Principal Financial Statements and Notes

Department of Defense
Agency Wide
CONSOLIDATED BALANCE SHEET
As of September 30, 2003 and 2002
($ in Millions)

	2003 Consolidated	2002 Consolidated Restated
1. ASSETS (Note 2)		
A. Intragovernmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	$ 251,544.1	$ 205,278.8
b. Non-Entity Seized Iraqi Cash	278.1	0.0
c. Non-Entity-Other	239.8	537.4
2. Investments (Note 4)	205,376.0	180,804.5
3. Accounts Receivable (Note 5)	1,066.6	1,121.9
4. Other Assets (Note 6)	105.0	0.1
5. Total Intragovernmental Assets	$ 458,609.6	$ 387,742.7
B. Cash and Other Monetary Assets (Note 7)	$ 1,534.9	$ 742.7
C. Accounts Receivable (Note 5)	7,299.9	6,341.9
D. Loans Receivable (Note 8)	64.0	44.2
E. Inventory and Related Property (Note 9)	194,174.1	146,198.6
F. General Property, Plant and Equipment (Note 10)	446,308.9	122,569.7
G. Investments (Note 4)	217.8	0.0
H. Other Assets (Note 6)	21,729.6	18,245.8
2. TOTAL ASSETS	$ 1,129,938.8	$ 681,885.6
3. LIABILITIES (Note 11)		
A. Intragovernmental:		
1. Accounts Payable (Note 12)	$ 101.3	$ 85.8
2. Debt (Note 13)	698.2	874.3
3. Environmental Liabilities (Note 14)	0.0	0.0
4. Other Liabilities (Note 15 & Note 16)	9,739.1	8,213.6
5. Total Intragovernmental Liabilities	$ 10,538.6	$ 9,173.7
B. Accounts Payable (Note 12)	$ 27,863.8	$ 24,182.4
C. Military Retirement Benefits and Other Employment-Actuarial Liabilities (Note 17)	1,429,565.5	1,328,826.5
D. Environmental Liabilities (Note 14)	61,490.6	59,353.1
E. Loan Guarantee Liability (Note 8)	25.9	10.8
F. Other Liabilities (Note 15 & Note 16)	29,109.3	29,795.3
G. Debt Held by Public (Note 13)	0.0	0.0
4. TOTAL LIABILITIES	$ 1,558,593.7	$ 1,451,341.8
5. NET POSITION		
A. Unexpended Appropriations (Note 18)	$ 192,955.8	$ 177,282.6
B. Cumulative Results of Operations	(621,610.7)	(946,738.8)
6. TOTAL NET POSITION	$ (428,654.9)	$ (769,456.2)
7. TOTAL LIABILITIES AND NET POSITION	$ 1,129,938.8	$ 681,885.6

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF NET COST

For the periods ended September 30, 2003 and 2002

($ in Millions)

	2003 Consolidated	2002 Consolidated Restated
1. Program Costs		
A. Intragovernmental Gross Costs	$ 11,748.3	$ 10,714.1
B. (Less: Intragovernmental Earned Revenue)	(13,239.0)	(15,586.8)
C. Intragovernmental Net Costs	$ (1,490.7)	$ (4,872.7)
D. Gross Costs With the Public	526,288.4	398,956.8
E. (Less: Earned Revenue From the Public)	(12,507.1)	(13,876.7)
F. Net Costs With the Public	$ 513,781.3	$ 385,080.1
G. Total Net Cost	$ 512,290.6	$ 380,207.4
2. Cost Not Assigned to Programs	0.0	0.0
3. (Less:Earned Revenue Not Attributable to Programs)	0.0	0.0
4. Net Cost of Operations	$ 512,290.6	$ 380,207.4

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended September 30, 2003 and 2002

($ in Millions)

	2003 Consolidated	2002 Consolidated Restated
CUMULATIVE RESULTS OF OPERATIONS		
1. Beginning Balances	$ (946,947.7)	$ (874,049.9)
2. Prior period adjustments (+/-)	383,283.8	(61,760.0)
3. Beginning Balances, as adjusted	(563,663.9)	(935,809.9)
4. Budgetary Financing Sources:		
4.A. Appropriations received	0.0	0.0
4.B. Appropriations transferred-in/out (+/-)	0.0	0.0
4.C. Other adjustments (rescissions, etc) (+/-)	(13.0)	0.0
4.D. Appropriations used	457,461.9	361,217.8
4.E. Nonexchange revenue	931.2	1,236.5
4.F. Donations and forfeitures of cash and cash equivalents	24.4	24.1
4.G. Transfers-in/out without reimbursement (+/-)	1,329.2	(706.7)
4.H. Other budgetary financing sources (+/-)	(2,867.4)	3,225.5
5. Other Financing Sources:		
5.A. Donations and forfeitures of property	4.6	0.3
5.B. Transfers-in/out without reimbursement (+/-)	(6,702.1)	744.3
5.C. Imputed financing from costs absorbed by others	3,866.9	3,520.0
5.D. Other (+/-)	308.1	16.7
6. Total Financing Sources	454,343.8	369,278.5
7. Net Cost of Operations (+/-)	512,290.6	380,207.4
8. Ending Balances	$ (621,610.7)	$ (946,738.8)

Department of Defense
Agency Wide
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2003 and 2002
($ in Millions)

	2003 Consolidated	2002 Consolidated Restated
UNEXPENDED APPROPRIATIONS		
1. Beginning Balances	$ 177,282.6	$ 163,190.6
2. Prior period adjustments (+/-)	0.0	1,553.3
3. Beginning Balances, as adjusted	177,282.6	164,743.9
4. Budgetary Financing Sources:		
4.A. Appropriations received	477,036.7	365,636.4
4.B. Appropriations transferred-in/out (+/-)	1,217.8	9,389.2
4.C. Other adjustments (rescissions, etc) (+/-)	(5,137.1)	(2,707.4)
4.D. Appropriations used	(457,444.2)	(359,779.5)
4.E. Nonexchange revenue	0.0	0.0
4.F. Donations and forfeitures of cash and cash equivalents	0.0	0.0
4.G. Transfers-in/out without reimbursement (+/-)	0.0	0.0
4.H. Other budgetary financing sources (+/-)	0.0	0.0
5. Other Financing Sources:		
5.A. Donations and forfeitures of property	0.0	0.0
5.B. Transfers-in/out without reimbursement (+/-)	0.0	0.0
5.C. Imputed financing from costs absorbed by others	0.0	0.0
5.D. Other (+/-)	0.0	0.0
6. Total Financing Sources	15,673.2	12,538.7
7. Net Cost of Operations (+/-)	0.0	0.0
8. Ending Balances	$ 192,955.8	$ 177,282.6

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended September 30, 2003 and 2002

($ in Millions)

		2003 Combined		2002 Combined Restated
BUDGETARY FINANCING ACCOUNTS				
BUDGETARY RESOURCES				
1. Budget Authority:				
1a. Appropriations received	$	546,761.4	$	415,113.9
1b. Borrowing authority		0.0		0.0
1c. Contract authority		28,109.0		2,318.0
1d. Net transfers (+/-)		1,000.3		986.6
1e. Other		0.0		0.0
2. Unobligated balance:				
2a. Beginning of period		217,722.3		210,128.9
2b. Net transfers, actual (+/-)		204.3		9,107.7
2c. Anticipated Transfers balances		0.0		0.0
3. Spending authority from offsetting collections:				
3a. Earned		0.0		0.0
1. Collected		135,587.2		117,942.4
2. Receivable from Federal sources		(714.6)		(1,116.6)
3b. Change in unfilled customer orders		0.0		0.0
1. Advance received		(30.6)		185.9
2. Without advance from Federal sources		11,000.9		3,576.2
3c. Anticipated for the rest of year, without advances		0.0		0.0
3d. Transfers from trust funds		0.0		0.0
3e. Subtotal		145,842.9		120,587.9
4. Recoveries of prior year obligations		22,841.9		15,293.1
5. Temporarily not available pursuant to Public Law		0.0		0.0
6. Permanently not available		(33,730.4)		(7,954.7)
7. Total Budgetary Resources	$	928,751.7	$	765,581.4

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended September 30, 2003 and 2002

($ in Millions)

	2003 Combined	2002 Combined Restated
STATUS OF BUDGETARY RESOURCES		
8. Obligations incurred:		
8a. Direct	$ 522,562.4	$ 420,239.6
8b. Reimbursable	147,147.8	128,030.3
8c. Subtotal	669,710.2	548,269.9
9. Unobligated balance:		
9a. Apportioned	55,052.0	40,917.6
9b. Exempt from apportionment	180,704.3	171,560.5
9c. Other available	(0.1)	(0.1)
10. Unobligated Balances Not Available	23,285.3	4,833.5
11. Total, Status of Budgetary Resources	$ 928,751.7	$ 765,581.4
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
12. Obligated Balance, Net - beginning of period	$ 181,919.4	$ 162,829.3
13. Obligated Balance transferred, net (+/-)	(23.9)	0.0
14. Obligated Balance, Net - end of period:		
14a. Accounts receivable	(10,216.4)	(10,929.3)
14b. Unfilled customer order from Federal sources	(38,422.1)	(27,421.1)
14c. Undelivered orders	213,597.8	176,183.8
14d. Accounts payable	49,412.6	45,789.1
15. Outlays:		
15a. Disbursements	604,105.8	509,723.7
15b. Collections	(135,556.8)	(118,128.2)
15c. Subtotal	468,549.0	391,595.5
16. Less: Offsetting receipts	(43,294.0)	(45,593.8)
17. Net Outlays	$ 425,255.0	$ 346,001.7

Department of Defense
Agency Wide
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2003 and 2002
($ in Millions)

	2003 Combined	2002 Combined Restated
NONBUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
1. Budget Authority:		
1a. Appropriations received	$ 0.0	$ 0.0
1b. Borrowing authority	50.5	44.2
1c. Contract authority	0.0	0.0
1d. Net transfers (+/-)	0.0	0.0
1e. Other	0.0	0.0
2. Unobligated balance:		
2a. Beginning of period	104.0	6.0
2b. Net transfers, actual (+/-)	0.0	0.0
2c. Anticipated Transfers balances	0.0	0.0
3. Spending authority from offsetting collections:		
3a. Earned	0.0	0.0
1. Collected	56.2	22.3
2. Receivable from Federal sources	(90.0)	90.6
3b. Change in unfilled customer orders	0.0	0.0
1. Advance received	0.0	0.0
2. Without advance from Federal sources	35.8	0.0
3c. Anticipated for the rest of year, without advances	0.0	0.0
3d. Transfers from trust funds	0.0	0.0
3e. Subtotal	2.0	112.9
4. Recoveries of prior year obligations	1.9	0.0
5. Temporarily not available pursuant to Public Law	0.0	0.0
6. Permanently not available	(0.2)	0.0
7. Total Budgetary Resources	$ 158.2	$ 163.1

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended September 30, 2003 and 2002

($ in Millions)

	2003 Combined	2002 Combined Restated
STATUS OF BUDGETARY RESOURCES		
8. Obligations incurred:		
8a. Direct	$ 136.4	$ 142.4
8b. Reimbursable	0.0	0.0
8c. Subtotal	136.4	142.4
9. Unobligated balance:		
9a. Apportioned	1.3	0.7
9b. Exempt from apportionment	0.0	0.0
9c. Other available	(0.1)	0.0
10. Unobligated Balances Not Available	20.6	20.0
11. Total, Status of Budgetary Resources	$ 158.2	$ 163.1
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
12. Obligated Balance, Net - beginning of period	$ (95.1)	$ 0.0
13. Obligated Balance transferred, net (+/-)	0.0	0.0
14. Obligated Balance, Net - end of period:		
14a. Accounts receivable	(0.6)	(90.6)
14b. Unfilled customer order from Federal sources	(35.8)	0.0
14c. Undelivered orders	66.3	89.6
14d. Accounts payable	0.0	0.7
15. Outlays:		
15a. Disbursements	63.6	52.0
15b. Collections	(56.2)	(22.3)
15c. Subtotal	7.4	29.7
16. Less: Offsetting receipts	0.0	0.0
17. Net Outlays	$ 7.4	$ 29.7

Department of Defense

Agency Wide

COMBINED STATEMENT OF FINANCING

For the periods ended September 30, 2003 and 2002

($ in Millions)

	2003 Combined	2002 Combined Restated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ 669,846.6	$ 548,412.3
2. Less: Spending authority from offsetting collections and recoveries (-)	(168,688.7)	(135,993.9)
3. Obligations net of offsetting collections and recoveries	501,157.9	412,418.4
4. Less: Offsetting receipts (-)	(43,294.0)	(45,593.8)
5. Net obligations	457,863.9	366,824.6
Other Resources		
6. Donations and forfeitures of property	4.6	0.3
7. Transfers in/out without reimbursement (+/-)	(6,702.1)	24.1
8. Imputed financing from costs absorbed by others	3,866.9	3,520.0
9. Other (+/-)	308.1	(475.5)
10. Net other resources used to finance activities	(2,522.5)	3,068.9
11. Total resources used to finance activities	455,341.4	369,893.5
Resources Used to Finance Items not Part of the Net Cost of Operations		
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
12a. Undelivered Orders (-)	(37,435.1)	(28,342.6)
12b. Unfilled Customer Orders	11,006.1	3,762.3
13. Resources that fund expenses recognized in prior periods	(686.3)	(7,317.5)
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	929.3	819.3
15. Resources that finance the acquisition of assets	(72,984.9)	(9,075.6)
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations		
16a. Less: Trust or Special Fund Receipts Related to	0.0	0.0
16b. Other (+/-)	6,623.6	(1.1)
17. Total resources used to finance items not part of the net cost of operations	(92,547.3)	(40,155.2)
18. Total resources used to finance the net cost of	362,794.1	329,738.3

Department of Defense

Agency Wide

COMBINED STATEMENT OF FINANCING

For the periods ended September 30, 2003 and 2002

($ in Millions)

	2003 Combined	2002 Combined Restated
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future		
19. Increase in annual leave liability	662.7	478.3
20. Increase in environmental and disposal liability	2,033.6	1,712.9
21. Upward/Downward reestimates of credit subsidy expense	0.0	0.0
22. Increase in exchange revenue receivable from the the public	(6.6)	(3.3)
23. Other (+/-)	95,403.2	34,270.2
24. Total components of Net Cost of Operations that will require or generate resources in future periods	98,092.9	36,458.1
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	55,274.7	7,229.5
26. Revaluation of assets or liabilities (+/-)	6,299.4	(377.4)
27. Other (+/-)	(10,170.5)	7,158.9
28. Total components of Net Cost of Operations that will not require or generate resources	51,403.6	14,011.0
29. Total components of net cost of operations that will not require or generate resources in the current	149,496.5	50,469.1
30. Net Cost of Operations	512,290.6	380,207.4

Agency Wide
STATEMENT OF CUSTODIAL ACTIVITY
For the periods ended September 30, 2003 and 2002
($ in Millions)

	2003 Combined	2002 Combined
1.SOURCE OF COLLECTIONS		
A. Deposits by Foreign Governments	$ 9,971.6	$ 10,732.3
B. Seized Iraqi Cash	808.9	0.0
C. Other Collections	0.0	0.0
D. Total Cash Collections	$ 10,780.5	$ 10,732.3
E. Accrual Adjustments (+/-)	$ 0.7	$ 0.2
F. Total Custodial Collections	$ 10,781.2	$ 10,732.5
2.DISPOSITION OF COLLECTIONS		
A. Disbursed on Behalf of Foreign Governments and International Organizations	$ 10,118.8	$ 10,570.0
B. Seized Assets Disbursed on behalf of Iraqi People	530.8	0.0
C. Increase (Decrease) in Amounts to be Transferred	(146.5)	162.5
D. Collections Used for Refunds and Other Payments	0.0	0.0
E. Retained by The Reporting Entity	0.0	0.0
F. Seized Assets Retained for Support of the Iraqi People	278.1	0.0
G. Total Disposition of Collections	$ 10,781.2	$ 10,732.5
3. NET CUSTODIAL COLLECTION ACTIVITY	$ 0.0	$ 0.0

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

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

The Department is unable to fully implement all elements of Federal GAAP and OMB Bulletin No. 01-09 due to limitations of its financial management processes and systems, including nonfinancial feeder systems and processes. The Department derives its reported values and information for major asset and liability categories 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 preparing financial statements in accordance with Federal GAAP. As a result, the Department cannot currently implement every aspect of Federal GAAP and OMB Bulletin No. 01-09. The Department continues to implement process and system improvements addressing the limitations of its financial and nonfinancial feeder systems. The Department provides a more detailed explanation of these financial statement elements in the applicable footnote.

1.B. Mission of the Reporting Entity

The National Security Act of 1947 created The Department of Defense (DoD) on September 18, 1947. 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. Fiscal year (FY) 2003 is the eighth year that the Department has prepared audited DoD Agency-wide financial statements required by the CFO Act and GMRA. The reporting entities within the Department changed to facilitate this reporting requirement. Auditors will be issuing opinions on the financial statements of the following stand-alone reporting entities: (1) Army General Fund, (2) Army Working Capital Fund, (3) Navy General Fund, (4) Navy Working Capital Fund, (5) Air Force General Fund, (6) Air Force Working Capital Fund, (7) Military Retirement Fund, (8) DoD Medicare-Eligible Retiree Health Care Fund (new for FY 2003), and (9) U.S. Army Corps of Engineers (Civil Works).

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

Also, the Department requires the following Defense Agencies to prepare internal stand-alone annual financial statements to be audited by certified public accounting firms: (1) Defense Logistics Agency, (2) Defense Finance and Accounting Service (DFAS), (3) Defense Information Systems Agency, (4) Defense Contract Audit Agency, (5) Defense Commissary Agency, (6) Defense Security Service, and (7) Defense Threat Reduction Agency.

1.C. Appropriations and Funds

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

- General funds are used for financial transactions arising under congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and construction accounts.

- Trust funds represent the receipt and expenditure of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

- Special funds are accounts for government receipts earmarked for a specific purpose.

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

- Working Capital funds (WCF) (revolving funds) receive their initial working capital through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial cost of products and services. Financial resources to replenish the initial working capital and to permit continuing operations are generated by the acceptance of customer orders. The Defense Working Capital Fund 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.

1.D. Basis of Accounting

For FY 2003, the Department's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Department's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of Federal GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by Federal GAAP. Most of the Department's legacy systems were designed to record on a budgetary basis.

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

In addition, the Department identifies programs based upon the major appropriation groups provided by Congress. The Department is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

The Department receives congressional appropriations as financing sources for general funds (annual and a multi-year basis). When authorized, these appropriations are supplemented by revenues generated by sales of goods or services through a reimbursable order process. The Department recognizes revenue as a result of costs incurred or services performed on behalf of other federal agencies and the public. Under the reimbursable order process, the Department recognizes revenue when earned.

Depot Maintenance and Ordnance Working Capital Funds (WCF) recognize revenue according to the percentage of completion method. Supply Management WCF activities recognize revenue from the sale of inventory items.

The Department does not include non-monetary support provided by U.S. Allies for common defense and mutual security in its list of other financing sources that appears in the Statement of Financing. The U.S. has agreements with foreign countries that include both direct or indirect sharing of costs that each country incurs in support of the same general purpose. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port. DoD is reviewing these types of financing and cost reductions in order to establish accounting policies and procedures to identify what, if any, of these costs are appropriate for disclosure in the Department's financial statements in accordance with generally accepted accounting principles. Recognition of support provided by host nations would affect both financing sources and recognition of expenses.

1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the Department's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, and environmental liabilities. The Department's expenditures for capital and other long-term assets are not recognized as operating expenses until depreciated in the case of Property, Plant and Equipment (PP&E) or consumed in the case of Operating Materials and Supplies (OM&S). Net increases or decreases in unexpended appropriations are recognized as a change in the net position. Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made. The Departments adjust operating expenses as a result of the elimination of balances between DoD Components. See Note 19.I., Intragovernmental Expenses and Revenue for disclosure of adjustment amounts.

1.G. Accounting for Intra-governmental Activities

The Department 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 Department as though the agency was a stand-alone entity.

- Public Debt

  The Department's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debts and its related costs to federal agencies. The DoD'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.

- Civilian/ Military Retirement Systems

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

- Actuarial Liability

    The Department reports the assets, funded actuarial liability, and unfunded actuarial liability for the military personnel in the DoD financial statements. The Department recognizes the actuarial liability for the military retirement health benefits in the Other Defense Organization General Fund column and the Medicare-eligible health care benefits in that Fund's column of the DoD Agency-wide consolidating/combining statements.

- Inter/Intra Governmental Elimination

    Preparation of reliable financial statements requires the elimination of transactions occurring between entities within the Department or between two or more federal agencies. However, the Department, as well as the rest of the federal government, cannot accurately identify all Intragovernmental transactions by customer because our systems do not track buyer and seller data needed to match related transactions. For FY 1999 and beyond, seller entities within the Department provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD Intragovernmental balances were then eliminated.

    The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the Department and other federal agencies. In September 2000, the FMS issued the "Federal Intragovernmental Transactions Accounting Policies and Procedures Guide." The Department was not able to fully implement the policies and procedures in this guide related to reconciling Intragovernmental assets, liabilities, revenues, and expenses for non-fiduciary transactions. The Department, however, was able to implement the policies and procedures contained in the "Intragovernmental Fiduciary Transactions Accounting Guide," as updated by the "Federal Intragovernmental Transactions Accounting Policies and Procedures Guide," issued October 2002 and updated October 2003, for reconciling Intragovernmental transactions pertaining to investments in federal securities, borrowings from the United States (U.S.) Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DoL), and benefit program transactions with the OPM.

1.H. Transactions with Foreign Governments and International Organizations

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

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

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

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in the Treasury's system. Differences between the Department's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled. See Note 3, Fund Balance with Treasury for material disclosure. Differences between accounting offices' detail-level records and Treasury's FBWT accounts are disclosed in Note 21.B, specifically, differences caused by in-transit disbursements and unmatched disbursements (which are not recorded in the accounting offices' detail-level records).

1.J. Foreign Currency

The Department conducts a significant portion of its operations overseas. The Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations (operation and maintenance, military personnel, military construction, family housing operation and maintenance, and family housing construction). The gains and losses are computed as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The Department does not separately identify currency fluctuations.

1.K. Accounts Receivable

As presented in the Balance Sheet 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 other federal agencies. Claims against other federal agencies are to be resolved between the agencies. See Note 5, Accounts Receivable for material disclosure.

1.L. Loans Receivable. As Applicable.

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

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

1.M. Inventories and Related Property

Effective October 1, 2002, Statement of Federal Financial Accounting Standards No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, revises accounting principles for military equipment (previously referred to as National Defense Property, Plant, and Equipment). The standard renames National

Defense Property, Plant, and Equipment to military equipment, classifies military equipment as general property, plant, and equipment, and requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. Likewise, military equipment (previously referred to as National Defense Property, Plant, and Equipment) also includes items which will now be classified as Operating Materials and Supplies.

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

The predominate amount of the Department's inventories are currently reported at an approximation of historical cost using Latest Acquisition Cost (LAC) adjusted for holding gains and losses. Approximately 5 percent of inventories are now reported at moving average cost (MAC) in accordance with the Department's new policy which was disseminated in July 2001.

The Latest Acquisition Cost method is used because legacy inventory systems were designed for material management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the United States Government Standard General Ledger (USSGL), as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). As noted above, utilizing new systems development processes, Components of the Department have transitioned, and are continuing to transition, inventory to the moving average cost method. Once completely implemented, the Department should be in full compliance with SFFAS No. 3.

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

Related property includes Operating Materials and Supplies (OM&S) and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses the consumption method of accounting for OM&S, for the most part, expensing material when it is issued to the end user. Where current systems cannot fully support the consumption method, the Department uses the purchase method - that is, materials and supplies are expensed when purchased. For FY 2003, the Department reported significant amounts using the purchase method either because the systems could not support the consumption method or because management deemed that the item is in the hands of the end user.

