

Department of Defense
Department of the Air Force
CONSOLIDATED BALANCE SHEET
As of December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
1. ASSETS (Note 2)		
A. Intragovernmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	\$ 73,189,710,913.71	\$ 146,096,122,025.85
b. Non-Entity Seized Iraqi Cash	0.00	0.00
c. Non-Entity-Other	89,199,802.96	381,599,048.80
2. Investments (Note 4)	716,676.76	714,787.77
3. Accounts Receivable (Note 5)	358,457,404.86	532,207,765.68
4. Other Assets (Note 6)	432,672,076.80	475,499,793.05
5. Total Intragovernmental Assets	<u>\$ 74,070,756,875.09</u>	<u>\$ 147,486,143,421.15</u>
B. Cash and Other Monetary Assets (Note 7)	\$ 126,643,263.39	\$ 315,860,533.35
C. Accounts Receivable (Note 5)	1,041,537,870.19	953,657,425.19
D. Loans Receivable (Note 8)	0.00	0.00
E. Inventory and Related Property (Note 9)	48,617,976,292.52	48,302,193,518.03
F. General Property, Plant and Equipment (Note 10)	124,227,647,123.36	119,804,204,257.36
G. Investments (Note 4)	0.00	0.00
H. Other Assets (Note 6)	10,703,277,482.58	10,864,627,290.60
2. TOTAL ASSETS	<u><u>\$ 258,787,838,907.13</u></u>	<u><u>\$ 327,726,686,445.68</u></u>
3. LIABILITIES (Note 11)		
A. Intragovernmental:		
1. Accounts Payable (Note 12)	\$ 1,713,256,028.19	\$ 2,197,831,208.86
2. Debt (Note 13)	0.00	0.00
3. Other Liabilities (Note 15 & 16)	1,547,381,995.09	1,737,300,123.88
4. Total Intragovernmental Liabilities	<u>\$ 3,260,638,023.28</u>	<u>\$ 3,935,131,332.74</u>
B. Accounts Payable (Note 12)	\$ 5,577,209,599.77	\$ 4,974,794,095.49
C. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,147,437,480.00	1,163,442,240.00
D. Environmental and Disposal Liabilities (Note 14)	7,015,396,086.13	7,257,705,831.65
E. Loan Guarantee Liability (Note 8)	0.00	0.00
F. Other Liabilities (Note 15 & Note 16)	4,158,068,470.40	4,297,145,332.40
4. TOTAL LIABILITIES	<u>\$ 21,158,749,659.58</u>	<u>\$ 21,628,218,832.28</u>
5. NET POSITION		
A. Unexpended Appropriations - Earmarked Funds (Note 23)	\$ (1,251,498.55)	\$ 0.00
B. Unexpended Appropriations - Other Funds	73,737,115,222.09	138,412,560,671.56
C. Cumulative Results of Operations - Earmarked Funds	6,122,935.20	0.00
D. Cumulative Results of Operations - Other Funds	163,887,102,588.81	167,685,906,941.84
6. TOTAL NET POSITION	<u>\$ 237,629,089,247.55</u>	<u>\$ 306,098,467,613.40</u>
7. TOTAL LIABILITIES AND NET POSITION	<u><u>\$ 258,787,838,907.13</u></u>	<u><u>\$ 327,726,686,445.68</u></u>

Department of Defense
 Department of the Air Force
CONSOLIDATED STATEMENT OF NET COST
 For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
1. Program Costs		
A. Gross Costs	\$ 33,276,674,888.10	\$ 33,274,656,224.61
B. (Less: Earned Revenue)	(1,857,610,431.23)	(1,639,881,110.12)
C. Net Program Costs	<u>\$ 31,419,064,456.87</u>	<u>\$ 31,634,775,114.49</u>
2. Cost Not Assigned to Programs	0.00	0.00
3. (Less: Earned Revenue Not Attributable to Programs)	0.00	0.00
4. Net Cost of Operations	<u><u>\$ 31,419,064,456.87</u></u>	<u><u>\$ 31,634,775,114.49</u></u>

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CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
1. Beginning Balances	\$ 161,344,101,372.29	\$ 168,982,134,685.46
2. Prior Period Adjustments:		
2.A. Changes in accounting principles (+/-)	0.00	0.00
2.B. Corrections of errors (+/-)	0.00	0.00
3. Beginning balances, as adjusted	161,344,101,372.29	168,982,134,685.46
4. Budgetary Financing Sources:		
4.A. Appropriations received		
4.A.1 Earmarked funds	0.00	0.00
4.A.2 All other funds	0.00	0.00
4.B. Appropriations transferred-in/out (+/-)	0.00	0.00
4.C. Other adjustments (rescissions, etc.) (+/-)	0.00	0.00
4.D. Appropriations used		
4.D.1 Earmarked Funds	0.00	0.00
4.D.2 All other Funds	33,500,786,457.44	30,181,722,524.53
4.E. Nonexchange revenue		
4.E.1 Earmarked funds	269,992.81	0.00
4.E.2 All other funds	0.06	289,179.52
4.F. Donations and forfeitures of cash and cash equivalents		
4.F.1 Earmarked funds	672,630.71	0.00
4.F.2 All other funds	0.00	779,777.29
4.G. Transfers-in/out without reimbursement (+/-)	0.00	0.00
4.H. Other budgetary financing sources (+/-)		
4.H.1 Earmarked funds	0.00	0.00
4.H.2 All other funds	0.00	0.00
5. Other Financing Sources:		
5.A. Donations and forfeitures of property		
5.A.1 Earmarked funds	0.00	0.00
5.A.2 All other funds	0.00	0.00
5.B. Transfers-in/out without reimbursement (+/-)	297,420,443.67	(27,397,460.00)
5.C. Imputed financing from costs absorbed by others	169,039,083.90	183,153,349.53
5.D. Other (+/-)	0.00	0.00
6. Total Financing Sources		
6.A. Earmarked funds	942,623.52	0.00
6.B. All other funds	33,967,245,985.07	30,338,547,370.87
7. Net Cost of Operations (+/-)		
7.A. Earmarked funds	270,854.06	0.00
7.B. All other funds	31,418,793,602.81	31,634,775,114.49
8. Net Change		
8.A. Earmarked funds	671,769.46	0.00
8.B. All other funds	2,548,452,382.26	(1,296,227,743.62)
9. Ending Balances		
9.A. Earmarked funds	6,122,935.20	0.00
9.B. All other funds	163,887,102,588.81	167,685,906,941.84

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CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
10. Total all funds	\$ <u>163,893,225,524.01</u>	\$ <u>167,685,906,941.84</u>

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CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
UNEXPENDED APPROPRIATIONS		
1. Beginning Balances	\$ 63,716,637,180.98	\$ 49,660,670,196.09
2. Prior Period Adjustments:		
2.A. Changes in accounting principles (+/-)	0.00	0.00
2.B. Corrections of errors (+/-)	0.00	0.00
3. Beginning balances, as adjusted	63,716,637,180.98	49,660,670,196.09
4. Budgetary Financing Sources:		
4.A. Appropriations received		
4.A.1 Earmarked funds	0.00	0.00
4.A.2 All other funds	43,400,512,000.00	118,485,621,000.00
4.B. Appropriations transferred-in/out (+/-)	266,516,000.00	1,158,181,000.00
4.C. Other adjustments (rescissions, etc) (+/-)	(147,015,000.00)	(710,189,000.00)
4.D. Appropriations used		
4.D.1 Earmarked Funds	0.00	0.00
4.D.2 All other Funds	(33,500,786,457.44)	(30,181,722,524.53)
4.E. Nonexchange revenue		
4.E.1 Earmarked funds	0.00	0.00
4.E.2 All other funds	0.00	0.00
4.F. Donations and forfeitures of cash and cash equivalents		
4.F.1 Earmarked funds	0.00	0.00
4.F.2 All other funds	0.00	0.00
4.G. Transfers-in/out without reimbursement (+/-)	0.00	0.00
4.H. Other budgetary financing sources (+/-)		
4.H.1 Earmarked funds	0.00	0.00
4.H.2 All other funds	0.00	0.00
5. Other Financing Sources:		
5.A. Donations and forfeitures of property		
5.A.1 Earmarked funds	0.00	0.00
5.A.2 All other funds	0.00	0.00
5.B. Transfers-in/out without reimbursement (+/-)	0.00	0.00
5.C. Imputed financing from costs absorbed by others	0.00	0.00
5.D. Other (+/-)	0.00	0.00
6. Total Financing Sources		
6.A. Earmarked funds	0.00	0.00
6.B. All other funds	10,019,226,542.56	88,751,890,475.47
7. Net Cost of Operations (+/-)		
7.A. Earmarked funds	0.00	0.00
7.B. All other funds		
8. Net Change		
8.A. Earmarked funds	0.00	0.00
8.B. All other funds	10,019,226,542.56	88,751,890,475.47
9. Ending Balances		
9.A. Earmarked funds	(1,251,498.55)	0.00
9.B. All other funds	73,737,115,222.09	138,412,560,671.56

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CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
10. Total all funds	\$ <u>73,735,863,723.54</u>	\$ <u>138,412,560,671.56</u>

Department of Defense
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COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended December 31, 2005 and 2004

	<u>2006 Combined</u>	<u>2005 Combined</u>
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES:		
1. Unobligated balance, brought forward, October 1	\$ 13,006,208,304.77	\$ 9,048,570,951.49
2. Recoveries of prior year unpaid obligations	395,966,940.39	186,918,904.07
3. Budget authority		
3.A. Appropriation	126,939,552,117.35	118,486,693,114.33
3.B. Borrowing authority	0.00	0.00
3.C. Contract authority	0.00	0.00
3.D. Spending authority from offsetting collections		
3.D.1 Earned		
3.D.1.a. Collected	2,050,418,400.73	1,955,898,526.13
3.D.1.b. Change in receivables from Federal sources	(573,667,965.18)	(230,627,423.68)
3.D.2 Change in unfilled customer orders		
3.D.2.a. Advance received	(125,182,600.00)	238,604,781.82
3.D.2.b. Without advance from Federal sources	911,185,351.03	1,751,848,378.80
3.D.3. Anticipated for rest of year, without advances	9,559,431.58	3,237,828,625.55
3.D.4. Previously unavailable	0.00	0.00
3.D.5. Expenditure transfers from trust funds	0.00	0.00
3.E. Subtotal	<u>129,211,864,735.51</u>	<u>125,440,246,002.95</u>
4. Nonexpenditure transfers, net, anticipated and actual	266,516,000.00	1,158,596,635.96
5. Temporarily not available pursuant to Public Law	(83,538,097,000.00)	0.00
6. Permanently not available	(147,015,000.00)	(710,189,000.00)
7. Total Budgetary Resources	<u><u>\$ 59,195,443,980.67</u></u>	<u><u>\$ 135,124,143,494.47</u></u>

Department of Defense
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COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended December 31, 2005 and 2004

	2006 Combined	2005 Combined
Status of Budgetary Resources:		
8. Obligations incurred:		
8.A. Direct	\$ 31,116,508,127.72	\$ 29,432,750,181.42
8.B. Reimbursable	1,472,112,858.23	5,815,849,543.26
8.C. Subtotal	<u>32,588,620,985.95</u>	<u>35,248,599,724.68</u>
9. Unobligated balance:		
9.A. Apportioned	22,958,432,704.12	96,986,706,046.20
9.B. Exempt from apportionment	3,674,170.37	3,177,170.81
9.C. Subtotal	<u>22,962,106,874.49</u>	<u>96,989,883,217.01</u>
10. Unobligated balance not available	3,644,716,120.23	2,885,660,552.78
11. Total status of budgetary resources	<u><u>\$ 59,195,443,980.67</u></u>	<u><u>\$ 135,124,143,494.47</u></u>
Change in Obligated Balance:		
12. Obligated balance, net		
12.A. Unpaid obligations, brought forward, October 1	51,840,780,579.14	53,808,138,556.79
12.B. Less: Uncollected customer payments from Federal sources, brought forward, October 1	<u>\$ (2,835,496,221.40)</u>	<u>\$ (2,304,005,646.31)</u>
12.C. Total unpaid obligated balance	49,005,284,357.74	51,504,132,910.48
13. Obligations incurred net (+/-)	<u>\$ 32,588,620,985.95</u>	<u>\$ 35,248,599,724.68</u>
14. Less: Gross outlays	(34,381,134,153.47)	(35,182,722,412.70)
15. Obligated balance transferred, net		
15.A. Actual transfers, unpaid obligations (+/-)	0.00	0.00
15.B. Actual transfers, uncollected customer payments from Federal sources (+/-)	<u>0.00</u>	<u>0.00</u>
15.C. Total Unpaid obligated balance transferred, net	0.00	0.00
16. Less: Recoveries of prior year unpaid obligations, actual	<u>(395,966,940.39)</u>	<u>(186,918,904.07)</u>
17. Change in uncollected customer payments from Federal sources (+/-)	(337,517,385.85)	(1,521,220,955.12)
18. Obligated balance, net, end of period		
18.A. Unpaid obligations	49,652,300,471.23	53,687,096,964.70
18.B. Less: Uncollected customer payments (+/-) from Federal sources (-)	<u>(3,173,013,607.25)</u>	<u>(3,825,226,601.43)</u>
18.C. Total, unpaid obligated balance, net, end of period	<u>46,479,286,863.98</u>	<u>49,861,870,363.27</u>
Net Outlays		
19. Net Outlays:		
19.A. Gross outlays	34,381,134,153.47	35,182,722,412.70
19.B. Less: Offsetting collections	(1,925,235,800.73)	(2,194,503,307.95)
19.C. Less: Distributed Offsetting receipts	(23,471,509.09)	(18,021,019.86)
19.D. Net Outlays	<u><u>\$ 32,432,426,843.65</u></u>	<u><u>\$ 32,970,198,084.89</u></u>

Department of Defense
 Department of the Air Force
COMBINED STATEMENT OF BUDGETARY RESOURCES
 For the periods ended December 31, 2005 and 2004

