Force assets—other DoD FMS (depot): $2,071,000

- ▲ Other assets uncollected federal excise taxes: $1,740,000
- ▲ Other assets returns to vendors pending credit: $168,141,000
- ▲ Other assets miscellaneous other assets: $10,589,000

Note 7—Cash and Other Monetary Assets

As of September 30, 2000

(Amounts in thousands)

Cash	$	102

The $102,000 is comprised of two entities:

- ✦ SMAG—$24,000 for fuels is an undeposited collection.
- ✦ ISAG—$78,000, representing undeposited collections, was a posting error at Pensacola during September processing. It has since been corrected in October 2000.

Note 8

Not Applicable.

Note 9—Inventory and Other Related Property

As of September 30, 2000

(Amounts in thousands)

Inventory, Net (Note 9.A.)	$	16,398,921
Operating Materials & Supplies, Net (Note 9.B.)		911,737
Total	$	17,310,658

Note 9.A—Inventory, Net

As of September 30, 2000

(Amounts in thousands)

		Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method
1. Inventories Categories:					
A. Available and Purchased for Resale	$	16,822,047	$ (12,237,068)	$ 4,584,979	Adj LAC
B. Held for Repair		10,451,341	0	10,451,341	O
C. Excess, Obsolete, and Unserviceable		119,303	0	119,303	O
D. Work in Process		1,243,298	0	1,243,298	Adj LAC
E. Total	$	28,635,989	$ (12,237,068)	$16,398,921	

Legend for Valuation Methods

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

2. Restrictions of Inventory Use, Sale, or Disposition: Normally all items in the inventory are sold. Under rare situations, issues without reimbursement are made when authorized by DoD directives.

3. Definitions of Columns Titles. Inventory, Gross Value represents the standard value used for inventory transactions in the financial system. Revaluation Allowance is the total difference between standard inventory values and either historical cost or net realizable value. Inventory, Net is approximate historical cost or net realizable value.

4. Other Information: Inventory data reported on the financial statements are derived from logistics systems designed for material management purposes. These systems do not maintain historical cost data necessary to comply with the Statement of Federal Financial Accounting Standard (SFFAS) No. 3, "Accounting for Inventory and Related Property." In addition, while these logistics systems provide management information on the accountability and visibility over inventory items, the timeliness at which this information is provided creates issues regarding the categorization of Inventory as held for use, held in reserve for future use, or excess, obsolete, and unserviceable. Furthermore, past audit results have led to uncertainties pertaining to the completeness and existence of the inventory quantities used to derive the values reported in the financial statements.

Supply Management is the only Air Force Activity group that has inventory. The Supply Management activities maintain day-to-day individual inventory stock records on items valued in the supply systems at Latest Acquisition Cost (LAC). This valuation method is per the direction of the DoD Comptroller. These values are based on prices paid for recently acquired items. However, the values are adjusted downward for unserviceable, anticipated excess, and anticipated condemnation items.

The unserviceable inventories are not valued at standard price. They are valued at forecast acquisition cost less repair cost. Unserviceable inventories applies to the Materiel Support Division which is the only activity that carries depot-level repairable items. Potential excess, obsolete and beyond repair inventory is not valued at standard. It is the net realized value which is 1.8 percent of acquisition cost.

The Inventory Held for Repair includes inventory awaiting repair or being repaired at a base maintenance facility, a depot maintenance facility, or a contractor repair facility. All three of those categories are supported by details in the appropriate logistics system and are reconciled to the general ledger account monthly.

Included in the Inventory Held for Sale balance is Inventory Intransit between Storage Locations. There are no logistics system details to support this balance. It is computed as part of the home office function by subtracting the Inventory Transferred In from the Inventory Transferred Out general ledger accounts. The difference is the Inventory Intransit balance.

Work-In Process (WIP) is used to value that portion of the maintenance contract that has been completed. The value of WIP is used in the cost of goods computation and appears on the AR(M)1307 report. A comparison of current and prior year WIP indicates an increase in contract labor and material. DMAG recognizes revenue incrementally. As job orders are completed, revenue is recognized by multiplying the completed job order by the appropriate sales rate. Since job orders can be associated with a specific contract, it can be said that a portion of that contract has been completed.

Note 9.B—Operating Materials and Supplies, Net

As of September 30, 2000

(Amounts in thousands)	OM&S Amount	OM&S, Net	Valuation Method
1. OM&S Categories:			
Held for Use	$ 911,737	$ 911,737	SP

Legend for Valuation Methods

SP = Standard Price

2. Definitions: OM&S Amount represents the standard value used for OM&S transactions in the financial system. OM&S, Net is the approximate historical cost or net realizable value.

3. Restrictions on Operating Materials and Supplies. All Air Force activity groups, except Supply Management, have operating materials and supplies. The activity groups use these materials and supplies in support of their respective missions.

4. Other Information: Operating Materials & Supplies (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 Standard (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, the timeliness at which this information is provided creates issues regarding the categorization of OM&S as held for use, held in reserve for future use, or excess, obsolete, and unserviceable. Furthermore, past audit results have led to uncertainties pertaining to the completeness and existence of OM&S quantities used to derive the values reported in the financial statements.

The Air Force attempts to use the consumption method of accounting for OM&S unless the Air Force believes the OM&S to be in the hands of the end user for use in normal operations. As stated above, current financial and logistics systems can not 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; and (3) identifying feeder systems that are used to manage OM&S items and develop plans to revise those systems to support the consumption method. However, for fiscal year 2000, significant portions of the Air Force's OM&S were reported under the purchase method because either the systems could not support the consumption method of accounting or because management believes the item to be in the hands of an end user. In some cases, the auditors disagree with the Department's determination that the items are in the hands of the end user.

