

**Department of Defense**  
**Air Force Working Capital Fund**  
**CONSOLIDATED BALANCE SHEET**  
**As of December 31, 2005 and 2004**

|  | <b>2006 Consolidated</b>           | <b>2005 Consolidated</b>           |
|--|------------------------------------|------------------------------------|
| <b>1. ASSETS (Note 2)</b>  |                                    |                                    |
| A. Intragovernmental:  |                                    |                                    |
| 1. Fund Balance with Treasury (Note 3)   |                                    |                                    |
| a. Entity  | \$ 1,179,565,906.83                | \$ 1,060,387,347.57                |
| b. Non-Entity Seized Iraqi Cash  | 0.00                               | 0.00                               |
| c. Non-Entity-Other  | 0.00                               | 0.00                               |
| 2. Investments (Note 4)  | 0.00                               | 0.00                               |
| 3. Accounts Receivable (Note 5)  | 406,803,115.39                     | 615,295,390.05                     |
| 4. Other Assets (Note 6)   | 0.00                               | 0.00                               |
| 5. Total Intragovernmental Assets  | <u>\$ 1,586,369,022.22</u>         | <u>\$ 1,675,682,737.62</u>         |
| B. Cash and Other Monetary Assets (Note 7)   | \$ 0.00                            | \$ 0.00                            |
| C. Accounts Receivable (Note 5)  | 214,660,817.08                     | 58,336,720.40                      |
| D. Loans Receivable (Note 8)   | 0.00                               | 0.00                               |
| E. Inventory and Related Property (Note 9)   | 33,664,826,072.85                  | 20,750,068,201.09                  |
| F. General Property, Plant and Equipment (Note 10)   | 1,187,143,673.74                   | 1,183,241,584.75                   |
| G. Investments (Note 4)  | 0.00                               | 0.00                               |
| H. Other Assets (Note 6)   | 498,333,486.50                     | 544,326,129.89                     |
| <b>2. TOTAL ASSETS</b>   | <u><u>\$ 37,151,333,072.39</u></u> | <u><u>\$ 24,211,655,373.75</u></u> |
| <b>3. LIABILITIES (Note 11)</b>  |                                    |                                    |
| A. Intragovernmental:  |                                    |                                    |
| 1. Accounts Payable (Note 12)  | \$ 98,745,910.22                   | \$ 188,547,564.15                  |
| 2. Debt (Note 13)  | 0.00                               | 0.00                               |
| 3. Other Liabilities (Note 15 & 16)  | 159,959,950.94                     | 256,070,171.72                     |
| 4. Total Intragovernmental Liabilities   | <u>\$ 258,705,861.16</u>           | <u>\$ 444,617,735.87</u>           |
| B. Accounts Payable (Note 12)  | \$ 650,592,591.80                  | \$ 454,305,854.46                  |
| C. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17) | 233,713,461.91                     | 238,729,115.79                     |
| D. Environmental and Disposal Liabilities (Note 14)  | 0.00                               | 0.00                               |
| E. Loan Guarantee Liability (Note 8)   | 0.00                               | 0.00                               |
| F. Other Liabilities (Note 15 & Note 16)   | 1,272,753,514.12                   | 1,483,844,295.06                   |
| <b>4. TOTAL LIABILITIES</b>  | <u><u>\$ 2,415,765,428.99</u></u>  | <u><u>\$ 2,621,497,001.18</u></u>  |
| <b>5. NET POSITION</b>   |                                    |                                    |
| A. Unexpended Appropriations - Earmarked Funds (Note 23)                                     | \$ 0.00                            | \$ 0.00                            |
| B. Unexpended Appropriations - Other Funds   | 0.00                               | 0.00                               |
| C. Cumulative Results of Operations - Earmarked Funds  | 0.00                               | 0.00                               |
| D. Cumulative Results of Operations - Other Funds  | 34,735,567,643.40                  | 21,590,158,372.57                  |
| <b>6. TOTAL NET POSITION</b>   | <u><u>\$ 34,735,567,643.40</u></u> | <u><u>\$ 21,590,158,372.57</u></u> |
| <b>7. TOTAL LIABILITIES AND NET POSITION</b>   | <u><u>\$ 37,151,333,072.39</u></u> | <u><u>\$ 24,211,655,373.75</u></u> |

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

|   | <b>2006 Consolidated</b> | <b>2005 Consolidated</b> |
|---|--------------------------|--------------------------|
| <b>1. Program Costs</b>                                       |                          |                          |
| A. Gross Costs  | \$ 2,321,210,319.59      | \$ 3,257,657,021.74      |
| B. (Less: Earned Revenue)                                     | (3,253,365,991.50)       | (2,875,390,021.20)       |
| C. Net Program Costs  | \$ (932,155,671.91)      | \$ 382,267,000.54        |
| <b>2. Cost Not Assigned to Programs</b>                       | 0.00                     | 0.00                     |
| <b>3. (Less: Earned Revenue Not Attributable to Programs)</b> | 0.00                     | 0.00                     |
| <b>4. Net Cost of Operations</b>                              | \$ (932,155,671.91)      | \$ 382,267,000.54        |

Department of Defense  
Air Force Working Capital Fund  
**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**  
For the periods ended December 31, 2005 and 2004

|   | 2006 Consolidated        | 2005 Consolidated        |
|---|--------------------------|--------------------------|
| <b>CUMULATIVE RESULTS OF OPERATIONS</b>                     |                          |                          |
| <b>1. Beginning Balances</b>                                | \$ 33,774,838,090.74     | \$ 21,890,389,890.99     |
| <b>2. Prior Period Adjustments:</b>                         |                          |                          |
| 2.A. Changes in accounting principles (+/-)                 | 0.00                     | 0.00                     |
| 2.B. Corrections of errors (+/-)                            | 0.00                     | 0.00                     |
| <b>3. Beginning balances, as adjusted</b>                   | <u>33,774,838,090.74</u> | <u>21,890,389,890.99</u> |
| <b>4. Budgetary Financing Sources:</b>                      |                          |                          |
| 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                                       | 0.00                     | 0.00                     |
| 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                     | 41,470,000.00            |
| 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                     |
| <b>5. Other Financing Sources:</b>                          |                          |                          |
| 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 (+/-)           | (10,606,169.45)          | 0.00                     |
| 5.C. Imputed financing from costs absorbed by others        | 39,180,050.20            | 40,565,482.12            |
| 5.D. Other (+/-)  | 0.00                     | 0.00                     |
| <b>6. Total Financing Sources</b>                           |                          |                          |
| 6.A. Earmarked funds  | 0.00                     | 0.00                     |
| 6.B. All other funds  | 28,573,880.75            | 82,035,482.12            |
| <b>7. Net Cost of Operations (+/-)</b>                      |                          |                          |
| 7.A. Earmarked funds  | 0.00                     | 0.00                     |
| 7.B. All other funds  | (932,155,671.91)         | 382,267,000.54           |
| <b>8. Net Change</b>  |                          |                          |
| 8.A. Earmarked funds  | 0.00                     | 0.00                     |
| 8.B. All other funds  | 960,729,552.66           | (300,231,518.42)         |
| <b>9. Ending Balances</b>                                   |                          |                          |
| 9.A. Earmarked funds  | 0.00                     | 0.00                     |
| 9.B. All other funds  | 34,735,567,643.40        | 21,590,158,372.57        |

Department of Defense  
Air Force Working Capital Fund  
**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**  
For the periods ended December 31, 2005 and 2004

|                            | 2006 Consolidated           | 2005 Consolidated           |
|----------------------------|-----------------------------|-----------------------------|
| <b>10. Total all funds</b> | \$ <u>34,735,567,643.40</u> | \$ <u>21,590,158,372.57</u> |



Department of Defense

Air Force Working Capital Fund

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>0.00</u>    | \$ <u>0.00</u>    |

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

|  | <b>2006 Combined</b>               | <b>2005 Combined</b>               |
|--|------------------------------------|------------------------------------|
| <b>BUDGETARY FINANCING ACCOUNTS</b>                      |                                    |                                    |
| <b>BUDGETARY RESOURCES:</b>                              |                                    |                                    |
| 1. Unobligated balance, brought forward, October 1       | \$ 292,678,750.15                  | \$ 134,439,106.78                  |
| 2. Recoveries of prior year unpaid obligations           | 445.51                             | 0.00                               |
| 3. Budget authority                                      |                                    |                                    |
| 3.A. Appropriation                                       | 0.00                               | 0.00                               |
| 3.B. Borrowing authority                                 | 0.00                               | 0.00                               |
| 3.C. Contract authority                                  | 10,467,685,840.16                  | 10,299,478,609.17                  |
| 3.D. Spending authority from offsetting collections      |                                    |                                    |
| 3.D.1 Earned   |                                    |                                    |
| 3.D.1.a. Collected                                       | 3,929,533,204.87                   | 3,879,543,166.07                   |
| 3.D.1.b. Change in receivables from Federal sources      | (133,530,318.58)                   | 212,937,817.04                     |
| 3.D.2 Change in unfilled customer orders                 |                                    |                                    |
| 3.D.2.a. Advance received                                | 16,160,854.08                      | 16,595,407.61                      |
| 3.D.2.b. Without advance from Federal sources            | (273,019,300.79)                   | 18,180,994.46                      |
| 3.D.3. Anticipated for rest of year, without advances    | 4,272,950,814.88                   | 4,611,868,990.65                   |
| 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>18,279,781,094.62</u>           | <u>19,038,604,985.00</u>           |
| 4. Nonexpenditure transfers, net, anticipated and actual | 0.00                               | 41,470,000.00                      |
| 5. Temporarily not available pursuant to Public Law      | 0.00                               | 0.00                               |
| 6. Permanently not available                             | (1,396,816,587.88)                 | 0.00                               |
| <b>7. Total Budgetary Resources</b>                      | <u><u>\$ 17,175,643,702.40</u></u> | <u><u>\$ 19,214,514,091.78</u></u> |