	<u>2006 Combined</u>	<u>2005 Combined</u>
NONBUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
1. Unobligated balance, brought forward, October 1	\$ 0.00	\$ 0.00
2. Recoveries of prior year unpaid obligations	0.00	0.00
3. Budget authority		
3.A. Appropriation	0.00	0.00
3.B. Borrowing authority	0.00	0.00
3.C. Contract authority	0.00	0.00
3.D. Spending authority from offsetting collections		
3.D.1 Earned		
3.D.1.a. Collected	0.00	0.00
3.D.1.b. Change in receivables from Federal sources	0.00	0.00
3.D.2 Change in unfilled customer orders		
3.D.2.a. Advance received	0.00	0.00
3.D.2.b. Without advance from Federal sources	0.00	0.00
3.D.3 Anticipated for rest of year, without advances	0.00	0.00
3.D.4 Previously unavailable	0.00	0.00
3.D.5 Expenditure transfers from trust funds	0.00	0.00
3.E. Subtotal	<u>0.00</u>	<u>0.00</u>
4. Nonexpenditure transfers, net, anticipated and actual	0.00	0.00
5. Temporarily not available pursuant to Public Law	0.00	0.00
6. Permanently not available	0.00	0.00
7. Total Budgetary Resources	<u><u>\$ 0.00</u></u>	<u><u>\$ 0.00</u></u>

Department of Defense
Department of the Air Force
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended December 31, 2005 and 2004

	2006 Combined	2005 Combined
Status of Budgetary Resources:		
8. Obligations incurred:		
8.A. Direct	\$ 0.00	\$ 0.00
8.B. Reimbursable	0.00	0.00
8.C. Subtotal	0.00	0.00
9. Unobligated balance:		
9.A. Apportioned	0.00	0.00
9.B. Exempt from apportionment	0.00	0.00
9.C. Subtotal	0.00	0.00
10. Unobligated balance not available	0.00	0.00
11. Total Status of Budgetary Resources	\$ 0.00	\$ 0.00
Change in Obligated Balance:		
12. Obligated balance, net		
12.A. Unpaid obligations, brought forward, October 1	0.00	0.00
12.B. Less: Uncollected customer payments from Federal sources, brought forward, October 1	\$ 0.00	\$ 0.00
12.C. Total unpaid obligated balance	0.00	0.00
13. Obligations incurred net (+/-)	\$ 0.00	\$ 0.00
14. Less: Gross outlays	0.00	0.00
15. Obligated balance transferred, net		
15.A. Actual transfers, unpaid obligations (+/-)	0.00	0.00
15.B. Actual transfers, uncollected customer payments from Federal sources (+/-)	0.00	0.00
15.C. Total Unpaid obligated balance transferred, net	0.00	0.00
16. Less: Recoveries of prior year unpaid obligations, actual	0.00	0.00
17. Change in uncollected customer payments from Federal sources (+/-)	0.00	0.00
18. Obligated balance, net, end of period		
18.A. Unpaid obligations	0.00	0.00
18.B. Less: Uncollected customer payments (+/-) from Federal sources (-)	0.00	0.00
18.C. Total, unpaid obligated balance, net, end of period	0.00	0.00
Net Outlays		
19. Net Outlays:		
19.A. Gross outlays	0.00	0.00
19.B. Less: Offsetting collections	0.00	0.00
19.C. Less: Distributed Offsetting receipts	0.00	0.00
19.D. Net Outlays	\$ 0.00	\$ 0.00

Department of Defense
Department of the Air Force
CONSOLIDATED STATEMENT OF FINANCING
For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	\$ 32,588,620,985.95	\$ 35,248,599,724.68
2. Less: Spending authority from offsetting collections and recoveries (-)	(2,658,720,126.97)	(3,902,643,167.14)
3. Obligations net of offsetting collections and recoveries	29,929,900,858.98	31,345,956,557.54
4. Less: Offsetting receipts (-)	(23,471,509.09)	(18,021,019.86)
5. Net obligations	29,906,429,349.89	31,327,935,537.68
Other Resources		
6. Donations and forfeitures of property	0.00	0.00
7. Transfers in/out without reimbursement (+/-)	297,420,443.67	(27,397,460.00)
8. Imputed financing from costs absorbed by others	169,039,083.90	183,153,349.53
9. Other (+/-)	0.00	0.00
10. Net other resources used to finance activities	466,459,527.57	155,755,889.53
11. Total resources used to finance activities	\$ 30,372,888,877.46	\$ 31,483,691,427.21
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 (-)	2,783,833,664.56	(3,115,759,581.12)
12b. Unfilled Customer Orders	786,002,751.03	1,990,453,160.62
13. Resources that fund expenses recognized in prior periods	(431,209,035.11)	(279,803,093.63)
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	23,471,509.09	18,021,019.86
15. Resources that finance the acquisition of assets	(4,582,489,536.08)	(3,230,737,421.70)
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations		
16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	0.00	0.00
16b. Other (+/-)	(297,420,443.67)	27,397,460.00
17. Total resources used to finance items not part of the net cost of operations	\$ (1,717,811,090.18)	\$ (4,590,428,455.97)
18. Total resources used to finance the net cost of operations	\$ 28,655,077,787.28	\$ 26,893,262,971.24

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

	<u>2006 Consolidated</u>	<u>2005 Consolidated</u>
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
19. Increase in annual leave liability	48,093,780.77	24,017,413.72
20. Increase in environmental and disposal liability	0.00	0.00
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0.00	0.00
22. Increase in exchange revenue receivable from the public (-)	0.00	0.00
23. Other (+/-)	0.00	252,551,990.25
24. Total components of Net Cost of Operations that will require or generate resources in future periods	<u>48,093,780.77</u>	<u>276,569,403.97</u>
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	3,579,974,667.95	1,804,003,443.96
26. Revaluation of assets or liabilities (+/-)	(572,668,466.08)	(883,066,073.32)
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0.00	0.00
27b. Cost of Goods Sold	0.00	0.00
27c. Operating Material & Supplies Used	463,194,176.25	288,452,544.11
27d. Other	(754,607,489.30)	3,255,552,824.53
28. Total components of Net Cost of Operations that will not require or generate resources	<u>2,715,892,888.82</u>	<u>4,464,942,739.28</u>
29. Total components of net cost of operations that will not require or generate resources in the current period	<u>\$ 2,763,986,669.59</u>	<u>\$ 4,741,512,143.25</u>
30. Net Cost of Operations	<u><u>\$ 31,419,064,456.87</u></u>	<u><u>\$ 31,634,775,114.49</u></u>

Note 1.	Significant Accounting Policies
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1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of the Air Force, as required by the “Chief Financial Officers (CFO) Act of 1990,” expanded by the “Government Management Reform Act (GMRA) of 1994,” and other appropriate legislation. The financial statements have been prepared from the books and records of the Air Force in accordance with the “Department of Defense (DoD) Financial Management Regulation,” the Office of Management and Budget (OMB) Circular A-136, “Financial Reporting Requirements,” and, to the extent possible, Federal Generally Accepted Accounting Principles (Federal GAAP). The accompanying financial statements account for all resources for which the Air Force is responsible, although information relative to classified assets, programs, and operations has been either excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified. The Air Force’s financial statements are in addition to the financial reports prepared by the Air Force pursuant to OMB directives that are used to monitor and control the Air Force’s use of budgetary resources.

The Air Force is unable to fully implement all elements of Federal GAAP and OMB Circular A-136 due to limitations in its financial and nonfinancial processes and feeder systems. Reported values and information for the Air Force’s major asset and liability categories are derived largely from nonfinancial feeder systems, such as inventory and logistics systems. These systems were designed to support reporting requirements that focused on maintaining accountability over assets and on reporting the status of federal appropriations rather than on preparing financial statements in accordance with Federal GAAP. As a result, the Air Force currently cannot implement every aspect of Federal GAAP and OMB Circular A-136. The Air Force is implementing process and system improvements that address the limitations of its financial and nonfinancial feeder systems.

The Air Force entered a material number of unsupported accounting entries because financial and nonfinancial feeder systems continue to lack sufficient customer identification information to accurately process eliminations. This issue was disclosed in the DoD Agency-wide Note 1 and is addressed in the Air Force’s plan to obtain a favorable opinion.

1.B. Mission of the Reporting Entity

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

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

The accounts used to prepare the financial statements are categorized as either entity or nonentity. Entity accounts consist of resources that are available for use in the operations of the entity. The Air Force is authorized to decide how to use resources in entity accounts or may be legally obligated to use these resources to meet entity obligations. Nonentity accounts, on the other hand, consist of assets that are held by an entity but that are not available for use in the operations of the entity. The following is a list of Air Force account numbers and titles (all accounts are entity accounts unless otherwise noted)

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

1.C. Appropriations and Funds

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

- General funds are used for financial transactions arising under congressional appropriations and include personnel, operation and maintenance, research and development, procurement, and construction accounts.
- Working Capital Fund (revolving fund) activities are reported in a separate set of audited financial statements and related footnotes.
- Trust funds represent the receipt and expenditure of funds held in trust by the Air Force for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.
- Special funds account for Air Force receipts earmarked for specific purposes.
- Deposit funds are generally used to (1) account for unidentified remittances, or (2) hold assets for which the Air Force is acting as an agent or a custodian or whose distribution is awaiting legal determination.
- Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. Earmarked funds also have a requirement to account for and report on the receipt, use and retention of revenues and other financing sources that distinguish it from general revenues

1.D. Basis of Accounting

The Air Force generally records transactions on a budgetary basis and not an accrual accounting basis as is required by Federal GAAP. For FY 2006, the Air Force's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Air Force's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of Federal GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by Federal GAAP.

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

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

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

1.E. Revenues and Other Financing Sources

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

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

1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses during the period in which they were incurred. However, because the Air Force's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made

for major items such as payroll expenses, accounts payable, and environmental liabilities. Expenditures for capital and other long-term assets are not recognized as expenses in the Air Force's operations until depreciated, in the case of Property, Plant, and Equipment (PP&E), or consumed, in the case of Operating Materials and Supplies (OM&S). Net increases or decreases in unexpended appropriations are recognized as constituting a change in the net position. Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made.

Operating expenses were adjusted as a result of the elimination of balances between DoD Components.

1.G. Accounting for Intragovernmental Activities

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

The Air Force's proportionate share of public debt and related expenses of the federal government are not included in the financial statements. Debt issued by the federal government and the related costs are not apportioned to federal agencies. The Air Force's financial statements do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing, whether from issuance of debt or tax revenues.

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

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

To prepare reliable financial statements, transactions occurring between components or activities within the Air Force must be eliminated. However, the Air Force, as well as the rest of the federal government, cannot accurately identify all intragovernmental transactions by customer. The Defense Finance and Accounting Service (DFAS) is responsible for eliminating transactions between components or activities of the Air

Force. Since FY 1999, seller entities within the DoD have provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have been adjusted to recognize unrecorded costs and accounts payable. Intra-Air Force balances were then eliminated.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the DoD and other federal agencies. In July 2005, the FMS issued the updated “Federal Intragovernmental Transactions Accounting Policies Guide.” The DoD was not able to fully implement the policies and procedures in this guide related to reconciling intragovernmental assets, liabilities, revenues, and expenses for nonfiduciary transactions. The Air Force, 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 Guide” (July 1, 2005 updated version, effective for FY 2005 reporting) for reconciling intragovernmental transactions. These transactions include or pertain to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees’ Compensation Act transactions with the Department of Labor, and benefit program transactions with the OPM.

1.H. Transactions with Foreign Governments and International Organizations

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

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

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

In addition, the DFAS sites and USACE Finance Center submit reports to the Department of the Treasury, providing information at the appropriation level on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in the Treasury’s system. Differences between the Air Force’s recorded balance in the FBWT accounts and Treasury’s FBWT accounts sometimes result and are subsequently reconciled. Material disclosures are provided at Note 3. Also disclosed at

Note 3 are differences between accounting offices' detail level records and Treasury's FBWT accounts, specifically, differences caused by intransit disbursements and unmatched disbursements (where the specific disbursement has not been recorded in the appropriate accounting offices' detail level records).

1.J. Foreign Currency

The Air Force conducts a significant portion of its operations overseas. The Congress established a special account to handle gains and losses from foreign currency transactions for the following five general fund appropriations: O&M, Military Personnel, Military Construction, Family Housing Operation and Maintenance, and Family Housing Construction. Gains and losses are computed as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustment to the original obligation amount at the time of payment. These currency fluctuations are not identified separately. See Note 7 for material disclosures.

1.K. Accounts Receivable

As presented in the balance sheet statement, accounts receivable include accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies. See Note 5 for material disclosures.

1.L. Direct Loans and Loan Guarantees

Not applicable

1.M. Inventories and Related Property

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

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

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

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

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

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

Investments in U.S. Treasury securities are reported at cost, determined as the net of unamortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment, using the effective interest rate method or other method if similar results are obtained. The Air Force’s intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, there is no provision made for reflecting unrealized gains or losses on these securities. Related earnings are allocated to appropriate Air Force activities to be used in accordance with the directions of the donor. See Note 4 for material disclosures.

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

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 \$100,000.00. Also, improvement costs over the DoD capitalization threshold of \$100,000.00 for General PP&E are required to be capitalized. All General PP&E assets, other than land, are depreciated on a straight-line basis. Land is not depreciated.

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

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

See Note 10 for material disclosures.

1.P. Advances and Prepayments

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

1.Q. Leases

Generally, lease payments are for the rental of equipment vehicles and operating facilities and are classified as either capital or operating leases. When a lease essentially is equivalent to an installment purchase of property (a capital lease), the Air Force records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The Air Force records the amounts as the lesser of the following two values: (1) the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor); or (2) the asset's fair value. The Air Force deems the use of estimates for these costs as adequate

and appropriate due to the relatively low dollar value of capital leases. Imputed interest is necessary to reduce net minimum lease payments to present value calculated at the incremental borrowing rate at the inception of the leases. Leases that do not transfer substantially all of the benefits or risks of ownership are classified as operating leases and are expensed over the period of the lease.