The U.S. Government Standard General Ledger (USG SGL) does not include an account for OM&S held for repair, nor does OMB's government-wide Form and Content guidance provide for specific footnote disclosure of the OM&S held for repair. Accordingly, no amount was disclosed last year for OM&S held for repair.

The value of Air Force government furnished material (GFM) and contractor acquired material (CAM) in the hands of contractors is generally 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 annually collect and report required information without duplicating information already in other existing logistics systems.

Note 10—General PP&E, Net

As of September 30, 2000

(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
1. Major Asset Classes:					
A. Buildings, Structures, Facilities	SL	20 or 40	$ 873,513	$ (497,255)	$ 376,258
B. Software	SL	5	314,844	(160,829)	154,015
C. Equipment	SL	5 or 10	1,914,269	(1,332,015)	582,254
D. Construction-in-Progress	N/A	N/A	142,841	N/A	142,841
E. Total General PP&E			$ 3,245,467	$ (1,990,099)	$ 1,255,368

Legend for Depreciation/Amortization Methods

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

2. Other Information: In Fiscal Year 2000, real property reported by the Automated Civil Engineering System (ACES), personal property reported by the Air Force Equipment Management System (AFEMS), and the Information Processing Management System (IPMS), data has not been validated and reconciled to reported figures received from the field activities.

Any WCF Special Tools and Special Test equipment in the possession and control of the Air Force are reported in the Air Force General Funds financial statements.

The value of Air Force 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 an approved strategy with the Office of Management and Budget, the General Accounting Office and the Inspector General, DoD, is developing new policies and a contractor reporting process to capture General PP&E information for future reporting purposes for compliance with federal-wide accounting standards.

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

Note 11—Liabilities Not Covered by Budgetary Resources

As of September 30, 2000

(Amounts in thousands)

1. Liabilities Not Covered by Budgetary Resources		
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	$	198,890
2. Liabilities Covered by Budgetary Resources		3,766,338
3. Total Liabilities:	$	3,965,228

4. Other Information: Amount of $198,890,000 (Military Retirement Benefits and Other Employment-Related Actuarial Liabilities) represents AFWCF FY2000 Workmen's compensation. Amounts are broken out among activity groups as follows:

- SMAG: 16,196,000
- DMAG: 173,671,000
- ISAG: 9,023,000

See notes 12, 15, and 16.

Note 12—Accounts Payable

As of September 30, 2000

(Amounts in thousands)	Accounts Payable	Total
1. Intragovernmental:	$ 192,597	$ 192,597
2. With the Public:	$ 201,906	$ 201,906
3. Total	$ 394,503	$ 394,503

4. Other Information: Intragovernmental Accounts Payable. For the majority of buyer-side transactions, the Air Force WCF'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 WCF was unable to reconcile intragovernmental accounts payable balances with its trading partners. The Department 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 reconciliation can not be accomplished with the existing or foreseeable resources.

The abnormal public balance is a result of posting Undistributed Disbursements. Component is not a true business activity and as such carries no accounts receivable or payable. Amounts reported for accounts receivable and payable are a result of posting undistributed collections to accounts receivable and undistributed disbursements to accounts payable. The effect of posting normal balance undistributed always results in abnormal balances. for accounts receivable and payable. In Component's case, because of the transfer of undistributed to this business activity, the transfer drove public accounts payable abnormal not only in Component but at the consolidated Air Force level as well.

Two ALCs within DMAG reported abnormal accounts payable balances in September, San Antonio with $30,712,000 and Warner Robins (Contract) with $33,439,000. Warner Robins, Organic had only an abnormal balance for public accounts payable, $92,000. These abnormal balances were adjusted up to a zero balance using expense as the contra. San Antonio's abnormal balance was created by a large amount in undistributed disbursements which is a debit balance. Warner Robins' abnormal balance was created through a systems problem. Transactions were established at the wrong price due to the D035A system sending random wrong price indicators to the G072D system. This problem has been reported through a Discrepancy Report to the Ogden Megacenter.

See notes 11, 15, and 16.

Note 13

Not Applicable.

Note 14

Not Applicable.

Note 15—Other Liabilities

As of September 30, 2000

(Amounts in thousands)

	Current Liability	Noncurrent Liability	Total
1. Intragovernmental:			
A. Advances from Others	$ 11,826	$ 0	$ 11,826
B. Deposit Funds and Suspense Account Liabilities	1,740	0	1,740
C. Other Liabilities	11,813	0	11,813
D. Total Intragovernmental Other Liabilities	$ 25,379	$ 0	$ 25,379
2. Nonfederal:			
A. Accrued Funded Payroll and Benefits	$ 154,204	$ 0	$ 154,204
B. Advances from Others	909	0	909
C. Nonenvironmental Disposal Liabilities: Other	(985)	0	(985)
D. Other Liabilities	3,179,108	13,220	3,192,328
E. Total Nonfederal Other Liabilities	$ 3,333,236	$ 13,220	$ 3,346,456
3. Total Other Liabilities	$ 3,358,615	$ 13,220	$ 3,371,835

4. Other Information Pertaining to Other Liabilities: Based upon the Air Force's interpretation of the Statement of Federal Financial Accounting Standard (SFFAS) No. 5, an environmental disposal liability is recognized for the asset when management makes a formal decision to dispose of the asset. The Air Force's auditors disagree with this interpretation of the standard. Their interpretation is that the environmental liability recognition should begin at the time the asset is placed in service. This issue raised by the auditors is one that has government-wide implications for all agencies. Until the issue is resolved on a government-wide basis, the DoD continues to adhere to the explicit literal provisions of SFFAS No. 5.