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

|   | 2006 Combined                | 2005 Combined                |
|---|------------------------------|------------------------------|
| <b>Status of Budgetary Resources:</b>   |                              |                              |
| 8. Obligations incurred:  |                              |                              |
| 8.A. Direct   | \$ 0.00                      | \$ 0.00                      |
| 8.B. Reimbursable   | 3,782,007,158.20             | 4,009,672,292.98             |
| 8.C. Subtotal   | <u>3,782,007,158.20</u>      | <u>4,009,672,292.98</u>      |
| 9. Unobligated balance:   |                              |                              |
| 9.A. Apportioned  | 13,368,117,828.73            | 15,136,673,813.80            |
| 9.B. Exempt from apportionment  | 0.00                         | 0.00                         |
| 9.C. Subtotal   | <u>13,368,117,828.73</u>     | <u>15,136,673,813.80</u>     |
| 10. Unobligated balance not available   | 25,518,715.47                | 68,167,985.00                |
| <b>11. Total status of budgetary resources</b>  | <u>\$ 17,175,643,702.40</u>  | <u>\$ 19,214,514,091.78</u>  |
| <b>Change in Obligated Balance:</b>   |                              |                              |
| 12. Obligated balance, net  |                              |                              |
| 12.A. Unpaid obligations, brought forward, October 1  | 8,621,327,352.90             | 8,980,235,422.78             |
| 12.B. Less: Uncollected customer payments<br>from Federal sources, brought forward, October 1 | <u>\$ (4,967,391,264.45)</u> | <u>\$ (4,224,253,591.14)</u> |
| 12.C. Total unpaid obligated balance  | 3,653,936,088.45             | 4,755,981,831.64             |
| 13. Obligations incurred net (+/-)  | <u>\$ 3,782,007,158.20</u>   | <u>\$ 4,009,672,292.98</u>   |
| 14. Less: Gross outlays   | (3,930,350,729.61)           | (3,928,332,456.37)           |
| 15. Obligated balance transferred, net  |                              |                              |
| 15.A. Actual transfers, unpaid obligations (+/-)  | 0.00                         | 0.00                         |
| 15.B. Actual transfers, uncollected customer<br>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>(445.51)</u>              | <u>0.00</u>                  |
| 17. Change in uncollected customer<br>payments from Federal sources (+/-)                     | 406,549,619.37               | (231,118,811.50)             |
| 18. Obligated balance, net, end of period   |                              |                              |
| 18.A. Unpaid obligations  | 8,472,983,335.98             | 9,061,575,259.39             |
| 18.B. Less: Uncollected customer payments (+/-)<br>from Federal sources (-)                   | <u>(4,560,841,645.08)</u>    | <u>(4,455,372,402.64)</u>    |
| 18.C. Total, unpaid obligated balance, net, end of period                                     | <u>3,912,141,690.90</u>      | <u>4,606,202,856.75</u>      |
| <b>Net Outlays</b>  |                              |                              |
| <b>19. Net Outlays:</b>   |                              |                              |
| 19.A. Gross outlays   | 3,930,350,729.61             | 3,928,332,456.37             |
| 19.B. Less: Offsetting collections  | (3,945,694,058.95)           | (3,896,138,573.68)           |
| 19.C. Less: Distributed Offsetting receipts   | 0.00                         | 0.00                         |
| <b>19.D. Net Outlays</b>  | <u>\$ (15,343,329.34)</u>    | <u>\$ 32,193,882.69</u>      |



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

|  | 2006 Combined  | 2005 Combined  |
|--|----------------|----------------|
| <b>NONBUDGETARY FINANCING ACCOUNTS</b>                   |                |                |
| <b>BUDGETARY RESOURCES</b>                               |                |                |
| 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  | 0.00           | 0.00           |
| 4. Nonexpenditure transfers, net, anticipated and actual | 0.00           | 0.00           |
| 5. Temporarily not available pursuant to Public Law      | 0.00           | 0.00           |
| 6. Permanently not available                             | 0.00           | 0.00           |
| <b>7. Total Budgetary Resources</b>                      | <b>\$ 0.00</b> | <b>\$ 0.00</b> |

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

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

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

|   | <b>2006 Consolidated</b>    | <b>2005 Consolidated</b>    |
|---|-----------------------------|-----------------------------|
|   | <hr/>                       | <hr/>                       |
| <b>Resources Used to Finance Activities:</b>  |                             |                             |
| Budgetary Resources Obligated   |                             |                             |
| 1. Obligations incurred   | \$ 3,782,007,158.20         | \$ 4,009,672,292.98         |
| 2. Less: Spending authority from offsetting collections and recoveries (-)                                | (3,539,144,885.09)          | (4,127,257,385.18)          |
| 3. Obligations net of offsetting collections and recoveries   | 242,862,273.11              | (117,585,092.20)            |
| 4. Less: Offsetting receipts (-)  | 0.00                        | 0.00                        |
| 5. Net obligations  | <hr/> 242,862,273.11        | <hr/> (117,585,092.20)      |
| Other Resources   |                             |                             |
| 6. Donations and forfeitures of property  | 0.00                        | 0.00                        |
| 7. Transfers in/out without reimbursement (+/-)   | (10,606,169.45)             | 0.00                        |
| 8. Imputed financing from costs absorbed by others  | 39,180,050.20               | 40,565,482.12               |
| 9. Other (+/-)  | 0.00                        | 0.00                        |
| 10. Net other resources used to finance activities  | <hr/> 28,573,880.75         | <hr/> 40,565,482.12         |
| <b>11. Total resources used to finance activities</b>   | <hr/> \$ 271,436,153.86     | <hr/> \$ (77,019,610.08)    |
| <b>Resources Used to Finance Items not Part of the Net Cost of Operations</b>                             |                             |                             |
| 12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided |                             |                             |
| 12a. Undelivered Orders (-)   | 22,721,589.49               | (138,691,524.67)            |
| 12b. Unfilled Customer Orders   | (256,858,446.71)            | 34,776,402.07               |
| 13. Resources that fund expenses recognized in prior periods  | (4,733,709.47)              | (190,619,089.97)            |
| 14. Budgetary offsetting collections and receipts that do not affect net cost of operations               | 0.00                        | 0.00                        |
| 15. Resources that finance the acquisition of assets  | (1,472,024,202.69)          | (1,402,323,145.74)          |
| 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 (+/-)  | 10,606,169.45               | 0.00                        |
| <b>17. Total resources used to finance items not part of the net cost of operations</b>                   | <hr/> \$ (1,700,288,599.93) | <hr/> \$ (1,696,857,358.31) |
| <b>18. Total resources used to finance the net cost of operations</b>                                     | <hr/> \$ (1,428,852,446.07) | <hr/> \$ (1,773,876,968.39) |

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

|   | <b>2006 Consolidated</b>        | <b>2005 Consolidated</b>      |
|---|---------------------------------|-------------------------------|
|   | <hr/>                           | <hr/>                         |
| <b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>      |                                 |                               |
| Components Requiring or Generating Resources in Future Period:  |                                 |                               |
| 19. Increase in annual leave liability  | 0.00                            | 0.00                          |
| 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 (-)   | 6,499.91                        | 0.00                          |
| 23. Other (+/-)   | 0.00                            | 0.00                          |
| 24. Total components of Net Cost of Operations that will require or generate resources in future periods                | <hr/> 6,499.91                  | <hr/> 0.00                    |
| Components not Requiring or Generating Resources:   |                                 |                               |
| 25. Depreciation and amortization   | 40,286,035.47                   | 49,620,516.74                 |
| 26. Revaluation of assets or liabilities (+/-)  | (707,457,289.92)                | (2,927,051,905.03)            |
| 27. Other (+/-)   |                                 |                               |
| 27a. Trust Fund Exchange Revenue  | 0.00                            | 0.00                          |
| 27b. Cost of Goods Sold   | 1,171,483,379.93                | 3,410,968,857.35              |
| 27c. Operating Material & Supplies Used   | 13,799,096.16                   | 33,867,577.21                 |
| 27d. Other  | (21,420,947.39)                 | 1,588,738,922.66              |
| 28. Total components of Net Cost of Operations that will not require or generate resources                              | <hr/> 496,690,274.25            | <hr/> 2,156,143,968.93        |
| <b>29. Total components of net cost of operations that will not require or generate resources in the current period</b> | <hr/> \$ 496,696,774.16         | <hr/> \$ 2,156,143,968.93     |
| <b>30. Net Cost of Operations</b>   | <hr/> <hr/> \$ (932,155,671.91) | <hr/> <hr/> \$ 382,267,000.54 |

|                |  |
|----------------|--|
| <b>Note 1.</b> | <b>Significant Accounting Policies</b> |
|----------------|--|

**1.A. Basis of Presentation**

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

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

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

**1.B. Mission of the Reporting Entity**

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

aggressors of the United States and its allies. The overall mission of the Air Force is to defend the United States through control and exploitation of air and space.