1.R. Other Assets

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

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

1.S. Contingencies and Other Liabilities

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

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

1.T. Accrued Leave

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

1.U. Net Position

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

Cumulative results of operations represent the difference between expenses and losses and financing sources (including appropriations, revenue, and gains) since the inception of an activity.

1.V. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other facilities that are located overseas and that have been obtained through various international treaties and agreements negotiated by the Department of State. The DoD purchases overseas capital assets with appropriated funds, but the host country retains title to land and improvements. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. These fixed assets are subject to loss in the event treaties are not renewed or other agreements are not reached that allow for the continued use by the DoD Components. Therefore, if the U.S. can no longer use foreign bases because treaties or other agreements have been terminated, losses will be recorded for the value of any nonretrievable capital assets after negotiations between the U.S. and the host country determine the amount to be paid the U.S. for such capital investments.

1.W. Comparative Data

The Financial Statements and accompanying Notes to the Financial Statements report the financial position and results of operations for the 1st Quarter of FY 2006. Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet and/or greater than 10 percent between FY 2005 and FY 2006 are explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

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

1.Y. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. In-transit payments are those payments that have been made to other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities' outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance. The Department of Defense policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of Federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities. The Air Force follows this procedure.

Note 2.	Nonentity Assets
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As of December 31	2006	2005
1. Intragovernmental Assets		
A. Fund Balance with Treasury	\$ 89,199,802.96	\$ 381,599,048.80
B. Investments	0.00	0.00
C. Accounts Receivable	3,133,721.90	47,015,732.22
D. Other Assets	0.00	0.00
E. Total Intragovernmental Assets	\$ 92,333,524.86	\$ 428,614,781.02
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	\$ 126,643,263.39	\$ 315,860,533.35
B. Accounts Receivable	176,551,517.86	114,762,092.54
C. Loans Receivable	0.00	0.00
D. Inventory & Related Property	0.00	0.00
E. General PP&E	0.00	0.00
F. Investments	0.00	0.00
G. Other Assets	156,907,524.61	552,407.67
H. Total Nonfederal Assets	\$ 460,102,305.86	\$ 431,175,033.56
3. Total Nonentity Assets	\$ 552,435,830.72	\$ 859,789,814.58
4. Total Entity Assets	\$ 258,235,403,076.41	\$ 326,866,896,631.10
5. Total Assets	\$ 258,787,838,907.13	\$ 327,726,686,445.68

Relevant Information for Comprehension

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

Fluctuations

The Nonentity Fund Balance with Treasury on line 1.A. decreased \$292,400 thousand, or 77 percent due to suspense account 3875, which includes Federal Income Tax withholding and withheld FICA, being reported as a Nonentity asset on the 1st Quarter 2005 financial statements. Suspense account 3875 is now reported as an Entity asset effective 2nd Quarter 2005.

The decrease of Intragovernmental Accounts Receivable on line 1.C. of \$43,882 thousand, or 93 percent is due to a management initiative in identifying invalid accounts receivable and subsequently taking the appropriate corrective action. Air Force was also successful in collecting on a substantial amount of delinquent debts.

The increase of Nonfederal Accounts Receivable on line 2.B. of \$61,790 thousand, or 54 percent can be attributed to an increase in receivables in accounts that closed on September 30, 2005. These receivables will show up as non entity assets on the 1st Quarter 2006 report for the first time.

Total Cash and Other Monetary Assets on line 2.A. decreased \$189,218 thousand, or 60 percent, between FY 2005 and FY 2006. Of this decrease, \$156,725 thousand can be attributed to changes in the reporting of Advances to Contractors under University Pool Agreements. University Pool Agreements are agreements to provide advances for research and development conducted on behalf of the Air Force at major academic research institutions. In FY 2004, guidance instructed that these advances be reclassified to Cash and Other Monetary Assets from Other Assets. The guidance was subsequently rescinded, resulting in their reclassification from Cash and Other Monetary Assets back to Other Assets on subsequent FY 2005 financial statements. Nonfederal Other Assets, line 2.G. also increased due to this reclassification.

In addition, implementation of a new procedure using the International Treasury Service (ITS.gov) to pay foreign vendors drove a \$15,967 thousand decrease in the Foreign Currency asset class. The Centralized Disbursing Directorate at DFAS-DE now sends U.S. dollars directly to the Bank of America in Germany for conversion to foreign currencies and for direct disbursement from the bank to foreign vendors. ITS.gov therefore bypasses the Air Force disbursing officers, whose need for foreign currency is thereby reduced.

Note 3.	Fund Balance with Treasury
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As of December 31	2006	2005
1. Fund Balances		
A. Appropriated Funds	\$ 73,209,448,677.27	\$ 146,440,969,024.12
B. Revolving Funds	0.00	0.00
C. Trust Funds	4,606,705.84	5,154,047.28
D. Special Funds	939,736.47	767,806.07
E. Other Fund Types	63,915,597.09	30,830,197.18
F. Total Fund Balances	\$ 73,278,910,716.67	\$ 146,477,721,074.65
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	\$ 36,138,303,969.66	\$ 146,477,721,171.70
B. Fund Balance per Air Force	73,278,910,716.67	146,477,721,074.65
3. Reconciling Amount	\$ (37,140,606,747.01)	\$ 97.05

Reconciling Amount

Parent Child Allocations that are not included in Air Force balances total \$16,959 thousand, increasing the reconciling amount. Included in these are allocations from Foreign Military Sales Military Assistance Program and the Department of Agriculture. Included in Air Force balance and not in Treasury balance is \$9,130 thousand for funds allocated to the Department of Transportation, decreasing the reconciling amount. This balance is reported on the Treasury Trial Balance 6654 for Treasury Index 69. In a parent/child relationship, the child reports the FBWT amount if the amount is material to the child. Continuing resolutions totaling \$37,148,435 thousand are included in the Air Force balance but are not reported on the Treasury Trial Balance, decreasing the reconciling amount.

Fluctuations

Appropriated Funds decreased 73,231,520 thousand, or 50 percent, due to being under continuing resolution authority for the first quarter of 2006.

The Trust Funds decreased \$547 thousand, or 11 percent, primarily due to a decrease in the Cadet Fund. The Cadet Fund decreased \$1,080 thousand because of timing differences in the collection of funds and processing of disbursements to liquidate outstanding balances. This decrease was offset by a gain in the Gift Fund of \$533 thousand due to decreased expenditures following the completion of the Air Force Museum.

Special Funds increased \$171 thousand, or 22 percent, due to an increase in appropriation 5095, Fish and Wildlife. This account reflects the sales of hunting and fishing licenses and the execution of these funds.

Other Fund Types increased \$33,085 thousand, 108 percent, which is primarily attributed the exclusion of clearing account balances from Other Fund Types. Other Funds Types represents the balance in Deposit Funds and Receipt Accounts. For the first quarter of 2005, this line included suspense accounts with a negative balance. In late 1st quarter FY 2005, OSD Guidance directed that these funds should instead be posted to Nonfederal Suspense Accounts. Due to these changes, the balances reflected in the 2005 total column are not reflective of the balances included in the current quarter column. All clearing account balances are included in appropriated funds.

Air Force Cadet Fund

The Cadet Fund is a revolving trust fund account maintained for the benefit of the U.S. Air Force Academy cadets. The Cadet Fund was initially funded by an appropriation and remains self-sufficient through equal collections and disbursements.

Check Issue Discrepancy

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

Note Reference

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

Status of Fund Balance with Treasury

As of December 31	2006	2005
1. Unobligated Balance		
A. Available	\$ 22,952,547,442.91	\$ 93,756,286,367.88
B. Unavailable	3,644,716,120.23	2,885,660,552.78
2. Obligated Balance not yet Disbursed	\$ 49,652,300,471.23	\$ 49,861,160,344.20
3. Nonbudgetary FBWT	\$ 203,067,105.97	\$ 0.00
4. NonFBWT Budgetary Accounts	\$ (3,173,720,423.67)	\$ 0.00
5. Total	<u>\$ 73,278,910,716.67</u>	<u>\$ 146,503,107,264.86</u>

Fluctuations

Increase in Unobligated Balance Unavailable and Unobligated Balance Available is attributable to first quarter 2006 continuing resolution authority.

Nonbudgetary FBWT and NonFBWT Budgetary Accounts were not reported in the footnote for 2005.

Disclosures Related to Suspense/Budget Clearing Accounts

As of December 31	2004	2005	2006	(Decrease)/ Increase from FY 2005 - 2006
Account				
F3875	\$ 52,456,048.89	\$ 317,089,520.68	\$ 309,609,853.34	(7,479,667.34)
F3880	2,695,350.78	1,422,825.23	263,748.00	(1,159,077.23)
F3882	(992,200.31)	22,334,845.76	25,284,205.87	2,949,360.11
F3885	(568,203,830.87)	(26,226,114.10)	(196,006,298.33)	(169,780,184.23)
F3886	0.00	0.00	0.00	0.00
Total	<u>\$ (514,044,631.51)</u>	<u>\$ 314,621,077.57</u>	<u>\$ 139,151,508.88</u>	<u>(175,469,568.69)</u>

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

Suspense account F3882 is utilized to accommodate the Military Thrift Savings Plan (TSP). The National Finance Center posts amounts into each member's account, and they are consolidated and posted to the Treasury before the Air Force can post the amounts in the military accounting system in the following month. The \$2,949 thousand increase is the result of increased participation in the TSP.

The increase (absolute value) in account F3885 IPAC is due to the inclusion in limit 007 of \$156,597 thousand and the remaining variance can be attributed to IPAC transactions received during the last business day of the month. When IPAC transactions are received, funds are placed in a suspense account until they can be researched and assigned a valid appropriation, which will fluctuate from one reporting period to another depending upon the amount processed to the Treasury at that time.

Disclosures Related to Problem Disbursements and In-Transit Disbursements
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As of December 31	2004	2005	2006	(Decrease)/ Increase from FY 2005 to 2006
1. Total Problem Disbursements, Absolute Value				
A. Unmatched Disbursements (UMDs)	\$ 185,471,745.35	\$ 248,802,852.01	\$ 133,761,226.45	(115,041,625.56)
B. Negative Unliquidated Obligations (NULO)	9,003,665.37	10,668,680.60	10,918,826.09	250,145.49
2. Total In-transit Disbursements, Net	\$ 1,319,269,103.60	\$ 5,320,034,080.37	\$ 904,736,919.50	(4,415,297,160.87)

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

The Air Force had a \$114,791 thousand decrease in problem disbursements and a \$4,415,297 thousand decrease in In-transit Disbursements. The Defense Finance and Accounting Service has efforts underway to improve the systems, to resolve all previous problem disbursements, and to process all In-transit Disbursements in a timely manner. The amount of Unmatched Disbursements (UMDs) over 180 days is \$0.00, of Negative Unliquidated Disbursements (NULOs) is \$0.00 and of In-transits is \$11,202,165.54. The amount of UMDs over 120 days old is \$0.00, for NULOs is \$0.00, and for In-transits is \$12,616,541.45. The current absolute value of In-transit disbursements is \$1,734,436,195.52.

The increase in NULOs of \$250,145.49 can be attributed to increased processing efforts to decrease overall Unmatched Disbursements (which resulted in a \$115,041 thousand decrease in UMDs). Some UMDs became NULOs however. Since there are no overaged NULOs, problem disbursements are being cleared within 120 days.

Note 4.	Investments and Related Interest
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As of December 31	2006				
	Par Value / Cost	Amortization Method	Unamortized (Premium) / Discount	Investments, Net	Market Value Disclosure
1. Intragovernmental Securities					
A. Nonmarketable, Market-Based	\$ 710,000.00		\$ 198.75	\$ 710,198.75	\$ 704,636.25
B. Accrued Interest	6,478.01			6,478.01	6,496.82
C. Total Intragovernmental Securities	<u>\$ 716,478.01</u>		<u>\$ 198.75</u>	<u>\$ 716,676.76</u>	<u>\$ 711,133.07</u>
2. Other Investments					
A. Total Investments	<u>\$ 0.00</u>		<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>N/A</u>

As of December 31	2005				
	Par Value / Cost	Amortization Method	Unamortized (Premium) / Discount	Investments, Net	Market Value Disclosure
3. Intragovernmental Securities					
A. Nonmarketable, Market-Based	\$ 710,000.00		\$ 19.07	\$ 710,019.07	\$ 714,099.06
B. Accrued Interest	4,768.70			4,768.70	4,768.70
C. Total Intragovernmental Securities	<u>\$ 714,768.70</u>		<u>\$ 19.07</u>	<u>\$ 714,787.77</u>	<u>\$ 718,867.76</u>
4. Other Investments					
A. Total Investments	<u>\$ 0.00</u>		<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>N/A</u>

Fluctuations

Accrued Interest for first quarter FY 2006 increased 37%, or \$1.7 thousand, due to an increase in interest rates on federal marketable securities.

Relevant Information for Comprehension

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

The Air Force Gift Fund was established to control and account for the disbursement and use of monies donated to the Air Force along with the interest received from the investment of such donations. The related earnings are allocated to appropriate Air Force activities to be used in accordance with the directions of the donor. These

funds are recorded as Non-Marketable Market Based U.S. Treasury Securities, which are not traded on any security exchange but which mirror the prices of marketable securities with similar terms.

Note Reference

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

Note 5.	Accounts Receivable
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As of December 31	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
1. Intragovernmental Receivables	\$ 358,457,404.86	N/A	\$ 358,457,404.86	\$ 532,207,765.68
2. Nonfederal Receivables (From the Public)	\$ 1,194,503,363.19	\$ (152,965,493.00)	\$ 1,041,537,870.19	\$ 953,657,425.19
3. Total Accounts Receivable	\$ 1,552,960,768.05	\$ (152,965,493.00)	\$ 1,399,995,275.05	\$ 1,485,865,190.87

The total allowance method is determined at the Air Force departmental level. For closed years receivables and deferred debts in litigation, an allowance rate of 50 percent results in an estimated allowance of \$69,679 thousand. Interest allowance of \$818 thousand is calculated using an average percent of write offs to outstanding public accounts receivable over a five year period starting with FY 2001 data. In addition, the allowance for Air Force entity receivables is computed each year based on the average percent of write offs to outstanding public accounts receivable for the last five years. This results in an estimated allowance of \$82,469 thousand.