ISAG	Intragovernmental Advances from Others:	84,000 (Air Force Operations and Maintenance)
	Nonfederal other Liabilities:	
	Accrued Contractual Services:	117,348,000
	Accrued Travel and Transportation	3,565,000
	Miscellaneous Other Liabilities	3,124,000

See notes 11, 12, and 16.

Note 16

Not Applicable.

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

As of September 30, 2000 (Amounts in Thousands)	Actuarial Present Value of Projected Plan Benefits	Unfunded Actuarial Liability
1. Total Military Retirement Benefits and Other Employment-Related Actuarial Liabilities:		
Workmen's Compensation (FECA)	$ 198,890	$ 198,890

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

Actuarial Cost Method Used:

Assumptions: Market Value of Investments in Market-based and Marketable Securities:

Future workers' compensation (FWC) figures are provided by the Department of Labor (DOL). The liability for FWC benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period.

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

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

Assumptions: Consistent with past practice, these projected annual benefit payments have been discounted to present value using the OMB's economic assumptions for 10-year Treasury notes and bonds.

The interest rate assumptions utilized for discounting were as follows:

2000
6.15% in Year 1,
6.28% in Year 2,
6.30% in Year 3, and thereafter

To provide more specifically for the effects of inflation on the liability for FWC benefits wage inflation factors, cost of living adjustments (COLAs) and medical inflation factors, consumer price index medical (CPIMs), were applied to the calculation of projected future benefits. These factors were also used to adjust the methodology'' historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections were as follows:

FY	COLA	CPIM
2000	1.97%	3.69%
2001	2.83%	4.24%
2002	2.90%	4.10%
2003	2.53%	4.16%
2004+	2.60%	4.16%

The model's resulting projections were analyzed to insure that the amounts were reliable. The analysis was based on three tests:

1. A comparison was done of the new model's prior year projected payments for the current year to the actual payments.
2. A comparison was done of the change in the liability amount by agency to the change in the aggregate liability.
3. A comparison was done of the historical payment data imported into the new model to the benefit payment in prior years.

Note 18—Unexpended Appropriations

As of September 30, 2000

(Amounts in Thousands)

1. Unexpended Appropriations:		
Unobligated, Available	$	63,971

2. Other Information Pertaining to Unexpended Appropriation: 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 on the Statement of Financing, which includes the change during the fiscal year in unexpended obligations against budget authority from all sources.

Only Supply Management has unexpended appropriations. Undelivered orders used in the calculation of net position includes both Undelivered Orders-Unpaid and Undelivered Order-Paid for Direct Appropriated funds.

Note 19—General Disclosures Related to the Statement of Net Cost

Imputed Expenses

As of September 30, 2000

(Amounts in thousands)

1. Civilian (CSRS/FERS) Retirement	$	43,428
2. Civilian Health	$	63,436
3. Civilian Life Insurance		170
4. Total Imputed Expenses	$	107,034

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

As of September 30, 2000

(Amounts in thousands)

1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance:		
Other Prior Period Adjustments		(1,419,599)
2. Imputed Financing:		
A. Civilian CSRS/FERS Retirement	$	43,428
B. Civilian Health		63,436
C. Civilian Life Insurance		170
D. Total Imputed Financing	$	107,034

3. Other Information: The DMAG prior period adjustments are to correct errors or omissions in prior year accounting reports.

Davis Monthan has a prior period adjustment of ($1,118,000) to correct an FY99 end of year 1307 Report miscalculation. Research revealed the September, 1999, 1307 Report overstated Accumulated Operating Results (AOR) by this amount which was the result of a formula error that caused the FY99 prior period adjustment to be posted on the 1307 Report in the wrong sign. This meant that the $559,000 FY99 prior period adjustment was doubled in the calculation of AOR, and therefore, AOR was overstated.

Ogden Air Logistics Center (ALC) has a prior period adjustment of $623,000 to correct an FY99 end of year 1307 report miscalculation. Research revealed the September, 1999 1307 Report understated AOR by this amount which was the result of a formula error that caused the FY99 prior period adjustment to be posted on the 1307 Report in the wrong sign. This meant that the $311,000 FY99 prior period adjustment was doubled in the the calculation of AOR, and therefore, AOR was understated.

ISAG has a prior period adjustment of ($4,170) that is the net of the write off for an unsupported balance for travel advances recorded in FY96 ($1,000) and write off of an erroneous balance for Commercial Accounts Payable and Government Accounts Payable recorded in FY97.

Financing Sources, Other, on the Statement of Changes in Net Position, is composed of the following:

ISAG—$18,801,000 (reclassified from account 5790, Invested Capital Used, to account 7190, Other Gains)

SMAG—$370,987,000 (reclassified from account 5790, Invested Capital Used, to account 7190, Other Gains)

Total—$389,788,000

Note 21—Disclosures Related to the Statement of Budgetary Resources

As of September 30, 2000

(Amounts in thousands)

1. Net Amount of Budgetary Resources Obligated for Undelivered at the End of the Period	$ 5,139,151
2. Available Borrowing and Contract Authority at the End of the Period	$ 700,863

3. Other Information:

Undelivered Orders Presented in Statement of Budgetary Resources: Undelivered Orders presented in the Statement of Budgetary Resources includes Undelivered Orders-Unpaid for both Direct and Reimbursable funds. It does not include Undelivered Orders-Paid.