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

### **1.C. Appropriations and Funds**

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

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

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

### **Supply Management**

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

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

## Depot Maintenance

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

## Information Services

The Information Services Activity Group (ISAG) performs software development and upgrades as well as legacy system maintenance primarily for Air Force customers. ISAG was deactivated as a Working Capital Fund Activity as of 30 September 2005. Beginning October 1, 2005 (FY 2006), only residual contractual operations remain in the Working Capital Fund. All new activity for Information Services in FY 2006 is currently being performed in Air Force Appropriated Funds.

## Transportation

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

## Air Force Working Capital Fund Component

The purpose of the Air Force Component Activity is to provide an activity within the AFWCF to record transactions that cannot be identified to a specific business area. The January 21, 1997 memorandum "Policy and Procedures for Cash Management Working Capital Funds (DWCF)" established the "Component Level Adjustment" column.

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

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

(1) Funding Authority:

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

(2) Minor Construction Funding:

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

(3) Software Development Costs:

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

(4) Capital Budgeting:

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

(5) Asset Capitalization and Depreciation:

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

(6) Rates and Prices:

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

The FY 2006, AFWCF operations encompassed three activity groups: Supply Management, Depot Maintenance, and Information Services. These activity groups use their resources to finance the initial cost of products or services for activities of the



United States Government, primarily those of the DoD. Work is generated by the acceptance of customer orders from ordering activities.

#### **1.D. Basis of Accounting**

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

Under the accrual method revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting is accomplished through unique general ledger accounts to facilitate compliance with legal and internal control requirements associated with the use of federal funds; however, the cash basis of accounting may be followed if the reported activity and amounts are not materially significant. In addition to the accrual basis of accounting, Depot Maintenance also uses the full absorption accounting principal. During FY 1996, the Defense Finance and Accounting Service, Denver Center (DFAS-DE), SAF/FMB, and the Office of the Secretary of Defense, Financial Management (OSD/FM) jointly agreed on the use of this principal by Depot Maintenance. This principal requires that overhead costs, such as depreciation and bad debt expenses, are included in the cost of services sold. The effect of known intrafund transactions is eliminated.

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

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

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

Material disclosures are provided at Note 10.

#### **1.E. Revenues and Other Financing Sources**

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

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

##### Supply Management

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

##### Depot Maintenance

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

Revenue recognition for Contract DMAG is based on the number of units produced times the Unit Sales Price (USP) and is recognized upon completion of the repair.

##### Information Services

The Information Services Activity Group (ISAG), as a service type organization, recognizes revenue in one of two ways based on the service level agreement between the

customer and the provider. ISAG uses either the completed contract method or the percentage of completion method.

#### **1.F. Recognition of Expenses**

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the Air Force's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, and environmental liabilities. Expenditures for capital and other long-term assets are not recognized as expenses in the AFWCF's operations until depreciated in the case of property, plant, and equipment (PP&E) or consumed in the case of operating materials and supplies (OM&S). Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made. Operating expenses were adjusted as a result of the elimination of balances between the DoD Components. Net increases or decreases in unexpended appropriations are recognized as a change in net position. See Note 18, Intragovernmental Expenses and Revenue, for disclosure of adjustment amounts.

#### **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 decisions applicable to the Air Force as though the agency was a stand-alone entity.

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

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

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

funded by the OPM in the Statement of Net Cost, and recognizes corresponding imputed revenue in the Statement of Changes in Net Position.

To prepare reliable financial statements, transactions occurring between components or activities within the DoD or between two or more federal agencies must be eliminated. However, the Air Force, as well as the rest of the federal government, cannot accurately identify all intragovernmental transactions by customer. The DFAS is responsible for eliminating transactions between the components or activities of the AFWCF. For FY 1999 and beyond, seller entities within the Department provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD intragovernmental balances were then eliminated.

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

#### **1.H. Transactions with Foreign Governments and International Organizations**

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

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

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

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections

received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in the Treasury's system. Differences between the AFWCF's recorded balance in the FBWT account and Treasury's FBWT sometimes result and are subsequently reconciled.

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

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

**1.J. Foreign Currency**

Not applicable.

**1.K. Accounts Receivable**

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

Material disclosures are provided at Note 5.

**1.L. Direct Loans and Loan Guarantees**

Not applicable.

**1.M. Inventories and Related Property**

Inventory for the AFWCF is all held in SMAG except for work-in-process inventory, which is in the Depot Management Activity Group. Prior to fiscal year 2004, the majority of the SMAG inventory was reported at approximate historical cost based on Latest Acquisition Cost (LAC), adjusted for holding gains and losses. During fiscal years 2004 and 2005, a major portion of the Supply Management Activity Group inventory changed

from the LAC method to the Moving Average Cost (MAC) method of valuation. This allowed SMAG to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property" for that percentage of the inventory. The conversion to MAC included programming changes for the SMAG accounting system to convert from the Air Force General Ledger (AFGL) to the USSGL for supply accounting.

Under the LAC method of inventory valuation, gains and losses resulting from valuation changes for inventory items were recognized and reported in the Statement of Net Cost and included in the calculation of Cost of Goods Sold. To calculate the allowances for gain or loss on inventories, DFAS Denver prepared an inventory worksheet monthly for each fund code within the SMAG. SFFAS No. 3, "Accounting for Inventory and Related Property," directs that using a historical cost valuation method does not require an allowance for holding gains and losses account. Additionally, SFFAS No. 3 provides for either the direct or allowance method to be used in valuing inventory held for repair. Therefore the change to a historical costing method also included the elimination of the allowance for holding gains and losses, revaluation of all inventories to a historical basis and the creation of an allowance for repairs. The implementation of Moving Average Cost for SMAG inventories in fiscal year 2004 and 2005 eliminated the need for the gains and losses allowance account for that portion of the inventory and has been credited against a prior period. Inventory held for repair is now valued at MAC with an allowance for repair equal to the latest repair cost.

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

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

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

Not applicable.

**1.O. General Property, Plant and Equipment**

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

Prior to FY 1996, General PP&E with an acquisition cost of \$15,000, \$25,000, and \$50,000 for FYs 1993, 1994, and 1995 respectively, and an estimated useful life of 2 or more years was capitalized. These assets remain capitalized and are reported on WCF

financial statements. General PP&E previously capitalized at amounts below \$100,000 were written off General Fund financial statements in FY 1998.

When it is in the best interest of the government, the Air Force provides government property necessary to complete contract work to contractors. Such property is either owned or leased by the Air Force, or purchased directly by the contractor for the government based on contract terms. When the value of contractor procured General PP&E exceeds the DoD capitalization threshold, the items should be included in the value of General PP&E reported on the Air Force's Balance Sheet. The AFWCF recently completed a study that indicates that the value of General PP&E that meets the capitalization requirement and is in the possession of contractors is not material to the Department's financial statements. Regardless, the AFWCF is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Air Force currently reports only the government property in the possession of contractors that is maintained in the Air Force's property systems.

For entities operating as business type activities (WCFs), all PP&E used in the performance of their mission is categorized as General PP&E, whether or not it meets the definition of any other PP&E categories. National Defense PP&E, Heritage Assets and Stewardship Land owned or maintained on a WCF installation are reported in the Supplemental Stewardship Report of the applicable military department. Material disclosures are provided at Note 10.

**1.P. Advances and Prepayments**

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

**1.Q. Leases**

Not applicable.

**1.R. Other Assets**

The AFWCF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that these long-term contracts can cause, the AFWCF provides financing payments. One type of financing payment that the AFWCF makes is for real property, and is based upon a percentage of completion. In accordance with SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported on the General PP&E line and in Note 10, General PP&E, Net. In addition, based on the provision of the Federal Acquisition Regulations, the AFWCF makes financing payments under fixed price contracts. The AFWCF reports these financing payments in the "Other Assets" line item because the AFWCF becomes liable only after the contractor delivers the goods in conformance with

the contract terms. If the contractor does not deliver a satisfactory product, the AFWCF is not obligated to reimburse the contractor for its costs, and the contractor is liable to repay the AFWCF for the full amount of the advance.