Relevant Information for Comprehension

As presented on the Consolidated Balance Sheet, accounts receivable include reimbursements receivable and refunds receivable such as out-of-service debts (amounts owed by former service members), contractor debt, and unused travel tickets. It also includes net interest receivables per Department of Defense (DoD) Financial Management Regulation (FMR) Vol. 6B guidance. Canceled accounts receivable are reported as nonentity receivables because these amounts are deposited into a Treasury Department miscellaneous receipt account when collected. Reconciliation between Report on Receivables Due from the Public and the balance sheet was accomplished. The differences between the balance sheet (line 1C) and Treasury Report on Receivables (TROR) Due from the Public (line 7) include the allowance for estimated uncollectible of \$152,965 thousand, unsupported disbursements in transit in the amount of \$243 thousand, and undistributed collections of \$(50,277) thousand. Undistributed collections are prorated between public and intragovernmental receivables on the balance sheet based on the percentages of distributed receivables. This reconciliation is performed to ensure that the financial statements are in agreement with the public receivables reported to the Department of the Treasury.

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

Fluctuations

The decrease of Intragovernmental Receivable on line 1 of \$ (173,750) thousand, or 33 percent is due to a management initiative in identifying invalid accounts receivable and subsequently taking the appropriate corrective action. Air Force was also successful in collecting on a substantial amount of delinquent debts.

Allocation of Undistributed Collections

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

Note Reference

ENTITY	CATEGORY	Intragovernmental	Nonfederal
Air Force GF	Nondelinquent Current	\$ 807,009,459.43	\$ 260,354,572.95
Air Force GF	Nondelinquent Noncurrent	\$ 2,413,456.00	-
Air Force GF	Delinquent 1 to 30 days	\$ 26,196,377.00	\$ 5,505,299.00
Air Force GF	Delinquent 31 to 60 days	\$ 41,577,329.00	\$ 13,893,105.00
Air Force GF	Delinquent 61 to 90 days	\$ 28,223,015.00	\$ 12,021,430.00
Air Force GF	Delinquent 91 to 180 days	\$ 10,729,208.00	\$ 6,904,879.00
Air Force GF	Delinquent 181 days to 1 year	\$ 962,127.00	\$ 9,041,127.00
Air Force GF	Delinquent Greater than 1 year and less than or equal to 2 years	\$ 12,156,686.00	\$ 662,981,814.00
Air Force GF	Delinquent Greater than 2 years and less than or equal to 6 years	\$ 837,896.00	\$ 32,667,558.00
Air Force GF	Delinquent Greater than 6 years and less than 10 years	\$ 8.00	\$ 186,696,887.00
Air Force GF	Delinquent Greater than 10 years	-	\$ 51,707,796.00
	Total	\$ 930,105,561.43	\$1,241,774,467.95
	Undistributed Disbursement	(2,762,932.57)	(47,514,643.21)
	Elimination Adjustments	(568,885,224.00)	
	Disbursement in Transit		243,538.45
	Allowance for Estimated Uncollectibles		(152,965,493.00)
	Total Accounts Receivable	\$ 358,457,404.86	\$1,041,537,870.19

The delinquencies for the Air Force consist primarily of debts that have been turned over to the Contract Debt System (CDS) and the Departmental Debt Management System (DDMS) for resolution.

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

Note 6.	Other Assets
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As of December 31	2006	2005
1. Intragovernmental Other Assets		
A. Advances and Prepayments	\$ 432,672,076.80	\$ 475,499,793.05
B. Total Intragovernmental Other Assets	\$ 432,672,076.80	\$ 475,499,793.05
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	\$ 10,451,600,256.01	\$ 10,751,087,207.08
B. Other Assets (With the Public)	251,677,226.57	113,540,083.52
C. Total Nonfederal Other Assets	\$ 10,703,277,482.58	\$ 10,864,627,290.60
3. Total Other Assets	\$ 11,135,949,559.38	\$ 11,340,127,083.65

Fluctuations

Other Assets with the Public, line 2.B., increased \$138,137 thousand, or 122 percent, primarily due to the correct reporting of advances to contractors as shown on the SF 1219, Statement of Accountability, as Other Assets this fiscal year. For 1st Quarter, FY 2005, guidance instructed the reclassification of these advances from the Other Asset line on the Balance Sheet to the Cash and Other Monetary Asset line in order to show all SF 1219 data on one line. The guidance was issued prematurely and was later rescinded, resulting in advances to contractors being reclassified back to Other Assets for 2nd Quarter, FY 2005.

Advances to contractors on the SF 1219 are payments as part of an advance-payment pool agreement with Massachusetts Institute of Technology and other nonprofit institutions. Advance-payment pool agreements are used for the financing of cost-type contracts with nonprofit educational or research institutions for experimental or research and development work when several contracts or a series of contracts require financing by advance payments.

Relevant Information for Comprehension

Other Assets

The amount of \$251,677 thousand on line 2.B., Other Assets with the Public, is composed of \$93,341 thousand in travel advances, \$1,611 thousand in other advances to contractors, and \$156,725 thousand in advances to contractors as reported on the SF 1219, Statement of Accountability.

Outstanding Contract Financing Payments

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

Note Reference

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

Note 7.	Cash and Other Monetary Assets
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As of December 31	2006	2005
1. Cash	\$ 122,390,963.66	\$ 295,641,994.62
2. Foreign Currency (Nonpurchased)	4,252,299.73	20,218,538.73
3. Total Cash, Foreign Currency, & Other Monetary Assets	\$ 126,643,263.39	\$ 315,860,533.35

Fluctuations

Total Cash, Foreign Currency & Other Monetary Assets decreased \$ 189,218 thousand, or 60 percent, between FY 2005 and FY 2006, caused by decreases in both the Cash and Foreign Currency asset classes.

The \$ 173,251 thousand, or 59 percent, decrease in the Cash asset class can be attributed to changes in the reporting of Advances to Contractors under University Pool Agreements of \$156,725 thousand. University Pool Agreements are agreements to provide advances for research and development conducted on behalf of the Air Force at major academic research institutions. In FY 2004, guidance instructed that these advances be reclassified to Cash and Other Monetary Assets from Other Assets. The guidance was subsequently rescinded, resulting in their reclassification from Cash and Other Monetary Assets back to Other Assets for 2nd Quarter, FY 2005.

The implementation of a new procedure in the 2nd Quarter, FY 2005 using the International Treasury Service (ITS.gov) to pay foreign vendors drove the \$15,967 thousand decrease in the Foreign Currency asset class. The Centralized Disbursing Directorate at DFAS-DE now sends U.S. dollars directly to the Bank of America in Germany for conversion to foreign currencies and for direct disbursement from the bank to foreign vendors. ITS.gov therefore bypasses the Air Force disbursing officers, whose need for foreign currency is thereby reduced.

Relevant Information for Comprehension

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

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

Note Reference

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

Note 8.	Direct Loan and/or Loan Guarantee Programs
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As of December 31

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

Direct Loans Obligated After FY 1991

As of December 31	2006		2005
Loan Programs			
1. Military Housing Privatization Initiative			
A. Loans Receivable Gross	\$ 0.00	\$	0.00
B. Interest Receivable	0.00		0.00
C. Foreclosed Property	0.00		0.00
D. Allowance for Subsidy Cost (Present Value)	0.00		0.00
E. Value of Assets Related to Direct Loans	\$ 0.00	\$	0.00
2. Total Loans Receivable	\$ 0.00	\$	0.00

Total Amount of Direct Loans Disbursed

As of December 31	2006	2005
Direct Loan Programs		
1. Military Housing Privatization Initiative	\$ 0.00	\$ 0.00
2. Total	<u>\$ 0.00</u>	<u>\$ 0.00</u>

Subsidy Expense for Post FY 1991 Direct Loan

As of December 31

2006	Interest Differential	Defaults	Fees	Other	Total
1. New Direct Loans Disbursed:					
Military Housing Privatization Initiative	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
2005	Interest Differential	Defaults	Fees	Other	Total
2. New Direct Loans Disbursed:					
Military Housing Privatization Initiative	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
2006	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
3. Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
2005	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
4. Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
2006		2005			
5. Total Direct Loan Subsidy Expense:					
Military Housing Privatization Initiative	\$ 0.00	\$ 0.00			
	<u>0.00</u>	<u>0.00</u>			

Subsidy Rate for Direct Loans

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

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

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

Defaulted Guaranteed Loans from Post FY 1991 Guarantees

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

Guaranteed Loans Outstanding

As of December 31	Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
Guaranteed Loans Outstanding		
1. Military Housing Privatization Initiative	\$ 0.00	\$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	\$ 0.00	\$ 0.00
3. Total	\$ 0.00	\$ 0.00
2006		
New Guaranteed Loans Disbursed		
1. Military Housing Privatization Initiative	\$ 0.00	\$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	\$ 0.00	\$ 0.00
3. Total	\$ 0.00	\$ 0.00
2005		
New Guaranteed Loans Disbursed		
1. Military Housing Privatization Initiative	\$ 0.00	\$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	\$ 0.00	\$ 0.00
3. Total	\$ 0.00	\$ 0.00

Liabilities for Post FY 1991 Loan Guarantees, Present Value

As of December 31	2006	2005
Loan Guarantee Program(s)		
1. Military Housing Privatization Initiative	\$ 0.00	\$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	0.00	0.00
3. Total	\$ 0.00	\$ 0.00

Subsidy Expense for Post FY 1991 Loan Guarantees

As of December 31

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

Subsidy Rates for Loan Guarantees

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

Schedule for Reconciling Loan Guarantee Liability Balances for Post FY 1991 Loan Guarantees
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As of December 31	2006	2005
1. Beginning Balance of the Loan Guarantee Liability	\$ 0.00	\$ 0.00
2. Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component		
A. Interest Supplement Costs	\$ 0.00	\$ 0.00
B. Default Costs (Net of Recoveries)	0.00	0.00
C. Fees and Other Collections	0.00	0.00
D. Other Subsidy Costs	0.00	0.00
E. Total of the above Subsidy Expense Components	\$ 0.00	\$ 0.00
3. Adjustments		
A. Loan Guarantee Modifications	\$ 0.00	\$ 0.00
B. Fees Received	0.00	0.00
C. Interest Supplements Paid	0.00	0.00
D. Foreclosed Property and Loans Acquired	0.00	0.00
E. Claim Payments to Lenders	0.00	0.00
F. Interest Accumulation on the Liability Balance	0.00	0.00
G. Other	0.00	0.00
H. Total of the above Adjustments	\$ 0.00	\$ 0.00
4. Ending Balance of the Loan Guarantee Liability before Reestimates	\$ 0.00	\$ 0.00
5. Add or Subtract Subsidy Reestimates by Component		
A. Interest Rate Reestimate	0.00	0.00
B. Technical/default Reestimate	0.00	0.00
C. Total of the above Reestimate Components	\$ 0.00	\$ 0.00
6. Ending Balance of the Loan Guarantee Liability	\$ 0.00	\$ 0.00

Administrative Expenses

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

Note 9.	Inventory and Related Property
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As of December 31	2006	2005
1. Inventory, Net	\$ 0.00	\$ 0.00
2. Operating Materials & Supplies, Net	48,617,976,292.52	48,302,193,518.03
3. Stockpile Materials, Net	0.00	0.00
4. Total	\$ 48,617,976,292.52	\$ 48,302,193,518.03

Inventory, Net

As of December 31	2006			2005		Valuation Method
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net		
1. Inventory Categories						
A. Available and Purchased for Resale	\$ 0.00	\$ 0.00	0.00	\$ 0.00	0.00	LAC,MAC
B. Held for Repair	0.00	0.00	0.00	0.00	0.00	LAC,MAC
C. Excess, Obsolete, and Unserviceable	0.00	0.00	0.00	0.00	0.00	NRV
D. Raw Materials	0.00	0.00	0.00	0.00	0.00	MAC,SP,LAC
E. Work in Process	0.00	0.00	0.00	0.00	0.00	AC
F. Total	\$ 0.00	\$ 0.00	0.00	\$ 0.00	0.00	

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

Operating Materials and Supplies, Net

As of December 31	2006			2005	Valuation Method
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	
1. OM&S Categories					
A. Held for Use	\$ 37,040,452,324.44	\$ 0.00	\$ 37,040,452,324.44	\$ 36,763,061,621.74	SP, LAC
B. Held for Repair	11,577,523,968.08	0.00	11,577,523,968.08	11,539,131,896.29	SP, LAC
C. Excess, Obsolete, and Unserviceable	1,106,414,370.29	(1,106,414,370.29)	0.00	0.00	NRV
D. Total	\$ 49,724,390,662.81	\$ (1,106,414,370.29)	\$ 48,617,976,292.52	\$ 48,302,193,518.03	

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

Information related to OM&S

General Composition of OM&S

OM&S include weapon systems spare and repair parts, ammunition, tactical missiles, centrally managed spare aircraft engines, and uninstalled cruise and ICBM missile motors.

Balances

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

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

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

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

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

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

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

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

To date, the Air Force has partially implemented three systems to report “moving average cost,” the DoD-approved methodology for reporting historical cost within any of the supply or inventory accounting systems for OM&S. (In only one system was the beginning balance validated). Most OM&S assets are in systems not yet converted to moving average cost so are still valued at standard price, with an allowance for Excess, Obsolete, and Unserviceable. Under current DoD policy, no allowance is made for serviceable ready-to-issue items (category Held for Use). An allowance equal to 100 percent of standard price, however, is made for the category Excess, Obsolete, and Unserviceable. This allowance results in a net book value of zero, which is considered appropriate because the items are coded condemned and, therefore, have no intrinsic value to the Air Force. The category Held for Repair represents suspended, unserviceable (but repairable) items which have a value to the Air Force but whose value is less than that of the Held for Use items and greater than that of the Excess, Obsolete and Unserviceable items. To date, the Office of the Secretary of Defense is currently developing guidance for computing an allowance for the Held for Repair category. As a result, Air Force continues to report Held for Repair at full standard price.