The Department implemented new policy in FY 2002 to account for condemned material, only, as "Excess, Obsolete, and Unserviceable." The net value of condemned material is zero, because the costs of disposal are greater than the potential scrap value. Potentially redistributable material, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in "Held for Use" or "Held for Repair" categories according to its condition.

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

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

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

The Department invests in both marketable and non-marketable securities. Marketable securities are investments trading on a public market. The two types of non-marketable securities are par value and market based Intragovernmental securities. The Bureau of Public Debt issues non-marketable Par Value Intragovernmental Securities. Non-marketable, Market Based Intragovernmental Securities mimic marketable securities, but are not traded publicly. See Note 4 for material disclosures.

1.O. General Property, Plant and Equipment

Statement of Federal Financial Accounting Standards No. 23*, Eliminating the Category National Defense Property, Plant, and Equipment*, establishes new generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades, for accounting periods beginning after September 30, 2002.

Until this change in accounting principle, the acquisition costs for military equipment were classified as National Defense Property, Plant, and Equipment (PP&E) and were expensed in the period incurred. Implementation of this new accounting principle required the Department to adjust the October 1, 2002 General PP&E balance to recognize the investment, accumulated depreciation, and net book value of military equipment that previously had been expensed. As discussed further in Note 10, General PP&E, the adjustment was based on data provided by the Bureau of Economic Analysis at the Department of Commerce and is not in compliance with GAAP.

General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of $100,000. Also, DoD requires capitalization of improvement costs over the DoD capitalization threshold of $100,000 for General PP&E. The Department depreciates all General PP&E, other than land, on a straight-line basis.

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for FYs 1993, 1994, and 1995 respectively, and an estimated useful life of two or more years. These assets remain capitalized and reported on WCF financial statements. General PP&E previously capitalized at amounts below $100,000 were written off General Fund financial statements in FY 1998. See Note 10, General PP&E, Net for material disclosures.

The United States Army Corps of Engineers (USACE) Civil Works General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost equals $25,000 (one exception is all buildings and structures related to hydro- power projects are capitalized regardless of cost.) During 2003 the Corps increased its buildings and structures threshold to $25K (from $0) for all Civil Works Appropriations with the exception of Revolving Fund and Power Marketing Agency (PMA) assets. All Civil Works Appropriations Buildings and Structures currently capitalized under $25K (excluding Revolving Fund and PMA) were expensed in FY 2003 and removed from Corps of Engineers Financial Management System (CEFMS). Starting in FY 2004 all Civil Works Buildings and Structures over $25K will be expensed except for PMA assets.

Government Equipment in the Hands of Contractors

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

The Department 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 Department currently reports only government property, maintained in the DoD's property systems, in the possession of contractors.

To bring DoD closer to full compliance with federal accounting standards, the Department has issued new property accountability and reporting regulations that require the DoD Components to maintain, in DoD Component property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards.

1.P. Advances and Prepayments

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

1.Q. Leases

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

1.R. Other Assets

The Department conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the Department provides financing payments. One type of financing payment that the Department makes, for real property, is based upon a percentage of completion. In accordance with the 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, the Federal Acquisition Regulations allow the Department to make financing payments under fixed price contracts that are not based on a percentage of completion. The Department reports these financing payments as advances or prepayments in the “Other Assets” line item. The Department treats these payments as advances or prepayments because the Department becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the Department is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the Department for the full amount of the advance.

The Department has completed its review of all applicable federal accounting standards; applicable public laws on contract financing; Federal Acquisition Regulation Parts 32, 49, and 52; and the OMB guidance in 5 CFR Part 1315, “Prompt Payment.” The Department concluded that SFFAS No. 1 does not fully or adequately address the subject of progress payment accounting and is considering appropriate actions.

1.S. Contingencies and Other Liabilities

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

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments. The Department’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.

Other liabilities arise as a result of anticipated disposal costs for the Department's assets. This type of liability has two components: nonenvironmental and environmental. Consistent with SFFAS No. 6, “Accounting for Property, Plant, and Equipment” recognition of an anticipated environmental disposal liability commences when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon the Department's policy, which is consistent with SFFAS No. 5 “Accounting for Liabilities of Federal Government”. The Department agrees to the recognition of nonenvironmental disposal liability for military equipment nuclear powered assets when placed into service. Such amounts are developed in conjunction with, and not easily separately identifiable from, environmental disposal costs. See Notes 14 and 15 for material disclosures.

1.T. Accrued Leave

The Department reports civilian annual leave and military leave that has been accrued and not used as of the balance sheet date as liabilities. The liability reported at the end of the fiscal year reflects the current pay rates.

1.U. Net Position

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

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

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

1.V. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other facilities, which are located overseas obtained through various international treaties and agreements negotiated by the Department of State. DoD purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. The DoD's fixed assets decrease by not renewing a treaty or not reaching agreements. Therefore, in the event treaties or other agreements are terminated whereby use of the foreign bases is prohibited, losses are recorded for the value of any non-retrievable capital assets after negotiations between the U.S. and the host country have been concluded to determine the amount to be paid the U.S. for such capital investments.

1.W. Comparative Data

Financial statement fluctuations greater than ten percent between year-end FY 2002 and year-end FY 2003 are explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

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

1.Y. Problem Disbursements

The elimination of problem disbursements is one of the highest financial management priorities of the Department. Problem disbursements are disbursements made that can not be matched to an obligation or that exceed an obligation amount in the accounting systems. Efforts are underway to improve systems and processes to resolve and prevent problem disbursements. See Note 21B, Disclosures Related to Problem Disbursements, In-Transits Disbursements, Suspense/Budget Clearing Accounts for additional disclosures.

Note 2.	Nonentity Assets

As of September 30,	2003	2002
(Amounts in millions)		
1. Intragovernmental Assets		
A. Fund Balance With Treasury	$ 517.9	$ 537.3
B. Investments		
C. Accounts Receivable	2.0	5.4
D. Other Assets		
E. Total Intragovernmental Assets	**$ 519.9**	**$ 542.7**
2. Non-Federal Assets		
A. Cash and Other Monetary Assets	$ 1,393.0	$ 578.2
B. Accounts Receivable	5,063.4	4,139.9
C. Loans Receivable		
D. Inventory and Related Property		
E. General PP&E		
F. Other Assets	126.0	125.0
G. Total Non-Federal Assets	**$ 6,582.4**	**$ 4,843.1**
3. Total Non-Entity Assets	**$ 7,102.3**	**$ 5,385.8**
4. Total Entity Assets	**$ 1,122,836.5**	**$ 676,499.8**
5. Total Assets	**$ 1,129,938.8**	**$ 681,885.6**

Other information:

Asset accounts are categorized as entity or nonentity. Entity assets consist of resources that the Department has the authority to use, or where management is legally obligated to use funds to meet entity obligations. Nonentity assets are assets for which the Department maintains stewardship accountability and responsibility to report, but are not available for use in the operations.

Other Disclosures

Nonentity Fund Balance with Treasury

Nonentity fund balance with treasury is comprised of $386.8 million in deposits and suspense accounts.

Iraqi custodial funding of $278.1 million is also included in nonentity fund balance with treasury. Iraqi custodial funding connotes Iraqi cash seized by coalition forces during Operation Iraqi Freedom. It will be used in support of the Iraqi people.
See Notes 3 and 23 for additional information.

Finally, nonentity fund balance with treasury includes net funds (funds collected less funds distributed) of the Foreign Military Sales Trust Fund (FMSTF). Under authority of the Arms Export and Control Act, the FMSTF receives collections from foreign governments that are dedicated specifically to FMS purchases.

Nonentity Intra-Governmental Accounts Receivable

The Department is reporting $2.0 million as nonentity intra-governmental accounts receivable. These are receivables from cancelled year appropriations. They will be returned to the Treasury as miscellaneous receipts once collected.

Nonentity Cash and Other Monetary Assets

Nonentity cash and other monetary assets consists of cash held by Disbursing Officers to carry out their paying, collecting and foreign currency accommodation exchange mission. The primary source of the amounts reported is the Standard Form 1219, Statements of Accountability reported by DoD Disbursing Officers. Foreign currency is valued using the Department of Treasury Prevailing Rate of Exchange. This rate is the most favorable rate that would legally be available to the U.S. Government's acquisition of foreign currency for its official disbursements and accommodation of exchange transactions.

Nonentity Non-Federal Accounts Receivable

Non-Federal receivables are primarily related to Navy General Fund advance payments made to contractors and associated accrued interest, which remains in litigation. In addition, the U.S. Army Corps of Engineers reports that their non-federal nonentity accounts receivable include long-term receivables due from state and local municipalities for water storage contracts, hydraulic mining, and the leasing of land for flood control purposes. The balance of the amounts reported as nonentity non-federal accounts receivable represent receivables from closed accounts, accrued interest receivable, penalties, fines and administrative fees receivable. The Department does not derive or receive any benefit from these collections but incurs the cost of administering them.

Non-Federal Other Assets

The $126.0 million reported as other nonentity assets primarily represents advances to contractors by the Air Force General Fund. These advances are payments made as a part of an advance-payment pool agreement made with the Massachusetts Institute of Technology and other non-profit institutions. Advance-payment pool agreements are used for the financing of cost-type contracts with nonprofit educational or research institutions for experimental, or research and development work, when several contracts or a series of contracts require financing by advance payments.

Note Reference

For additional line item discussion, see:
Note 3, Fund Balance with Treasury
Note 4, Investments
Note 5, Accounts Receivable
Note 6, Other Assets
Note 7, Cash and Other Monetary Assets
Note 8, Loans Receivable
Note 9, Inventory and Other Related Property

Note 3. Fund Balance with Treasury

As of September 30		2003		2002
(Amounts in millions)				
1. Fund Balances:				
A. Appropriated Funds	$	238,052.2	$	195,621.4
B. Revolving Funds		11,131.1		7,823.4
C. Trust Funds		559.0		809.6
D. Other Fund Types		2,319.7		1,561.8
E. Total Fund Balances	$	252,062.0	$	205,816.2
2. Fund Balances Per Treasury Versus Agency:				
A. Fund Balance per Treasury	$	251,682.0	$	204,945.0
B. Fund Balance per Department of Defense		252,062.0		205,816.2
C. Reconciling Amount	$	(380.0)	$	(871.2)

3. Explanation of Reconciliation Amount:

Reporting Entity (Amounts in millions)		Fund Balance with Treasury FY 2003		Fund Balance per Entity Books FY 2003		Reconciling Amount FY 2003		Reconciling Amount FY 2002
Navy GF	$	78,415	$	78,415	$		$	
Air Force GF		59,766		59,766				
Army GF		55,035		55,035				
ODO GF		48,423		48,737		(314)		(813)
Corps of Engineers		2,530		2,596		(66)		(59)
MERHCF		5		5				
MRF		25		25				
Air Force WCF		2,475		733		1,742		860
Army WCF		1,549		1,549				
ODO WCF		1,631		3,373		(1,742)		(859)
Navy WCF		1,828		1,828				
Total	**$**	**251,682**	**$**	**252,062**	**$**	**(380)**	**$**	**(871)**

Analysis of Reconciling Amounts

Currently, the Department of Treasury reports fund balances at the appropriation basic symbol level. The Defense Finance and Accounting Service Central Sites adjust their funds to agree with the official DoD cash figures shown in each entity's expenditure system:

- Data Element Management/Accounting Reporting System (DELMAR) for Army
- Centralized Expenditure and Reimbursement Processing System (CERPS) for Navy

- Merged Accounting and Fund Reporting System (MAFR) for Air Force

For the Defense Agencies, the Department of the Defense reconciles at the agency-wide level, since Defense Treasury Index 97 funds allotted at limit level preclude individual entity reporting compliance. The Department continues to improve internal methodology to properly account for their funds at the entity level.

As of year-end FY 2003, the Department of Defense shows a reconciling net difference of ($380) million with the Department of the Treasury, which is comprised of:

- ($314) million in undistributed collections and disbursements reported at the departmental level for the ODO General Fund but not yet recorded by the applicable agency;
- ($66) million in collections reported by the Department of the Treasury for the Inland Waterways and Harbor Maintenance Trust Funds. The Corps of Engineers is the lead agency for reporting;
- $1,742 million in cash for the United States Transportation Command is recorded as Fund Balance with Treasury in the Air Force Working Capital Fund. The accounting for these funds is actually performed within the Entity Books of the ODO Working Capital Fund. For final Fiscal Year end reporting, the Fund Balance with Treasury for the ODO Working Capital Fund is adjusted downward to reconcile with the Air Force Working Capital Fund;
- ($1,742) million which is the downward adjustment to the Fund Balance with Treasury for the ODO Working Capital Fund to reflect that the cash reporting to the Department of the Treasury for the United States Transportation Command is done through the Air Force Working Capital Fund.

4. Other Information Related to Fund Balance with Treasury:

<u>Total Fund Balance</u>

Total Fund Balance increased, between year-end FY 2002 and year-end FY 2003, by approximately $46.2 billion (21 percent). The Appropriated Funds increased by approximately $42.4 billion (22 percent). This was primarily as a result of increased budget authority in FY 2003 for the Army, Air Force and Navy General Funds. Between year-end FY 2002 and year-end FY 2003, Army General Funds increased by approximately $15.5 billion (39 percent), Air Force General Funds increased by approximately $11.8 billion (25 percent), and Navy General Funds increased by approximately $10.2 billion (15 percent). The increases are primarily attributable to increased funding for various issues such as Operation Enduring Freedom, Operation Iraqi Freedom, and funding for the Army Vision and Transformation. Some of the increase is from the Defense Emergency Response Fund (DERF) for fighting terrorism throughout the world.

The Army General Fund increase also includes $109.1 million in Vested Iraqi Cash. This cash that represents frozen Iraqi deposits in the United States is vested in accordance with the International Emergency Economic Powers Act, Section 1701 and will be used in support of the Iraqi people. Army has collected $1,660.2 million of Vested Iraqi Cash and has disbursed $1,551.1 million benefiting the Iraqi people as follows:

	Disbursed ($ in millions)
Iraqi Salaries	$1,170.7
Repair/Reconstruction/Humanitarian Assistance	$ 40.6
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	$ 339.8
Total Disbursed	**$1,551.1**

The Revolving Funds increased by approximately $3.3 billion (42 percent). This was primarily as a result of increases to the Army Working Capital Fund and the Other Defense Organizations Working Capital Fund. The Army Working Capital Fund increased as a result of a reversal of interfund credits and from receipt of an allocation of appropriated funds to use for under-utlized plant capacity, purchases of war reserves and spare parts. The Other Defense Organizations Working Capital Fund primarily increased due to heightened levels of reimbursable activity in both the Airlift Mobility Command and the Military Sealift Command for providing transportation for both Operation Enduring Freedom and Operation Iraqi Freedom.

The Trust Funds decreased by approximately $250.6 million (31 percent) primarily because the foreign military trust fund's current year disbursements exceeded current year collections.

The Other Fund Types increased by approximately $757.9 million (49 percent) primarily as a result of the $464.8 million in the Iraqi Relief and Reconstruction Fund and $278.1 million in non-entity seized (Custodial) Iraqi cash. During FY 2003, the non-entity seized (Custodial) Iraqi cash had collections of $808.9 million and disbursements of $530.8 million resulting in the balance of $278.1 million (See Note 23). The Iraqi seized cash will be used in support of the Iraqi people.

Check Issue Discrepancy

The Department of Defense is in the process of collecting information for all check issue discrepancy data that are unsupportable because: (1) records have been lost during deactivation of disbursing offices, (2) the Department of the Treasury may not assist in research efforts for transactions over 1-year old, or (3) corrections were processed for transactions that the Department of the Treasury had removed from the check comparison report. Transactions that have no supporting documentation due to one of the preceding situations shall be provided to the Department of the Treasury with a request to remove them from the Treasury Check Comparison Report. The vast majority of the remaining check issue discrepancies are a result of timing differences between the Department of Defense and the Department of the Treasury for processing checks. Check issue discrepancies greater than 180 days at year-end FY 2003 were approximately ($16) million.

Intra-governmental Payment and Collection (IPAC)

The Intra-governmental Payment and Collection (IPAC) differences are reconcilable differences that represent amounts recorded by the Department of the Treasury but not reported by the organizations. IPAC differences greater than 180 days at year-end FY 2003 were approximately $126 thousand.

Deposit Differences

The Deposit differences are reconcilable differences that represent deposit amounts reported by the Department of the Treasury or the Department of Defense. Deposit differences greater than 180 days at year-end FY 2003 were approximately ($4.5) million.

Note Reference:

- See Note Disclosure 1. I. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Funds with the U.S. Treasury.
- See Footnote 2 and Footnote 21B for further discussions on Other Fund Balance Types (e.g., Suspense, Budget Clearing, Special and Deposit, etc.)
- See Footnote 18 for information summarizing the status of Funds Balance With Treasury, as discussed by OMB regulation 01-09.

Note 4. Investments

As of September 30	2003					2002
	Cost	Amortization Method	Amortized (Premium/ Discount)	Investments, Net	Market Value Disclosure	Investments, Net
(Amounts in millions)						
1. Intra-governmental Securities:						
A. Marketable	$ 0.0		$ 0.0	$ 0.0	$ 0.0	$ 120.9
B. Non-Marketable, Par Value	0.0		0.0	0.0	0.0	0.0
C. Non-Marketable, Market-Based	214,603.3	Effective Interest	(12,862.3)	201,741.0	217,272.9	176,447.9
D. Subtotal	$ 214,603.3		$ (12,862.3)	$ 201,741.0	$ 217,272.9	$ 176,568.8
E. Accrued Interest	$ 3,635.0			$ 3,635.0	$ 3,635.0	$ 4,235.7
F. Total Intragovernmental Securities	$ 218,238.3		$ (12,862.3)	$ 205,376.0	$ 220,907.9	$ 180,804.5
2. Other Investments:	$ 217.8		0.0	$ 217.8	0.0	$ 0.0

3. Other Information:

The decrease of $120.9 million in marketable securities is due to a reclassification from Intra-governmental to Other Investments.

The increase in Other Investments by $217.8 million represents the $120.9 million mentioned above and new investments in the amount of $96.9 million for the DoD limited partnerships. These limited partnerships have been entered into on behalf of the U.S. Government by both the Department of the Navy and Army in support of the Military Housing Privatization Initiative as signed into Public Law 104-106 110, Stat 186 on February 11, 1996, and do not require Market Value Disclosure.

The Net Investments increased by $25,293.1 million in Non-Marketable, Market-Based securities from year-end FY 2002 to year-end FY 2003. The majority of this increase is attributable to the following reporting entities:

- Investments of $18,445.2 million made by the Medicare-Eligible Retiree Health Care Fund, which was established at the beginning of FY 2003 (October 1, 2002).
- A positive cash flow of $6,675.5 million earned by the Military Retirement Fund.

Note 5. Accounts Receivable

As of September 30	2003			2002
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in millions)				
1. Intra-governmental Receivables:	$ 1,066.6	N/A	$ 1,066.6	$ 1,121.9
2. Non-Federal Receivables (From the Public):	$ 7,918.1	$ (618.2)	$ 7,299.9	$ 6,341.9
3. Total Accounts Receivable:	$ 8,984.7	$ (618.2)	$ 8,366.5	$ 7,463.8

4. Allowance method:

DoD Components used a variety of techniques for estimating Allowance for Uncollectible Accounts Receivable from the public. While the exact details differed among the Components, estimates were usually based on either a percentage of actual prior-year write-offs or a percentage of aged receivables from the public.

5. Other information:

Fluctuations

Total accounts receivable, net increased by $902.7 million or 12 percent between year-end FY 2002 and year-end FY 2003.

Intra-governmental receivables decreased by $55.3 million or 5 percent. The decrease was primarily due to improved accounts receivable reporting procedures implemented in FY 2003.

Non-federal receivables, net increased by $958.0 million or 15 percent. The following factors caused an increase of $1,599.8 million:

- Improved accounts receivable management and reporting procedures and polices
- Reporting of non-current interest receivable for water storage contracts that were not recorded in FY 2002 by the U.S. Army Corps of Engineers ($879.9 million)
- Reclassifying amounts due from foreign governments previously recorded as other assets by the Air Force Working Capital Fund ($116.3 million)
- Recording interest related to a pending contract settlement currently in litigation for the Department of the Navy ($56.8 million)

This increase was partially offset by a $641.8 million decrease primarily due to the reversal of a debt previously in litigation by the Air Force General Fund ($299.1 million) and due to the collection of contractor claims processing errors that occurred in FY 2002 for the Defense Health Program ($202.6 million).

Other Information Related to Intra-Governmental Accounts Receivable

Intra-governmental Accounts Receivable of $1,066.6 million consists of:

	Amount ($ in millions)
Army General Fund	$ 80.2
Navy General Fund	$ 80.6
Air Force General Fund	$ 141.5
US Army Corps of Engineers	$ 414.1
Other Defense Components	$ 350.2
Total	**$1,066.6**

Other Information Related to Non-Federal Accounts Receivable

Non-federal Accounts Receivable, Net of $7,299.9 million consists of:

	Amount ($ in millions)
Army General Fund	$ 514.6
Navy General Fund	$3,382.1
Air Force General Fund	$ 772.5
US Army Corps of Engineers	$1,935.6
Other Defense Components	$ 695.1
Total	**$7,299.9**

Allocation of Undistributed Collections

Undistributed collections occur when a collection is received, but cannot be matched to an appropriate receivable. The Department's policy is to allocate supported undistributed collections between intra-governmental and non-federal categories based on the percentage of intra-governmental and non-federal accounts receivable. Unsupported undistributed collections are recorded as Other Liabilities in Note 15.

Elimination Adjustments

The Department's accounting systems do not capture trading partner data for purchases at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Department was unable to reconcile intra-governmental accounts receivable balances with its trading partners. Through the ongoing Business Management Modernization Program, the Department intends to develop long-term systems improvements by FY 2006 that will capture the data necessary to perform reconciliations.

Other Information Related to Non-Federal Refunds Receivable

Three DoD Components reported non-federal refunds receivable in excess of 10 percent of the total non-federal accounts receivable:

	FY2003 Non-Federal Refunds Receivable (Net) (in millions)	**FY2003 Non-Federal Accounts Receivable (Net) (in millions)**	**Percentage of Net Amount**
Army General Fund	$314.5	$514.6	61.1%
Army WCF	5.4	31.2	17.3%
Military Retirement Fund	5.6	14.7	38.1%

Amounts reported for non-federal refunds receivable primarily originated from debts owed by military service members.

Note Reference

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

For further discussion on "Accounts Receivable" see the Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1007 and Volume 4, Chapter 3.

Note 6. Other Assets

As of September 30	2003	2002
(Amounts in millions)		
1. Intra-governmental Other Assets:		
A. Advances and Prepayments	$ 105.0	$ 0.1
B. Other Assets	0.0	0.0
C. Total Intra-governmental Other Assets	$ 105.0	$ 0.1
2. Non-Federal Other Assets:		
A. Outstanding Contract Financing Payments	$ 18,868.7	$ 15,227.2
B. Other Assets (With the Public)	2,860.9	3,018.6
C. Total Non-Federal Other Assets	$ 21,729.6	$ 18,245.8
3. Total Other Assets:	$ 21,834.6	$ 18,245.9

4. Other Information Related to Other Assets:

Fluctuations

Total Other Assets increased $3,558.7 million (approximately 19.7 percent) from year-end FY 2002 to year-end FY 2003. Outstanding Contract Financing Payments was the most significant change as the account increased by $3,641.5 million (23.9 percent). This increase in Outstanding Contract Financing Payments occurred largely as a result of additional progress payments of $2,369.4 million made by the Air Force during FY 2003 primarily for the F-22 program. An additional increase in Outstanding Contract Financing Payments of $1,200.3 million was due to increased funding in Navy Procurement accounts; primarily in their Aircraft Procurement account.

Intragovernmental Other Assets

As of year-end FY 2003, there were approximately $105.0 million in Advances and Prepayments between the DoD and the Department of the Interior. These Advances and Prepayments are supported by the Department of Interior's Intergovernmental Reconciliation Accounting System report. This represents an increase of $104.9 million from year-end FY 2002 when there was $90.1 million that represented the FY 2002 Advances and Prepayments activity between the Department and other federal agencies.