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 Statement of Budgetary Resources), are not included in "Spending Authority From Offsetting Collections and Adjustments" line of the Statement of Budgetary Resources or the "Spending Authority for Offsetting Collections and Adjustments" line of the Statement of Financing.

The consolidated Statements of Budgetary Resources for Air Force Component, DMAG, and SMAG differ from September 30, 2000, SF 133s because of the Rebaselining Initiative. A complete set of DFAS Arlington guidance which includes spreadsheets documenting required adjustments is on file at DFAS AAC/DE and is available upon request.

Note 22—Disclosures Related to the Statement of Financing

Transfers In and Out of property for General and Working Capital Funds; and transfers of collections and disbursements to the Component level for applicable Defense Working Capital Funds which are reflected on the Statement of Changes in Net Position and are not included in the Statement of Financing.

Because this is a combining statement, interagency eliminations are not required.

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 and the statement of financing. Statement of financing costs capitalized on the balance sheet has been adjusted to make the two statements match. Differences between budgetary and proprietary data for Department of the Defense General Funds is a previously identified deficiency. During FY 2001 DoD will develop alternative procedures to better prepare the statement of financing for FY 2001 AFS reporting.

Note 23

Not Applicable.

Note 24—Other Disclosures

Unmatched Disbursements, Negative Unliquidated Obligations, and Aged In-Transit Disbursements (In Thousands):

WCF Funds	September 1999	September 2000	Change	Percent Change
Unmatched Disbursements*	$ 6,311	$ 2,996	$ (3,315.00)	(53%)
Negative Unliquidated Obligations**	39,288	17,692	(21,596)	(55%)
Aged In-Transit Disbursements***	22,173	3,990	(18,183)	(82%)
Totals	$ 67,772	$ 24,678	$ (43,094)	(63%)

* Net totals of contract payment notice rejects, Inter-service, and Recons. CPN rejects total $723,000. MAFR rejects are now included as Intransits. There were no Air to Air rejects. Cross Disbursing rejects $44,000. Recons difference $2.229 million. The net change is coming from CPN rejects decreasing $6.2 million, Air to Air decreasing $1.2 million, Cross Disbursing decreasing $750,000, and Recons increasing $4.8 million.

** Unobligated NULOs, including those awaiting correction from paying station. At the end of FY 00, obligated and unobligated NULOs totaling $24.6 million were reported at accounting classification reference number (ACRN) level (gross) compared to $47 million in Sep 99. Of the $24.6 million, $5.2 million were 0 to 120 days old, $1.6 million were 121 to 180 days old, and $17.8 million were over 180 days old.

*** Treasury Variance is no longer a category of Intransits per DFAS-HQ instruction. Treasury Variance is still a part of Undistributed. Intransits now includes MAFR Rejects. FY00 MAFR Rejects greater than 60 days total $922 thousand.

DFAS-HQ performance contract set a goal to reduce Problem Disbursements and Intransits by 75 percent by September 2000 from September 1998 base line. DFAS-DE has achieved this goal.

These figures do not include the Military Sealift Command and Military Traffic Management Command pieces of the U.S. Transportation Command.

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Working Capital Funds

Required Supplementary Information

Schedule, Part A DoD Intragovernmenal Asset Balances Which Reflect Entity Amount with Other Federal Agencies:	Treasury Index:	Accounts Receivable:	Other:
Department of Agriculture	12	28	
Department of the Interior	14	6	
Department of Justice	15	597	
Department of the Navy, General Funds (GF)	17	16,124	
United States Postal Service	18	1	
Department of State	19	2,126	
Department of the Treasury	20	214	
Department of the Army, GF	21	5,329	
Department of Veterans Affairs	36	354	
General Service Administration	47	1,984	
Department of the Air Force, GF	57	629,705	796
Environmental Protection Agency	68	2	
Department of Transportation	69	1,336	
Small Business Administration	73	4	
Department of Health and Human Services	75	2	
National Aeronautics and Space Administration	80	7,924	
Department of Energy	89	2,310	
U.S. Army Corps of Engineers (Civil Works)	96	805	
Department of the Army, WCF	97-4930-001	1,218	2,646
Department of the Navy, WCF	97-4930-002	9,387	
Other Defense Organizations, GF	97	35,055	2
Other Defense Organizations, WCF	97-4930	14,939	62,149
Total		729,449	65,593

Schedule, Part B DoD Intragovernmenal Entity Liabilities Which Reflect Entity Amounts with Other Federal Agencies:	Treasury Index:	Accounts Payable:	Other:
Department of the Navy, General Funds (GF)	17	908	537
Department of the Treasury	20		1,741
Department of the Army, GF	21	2,370	1
Office of Personnel Management	24		11,818
Department of the Air Force, GF	57	17,163	10,844
National Aeronautics and Space Administration	80		18
Department of Energy	89		13
Department of the Army, WCF	97-4930-001	15,187	1
Department of the Navy, WCF	97-4930-002	3,352	79
Other Defense Organizations, GF	97	1,678	298
Other Defense Organizations, WCF	97-4930	151,938	34
Total		192,597	25,384