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

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

Operating Materials and Supplies (OM&S) Value

The OM&S data reported on the financial statements are derived from logistics systems designed for material management purposes. Some of these systems do not maintain the historical cost data necessary to comply with the valuation requirements of the Statement of Federal Financial Accounting Standards (SFFAS) No. 3, “Accounting for Inventory and Related Property.”

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

In general, the Air Force is using the consumption method of accounting for OM&S, since OM&S is defined in the SFFAS No. 3 as material that has not yet been issued to the end user. Once issued, the

material is expensed. According to federal accounting standards, the consumption method of accounting should be used to account for OM&S unless (1) the amount of OM&S is not significant, (2) OM&S are in the hands of the end-user for use in normal operations, or (3) it is cost-beneficial to expense OM&S when purchased (purchase method).

Note Reference

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

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

Other Air Force Disclosures

In the past, the Air Force provided only minimal OM&S accounting data that could be used to prepare the financial statements but has made considerable strides in improving the systems to provide actual transactions for completing the financial statements. However in some cases, the data provided still consists of only beginning and ending balances for each of the asset accounts Held for Use; Excess, Obsolete, Unserviceable; and Held for Repair. Without the required additional data (acquisitions, transfers in, amounts consumed, transfers out, trading partner data, etc), the Defense Finance and Accounting Service (DFAS) could only report the net change between prior-period ending balances and the values reported as current-period ending balances.

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

Stockpile Materials, Net

As of December 31	2006			2005		
	Stockpile Materials Amount	Allowance for Gains (Losses)	Stockpile Materials, Net	Stockpile Materials, Net	Valuation Method	
1. Stockpile Materials Categories						
A. Held for Sale	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	AC, LCM	
B. Held in Reserve for Future Sale	0.00	0.00	0.00	0.00	AC, LCM	
C. Total	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>		

Legend for Valuation Methods:

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

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

Note 10. General PP&E, Net

As of December 31	2006					2005
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
1. Major Asset Classes						
A. Land	N/A	N/A	\$ 433,451,574.11	N/A	\$ 433,451,574.11	\$ 431,699,507.04
B. Buildings, Structures, and Facilities	S/L	20 Or 40	44,722,966,562.48	\$ (25,661,211,982.54)	19,061,754,579.94	18,282,605,006.74
C. Leasehold Improvements	S/L	lease term	0.00	0.00	0.00	0.00
D. Software	S/L	2-5 Or 10	484,668,000.00	(140,107,199.60)	344,560,800.40	23,782,113.00
E. General Equipment	S/L	5 or 10	36,253,032,344.38	(29,551,177,583.65)	6,701,854,760.73	8,351,281,393.10
F. Military Equipment	S/L	Various	317,570,000,000.00	(224,290,000,000.00)	93,280,000,000.00	89,230,000,000.00
G. Assets Under Capital Lease	S/L	lease term	453,481,227.52	(307,197,860.47)	146,283,367.05	162,100,602.75
H. Construction-in- Progress	N/A	N/A	4,259,246,123.82	N/A	4,259,246,123.82	3,322,482,047.73
I. Other			495,917.31	0.00	495,917.31	253,587.00
J. Total General PP&E			<u>\$ 404,177,341,749.62</u>	<u>\$ (279,949,694,626.26)</u>	<u>\$ 124,227,647,123.36</u>	<u>\$ 119,804,204,257.36</u>

¹ Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

Fluctuations

The overall increase of \$ 320,779 thousand, or 1,349 percent, for Software on line 1.D. is the result of Air Force providing a budgetary figure for the Audited Financial Statements commencing with the 4th Quarter FY 2005. The new figure was derived using the 'best' budget data available (i.e., FY 2003 and FY 2004) in conjunction with the DoD study "Industry Software Cost, Quality and Productivity Benchmarks," which indicated 60 percent of the total software effort was development, 20 percent was preliminary design and 20 percent was post deployment. The FY 2004 and FY 2005 President's budget identified approximately 68 systems with software development over the \$100 thousand capitalization criteria. These systems were analyzed further to identify and categorize them into Air Force General Fund, Air Force Working Capital Fund, and Other.

The General Equipment on line 1.E decreased by \$1,649,426 thousand, or 20 percent, due to more accurate values for POD acquisitions, systematic generation of depreciation for PODs, and an increased rate of depreciation of 12 percent for all equipment.

The Construction-in-Progress (CIP) on line 1.H. increased \$ 936,764 thousand, or 28 percent, because the Treasury Index 97 funds were incorporated into the Air Force Construction-in-Progress total projects during the 3rd Quarter, FY 2005. The reporting of CIP has long been a problem, not only with Air Force but with all services. TI 97 funds allocated to the Air Force and used on Air Force real property projects that benefit the AF must be reported on the Air Force financial statements (see DoD FMR Volume 4, Chapter 6, page 6-20).

When a Construction Agent, such as United States Army Corps of Engineers (USACE) or Naval Facilities Engineering Command (NAVFAC), constructs a building, they use funds from several

different Appropriations; some of which are TI97 funds. In the past, the USACE and NAVFAC did not provide all of the necessary data that would identify which service should be reporting these CIP values. The DoD Component that is to receive the constructed property shall report CIP amounts on their financial statements, regardless of what type of funds were used to fund the construction. Without knowing if this was an Air Force construction project, or if the Air Force was going to be the end user, these TI97 funds were left with the DoD agencies funding the project. DFAS and the services have been working this issue and have now been able to identify most, if not all projects under construction, and are now able to identify who should do the reporting. These TI97 funds have now been added to the Air Force CIP as required. Some issues still have not been resolved. This has been discussed with OSD Accounting Policy.

The Other asset class on line 1.I. increased by \$ 242 thousand, or 95 percent. The Other category represents the timing factor inherent in timber harvesting. The timber markets, driven by supply and demand, are volatile and fluctuate. Timber sale contracts are awarded at irregular intervals, with some contracts held back until the market improves. Similarly, when buyers pay for just the timber they cut, they may hold off when markets are bad and cut more when markets are good. Weather conditions also influence the flow of timber and revenue.

Relevant Information for Comprehension

The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards No. 23, "Eliminating the Category National Defense Property, Plant and Equipment," in May 2003. This standard, which became effective for accounting periods after September 30, 2002, establishes Generally Accepted Accounting Principles (GAAP) for valuing and reporting military equipment (e.g., aircraft, satellites, and intercontinental ballistic missiles) in federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. The Department of Defense has determined that it is not practical at this time to accumulate sufficient information from internal records to value military equipment in accordance with GAAP. The Department is currently working to revise its accounting processes and systems to support the informational needs of management and compliance with GAAP. In the interim, the Department will base the value of military equipment for financial statement presentation purposes on data provided by the Bureau of Economic Analysis (BEA) at the Department of Commerce.

The value of the Bureau of Economic Analysis (BEA) data provided by the DoD to the Air Force for inclusion in the financial statements for the 1st Quarter, 2006 amounted to approximately \$317,570,000 thousand, less accumulated depreciation of \$224,290,000 thousand, for a net realized book value of \$93,280,000 thousand.

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

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

Heritage Assets

Heritage Assets and Stewardship Land are resources that protect, restore, enhance, modernize, preserve and sustain mission capability within the AF through effective planning and management of natural and cultural resources to guarantee access to air, land and waters. These assets are resources that are managed to provide multiple use activities for the public benefit. This includes actions to comply with requirements such as Federal Laws, Executive Orders, DoD policies, final governing standards and other binding agreements.

Heritage Assets, within the Air Force, consist of buildings and structures, museums, major collections, monuments and memorials, archeological sites and cemeteries, while Stewardship Land consist mainly of mission essential (donated, public domain, executive order) land. The Air Force, with minor exceptions, uses most of the buildings and structures as part of their every day activities and includes them on the balance sheet as multi-use heritage assets (capitalized and depreciated). The mission essential stewardship land is used for many different activities including general base operations, training sites, bombing ranges, recreation, and timber production.

Buildings and Structures – The Air Force considers 6,153 buildings and structures on Air Force bases and sites as heritage assets. To be considered a heritage asset, the building and /or facility must be listed, eligible, or potentially eligible for the National Register. These buildings and structures are maintained by each base civil engineering group as part of their overall responsibility.

Museums – The Air Force Museum System consist of 19 museums with the major museum located at Wright-Patterson Air Force Base, Ohio. It houses the main collection of historical artifacts. Seventeen museums are considered Air Force Field Museums or Heritage Centers, which also contain items of historical interest, some of them specific to the general locality. The 19th museum belongs to the Air National Guard.

Major Collections – The Air Force has four significant collections consisting of the Air Force art collection and three collections located at the Air Force Academy. Included in these collections are historical items and memorabilia as well as distinctive works of art.

Cemeteries - The Air Force has administrative and curatorial responsibilities for 39 cemeteries on it active duty bases.

Archeological Sites – The Air Force has 1,685 archeological sites listed on or eligible for the National Register. In addition, 9,292 sites are recorded but not evaluated to be included as archeological sites.

Other Air Force Disclosures

During the 2005 hurricane season, there were a record number of historic storms causing extensive damage to real property assets at numerous Department of the Air Force installations. Hurricanes Dennis, Katrina and Rita were especially damaging. Multi-disciplinary Air Force Civil Engineer teams consisting of structural and mechanical engineers, architects, roofing specialists and construction contract specialists were quickly dispatched to the Gulf Coast region of the United States to aid mission recovery and assist in assessing the damage caused by these storms.

AF engineers continue to provide support to local base civil engineer teams at damaged installations. Among the installations recovering from significant damage are Keesler AFB, Columbus AFB, and

Gulfport Combined Readiness Training Center in Mississippi, and Tyndall AFB and Eglin AFB in Florida. The Civil Engineer Damage Assessment Teams are dealing with three broad categories of buildings, structures, and utilities: (1) facilities that only have cosmetic/minor damage and therefore small repair costs; (2) facilities that have major damage that it makes more economic sense to build new rather than repair and therefore new military construction; and (3) structures that have significant damage, but it makes more economic sense to repair them than to build new and therefore capitalized improvements. Once the assessments are completed and decision on course of action and execution method are made, the values of the buildings, structures, and utilities on the financial statements will either increase due to new construction and capital improvements or adjust downward because they were demolished by the hurricanes and/or require demolition as part of the recovery and restoration effort.

For the 1st Quarter, FY 2006 reports, the Air Force used some FY 2002 ending data for (ST/STE) but did use actual data for the B2 aircraft. The FY 2002 values were still being used for all other (ST/STE) because the two systems previously used to report ST/STE have been turned off and are scheduled to be replaced by Air Force Equipment Management System (AFEMS) in FY 2006.

The value of the Air Force's General PP&E real property in the possession of contractors is included in the values reported above for the Major Asset Classes of Land and Buildings, Structures, and Facilities. The value of General PP&E personal property (Major Asset Classes of Software and Equipment) does not include all of the General PP&E above the DoD capitalization threshold in the possession of contractors. The net book amount of such property is immaterial in relation to the total General PP&E net book value. The Government Accountability Office, the Inspector General, DoD, and the Department are developing new policies and a contractor-reporting process to capture General PP&E information for future reporting purposes in compliance with GAAP.

Note Reference

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

Assets Under Capital Lease

As of December 31	2006	2005
1. Entity as Lessee, Assets Under Capital Lease		
A. Land and Buildings	\$ 453,481,227.52	\$ 408,539,654.46
B. Equipment	0.00	0.00
C. Other	0.00	0.00
D. Accumulated Amortization	(307,197,860.47)	(246,439,051.71)
E. Total Capital Leases	<u>\$ 146,283,367.05</u>	<u>\$ 162,100,602.75</u>

The Air Force is the lessee in ten capital leases. These leases are for military family housing acquired through Section 801 Family Housing Program. The leased items are capitalized and reported as an asset when the costs of the items exceed the capitalization threshold. Leased items not meeting the capitalization threshold are expensed. All leases originating prior to FY 1992 are funded on a fiscal-year basis. Six of the current military family housing leases originated before FY 1992. The Air Force has adjusted their records to account for the termination and conveyance of one lease as of October 30, 2004.

Fluctuations

The increase of \$44,941 thousand, or 11 percent in Land and Building and \$55,444 thousand, or 23 percent increase in accumulated amortization is the result of a change in methodology for the use of interest rates that applies to the individual leases. The Air Force previously used the interest rate provided with each of the ten capital leases. This interest rate did not accurately provide the cost of money to compute fair market value. The current interest rate used reflects the appropriate government rate that best reflects the government's cost of borrowing, using the historical rates from the Federal Reserve. The new methodology is an effort by the Air Force to improve the reporting of Capital Leases. In addition, the new change was coordinated between the Air Force and OSD.

Note 11.	Liabilities Not Covered by Budgetary Resources
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As of December 31	2006	2005
1. Intragovernmental Liabilities		
A. Accounts Payable	\$ 0.00	\$ 0.00
B. Debt	0.00	0.00
C. Other	504,052,333.77	334,773,640.41
D. Total Intragovernmental Liabilities	\$ 504,052,333.77	\$ 334,773,640.41
2. Nonfederal Liabilities		
A. Accounts Payable	\$ 229,860,207.93	\$ 390,323,441.37
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,147,437,480.00	1,163,442,240.00
C. Environmental Liabilities	6,472,467,017.88	6,734,342,293.50
D. Loan Guarantee Liability	0.00	0.00
E. Other Liabilities	2,666,927,081.60	3,142,755,970.97
F. Total Nonfederal Liabilities	\$ 10,516,691,787.41	\$ 11,430,863,945.84
3. Total Liabilities Not Covered by Budgetary Resources	\$ 11,020,744,121.18	\$ 11,765,637,586.25
4. Total Liabilities Covered by Budgetary Resources	\$ 10,138,005,538.40	\$ 9,862,581,246.03
5. Total Liabilities	\$ 21,158,749,659.58	\$ 21,628,218,832.28

Fluctuations and Abnormalities

Intragovernmental Other Liabilities, line 1.C., increased \$169,279 thousand, or 51 percent, primarily due to the reconciliation and clean-up of Custodial Liabilities.