For Intragovernmental Other Assets overall, per DoD's practice, buyer-side "advances to others" balances were adjusted to agree with the seller-side "advances from others" balances in the financial records of other DoD reporting entities. Additionally, the buyer-side "prepayments" balances were adjusted to agree with seller-side "deferred credits" balances in the financial records of other DoD reporting entities.

Non-Federal Other Assets

Outstanding Contract Financing Payments

The Department reports, as an advance and prepayment, all outstanding financing payments for fixed-price contracts that are not based on percentage or stage of completion. Under the contract terms, the Department becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the Department is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the Department for the full amount of the outstanding contract financing payments.

Other Assets (With the Public)

For Other Assets (With the Public) overall, there was a $157.7 million (5.2 percent) decrease.

Other Non-Federal Assets Disclosure

Type of Asset		**FY 2003 (in millions)**
Non-Federal		
Other Contract Financing Payments		
Army GF	$	3,163.7
Navy GF		5,809.6
Air Force GF		9,645.3
Army WCF		250.1
Total Other Contract Financing Payments	**$**	**18,868.7**
Other Assets With The Public		
Army		
Advances to Others	$	376.1
Prepayments		.2
Other Assets		48.8
Navy		
Advances to Others	$	168.2
Prepayments		355.1
Other Assets		716.5
Air Force		
Advances to Others	$	434.0
Other Assets		213.2

DLA		
Advances to Others and Misc. Advances		211.1
Other Agencies		
Advances to Others	$	89.5
Prepayments		246.5
Other Assets from Multiple Reporting Entities		1.7
Total Other Assets With the Public	**$**	**2,860.9**

Navy's $716.5 million Other Assets (With the Public) includes $606.3 million relating to the outstanding debt principal reported for the Transportation Activity Group involving Time Charter arrangements made by Military Sealift Command for the long-term use of the Afloat Prepositioning Force – Navy ships. The outstanding debt principal is reported here to reconcile with the amount reported by the Federal Financing Bank through the trading partner elimination process (see Note 13 for additional disclosures).

Note Reference

See Note Disclosure 1. R. - Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Other Assets.

Note 7. Cash and Other Monetary Assets

As of September 30	2003		2002	
(Amounts in millions)				
1. Cash	$	1,290.8	$	573.2
2. Foreign Currency (purchased and non-purchased)		244.1		148.6
3. Other Monetary Assets		0.0		20.9
4. Total Cash, Foreign Currency, & Other Monetary Assets	$	1,534.9	$	742.7

5. Other Information Pertaining to Entity Cash & Other Monetary Assets:

Definitions

Cash and Foreign Currency – Cash is the total of cash resources under the control of the Department of Defense, which includes coin, paper currency, negotiable instruments, and amounts on deposit in banks and other financial institutions. Cash available for agency use includes petty cash funds and cash held in revolving funds which will not be transferred into the U.S. Government General Fund. Foreign currency consists of the total U.S. dollar equivalent of both purchased and non-purchased foreign currencies held in foreign currency fund accounts. Non-purchased foreign currency is limited to the Treasury Index 97X7000 fund account (formerly called FT accounts). There is a very limited dollar amount for non-purchased foreign currency. Non-purchased foreign currencies are acquired under the provisions of foreign assistance or foreign agricultural development programs.

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

Fluctuation and/or Abnormalities

Cash increased $717.6 million (125.2 percent) primarily resulting from increases in cash on hand to support the military build-up related to both Operation Iraqi Freedom and Operation Enduring Freedom. Foreign currency increased $95.5 million (64.2 percent) primarily as a result of deployment for both Operation Iraqi Freedom and Operation Enduring Freedom. The foreign currency is primarily required to pay foreign vendors, provide cash for agents in support of deployed tactical units, and provide currency for exchange of U.S. dollars for troops stationed overseas. The other significant reason for the increase in foreign currency is attributed to the advance provided by the Korean government to the Army Corps of Engineers to cover construction, labor, and logistics costs of the Corps. Other monetary assets decreased by $20.9 million when an evaluation determined that the amount should be reclassified as an investment.

Cash and Foreign Currency

Cash and foreign currency reported consists primarily of cash held by Disbursing Officers to carry out their paying, collecting and foreign currency accommodation exchange missions. The primary source of the amounts reported for cash and purchased foreign currency is the Standard Form 1219, Statement of Accountability. The non-purchased foreign currency, if there is any, is reported on the monthly DD Form 1363 (Statement of Transactions and Accountability (FT Accounts). Foreign currency is valued using the Department of Treasury Prevailing Rate of Exchange. This rate is the most favorable rate that would legally be available to the U.S. Government's acquisition of foreign currency for its official disbursements and provide currency for exchange of U.S. dollars for troops. Cash seized during Operation Iraqi Freedom is restricted for use to assist the Iraqi people and support the reconstruction of Iraq.

Note Reference

See Note Disclosure 1. J. - Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Foreign Currency.

Note 8. A.	Direct Loan and/or Loan Guarantee Programs

1. **Direct Loan and/or Loan Guarantee Programs:** The entity operates the following direct loan and/or loan guarantee program(s):
   Military Housing Privatization Initiative
   Armament Retooling & Manufacturing Support Initiative

2. **Other Information:**

Relevant Information for Comprehension

"Federal Credit Reform Act of 1990" (CRA) governs all direct loan obligations and loan guarantee commitments made or amended after FY 1991 resulting in direct loans or loan guarantees. The Department complies with the CRA and reports direct loans and loan guarantees in accordance with OMB Bulletin 01-09 "Form and Content of Agency Financial Statements."

- Direct loans are reported net of allowance for subsidy cost at present value.
- Loan guarantee liabilities are reported at present value.

Military Housing Privatization Initiative

The Military Housing Privatization Initiative (MHPI) includes both a Direct Loan and Loan Guarantee Program. MHPI fosters a mutually beneficial relationship between the Department of Defense (DoD) and the private sector. The DoD obtains private sector capital to leverage government dollars. The DoD provides protection against specific risks, such as base closure or member deployment, for the private sector partner.

The Loan Guarantee Program authorized by the National Defense Authorization Act for FY 1996, Public Law 104-106 Statute 186, Section 2801, includes a series of powerful authorities that allow the Department to work with the private sector to renovate military housing. The Department's goals are to:

- obtain private capital to leverage government dollars;
- make efficient use of limited resources; and
- use a variety of private sector approaches to build and renovate military housing.

The Act also provides the Department with a variety of authorities to obtain private sector financing and expertise to improve military housing. The Department uses these authorities individually, or in combination. They include:

- guarantees, both loan and rental
- conveyance/leasing of existing property and facilities
- differential lease payments
- investments, both limited partnerships and stock/bond ownership
- direct loans

Armament Retooling and Manufacturing Support Initiative

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

The US Department of Agriculture Rural Business-Cooperative Service (RBS) and the United States Army established a Memorandum of Understanding (MOU) to furnish services to the Army in connection with the ARMS Initiative Loan Guarantee

Program (AILG) pursuant to Section 193 of the Armament Retooling and Manufacturing Support Act of 1992 (P.L. 102-484), as amended (10 U.S.C. 2501 note). The Army was authorized by the National Defense Authorization Act for Fiscal Year 1995 (P.L. 103-337) to enter into this MOU with RBS pursuant to 31 U.S.C. 1535. RBS has the needed programmatic and administrative services necessary and convenient and to provide other services required administering the AILG Program. Therefore, to ensure service to the public and for protection of the federal interests and rights, it was necessary for Army to obtain services from RBS.

Prior to FY 2002, the RBS was required to include this program in the US Department of Agriculture (USDA) financial statements. In FY 2002, the USDA was not required to include this program and the Department of the Army reports the balance. This complies with the Office of Management and Budget (OMB) Bulletin No. 01-09, Note 36 and OMB Circular A-11, Section 20.4.

Note 8.B. Direct Loans Obligated After FY 1991

As of September 30	2003	2002
(Amounts in millions)		
Loan Programs		
1. Military Housing Privatization Initiative:		
A. Loans Receivable Gross	$ 129.1	$ 92.6
B. Interest Receivable	0.0	0.0
C. Foreclosed Property	0.0	0.0
D. Allowance for Subsidy Cost (Present Value)	(65.1)	(48.4)
E. Value of Assets Related to Direct Loans	$ 64.0	$ 44.2
2. Armament Retooling & Manufacturing Support Initiative:		
A. Loans Receivable Gross	$ 0.0	$ 0.0
B. Interest Receivable	0.0	0.0
C. Foreclosed Property	0.0	0.0
D. Allowance for Subsidy Cost (Present Value)	0.0	0.0
E. Value of Assets Related to Direct Loans	$ 0.0	$ 0.0
3. Total Loans Receivable:	$ 64.0	$ 44.2

4. Other Information:

Subsidy costs are recognized when direct loans are disbursed to borrowers and are reestimated each year. Allowance for subsidy cost is the difference between the outstanding principal of the loans and the present value of their net cash inflows. New loans in the amount of $36.7 million were disbursed relating to housing at Elmendorf, Alaska and Camp Pendleton, California. There were loan principal repayments of

$.2 million during FY 2003 for the Lackland Air Force Base, TX project, resulting in a net increase of $36.5 million. The difference between the FY 2002 Beginning Balance of Allowance for Subsidy Cost (Present Value) in this note and note 8.F. is due to a correction of $6.6 million recognized in the current period. This amount is not material to the DoD, so the prior year amounts are not being restated.

Note 8.C. Total Amount of Direct Loans Disbursed

As of September 30 (Amounts in millions)	2003	2002
Direct Loan Programs		
1. Military Housing Privatization Initiative:	$ 36.7	$ 92.6
2. Armament Retooling & Manufacturing Support Initiative	0.0	0.0
3. Total	$ 36.7	$ 92.6

4. Other Information:

Direct loans disbursed declined by 60 percent or $55.9 million from FY 2002 to FY 2003. This is due to the reduced number of direct loans issued. Total direct loans disbursed in FY 2003 for the MHPI program are (in millions):

Camp Pendleton Marine Corps Base, California	6.0
Elmendorf Air Force Base, Alaska	30.7
Total Direct Loans Disbursed	36.7

Gross direct loans disbursed for the MHPI program from inception consists of the following (millions):

Dyess Air Force Base, Texas	28.9
Elmendorf Air Force Base, Alaska	48.0
Lackland Air Force Base, Texas	10.6
Warner Robins Air Force Base, Georgia	22.3
Camp Pendleton Marine Corps Base, California	17.0
Kingsville Air Force Base, Texas	2.5
Total	129.3

Direct loans disbursed in FY 2002 consisted of the following (in millions):

Dyess Air Force Base, Texas	28.9
Elmendorf Air Force Base, Alaska	17.3
Lackland Air Force Base, Texas	10.6
Warner Robins Air Force Base, Georgia	22.3
Camp Pendleton Marine Corps Base, California	11.0
Kingsville Air Force Base, Texas	2.5
Total	92.6

Note 8.D. Subsidy Expense for Post-1991 Direct Loans

As of September 30 (Amounts in millions)					
2003	**Interest Differential**	**Defaults**	**Fees**	**Other**	**Total**
1.Subsidy Expense for New Direct Loans Disbursed:					
Military Housing Privatization Initiative	$ 19.2	$ 4.1	$ 0.0	$ 0.0	$ 23.3
Armament Retooling & Manufacturing Support Initiative	0.0	0.0	0.0	0.0	0.0
Total	$ 19.2	$ 4.1	$ 0.0	$ 0.0	$ 23.3
2002	**Interest Differential**	**Defaults**	**Fees**	**Other**	**Total**
2.Subsidy Expense for New Direct Loans Disbursed:					
Military Housing Privatization Initiative	$ 34.6	$ 7.2	$ 0.0	$ 0.0	$ 41.8
Armament Retooling & Manufacturing Support Initiative	0.0	0.0	0.0	0.0	0.0
Total	$ 34.6	$ 7.2	$ 0.0	$ 0.0	$ 41.8
2003	**Modifications**	**Interest Rate Reestimates**	**Technical Reestimates**	**Total Reestimates**	**Total**
3. Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0
Armament Retooling & Manufacturing Support Initiative	0.0	0.0	0.0	0.0	0.0
Total	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0
2002	**Modifications**	**Interest Rate Reestimates**	**Technical Reestimates**	**Total Reestimates**	**Total**
4. Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0
Armament Retooling & Manufacturing Support Initiative	0.0	0.0	0.0	0.0	0.0
Total	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0

	2003	2002
5. Total Direct Loan Subsidy Expense:		
Military Housing Privatization Initiative	$ 23.3	$ 41.8
Armament Retooling & Manufacturing Support Initiative	0.0	0.0
Total	$ 23.3	$ 41.8

6. Other Information:

The interest rate and default cost values represent the amounts for the three phased loans disbursed in FY 2003. These rates are established for each individual loan, ranging from 66 percent for the Camp Pendleton Marine Corps Base, CA project to 43 percent for the Elmendorf Air Force Base, AK project.

The decline in the reporting of Interest Rate Differential Costs and Default Costs from year-end FY 2002 is proportional to six loans disbursed for FY 2002 and two loans disbursed in FY 2003. The reduction in loans disbursed results in an $18.5 million decrease for the direct loan subsidy expense. The subsidy rate differs for each project, from 66 percent for Camp Pendleton Marine Corps Base, CA to 43 percent for Elmendorf Air Force Base, AK. This has a direct impact on the variance from FY 2002 to FY 2003.

The $23.3 million in total Subsidy Expense includes the recognition of Subsidy from loans disbursed prior to FY 2003. This represents a correction of $6.6 million recognized in the current period and not a reestimate. This amount is not material to the DoD, so the prior-year amounts are not being restated.

As of September 30, 2003, there were no reestimates for the Direct Loans Program.

Note 8.E. Subsidy Rate for Direct Loans

	Interest Differential	Defaults	Fees	Other	Total
Direct Loans:					
1. Military Housing Privatization Initiative:	30.62%	9.33%	0.00%	0.00%	39.95%
2. Armament Retooling & Manufacturing Support Initiative	0.00%	0.00%	0.00%	0.00%	0.00%

3. Other Information:

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

Subsidy rates for FY 2004 are included in the FY 2004 Presidential Budget Federal Credit Supplement and are published at the following website:

http://www.whitehouse.gov/omb/budget/fy2004/pdf/cr_supp.pdf.

Note 8.F. Schedule for Reconciling Subsidy Cost Allowance Balances for Post-1991 Direct Loans

Beginning Balance, Changes and Ending Balance		2003
(Amounts in millions)		
1. Beginning balance of the subsidy cost allowance	$	41.8
2. Add: subsidy expense for direct loans disbursed during the reporting years by component:		
A. Interest rate differential costs	$	19.2
B. Default costs (net of recoveries)		4.1
C. Fees and other collections		0.0
D. Other subsidy costs		0.0
E. Total of the above subsidy expense components	$	23.3
3. Adjustments:		
A. Loan modifications	$	0.0
B. Fees received		0.0
C. Foreclosed property acquired		0.0
D. Loans written off		0.0
E. Subsidy allowance amortization		0.0
F. Other		0.0
G. Total of the above adjustment components	$	0.0
4. Ending balance of the subsidy cost allowance before reestimates	$	65.1
5. Add or subtract subsidy reestimates by component:		
A. Interest rate reestimate	$	0.0
B. Technical/default reestimate		0.0
C. Total of the above reestimate components	$	0.0
6. Ending balance of the subsidy cost allowance	$	65.1

Note 8.G. Defaulted Guaranteed Loans from Post-1991 Guarantees

As of September 30	2003	2002
(Amounts in millions)		
Loan Guarantee Program(s)		
1. Military Housing Privatization Initiative:		
A. Defaulted Guaranteed Loans Receivable, Gross	$ 0.0	$ 0.0
B. Interest Receivable	0.0	0.0
C. Foreclosed Property	0.0	0.0
D. Allowance for Subsidy Cost (Present Value)	0.0	0.0
E. Value of Assets Related to Defaulted Guaranteed Loans Receivable	$ 0.0	$ 0.0
2. Armament Retooling & Manufacturing Support Initiative		
A. Defaulted Guaranteed Loans Receivable, Gross	$ 0.0	$ 0.0
B. Interest Receivable	0.0	0.0
C. Foreclosed Property	0.0	0.0
D. Allowance for Subsidy Cost (Present Value)	0.0	0.0
E. Value of Assets Related to Defaulted Guaranteed Loans Receivable	$ 0.0	$ 0.0
3. Total Value of Assets Related to Defaulted Guaranteed Loans Receivable	$ 0.0	$ 0.0
4. Other Information:		

As of the September 30, 2003, the Department had no defaulted guaranteed loans.

Note 8.H. Guaranteed Loans Outstanding

As of September 30 (Amounts in millions) Loan Guarantee Program Title	Outstanding Principal, Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
2003		
1. Military Housing Privatization Initiative	$ 389.0	$ 389.0
2. Armament Retooling & Manufacturing Support Initiative	26.8	24.0
3. Total	$ 415.8	$ 413.0
2002		
1. Military Housing Privatization Initiative	$ 75.0	$ 75.0
2. Armament Retooling & Manufacturing Support Initiative	8.6	7.7
3. Total	$ 83.6	$ 82.7

4. Other Information:

MHPI

During FY 2003 new Guaranteed Loans were created for Kirtland Air Force Base, NM, Wright Patterson Air Force Base, OH, Warner Robins Air Force Base, GA, Elmendorf Air Force Base, AK and Lackland Air Force Base, TX. The Guaranteed Loans Outstanding for the MHPI program as of the end of FY 2003 consists of the following (in millions):

Warner-Robins Air Force Base, GA	25.6
Fort Carson Army Installation, CO	147.0
Kirtland Air Force Base, NM	74.0
Wright Patterson Air Force Base, OH	65.0
Elmendorf Air Force Base, AK	48.0
Lackland Air Force Base, TX	29.4
Total	389.0

ARMS

Guaranteed loans outstanding increased by $18.2 million or 213 percent as a result of issuing two additional loans in FY 2003.

Note 8.I. Liability for Post-1991 Loan Guarantees, Present Value

As of September 30 (Amounts in millions)	2003	2002
Loan Guarantee Program Title		
1. Military Housing Privatization Initiative	$ 24.6	$ 13.4
2. Armament Retooling & Manufacturing Support Initiative	1.3	0.7
3. Total	$ 25.9	$ 14.1

4. Other Information:

MHPI

The net increase of $11.2 million between FY 2002 and FY 2003 is the result of new guaranteed loans. New guaranteed loans for FY 2003 are listed in note 8.H. The FY 2003 liability also includes a correction of a negative $2.1 million recognized in the current period and not a reestimate. This amount is not material to the DoD, so the prior-year amounts are not being restated.

ARMS

Total Loan Guarantee Liabilities increased $.6 million as a result of two additional loans issued in FY 2003.

Note 8.J.	Subsidy Expense for Post-1991 Loan Guarantees

As of September 30 (Amounts in millions)					
2003	Interest Differential	Defaults	Fees	Other	Total
1. Subsidy Expense for New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	$ 0.0	$ 11.3	$ 0.0	$ 0.0	$ 11.3
Armament Retooling & Manufacturing Support Initiative	0.0	0.1	(0.0)	0.0	0.1
Total	$ 0.0	$ 11.4	$ 0.0	$ 0.0	$ 11.4
2002	Interest Differential	Defaults	Fees	Other	Total
2. Subsidy Expense for New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	$ 0.0	$ 10.1	$ 0.0	$ 0.0	$ 10.1
Armament Retooling & Manufacturing Support Initiative	0.0	(0.0)	0.0	0.0	0.0
Total	$ 0.0	$ 10.1	$ 0.0	$ 0.0	$ 10.1
2003	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
3. Loan Guarantee Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0
Armament Retooling & Manufacturing Support Initiative	0.0	0.0	0.0	0.0	0.0
Total	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0
2002	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
4. Loan Guarantee Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0
Armament Retooling & Manufacturing Support Initiative	0.0	0.0	0.0	0.0	0.0
Total	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0

	2003	2002
5. Total Loan Guarantee Subsidy Expense:		
Military Housing Privatization Initiative	$ 11.3	$ 10.1
Armament Retooling & Manufacturing Support Initiative	0.1	0.0
Total	$ 11.4	$ 10.1

6. Other Information:

MHPI

The MHPI has $11.3 million in Default Subsidy, which includes the recognition of subsidy from loans disbursed prior to FY 2003. This amount also includes a correction of a negative $2.1 million recognized in the current period and not a reestimate. This amount is not material to the DoD, so the prior-year amounts are not being restated.

ARMS

ARMS loan guarantee subsidy expense increased by $0.1 million as a result of increased loan activity.

Note 8.K. Subsidy Rate for Loan Guarantees

	Interest Supplements	Defaults	Fees and other Collections	Other	Total
Loan Guarantees:					
1. Military Housing Privatization Initiative:	0.00%	5.40%	0.00%	0.00%	5.40%
2. Armament Retooling & Manufacturing Support Initiative	0.00%	4.94%	-1.60%	0.00%	3.34%

3. Other Information:

MHPI

The subsidy rates disclosed pertain only to the current year's cohorts. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year that could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes modifications and reestimates.

These rates are obtained from the following web site: http://www.whitehouse.gov/omb/budget/fy2004/pdf/cr_supp.pdf.

The FY 2004 Federal Credit Supplement provides summary information about Federal Direct Loan and Loan Guarantee Programs subject to the Federal Credit Reform Act (FCRA) of 1990, as amended by the Balanced Budget Act of 1997. The data is based on legislation enacted for FY 2002 and the proposals contained in the President's 2003 Budget.

Note 8.L. Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees

Beginning Balance, Changes and Ending Balance		2003
(Amounts in millions)		
1. Beginning balance of the loan guarantee liability	$	14.1
2. Add: subsidy expense for guaranteed loans disbursed during the reporting years by component:		
A. Interest supplement costs	$	0.0
B. Default costs (net of recoveries)		11.4
C. Fees and other collections		(0.0)
D. Other subsidy costs		0.0
E. Total of the above subsidy expense components	$	11.4
3. Adjustments:		
A. Loan guarantee modifications	$	0.0
B. Fees received		0.4
C. Interest supplements paid		0.0
D. Foreclosed property and loans acquired		0.0
E. Claim payments to lenders		0.0
F. Interest accumulation on the liability balance		0.0
G. Other		0.0
H. Total of the above adjustments	$	0.4
4. Ending balance of the loan guarantee liability before reestimates	$	25.9
5. Add or subtract subsidy reestimates by component:		
A. Interest rate reestimate		0.0
B. Technical/default reestimate		0.0
C. Total of the above reestimate components	$	0.0
6. Ending balance of the loan guarantee liability	$	25.9
7. Other Information:		

Note 8.M. Administrative Expense

As of September 30	2003	2002
(Amounts in millions)		
1. Direct Loans:		
Military Housing Privatization Initiative	$ 0.0	$ 0.0
Armament Retooling & Manufacturing Support Initiative	0.0	0.0
Total	$ 0.0	$ 0.0
2. Loan Guarantees:		
Military Housing Privatization Initiative	$ 0.0	$ 0.0
Armament Retooling & Manufacturing Support Initiative	0.0	0.0
Total	$ 0.0	$ 0.0

3. Other Information:

Administrative Expense is limited to separately identified expenses administered to direct and guaranteed loans. DoD does not maintain a separate program to capture the expenses related to direct and guaranteed loans only for the MHPI.

Administrative Expense for the ARMS is a fee paid to the U.S. Department of Agriculture Rural Business-Cooperative Service (RBS) for administering the loan guarantees under the ARMS, which is a joint program (see Note 8.A.). Administrative Expense for the ARMS is immaterial to the DoD financial statements.