Schedule, Part C DoD Intragovernmental Revenues and Related Costs with Other Federal Agencies:	Treasury Index:	Earned Revenue:
Executive Office of the President, Defense Security Assistance Agency	11	356
Department of Agriculture	12	33
Department of Commerce	13	6
Department of the Interior	14	5
Department of Justice	15	8,024
Department of the Navy, General Funds (GF)	17	230,572
United States Postal Service	18	3
Department of State	19	2,068
Department of the Treasury	20	2,737
Department of the Army, GF	21	54,179
Department of Veterans Affairs	36	44
General Service Administration	47	3,332
National Science Foundation	49	37
Department of the Air Force, GF	57	9,029,442
Environmental Protection Agency	68	2
Department of Transportation	69	2,338
Small Business Administration	73	11
Department of Health and Human Services	75	58
National Aeronautics and Space Administration	80	23,643
Department of Energy	89	20,451
U.S. Army Corps of Engineers (Civil Works)	96	805
Department of the Army, WCF	97-4930-001	5,094
Department of the Navy, WCF	97-4930-002	52,216
Other Defense Organizations, GF	97	901,184
Other Defense Organizations, WCF	97-4930	781,838
Total		11,118,479

Schedule, Part E DoD Intragovernmenal Nonexchange Revenues:	Treasury Index:	Nonexchange Revenue	
		Transfers-in	Transfers-Out
Other Defense Organizations, WCF	97-4930	229,402	378,445
Total		229,402	378,445

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Working Capital Funds

Audit Opinion

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

February 7, 2001

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 2000 Air Force Working Capital Fund Financial Statements (Project No. D-2001FD-0051.02)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. We delegated to the Air Force Audit Agency (AFAA) the audit of the FY 2000 Air Force Working Capital Fund financial statements. Summarized as follows are the AFAA disclaimer of opinion on the FY 2000 Air Force Working Capital Fund financial statements, and the results of our review of the AFAA audit. The information provided in this memorandum contains reasons for the AFAA disclaimer. We endorse the disclaimer of opinion expressed by AFAA.

Disclaimer of Opinion. The AFAA disclaimer of opinion on the FY 2000 Air Force Working Capital Fund financial statements, dated February 7, 2001, states that AFAA was unable to express an opinion on the financial statements. We concur with the AFAA disclaimer of opinion. The AFAA disclaimer of opinion concludes that the financial information was unreliable and financial systems and processes, as well as associated internal control structures, were inadequate to produce reliable financial information, as indicated in the following examples:

- Air Force supply management systems did not provide sufficient audit trails to confirm and value the in-transit inventory reported as part of inventory held for sale on the Balance Sheet.
- Air Force depot maintenance systems lacked a transaction-driven general ledger supported by appropriate subsidiary ledgers and special journals. In addition, the depot maintenance systems did not perform percentage-of-completion accounting or properly account for cost of goods sold and work-in-process.
- The Air Force Working Capital Fund property, plant, and equipment valuation are unverifiable.
- The Air Force Working Capital Fund general ledger was inconsistent with the U.S. Government Standard General Ledger.

Internal Controls. The AFAA tested internal controls but did not express a separate opinion because opining on internal controls was not one of its objectives. However, AFAA determined that internal controls did not provide reasonable assurance of achieving the internal control objectives described in Office of Management and Budget Bulletin 01-02, "Audit Requirements for Federal Financial Statements," dated October 16, 2000. For example, the Air Force was unable to provide supporting documentation for $22.6 million of disbursement transactions and $516.9 million in open obligations. Additionally, the Defense Finance and Accounting Service made $4.2 billion in improper and unsupported monthly adjustments and $31.9 billion in improper and unsupported year-end adjustments to the Air Force Working Capital accounting records. The Air Force and the Defense Finance and Accounting Service recognized many of the financial reporting weaknesses and reported them in their FY 2000 Annual Statements of Assurance. Details on the internal control weaknesses will be provided in separate AFAA reports.

Compliance With Laws and Regulations. AFAA identified areas of noncompliance with laws and regulations. Under the Federal Financial Management Improvement Act of 1996, AFAA work showed that the financial management systems did not substantially comply with Federal financial management system requirements, applicable Federal financial accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

Review of Air Force Audit Agency Work. To fulfill our responsibilities for determining the accuracy and completeness of the independent work that AFAA conducted, we reviewed the audit approach and planning and monitored progress at key points. We also performed other procedures to determine the fairness and accuracy of the approach and conclusions.

We reviewed the AFAA work on the FY 2000 Air Force Working Capital Fund financial statements from November 21, 2000, through February 7, 2001, in accordance with generally accepted Government auditing standards.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

OFFICE OF THE SECRETARY

7 February 2001

To the Acting Secretary of the Air Force
Chief of Staff, USAF

We were engaged to audit the Air Force Working Capital Fund financial state-ments for the fiscal year ended 30 September 2000. The annual financial statements consist of the Balance Sheet and related Statement of Net Cost, Statement of Change in Net Position, Statement of Budgetary Resources, and Statement of Financing. Preparation of the financial statements is the responsibility of the Defense Finance and Accounting Service (DFAS) and Air Force management. This report presents our independent opinion on the financial statements, evalua-tion of the effectiveness of internal controls over financial reporting, and assessment of compliance with laws and regulations.

Opinion on the Financial Statements

We were not able to obtain sufficient evidential matter, or to apply other auditing procedures, to satisfy ourselves as to the fairness of the Air Force Working Capital Fund financial statements. Therefore, in accordance with Government Auditing Standards and the provisions of Office of Management and Budget (OMB) Bulletin 01-02, Audit Requirements for Federal Financial Statements, 16 October 2000, we are unable to express, and we do not express, an opinion on the reliability of the Air Force Working Capital Fund financial statements for the fiscal year ended 30 September 2000. As a result of our inability to audit, we concluded the amounts reported in the consolidated financial statements and related notes may not provide reliable information for government and public decision-making purposes.