The fluctuation in Nonfederal Accounts Payable is due to a concerted effort starting the 2nd Qtr of FY 2005 to clean up accounts payable in cancelled appropriations; items in the General Accounting and Finance System – Rehost (GAFS-R) system were cleared that were found not to be supported in the General Accounting and Finance System – Base Level (GAFS-BL) system.

Information Related to Liabilities Not Covered by Budgetary Resources

Other Liability Disclosures

Other Intragovernmental Liabilities Not Covered by Budgetary Resources consists of \$189,476 thousand in Federal Employees' Compensation Act (FECA) reimbursement to the Department of Labor, \$33,253 thousand in unemployment compensation, and \$281,323 thousand in custodial liabilities.

Other Nonfederal Liabilities Not Covered by Budgetary Resources consists of \$222,570 thousand in capital lease liabilities, \$234,259 thousand in contingent liabilities, \$2,381,416 thousand in accrued annual leave liabilities for military and civilians, and \$311 thousand in accrued interest liability.

Note Reference

For Additional Line Item discussion, see:

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

Note 12.	Accounts Payable
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As of December 31	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
1. Intragovernmental Payables	\$ 1,713,256,028.19	\$ N/A	\$ 1,713,256,028.19	\$ 2,197,831,208.86
2. Nonfederal Payables (to the Public)	5,577,209,599.77	0.00	5,577,209,599.77	4,974,794,095.49
3. Total	<u>\$ 7,290,465,627.96</u>	<u>\$ 0.00</u>	<u>\$ 7,290,465,627.96</u>	<u>\$ 7,172,625,304.35</u>

The Intragovernmental Payables category consists of amounts owed to other federal agencies for goods or services ordered and received but not yet paid for. Interest, penalties, and administrative fees are not applicable to intragovernmental payables. As a result of guidance from Treasury, Judgment Fund Liabilities resulting from the Contract Dispute Act (CDA) and the Notification and Federal Employee Antidiscrimination and Retaliatory Act (NoFEAR) of 2002 are now included in Intragovernmental Payables. The Non-Federal Payables (to the Public) category consists of payments to non-federal governmental entities.

Fluctuations

Accounts Payable – Public increased by \$602,416 thousand, or 12 percent. This net increase can be attributed to a \$546,725 thousand increase in Aircraft Procurement - Air Force Materiel Command resulting from production increases for the F-22, C-130J, Predator and final delivery of the Joint STARS aircraft. The remaining \$55,691 thousand increase is shared by a number of other program entities.

Accounts Payable – Intragovernmental decreased by \$ 484,575 thousand or 22 percent. The variance can be attributed to a \$198,708 thousand decrease in liabilities to the Department of the Treasury, a \$ 58,030 thousand decrease to the Army General Fund, and a decrease of \$149,714 thousand to the Department of Labor. The fluctuation associated with Intragovernmental accounts payable is impacted by the elimination process that requires the accrual of accounts payable to agree with Air Force trading partner seller data. Also, the recording of accounts payable based on actual seller side data provided by the agency or using an estimation technique for those agencies that did not provide actuals contributes to the fluctuation as well. The estimation technique was implemented in the 4th Quarter FY 2004 and continues to be refined.

Other Disclosures

Judgment Fund liabilities for the 1st Quarter FY 2006 total \$8,098 thousand as of December 31, 2005. This is a result of contractor claims under the Contract Disputes Act in the amount of \$8,017 thousand for Air Force contracts that have been adjudicated in favor of the contractor by a court or a board. Initially, Treasury pays the monetary

awards to the contractor. The Air Force must subsequently reimburse the Treasury's Judgment Fund for the amount that was paid to the contractors. Also included is approximately \$80 thousand owed for Judgment Fund liabilities that resulted because of the Notification of reimbursements to Treasury's Judgment Fund, and because of judgments amounts resulting from the Federal Employee Antidiscrimination and Retaliatory Act of 2002. These amounts can change daily and can fluctuate substantially due to new billings by the Treasury, and to payments made to the Treasury by DFAS and the U.S. Army Corps of Engineers on behalf of the Air Force.

Intragovernmental Eliminations

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

Comparison prior to eliminations:

	Dec 2005	Dec 2004	\$ Change
Intragovernmental accounts payable	\$ 498,462	\$ 805,530	\$ (307,068)
Accruals to match seller data	<u>1,783,682</u>	<u>2,034,149</u>	<u>(250,467)</u>
	2,282,144	2,839,679	(557,535)
Less: Intra-Air Force eliminations	<u>568,888</u>	<u>641,848</u>	<u>(72,960)</u>
Total	\$ 1,713,256	\$ 2,197,831	\$ (484,575)
(All data in thousands)			

Allocation of Undistributed Disbursements

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

Note Reference

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

Note 13.	Debt
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As of December 31	2006			2005	
	Beginning Balance	Net Borrowing	Ending Balance	Net Borrowing	Ending Balance
1. Agency Debt (Intragovernmental)					
A. Debt to the Treasury	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
B. Debt to the Federal Financing Bank	0.00	0.00	0.00	0.00	0.00
C. Total Agency Debt	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
2. Total Debt	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00

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
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As of December 31	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
1. Environmental Liabilities-- Nonfederal				
A. Accrued Environmental Restoration (DERP funded) Costs:				
1. Active Installations-- Environmental Restoration (ER)	\$ 387,680,000.00	\$ 3,541,031,803.60	\$ 3,928,711,803.60	\$ 4,145,121,929.54
2. Active Installations--ER for Closed Ranges	15,000,000.00	1,329,856,000.00	1,344,856,000.00	1,344,856,000.00
3. Formerly Used Defense Sites (FUDS)--ER	0.00	0.00	0.00	0.00
4. FUDS--ER for Transferred Ranges	0.00	0.00	0.00	0.00
B. Other Accrued Environmental Costs (Non-DERP funds)				
1. Active Installations-- Environmental Corrective Action	0.00	135,793,512.78	135,793,512.78	179,496,892.26
2. Active Installations-- Environmental Closure Requirements	2,354,000.00	49,301,000.00	51,655,000.00	112,283,000.00
3. Active Installations-- Environ. Response at Active Ranges	0.00	0.00	0.00	0.00
4. Other	0.00	0.00	0.00	0.00
C. Base Realignment and Closure (BRAC)				
1. BRAC Installations-- Environmental Restoration (ER)	153,069,415.76	1,025,415,490.22	1,178,484,905.98	1,337,508,567.74
2. BRAC Installations--ER for Transferring Ranges	0.00	0.00	0.00	0.00
3. BRAC Installations-- Environmental Corrective Action	19,413,672.38	130,050,485.78	149,464,158.16	138,439,442.11
4. Other	29,409,714.47	197,020,991.14	226,430,705.61	0.00
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0.00	0.00	0.00	0.00
2. Nuclear Powered Submarines	0.00	0.00	0.00	0.00
3. Other Nuclear Powered Ships	0.00	0.00	0.00	0.00
4. Other National Defense Weapons Systems	0.00	0.00	0.00	0.00
5. Chemical Weapons Disposal Program	0.00	0.00	0.00	0.00
6. Other	0.00	0.00	0.00	0.00
2. Total Environmental Liabilities	\$ 606,926,802.61	\$ 6,408,469,283.52	\$ 7,015,396,086.13	\$ 7,257,705,831.65

New cost estimates for all environmental liabilities are only submitted at year-end. Quarterly changes to the liability figure are a result of current-year expenditures.

Fluctuations

Other Accrued Environmental Costs (Non-DERP funds) Active Installations - Environmental Corrective Action decreased \$43,703 thousand, or 24 percent. RCRA corrective actions are defined by the Environmental Protection Agency as Solid Waste Management Units (SWMU). SWMUs are not determined in a scientific manner and may arise from any indication of potential pollution. Therefore, there are a high number of SWMUs. Limited initial investigation generally leads to the conclusion that there is no significant pollution at the SWMU. The amount of

the liability fluctuates greatly from year-to-year as further investigation results in significant changes in cost estimates. These changes result from the additional information gained in each step of the cleanup process and the relatively few sites that actually require significant cleanup costs.

Other Accrued Environmental Costs (Non-DERP funds) Active Installations - Environmental Closure Requirements decreased \$60,628 thousand, or 54 percent, due primarily to the fact that the Air Force no longer recognizes the costs of closure for Underground Storage Tanks (USTs) and Treatment, Storage, and Disposal Facilities (TSDFs) as environmental liabilities. The Air Force does not plan to abandon these facilities and therefore has no liability to be recognized in the financial statements. RCRA states that the cleanup of a UST facility takes place only when the tank is abandoned for 12 consecutive months. The only closure liability that meets the accounting requirements for recognition is that of landfills. As of September 30, 2005, the liability for landfill closure was estimated at \$51,655 thousand based on the percentage of the landfill used as of September 30, 2005 with a total liability for landfill closures of \$203,800 thousand. The change in the landfill liability represents increased improvement in direct cost estimates to close and monitor landfills, as well as improved information concerning the use of the landfills. The size of a landfill is not limited over time and opening a greater capacity each period may expand the landfill. Therefore, a landfill that was 50 percent full last year may only be 40 percent full this year. The Air Force plans to develop a methodology to reduce the variability in the capacity used to amortize the landfill liability.

Base Realignment and Closure (BRAC) Installations – Environmental Restoration decreased \$159,024 thousand, or 12 percent. The decrease is due to cleanup work performed, expensed, and paid during the reporting period as well as revaluations attributed primarily to the adjustment of Chanute Air Force Base's Last Remedial Action In Place (LRIP) date from FY 2007 to FY 2009. This adjustment was the result of the Air Force Real Property Agency's (AFRPA's) bottoms-up review and subsequent budget scrubs. In FY 2004, with LRIP projected for FY 2007, Chanute based its environmental assumptions on fast-track cleanup efforts and programmed massive dig and haul efforts and Engineering Evaluation Cost Analysis (EECA) to meet the September 30, 2007 LRIP date. With the FY 2009 LRIP, many fast track requirements were eliminated or scopes significantly reduced, which affected Cost-To-Complete (CTC) projections. In addition to the LRIP date change, Chanute's current Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) status - the Remedial Investigation phase - has produced more accurate data during FY 2005 which in turn has allowed the BRAC Environmental Coordinator to make better assumptions to more clearly define the environmental requirements for Chanute. The data supports significantly less remedial action than was previously assumed by operating location. Many of the environmental sites can be recommended in Record of Decision documents for Long Term Monitoring with Land Use Control/Institutional Controls cost rather than dig and haul and/or active systems, which have greatly reduced out-year costs.

Base Realignment and Closure (BRAC) – Other increased \$226,431 thousand, or 100 percent. The increase is due to improved identification of costs resulting in the addition of this line item 4th Quarter, FY 2005. The increase includes cost for manpower services at BRAC installations and headquarters offices for services performed by Global Engineering Integration and Technical Assistance (GEITA). This contractual support provides program level support for management oversight services at various BRAC installations. This supports the strategy development and execution for environmental and property transfer programs. This support allows the installations to remain on track working towards the Defense Planning Goals which includes: property transfer, Remedial Actions In Place (RIP), Last RIP (LRIP), Operating Properly and Successfully (OPS), Response Complete (RC) and ultimately, Site Closure (SC). Also, the increase includes costs for the Air Force Center for Environmental Excellence (AFCEE). AFCEE provides technical, management, contract and administrative manpower assistance to manage and execute BRAC projects and other closure related matters for closure bases. The Program Managers are the heart of program execution and single point of contact for all activities cradle-to-grave. Programs Managers frequently require technical consultation from staff members who are experts in toxicology, risk assessment, engineering, chemistry,

and hydrogeology. Contracting personnel provide the necessary contracting expertise to conduct acquisition planning, develop contracting strategies, execute contract awards, and administer those contracts. Administrative personnel are required to adequately leverage the myriad of technical and project management correspondence, reports, visitors, and callers to relieve staff from clerical duties.

In addition, various mandated direct costs are included in the total cost. These costs include the cost for Technical Assistance for Public Participation (TAPP) grants which allow community members to obtain objective, independent scientific and engineering support concerning the restoration process through the issuance of government purchase orders to small businesses. Also, included are costs for the Agency for Toxic Substances and Disease Registry (ATSDR), which is mandated under CERCLA Section 104(i) to evaluate all federal facilities on or proposed to the Environmental Protection Agency's (EPA's) National Priorities List (NPL) for public health concerns. In addition, under the EPA's Fast Track Cleanup, an agreement was made between service components and DoD to provide funds to the Deputy Under Secretary of Defense (Installation and Environment) in support of the BRAC Fast Track Program. They provide assistance in setting up BRAC Environmental Coordinator/BRAC Cleanup Teams (BEC/BCT) workshops to develop BRAC environmental policies and issue Defense Planning Guidance and Goals. Also, direct costs are included for the Defense/State Memorandum of Agreement (DSMOA) program which was established by DoD to enhance state and territorial involvement in the cleanup of active and closing DoD installations and at Formerly Used Defense Sites (FUDS). This program provides funds to federal organizations and state regulatory programs that mandate funding in order to support AFRPA.

General Disclosures

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

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

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

Non-DERP, non-BRAC environmental cleanup liabilities represent corrective actions generally required under RCRA law. These environmental cleanup liabilities are estimated in the same manner as DERP environmental cleanup liabilities. The change in non-DERP, non-BRAC environmental cleanup liabilities during a reporting period is comprised of revaluations of the cost-to-complete for engineering sites that existed at the beginning of the period plus the cost-to-complete for new engineering sites added during the reporting period less amounts expensed during the period. Because the non-DERP, non-BRAC environmental cleanup activity is part of general funding achieved using Air Force Operation and Maintenance appropriated funds, there is no special accounting for the costs of the

cleanup program per se. Therefore, the costs captured for the non-DERP, non-BRAC environmental cleanup reflect only direct costs. Because this program was not tracked and appropriated specifically, there was no accounting specific to this program. Expense codes for this program were established in 1999 and implemented in FY 2000. Therefore, the expense portion of the estimate has no significant history. Because of the lack of expense history for the program, there is no reliable data for estimating the current portion of the non-DERP, non-BRAC environmental cleanup liability. It is believed that the current portion of the environmental cleanup liability in this area is relatively small and not material in the classification of liabilities. Because the non-DERP, non-BRAC environmental cleanup liabilities are only estimated between 1 July and 1 September of each year, there is no significant change other than at fiscal yearend for non-DERP, non-BRAC environmental liabilities. On less than an annual basis the only change to the liability estimate in this area is the amount recorded as expensed during the reporting period.