### **1.S. Contingencies and Other Liabilities**

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

### **1.T. Accrued Leave**

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

### **1.U. Net Position**

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

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

### **1.V. Treaties for Use of Foreign Bases**

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



**1.W. Comparative Data**

The AFWCF presents the current and previous year's financial data for comparative purposes. This data is presented in the financial statements, as well as in the notes to the principal statements.

**1.X. Unexpended Obligations**

The AFWCF presents the current and previous year's financial data for comparative purposes. This data is presented in the financial statements, as well as in the notes to the principal statements.

**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.

|                |                         |
|----------------|-------------------------|
| <b>Note 2.</b> | <b>Nonentity Assets</b> |
|----------------|-------------------------|

| As of December 31                  | 2006                 | 2005                 |
|------------------------------------|----------------------|----------------------|
| <b>1. Intragovernmental Assets</b> |                      |                      |
| A. Fund Balance with Treasury      | \$ 0.00              | \$ 0.00              |
| B. Investments                     | 0.00                 | 0.00                 |
| C. Accounts Receivable             | 0.00                 | 0.00                 |
| D. Other Assets                    | 0.00                 | 0.00                 |
| E. Total Intragovernmental Assets  | \$ 0.00              | \$ 0.00              |
| <b>2. Nonfederal Assets</b>        |                      |                      |
| A. Cash and Other Monetary Assets  | \$ 0.00              | \$ 0.00              |
| B. Accounts Receivable             | 0.00                 | 0.00                 |
| 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                    | 0.00                 | 0.00                 |
| H. Total Nonfederal Assets         | \$ 0.00              | \$ 0.00              |
| <b>3. Total Nonentity Assets</b>   | \$ 0.00              | \$ 0.00              |
| <b>4. Total Entity Assets</b>      | \$ 37,151,333,072.39 | \$ 24,211,655,373.75 |
| <b>5. Total Assets</b>             | \$ 37,151,333,072.39 | \$ 24,211,655,373.75 |

Asset accounts 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. The Air Force 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 are not available for use in the operations of the entity.

The Air Force Working Capital Fund does not have any nonentity assets.

|                |                                   |
|----------------|-----------------------------------|
| <b>Note 3.</b> | <b>Fund Balance with Treasury</b> |
|----------------|-----------------------------------|

As of December 31

|  | 2006                | 2005                |
|--|---------------------|---------------------|
| <b>1. Fund Balances</b>                            |                     |                     |
| A. Appropriated Funds                              | \$ 0.00             | \$ 0.00             |
| B. Revolving Funds                                 | 1,179,565,906.83    | 1,060,387,347.57    |
| C. Trust Funds                                     | 0.00                | 0.00                |
| D. Special Funds                                   | 0.00                | 0.00                |
| E. Other Fund Types                                | 0.00                | 0.00                |
| F. Total Fund Balances                             | \$ 1,179,565,906.83 | \$ 1,060,387,347.57 |
| <b>2. Fund Balances Per Treasury Versus Agency</b> |                     |                     |
| A. Fund Balance per Treasury                       | \$ 350,900,821.73   | \$ 1,279,606,433.10 |
| B. Fund Balance per AFWCF                          | 1,179,565,906.83    | 1,060,387,347.57    |
| <b>3. Reconciling Amount</b>                       | \$ (828,665,085.10) | \$ 219,219,085.53   |

The reconciling amount on line 3 above represents \$(828.7) million for the United States Transportation Command (USTC), which is reported at the Department of the Treasury as part of the Air Force Working Capital Fund (AFWCF). However, for the purposes of Audited Financial Statements (AFS), USTC is included with the Other Defense Organizations (ODO) reporting, which is separate from the AFWCF. Therefore, USTC cash is not included on the AFWCF AFS statements.

#### Fluctuations and Abnormalities

Fund Balance with Treasury increased \$119.1 million (11 percent) in FY 2006. The Supply Management Activity Group (SMAG) accounted for the majority of the increase. SMAG had a \$151.7 million increase which was offset by the \$32.6 million in combined losses experienced in both the remaining activity groups, Information Services Activity Group (ISAG) and the Depot Maintenance Activity Group (DMAG). The increase in SMAG can be attributed to three factors, the \$68.9 million increase in the General Support Division (GSD), the \$59.6 million increase in the Medical-Dental Division and the \$23 million increase in the Material Support Division.

The GSD had a \$68.9 million increase in their Fund Balance with Treasury primarily attributed to favorable financial performance, coupled with favorable balance sheet performance. Net operating results for GSD before eliminations and mandated Audited Financial Statement adjustments, totaled \$45.5 million, which is a source of cash inflow. In addition to these operating gains, GSD also experienced favorable balance sheet performance as well. GSD collected an additional \$23.4 million in funds as a result of a \$42.1 million decrease in accounts receivable offset by an \$18.7 million decrease in accounts payable over the prior year.

The Medical-Dental Division had a \$59.6 million increase in the Fund Balance with Treasury which is primarily attributed to resolution of an accounts receivable collection issue that arose in FY 2005. The

backlog of receivables has been collected therefore the Fund Balance with Treasury has been replenished. Further disclosures on the accounts receivable issue are disclosed in Note 5.

The Material Support Division (MSD) had a \$23 million increase in their Fund Balance with Treasury primarily attributed to favorable balance sheet performance offset by operating losses. Net operating results for MSD before eliminations and mandated Audited Financial Statement adjustments totaled \$220 million in losses, which is a cash outflow. The losses resulted from FY2005 budgeted losses and the discontinued reimbursement for spare parts from the Air Force General Fund. These operating losses were offset by the \$243 million in funds not yet disbursed due to changes in balance sheet accounts. MSD collected an additional \$94.3 million in accounts receivable over the prior year, increased their accounts payable \$122.7 million (discussed in Note 12), and increased the fund balance an additional \$26 million through the liquidation of other assets and liabilities. Overall, the increases from these items total \$23 million.

The decrease of \$18.3 million in ISAG is due to the removal of the activity from the AFWCF. As residual activity continues to be worked, the corresponding Fund Balance will continue to decrease.

The decrease of \$15.5 million in DMAG represent a 3 percent overall decrease, which is due to normal business fluctuations and timing of cash transactions.

#### Note Reference

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

## Status of Fund Balance with Treasury

| As of December 31                             | 2006                   | 2005                  |
|---|------------------------|-----------------------|
| <b>1. Unobligated Balance</b>                 |                        |                       |
| A. Available                                  | \$ 9,120,685,729.32    | \$ 10,592,972,808.15  |
| B. Unavailable                                | 0.00                   | 0.00                  |
| <b>2. Obligated Balance not yet Disbursed</b> | \$ 8,472,983,335.98    | \$ (9,532,585,460.09) |
| <b>3. Nonbudgetary FBWT</b>                   | \$ 0.00                | \$ 0.00               |
| <b>4. NonFBWT Budgetary Accounts</b>          | \$ (16,414,103,158.47) | \$ 0.00               |
| <b>5. Total</b>                               | \$ 1,179,565,906.83    | \$ 1,060,387,348.06   |

The amounts reported in this schedule represent the budgetary resources associated with cash. The decrease of \$1.4 billion (14 percent) on Line 1 can be attributed to a policy change in the treatment of contract authority that was implemented by the Under Secretary of Defense Comptroller’s office in September of FY 2005. Contract authority invoked is no longer reflected as available, it is now reflected on Line 2. This policy change had no impact on actual Fund Balance with Treasury. The increase of \$18.0 billion on Line two is due to three factors. The first factor is the offset of the change on Line 1. The second factor are mapping changes that occurred in FY 2006 which established a further breakout of the Status of Fund Balance with Treasury as reflected on Line 4. In FY 2005, the Line 4 amounts were included on Line 3. The remaining change was discussed in the Fund Balance with Treasury portion above.

**Disclosures Related to Suspense/Budget Clearing Accounts**

| As of December 31 | 2004           | 2005           | 2006           | (Decrease)/<br>Increase from FY<br>2005 - 2006 |
|-------------------|----------------|----------------|----------------|--|
| <b>Account</b>    |                |                |                |  |
| F3875             | \$ 0.00        | \$ 0.00        | \$ 0.00        | 0.00   |
| F3880             | 0.00           | 0.00           | 0.00           | 0.00   |
| F3882             | 0.00           | 0.00           | 0.00           | 0.00   |
| F3885             | 0.00           | 0.00           | 0.00           | 0.00   |
| F3886             | 0.00           | 0.00           | 0.00           | 0.00   |
| <b>Total</b>      | <u>\$ 0.00</u> | <u>\$ 0.00</u> | <u>\$ 0.00</u> | <u>0.00</u>                                    |

Not applicable.

|  |
|--|
| <b>Disclosures Related to Problem Disbursements and In-Transit Disbursements</b> |
|--|

| As of December 31   | 2004              | 2005              | 2006              | (Decrease)/<br>Increase from FY<br>2005 to 2006 |
|---|-------------------|-------------------|-------------------|---|
| <b>1. Total Problem Disbursements,<br/>Absolute Value</b> |                   |                   |                   |   |
| A. Unmatched Disbursements<br>(UMDs)                      | \$ 7,832,397.95   | \$ 16,989,719.69  | \$ 19,292,689.34  | 2,302,969.65                                    |
| B. Negative Unliquidated<br>Obligations (NULO)            | 2,057,017.58      | 2,407,773.58      | 1,856,603.76      | (551,169.82)                                    |
| <b>2. Total In-transit Disbursements,<br/>Net</b>         | \$ 358,451,054.78 | \$ 776,593,940.54 | \$ 244,522,896.16 | (532,071,044.38)                                |

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

Due to the accelerated reporting requirements the 2005 column represents November 2004 amounts. The 2004 and 2006 columns are both December balances.