We base our disclaimer on the inability of Air Force and DFAS to correct previ-ously reported material deficiencies that affect the reliability of the Air Force Working Capital Fund Fiscal Year (FY) 2000 financial statements. The Air Force and DFAS continue their efforts to improve financial reporting; however, the financial systems and processes, as well as the associated internal control structure, remain inadequate to produce reliable financial information. For example:

- Air Force supply management systems still did not provide sufficient audit trails to confirm and value the in-transit inventory reported as part of inventory held for sale on the Balance Sheet.

- Air Force depot maintenance systems lacked a transaction-driven general ledger supported by appropriate subsidiary ledgers and special journals. Also, the depot maintenance systems did not perform percentage-of-completion accounting or properly account for cost of goods sold and work-in-process.
- The Air Force Working Capital Fund property, plant, and equipment (PP&E) valuation continued to be unverifiable.
- The Air Force Working Capital Fund general ledger was inconsistent with the U.S. Government Standard General Ledger.

REQUIRED SUPPLEMENTARY INFORMATION

The Required Supplementary Information for Deferred Maintenance is not a re-quired part of the Air Force Working Capital Fund principal financial statements. Therefore, we did not audit, and do not express an opinion on, such information. Further, we did not apply certain procedures prescribed by professional standards because the information reported derives from the same data sources as the finan-cial statements and, as such, may not provide a reliable source for the information.

MANAGEMENT INITIATIVES

The Air Force and DFAS continue actions to improve Air Force Working Capital Fund financial data accuracy and reporting. Examples of ongoing initiatives that should contribute to this goal are discussed below. During future audits, we will evaluate the effectiveness of these actions.

- In the supply management area, the Air Force established a program management office to develop an accounting process for recording in-ventory at historical value. The program management office has also undertaken initiatives to identify the actions necessary to comply with generally accepted accounting principles for inventory assets and support the information reported in the financial statements. The Air Force anticipates these efforts will be completed by FY 2003.
- In the depot maintenance area, the Air Force continues efforts to implement system corrections required to comply with federal financial accounting requirements. When implemented, the depot maintenance systems will (1) provide an automated transaction-driven general ledger, (2) maintain subsidiary support for account balances, (3) recognize revenue using the percentage-of-completion methodology, and (4) account for costs of goods sold and work-in-process based on actual costs incurred. The Air Force plans to implement the changes to the organic and contract depot maintenance systems by FY 2002.
- The Air Force has engaged accounting firms to assist in assessing the existence, completeness, and valuation of PP&E assets recorded in the databases of various capital asset systems. These efforts began in November 1998 and continued during FY 2000.

- To correct general ledger deficiencies, the Air Force and DFAS have initiatives underway to implement the U.S. Government Standard Gen-eral Ledger in the Air Force Working Capital Fund accounting systems. Among these initiatives are the conversion of the Standard Material Accounting System, the Defense Industrial Financial Management System, and the Contract Maintenance Accounting and Production System to the U.S. Government Standard General Ledger. The Air Force and DFAS estimate completion of these efforts by FY 2003.

We believe these efforts are steps in the right direction and will help to resolve many of the problems with existing systems. We will continue to work closely with management to address the material deficiencies precluding an unqualified audit opinion.

Report on Internal Controls

Management is responsible for establishing and maintaining an internal control structure to provide reasonable, but not absolute, assurance that transactions are properly recorded, processed, and summarized to (a) permit financial statement preparation in accordance with generally accepted accounting standards and (b) safeguard assets against loss from unauthorized acquisition, use, or disposal. Because of inherent limitations in any internal control, errors or fraud may nevertheless occur and not be detected. Also, projecting internal control evaluation results to future periods is subject to the risk that procedures may become inadequate. In addition, our consideration of internal controls would not necessarily disclose all material weaknesses. Under auditing standards, a material weakness is a condition where controls do not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the financial statements, may occur and not be detected on a timely basis by employees performing their assigned functions. Reportable conditions involve matters coming to our attention that relate to significant deficiencies in the design or operation of the internal control structure over financial reporting that, in our judgment, could adversely affect the Air Force's ability to record, process, sum-marize, and report Working Capital Fund financial data.

Over the last 9 years, we identified numerous findings and made recommendations to improve internal controls related to financial reporting for the Air Force Work-ing Capital Fund. Although we have noted progress in several areas to correct these previously identified problems, a significant number of corrective actions are still in progress. Appendix I identifies the prior audit findings and recommendations that remained open during FY 2000.

Furthermore, although we accomplished internal control testing, our financial statement audit objectives did not include providing a separate internal control opinion; accordingly, we do not express such an opinion. However, the OMB Bulletin, Audit Requirements for Federal Financial Statements, requires that we describe material weaknesses and reportable conditions identified during the audit. Therefore, the following paragraphs summarize material weaknesses and report-able conditions that existed in the design or operation of the internal control structure over financial reporting in effect at 30 September 2000. Based on these weaknesses, we determined the internal control structure did not provide reasonable assurance of achieving the internal control objectives described in the OMB bulletin. Most material weaknesses and reportable conditions presented in this report are the same as those included in prior-year Air Force Working Capital Fund financial statement audit reports. Specific weaknesses, along with recom-mended remedial actions, timeframes for corrective actions, and management comments, are more fully described in separate audit reports issued to Air Force and DFAS management.