Note 9. Inventory and Related Property

As of September 30	2003	2002
(Amounts in millions)		
1. Inventory, Net (Note 9.A.)	$ 52,995.0	$ 53,375.1
2. Operating Materials & Supplies, Net (Note 9.B.)	139,351.2	90,715.4
3. Stockpile Materials, Net (Note 9.C.)	1,827.9	2,108.1
4. Total	$ 194,174.1	$ 146,198.6

Note 9.A. Inventory, Net

As of September 30	2003			2002	
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	Valuation Method
(Amounts in millions)					
1. Inventory Categories:					
A. Available and Purchased for Resale	$ 70,162.0	$ (36,465.4)	33,696.6	$ 34,984.5	
B. Held for Repair	27,763.6	(10,408.3)	17,355.3	16,066.1	
C. Excess, Obsolete, and Unserviceable	3,823.3	(3,823.3)	0.0	0.0	
D. Raw Materials	9.8	0.0	9.8	0.0	
E. Work in Process	1,933.3	0.0	1,933.3	2,324.5	
F. Total	$ 103,692.0	$ (50,697.0)	52,995.0	$ 53,375.1	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses
SP = Standard Price
AC = Actual Cost
NRV = Net Realizable Value
O = Other
MAC = Moving Average Cost

2. Restrictions of Inventory Use, Sale, or Disposition:

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

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

3. Other Information:

Category	Valuation Method
Available and Purchased for Resale	LAC; MAC; AC
Held for Repair	LAC; O; MAC
Excess, Obsolete, and Unserviceable	LAC; AC; NRV; O
Work in Process	MAC; LAC; SP

Definitions

Inventory Available and Purchased for Resale includes consumable spare and repair parts and repairable items owned and managed by the Department. This inventory includes material held due to a managerial determination that these items should be retained to support military or national contingencies.

Inventory Held for Repair is damaged inventory that requires repair to make suitable for sale. It is more economical to repair than to procure these inventory items. In addition, because the Department often relies on weapon systems and machinery no longer in production, the Department supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force.

Excess, Obsolete, and Unserviceable inventory consists of scrap materials or items that cannot be economically repaired and are awaiting disposal. Potentially reusable material, presented in previous years as "Excess, Obsolete and Unserviceable" is included in "Held for Use" or "Held for Repair" categories according to its condition. As explained below, this category is no longer used.

Work in Process balances include costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs. Work in Process also includes the value of finished products or completed services pending the submission of bills to the customer. The Work in Process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including the amount withheld from payment to ensure performance, and the amount paid to other Government plants for accrued costs of end items of material ordered but not delivered.

Changes from Prior Year's Accounting Methods – Inventory Valuation

Effective for fiscal year 2002 and prior, OUSD(C) memorandum dated August 12, 2002, Subj: Accounting for Excess, Obsolete, and Unserviceable Inventory and Operating Materials and Supplies, implemented a Department-wide change in policy for classification of and accounting for excess, obsolete, and unserviceable inventory. This policy change revised the Department's previous process which used supply stratification reports to determine potential excess items. These items were written down annually to Net Realizable Value - with the annual net changes recorded as expenses. The change in policy limited the write-down of inventory to specific condition codes for condemned items with a net realizable value of zero. This change was applied to FY 2002 and prior and, accordingly, required a reversal of previous years' expenses - and a reestablishment of significant amounts of inventory as Inventory "Available and Purchased for Resale." This policy is reflected in the following schedule of Inventory, Net, by reporting Service and Agency:

	Inventory, Net Categories				
Agencies	Available and Purchased for Resale	Held for Repair	Work In Process	Sept 30, 2003 Total (in Millions)	Sept 30,2002 Total (in millions)
Army	11,269.0	895.1	261.0	12,425.0	$11,319.3
Navy	3,319.3	13,242.9	957.2	17,519.4	17,012.6
Air Force	6,598.8	3,206.7	693.6	10,499.2	12,846.8
Defense Logistics Agency	12,149.0	10.5		12,159.5	11,525.1
Other Defense Agencies	370.4		21.5	391.9	671.3
Total	**33,706.4**	**17,355.2**	**1,933.3**	**52,995.0**	$53,375.1
Total – September 30, 2002	$34,984.0	$16,066.6	$2,324.5	$53,375.1	

Fluctuations and/or Abnormalities

The high value for Navy "Held for Repair" was attributed to increased support for Operation Iraqi Freedom which included significant movement of reparable items from activities to repair facilities such as shipyards and aircraft maintenance facilities.

The overall decrease in Inventory, Net is $380.1 million. This amount is .72 percent of the total value of Inventory. This reflects the requirements of Operation Iraqi Freedom.

U.S. Army
Raw Materials increased $9.8 million or 100%. The Army Working Capital Fund is reporting this category of inventory for the first time in FY 2003. This is the result of implementation of the Army's Logistics Management Program at some of its activities. These reclassified items were previously reported as Available and Purchased for Resale.

General Composition of Inventory

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

1) Held for sale, or held for repair for eventual sale;
2) In the process of production for sale; or
3) To be consumed in the production of goods for sale or in the provision of services for a fee.

Spare and repair parts, clothing and textiles, fuels, ammunition, missiles, aircraft engines, and other items held for consumption by General Funds are categorized as Operating Materials & Supplies. (See Note 9.B.)

Inventory "held for repair" is damaged material that requires repair to make it usable. "Excess inventory" is condemned material that must be retained for management purposes. "Work in process" includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services. The United States Standard General Ledger does not include a separate work in process general ledger account unrelated to sales.

Changes from Prior Year's Accounting Methods – Revaluation Allowance

"In accordance with generally accepted accounting principles and Statement of Federal Financial Accounting Standards Number 3, the Department's inventory is required to be valued at historical cost or at an approximation of historical cost utilizing an accepted method as stated in SFFAS No. 3. Because the Department's logistics and accounting systems were not designed to maintain historical values as required, the Department has been utilizing an accepted alternative which adjusts latest acquisition costs (LAC) and standard prices to an approximation of historical cost. Latest acquisition cost and standard prices apply the latest procurement prices to all like items in inventory. LAC and standard price methods, however, typically create inflated inventory values due to unrealized gains generated by procurement cost adjustments to all items. Because such gains should not be realized until items are sold, the Department requires an adjustment for price gains and operating surcharges for regulatory reporting. These gains have been, and continue to be, captured in an Allowance account which, when netted against gross inventory values, produce a net inventory which approximates historical cost.

In a July 6, 2001 memorandum, the Office of the Under Secretary of Defense (Comptroller) prescribed moving average cost (MAC) as the inventory valuation method to be used by the Department. However, the change in policy recognized the deficiencies in current systems as noted above and authorized the continued use of the Allowance method for other functional areas (e.g., logistics, procurement, budget) - and for legacy financial systems - but only until such time as those systems are replaced. Transition from the Allowance method to MAC began in fiscal year 2002 and continues in 2003 and beyond.

Note Reference

See Note Disclosure 1. M. **-** Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Inventory and Related Property.

For regulatory discussion on accounting treatment of "Inventory, Net" see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 101103.

Note 9.B. Operating Materials and Supplies, Net

As of September 30	2003			2002	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in millions)					
1. OM&S Categories:					
A. Held for Use	$ 122,732.3	$ 0.0	$ 122,732.3	$ 79,979.5	
B. Held for Repair	18,169.3	(1,550.4)	16,618.9	10,255.6	
C. Excess, Obsolete, and Unserviceable	3,708.9	(3,708.9)	0.0	480.3	
D. Total	$ 144,610.5	$ (5,259.3)	$ 139,351.2	$ 90,715.4	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost adjusted for holding gains and losses
SP= Standard Price
AC= Actual Cost
NRV = Net Realizable Value
O = Other
MAC = Moving Average Cost

2. Restrictions on OM&S:

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

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

3. Other Information:

OM&S Categories	**Valuation Method**
Held for Use	LAC; MAC; AC; SP; O
Held for Repair	LAC; SP; MAC; O
Excess, Obsolete, and Unserviceable	AC; NRV; O; SP

General Composition of Operating Materials and Supplies

Operating Materials and Supplies includes spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally managed aircraft engines.

Decision Criteria for Identifying the Category to Which Operating Materials and Supplies are Assigned

Managers determine which items are more costly to repair than to replace. Items retained for management purposes are coded "condemned." The net value of these items is zero, and is shown as "Excess, Obsolete, and Unserviceable." The category "Held for Use" includes all issuable and economically reparable material. Before FY 2002, the Department showed "Potentially re-distributable" material, regardless of condition, as "Excess, Obsolete, and Unserviceable."

Fluctuations and/or Abnormalities for OM&S, Net

	Operating Materials & Supplies, Net				
Agencies	Held for Use	Held for Repair	Excess, Obsolete, and Unserviceable	Sept 30,2003 Total (in millions)	Sept 30,2002 Total (in millions)
Army	32,383.4	-	-	32,383.4	26,964.9
Navy	50,685.2	3,663.2	-	54,348.4	33,003.6
Air Force	39,515.5	12,955.7	-	52,471.2	28,817.5
Defense Logistics Agency	8.6	-	-	8.6	10.5
Other Defense Agencies	139.6	-	-	139.6	1,918.9
Total	**122,732.3**	**16,618.9**		**139,351.2**	90,715.4
Total – September 30, 2002	79,979.5	10,225.6	480.3	90,715.4	

Fluctuations and/or Abnormalities

OM&S increased by $48,635.8 million. The majority of this increase is attributable to the implementing the requirements under Statement of Federal Financial Accounting Standards (SFFAS) #23. "Eliminating the Category National Defense Property, Plant and Equipment (NDPP&E)." As a result the Department now reports under OM&S assets formerly reported as NDPP&E. This information was previously reported as Required Supplementary Stewardship Information (RSSI).

Government Furnished Material (GFM) and Contractor Acquired Material (CAM). Generally, the value of the Department's GFM and CAM in the hands of contractors is not included in the OM&S values reported above. 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 Reference

See Note Disclosure 1. M. **-** Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Inventory and Related Property.

For regulatory discussions on accounting treatment of “Stockpile Materials, Net” see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 101106.

Note 9.C. Stockpile Materials, Net

As of September 30	2003 Stockpile Materials Amount	2003 Allowance for Gains (Losses)	2003 Stockpile Materials, Net	2002 Stockpile Materials, Net	Valuation Method
(Amounts in millions)					
1. Stockpile Materials Categories:					
A. Held for Sale	$ 1,691.7	$ 0.0	$ 1,691.7	$ 2,039.7	
B. Held in Reserve for Future Sale	136.2	0.0	136.2	68.4	
C. Total	$ 1,827.9	$ 0.0	$ 1,827.9	$ 2,108.1	

Legend for Valuation Methods:

LAC= Latest Acquisition Cost
SP= Standard Price
AC= Actual Cost
NRV = Net Realizable Value
O = Other

2. Restrictions on Stockpile Materials:

There are legal restrictions on the use of stockpile materials. Strategic and critical materials are stockpiled in the interest of national defense to preclude a dangerous and costly dependence on foreign sources of supply in times of a national emergency. Due to environmental considerations, there is a moratorium on the sale of mercury and thorium nitrate.

3. Other Information:

Category	**Valuation Method**
Held for Sale	AC; LCM (Lower of Cost or Market)
Held for Reserve	AC; LCM

General Composition of Stockpile Materials

Stockpile materials are strategic and critical materials, held due to statutory requirements, for use in national defense, conservation or national emergencies. Strategic and critical materials are stockpiled in the interest of national defense to preclude a dangerous and costly dependence on foreign sources of supply in times of a national emergency. The quantities to be stockpiled are required to be sufficient to sustain the U. S. for a period of not less than three years during a national emergency (including a sustained conventional global war of indefinite duration). Required stockpile levels may only be changed by law through a Presidential proposal in the Annual Material Plan submitted to Congress.

Decision Criteria for Categorizing Stockpile Materials as "Held For Sale"

Materials for which Congress has not authorized sale are classified as Materials Held in Reserve. The balance of the stockpile is available for sale on the open market and is classified as Held for Sale. Disposals cannot be made from the stockpile except under the following situations: (1) necessary upgrading, refining, or processing; (2) necessary rotation to prevent deterioration; (3) determination as excess with potential financial loss if retained; and (4) as authorized by law.

Changes in the Criteria for Categorizing Stockpile Materials as "Held For Sale"

All materials held by the Defense National Stockpile (DNS) are classified as Materials Held in Reserve until Congressional action declares the materials are no longer required to be stockpiled and are available for sale on the open market. When DNS receives authorization to offer materials declared no longer needed and available for sale, DNS removes the materials from Material Held in Reserve and reclassifies them as Material Held for Sale.

Other Information Related to Stockpile Material, Net

The financial statements report the recorded historical cost in accordance with the lower of cost or market (LCM) principal.

Note Reference

See Note Disclosure 1. M. **-** Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Inventory and Related Property.

For regulatory discussion on accounting treatment of “Stockpile Materials,, Net” see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 101109.

Note 10.	General PP&E, Net

As of September 30	2003					2002
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in millions)						
1. Major Asset Classes:						
A. Land	N/A	N/A	$ 9,663.4	N/A	$ 9,663.4	$ 9,560.0
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,527.4	$ (83,139.4)	76,388.0	73,556.1
C. Leasehold Improvements	S/L	lease term	196.6	(100.4)	96.2	101.2
D. Software	S/L	2-5 Or 10	5,022.2	(2,629.5)	2,392.7	1,391.7
E. Equipment	S/L	5 Or 10	1,163,111.2	(825,057.0)	338,054.2	13,454.6
F. Assets Under Capital Lease [1]	S/L	lease term	577.2	(343.6)	233.6	264.4
G. Construction-in-Progress	N/A	N/A	19,388.3	N/A	19,388.3	24,143.2
H. Other			92.5	0.0	92.5	98.5
I. Total General PP&E			$ 1,357,578.8	$ (911,269.9)	$ 446,308.9	$ 122,569.7

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

Legend for Valuation Methods:

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

2. Other Information:

Fluctuations and/or Abnormalities

Total General PP&E increased by $323.7 billion (264.2 percent) from year-end FY 2002 to year-end FY 2003. The majority of this fluctuation was due to re-establishing the value of military equipment on the Balance Sheet (see disclosure below).

Equipment increased by $324.6 billion. This increase was primarily due to inclusion of $325.1 billion in military equipment. The estimated total acquisition cost of military equipment was $1,123.5 billion with accumulated depreciation of $798.4 billion resulting in a net book value of $325.1 billion. Military equipment was previously reported as National Defense PP&E in the Required Supplementary Stewardship Information.

The software increased by a net of $1,001.0 million (71.9 percent) due to the reclassification from the Construction-in-Progress (CIP) category to the software category. The majority of the change is attributable to the DFAS Working Capital Fund's reclassification of $433.9 million and the Air Force Working Capital Fund's reclassification of $510.0 million.

The CIP account decreased by $4,754.9 million (19.7 percent). The principal reasons for the decrease were as follow:

- The reclassification of software totaling $1,001.0 million (as described above).
- Compliance with a DoDIG audit recommendation to expense approximately $1,000.0 million for cost-sharing.
- The Corps of Engineer corrective action of $2,584.8 million to transfer out completed assets and to reclassify non project cost to expense.

Other Information Related to General PP&E, Net

Military Equipment

The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, in May 2003. This standard, which is effective for accounting periods beginning after September 30, 2002, establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades.

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

The data provided by BEA consist of investment and net book value data for 84 groups of equipment such as aircraft, ships and combat vehicles. BEA uses Department budget data for equipment acquisitions and actual quantities of equipment items delivered to calculate the Department's annual investment in equipment, after recognizing any equipment transfers or war losses. The Department adjusted BEA data to eliminate equipment items that are not accounted for as military equipment, such as spares, munitions, and inventory items, which are accounted for and reported as Inventory and Related Property.

Note 10.A. Assets Under Capital Lease

As of September 30	2003	2002
(Amounts in millions)		
1. Entity as Lessee, Assets Under Capital Lease:		
A. Land and Buildings	$ 574.6	$ 576.3
B. Equipment	2.6	11.5
C. Other	0.0	0.0
D. Accumulated Amortization	(343.6)	(323.4)
E. Total Capital Leases	$ 233.6	$ 264.4

2. Description of Lease Arrangements:

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

3. Other Information:

Fluctuations and/or Abnormalities

Assets Under Capital Lease decreased $30.8 million or 11.6 percent primarily due to straight-line depreciation of lease assets and expiration of leases.

Other Disclosures

Imputed interest was necessary to reduce net minimum lease payments to the present value calculated at the incremental borrowing rate at the inception of the leases.

Note Reference

Note 15B discusses the related capital lease liabilities. It discloses the current and noncurrent portion.

See Note 1.Q. – Significant Accounting Policies for additional discussion on financial reporting requirements and Department of Defense policies governing leases.

Note 11.	Liabilities Not Covered by Budgetary Resources

As of September 30,		2003		2002
(Amounts in millions)				
1. Intragovernmental Liabilities:				
A. Accounts Payable	$	0.0	$	7.0
B. Debt		18.2		65.6
C. Environmental Liabilities		0.0		0.0
D. Other		4,814.5		4,268.0
E. Total Intragovernmental Liabilities	**$**	**4,832.7**	**$**	**4,340.6**
2. Non-Federal Liabilities				
A. Accounts Payable	$	0.0	$	0.0
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities		1,233,557.2		1,157,773.5
C. Environmental Liabilities		58,047.6		55,420.3
D. Loan Guarantee Liability		0.0		0.0
E. Other Liabilities		12,552.1		11,439.7
F. **Total Non-Federal Liabilities**	**$**	**1,304,156.9**	**$**	**1,224,633.5**
3. Total Liabilities Not Covered by Budgetary Resources	**$**	**1,308,989.6**	**$**	**1,228,974.1**
4. Total Liabilities Covered by Budgetary Resources	**$**	**249,604.1**	**$**	**222,367.7**
5. Total Liabilities	**$**	**1,558,593.7**	**$**	**1,451,341.8**

Definitions

Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered by realized budgetary resources as of the balance sheet date.

Liabilities Covered by Budgetary Resources are those that are incurred by the reporting entity which are covered by realized budget resources as of the balance sheet date. Budgetary resources encompass not only new budget authority, but also other resources available to cover liabilities for specified purposes in a given year. Available budgetary resources include (1) new budget authority; (2) spending authority from offsetting collections (credited to an appropriation or fund account); (3) recoveries of unexpired budget authority through downward adjustments of prior year obligations; (4) unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year; and (5) permanent indefinite appropriations or borrowing authority, which have been enacted and signed into law as of the balance sheet date, provided that the resources may be apportioned by the Office of Management and Budget (OMB) without further action by the Congress or without a contingency first having to be met.

Fluctuations

Fluctuations in liabilities are disclosed in the individual footnotes. See Note Reference below for the applicable note schedule.

Other Information Related to Liabilities Not Covered By Budgetary Resources

Not Covered by Budgetary Resources (Fiscal Year 2002)

In FY 2002 certain liabilities that were covered by budgetary resources were improperly classified as not covered by budgetary resources. For FY 2003 reporting, mapping corrections of this misclassification resulted in a change to the amount of not covered by budgetary resources reported in the prior year column.

Intra-governmental Other

Intra-governmental Other (not covered by budgetary resources) consist primarily of an unliquidated progress payments and associated accrued interest receivable of $2,409.3 million for contractor debt, workmen compensation of $1,278.2 million, judgement fund liabilities of $591.4 million, and other custodial liabilities of $351.8 million. The contractor debt is reported as an unfunded liability to Treasury. Collections on this debt will be due and payable to Treasury as the appropriations are in a cancelled status. See Note 5 for further disclosure.

Non-Federal Other Liabilities

Non-Federal Other Liabilities (not covered by budgetary resources) consist primarily of unfunded annual leave of $7,572.7 million, non-environmental disposal liabilities of $2,168.7 million, and contingent liabilities of $1,528.6 million.

Note Reference

For Additional Line Item discussion, see:
Note 2, Nonentity and Entity Assets
Note 8, Direct Loans and/or Loan Guarantee Programs
Note 12, Accounts Payable
Note 13, Debts
Note 14, Environmental Restoration Liabilities, and Environmental Disposal Liabilities
Note 15, Other Liabilities
Note 17, Military Retirement Benefits and Other Employment-Related Actuarial Liabilities
Note 23, Disclosures Related to the Statement of Custodial Activity

Note 12. Accounts Payable

As of September 30	2003			2002
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in millions)				
1. Intra-governmental Payables:	$ 101.3	N/A	$ 101.3	$ 85.8
2. Non-Federal Payables (to the Public):	$ 27,862.8	$ 1.0	$ 27,863.8	$ 24,182.4
3. Total	$ 27,964.1	$ 1.0	$ 27,965.1	$ 24,268.2

4. Other Information:

The Non-Federal Payables balance for fiscal year 2002 of $24,182.4 million is $22.6 million more than the agency-wide balance of $24,159.8 million published in the FY 2002 Performance and Accountability Report. The reason for the difference is as follows:

The Defense Finance and Accounting Service made a $22.6 million prior period adjustment to record a fiscal year 2002 audit adjustment that had been made to the DFAS statements after publishing the DoD-wide statements. A prior period adjustment was recorded in fiscal year 2003 to include this change in the DoD-wide statements.

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

Fluctuations

Total accounts payable, net increased by $3,696.9 million or 15.2 percent between year-end FY 2002 and year-end FY 2003.

Intra-governmental Accounts Payable

Intra-governmental accounts payable increased by $15.5 million or 18 percent between year-end FY 2002 and year-end FY 2003. The major contributors to the increase were:

	Amount ($ in millions)
Air Force General Fund	$ 13.8
US Army Corps of Engineers	$ 12.1
Other Defense Organizations Working Capital Funds	$ (9.3)
Other Defense Components	$ (1.1)
Total	**$ 15.5**

The increase in intra-governmental payables was primarily the result of new trust fund payables. The U.S. Corps of Engineers is the lead agency for reporting the Inland Waterways and the Harbor Maintenance Trust Funds. Based on a change in accounting procedures, the Corps now reports both the payables and the receivables for transfers of invested balances. This increase is also the result of improved reporting of payables.

Non-Federal Payables

Non-federal accounts payables, net increased $3,681.4 million or 15.2 percent from year-end FY 2002 to year-end FY 2003. The major contributors to the increase were:

	Amount ($ in millions)
Army General Fund	$ 3,121.9
Navy General Fund	$ 232.1
Air Force General Fund	$ 873.9
Army Working Capital Fund	$ (168.6)
Navy Working Capital Fund	$ 303.2
Air Force Working Capital Fund	$(1,702.5)
US Army Corps of Engineers	$ (27.8)
Other Defense Organizations General Funds	$ 360.7
Other Defense Organizations Working Capital Funds	$ 582.5
Medicare-Eligible Retiree Health Care Fund	$ 106.0
Total	**$ 3,681.4**

The net increase in non-federal payables is attributable to the following factors:

- Additional spending for Operations Enduring Freedom, Iraqi Freedom and Noble Eagle. The Department's accounting systems cannot separate Iraqi-related accounts payable from peacetime accounts payable.
- Establishment of Medicare-Eligible Retiree Health Care Fund on October 1, 2002.
- Preparation of trading partner elimination journal vouchers at the consolidated activity group level, reducing the magnitude of the adjustment.
- Reclassification of unsupported, undistributed collections from United States Standard General Ledger (USSGL) account 2120, Disbursements in Transit, to USSGL account 2400, Liability for Deposit Funds, Clearing Accounts and Undeposited Collections, which are reported as Other Liabilities.
- Improved accounts payable reporting procedures implemented in FY 2003.

Other Information Related to Intra-Governmental Accounts Payable

Intra-governmental accounts payable of $101.3 million consists of:

	Amount ($ in millions)
US Army Corps of Engineers	$ 78.1
Other Defense Organizations General Fund	$ 0.5
Other Defense Organizations Working Capital Funds	$ 22.7
Total	**$ 101.3**

Other Information Related to Non-Federal Accounts Payable

Non-federal accounts payable of $27,863.8 million consists of:

	Amount ($ in millions)
Army General Fund	$ 9,089.1
Navy General Fund	$ 1,742.5
Air Force General Fund	$ 7,080.9
Army Working Capital Fund	$ 342.4
Navy Working Capital Fund	$ 2,102.9
Air Force Working Capital Fund	$ 89.0
US Army Corps of Engineers	$ 568.1
Other Defense Organizations General Fund	$ 2,648.0
Other Defense Organizations Working Capital Funds	$ 4,094.9
Medicare-Eligible Retiree Health Care Fund	$ 106.0
Total	**$27,863.8**

Undistributed disbursements

Undistributed disbursements represent the difference between disbursements and collections recorded at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury via the reconciled DD 1329 and DD 1400. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. Intransit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities' outstanding accounts payable balance.