The AFWCF has a \$1.8 million increase in problem disbursements and a \$532.1 million decrease in In-transit disbursements. The amount of Unmatched Disbursements (UMDs) over 180 days old is \$0.00, for Negative Unliquidated Obligations (NULOs) is \$0.00, and for In-transit is \$3.1 million. The amount of UMDs over 120 days old is \$0.00, for NULO is \$0.00, and for In-transit is \$8.6 million. The current absolute value of In-transit disbursements is \$297.2 million.

The increase in UMDs can be attributed to slow processing of FY 2006 obligations for non contractual documents during the 1<sup>st</sup> Qtr Fy 2006. All responsible parties have coordinated activities to ensure the obligations are posted timely and resolution is expected in the 2<sup>nd</sup> Qtr FY 2006. The decrease in In-transits is due to clean up of backlogs caused by database mergers (San Antonio to Limestone in October 2004, and Omaha to Dayton in May 2005) and difficulties encountered with the merger of the Contract Procurement Accounting System (CPAS) and the General Accounting and Finance System (GAFS). Also, a substantial amount of problems were encountered when we implemented new business processes for handling disbursements.

|                |   |
|----------------|---|
| <b>Note 4.</b> | <b>Investments and Related Interest</b> |
|----------------|---|

| As of December 31                      | 2006             |                     |                                  |                  |                         |
|--|------------------|---------------------|----------------------------------|------------------|-------------------------|
|  | Par Value / Cost | Amortization Method | Unamortized (Premium) / Discount | Investments, Net | Market Value Disclosure |
| <b>1. Intragovernmental Securities</b> |                  |                     |                                  |                  |                         |
| A. Nonmarketable, Market-Based         | \$ 0.00          |                     | \$ 0.00                          | \$ 0.00          | \$ 0.00                 |
| B. Accrued Interest                    | 0.00             |                     |                                  | 0.00             | 0.00                    |
| C. Total Intragovernmental Securities  | <u>\$ 0.00</u>   |                     | <u>\$ 0.00</u>                   | <u>\$ 0.00</u>   | <u>\$ 0.00</u>          |
| <b>2. Other Investments</b>            |                  |                     |                                  |                  |                         |
| 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 |
| <b>3. Intragovernmental Securities</b> |                  |                     |                                  |                  |                         |
| A. Nonmarketable, Market-Based         | \$ 0.00          |                     | \$ 0.00                          | \$ 0.00          | \$ 0.00                 |
| B. Accrued Interest                    | 0.00             |                     |                                  | 0.00             | 0.00                    |
| C. Total Intragovernmental Securities  | <u>\$ 0.00</u>   |                     | <u>\$ 0.00</u>                   | <u>\$ 0.00</u>   | <u>\$ 0.00</u>          |
| <b>4. Other Investments</b>            |                  |                     |                                  |                  |                         |
| A. Total Investments                   | <u>\$ 0.00</u>   |                     | <u>\$ 0.00</u>                   | <u>\$ 0.00</u>   | <u>N/A</u>              |

Not Applicable.



|                |                            |
|----------------|----------------------------|
| <b>Note 5.</b> | <b>Accounts Receivable</b> |
|----------------|----------------------------|

| As of December 31  | 2006              |  |                             | 2005                        |
|--|-------------------|--|-----------------------------|-----------------------------|
|  | Gross Amount Due  | Allowance For<br>Estimated<br>Uncollectibles | Accounts Receivable,<br>Net | Accounts Receivable,<br>Net |
| <b>1. Intragovernmental<br/>Receivables</b>                | \$ 406,803,115.39 | N/A  | \$ 406,803,115.39           | \$ 615,295,390.05           |
| <b>2. Nonfederal<br/>Receivables (From<br/>the Public)</b> | \$ 214,660,817.08 | \$ 0.00                                      | \$ 214,660,817.08           | \$ 58,336,720.40            |
| <b>3. Total Accounts<br/>Receivable</b>                    | \$ 621,463,932.47 | \$ 0.00                                      | \$ 621,463,932.47           | \$ 673,632,110.45           |

Fluctuations

Intragovernmental receivables decreased \$208.5 million (34 percent). The amount consists primarily of a \$157.6 million decrease in the Supply Management Activity Group (SMAG). The decrease in SMAG is caused by two events. Medical/Dental Support had a decrease of \$88.9 million due to a collection error in November and December of FY 2005. The amount for FY 2005 was overstated due to this error and the amount in FY 2006 reflects normal activity. The second event is due to a decrease in Material Support Division. A decrease of \$68.4 million was caused by a backlog of collections in December FY 2005, which led to the increase of accounts receivables balance. By mid FY 2005 the backlog was collected and the FY 2006 amount reflects normal activity. The Information Systems Activity Group (ISAG) had a decrease of \$32.8 million. This decrease was largely caused by the removal of ISAG as a Working Capital Fund. The accounts receivable balance consists of FY 2005 outstanding contracts. All receivables for FY 2006 have been included as appropriated funds.

Non-federal receivables increased \$156.3 million (268 percent). The amount consists primarily of an increase of \$158.7 million in SMAG. The increase was attributed to a change in classification of receivables from Foreign Military Sales that were previously recorded as other assets. This change occurred in the 3<sup>rd</sup> Qtr, FY 2005 reports.

Information Related to Accounts ReceivablesAllowance Method

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

### Allocation of Undistributed Collections

The Department of Defense (DoD) policy is to allocate supported undistributed collections between federal and non-federal categories based on the percentage of federal and non-federal accounts receivable.

Unsupported undistributed collections are recorded in USSGL account 2400, Liability For Deposit Funds, Clearing Accounts, and Undeposited Collections. The Air Force Working Capital Fund (AFWCF) followed this allocation procedure, applying \$700.6 thousand in undistributed collections to accounts receivable and recording \$54.8 million of unsupported undistributed to USSGL account 2400.

### Elimination Adjustments

Accounts receivable within the AFWCF have been eliminated for statement presentation purposes. The total value of the receivables that were eliminated on these financial statements is \$307.5 million.

The Air Force accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Air Force was unable to reconcile 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 reconciliations.

### Receivables over 180 Days

The Air Force has \$4.3 million intragovernmental receivables and \$10.3 million non-federal receivables over 180 days. Processes have been implemented to closely monitor the delinquent receivables and to refer them to the appropriate entity for resolution.

### Detailed Accounts Receivable Aging Per Monthly Receivables Report (MRR)

| AGING CATEGORY   | INTRAGOVERNMENTAL<br>Rounded to Thousands | NONFEDERAL<br>Rounded to Thousands |
|--|---|------------------------------------|
| Nondelinquent Current:   |   |                                    |
| Per MRR  | \$ 693,175                                | \$203,131                          |
| Supported Undistributed Collections                              | 447                                       | 276                                |
| Intra AFWCF Eliminations   | -307,268                                  | 0                                  |
| Nondelinquent Noncurrent   | 231                                       | 0                                  |
| Delinquent 1 to 30 days  | 15,150                                    | 533                                |
| Delinquent 31 to 60 days   | 695                                       | 276                                |
| Delinquent 61 to 90 days   | 585                                       | 21                                 |
| Delinquent 91 to 180 days  | -560                                      | 85                                 |
| Delinquent 181 days to 1 year                                    | 191                                       | 371                                |
| Delinquent Greater than 1 year and less than or equal to 2 years | 4,151                                     | 9,040                              |

|   |           |           |
|---|-----------|-----------|
| Delinquent Greater than 2 years and less than or equal to 6 years | 6         | 794       |
| Delinquent Greater than 6 years and less than 10 years            | 0         | 131       |
| Delinquent Greater than 10 years                                  | 0         | 3         |
|   |           |           |
| Totals  | \$406,803 | \$214,661 |

Federal accounts receivables delinquent over 30 days account for 0.8 percent of gross federal accounts receivables. Non-federal accounts receivables delinquent over 30 days account for 5.3 percent of gross non-federal receivables. Delinquent accounts receivables are referred to either Columbus Contract Debt Collection Office or the Defense Debt Management System at DFAS-DE for collection action.