SUPPORTING DOCUMENTATION

a. DFAS-Columbus did not provide supporting documentation for 32 ($22.6 million) of 86 ($65 million) disbursement transactions tested. (Draft Report of Audit 00068002, Air Force Working Capital Fund, Fiscal Year 2000, Collections and Disbursements)

b. Air Force fund managers were not able to provide supporting documentation for 374 ($516.9 million) of 725 ($891 million) Wholesale Supply and Information Services Activity Group open obligation transactions tested (such as undelivered orders outstanding, accounts payable, unfilled customer orders, and accrued expenses). (Draft Reports of Audit 00068023, Air Force Working Capital Fund, FY 2000 Statement of Budgetary Resources-Wholesale Supply Selected Accounts, and 00068024, Air Force Working Capital Fund, FY 2000 Statement of Budgetary Resources-Information Services Activity Group Selected Accounts)

ACCOUNTING ADJUSTMENTS

DFAS-Denver Center made $4.2 billion in improper and unsupported monthly adjustments and $31.9 billion in improper and unsupported year-end adjustments to Air Force Working Capital Fund accounting records. (Office of the Inspector General, Department of Defense, Draft Report of Project D2001FD-0014, untitled)

PERFORMANCE MEASURES

We obtained an understanding of the sources and controls related to performance measures reported in the overview to the principal statements and notes. Although we performed only a limited review, we did note a condition that, in our judgment, could adversely affect the Air Force Working Capital Fund's ability to collect, process, record, summarize, and report performance information. The Overview Section accompanying the Working Capital Fund financial statements indicated that a key performance indicator impacting support of Air Force mission capability was the Aircraft Quality Defect Rate.[1] In FY 2000, we reported that the Quality Deficiency Reporting System (G02 1) maintained incomplete information, Consequently, the performance results relating to depot maintenance aircraft defi-ciency reporting may be misstated. (Report of Audit 99062011, Quality Deficiency Reporting, 7 July 2000)

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[1] The Aircraft Quality Defect Rate measures the quality of completed aircraft work from programmed depot maintenance.

Report on Compliance with Laws and Regulations

Air Force management is responsible for complying with laws and regulations applicable to the Air Force Working Capital Fund. Issues that should concern management include compliance with laws and regulations pertaining to the objectives of Air Force Working Capital Fund programs and the activities, functions, and manner in which programs and services are delivered. Material instances of non-compliance are failures to follow requirements or violations of prohibitions contained in laws or regulations that cause us to conclude the aggre-gation of the misstatements resulting from those failures or violations is material to the financial statements, or the sensitivity of the matter would cause others to perceive the misstatements as significant.

As part of obtaining reasonable assurance that financial statements are free of material misstatement, we tested Air Force compliance with certain laws and regulations where noncompliance could have a direct and material effect on finan-cial statement amounts, to include requirements contained in the Federal Financial Management Improvement Act (FFMIA) and Federal Managers' Financial Integ-rity Act (FMFIA). Our financial statement audit objectives did not include providing a separate opinion on overall compliance with laws and regulations, and accordingly, we do not express such an opinion.

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

Under the Federal Financial Management Improvement Act of 1996, we are required to report whether the agency's financial management systems substantially comply with federal financial management systems requirements, federal accounting standards,[2] and the U.S. Government Standard General Ledger at the transaction level. Our follow-up audit work confirmed that previously reported issues continued to exist during FY 2000. Below, we address the instances of non-compliance with the three FFMIA requirements and describe the details related to the specific weaknesses, along with recommended corrective actions, timeframes for corrective actions, and management comments, in the cited reports.

a. Federal Financial Management System Requirements. For FY 2000, the financial management systems that support the Air Force Working Capital Fund did not substantially comply with federal financial management system require-ments to (1) maintain adequate subsidiary records for audit trails in Air Force and DFAS financial management systems; (2) implement accounting systems with transaction-driven general ledgers; and (3) provide adequate application controls, such as separation of duties, support for transactions, transaction controls, and data reconciliation, to critical Air Force feeder systems, In addition, due to significant application control weaknesses in the accounting and feeder systems, neither the DFAS nor the Air Force could ensure the systems properly recorded, processed, and summarized only valid transactions and provided

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[2] The American Institute of Certified Public Accountants recognizes the Statements of Federal Financial Accounting Standards issued by the Federal Accounting Standards Advisory Board as generally accepted accounting principles for federal government agencies.

accurate information. During the FY 2000 reporting period, the financial management systems contin-ued to contain reportable conditions, such as inadequate access controls, insufficient audit trails and data verifica-tion/reconciliation processes, and inade-quate system documentation. These weaknesses increased the risk for fraud, errors, and material misstatements to occur within the system and the resulting financial statements. The DFAS and Air Force have acknowledged many of the system weaknesses and reported them in their FY 2000 annual assurance state-ments on internal management controls. To address these control weaknesses, the DFAS and Air Force are eliminating or replacing non-compliant legacy systems, modifying existing systems, and changing business practices to correct previously identified control deficiencies.

b. Federal Accounting Standards. For FY 2000, the financial management systems that supported the Air Force Working Capital Fund did not substantially comply with federal accounting standards. Specifically:

(1) SFFAS No. 1, Accounting for Selected Assets and Liabilities. The Depot Maintenance Activity Group (DMAG) recorded accrued liability and work-in-process costs based on estimated amounts instead of actual costs incurred. (Report of Audit 98068038, Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, Fiscal Year 1998, 12 July 1999)

(2) SFFAS No. 3, Accounting for Inventory and Related Property. The DMAG recorded the value of operating materials and supplies at current stock list prices instead of historical cost. (Report of Audit 98068038, Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, FY 1998, 12 July 1999)