Allocation of Undistributed Disbursements

The Department of Defense policy is to allocate supported undistributed disbursements between federal and non-federal categories based on the percentage of federal and non-federal accounts payable. The majority of the DoD Components reported following this allocation procedure, however, Army General Fund and Army Working Capital Fund allocated supported undistributed disbursements solely to non-federal accounts payable. Unsupported undistributed disbursements are recorded in United States Standard General Ledger (USSGL) account 2120, Disbursements in Transit.

Intra-governmental Eliminations

For the majority of the intra-agency sales, the Department of Defense's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the reporting entities were unable to reconcile intra-governmental accounts payable to the related intra-governmental accounts receivable that generated the payable.

The Department of Defense summary-level seller accounts receivable balances were compared to the Agencies' accounts payable. Adjustments were posted to the Agencies' accounts payable based on the comparison with the accounts receivable of the DoD Components providing goods and services to the Agencies. Positive differences were treated as unrecognized accounts payable.

Note Reference

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

Note 13. Debt

As of September 30	2003			2002
(Amounts in millions)	Beginning Balance	Net Borrowings	Ending Balance	Ending Balance
1. Public Debt:				
A. Held by Government Accounts	N/A	N/A	N/A	N/A
B. Held by the Public	N/A	N/A	N/A	N/A
C. Total Public Debt	N/A	N/A	N/A	N/A
2. Agency Debt:				
A. Debt to the Treasury	$ 81.5	$ (0.2)	$ 81.3	$ 81.5
B. Debt to the Federal Financing Bank	792.8	(175.9)	616.9	792.8
C. Debt to Other Federal Agencies	0.0	0.0	0.0	0.0
D. Total Agency Debt	$ 874.3	$ (176.1)	$ 698.2	$ 874.3
3. Total Debt:	$ 874.3	$ (176.1)	$ 698.2	$ 874.3
4. Classification of Debt:				
A. Intra-governmental Debt			$ 698.2	$ 874.3
B. Non-Federal Debt			N/A	N/A
C. Total Debt			$ 698.2	$ 874.3
5. Other Information:				

Debt to the Treasury

<u>Loan Subsidy Program Related to the Family Housing Improvement Fund's Military Housing Privatization Initiative (MHPI)</u>

The outstanding amount consists of interest and principal payments due to the Treasury. Funds in this account are used to provide direct loans to borrowers to acquire housing previously maintained and operated by the military under the MHPI. The outstanding debt of $ 63.9 million reflects a $7.1 million increase from the September 30, 2002 net borrowings. This increase is primarily due to Elmendorf AFB Alaska borrowing money from the US Treasury.

The U.S. Army Corps of Engineers Promissory Notes with the Treasury Fund Capital Improvements to the Washington Aqueduct

During FY 1997, 1998, and 1999, the U.S. Army Corps of Engineers executed three promissory notes totaling $75.0 million with the Department of the Treasury. Funds provided were used for capital improvements to the Washington Aqueduct. Arlington County and Falls Church, Virginia and the District of Columbia provide funding to repay the debt. During fiscal year 2003, actual drawdown of funds from the Treasury total $1.5 million. Principal repayments during fiscal year 2003 total $8.7 million. The decrease from FY 2002 represents principal repayments towards liquidating the debt.

Debt to the Federal Financing Bank (FFB)

Fluctuations and/or Abnormalities

Debt to the FFB decreased by $175.9 million from FY 2002 primarily as a result of FY 2003 reduction of the outstanding debt principal amount for the Department of the Navy Transportation Activity Group ($135.1 million) and the U.S. Transportation Command ($40.2 million).

The Department of Navy

As part of the Afloat Prepositioning Force (APF-N) program, the Department of the Navy makes loan repayments to the Treasury FFB on behalf of ship owners and in lieu of capital lease payments to these same ship owners. The FFB is reporting a debt in the amount of $615.6 million, which represents an outstanding principal balance of $606.2 million and accrued interest payable of $9.4 million, for the Transportation Activity. See Notes 3 and 6 for additional disclosures.

The United States Transportation Command

The debt consists of the principal and accrued interest balances left on the Military Sealift Command's (MSC) T-5 program that provides ships for time charter to MSC to meet requirements not available in the marketplace. The ships were financed with approximately 30 percent equity investments and 70 percent debt borrowings. The debt is in the form of loans from the FFB to the vessel owners. In order to simplify the payments, the FFB cross-disburses the semi-annual principal payments directly from the working capital fund. MSC records the equity payments upon receipt of invoices. Interest is paid by voucher rather than by non-expenditure transfer. Information provided by MSC indicates the FY 2003 year-to-date interest expense and accrued interest is $1.3 million as of September 30, 2003. This balance is payable in July 2004. MSC purchased all but the "Darnell:" class T-5 ships.

Balance September 30, 2002 (millions)	41.4
Payments made during FY 2003	(40.2)
Principal Balance September 30, 2003	1.2
Accrued Interest September 30, 2003	0.1
Total Outstanding Debt September 30, 2003	1.3

Note Reference

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

Note 14. Environmental Liabilities and Disposal Liabilities

As of September 30	2003			2002
(Amounts in millions)	Current Liability	Noncurrent Liability	Total	Total
1. Environmental Liabilities – Non Federal				
A. Accrued Environmental Restoration (DERP funded) Costs:				
1. Active Installations--Environmental Restoration (ER)	$ 1,626.8	$ 10,207.0	$ 11,833.8	$ 13,033.7
2. Active Installations--ER for Closed Ranges	37.4	4,324.7	4,362.1	1,705.1
3. Formerly Used Defense Sites (FUDS) -- ER	265.0	3,974.4	4,239.4	4,304.8
4. FUDS--ER for Transferred Ranges	128.2	13,496.2	13,624.4	11,220.3
B. Other Accrued Environmental Costs (Non-DERP funds)				
1. Active Installations--Environmental Corrective Action	74.7	486.3	561.0	456.3
2. Active Installations--Environmental Closure Requirements	9.4	94.2	103.6	109.7
3. Active Installations--Environ.Response at Active Ranges	60.5	215.8	276.3	292.2
4. Other	0.4	49.6	50.0	31.7
C. Base Realignment and Closure (BRAC)				
1. BRAC Installations--Environmental Restoration (ER)	730.4	2,886.2	3,616.6	4,015.0
2. BRAC Installations--ER for Transferring Ranges	14.3	497.3	511.6	397.4
3. BRAC Installations--Environmental Corrective Action	7.2	180.7	187.9	208.6
4. Other	190.4	0.0	190.4	269.7
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0.0	5,565.0	5,565.0	4,890.0
2. Nuclear Powered Submarines	0.0	4,888.9	4,888.9	4,888.9
3. Other Nuclear Powered Ships	0.0	269.1	269.1	269.1
4. Other National Defense Weapons Systems	4.7	292.4	297.1	278.3
5. Chemical Weapons Disposal Program	1,387.8	9,422.5	10,810.3	12,817.3
6. Other	103.0	0.1	103.1	165.1
2. Total Environmental Liabilities:	$ 4,640.2	$ 56,850.4	$ 61,490.6	$ 59,353.2
3. Other Information Related to Environmental Liabilities:				

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

Methodology Used to Estimate Environmental Liabilities

The Department is currently using two independently validated estimating models in addition to engineering estimates. The validation was performed in accordance with DoD Instruction 5000.61. The models are the Remedial Action Cost Engineering Requirements (RACER) model and the Department of Navy Cost-to-Complete (CTC) module of the Navy Normalization of Data System (NORM). Additionally, cost estimates are based on the following: (1) historic comparable project, (2) a specific bid or independent government cost estimate for the project, (3) site level data, and (4) annual cost-to-complete estimate. The cost-to-complete estimate is prepared in the Defense Environmental Restoration Program (DERP) in accordance with the Management Guidance for the DERP and the DoD FMR 7000.14.

General Disclosures

<u>Sources of Cleanup Requirements</u>

The DoD has cleanup requirements for the Defense Environmental Restoration Program (DERP) sites at active and BRAC installations and Formerly Used Defense Sights (FUDS), non-DERP at active installations, weapon systems programs, and chemical weapons disposal programs. The DoD follows the Comprehensive Environment Response, Compensation Liability Act (CERCLA) and the Superfund Amendment and Reauthorization Act (SARA) to clean up DERP-eligible contamination. Non-DERP eligible contamination cleanup is performed in accordance with the Resource Conservation and Recovery Act (RCRA). The Army is DoD Executive Agent for cleaning up contamination at sites formerly used by DoD. The CERCLA and RCRA require DoD to clean up contamination in coordination with regulatory agencies, other responsible parties, and current property owners. Failure to comply with agreements and legal mandates can put DoD at risk of fines and penalties.

The Chemical Weapons Disposal Program is based on the fiscal year 1986 National Defense Authorization Act (PL 99-145, as amended by subsequent acts) that directed the DoD to destroy the unitary chemical stockpile by April 29, 2004. The Army, as Executive Agent within the DoD, provides policy, direction, and oversight for both the Chemical Stockpile Program and the Non-Stockpile Chemical Materiel Project. As such, the Army is responsible for the safe and economical disposal of the U.S. stockpile of lethal and incapacitating chemical warfare agents and munitions. The program objective is to destroy the U.S. Stockpile of unitary chemical agents and munitions in accordance with the public law and the schedules approved by the Defense Acquisition Decision Memorandum dated September 26, 2001, and updated in the April 2003 Acquisition Program Baseline.

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

Method for Assigning Estimated Total Cleanup Costs (DERP & BRAC Funded)

The estimated total cleanup cost for the current operating period is assigned based on the amount of the current year appropriation. The total cleanup cost is the cost to complete cleanup and unliquidate obligations that will be expended within 12 months from the Balance Sheet date.

Unamortized Portion of Estimated Total Cleanup Costs

The DoD has not identified any unamortized portion of the estimated total cleanup cost associated with General Property, Plant and Equipment (PP&E). The Department's Financial Management Regulation requires the unamortized clean-up cost associated with PP&E to be recognized. Air Force is currently booking the entire environmental disposal cost associated with PP&E. The Department is working with the Military Departments to ensure the regulation is properly implemented.

Material Changes in Total Estimated Liability Costs Due to Changes in Laws, Technology, or Plans

The Department of Army has no material changes in the total estimated liability due to changes in laws, technology, or plans. The major change in technology affecting the liability estimate was standardizing the use of the estimating tools consistently across the Army programs.

Survey data of the Department of the Navy Environmental Restoration Program cost estimate changes for sites that had over 10 percent change or $.5 million indicates diverse reasons for change in estimates. Multiple reasons may apply both as increases or decreases at any site. The reasons for changes are estimation changes (26 percent), regulatory changes (60 percent), and technical changes (15 percent). Reasons for changes in estimation are as follows: cost to complete (CTC) overlooked or previously unknown contaminants, better site characterization with sampling, cost avoidance rerun CTC, re-estimation based on different assumptions and/or escalation, and re-estimation of costs based on lessons learned. Reasons for changes in the regulatory area are as follows: addition of range rule/munitions requirements, additional or extended long-term monitoring requirements or 5 year reviews, no further action agreement with regulator, and risk-based corrective action. Reasons for changes in the area of technology are as follows: additional contamination level sampling, additional or extended remedial action operation, additional sites and incomplete site data, and technical solution changed.

The Department of the Air Force has no material changes in the total estimated liability due to changes in laws, technology, or plans.

Nature of Estimates and the Disclosure of Information Regarding Possible Changes Due to Inflation, Deflation, Technology, or Applicable Laws and Regulations

The Department of Army estimates used for environmental liability calculations are estimates of the cost to complete at all activities at a site of environmental concern. The cost estimates are calculated at the site-level using a validated cost-estimating model or an engineered cost and entered into a database. There were no changes to the total liability cost due to inflation, deflation, technology, or applicable laws and regulations.

Changes in the Liability Estimate from FY 2002

Accrued Environmental Restoration (DERP-funded) Costs

The Active Installations - Environmental Restoration liability decreased by $1,199.9 million (9 percent). The majority of the change is attributed to the following. The Department of Army liability decreased $472.4 million due to disbursements of unliquidated current obligations and the award of several performance-based contracts. The Department of Air Force decrease of $335.4 million is the result of aggressive work by the Air Force Environmental Restoration Tiger Team to establish a new policy relative to Areas of Concern (AOCs)/Not Evaluated (NE) Sites. Also, additional guidance provided to the field has improved cost estimating and reporting in the Air Force Restoration Information Management System (AFRIMS) and improved data fidelity. The Department of the Navy decrease of $388.7 million is the result of adjusted projections using more conservative estimates that approximate the expected rate of execution.

The Active Installations - Environmental Restoration for Closed Ranges category had a net increase of $2,657.0 million (156 percent). The majority of the change is the result of changes in the Department of the Army's environmental liability for closed ranges. Department of the Army had a substantial increase ($2,533.3 million) due to an additional 39 percent of site level data collected through the Army range inventory, which is 52 percent complete.

For the Formerly Used Defense Sites - Environmental Restoration for Transferred Ranges, the Department of the Army was the sole contributor to the 21 percent liability increase. In addition to over 50 new projects, the Army's estimated cost for clearance of total range acreage increased almost 40 percent due to better data quality from newly prepared range characterization reports and changes in the DoD's database definitions for land use restrictions. Faced with 14 million or more acres of ranges that may require response action, no cleanup goals or standards, technology shortfalls, and changing interpretations of what constitutes a range, it is expected that cost-to-complete will fluctuate during the next several years.

Other Accrued Environmental Costs (Non-DERP Funds)

Active Installations - Environmental Corrective Action increased $104.7 million or 23 percent mainly because of changes in the Defense Logistics Agency and the Department of Air Force liabilities. The Department of the Air Force liability increased by

$29.3 million due to an error in reporting liability amounts in FY 2002. A Defense Logistics Agency activity, Defense Energy Support Center (DESC), recorded $68.8 million for environmental cleanup costs for the first time. No liability was shown for FY 2002 because the accrual amount was not available until after the financial statements were finalized. It is noted that FY 2002 was the first year such data was gathered and complete figures were not available at the time of the annual statement. (The additional liability amounts were reported during the audit to DLA's auditing firm.)

Active Installations - Environmental Response at Active Ranges liability had a net decrease of $15.9 million. The Department of the Army liability decreased by $27.9 million, and the major factors contributing to the changes are improved cost estimates and revised estimated cleanup levels. The DoD Component reporting entity reported an increase of $12.0 million, which is a result of clean up efforts at installation training range facilities. In FY 2002 the amount was reported in the total for the Environmental Disposal for Weapons System Program.

The Other Accrued Environmental Costs - Other category had a net increase of $18.3 million (57 percent). The net increase is due to the Department of the Army removing liability amounts ($15.2 million) for the Low Level Radioactive Waste (LLRW) Disposal Program. This program facilitates the process of identifying, investigating, and remediating sites contaminated by low-level radioactive waste through RCRA corrective actions or Comprehensive Environmental Response, Compensation, and Liability Act response actions. The program liabilities were classified as possible and remote for year-end FY 2003 financial reporting. Additionally, the DoD Component reporting entity environmental liabilities increased by $33.5 million and is the result of the liability amount being erroneously moved between programs. Corrections were made to properly categorize these costs in FY 2003.

Base Realignment and Closure (BRAC)

The BRAC Installations - Environmental Restoration had a net decrease of $398.4 million. The Military Services accounted for the majority of the decrease. The Department of the Army accounted for $56.5 million, which is due to re-characterization of sites. The Department of Navy accounted for $137.4 million, which is the result of using more conservative estimates that approximate the expected rate of execution. The Department of Air Force accounted for $174.7 million of the decrease. The Air Force decrease is primarily because of focused management oversight of the Air Force Restoration Information Management System (AFRIMS) data and the critical review of restoration costs and schedule maintained in AFRIMS.

The BRAC Installations - Environmental Restoration for Transferring Ranges had a net increase of $114.2 million (29 percent). The Department of the Army and the Department of the Navy attributed to the net increase in transferring ranges liability. The Department of Army increase of $128.5 million is due to the addition of new sites with the completion of the range inventory. The Department of the Navy liability decreased by $14.3 million and is the result of adjusted predictions using more conservative estimates that approximate the expected rate of execution.

The BRAC Installations - Environmental Corrective Action liability net decrease is mainly due to the Department of Army's liability decreasing by $24.3 million. The major factor contributing to the Army's decrease is current estimates that support regulatory closure.

For the BRAC Realignment and Closure - Other the Department of the Army was the sole contributor to the decrease of $79.3 million or 29 percent. The major factor contributing to the change is disbursements of current liability unliquidated obligations.

Environmental Disposal for Weapons Systems Programs

The Nuclear Powered Aircraft Carriers environmental liability increased by $675.0 million or 14 percent. The increase is the result of adding the environmental liability of an aircraft carrier, the Ronald Reagan, and an adjustment for inflation.

The Chemical Weapons Disposal Program total of $10,810.3 million for year-end FY 2003 is based on the probable costs for the Program Manager for Elimination of Chemical Weapons (PMECW), the Chemical Stockpile Emergency Preparedness Project, and the Project Manager for the Assembled Chemical Weapons Alternatives (PMACWA). The liability estimate decreased by $2,007.0 million or 16 percent from the FY 2002 total and is due primarily to the use of a new Acquisition Program Baseline to formulate the PMECW estimate. As designs mature for the disposal technologies to be used by the PMACWA at Army facilities, future liabilities reported may change materially.

The Environmental Disposal for Weapons Systems Programs - Other category has a net decrease of $62.0 million or 38 percent. This net decrease is due to the DoD Component reporting entity environmental liabilities being erroneously moved between programs. Corrections were made to properly categorize these costs in FY 2003.

Ranges

The Department of Army estimated its environmental liability for closed, transferred and transferring ranges at $17,303.1 million. The Army has completed 100 percent of the inventory of transferred ranges at 1,701 formerly used properties and transferring ranges at 63 sites. The Army continues to inventory closed ranges at 443 sites and is 52 percent complete.

Beginning in FY 2001, the Department of the Navy began an inventory of closed and transferring ranges under the Munitions Response Program and the Unexploded Ordnance Program. The inventory was completed September 2002 and contains 196 closed ranges and 16 transferring ranges.

The Department of Air Force environmental liabilities on ranges refer only to munitions related activities. Other actions are captured under the DERP, BRAC and non-DERP non-BRAC environmental cleanup categories. The environmental liability is reported only for closed ranges that number 260 as of September 30, 2003.

- <u>Closed Ranges</u>

  The Department of Army and the Department of Navy must expend $3,182.7 million and $341.3 million, respectively, to characterize, investigate and cleanup closed ranges. Until such characterization is completed, total environmental liabilities cannot be estimated. Closed ranges have been taken out of service as a range and put to new use (incompatible with range activities) or are not considered by the military to be a potential range area. A closed range is still under the control of a DoD Component. For FY 2003, the Navy determined that it owns 196 closed ranges.

  The Department of Air Force identified 260 closed ranges that resulted in an estimated environmental cleanup liability of $838.1 million. The total liability is expected to increase significantly over the coming years as the Air Force continues to refine the inventory and expand investigations of other closed ranges.

- <u>Transferring Ranges</u>

  The Department of Army has completed 100 percent of the inventory of transferring ranges. The current liability estimate is $496.0 million. Additionally, the Department of the Navy estimated and reported $15.6 million for transferring ranges, which includes military munitions, chemical residues, and munitions scrap. Transferring ranges are proposed for transfer or will be returned from DoD to another entity, including other federal entities.

- Transferred Ranges

  The Department of Army has completed the inventory of transferred ranges with site level cost data collected from 1701 properties. Currently, the estimated liability for those ranges is $13,624.4 million. Transferred ranges are properties formerly used as a military ranges that are no longer under military control or lease and have been transferred, or returned from the DoD to another entity, including federal entities.

- Active Ranges

  At this time, the Department of Army is conducting only one active range investigation and characterization, that being the Massachusetts Military Reservation. The cost of the characterization and investigation is $264.3 million. This amount pays for sampling and analysis, groundwater monitoring, feasibility studies, soil and groundwater cleanup, and Unexploded Ordinance (UXO) investigation and response. Currently, the active ranges include military ranges that are being regularly used, but are considered by the cognizant Military Service to be a potential range area.