Note Reference

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

|                |                     |
|----------------|---------------------|
| <b>Note 6.</b> | <b>Other Assets</b> |
|----------------|---------------------|

| As of December 31                          | 2006              | 2005              |
|--|-------------------|-------------------|
| <b>1. Intragovernmental Other Assets</b>   |                   |                   |
| A. Advances and Prepayments                | \$ 0.00           | \$ 0.00           |
| B. Total Intragovernmental Other Assets    | \$ 0.00           | \$ 0.00           |
| <b>2. Nonfederal Other Assets</b>          |                   |                   |
| A. Outstanding Contract Financing Payments | \$ 0.00           | \$ 0.00           |
| B. Other Assets (With the Public)          | 498,333,486.50    | 544,326,129.89    |
| C. Total Nonfederal Other Assets           | \$ 498,333,486.50 | \$ 544,326,129.89 |
| <b>3. Total Other Assets</b>               | \$ 498,333,486.50 | \$ 544,326,129.89 |

**Non-Federal Other Assets (in Thousands)**

| Types of Asset   | 2006             | 2005             |
|--|------------------|------------------|
| <b>Advances -</b>  |                  |                  |
| SMAG - Advances and Prepayments to Contractors                     | \$329,956        | \$257,105        |
| DMAG - Advances and Prepayments to Contractors                     | 48,690           | 988              |
| <b>Total Advances</b>  | <b>378,646</b>   | <b>258,093</b>   |
| <b>Other Assets -</b>  |                  |                  |
| SMAG - Air Force assets – other DoD foreign military sales (depot) | 0                | 158,730          |
| SMAG - Other assets returns to vendors pending credit              | 117,188          | 116,332          |
| DMAG – Unallocated labor and materials                             | 2,499            | 11,171           |
| <b>Total Other Assets</b>  | <b>119,687</b>   | <b>286,233</b>   |
| <b>Total Non-Federal Other Assets</b>                              | <b>\$498,333</b> | <b>\$544,326</b> |

Note Reference

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

|                |                                       |
|----------------|---------------------------------------|
| <b>Note 7.</b> | <b>Cash and Other Monetary Assets</b> |
|----------------|---------------------------------------|

| As of December 31   | 2006    | 2005    |
|---|---------|---------|
| <b>1. Cash</b>  | \$ 0.00 | \$ 0.00 |
| <b>2. Foreign Currency (Nonpurchased)</b>                           | 0.00    | 0.00    |
| <b>3. Total Cash, Foreign Currency, &amp; Other Monetary Assets</b> | \$ 0.00 | \$ 0.00 |

Definitions

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

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

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

|                |   |
|----------------|---|
| <b>Note 8.</b> | <b>Direct Loan and/or Loan Guarantee Programs</b> |
|----------------|---|

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

Not Applicable.

## Direct Loans Obligated After FY 1991

| As of December 31                                   | 2006           | 2005           |
|---|----------------|----------------|
| <b>Loan Programs</b>                                |                |                |
| <b>1. Military Housing Privatization Initiative</b> |                |                |
| 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        |
| <b>2. Total Loans Receivable</b>                    | <b>\$ 0.00</b> | <b>\$ 0.00</b> |

|   |
|---|
| <b>Total Amount of Direct Loans Disbursed</b> |
|---|

| As of December 31                            | 2006           | 2005           |
|--|----------------|----------------|
| <b>Direct Loan Programs</b>                  |                |                |
| 1. Military Housing Privatization Initiative | \$ 0.00        | \$ 0.00        |
| <b>2. Total</b>                              | <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   |
|--|-----------------------|---------------------------|-----------------------|-------------------|---------|
| <b>1. New Direct Loans Disbursed:</b>                |                       |                           |                       |                   |         |
| Military Housing Privatization Initiative            | \$ 0.00               | \$ 0.00                   | \$ 0.00               | \$ 0.00           | \$ 0.00 |
| 2005   | Interest Differential | Defaults                  | Fees                  | Other             | Total   |
| <b>2. New Direct Loans Disbursed:</b>                |                       |                           |                       |                   |         |
| Military Housing Privatization Initiative            | \$ 0.00               | \$ 0.00                   | \$ 0.00               | \$ 0.00           | \$ 0.00 |
| 2006   | Modifications         | Interest Rate Reestimates | Technical Reestimates | Total Reestimates | Total   |
| <b>3. Direct Loan Modifications and Reestimates:</b> |                       |                           |                       |                   |         |
| Military Housing Privatization Initiative            | \$ 0.00               | \$ 0.00                   | \$ 0.00               | \$ 0.00           | \$ 0.00 |
| 2005   | Modifications         | Interest Rate Reestimates | Technical Reestimates | Total Reestimates | Total   |
| <b>4. Direct Loan Modifications and Reestimates:</b> |                       |                           |                       |                   |         |
| Military Housing Privatization Initiative            | \$ 0.00               | \$ 0.00                   | \$ 0.00               | \$ 0.00           | \$ 0.00 |
|  |                       |                           |                       |                   |         |
|  |                       | 2006                      | 2005                  |                   |         |
| <b>5. Total Direct Loan Subsidy Expense:</b>         |                       |                           |                       |                   |         |
| Military Housing Privatization Initiative            | \$ 0.00               | \$ 0.00                   | \$ 0.00               |                   |         |

## Subsidy Rate for Direct Loans

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

|  |
|--|
| <b>Schedule for Reconciling Subsidy Cost Allowance Balances for Post 1991 Direct Loans</b> |
|--|

| As of December 31   | 2006    | 2005    |
|---|---------|---------|
| <b>1. Beginning Balance of the Subsidy Cost Allowance</b>   | \$ 0.00 | \$ 0.00 |
| <b>2. Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component</b> |         |         |
| 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    |
| <b>E. Total of the above Subsidy Expense Components</b>   | \$ 0.00 | \$ 0.00 |
| <b>3. Adjustments</b>   |         |         |
| 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    |
| <b>G. Total of the above Adjustment Components</b>  | \$ 0.00 | \$ 0.00 |
| <b>4. Ending Balance of the Subsidy Cost Allowance before Re-estimates</b>                        | \$ 0.00 | \$ 0.00 |
| <b>5. Add or Subtract Subsidy Re-estimates by Component</b>                                       |         |         |
| 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 |
| <b>6. Ending Balance of the Subsidy Cost Allowance</b>  | \$ 0.00 | \$ 0.00 |

**Defaulted Guaranteed Loans from Post FY 1991 Guarantees**

| As of December 31  | 2006 |      | 2005 |      |
|--|------|------|------|------|
| <b>Loan Guarantee Program(s)</b>   |      |      |      |      |
| <b>1. Military Housing Privatization Initiative</b>                              |      |      |      |      |
| 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 |
| <b>2. Armament Retooling &amp; Manufacturing Support Initiative</b>              |      |      |      |      |
| 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 |
| <b>3. Total Value of Assets Related to Defaulted Guaranteed Loans Receivable</b> |      |      |      |      |
|  | \$   | 0.00 | \$   | 0.00 |

## Guaranteed Loans Outstanding

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

|  |
|--|
| <b>Liabilities for Post FY 1991 Loan Guarantees, Present Value</b> |
|--|

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

## Subsidy Expense for Post FY 1991 Loan Guarantees

As of December 31

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

**Subsidy Rates for Loan Guarantees**

| As of December 31  | Interest Supplements | Defaults | Fees and other Collections | Other | Total |
|--|----------------------|----------|----------------------------|-------|-------|
| <b>Loan Guarantee Programs:</b>                          |                      |          |                            |       |       |
| 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% |



|  |
|--|
| <b>Schedule for Reconciling Loan Guarantee Liability Balances for Post FY 1991<br/>Loan Guarantees</b> |
|--|

| As of December 31   | 2006           | 2005           |
|---|----------------|----------------|
| <b>1. Beginning Balance of the Loan Guarantee Liability</b>   | \$ 0.00        | \$ 0.00        |
| <b>2. Add: Subsidy Expense for Guaranteed Loans<br/>Disbursed during the Reporting Years by Component</b> |                |                |
| 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           |
| <b>E. Total of the above Subsidy Expense Components</b>   | <b>\$ 0.00</b> | <b>\$ 0.00</b> |
| <b>3. Adjustments</b>   |                |                |
| 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           |
| <b>H. Total of the above Adjustments</b>  | <b>\$ 0.00</b> | <b>\$ 0.00</b> |
| <b>4. Ending Balance of the Loan Guarantee Liability before<br/>Reestimates</b>                           | <b>\$ 0.00</b> | <b>\$ 0.00</b> |
| <b>5. Add or Subtract Subsidy Reestimates by Component</b>  |                |                |
| A. Interest Rate Reestimate   | 0.00           | 0.00           |
| B. Technical/default Reestimate   | 0.00           | 0.00           |
| <b>C. Total of the above Reestimate Components</b>  | <b>\$ 0.00</b> | <b>\$ 0.00</b> |
| <b>6. Ending Balance of the Loan Guarantee Liability</b>  | <b>\$ 0.00</b> | <b>\$ 0.00</b> |