(3) SFFAS No. 6, Accounting for Property, Plant, and Equipment. Air Force Working Capital Fund entities did not record all costs incurred in valuing PP&E assets. (Report of Audit 98068002, Air Force Supply/Depot Maintenance Property, Plant, and Equipment; and Report of Audit 98068038, Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, Fiscal Year 1998, 12 July 1999)

(4) SFFAS No. 7, Accounting for Revenue and Other Financing. The DMAG recorded revenue based on completed units instead of the percentage-of-completion method. (Memorandum Report 98068006, Depot Maintenance Activ-ity Group, Air Force Working Capital Fund; and Report of Audit 98068038, Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, Fiscal Year 1998, 12 July 1999)

In the FY 2000 Working Capital Fund management representation letter, the Air Force acknowledged the financial management systems contain several departures from federal accounting standards. The Air Force is working hard to solve these problems but will require several years to achieve substantial progress.

c. U.S. Government Standard General Ledger at the Transaction Level. For FY 2000, the Air Force Working Capital Fund accounting systems had not fully implemented the U.S. Government Standard General Ledger at the transaction level for budgetary accounts. Therefore, instead of using budgetary accounts to prepare the Report of Execution, the DFAS-Denver Center relied on proprietary and statistical accounts and data not recorded in the accounting records. As a result, the amounts presented in the Statement of Budgetary Resources and the Statement of Financing were not auditable. (Office of the Inspector General, Department of Defense, Draft Report of Project D2001FD-0014, untitled)

The DFAS plans to incorporate the U.S. Government Standard General Ledger in the Standard Material Accounting System and Defense Industrial Financial Management System. In addition, the Air Force plans to implement the U.S. Government Standard General Ledger in the Contract Maintenance Accounting and Production System. The DFAS and Air Force estimate these efforts will be completed by FY 2003.

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT

With respect to management's disclosure of internal control material weaknesses in the DFAS and Air Force Working Capital Fund Federal Managers' Financial Integrity Act reports, we did not identify any material weaknesses related to finan-cial reporting not previously reported.

Objective, Scope, and Methodology

Management is responsible for:

- Preparing the annual financial statements in conformity with applicable accounting principles,
- Establishing and maintaining internal controls and systems to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met, and
- Complying with applicable laws and regulations.

The Air Force Audit Agency (AFAA) is responsible for:

- Planning and performing an audit to obtain reasonable assurance about whether the principal financial statements are reliable (free of material misstatement) and presented fairly in conformity with OMB Bulletin 97-0 1, Form and Content of Agency Financial Statement, 16 October 1996, as amended 11 September 2000, and applicable accounting prin-ciples;
- Obtaining reasonable assurance about whether relevant management internal controls are in place and operating effectively; and
- Testing management's compliance with selected provisions of laws and regulations and performing limited procedures to test the consistency of other information presented in the annual financial statement with the consolidated financial statements.

To fulfill these responsibilities, we:

- Examined, on a test basis, evidence supporting the amounts and disclo-sures in the principal financial statements;
- Assessed the accounting principles used and significant estimates made by management;
- Evaluated the overall presentation of the financial statements;
- Tested compliance with selected provisions of laws and regulations;
- Obtained an understanding of the design of internal controls, determined whether they have been placed in operation, assessed control risk, and performed tests of the reporting entity's internal controls; and
- Followed up on previously reported deficiencies.

In reviewing the Air Force Working Capital Fund consolidated financial statements, we evaluated internal controls to determine the reliability of financial and performance reporting related to the principal statements, accompanying footnotes, and performance measures.

In the area of financial reporting, we determined whether Air Force and DFAS personnel properly recorded, processed, and summarized transactions to permit the preparation of financial statements in accordance with federal accounting standards. We also (1) evaluated the safeguarding of assets against loss from unauthorized acquisition, use, or disposition; (2) obtained an understanding of the design of internal controls; (3) determined whether they were in operation; (4) assessed control risk; and (5) tested controls.

We obtained an understanding of internal control designs related to the existence and completeness of assertions regarding the performance measures included in the overview accompanying the Air Force Working Capital Fund financial statements.

The Department of Defense Inspector General (DoD IG), Denver Field Office, assisted us in reviewing the DFAS-Denver Center's compilation of the FY 2000 Air Force Working Capital Fund financial statements. We believe our audit work and that of the DoD IG provide a reasonable basis for our audit opinion.

We accomplished the audit from January to December 2000 at the Office of the Secretary of the Air Force, Financial Management and Comptroller; DFAS loca-tions (DFAS centers and DFAS field organizations); HQ Air Force Materiel Command (AFMC); and Air Force active duty units. We provided a draft of this report to management in January 2001.

Summary of Prior Audit Coverage

The General Accounting Office (GAO), DoD IG, and AFAA have conducted multiple reviews related to financial management issues. We issued a disclaimer for our FY 1999 Air Force Working Capital Fund Financial

Statements review (Report of Audit 99068011, Opinion on Fiscal Year 1999 Air Force Working Capital Fund Financial Statements, 9 February 2000). The GAO reports can be accessed over the Internet at http://www.gao.gov; DoD IG reports, at http://www.dodig.osd.mil; and AFAA reports, at http://www.afaa.af.mil.

We appreciate the cooperation and courtesies extended to our auditors.

JACKIE R. CRAWFORD
The Auditor General

The U.S. Air Force Annual Financial Statement is available for viewing on the Internet at www.saffm.hq.af.mil under the FMP tab.