Service Component – Environmental Restoration (Cleanup) Liabilities and Environmental Disposal Liabilities (Amounts in millions)	Army	Navy	Air Force	ODO
1. Environmental Liabilities:				
B. Non-Federal:				
1. Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) funded) Costs:				
a. Active Installations-Environmental Restoration (ER)	$ 3,696.1	$ 3,132.1	$ 4,902.0	$ 103.6
b. Active Installations--ER for Closed Ranges	3,182.7	341.3	838.1	
c. Formerly Used Defense Sites (FUDS) –ER	4,239.4			
d. FUDS--ER for Transferred Ranges	13,624.4			
2. Other Accrued Environmental Costs (Non-DERP funds)				
a. Active Installations--Environmental Corrective Action	287.9		204.3	68.8
b. Active Installations--Environmental Closure Requirements	37.2		66.4	
c. Active Installations--Environ. Response at Active Ranges	264.3			12.0
d. Other				50.0
3. Base Realignment and Closure (BRAC)				
a. BRAC Installations--Environmental Restoration (ER)	518.7	1,155.9	1,909.0	33.0
b. BRAC Installations--ER for Transferring Ranges	496.0	15.6		
c. BRAC Installations--Environmental Corrective Action	48.0		139.9	
d. Other	190.4			
4. Environmental Disposal for Weapon Systems Programs				
a. Nuclear Powered Aircraft Carriers		5,565.0		
b. Nuclear Powered Submarines		4,888.9		
c. Other Nuclear Powered Ships		269.1		
d. Other National Defense Weapon Systems		246.5	50.6	
e. Chemical Weapons Disposal Program	10,810.3			
f. Other				103.1
5. Total Non-Federal Environmental Liabilities:	$ 37,395.4	$ 15,614.4	$ 8,110.3	$ 370.5

Other Information

Others Category Disclosure Comparative Table

Types	September 30, 2003 **($ in Millions)**
Other Accrued Environmental Costs (Non-DERP funds) - Other	
Defense Threat Reduction Agency Estimated Clean up Cost-ODO	1.5
DoD Component Level Estimated Clean up Cost-ODO	35.1
Defense Commissary Agency-ODO	13.4
Total	**$ 50.0**
BRAC – Other	
Army's Prior Year BRAC ULOs That Cannot Be Identified To A Specific Program	$ 190.4
Environmental Disposal for Weapons Systems Programs-Other	
National Defense Stockpile -ODO	
Thorium Nitrate Disposal or Upgrade	$ 58.0
Long Term Storage or Repackaging Mercury	19.2
Cleanup Costs	19.9
Badalite Ore Disposal	6.0
Total	**$ 103.1**

Note 15.A. Other Liabilities

As of September 30 (Amounts in millions)	2003 Current Liability	2003 Noncurrent Liability	2003 Total	2002 Total
1. Intra-governmental:				
A. Advances from Others	$ 272.5	$ 0.0	$ 272.5	$ 331.2
B. Deferred Credits	0.0	0.0	0.0	0.0
C. Deposit Funds and Suspense Account Liabilities	372.3	0.0	372.3	318.5
D. Resources Payable to Treasury	0.0	0.0	0.0	1,053.4
E. Disbursing Officer Cash	1,509.4	0.0	1,509.4	696.9
F. Nonenvironmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	0.0	0.0	0.0	0.0
(2) Excess/Obsolete Structures	0.0	0.0	0.0	0.0
(3) Conventional Munitions Disposal	0.0	0.0	0.0	0.0
(4) Other	0.0	0.0	0.0	0.0
G. Accounts Payable-- Cancelled Appropriations	7.0	0.0	7.0	0.0
H. Judgement Fund Liabilities	344.1	247.3	591.4	638.2
I. FECA Reimbursement to the Department of Labor	594.5	826.3	1,420.8	1,415.0
J. Capital Lease Liability	0.0	0.0	0.0	0.0
K. Other Liabilities	3,795.5	1,770.2	5,565.7	3,760.4
L. Total Intra-governmental Other Liabilities	$ 6,895.3	$ 2,843.8	$ 9,739.1	$ 8,213.6

As of September 30 (Amounts in millions)	2003 Current Liability	2003 Noncurrent Liability	2003 Total	2002 Total
2. Non-Federal:				
A. Accrued Funded Payroll and Benefits	$ 9,118.0	$ 0.0	$ 9,118.0	$ 9,138.6
B. Advances from Others	1,167.3	0.0	1,167.3	1,194.0
C. Deferred Credits	9.7	0.0	9.7	6.4
D. Loan Guarantee Liability	0.0	0.0	0.0	0.0
E. Liability for Subsidy Related to Undisbursed Loans	0.0	0.0	0.0	0.0
F. Deposit Funds and Suspense Accounts	272.4	(167.1)	105.3	50.1
G. Temporary Early Retirement Authority	5.2	3.3	8.5	29.1
H. Nonenvironmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	0.0	574.9	574.9	566.1
(2) Excess/Obsolete Structures	93.2	301.7	394.9	395.1
(3) Conventional Munitions Disposal	0.0	1,198.8	1,198.8	1,424.3
(4) Other	0.0	0.0	0.0	27.0
I. Accounts Payable--Cancelled Appropriations	426.7	175.6	602.3	679.6
J. Accrued Unfunded Annual Leave	7,644.9	0.4	7,645.3	6,959.3
K. Accrued Entitlement Benefits for Military Retirees and Survivors	0.0	0.0	0.0	0.0
L. Capital Lease Liability	44.7	291.7	336.4	367.2
M. Other Liabilities	6,347.9	1,600.0	7,947.9	8,958.5
N. Total Non-Federal Other Liabilities	$ 25,130.0	$ 3,979.3	$ 29,109.3	$ 29,795.3
3. Total Other Liabilities:	$ 32,025.3	$ 6,823.1	$ 38,848.4	$ 38,010.4

4. Other Information Pertaining to Other Liabilities:

Fluctuations and/or Abnormalities- Intra-governmental Other Liabilities:

Total Intra-governmental Other Liabilities Fluctuation Analysis

Total Intra-governmental Other Liabilities increased $1,525.5 million (19 percent) from year-end FY 2002 through year-end FY2003. The following item(s) contributed to the majority of the overall change:

Advances from Others (Line 1.A.):

Advances from Others decreased $58.7 million (18 percent) from year-end FY 2002 through year-end FY 2003. The following item(s) contributed to the majority of the overall change:

- Air Force General Fund (GF) decreased $79.0 million (45 percent). The decrease is due to the timing of the receipt and execution of orders which causes variations in its year-end balances.
- Navy Working Capital Fund (WCF) increased $33.8 million (45 percent). The increase occurred in Depot Maintenance Shipyards and the Naval Air Warfare Center (NAWC), a Research and Development activity. The increase is associated with the conversion from the DoD Industrial Financial Management System to SIGMA, an Enterprise Resource Planning System. The conversion of funding produced a reclassification between intra-governmental and public, which now ensures the proper posting of this account. Additionally, there were program problems encountered in the billing area that have hampered the ability to bill certain customers. Once the bills are produced, the appropriate customer advances will be liquidated.
- Army GF decreased $8.2 million (13 percent). The decrease is attributable to the Drug Enforcement Training Program that purchases equipment and training materials for state and local law enforcement officials. A large dollar amount was obligated on these contracts in FY 2003 and the majority was executed.
- United States Army Corps of Engineers (USACE) decreased $7.1 million (40 percent) as a result of work completion and advances being earned.
- Air Force WCF increased $1.5 million. With the implementation of DIFMS in FY 2003, DMAG changed its procedures on revenue recognition from the incremental revenue recognition (IRR) to the percentage of completion method, resulting in advances being recorded versus progress billings.

<u>Deposit Funds and Suspense Account Liabilities (Line 1.C):</u>
Deposit Funds and Suspense Account Liabilities increased by $53.8 million (17 percent) from year-end FY 2002 through year-end FY 2003. The following item(s) contributed to the majority of the overall change:

- Army GF increased $69.0 million. The majority of this increase is attributable to the Army member Savings Deposit-Desert Shield/Desert Storm Savings program and the Servicemen’s Group Life Insurance Funds, Suspense, Department of Army. The Savings Deposit Program increased primarily due to cash contributions and allotment deductions from service members stationed in the Southwest Asia/Persian Gulf Region who are drawing imminent danger pay. Also included are interest deposits from the military appropriation. Army Servicemen's Group Life Insurance Funds, Suspense, Department of Army increased primarily due to more servicemen and women supporting the contingency missions in the war zones around the globe.
- ODO GF increased $17.6 million (44 percent). The fluctuation relates to the accounting treatment for deposit funds and clearing accounts throughout the fiscal year. At fiscal year-end, all receipt accounts are considered withdrawn to the Treasury, and certain clearing accounts are closed or transferred to the Treasury. At the beginning of each fiscal year, these fund accounts are re-established and accounted for until closed or transferred at year-end.
- Navy GF decreased $26.9 million (11 percent). A $26.9 million reduction in the nonentity fund balance with Treasury occurred primarily as a result of a $47 million decrease in withheld state and local taxes, and a $28 million decrease of defense military receipts not other classified. The decrease is offset by an increase of $55 million in recoveries under Foreign Military Sales.
- USACE decreased $13.9 million (96 percent). Deposit funds and suspense account liabilities were reduced with the disposition of a disputed collection related to a water storage contract.

- Air Force GF increased $7.9 million (51 percent). The increase is related to intra-governmental paying and collection (IPAC) transactions and the Uniformed Services Thrift Savings Plan (TSP) deductions, which are posted to suspense accounts. IPAC transactions are aged and monitored to ensure they are cleared timely. The Uniformed Services TSP represents a timing difference between the posting of the TSP deductions by the National Finance Center and the posting of these amounts in the military accounting systems in the following month.

Resources Payable to Treasury (Line 1.D.):
Resources Payable to Treasury decreased $1,053.4 million (100 percent) from year-end FY 2002 through year-end FY 2003. The following item(s) contributed to the majority of the overall change:

- Air Force GF decreased $1,006.9 million (100 percent). The decrease is due to the reclassification of cancelled authority for recording accounts receivable.
- Navy GF decreased $.9 million (100 percent). The decrease is due to the reduction in interest payable to Treasury for Marine Corps.
- U.S. Army Corps of Engineers decreased $33.6 million (100 percent). Resources payable to Treasury were used in FY 2002 to record the offset to accounts receivable in receipt accounts. The receipts are collected into Treasury receipt accounts. In accordance with an audit recommendation, these liabilities are now reported in line 1K, Other Liabilities.
- ODO GF decreased $11.6 million. The decrease is based on efforts associated with the tri-annual review of outstanding accounts receivable accounts. Accounting offices were directed to review and validate their open accounts receivable amounts. As a result of this initiative, there were no outstanding resources payable to the Treasury reported for FY 2003.

Disbursing Officer Cash (Line 1.E):
Disbursing Officer Cash increased $812.4 million (117 percent) from year-end FY 2002 through year-end FY 2002. The following item(s) contributed to the majority of the overall change:

- Army GF increased $651.7 million (217 percent) in support of contingency missions for Operation Iraqi Freedom and Operation Enduring Freedom.
- Navy GF increased $152.3 million (117 percent) in support of contingency missions for Operation Iraqi Freedom and Operation Enduring Freedom.

Accounts Payable – Cancelled Appropriations (Line 1.G):
ODO GF increased $7.0 million from year-end FY 2002 through year-end FY 2003. The increase is attributed to the Missile Defense Agency (MDA). The accounts payable cancelled appropriation is based on unliquidated cancelled appropriation unearned revenue which requires a refund. This $6.9 million account will remain recorded until the refund is completely executed.

Other Liabilities (Line 1.K.):
Other Liabilities increased $1,805.3 million (48 percent) from year-end FY 2002 through year-end FY 2003. The following item(s) contributed to the majority of the overall change:

- Air Force GF increased $556.6 million. The increase is primarily due to the reclassification of resources payable to Treasury to other liabilities, which resulted in an increase of $449.2 million. The increase in other liabilities also represents $33.0 million in government contributions for employee benefits and $27.4 million in other unfunded unemployment compensation liabilities.
- U.S. Army Corps of Engineers increased $999.8 million (112 percent). The increase is due to the reporting of the offset for long-term interest receivables. Interest receivables and the corresponding liability were not reported in FY 2002 and prior periods because the interest had not been earned yet. In accordance with an audit recommendation, the Corps is now including the offset for interest receivable in the amount of $881.9 million. The remaining increase is due to changes in reporting resources payable to the Treasury.
- Navy GF increased $306.5 million (13 percent). The majority of the change occurred in nonentity public account receivable, which increased based upon improved efforts in identifying receivables and interest on these receivables. All receivables are payables to the Treasury.
- ODO GF decreased $76.2 million (64 percent). The decrease is due to the disbursement of all liabilities for subsidies related to undisbursed loans, which were reported in FY 2002 for $86.6 million. The disbursement of these loans decreased the total amount of other liabilities reported for FY 2003. The remainder of the difference from FY 2003 to FY 2002 is attributable to multiple entities, which individually do not comprise 10 percent of the total change.

<u>Judgement Fund Liabilities (Line 1.H.):</u>
Judgement Fund Liabilities decreased $46.8 million (7 percent) from year-end FY 2002 through year-end FY 2003. The following item(s) contributed to the majority of the overall change:

- Navy GF decreased $56.6 million (54 percent) due to the aggressive effort by the Navy to reconcile and resolve claims under the Contract Dispute Act.
- Air Force GF decreased $51.5 million (17 percent). The decrease is due to the Air Force paying approximately $52.5 million more to the Treasury on debts owed than Treasury billed to the Air Force in new debts.
- Army GF increased $68.9 million (92 percent) due to a litigation settlement.

Fluctuations and/or Abnormalities- Non-Federal:

<u>Total Non-Federal Fluctuation Analysis</u>
Total Non-Federal Other Liabilities decreased $686.0 million (2 percent) from year-end FY 2002 through year-end FY 2003. The following item(s) contributed to the majority of the overall change:

<u>Other Liabilities (Line 2.M.):</u>
Other Liabilities decreased $1,010.6 million (11 percent) from year-end FY 2002 through year-end FY 2003. The following item(s) contributed to the majority of the overall change:

- Air Force WCF decreased $1,277.1 million (43 percent). This decrease is attributable to the following factors:
  - Progress billings of $915 million are no longer recorded due to the change in revenue recognition by Depot Maintenance Activity Group (DMAG). Under the new method, advances are lower than the FY 2002 progress billings due to a $386 million decrease attributable to Contract DMAG being removed from the Air Force WCF, and $209.7 million in eliminations with the Supply Management Activity Group (SMAG).
  - Work in process for DMAG decreased $342.2 million, which is attributable to contract DMAG being removed from the Air Force WCF. The reduction in contracts has resulted in a decline in material, labor and overhead costs and accruals.
  - Future purchases from Foreign Military Sales in SMAG has decreased $19 million.
- Army GF increased $382.9 million (18 percent). This increase is primarily attributed due to the reporting of $283 million of contingent liabilities, $278.1 million of custodial liability for seized Iraqi cash, and $57.7 million of employer contributions. The total contingent liabilities increase is due to the capturing and reporting of information for the first time from the U.S. Army Legal Services Agency's Environmental Law Division and Contract Appeals Division. Contract holdbacks decreased $246.3 million from a change implemented at DFAS in the computation of contract holdbacks.

<u>Nonenvironmental Disposal Liabilities, Conventional Munitions Disposal (Line 2.H.3):</u>
Nonenvironmental Disposal Liabilities, Conventional Munitions Disposal decreased $225.5 million (16 percent) from year-end FY 2002 through year-end FY 2003. The following item(s) contributed to the majority of the overall change:

- Army GF decreased $231.3 million (16 percent). Of this amount, $69.5 million is due to a stockpile reduction, while the remaining $161.9 million decrease is the result of a new weighted average cost per ton.
- Air Force GF increased $5.8 million. Previously, this liability was only disclosed in the notes, but for FY2003 it is included in the audited financial statements.

<u>Nonenvironmental Disposal Liabilities, Other (Line 2.H.4):</u>
Nonenvironmental Disposal Liabilities, Other, decreased $27.0 million (100 percent) from year-end FY 2002 through year-end FY 2003. This amount ($26.9 million) was erroneously recorded to nonenvironmental disposal liabilities - other. The error was identified and corrected for FY 2003 resulting in a zero balance.

<u>Accrued Unfunded Annual Leave (Line 2.J.):</u>
Accrued Unfunded Annual Leave increased $686.0 million (10 percent) from year-end FY 2002 through year-end FY 2003. The following item(s) contributed to the majority of the overall change:

- Air Force GF increased $478.3 million (29 percent). This is a result of increases in military and civilian leave balances. The increase in military leave is impacted by the activation of military personnel in support of the war in Iraq, because the use of leave is restricted during a war.

- Navy GF increased $237.2 million (12 percent). This amount includes Navy personnel involved in the war effort. The majority of the increase is in Military personnel appropriations.
- Army GF decreased $77.7 million (3 percent). The liability for civilian leave decreased $260 million as the liability for military leave increased $183.2 million.

Other Information Related to Other Liabilities:

Intra-governmental Other Liabilities (Line 1.K.) increased by $1,805.3 million (48 percent). The table below depicts approximately 99 percent of the Intra-governmental Other Liabilities by Entity:

Intra-governmental Other Liabilities (Line 1.K) for 2003 (millions)			
Entity	**Current Liability**	**Non Current Liability**	**Total Liability**
Navy GF	2,740.1	.09	2,740.2
Navy WCF	49.6		49.6
Air Force GF	621.4		621.4
Air Force WCF	6.1		6.1
Army GF	169.0		169.0
Army WCF	11.3		11.3
USACE	135.7	1,759.7	1,895.4
ODO GF	42.7	.8	43.5
ODO WCF	18.6	9.4	28.0
MRF	.7		.7
		Total	**5,565.2**

Non-Federal Other Liabilities (Line 2.M.) decreased by $1,010.6 million (11 percent). The table below depicts approximately 99 percent of the Non-Federal Other Liabilities by Entity:

Non-Federal Other Liabilities (Line 2.M.) for 2003 (millions)			
Entity	**Current Liability**	**Non Current Liability**	**Total Liability**
Navy GF	124.9	71.6	196.5
Navy WCF	1,956.3		1,956.3
Air Force GF	.8	189.2	190.0
Air Force WCF	1,725.2		1,725.2
Army GF	1,171.4	1,335.1	2,506.5
Army WCF	39.6		39.6
USACE	144.6		144.6
ODO GF	1,019.4	.4	1,019.8
ODO WCF	165.1	3.7	168.8
MRF	.2		.2
		Total	**7,947.5**

The Department may incur additional liabilities in FY 2004 due to legislation making TRICARE, the military's health care program available to members of the National Guard and the reserves when they are not on active duty.

Note 15.B.	Capital Lease Liability

As of September 30 (Amounts in millions)	2003				2002
	Asset Category				
	Land and Buildings	Equipment	Other	Total	Total
1. Future Payments Due:					
A. 2004	$ 66.5	$ 0.9	$ 0.0	$ 67.4	$ 69.6
B. 2005	66.4	0.0	0.0	66.4	67.9
C. 2006	66.1	0.0	0.0	66.1	67.1
D. 2007	60.2	0.0	0.0	60.2	66.1
E. 2008	47.5	0.0	0.0	47.5	60.2
F. After 5 Years	184.4	0.0	0.0	184.4	220.5
G. Total Future Lease Payments Due	$ 491.1	$ 0.9	$ 0.0	$ 492.0	$ 551.4
H. Less: Imputed Interest Executory Costs	155.6	0.0	0.0	155.6	184.2
I.Net Capital Lease Liability	$ 335.5	$ 0.9	$ 0.0	$ 336.4	$ 367.2
2. Capital Lease Liabilities Covered by Budgetary Resources:				$ 326.1	$ 336.5
3. Capital Lease Liabilities Not Covered by Budgetary Resources:				$ 127.2	$ 165.2
4. Other Information:					

Fluctuations and/or Abnormalities:

The liabilities associated with capital leases are often not recorded in legacy systems. The proper breakout of future payments to appropriate years will be done when a process for capturing lease liabilities is implemented. The decrease between year-end FY 2002 and year-end FY 2003 was caused by a classified program within the Department Component Level Accounts.

Capital Lease Liabilities Not Covered by Budgetary Resources

For the Department of Defense, all leases prior to FY 1992 are funded on a FY basis causing the non-current amounts to be shown as Not Covered by Budgetary Resources. All capital leases and lease purchases entered into after FY 1992 are funded in the first year of the lease.

Capital Lease Liabilities Covered by Budgetary Resources

The leases that originated after FY 1992 are required to be fully funded in the year of their inception. Therefore, Budgetary Resources show the present value of those lease payments as Covered.

The following table compares Capital Leases at year-end FY 2002 to year-end FY 2003.

Comparison of Capital Leases between Year-end FY 2002 and Year-end FY 2003 (amounts in millions)				
Future Payments Due	YE 2002	YE 2003	Increase/Decrease	% Change
A. 2004	$69.6	$67.4	($2.2)	-3%
B. 2005	$67.9	$66.4	($1.5)	-2%
C. 2006	$67.1	$66.1	($1.0)	-1%
D. 2007	$66.1	$60.2	($5.9)	-9%
E. 2008	$60.2	$47.5	($12.7)	-21%
F. 2009 +	$220.5	$184.4	($36.1)	-16%
G. Total	$551.4	$492.0	($59.4)	-11%
H. Less Imputed Interest Executory Costs	($184.2)	($155.6)	$28.6	-16%
I. Net	$367.2	$336.4	($30.8)	-8%
Capital Lease Liability Covered by Budgetary Resources	$336.5	$326.1	($10.4)	-3%
Capital Lease Liability Not Covered by Budgetary Resources	$165.2	$127.2	($38.0)	-23%

Note Reference

- See Note Disclosure 1.Q. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Leases.
- For regulatory discussion on "Capital Lease Liability," see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1017.

Note 16. Commitments and Contingencies

Disclosures Related to Commitments and Contingencies:

Nature of Contingency

The Department is subject to various claims that represent contingent liabilities for the United States Government. While no opinion has been expressed regarding the likely outcome or possible loss associated with specific claims, experience indicates that many claims are settled for less than sought or dismissed altogether. In some cases the possibility of loss is remote. Liabilities are not accrued in the Department's financial statements.

In addition, the Department has other contingent liabilities that are considered reasonably possible. These liabilities are not accrued in the Department's financial statements.
As of September 30, 2003, the Department has approximately $13,684.6 million in claims that are considered reasonably possible. The estimates for the Components are included in the table below:

Estimate of the Possible Liability by Major Component

Contingent Liabilities (Amounts in millions)					
	Army	Navy	Air Force	ODO WCF (DLA)	Total
Chemical Demilitarization Non-Stockpile Disposal	8,970.0				8,970.0
Chemical Demilitarization Emergency Preparedness Program					
Contractual Actions		103.9	21.0		124.9
Contractual Commitments		9.9			9.9
Employee Related Actions	0.2	26.3			26.5
Other (foreign country tax)		70.0			70.0
Environmental Claims	10.0				10.0
Judgement Fund Liabilities	10.0				10.0
Claims & Litigation from Civil Law	222.3	5.5	244.7	2,940.0	3,412.5
Site Closure Costs		4.0			4.0
Environment Cleanup Costs					
Army Contract Appeals Division	46.0				46.0
Army Environmental Law Division	107.0				107.0
Network Enterprise Technology Command	0.9				0.9
Low-Level Radioactive Waste Disposal	36.0				36.0
Environmental Restoration	856.9				856.9
TOTAL	10,259.3	219.6	265.7	2.9	13,684.6

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

For regulatory discussion on "Commitments and Contingencies," see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1018.

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

As of September 30	2003								2002	
	Actuarial Present Value of Projected Plan Benefits		Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)		Unfunded Actuarial Liability			Unfunded Actuarial Liability	
(Amounts in millions)										
1. Pension and Health Benefits:										
A. Military Retirement Pensions	$	736,061.6	6.25%	$	(176,028.9)	$	560,032.7		$	557,646.2
B. Military Retirement Health Benefits		206,839.4	6.25%		0.0		206,839.4			592,046.0
C. Medicare-Eligible Retiree Benefits		476,170.2	6.25%		(18,182.4)		457,987.8			0.0
D. Total Pension and Health Benefits	$	1,419,071.2		$	(194,211.3)	$	1,224,859.9		$	1,149,692.2
2. Other:										
A. FECA	$	7,596.1		$	0.0	$	7,596.1		$	7,183.2
B. Voluntary Separation Incentive Programs		1,690.1	4.0%		(760.0)		930.1			763.3
C. DoD Education Benefits Fund		1,208.1	4.4%		(1,036.9)		171.2			134.8
		0.0			0.0		0.0			0.0
D. Total Other	$	10,494.3		$	(1,796.9)	$	8,697.4		$	8,081.3
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$	1,429,565.5		$	(196,008.2)	$	1,233,557.3		$	1,157,773.5

4. Other Information Pertaining to Military Retirement Benefits and Other Employment-Related Actuarial Liabilities:
Actuarial Cost Method Used: See narrative below.
Assumptions: See narrative below.
Market Value of Investments in Market-based and Marketable Securities: See narrative below.

Fluctuations and Abnormalities

The unfunded actuarial liability for the Military Retirement Pensions increased $2,386.5 million, or .4 percent, from year-end FY 2002 to year-end FY 2003. Additional information about Military Retirement Pensions and the net pension expense is disclosed in the paragraph below entitled "Military Retirement."

The unfunded actuarial liability for the Military Retirement Health Benefits decreased $385,206.6 million, or 65.1 percent, from year-end FY 2002 to year-end FY 2003. This net decrease was caused by the creation of the Medicare-Eligible Health Care Fund (MERHCF) on October 1, 2002. The establishment of this new fund required the subsequent transfer of a $405,553.0 million actuarial liability from the Defense Health Program (DHP) to the MERHCF. In addition, there was an increase of $20,346.0 million in the overall liability for the DHP (after the $405,553.0 million transfer to the MERHCF) because of FY 2003 interest costs and normal costs, plus the gains in the actuarial liability due to changes in trend assumptions. Additional information is contained in the Military Retirement Health Benefits Actuarial Liability paragraph.

The unfunded actuarial liability for the Medicare-Eligible Retiree Benefits increased from zero to $457,987.8 million from year-end FY 2002 to FY 2003. Since the DoD MERHCF was established at the beginning of FY 2003 (October 1, 2002), this fund was not included in the FY 2002 financial statements. Additional details about this fund and the change in the actuarial liability are provided in the Military Retirement Health Benefits Actuarial Liability paragraph.

The unfunded actuarial liability for the Federal Employees Compensation Act increased $412.9 million, or 5.7 percent. Additional information about this program is provided in the FECA paragraph.

The unfunded actuarial liability for the Voluntary Separation Incentive Programs increased $166.8 million, or 21.9 percent. The increase is the combined result of an increase in the actuarial present value of the plan benefits and a decrease in the value of the assets available to pay benefits. Additional information is provided in the Voluntary Separation Incentive Programs paragraph.

The unfunded actuarial liability for the DoD Education Benefits Fund increased $36.4 million, or 27.0 percent. The increase is the combined result of an increase in the actuarial present value of the plan benefits and an increase in the value of the assets available to pay benefits. Additional information is discussed in the DoD Education Benefits Fund paragraph.