**Administrative Expenses**

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

|                |                                       |
|----------------|---------------------------------------|
| <b>Note 9.</b> | <b>Inventory and Related Property</b> |
|----------------|---------------------------------------|

| As of December 31                      | 2006                        | 2005                        |
|--|-----------------------------|-----------------------------|
| 1. Inventory, Net                      | \$ 33,188,502,230.26        | \$ 20,236,632,321.65        |
| 2. Operating Materials & Supplies, Net | 476,323,842.59              | 513,435,879.44              |
| 3. Stockpile Materials, Net            | 0.00                        | 0.00                        |
| <b>4. Total</b>                        | <b>\$ 33,664,826,072.85</b> | <b>\$ 20,750,068,201.09</b> |

## Inventory, Net

| As of December 31                      | 2006                        |                              |                          | 2005                        | Valuation Method |
|--|-----------------------------|------------------------------|--------------------------|-----------------------------|------------------|
|  | Inventory, Gross Value      | Revaluation Allowance        | Inventory, Net           | Inventory, Net              |                  |
| <b>1. Inventory Categories</b>         |                             |                              |                          |                             |                  |
| A. Available and Purchased for Resale  | \$ 23,189,173,321.17        | \$ (6,418,562.42)            | 23,182,754,758.75        | \$ 10,050,376,088.44        | LAC,MAC          |
| B. Held for Repair                     | 13,860,608,769.15           | (4,096,854,069.50)           | 9,763,754,699.65         | 9,700,937,621.35            | LAC,MAC          |
| C. Excess, Obsolete, and Unserviceable | 773,294,069.61              | (773,294,069.61)             | 0.00                     | 0.00                        | NRV              |
| D. Raw Materials                       | 0.00                        | 0.00                         | 0.00                     | 0.00                        | MAC,SP,LAC       |
| E. Work in Process                     | 241,992,771.86              | 0.00                         | 241,992,771.86           | 485,318,611.86              | AC               |
| <b>F. Total</b>                        | <b>\$ 38,065,068,931.79</b> | <b>\$ (4,876,566,701.53)</b> | <b>33,188,502,230.26</b> | <b>\$ 20,236,632,321.65</b> |                  |

### 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

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

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

### Definitions

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

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

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

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

### Fluctuations

Inventory increased \$12.9 billion (64 percent) due to the following factors.

Inventory Available and Purchased for Resale values for the Supply Management Activity Group (SMAG) had an increase of \$13.1 billion. The increase is primarily the result of an inventory valuation change from Latest Acquisition Cost to Moving Average Cost. In the 4<sup>th</sup> Qtr of FY 2005, \$11.3 billion was removed from the Material Support Division's revaluation allowance account as a result of the new inventory procedures. The valuation account offsets the overall inventory values, therefore the overall inventory value increased.

Work in Process (WIP) had a decrease of \$243.3 million in the Depot Maintenance Activity Group (DMAG). This decrease can be attributed to two events. The first event is the continuing phase out of Contract Depot Maintenance Activity Group (CDMAG) operations from the Working Capital Fund. This phase-out caused the \$139.9 million WIP decrease in CDMAG. The second event, a \$103.4 million decrease in Organic WIP, was due to less work being inducted into the WIP than what had been completed, coupled with the clean-up effort of some of the old customer orders that still had open WIP balances.

### General Composition of Inventory

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

The category inventory held for repair consists of damaged material that requires repair to make it usable. Excess inventory is condemned material that must be retained for management purposes. The category held for sale includes all issuable material. The category held for repair includes all economically repairable material. Work in process includes depot maintenance work with its

associated labor, applied overhead, and supplies used in the delivery of maintenance services. The U.S. Standard General Ledger does not include a separate work in process account unrelated to sales. Inventory is assigned to categories based on guidance in the DoD Financial Management Regulation, Volume 11B.

Note Reference

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

## 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                |  |                  |
| <b>1. OM&amp;S Categories</b>          |                          |                       |                          |                          |  |                  |
| A. Held for Use                        | \$ 476,323,842.59        | \$ 0.00               | \$ 476,323,842.59        | \$ 513,435,879.44        |  | SP, LAC          |
| B. Held for Repair                     | 0.00                     | 0.00                  | 0.00                     | 0.00                     |  | SP, LAC          |
| C. Excess, Obsolete, and Unserviceable | 0.00                     | 0.00                  | 0.00                     | 0.00                     |  | NRV              |
| <b>D. Total</b>                        | <b>\$ 476,323,842.59</b> | <b>\$ 0.00</b>        | <b>\$ 476,323,842.59</b> | <b>\$ 513,435,879.44</b> |  |                  |

### Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses  
 SP = Standard Price  
 AC = Actual Cost

NRV = Net Realizable Value  
 O = Other

### General Composition of Operating Materials and Supplies

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

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

Note Reference

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



## Stockpile Materials, Net

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

**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

Not Applicable.

**Note 10. General PP&E, Net**

| As of December 31                              | 2006                                    |                 |                      |  |                     | 2005                       |  |
|--|---|-----------------|----------------------|--|---------------------|----------------------------|--|
|  | Depreciation/<br>Amortization<br>Method | Service<br>Life | Acquisition<br>Value | (Accumulated<br>Depreciation/<br>Amortization) | Net Book<br>Value   | Prior FY Net<br>Book Value |  |
| <b>1. Major Asset Classes</b>                  |   |                 |                      |  |                     |                            |  |
| A. Land  | N/A                                     | N/A             | \$ 0.00              | N/A  | \$ 0.00             | \$ 0.00                    |  |
| B. Buildings,<br>Structures, and<br>Facilities | S/L                                     | 20 Or 40        | 875,127,046.46       | \$ (575,573,522.56)                            | 299,553,523.90      | 246,083,919.82             |  |
| C. Leasehold<br>Improvements                   | S/L                                     | lease term      | 0.00                 | 0.00   | 0.00                | 0.00                       |  |
| D. Software                                    | S/L                                     | 2-5 Or 10       | 1,031,354,207.62     | (694,006,561.81)                               | 337,347,645.81      | 368,302,984.17             |  |
| E. General<br>Equipment                        | S/L                                     | 5 or 10         | 2,054,935,540.08     | (1,545,086,589.15)                             | 509,848,950.93      | 539,839,465.93             |  |
| F. Military Equipment                          | S/L                                     | Various         | 0.00                 | 0.00   | 0.00                | 0.00                       |  |
| G. Assets Under<br>Capital Lease               | S/L                                     | lease term      | 0.00                 | 0.00   | 0.00                | 0.00                       |  |
| H. Construction-in-<br>Progress                | N/A                                     | N/A             | 40,393,553.10        | N/A  | 40,393,553.10       | 29,015,214.83              |  |
| I. Other                                       |   |                 | 0.00                 | 0.00   | 0.00                | 0.00                       |  |
| J. Total General<br>PP&E                       |   |                 | \$ 4,001,810,347.26  | \$ (2,814,666,673.52)                          | \$ 1,187,143,673.74 | \$ 1,183,241,584.75        |  |

<sup>1</sup> Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

**Information Related to General PP&E, Net**

Real property reported by the Automated Civil Engineering System (ACES) and personal property reported by the Air Force Equipment Management System (AFEMS) and the Information Processing Management System (IPMS) has not been validated and reconciled to reported figures received by Defense Finance and Accounting Service (DFAS) from the field activities. However, the Depot Maintenance Air Logistic Centers (ALC) and Aerospace Maintenance and Regeneration Center (AMARC) use the ACES to capture the costs of real property based on preponderance of use for each building. They use the straight-line method for recording depreciation maintained on spreadsheets in place of the ACES schedule. The accounting entries are recorded directly into the field-level trial balances.