Included in the DERP Environmental Restoration Liability for September 30, 2005 are 32 engineering sites that represent building demolition and debris removal totaling \$50,000 thousand. These costs represent joint costs that entail environmental and non-environmental aspects that cannot be separated for reporting purposes.

All environmental liabilities for DERP restoration represent estimates of cleanups covering all time and actual results may vary significantly from such estimates. The current liability represents a deflated level of expected activity during fiscal year 2006 and should be accurate although not precise because of variations in the timing of expense recognition and official estimates for the year's activity.

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

The environmental cleanup of military ranges is governed by the Military Munitions Rule in 40 CFR 266.201. Environmental cleanup liabilities on ranges refer only to munitions related activities. Other actions are captured under the DERP, BRAC, and non-DERP, non-BRAC environmental cleanup categories. Additionally, environmental cleanup liabilities are reported only for closed ranges.

Environmental cleanup areas within a closed range are referred to as Munitions Response Areas (MRAs). As studies are done to find munitions-related contamination on closed ranges, the number of sites is expected to rise. As investigations progress, the number of sites will increase to reflect specific areas of pollution. The Air Force expects the number of sites reported to increase as pollution is discovered and sites are defined in areas less than the total boundary of the closed range. For example, one closed range of 100 acres may become three sites: one of five acres with pollution A, one of 15 acres with pollution B, and the remaining 80 acres with no pollution found. Thus, one closed range can become three sites, each with its own cost-to-complete cleanup estimate. The sum of the sites' costs-to-complete cleanup becomes the environmental cleanup liability for closed ranges. The environmental cleanup for closed ranges is in its infancy, and the total liability is expected to increase significantly over the coming years as investigations progress. Current policy is to investigate all closed ranges by the end of 2007.

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

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

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

Environmental closure liabilities are incurred under RCRA with the cost-to-complete closure reported for RCRA facilities. Cost estimates are prepared under assumptions defined in the RCRA law and estimated using RACER in the absence of a specific contract cost or bid. The specific facilities reported are RCRA permitted landfills.

Disposal liabilities are presented as an accrued amount for the life of the landfill, and the total liability is presented in the year-end narrative. The accounting standard requires full cost be recognized for closure liability. Closure liabilities recognized by the Air Force cover only direct costs. No cost accounting exists to determine indirect closure costs. Costs incurred in periods greater than 30 years into the future are considered immaterial. The present value of such costs would be negligible in recognition of closure liabilities if such recognition were not on a current cost basis.

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

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

Reporting of landfill closure liability is not in conformance with the accounting standard. The standard would recognize all future costs regardless of timing. The Air Force recognizes only the initial closure. A landfill cap typically requires replacement every 30 to 40 years. An estimation of current costs based on all future costs, regardless of timing, would result in an infinite liability. This result would be meaningless and not the intent of the standard. Therefore, the Air Force reports only the cost of the initial cap required to close a landfill. The Air Force believes this reporting is more meaningful. The present value of the future caps (those after the initial cap) would be negligible.

Base Realignment and Closure (BRAC) Installations - Environmental Restoration, Environmental Corrective Action, and Other:

The Air Force Real Property Agency (AFRPA) estimates their total environmental liability only at year-end. Quarterly changes to the liability figure are a result of current-year expenditures. This amount includes all cleanup requirements to meet applicable laws and regulatory requirements and to transfer property. However, this amount does not include Land Use Control/Institutional Control costs beyond system operations associated with property transfer. Cost estimates are assigned to current operating periods using RACER.

Reporting of Estimates

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

Our financial statements would be affected to the extent there are material differences between these estimates and actual results. There are areas in which management judgment in selecting any available alternative could produce a materially different result. Because the estimated costs are derived from the summation of cost estimates at individual engineering sites the overall liability recognized cannot be attributed to specific causes, such as technology changes or changes in legal requirements during the period.

Engineering sites represent cost centers established for the purposes of management of the cleanup activities directly related to the process. The basis for accounting is the accounting site that is the installation. The installation represents the lowest level for which expenses may be determined. However, expenses also are summed across the Air Force in the determination of the changes in the liability estimates. Because of this rollup activity in the determination of a financial statement for the entire entity, changes cannot be attributed to specific reasons at the Air force level. Such attribution would be meaningless and misleading and is not attempted by the Air Force.

Note Reference

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

Note 15.	Other Liabilities
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As of December 31	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
1. Intragovernmental				
A. Advances from Others	\$ 490,305,443.74	\$ 0.00	\$ 490,305,443.74	\$ 527,581,440.16
B. Deposit Funds and Suspense Account Liabilities	113,867,303.01	0.00	113,867,303.01	349,985,057.70
C. Disbursing Officer Cash	283,368,263.39	0.00	283,368,263.39	315,860,533.35
D. Judgment Fund Liabilities	0.00	0.00	0.00	0.00
E. FECA Reimbursement to the Department of Labor	258,457,723.56	60,247,460.50	318,705,184.06	328,812,708.19
F. Other Liabilities	339,954,893.89	1,180,907.00	341,135,800.89	215,060,384.48
G. Total Intragovernmental Other Liabilities	\$ 1,485,953,627.59	\$ 61,428,367.50	\$ 1,547,381,995.09	\$ 1,737,300,123.88
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	\$ 872,757,119.24	\$ 0.00	\$ 872,757,119.24	\$ 1,222,780,187.06
B. Advances from Others	82,551,902.27	0.00	82,551,902.27	80,427,698.04
C. Deferred Credits	0.00	0.00	0.00	0.00
D. Deposit Funds and Suspense Accounts	65,837,639.98	0.00	65,837,639.98	(338,182,968.86)
E. Temporary Early Retirement Authority	335,363.11	0.00	335,363.11	951,617.59
F. Nonenvironmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	0.00	0.00	0.00	0.00
(2) Excess/Obsolete Structures	0.00	0.00	0.00	423,781,000.00
(3) Conventional Munitions Disposal	0.00	0.00	0.00	0.00
(4) Other	0.00	0.00	0.00	0.00
G. Accrued Unfunded Annual Leave	2,381,416,279.24	0.00	2,381,416,279.24	2,281,615,628.65
H. Capital Lease Liability	28,154,491.06	182,900,929.72	211,055,420.78	235,636,595.27
I. Other Liabilities	309,855,515.13	234,259,230.65	544,114,745.78	390,135,574.65
J. Total Nonfederal Other Liabilities	\$ 3,740,908,310.03	\$ 417,160,160.37	\$ 4,158,068,470.40	\$ 4,297,145,332.40
3. Total Other Liabilities	\$ 5,226,861,937.62	\$ 478,588,527.87	\$ 5,705,450,465.49	\$ 6,034,445,456.28

Intragovernment Fluctuations

Deposit Funds and Suspense Accounts decreased by \$236,118 thousand or 67 percent due to better guidance from the OSD on the classification of suspense and deposit accounts was received beginning 2nd quarter FY 2005. Through first quarter FY 2005, amounts in certain suspense accounts were posted as Intragovernmental Suspense Account Liabilities. In late 1st quarter FY 2005, OSD Guidance directed that these funds should

instead be posted to Nonfederal Suspense Accounts. Due to these changes, the balances reflected in the 2005 total column is not reflective of the balances included in the current quarter column.

The total variance of \$32,492 thousand or a 10.29% decrease in Intragovernmental Disbursing Officer Cash (line 1.D, above) can be explained in two parts. First, the implementation of a new procedure using the International Treasury Service (ITS.gov) to pay foreign vendors drove a \$15,967 thousand decrease in the Foreign Currency asset class. The Centralized Disbursing Directorate at DFAS-DE now sends U.S. dollars directly to the Bank of America in Germany for conversion to foreign currencies and for direct disbursement from the bank to foreign vendors. ITS.gov therefore bypasses the Air Force disbursing officers, whose need for foreign currency is thereby reduced. Second, the remaining \$16,527 thousand decrease in cash can be attributed to changing requirements of the disbursing officers to carry out their paying and collecting functions.

Other Liabilities

The increase of \$126,076 thousand, or 59 percent, in Other Liabilities is primarily due to reconciliation and clean-up of Custodial Liabilities. The amount of \$341,136 thousand represents \$25,529 thousand in government contributions for employee benefits, \$1,181 thousand in unfunded unemployment compensation liabilities, \$33,253 thousand in funded unemployment compensation liabilities, \$281,323 thousand in custodial liabilities, and \$(150) thousand in DoD education benefit liabilities.

NonFederal Fluctuations

Accrued Funded Payroll and Benefits decreased in the amount of \$350,023 thousand or 29 percent as a result of less accrual needed for military payroll during FY 2005. In addition, the process of recording military payroll was automated during FY 05, improving the process by capturing the information directly from our field sites by changing the posting logic in GAFS-R.

Through first quarter FY 2005, amounts in certain suspense accounts were posted as Intragovernmental Suspense Account Liabilities. In late 1st quarter 2005, OSD Guidance directed that these funds should instead be posted to Nonfederal Suspense Accounts. This change also affected line 1.B, above. OSD guidance now classifies Nonfederal Deposit Funds and Suspense Accounts (line 2.D, above) to include all Deposit Funds plus Suspense Account F3882: Military Thrift Savings Plan. The 2005 Total column does not follow this direction, as it was configured before the guidance was developed. The \$404,021 or -119% variance results in part from the exclusion of suspense accounts from the 2006 figure.

The Temporary Early Retirement Authority (TERA) liabilities decrease of \$616 thousand or 65 percent is due to the expiration of the authority in FY 2001. The liability will continue to decrease as expenditures are made because the program was terminated resulting in no new liabilities.

Nonenvironmental Disposal Liabilities – Excess/Obsolete Structures decreased \$423,781 thousand or 100 percent due to the completion of Defense Reform Initiative Directive (DRID) 36. The liability was originally established to meet reporting requirements for DRID 36 which provided facility demolition goals for the Air Force beginning in FY 1998. DRID 36 directed that increased funding be used to eliminate these structures by FY 2003. Currently, there are no established facility demolition goals for the Air Force.

The decrease in Capital Lease Liability in the amount of \$24,581 thousand or 10 percent is the result of a change in methodology for the use of interest rates that applies to the individual leases. The Air Force previously used the interest rate provided with each of the eleven capital leases. This interest rate did not accurately provide the cost of money to compute fair market value. The current interest rate used reflects the appropriate government rate that best reflects the governments cost of borrowing, using the historical rates from the Federal Reserve. The new methodology is an effort by the Air Force to improve the reporting of Capital Leases with coordination between the Air Force and OSD.

Other Liabilities increased by a total of \$153,979 thousand or 38 percent. The major contributor of this is the posting of Contract Holdbacks in the amount of \$154,220 thousand as other liabilities. The new requirement for FY 2006 is being directed by the Treasury Financial Manual Supplement, Section V.

Other Liabilities

The amount of \$544,115 thousand represents legal contingencies of \$234,259 thousand, accrued interest liability of \$311 thousand, employee benefits in the amount of \$155,325 thousand and contract holdbacks of \$154,220.

The recorded estimated probable liability amount of \$12,203 thousand has been included in the accompanying financial statements for open contractor claims greater than \$100,000 and neither under appeal nor in litigation. In addition to the contractor claims under appeal and the open contractor claims for an amount greater than \$100,000, the Air Force was party to numerous other contractor claims in amounts less than \$100,000 per claim. These claims are a routine part of the contracting business and are typically resolved through mutual agreement between the contracting officer and the contractor. Because of the routine nature of these claims, no requirement exists for a consolidated tracking mechanism to record the amount of each claim, the number of open claims, or the probability of the claim being settled in favor of the claimant. The potential liability arising from these claims in aggregate would not materially affect the operations or financial condition of the Air Force. A reasonably possible liability is estimated at \$8,386 thousand and is not included in the reported amount.

The total estimated probable liability for claims and litigation against the Air Force handled by the Civil Law and Litigation Directorate, as of Dec 31, 2005, was valued at \$191,864 thousand and has been included in the accompanying financial statements. As of Dec 31, 2005, the Air Force was party to 5,797 claims and litigation actions. This liability dollar amount recorded in the financial statements is an estimate based on the weighted average payout rate for the previous three years. A reasonably possible liability is estimated at \$86,748 thousand and is not included in the reported amount. Neither past payments nor the current contingent liability estimate provides a basis for accurately projecting the results of any individual lawsuit or claim. It is uncertain that claims will ever accrue to the Air Force. In addition, many claims and lawsuits, even if successful, will not be paid out of Air Force Funds.

As of Dec 31, 2005, the Air Force was party to 78 contract appeals before the Armed Services Board of Contract Appeals (ASBCA). The probable amount of loss from contractor claims of 30,191 thousand has been included in the financial statements. The contractor claims involve unique circumstances, which are considered by the ASBCA in formulating decisions on the cases. Such claims are funded primarily from Air Force appropriations. A reasonably possible liability is estimated at \$308,076 thousand and is not included in the reported amount.