Military Retirement Health Benefits (MRHB) Actuarial Liability

For the fiscal year ending September 30, 2002, the unfunded actuarial liability for the Military Retiree Health Care program was $592,046.0 million. Chapter 56 of Title 10, United States Code created the Department of Defense (DoD) Medicare-Eligible Retiree Health Care Fund (MERHCF) effective October 1, 2002. The purpose of the MERHCF is to accumulate funds to finance, on an actuarially sound basis, liabilities of the DoD under Uniformed Services Retiree Health Care Programs for Medicare-eligible beneficiaries.

Chapter 56 also created the DoD Medicare-Eligible Retiree Health Care Board of Actuaries with a charter to set methods and assumptions to be used for determining MERHCF's original unfunded liability and normal cost contributions. The Board determined the original unfunded liability of MERHCF and set a schedule over which to amortize the liability. Using approved methods, the DoD Office of the Actuary determined that the original unfunded liability of MERHCF, as of October 1, 2002, was $405,553.0 million. This amount includes the liability for Medicare-eligible members and former members of the DoD Uniformed Services who are entitled to retired or retainer pay, and their eligible dependents who are Medicare-eligible. The DoD Office of the Actuary did not include the liability for beneficiaries of the non-DoD Uniformed Services.

Creation of the MERHCF necessitated the transfer of the $405,553.0 million Medicare-Eligible Health Care actuarial liability to the MERHCF. The balance remaining represents the Defense Health Program (DHP) portion of the liability. The basis of the revised FY 2003 beginning balance of the MRHB actuarial liability is as follows:

(Amounts in millions)

FY 2002 ending balance of the total MRHB Actuarial Liability	$592,046.0
FY 2003 transfer of Medicare-Eligible Health Care liability to the MERHCF	405,553.0
Defense Health Program portion of the MRHB Liability FY 2003 beginning balance	$186,493.0

Change in Defense Health Program MHRB Actuarial Liability

(Amount in millions)

Actuarial Liability as of 9/30/02 (DoD pre-Medicare + DoD Medicare cost basis effect)	$ 186,493.0
Expected Normal Cost for FY03	6,457.6
Expected Benefit Payments for FY03	(6,185.3)
Interest Cost for FY03	11,664.2
Actuarial (gains)/losses due to changes in trend assumptions	1,435.8
Actuarial (gains)/losses due to other factors	6,974.1
Actuarial Liability as of 9/30/03 (DoD pre-Medicare + all uniformed services Medicare cost-basis effect)	$ 206,839.4

Actuarial Cost Method Used for DHP Actuarial Liability. Aggregate Entry-Age Normal

Assumptions in Calculation of DHP Liability:

Interest Rate: 6.25%

Medical Trend

Medicare Inpatient:	4.0% from FY02 to FY03, ultimate rate of 6.25% in 2027
Medicare Outpatient:	5.5% from FY02 to FY03, ultimate rate of 6.25% in 2027
Medicare Prescriptions (Direct Care):	10.08% from FY02 to FY03, ultimate rate of 6.25% in 2027
Medicare Prescriptions (Purchased Care):	15.54% from FY02 to FY03, ultimate rate of 6.25% in 2027
Non-Medicare Inpatient:	4.5% from FY02 to FY03, ultimate rate of 6.25% in 2027
Non-Medicare Outpatient:	9.7% from FY02 to FY03, ultimate rate of 6.25% in 2027
Non-Medicare Prescriptions:	13.9% from FY02 to FY03, ultimate rate of 6.25% in 2027

Other Information

The DHP liability includes pre-Medicare liabilities for the DoD, plus a cost-basis effect related to the direct care portion of Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2003, liability is:

	(Amount in millions)
DoD	$ 206,409.2
U.S. Coast Guard	$ 381.1
Public Health Service	$ 45.8
National Oceanic and Atmospheric Administration	$ 3.1

Liabilities in the MRHB liability are valued at a higher cost basis for direct care than they are in the corresponding liabilities reported for the MERHCF. Thus, the DHP liability, reflecting the difference between the MRHB and the MERHCF liabilities, includes both pre-Medicare liabilities for the DoD, plus a cost-basis effect related to Medicare liabilities for all Uniformed Services.

Actuarial gains/losses due to other factors include new population data, other actuarial experience being different from assumed, the cost basis effect for non-DoD Uniformed Services Medicare liabilities, and actuarial assumption changes other than the change in trend assumptions.

Change in MERHCF Actuarial Liability **(Amount in millions)**

Actuarial Liability as of 9/30/02 (DoD Medicare)	$405,553.0
Transferred Actuarial Liability as of 9/30/02 (non-DoD uniformed services Medicare)	$6,645.8
Actuarial Liability as of 9/30/02 (all uniformed services Medicare)	$412,198.8
Expected Normal Cost for FY03	$7,923.2
Expected Benefit Payments for FY03	($5,584.1)
Interest Cost for FY03	$25,834.4
Estimated actuarial (gains)/losses on non-DoD uniformed services liabilities	$2,347.3
Actuarial (gains)/losses due to other factors	$25,680.4
Actuarial (gains)/losses due to changes in trend assumptions	$7,770.2
Actuarial Liability as of 9/30/03 (all uniformed services Medicare)	$476,170.2

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

Assumptions in Calculation of MERHCF Liability

Interest Rate: 6.25%

Medical Trend:

Medicare Inpatient:	4.0% from FY02 to FY03, ultimate rate of 6.25% in 2027.
Medicare Outpatient:	5.5% from FY02 to FY03, ultimate rate of 6.25% in 2027.
Medicare Prescriptions (Direct Care):	10.08% from FY02 to FY03, ultimate rate of 6.25% in 2027.
Medicare Prescriptions (Purchased Care):	15.54% from FY02 to FY03, ultimate rate of 6.25% in 2027.

The MERHCF liability includes Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2003, liability ($ millions) is:

DoD	$466,537.4
Coast Guard	$8,613.2
Public Health Service	$954.2
NOAA	$65.5

FY 2003 Service contributions to the MERHCF ($ millions) were:

DoD	$8,001.6
Coast Guard	$172.7
Public Health Service	$25.2
NOAA	$1.2

MERHCF liabilities are valued at a lower cost basis for direct care than they are in the corresponding liabilities reported for the Military Retirement Health Benefits liability. Thus, the MERHCF liability is approximately $19.5 billion lower than the Medicare portion of the Military Retirement Health Benefits liability.

Estimated actuarial gains/losses on the non-DoD uniformed services liabilities reflect new assumptions in the calculation of their liabilities. Actuarial gains/losses due to other factors include new population data, other actuarial experience being different from assumed, and actuarial assumption changes other than the change in trend assumptions.

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

Projected revenues into the Medicare Eligible Retiree Health Care Fund, authorized by Chapter 56 of Title 10, United States Code, come from three sources: interest earnings on Fund assets, monthly Uniformed Services contributions, and annual contributions from the Treasury Department. The monthly contributions are determined as a per-capita amount (approved by the DoD Medicare Eligible Retiree Health

Care Board of Actuaries) times end strength. The contribution from Treasury is paid into the Fund at the beginning of each fiscal year, and represents the amortization of the unfunded liability for service performed prior to October 1, 2002, as well as the amortization of actuarial gains and losses that have arisen since then. The Board determines Treasury's contribution, and the Secretary of Defense directs the Secretary of Treasury to make the payment.

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

Military Retirement

The net pension expense for the actuarial accrued liability is developed in the table below:

Net Pension Expense for the Years Ended September 30

(Amounts in millions)

	2003	**2002**
A. Beginning of Year Accrued Liability	$726,915.4	$705,248.9
B. Normal Cost Liability	13,719.4	12,935.3
C. Plan Amendment Liability	880.3	5,563.5
D. Assumption Change Liability	(4,626.3)	(2,334.4)
E. Benefit Outlays	(35,716.8)	(35,187.8)
F. Interest on Pension Liability	44,755.2	43,393.2
G. Actuarial Loss (Gain)	(9,865.7)	(2,703.4)
H. End of Year Accrued Liability (A+B+C+D+E+F+G)	$736,061.5	$726,915.3
I. Net Change in Actuarial Liabilities (B+C+D+E+F+G)	$9,146.1	$21,666.4

Other Information

Each year the accrued liability is expected to increase with the normal cost, decrease with benefit outlays, and increase with the interest cost. In the absence of (1) actuarial gains and losses, (2) plan benefit changes, and (3) assumption changes, an increase of $22.758 billion in the accrued liability was expected during FY 2003.

The September 30, 2003, accrued liability includes changes due to (1) assumptions, (2) benefit changes, and (3) experience. The new assumptions include (a) permanent disability retiree death and other loss rates, (b) updates and enhancements to the survivor valuation model , (c) first-year retiree offset factors, and (d) a new long-term salary increase assumption of 3.75 percent.

The combined effect of the actuarial assumption changes is a decrease in the September 30, 2003, accrued liability of $4.626 billion shown on Line D. The change in retirement benefits for FY 2003 includes the reform of basic pay rates mandated by the FY 2003 DoD Authorization Act. The effect of the benefit change is an increase in the September 30, 2003, Accrued Liability of $0.880 billion, shown on Line C. The decrease in accrued liability due to the net experience gain of $9.866 billion, shown on line G, reflects the new population on which the September 30, 2002, roll-forward is based, as well as other economic experience being different than assumed.

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

The Military Retirement System is a single-employer, defined benefit plan. Administrative costs of the Fund are not ascertainable. Projected revenues into the Fund, authorized by Public Law (PL) 98-94, come from three sources: monthly DoD contributions, annual unfunded liability payment from the U.S. Treasury, and interest earnings on Fund assets. The monthly DoD contributions are determined as a percentage (approved by the DoD Retirement Board of Actuaries) of basic pay. The unfunded liability payment from the U.S. Treasury is paid into the Fund at the beginning of each fiscal year, and represents the amortization of the unfunded liability for service performed prior to October 1, 1984, as well as the amortization of actuarial gains and losses that have arisen since then. The DoD Retirement Board of Actuaries determines U.S. Treasury's unfunded liability payment, and the Secretary of Defense directs the Secretary of Treasury to make the payment.

The long-term economic assumptions for the FY 2002 valuation were 6.25 percent interest, 3.0 percent Consumer Price Index, and 3.5 percent salary increase. At its annual meeting in September, 2003, the DoD Retirement Board of Actuaries decided to increase the long-term annual salary increase assumption to 3.75 percent for the September 30, 2003, valuation. For fiscal years 2003 and 2004, the inflation rates of 1.4 percent (actual) and 2.0 percent (estimated), and the salary increases of 4.1 percent (actual) and 3.7 percent (estimated) were used. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience.

Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year's valuation results as reported in the DoD Office of the Actuary's Valuation of the Military Retirement System. For purposes of the Fund's financial reporting, this process is applied annually.

Market Value of Investments in Market-Based and Marketable Securities: $198,003.7 million

Federal Employees Compensation Act (FECA)

Fluctuations and Abnormalities

The unfunded liability for FECA increased 5.7 percent from year-end FY 2002 to year-end FY 2003.

Assumptions

The actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DoD at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined by using historical benefit payment patterns to predict the future payments. Cost-of-living adjustments and medical inflation factors are also included in the calculation of projected future benefits. Consistent with past practices, these projected annual benefit payments are then discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

Year 1	5.21%
Year 2	5.21%
Year 3 and thereafter	5.21%

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

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

CBY	COLA	CPIM
2001	3.33%	4.44%
2002	3.00%	4.15%
2003	2.56%	4.09%
2004	2.50%	4.09%
2005+	2.50%	4.09%

The model's resulting projections were critically analyzed to insure that the estimates were reliable. The analysis was primarily based on two tests: (1) a comparison of the percentage change in the liability amount by agency, to the percentage change in the actual payments, and (2) a comparison of the ratio of the estimated liability, to the actual payment of the beginning year, as calculated for the current projection to the liability-payment ratio calculated for the prior projection.

Voluntary Separation Incentive Programs (VSI)

Actuarial Cost Method Used: See narrative on fluctuations.

Assumptions

The VSI Fund (recorded on the books of the U. S. Treasury) is used to accumulate funds to finance, on an actuarially sound basis, the liabilities of the DoD incurred under this program. The VSI benefit is an annual annuity paid to a member who has separated under this program and is paid for a period of time equal to twice the member's years of service. These benefits are paid by the VSI Fund, which receives contributions from the Military Services' military personnel accounts. Contribution amounts are determined by the DoD Office of the Actuary in conjunction with the Under Secretary of Defense (Comptroller) (USD(C)), based on a comparison of liabilities to assets. Future contribution amounts for current VSI recipients will be determined by the Board of Actuaries. No future military personnel are scheduled to separate under this option.

Market Value of Investments in Market-Based and Marketable Securities: $804.6 million

Fluctuations and Abnormalities

The 22 percent increase in the VSI unfunded actuarial liability is the combined result of an increase in the actuarial present value of the plan benefits, and a decrease in the value of the assets available to pay benefits. Since the VSI program is discontinued as far as new applicants, each year the actuarial liability is expected to decrease with benefit outlays, and increase with the interest cost. In the absence of (1) actuarial gains and losses, and (2) assumption changes, a decrease of $68.1 million in the actuarial liability was expected during FY 2003. However, the September 30, 2003, actuarial liability includes changes due to (1) assumptions, and (2) experience. The new assumption is a new long-term rate of return on investments of 4 percent. The effect of the actuarial assumption change is an increase in the September 30, 2003, actuarial liability of $215.0 million. The decrease in actuarial liability due to the net experience gain of $2.5 million reflects the new population data on which the September 30, 2003, actuarial liability is based, as well as other economic experience being different than assumed.

DoD Education Benefits Fund

Actuarial Cost Method Used: See narrative on fluctuations.

Assumptions

The Education Benefits Fund was established by Public Law 98-525. The fund is designed to accumulate resources for the Educational Assistance programs promoting the recruitment and retention of members for the All-Volunteer Forces and the Total Force Concept of the Armed Forces. The fund is also designed to aid in the readjustment of Armed Forces service members to civilian life after they separate from military service.

Market Value of Investments in Market-Based and Marketable Securities: $1,077.5 million

Fluctuations and Abnormalities

The 27 percent increase in the DoD Education Benefits unfunded actuarial liability is the combined result of an increase in the actuarial present value of the plan benefits, and an increase in the value of the assets available to pay benefits. The modified estimate of the present value of benefits (PVB) for the DoD Education Benefits Fund in FY 2003 relative to what was reported in FY 2002 includes more complete experience and includes for the first time an estimate of $17.0 million for Category 3 benefits paid from the Fund. The PVB also went up because of a lower interest rate assumption (4.4 percent vs. 5.5 percent) and a benefit change whereby Chapter 1606 eligible personnel have 14 years (previously 10 years) to use the benefit. The resulting increases in the PVB were offset somewhat due to other changes in the rates and methodology. For the number reported as of September 30, 2003, there is an additional effect of approximately $15.0 (net) million due to an additional year of new entrants and calculating the present value of the stream of projected future benefits as of a year later.

Note Reference

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

Note 18. Unexpended Appropriations

As of September 30		2003		2002
(Amounts in millions)				
1. Unexpended Appropriations:				
A. Unobligated, Available	$	30,851.1	$	30,115.5
B. Unobligated, Unavailable		5,069.9		4,551.8
C. Unexpended Obligations		157,034.8		142,615.3
D. Total Unexpended Appropriations	$	192,955.8	$	177,282.6

2. Other Information Pertaining to Unexpended Appropriations:

Definitions

Unexpended appropriations are the amount of budget authority remaining for disbursement against current or future obligations.

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

Unexpended obligations represent funds that have been committed for goods that have not been received or services that have not been performed.

Relevant Information for Comprehension:

Unexpended Obligations

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 line 12, Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but Not Yet Provided, on the Statement of Financing. This line on the Statement of Financing includes the change during the fiscal year in Unexpended Obligations against budget authority from all Military Services.

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

Disclosures Related to the Statement of Net Cost

Fluctuations

On the Department of Defense (DoD) Consolidated Statement of Net Cost (SoNC), intra-governmental earned revenue decreased by $2,347.8 million or 15.1 percent between year-end FY2002 and year-end FY2003, which was primarily due to amount of interest earned by the Military Retirement Trust. Interest on investments for this fund decreased from $12,398 million in FY 2002 to $9,998 million in FY 2003. Securities that were purchased with higher coupon rates were invested at lower coupon rates in FY 2003 resulting in less interest earned.

Gross Costs with the Public increased by $127,331.6 million between year-end FY 2002 and year-end FY2003. Affecting this increase was the implementation of the new accounting standard SFFAS No. 23 "Eliminating the Category of National Defense Property, Plant, and Equipment." The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades.

Information Related to the Statement of Net Cost

Statement of Net Cost

The Consolidated SoNC in the federal government is unique because its principles are driven on understanding the net cost of programs and/or organizations that the federal government supports through appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

Reporting Entities

For General Funds, the amounts presented in the SoNC are based on obligations and disbursements and therefore may not in all cases report actual accrued costs. The Department of Defense generally records transactions on a cash basis and not an accrual basis as is required by generally accepted accounting principles. Therefore, the Department's systems do not capture actual costs. As such, information presented in the SoNC is based on budgetary obligations, disbursements, and collection transactions, as well as non-financial feeder systems, then adjusted to record known accruals for major items such as payroll expenses, accounts payable, and environmental liabilities.

For Working Capital Funds, while the Department's Working Capital Funds (WCFs) generally record transactions on an accrual basis as is required by generally accepted accounting principles, the systems do not always capture actual costs. Information presented on the SoNC is primarily based on budgetary obligation, disbursements, or collection transactions, as well as information from non-financial feeder systems.

The Statement of Net Costs restates the fiscal year 2002 balances for the Special Operations Command and the U.S. Army Corps of Engineers using prior period adjustments. See note 20 for further details.

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

As of September 30	2003			2002
(Amounts in millions)				
Budget Functional Classification	Gross Cost	(Less: Earned Revenue)	Net Cost	Net Cost
1. Department of Defense Military (051)	$ 415,556.5	$ (14,527.6)	$ 401,028.9	$ 329,179.1
2. Water Resources by U.S. Army Corps of Engineers (301)	10,087.7	(779.7)	9,308.0	6,167.2
3. Pollution Control and Abatement by US. Army Corps of Engineers (304)	140.2	0.0	140.2	149.0
4. Federal Employees Retirement and Disability, Department of Defense Military Retirement Fund (602)	44,545.9	(9,998.4)	34,547.5	44,458.1
5. Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund (702)	330.7	(45.3)	285.4	254.0
6. Medicare Eligible Retiree Health Care Fund (551)	67,375.7	(395.1)	66,980.6	0.0
7. Total	$ 538,036.7	$ (25,746.1)	$ 512,290.6	$ 380,207.4

8. Other Information

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

The Department's accounting systems do not capture cost data in a manner that enables the Department to determine if the cost was incurred to generate intragovernmental revenue. Therefore, the Department was unable to complete this note. The Department is in the process of upgrading its financial and feeder systems and will be addressing this issue. Additionally, the identification of intragovernmental revenue and expenses is a government-wide problem. The OMB and the Department of the Treasury have efforts underway to develop government-wide guidance to enable accurate reporting of intragovernmental transactions.

Note 19.D. Imputed Expenses

As of September 30 (Amounts in millions)	2003	2002
1. Civilian (e.g.,CSRS/FERS) Retirement	$ 1,717.2	$ 1,340.0
2. Civilian Health	1,948.4	1,864.7
3. Civilian Life Insurance	20.9	20.6
4. Military Retirement Pension	0.0	0.0
5. Military Retirement Health	0.0	0.0
6. Judgment Fund	180.4	294.7
7. Total Imputed Expenses	$ 3,866.9	$ 3,520.0

8. Other Information

Note 19.E. Benefit Program Expenses

As of September 30 (Amounts in millions)	2003	2002
1. Service Cost	$ 28,100.2	$ 13,128.0
2. Period Interest on the Benefit Liability	82,253.8	34,747.0
3. Prior (or past) Service Cost	880.3	(36,477.0)
4. Period Actuarial Gains or (Losses)	20,509.8	8,148.0
5. Gains/Losses Due to Changes in Medical Inflation Rate Assumption	9,206.0	2,080.0
6. Total Benefit Program Expense	$ 140,950.1	$ 21,626.0

7. Other Information

Note 19. F.	Exchange Revenue

Disclosures Related to the Exchange Revenue:

Definition:

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

Note Reference

For regulatory discussion on Exchange Revenue, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 102120.

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

Disclosures Related to Amounts for FMS Program Procurements from Contractors:

The cost of items purchased by foreign governments under the Foreign Military Sales (FMS) Program and provided directly to the foreign governments by contractors are not reported in the Statement of Net Cost. As of September 30, 2003, we estimate the amounts purchased by foreign governments under the FMS Program to be $13.0 billion.

Note 19.H.	Stewardship Assets

Disclosures Related to Stewardship Assets:

Stewardship assets include Heritage Assets, Stewardship Land, Non-Federal Physical Property, and Investments in Research and Development. The current-year cost of acquiring, constructing, improving, reconstructing, or renovating stewardship assets are included in the SoNC. Material yearly investment amounts related to stewardship assets are provided in the Required Supplemental Stewardship Information section of this financial statement.

Note 19.I. Intra-governmental Revenue and Expense

Disclosures Related to Intra-governmental Revenue and Expense:

Intragovernmental Revenue and Expenses.

The Department's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Department was unable to reconcile intragovernmental revenue 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 cannot be accomplished with the existing or foreseeable resources.

Note 19.J. Suborganization Program Costs

As of September 30	2003			2002
(Amounts in millions)	Subentity A	Subentity B	Subentity C	
1. Program A Costs:				
A. Intra-governmental Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0
B. Non-Federal Costs:				
1. Transfer Payments	0.0	0.0	0.0	0.0
2. Administrative Costs	0.0	0.0	0.0	0.0
3. Other Costs	0.0	0.0	0.0	0.0
4. Program A Non-federal Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0
C. Total Program A Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0
2. Program B Costs:				
A. Intra-governmental Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0
B. Non-Federal Costs:				
1. Transfer Payments	0.0	0.0	0.0	0.0
2. Administrative Costs	0.0	0.0	0.0	0.0
3. Other Costs	0.0	0.0	0.0	0.0
4. Program B Nonfederal Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0
C. Total Program B Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0
3. Program C Costs:				
A. Intra-governmental Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0
B. Non-Federal Costs:				
1. Transfer Payments	0.0	0.0	0.0	0.0
2. Administrative Costs	0.0	0.0	0.0	0.0
3. Other Costs	0.0	0.0	0.0	0.0
4. Program C Nonfederal Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0
C. Total Program C Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0

4. Program D Costs:				
A. Intra-governmental Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0
B. Non-Federal Costs:				
1.Transfer Payments	0.0	0.0	0.0	0.0
2.Administrative Costs	0.0	0.0	0.0	0.0
3.Other Costs	0.0	0.0	0.0	0.0
4.Program D Non-federal Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0
C. Total Program D Costs	$ 0.0	$ 0.0	$ 0.0	$ 0.0

5. Other Information:

Programs and Major Appropriation Groups

The Department of Defense (DoD) identifies programs based on the nine major appropriation groups provided by the Congress. The Department is in the process of reviewing available data and attempting to develop a cost reporting methodology that fulfills the need for cost information required by SFFAS No. 4 to keep the financial statements from becoming overly voluminous.

Until cost-allocating processes and expanded intra-DoD eliminating capabilities are incorporated into the accounting processes, the usefulness of further sub-organization-reported (major command) net costs is limited. This limitation is the reason that no additional statements of sub-organization cost at lower levels are presented with these statements.

The DoD is unable to accumulate costs for major programs based on performance measures identified under requirements of the Government Performance and Results Act because current financial processes and systems do not capture and report this type of cost information. Until the processes and systems are upgraded, the DoD as a whole will break out programs by major appropriation groupings.

The SoNC format requires reporting program costs by costs incurred with intragovernmental and public entities. Although overall program costs are believed to be fairly stated, the cost allocations between intragovernmental and public entities that were based on available vendor type data may not be totally accurate.

Note Reference

For regulatory discussion on Sub-organization Program Costs, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 102128.

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

As of September 30	Cumulative Results of Operations 2003	Unexpended Appropriations 2003	Cumulative Results of Operations 2002	Unexpended Appropriations 2002
(Amounts in millions)				
1. Prior Period Adjustments Increases (Decreases) to Net Position				
Beginning Balance:				
A. Changes in Accounting Standards	$ 383,129.9	$ 0.0	$ (0.0)	$ 0.0
B. Errors and Omissions in Prior Year Accounting Reports	153.9	0.0	(63,388.8)	1,553.3
C. Other Prior Period Adjustments	0.0	0.0	1,628.8	0.0
D. Total Prior Period Adjustments	$ 383,283.8	$ 0.0	$ (61,760.0)	$ 1,553.3
2. Imputed Financing:				
A. Civilian CSRS/FERS Retirement	$ 1,717.2	$ 0.0	$ 1,340.1	$ 0.0
B. Civilian Health	1,948.4	0.0	1,864.7	0.0
C. Civilian Life Insurance	20.9	0.0	20.6	0.0
D. Military Retirement Pension	0.0	0.0	0.0	0.0
E. Military Retirement Health	0.0	0.0	0.0	0.0
F. Judgment Fund	180.4	0.0	294.6	0.0
G. Total Imputed Financing	$ 3,866.9	$ 0.0	$ 3,520.0	$ 0.0

3. Other Information:

Prior-Period Restatement of Balances

The US Special Operations Command (USSOCOM) reported a prior-period adjustment totaling $2.9 billion. This adjustment restated the General PP&E account for items not reported in previous fiscal years 1999 through 2002 and was made in accordance with Federal Accounting Standards Advisory Board SFFAS Number 21 and SFFAS Number 7. This adjustment is considered as an error and omission in prior year accounting reports.

The United States Army Corps of Engineers made a prior-period adjustment to eliminate $2.7 billion of construction in progress (CIP) for the portion related to cost-share projects. This adjustment restated the CIP account and the related allowance account based on a recommendation from the DoD Inspector General's Office. This adjustment is considered as an error and omission in prior year accounting reports.

The Balance Sheet, Statement of Net Costs, and Statement of Changes in Net Position reflect restated balances for these adjustments.

Prior-Period Adjustments

The Department of Defense recorded $383.3 billion in prior-period adjustments in FY 2003. These adjustments consist of the following:

An adjustment of $383.1 billion is related to changes in the Statement of Federal Financial Accounting Standards (SFFAS) Number 23. Effective October 1, 2002, the SFFAS Number 23, "Eliminating The Category National Defense Property, Plant, and Equipment," revised the accounting principles for reporting military equipment (previously referred to as National Defense Property, Plant, and Equipment (NDPP&E)). The standard renames NDPP&E to military equipment and classifies military equipment as general property, plant, and equipment (GPP&E). The standard also requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. Implementation of the new accounting principles requires the adjustment of the October 1, 2002, General Property, Plant, and Equipment balance to recognize the investment, accumulated depreciation, and net book value of military equipment that previously had been expensed. The adjustment was based on data provided by the Bureau of Economic Analysis, Department of Commerce.

The Defense Finance and Accounting Service made a $5.5 million prior period adjustment to record a fiscal year 2002 audit adjustment that had been made to the DFAS statements after publishing the DoD-wide statements. A prior period adjustment was recorded in fiscal year 2003 to include this change in the DoD-wide statements.

Air Force Working Capital Fund has a prior period adjustment of $55.1 million. This is an auditor directed adjustment.

Other Disclosures

Imputed Financing

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

In FY 2003, the imputed financing increased by $347.0 million or 10 percent. The majority of the change is attributed to increases in the employee benefits service cost factors with little or no increase in the employee and employer contribution cost factors. Additionally, DoD recognized FERS imputed financing costs for the first time. Prior to FY 2003, DoD paid 100 percent of FERS employees' benefits. However, in FY 2003, the service cost for FERS increased but the employee and employer contributions did not change. Therefore, DoD is recognizing the difference between the service cost factor for FERS and the employee and employer cost factors for FERS as imputed financing costs. Also, changes occurred in the annual gross base pay, which is used to calculate imputed financing costs.

Appropriations for Iraqi Freedom

Appropriations used (Line 4.D.) increased $96.0 billion.
Appropriation received (Line 4.A.) increased $111.0 billion.

Note 21.A. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2003	2002
(Amounts in millions)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 215,000.2	$ 183,920.1
2. Available Borrowing and Contract Authority at the End of the Period	21,150.6	21,098.5

3. Other Information:

Table Fluctuations

Line 1, Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period, in the table above, increased $31,080.1 million, or 16.9 percent.

In general, many line items on the Statement of Budgetary Resources changed substantially due to the increased appropriations for Iraqi Freedom. Obligations incurred increased $121 billion. Other reasons for this fluctuation include increased funding to support Operations Enduring Freedom and Noble Eagle; war-fighting readiness; force protection; procurement of helicopters; development of future combat systems; and war reserves.

The Other Defense Organizations – General Fund reported that differences exist between the SBR and the year-end SF-133 (line 2A and line 12). These differences are primarily attributable to inconsistencies in the ending balances on the FY 2002 FACTS-II data file and the beginning balances on the FY 2003 FACTS-II data file. This data file is used to create the SBR. Adjustments to the budgetary trial balance input as part of the FY 2003 audited financial statements process also caused differences between the two reports.

Other Information Related to the Statement of Budgetary Resources

Accounting Standard: U.S. Standard General Ledger

The Department of Defense has not fully implemented the U.S. Government Standard General Ledger in all operational accounting systems. Guidance from the Treasury Financial Manual, Part 2, Chapter 4000, FACTS-II, is used to populate the Department's Statement of Budgetary Resources. However, some of the Department's entities still use proprietary accounts to produce their budgetary accounting data. The Department's accounting systems neither provide nor capture data needed for obligations incurred and recoveries of prior-year obligations in accordance with OMB Circular A-11, "Preparation, Submission, and Execution of the Budget," requirements. Although the Department of Defense developed an alternative methodology to calculate these items, the amount of distortion cannot be reliably determined and may or may not be material.

Foreign Military Sales Trust Funds

Beginning in FY 2002, the Department of Defense treated Foreign Military Sales (FMS) Trust Funds as nonfederal and presented these amounts in the Balance Sheet and the Statement of Net Cost. Accounts receivables and collections related to FMS are recognized on the Statement of Budgetary Resources (SBR). Therefore, reconciling differences exist between the SBR and the Balance Sheet. The Office of the Under Secretary of Defense (Comptroller) is currently researching the issue to determine the proper treatment of FMS Trust Fund transactions to ensure proper reporting.

Intra-entity Transactions

The SBR does not include intra-entity transactions because the statements are presented as combined and combining.

- Pursuant to section 303(2) of Public Law (PL) 107-296, functions of the National Bio-Weapons Defense Analysis Center of DoD, including related functions of the Secretary of Defense were transferred to the Department of Homeland Security (DHS). As a result, budgetary resources totaling $1,022.8 million were transferred from several DoD organizations to the DHS as of September 2003.

Schedule of Transfers to the Department of Homeland Security
($Millions)

Transferred From	**Type of Budget Resource**	**$ Amount**
Chemical Biological Defense Program – Defense Threat Reduction Agency (DTRA	Budget Authority	416.5
Defense Emergency Response Fund	Unobligated Balance	75.6
Iraqi Freedom Fund	Budget Authority	400.0
Defense Information Systems Agency (DISA)	Budget Authority	62.5
DISA	Unobligated Balance	44.3
DISA	Unliquidated Obligations	23.9
Total Budgetary Resources		1,022.8

- In August 2003, the Department of the Army transferred $23.0 million in funds to DTRA in support of DHS, Directorate of Science and Technology. The transfer was authorized pursuant to Title III of the Homeland Security Act of 2002, PL 107-296. The funds transferred from the Army to DTRA support the BioNet Defense Initiative (previously called the Biological Defense Initiative (BDI)). Obligations incurred for these funds as of September 30, 2003, totaled $1.2 million.

Apportionment Categories

OMB Bulletin No. 01-09, section 9.27, specifically requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B, and exempt from apportionment. This disclosure should agree with the aggregate of the related information as included in each reporting entity's SF 133, Report on Budget Execution and Budgetary Resources, and lines 8A and 8B in the SBR. Two reporting entities disclosed differences among four lines (8A, 8B, 9A, and 9B) on the SF 133 and SBR.

The Army General Fund reported that, for FY 2002 and 2003, its direct and reimbursable delivered orders on the SBR do not agree with lines 8A and 8B on the SF 133. Also, lines 9A and 9B on the SBR do not agree with the SF 133 because of the incorrect reporting by FACTS II of the status of funds for Basic Symbols 1096, Iraqi Relief and Restoration Fund; 5095, Wildlife Conservation; 5098, Restoration of Rocky Mountain Arsenal; 5286, National Science Center; 8063, Trust Fund for Walter Reed Army Medical Center; and 8927, Trust Fund for Army General Fund Gift Funds FACTS-II uses the Allotments - Realized Resources status for these basic symbols rather than the Unobligated Funds Not Subject to Apportionment status.

The specific direct and reimbursable obligations apportioned under the three required categories are displayed in the tables below:

Direct Obligations – Apportionment Categories

Reporting Entity	Category A ($Millions)	Category B ($Millions)	Exempt from Apportionment ($Millions)
Army General Fund	124,340	3,672	
Navy General Fund – see disclosure	124,498		
Air Force General Fund	73,188	50,177	11
Army Working Capital Fund	249		
Navy Working Capital Fund	0		
Air Force Working Capital Fund		24	
US Corps of Engineers	5,516		30
Military Retirement Fund		35,396	
Medicare Eligible Healthcare Fund	4,583		
Other Defense Organizations – Working Capital Funds	1,076		
Other Defense Organizations – General Fund	99,266	280	423

Reimbursable Obligations – Apportionment Categories

Reporting Entity	Category A ($Millions)	Category B ($Millions)	Exempt from Apportionment ($Millions)
Army General Fund	18,430		
Navy General Fund – see disclosure	8,080		
Air Force General Fund	5,244	2,976	11
Army Working Capital Fund	12,322		
Navy Working Capital Fund	27,264		
Air Force Working Capital Fund		16,976	
US Corps of Engineers	5,034		
Other Defense Organizations – Working Capital Fund	46,893		
Other Defense Organizations – General Fund – see disclosure	3,917		

Disclosures Relating to Apportionment Categories

The Navy General Fund reported that, due to system limitations, both types of its obligations cannot be categorized. Therefore, Navy's direct and reimbursable obligations are all reported in the above table as "category A." The Other Defense Organizations – General Fund reported that its systems cannot determine the different categories of reimbursable obligations. Therefore, these obligations are reported in the above table as "category A."

Spending Authority from Offsetting Collections

Adjustments in funds that are temporarily not available pursuant to Public Law as well as those funds that are permanently not available are neither included on the "Spending Authority from Offsetting Collections" line on the Statement of Budgetary Resources nor included on the "Spending Authority for Offsetting Collections and Recoveries" line on the Statement of Financing.

Undelivered Orders

Undelivered Orders presented in the Statement of Budgetary Resources include Undelivered Orders-Unpaid for both direct and reimbursable funds.

Note 21.B. Disclosures Related to Problem Disbursements, In-transit Disbursements and Suspense/Budget Clearing Accounts

As of September 30	September 2001	September 2002	September 2003	(Decrease)/Increase from 2002 to 2003
(Amounts in millions)				
1. Total Problem Disbursements				
A. Absolute Unmatched Disbursements	$ 1,041.0	$ 858.0	$ 854.0	$ (4.0)
B. Negative Unliquidated Obligations	205.0	122.0	125.0	3.0
2. Total In-transit Disbursements, Net	$ 6,240.0	$ 4,550.0	$ 4,675.0	$ 125.0

3. Other Information Related to Problem Disbursements and In-transit Disbursement

The amounts disclosed in the above table do not represent the total DoD problem disbursement amounts. The Department has fiduciary responsibility for the Foreign Military Sales program (Treasury Index 11), but is not required to include this program in its Agency-wide statements and notes. In addition, there are other issues that are causing a variance between the amounts reported on the table above and those amounts included in DoD's monthly Problem Disbursement and In-transit Report. These variances are currently under investigation. The discussion below addresses the Department's total problem disbursement amounts.

For year-end FY 2003, the Department of Defense reported $854 million (absolute value) in Unmatched Disbursements (UMD), which is a decrease of $4 million since fourth quarter of FY 2002. A UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

For year-end FY 2003, the Department reported $125 million (absolute value) in Negative Unliquidated Obligations (NULOs), which is an increase of $3 million since year-end FY 2002. A NULO occurs when a payment is made against a valid obligation but the payment is greater than the amount of the obligation recorded in the official accounting system. These problem disbursements represent the absolute value of disbursements of Department of Defense funds that have been reported by a disbursing station to the Department of the Treasury, but have not yet been precisely matched against the specific source obligation that gave rise to the disbursements. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

For year-end FY 2003, the Department of Defense reported $4,675 million (net) for In-Transits, which is an increase of $125 million since year-end FY 2002. The In-Transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

The elimination of both problem disbursements and aged in-transits is one of the highest financial management priorities of the Under Secretary of Defense (Comptroller). The Defense Finance and Accounting Service has efforts underway to improve the systems and to resolve all previous problem disbursements and to process all in-transit disbursements.

4. Suspense/Budget Clearing Accounts,Net

Account	September 2001	September 2002	September 2003	(Decrease)/Increase
F3875	$ 92.5	$ 525.0	$ (628.8)	$ (1,153.8)
F3880	0.3	2.5	(6.0)	(8.5)
F3882	0.0	23.2	(21.6)	(44.8)
F3885	350.5	258.7	(399.5)	(658.2)
F3886	5.2	6.3	0.2	(6.1)
Total	$ 448.5	$ 815.7	$ (1,055.7)	$ (1,871.4)

5. Other Information Related to Suspense/Budget Clearing Accounts:

The Department of Defense has made a concerted effort to reduce balances in the suspense and budget clearing accounts disclosed on line 4 above. A description of the suspense and budget clearing accounts and their respective balances follows:

- The F3875, F3885, and F3886 suspense accounts represent the source of the transaction. Account F3875, which reported a negative balance of $103.5 million, represents the Disbursing Officer's (DO) suspense. Account F3885, which represents the Interfund/IPAC suspenses, reported a balance of $425.2 million Account F3886, with a balance of $0.2 million, represents the (payroll) Thrift Savings Plan suspense. These three suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation.

- The F3880 suspense account, which reported a negative balance of $6.0 million, represents the balance of Treasury checks that (1) have either been lost by the payee and need to be reissued, (2) have never cashed by the payee, or (3) have been cancelled by the Treasury and need to be transferred to the original appropriation.

- The F3882 suspense account, which reported a negative balance of $13.3 million, was established for the Uniformed Services Thrift Savings Plan in FY 2002. The amounts in this account represent a timing difference between the posting of the Thrift Savings Plan deductions by the National Finance Center and the posting of these same amounts in the military accounting systems in the following month.

On September 30 of each fiscal year, most of the uncleared suspense/budget clearing account balances are reduced to zero (as required by the Department of the Treasury) by transferring the balances to the proper appropriation accounts. On October 1 of the following fiscal year, the uncleared suspense/clearing account balances are reestablished.

<u>Note Reference</u>

See Note 2 – Nonentity and Entity Assets for further explanation on deposits, suspense, and budget clearing accounts.
See Note 3 – Fund Balance with Treasury for additional disclosures on deposits, suspense, and budget clearing accounts.

Note 22.	Disclosures Related to the Statement of Financing

Disclosures Related to the Statement of Financing:

Fluctuations and/or Abnormalities

Transfers In/out Without Reimbursement decreased by $6.7 billion due to the transfer of a $6.6 billion liability from Other Defense Organizations to the Medicare-Eligible Retiree Health Care Fund, which was established in FY 2003. In addition, $56.7 million in assets were transferred to the Department of Interior from the U.S. Army Corps of Engineers.

Resources That Fund Expenses Recognized in Prior Periods increased (negative decrease) primarily due to a change in environmental liabilities. In FY 2002, the Army modified its cost estimating tool for transferred ranges and increased quality control of program requirements for closed ranges. This resulted in a $5.6 billion decrease in environmental liabilities in FY 2002. There was no comparative decrease in FY 2003.

Resources That Finance the Acquisition of Assets decreased by $63.9 billion from FY 2002 due to an increase in acquisitions. Increases in acquisitions appear as a negative amount on the Statement of Financing because budgetary expenditures for assets that are capitalized on the Balance Sheet are subtracted from total obligations in order to reconcile budgetary obligations with the net cost of operations. Increases in acquisitions were a result of support for Operating Enduring Freedom/Operation Iraqi Freedom. The acquisitions increased by $25.1 billion for the Army General Fund, $19.0 billion for Navy General Fund, $8.3 billion for the Air Force General Fund, and $1.0 billion for the Under Secretary of Defense for Acquisition, Technology and Logistics Working Capital Funds.

Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations increased by $6.6 billion from FY 2002. The increase was caused by the transfer of a $6.6 billion liability from Other Defense Organizations to the Medicare-Eligible Retiree Health Care Fund, which was established in FY 2003. Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations is primarily an offset to Transfers In/out Without Reimbursement.

Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods reports unfunded expenses that were incurred during FY 2003. The cumulative total of unfunded expenses from all fiscal years is reported as “Liabilities Not Covered by Budgetary Resources” in Note 11.

Other Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period consist primarily of actuarial future funded expenses. Actuarial future funded expenses, increased by $61.1 billion from year-end FY 2002 to

FY 2003. The increase resulted primarily from increased actuarial expenses for the DoD Medicare-Eligible Retiree Health Care Fund.

Depreciation and Amortization Expense increased by $48.0 billion from year-end FY 2002 to year-end FY 2003. The increase is due primarily to the reestablishment of Military Equipment as a capital asset.

Revaluation of Assets or Liabilities increased by $6.7 billion, primarily due to the correction of a mapping error of $3.4 billion for “Loss on Dispositions of Assets” for the Navy General Fund, and $1.6 billion in Navy OM&S consumed. Navy displays this as Revaluation of Assets or Liabilities, while Air Force and Army display consumption (correctly) as Other Components of Net Cost That Will Not Require or Generate Resources in Future Periods. In addition, Army posted a $1.5 billion adjustment as Revaluation of Assets or Liabilities to balance its Statement of Financing in FY 2002, and did not do so this year.

The $17.3 billion decrease in Other Components of Net Cost That Will Not Require or Generate Resources in Future Periods is primarily attributable to the reporting of trust fund undistributed revenue from Offsetting Receipts to Other Components of Net Cost That Will Not Require or Generate Resources in Future Periods ($23.7 billion) and the U.S. Army Corps of Engineers (USACE) $2.6 billion restatement of FY 2002 Net Cost. Trust fund undistributed revenue was correctly reported as part of Offsetting Receipts in FY 2002 and the Treasury Department changed the formatting of the Statement of Financing for FY 2003. The USACE made an adjustment to remove Construction In Process for cost share projects from the its books per audit recommendation. The decrease was partly offset by increases in Operating Materials and Supplies consumed by Air Force and Army due to support for Operation Enduring Freedom and Operation Iraqi Freedom.

Other Disclosures

The objective of the Statement of Financing is to reconcile the difference between budgetary obligations and the net cost of operations reported. The OMB Bulletin 01-09 requires the SOF to be presented on a consolidated basis. The Department is unable to perform the required intragovernmental eliminations to report the line items on a consolidated basis. Accordingly, the Statement of Financing is presented as combined statement.

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

- Resources That Finance the Acquisition of Assets $10,629.5 million
- Other Components Not Requiring of Generating Resources $1,839.4 million
- Statement of Net Cost * $89.7 million

* The Army General Fund adjusted the Statement of Net Cost instead of the Statement of Financing.

Note 23.	Disclosures Related to the Statement of Custodial Activity

Disclosures Related to the Statement of Custodial Activity:

A Statement of Custodial Activity is prepared by reporting entities whose primary mission is collecting taxes or other revenues, particularly sovereign revenues that are intended to finance the entire government's operations, or at least the programs of other entities, rather than their own activities.

Fluctuations and/or Abnormalities

Iraqi Seized Assets were first reported in FY 2003 attributing to the Statement of Custodial Activity's variances between FY 2002 and FY 2003.

Other Information Related to the Statement of Custodial Activity

During Operation Iraqi Freedom, the U.S. Government seized assets from the former Iraqi State or regime which is being used to assist the Iraqi people and support the reconstruction of Iraq. As of September 30, 2003, the following table depicts the custodial activity the Army has conducted pertaining to these seized assets (cash).

SOURCE OF COLLECTIONS	(Amounts in millions)
Seized Iraqi Cash	**$ 808.9**
DISPOSITION OF COLLECTIONS	
Iraqi Salaries	$ 30.2
Repair/Reconstruction/Humanitarian Assistance	$ 170.6
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	$ 254.6
Fuel/Supplies	$ 75.4
Total Disbursed on behalf of the Iraqi People	$ 530.8
Retained for Future Support of the Iraqi People	$ 278.1
Total Disposition of Collections	**$ 808.9**
NET CUSTODIAL COLLECTION ACTIVITY	**$ 0**

Foreign Military Sales Trust Fund

Under authority of the Arms Export and Control Act, the Foreign Military Sales Trust Fund (FMSTF) receives collections from foreign governments that are dedicated specifically to FMS purchases. Funds collected into the Trust Fund are in advance of the performance of services or sale of articles. These advance collections constitute a fiduciary relationship with the countries and are outside of the Federal budget. Current-year collections into the FMSTF for FY 2003 equal $9,971.6 million and disbursed on the behalf of foreign governments and international organizations equals $10,118.7 million.

In accordance with the DoD Acting Chief Financial Officer's memorandum of August 31, 1992, the FMSTF does not recognize nor report revenue, with the exception of cost clearing accounts which are reflected in all other components of the Audited Financial Statements except the Statement of Custodial Activity. Since various DoD components actually perform the services and sell the articles, recognition of revenue and expense occurs in the financial statements of the applicable DoD components.

Other Disclosures

For Regulatory Disclosure related to the Statement of Custodial Activity see, Department of Defense Financial Management Regulations, Volume 6B, Chapter 10, Paragraph 1025.

Note 24.A.	Other Disclosures

1. ENTITY AS LESSEE-Operating Leases

As of September 30	2003				2002
(Amounts in millions)					
B. Future Payments Due: Fiscal Year	Land and Buildings	Equipment	Other	Total	Total
2004	$ 94.1	$ 1.3	$ 1.2	$ 96.6	$ 71.6
2005	94.7	0.7	0.1	95.5	68.1
2006	96.9	0.6	0.0	97.5	67.7
2007	98.3	0.2	0.0	98.5	67.7
2008	97.2	0.2	0.0	97.4	62.7
After 5 Years	73.5	0.0	0.0	73.5	77.6
Total Future Lease Payments Due	$ 554.7	$ 3.0	$ 1.3	$ 559.0	$ 415.4

Fluctuations and Abnormalities:

There was an increase of $143.5 million in Total Future Lease Payments Due from year-end FY 2002 to year-end FY 2003. The majority of this variance is due to a new operating lease of $124.8 million for office facilities for the Defense Contract Management Agency.

Definitions

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

Land and Buildings Leases

- "Office Space" is the largest component. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Inter-service Support Agreements. Future year projections used the Consumer Price Index, rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites.

Equipment Leases

- The majority of these leases are for equipment with a variety of lease Terms. Renewal of the leases is not expected upon expiration.

Other Leases

- Other Information – This includes any other operating leases. Leases are generally 1-year leases. The Department expects to continue to reduce the level of owned assets while increasing the number of operational leases. The Department will strive to displace commercial leases in favor of GSA leases because GSA leases are typically more economical.

Note 24.B. Other Disclosures

Other Disclosures:

N/A