Other Disclosures

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

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

Capital Lease Liability

As of December 31	2006				2005
	Asset Category				
	Land and Buildings	Equipment	Other	Total	Total
1. Future Payments Due					
A. 2006	\$ 72,037,258.12	\$ 0.00	\$ 0.00	\$ 72,037,258.12	\$ 45,432,927.60
B. 2007	38,594,449.78	0.00	0.00	38,594,449.78	45,151,536.20
C. 2008	38,477,782.80	0.00	0.00	38,477,782.80	42,056,230.80
D. 2009	38,477,782.80	0.00	0.00	38,477,782.80	38,977,523.80
E. 2010	36,785,618.84	0.00	0.00	36,785,618.84	38,501,782.80
F. After 5 Years	33,216,537.50	0.00	0.00	33,216,537.50	115,277,577.61
G. Total Future Lease Payments Due	\$ 257,589,429.84	\$ 0.00	\$ 0.00	\$ 257,589,429.84	\$ 325,397,578.81
H. Less: Imputed Interest Executory Costs	46,534,009.06	0.00	0.00	46,534,009.06	89,760,983.54
I. Net Capital Lease Liability	\$ 211,055,420.78	\$ 0.00	\$ 0.00	\$ 211,055,420.78	\$ 235,636,595.27
2. Capital Lease Liabilities Covered by Budgetary Resources				\$ 160,114,379.15	\$ 188,412,827.60
3. Capital Lease Liabilities Not Covered by Budgetary Resources				\$ 50,941,041.63	\$ 47,223,767.67

The Air Force is the lessee in ten capital leases. These leases are for military family housing acquired through the Section 801 Family Housing Program. All leases originating prior to FY 1992 are funded on a fiscal year basis. Six of the current military family housing leases were awarded before FY 1992. In addition, the Air Force has adjusted their records to account for the termination and conveyance of one lease as of October 30, 2004.

Fluctuations

The decrease in Capital Lease Liability in the amount of \$24,581 thousand or 10 percent is the result of a change in methodology for the use of interest rates that applies to the individual leases. The Air Force previously used the interest rate provided with each of the eleven capital leases. This interest rate did not accurately provide the cost of money to compute fair market value. The current interest rate used reflects the appropriate government rate that best reflects the governments cost of borrowing, using the historical rates from the Federal Reserve. The new methodology is an effort by the Air Force to improve the reporting of Capital Leases with coordination between the Air Force and OSD.

Note 16.	Commitments and Contingencies
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Relevant Information for Comprehension

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

Contractual Actions:

Contractor Claims		\$ 8,386 Thousand
Appeals before Armed Services Board of Contract Appeals (ASBCA)		<u>308,076</u> Thousand
		\$316,462 Thousand
Claims and Litigation from Civil Law		\$ <u>86,748</u> Thousand
	Total	\$403,210 Thousand

Note Reference

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

Note 17.	Military Retirement Benefits and Other Employment Related Actuarial Liabilities
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As of December 31	2006			2005	
	Actuarial Present Value of Projected Plan Benefits	Assume Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
1. Pension and Health Benefits					
A. Military Retirement Pensions	\$ 0.00		\$ 0.00	\$ 0.00	\$ 0.00
B. Military Retirement Health Benefits	0.00		0.00	0.00	0.00
C. Military Medicare-Eligible Retiree Benefits	0.00		0.00	0.00	0.00
D. Total Pension and Health Benefits	\$ 0.00		\$ 0.00	\$ 0.00	\$ 0.00
2. Other					
A. FECA	\$ 1,147,437,480.00		\$ 0.00	\$ 1,147,437,480.00	\$ 1,163,442,240.00
B. Voluntary Separation Incentive Programs	0.00		0.00	0.00	0.00
C. DoD Education Benefits Fund	0.00		0.00	0.00	0.00
D. Total Other	\$ 1,147,437,480.00		\$ 0.00	\$ 1,147,437,480.00	\$ 1,163,442,240.00
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	\$ 1,147,437,480.00		\$ 0.00	\$ 1,147,437,480.00	\$ 1,163,442,240.00

Actuarial Cost Method Used:

Assumptions:

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

Military Retirement Pensions

Assumptions:

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

Military Retirement Health Benefits

Assumptions:

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

Federal Employees' Compensation Act (FECA)

Assumptions and Actuarial Cost Method Used:

The Air Force's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the Air Force at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the Office of Management and Budget's (OMB's) economic assumptions for 10-year U.S. Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

2005
4.528% in Year 1
5.020% in Year 2 and thereafter

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

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

<u>CBY</u>	<u>COLA</u>	<u>CPIM</u>
2005	2.20%	4.33%
2006	3.33%	4.09%
2007	2.93%	4.01%
2008	2.40%	4.01%
2009+	2.40%	4.01%

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

Note Reference

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

Note 18.	General Disclosures Related to the Statement of Net Cost
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Intragovernmental Costs and Exchange Revenue		
As of December 31	2006	2005
1. Intragovernmental Costs	\$ 9,638,972,532.33	\$ 7,102,879,421.35
2. Public Costs	23,637,702,355.77	26,171,776,803.26
3. Total Costs	\$ 33,276,674,888.10	\$ 33,274,656,224.61
4. Intragovernmental Earned Revenue	\$ (673,956,542.81)	\$ (409,912,291.34)
5. Public Earned Revenue	(1,183,653,888.42)	(1,229,968,818.78)
6. Total Earned Revenue	\$ (1,857,610,431.23)	\$ (1,639,881,110.12)
7. Net Cost of Operations	\$ 31,419,064,456.87	\$ 31,634,775,114.49

Statement of Net Cost fluctuations

Intragovernmental Costs increased \$2,536,093 thousand, or 36 percent, in FY 2006, driven by an increase in personnel costs. Beginning in FY 2006, the Air Force changed business practices for funding Medicare-Eligible Retiree Health Fund Contributions. In the prior FY the Air Force made contributions to the trust fund on a monthly basis. Beginning in FY 06, the Air Force contributed the amount for the entire year to the trust fund in the first quarter. Intragovernmental costs reflect contributions to the trust fund of \$2,032,519 thousand, \$254,333 thousand, and \$385,869 thousand for the Active Air Force, Air Force Reserve, and the Air National Guard respectively.

Public costs decreased \$2,534,074 thousand, or 10 percent, during first quarter FY 2006. Intragovernmental activity for both the DoD and Non-DoD was greater than in first quarter FY 2005. During FY05, the Air Force made a concerted effort to ensure that amounts reported for accounts payable were on the books and represented field-reported data. This data clean up resulted in a decrease in the amount of accrual needed to match seller-side data, resulting in a lesser amount expensed and reclassified to public cost for elimination purposes.

Intragovernmental Earned Revenue increased \$264,044 thousand, or 64 percent, in FY 2006, driven mainly by a decrease in intra-Air Force transactions. Intra-Air Force transactions are removed from the revenue generated by all government sources by matching seller-side transactions to buyer-side transactions and eliminating those transactions which are between two Air Force entities. Intra-Air Force transactions for the quarter decreased \$425,642 thousand while overall program revenues remained at a consistent level. Since more revenue was generated from entities outside of DoD, Intragovernmental Earned Revenue increased. Intra-Air Force revenue has been

impacted by being under Continuing Resolution Authority. Offsetting this increase was decrease in revenue of \$122,348 thousand in Operations and Maintenance Revenues from the Air National Guard. The Air National Guard's Intragovernmental Earned Revenue has been impacted by being under a continuing resolution authority for the first quarter of 2006.

Note 19.	Disclosures Related to the Statement of Changes in Net Position
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As of December 31	2006		2005	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
1. Prior Period Adjustments				
Increases (Decreases) to Net Position Beginning Balance				
A. Changes in Accounting Standards	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
B. Errors and Omissions in Prior Year Accounting Reports	0.00	0.00	0.00	0.00
C. Total Prior Period Adjustments	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	\$ 54,190,669.89	\$ 0.00	\$ 55,122,673.98	\$ 0.00
B. Civilian Health	111,803,692.00	0.00	104,921,597.50	0.00
C. Civilian Life Insurance	334,105.48	0.00	312,895.02	0.00
D. Judgment Fund	2,710,616.53	0.00	22,796,183.03	0.00
E. IntraEntity	0.00	0.00	0.00	0.00
F. Total Imputed Financing	\$ 169,039,083.90	\$ 0.00	\$ 183,153,349.53	\$ 0.00

Relevant Information for Comprehension

Imputed Financing

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

The total Civilian Retirement imputed financing of \$54,191 thousand is comprised of \$47,138 thousand for the CSRS and \$7,053 thousand for the FERS.

The imputed revenue is equal to the imputed expense recognized in the Statement of Net Cost.

Fluctuations

The Judgement Fund imputed expense decrease of \$20,086 thousand is due to a decline in the number of Air Force lawsuits requiring payment by the Department of Treasury

Note Reference

For regulatory disclosure related to the Statement of Changes in Net Position, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1022.

Note 20.	Disclosures Related to the Statement of Budgetary Resources
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As of December 31	2006	2005
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 51,803,667,602.86	\$ 46,021,481,025.81
2. Available Borrowing and Contract Authority at the End of the Period	0.00	0.00

Other Information Related to the Statement of Budgetary Resources

The amount of direct obligations incurred and apportioned under category A is \$20,743,496 thousand, category B is \$10,372,789 thousand, and exempt is \$223 thousand. For reimbursable obligations incurred and apportioned, category A is \$815,928 thousand, category B is \$656,185 thousand, and exempt is \$0.

Unexpended Obligations presented in the SBR includes Unexpended Obligations for both direct and reimbursable funds. The Department of Defense has not fully implemented the U.S. Standard General Ledger (USSGL) in all operational accounting systems. The statement does not include any amounts for which the Department of Treasury is willing to accept corrections to canceled appropriation amounts, in accordance with the Statement of Federal Financial Accounting Standards No.1.

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

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

Note 21.	Disclosures Related to the Statement of Financing
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The objective of the Statement of Financing is to reconcile the difference between budgetary obligations and the net cost of operations reported. It is presented as consolidated. The following Statement of Financing lines are presented as combined instead of consolidated due to intra-agency budgetary transactions not being eliminated: Obligations Incurred, Spending Authority from Offsetting Collections and Recoveries, Obligations Net of Offsetting Collections and Recoveries, Net Obligations, Undelivered Orders, and Unfilled Orders. Due to limitations in the Department of the Air Force's financial system, budgetary data are not in agreement with proprietary expenses and assets capitalized. Differences between budgetary and proprietary data constitute a previously identified deficiency.

Note 1A and Note 1F provide additional detail.

Other Information Related to the Statement of Financing

Components Not Requiring or Generating Resources, Other consists of \$1,452 thousand in bad debt expense, \$(209,250) thousand in Other Expenses not Requiring Budgetary Resources, and \$(546,809) thousand in Cost Capitalization Offset.

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

Intra-entity transactions have not been eliminated because the statements are presented as consolidated.

Note 22.	Disclosures Related to the Statement of Custodial Activity
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Not applicable

Note 23.	Earmarked Funds
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BALANCE SHEET	
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As of December 31

MRF

MERHCF

Other Earmarked
FundsTotal Earmarked
Funds**ASSETS**

Fund balance with

Treasury	\$	0.00	\$	0.00	\$	5,546,442.31	\$	5,546,442.31
Investments		0.00		0.00		716,676.76		716,676.76
Accounts and Interest Receivable		0.00		0.00		872.00		872.00
Other Assets		0.00		0.00		0.00		0.00
Total Assets	\$	0.00	\$	0.00	\$	6,263,991.07	\$	6,263,991.07

LIABILITIES and NET POSITION

Military Retirement

Benefits and Other

Employment Related

Actuarial Liabilities	\$	0.00	\$	0.00	\$	0.00	\$	0.00
Other Liabilities		0.00		0.00		1,392,554.74		1,392,554.74
Unexpended Appropriations		0.00		0.00		(1,251,498.55)		(1,251,498.55)
Cumulative Results of Operations		0.00		0.00		6,122,935.20		6,122,935.20
Total Liabilities and Net Position	\$	0.00	\$	0.00	\$	6,263,991.39	\$	6,263,991.39

STATEMENT OF NET COST

As of December 31

Program Costs	\$	0.00	\$	0.00	\$	2,783,888.51	\$	2,783,888.51
Less Earned Revenue		0.00		0.00		0.00		0.00
Net Program Costs	\$	0.00	\$	0.00	\$	2,783,888.51	\$	2,783,888.51
Less Earned Revenues Not Attributable to Programs		0.00		0.00		0.00		0.00
Net Cost of Operations	\$	0.00	\$	0.00	\$	2,783,888.51	\$	2,783,888.51

STATEMENT OF CHANGES IN NET POSITION

As of December 31

Net Position Beginning

of the Period	\$	0.00	\$	0.00	\$	4,199,667.19	\$	4,199,667.19
Net Cost of Operations		0.00		0.00		2,783,888.51		2,783,888.51
Other Nonexchange Revenue		0.00		0.00		3,455,657.97		3,455,657.97
Change in Net Position	\$	0.00	\$	0.00	\$	671,769.46	\$	671,769.46
Net Position End of Period	\$	0.00	\$	0.00	\$	4,871,436.65	\$	4,871,436.65

Relevant Information for Comprehension

Earmarked funds are financed by specifically identified revenues and other financing sources that are required by statute to be used for designated activities and must be accounted for separately from the Department's general revenues. The Federal Accounting Standards Advisory Board (FASAB) addressed the reporting issues involving earmarked funds in the Statement of Federal Financial Accounting Standards (SFFAS) 27, "Identifying and Reporting Earmarked Funds".

Earmarked funds remain available over time. These funds may be classified as a trust, special or public enterprise fund. The three required criteria for an earmarked fund are:

1. A statute committing the Department to use specifically identified revenues and other financing sources only for designated activities, benefits or purposes;
2. Explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits or purposes;
3. A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguishes the earmarked fund from the Department's general revenues.

Disclosures

First Quarter FY 2006 is the first quarter Note 23 for Earmarked Funds is required. As such, there are no variances to be explained.

Note 24.	Other Disclosures
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As of December 31	2006 Asset Category			
	Land and Buildings	Equipment	Other	Total

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

Future Payments Due

Fiscal Year

2006	\$ 80,301,400.00	\$ 0.00	\$ 135,762,466.00	\$ 216,063,866.00
2007	76,877,300.00	0.00	138,477,716.00	215,355,016.00
2008	100,960,000.00	0.00	141,247,270.00	242,207,270.00
2009	116,386,600.00	0.00	144,072,215.00	260,458,815.00
2010	117,543,100.00	0.00	146,953,660.00	264,496,760.00
After 5 Years	126,285,600.00	0.00	149,892,733.00	276,178,333.00

**Total Future Lease
Payments Due**

	\$ 618,354,000.00	\$ 0.00	\$ 856,406,060.00	\$ 1,474,760,060.00
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