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

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

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

Note Reference

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

|                                   |
|-----------------------------------|
| <b>Assets Under Capital Lease</b> |
|-----------------------------------|

| As of December 31                                      | 2006    |    | 2005 |
|--|---------|----|------|
| <b>1. Entity as Lessee, Assets Under Capital Lease</b> |         |    |      |
| A. Land and Buildings                                  | \$ 0.00 | \$ | 0.00 |
| B. Equipment   | 0.00    |    | 0.00 |
| C. Other   | 0.00    |    | 0.00 |
| D. Accumulated Amortization                            | 0.00    |    | 0.00 |
| E. Total Capital Leases                                | \$ 0.00 | \$ | 0.00 |

Not Applicable.

|                 |   |
|-----------------|---|
| <b>Note 11.</b> | <b>Liabilities Not Covered by Budgetary Resources</b> |
|-----------------|---|

| As of December 31  | 2006                       | 2005                       |
|--|----------------------------|----------------------------|
| <b>1. Intragovernmental Liabilities</b>  |                            |                            |
| A. Accounts Payable  | \$ 0.00                    | \$ 0.00                    |
| B. Debt  | 0.00                       | 0.00                       |
| C. Other   | 0.00                       | 0.00                       |
| <b>D. Total Intragovernmental Liabilities</b>  | <b>\$ 0.00</b>             | <b>\$ 0.00</b>             |
| <b>2. Nonfederal Liabilities</b>   |                            |                            |
| A. Accounts Payable  | \$ 0.00                    | \$ 0.00                    |
| B. Military Retirement Benefits and<br>Other Employment-Related<br>Actuarial Liabilities | 233,713,461.91             | 238,729,115.79             |
| C. Environmental Liabilities   | 0.00                       | 0.00                       |
| D. Loan Guarantee Liability  | 0.00                       | 0.00                       |
| E. Other Liabilities   | 0.00                       | 0.00                       |
| <b>F. Total Nonfederal Liabilities</b>   | <b>\$ 233,713,461.91</b>   | <b>\$ 238,729,115.79</b>   |
| <b>3. Total Liabilities Not Covered by Budgetary Resources</b>                           | <b>\$ 233,713,461.91</b>   | <b>\$ 238,729,115.79</b>   |
| <b>4. Total Liabilities Covered by Budgetary Resources</b>                               | <b>\$ 2,182,051,967.08</b> | <b>\$ 2,382,767,885.39</b> |
| <b>5. Total Liabilities</b>  | <b>\$ 2,415,765,428.99</b> | <b>\$ 2,621,497,001.18</b> |

Definitions

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

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

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

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

Note Reference

For additional line item discussion, see:

Note 8, Direct Loans and/or Loan Guarantee Programs

Note 12, Accounts Payable

Note 13, Liabilities Not Covered and Covered by Budgetary Resources

Note 14, Environmental Restoration Liabilities and Environmental Disposal Liabilities

Note 15, Other Liabilities

Note 16, Commitments and Contingencies

Note 17, Military Retirement Benefits and Other Employment Related

|                 |                         |
|-----------------|-------------------------|
| <b>Note 12.</b> | <b>Accounts Payable</b> |
|-----------------|-------------------------|

| As of December 31                      | 2006                     |  |                          | 2005                     |
|--|--------------------------|--|--------------------------|--------------------------|
|  | Accounts Payable         | Interest, Penalties,<br>and Administrative<br>Fees | Total                    | Total                    |
| 1. Intragovernmental Payables          | \$ 98,745,910.22         | \$ N/A   | \$ 98,745,910.22         | \$ 188,547,564.15        |
| 2. Nonfederal Payables (to the Public) | 650,592,591.80           | 0.00   | 650,592,591.80           | 454,305,854.46           |
| <b>3. Total</b>                        | <b>\$ 749,338,502.02</b> | <b>\$ 0.00</b>                                     | <b>\$ 749,338,502.02</b> | <b>\$ 642,853,418.61</b> |

Definition

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

Fluctuations and Abnormalities

Intragovernmental payables decreased by \$89.8 million (48 percent). The primary cause was a decrease of \$76.5 million in the Supply Management Activity Group (SMAG). The decrease was caused by three events related to payables to Defense Logistics Agency (DLA). The first event is a result of payables DLA being aggressively worked in FY 2005 by Air Force and DLA to get DLA bills reconciled. The second event was decrease in over-ocean transportation costs with DLA as a result of a decrease in operations with Iraqi Freedom. The third event is a decrease in inventory storage costs with DLA.

Non-Federal payables increased \$196.3 million (43 percent). Two identifiable events caused an increase of \$212.7 million, offset by various immaterial decreases of \$16.4 million. SMAG had an increase of \$130.8 million as a result of disconnects between the Contract Procurement Accounting System (CPAS) and the General Accounting and Finance System (GAFS). Further research is required to identify the cause of these differences. The Depot Maintenance Activity Group (DMAG) had an increase of \$81.9 million as a result of a reclassification of FY 2006 payables from federal to non-federal for trading partner data to match seller data. The reclassification was due to DMAG's inability to segregate between federal and non-federal at a general ledger account level. A system fix is to be implemented in the summer of 2006. This problem was not visible in FY 2005 due to a large backlog of SMAG accounts receivable which were eliminated against DMAG payables. It appears that the entire backlog may

not have been accrued as payables for DMAG in FY 2005, thus understating public payables.

### Undistributed Disbursements

Undistributed disbursements consist of the difference between (1) disbursements/collections recorded at the transaction level to a specific obligation, payable, or receivable in the activity field records, and (2) those disbursements/collections reported by the U.S. Treasury via the reconciled DD1329 and DD1400. The total undistributed disbursement amounts displayed in this note should agree with the undistributed amounts reported on accounting reports (SF 133/(M) 1002/(M) 1307). In-transit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to each entity's outstanding accounts payable balance at year-end. Accounts payable were adjusted downward in the amount of \$298.9 million for these payments.

### Allocation of Undistributed Disbursements

The Department of Defense (DoD) policy is to allocate supported undistributed disbursements between intragovernmental and non-federal categories based on the percentage of intragovernmental and non-federal accounts payable. Unsupported undistributed disbursements should be recorded in U.S. Standard General Ledger account (USSGLA) 2120, Disbursements in Transit. The AFWCF followed this allocation policy reporting \$184.4 million in USSGLA 2120.

### Intragovernmental Eliminations

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

The DoD intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliations cannot be accomplished with the existing or foreseeable resources.



Note Reference

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

|                 |             |
|-----------------|-------------|
| <b>Note 13.</b> | <b>Debt</b> |
|-----------------|-------------|

| As of December 31                         | 2006              |                |                | 2005           |                |
|---|-------------------|----------------|----------------|----------------|----------------|
|   | Beginning Balance | Net Borrowing  | Ending Balance | Net Borrowing  | Ending Balance |
| <b>1. Agency Debt (Intragovernmental)</b> |                   |                |                |                |                |
| 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        |
| <b>2. Total Debt</b>                      | <b>\$ 0.00</b>    | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> |

Not Applicable.

|                 |   |
|-----------------|---|
| <b>Note 14.</b> | <b>Environmental Liabilities and Disposal Liabilities</b> |
|-----------------|---|

| As of December 31  | 2006              |                      |                | 2005           |
|--|-------------------|----------------------|----------------|----------------|
|  | Current Liability | Noncurrent Liability | Total          | Total          |
| <b>1. Environmental Liabilities--</b>                        |                   |                      |                |                |
| <b>Nonfederal</b>  |                   |                      |                |                |
| A. Accrued Environmental Restoration (DERP funded) Costs:    |                   |                      |                |                |
| 1. Active Installations-- Environmental Restoration (ER)     | \$ 0.00           | \$ 0.00              | \$ 0.00        | \$ 0.00        |
| 2. Active Installations--ER for Closed Ranges                | 0.00              | 0.00                 | 0.00           | 0.00           |
| 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              | 0.00                 | 0.00           | 0.00           |
| 2. Active Installations-- Environmental Closure Requirements | 0.00              | 0.00                 | 0.00           | 0.00           |
| 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)       | 0.00              | 0.00                 | 0.00           | 0.00           |
| 2. BRAC Installations--ER for Transferring Ranges            | 0.00              | 0.00                 | 0.00           | 0.00           |
| 3. BRAC Installations-- Environmental Corrective Action      | 0.00              | 0.00                 | 0.00           | 0.00           |
| 4. Other   | 0.00              | 0.00                 | 0.00           | 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           |
| <b>2. Total Environmental Liabilities</b>                    | <b>\$ 0.00</b>    | <b>\$ 0.00</b>       | <b>\$ 0.00</b> | <b>\$ 0.00</b> |

Not Applicable.

|                 |                          |
|-----------------|--------------------------|
| <b>Note 15.</b> | <b>Other Liabilities</b> |
|-----------------|--------------------------|

| As of December 31                                   | 2006                       |                      |                            | 2005                       |
|---|----------------------------|----------------------|----------------------------|----------------------------|
|   | Current Liability          | Noncurrent Liability | Total                      | Total                      |
| <b>1. Intragovernmental</b>                         |                            |                      |                            |                            |
| A. Advances from Others                             | \$ 155,018,712.70          | \$ 0.00              | \$ 155,018,712.70          | \$ 241,365,409.61          |
| B. Deposit Funds and Suspend Account Liabilities    | 0.00                       | 0.00                 | 0.00                       | 0.00                       |
| C. Disbursing Officer Cash                          | 0.00                       | 0.00                 | 0.00                       | 0.00                       |
| D. Judgment Fund Liabilities                        | 0.00                       | 0.00                 | 0.00                       | 0.00                       |
| E. FECA Reimbursement to the Department of Labor    | 0.00                       | 0.00                 | 0.00                       | 0.00                       |
| F. Other Liabilities                                | 4,941,238.24               | 0.00                 | 4,941,238.24               | 14,704,762.11              |
| <b>G. Total Intragovernmental Other Liabilities</b> | <b>\$ 159,959,950.94</b>   | <b>\$ 0.00</b>       | <b>\$ 159,959,950.94</b>   | <b>\$ 256,070,171.72</b>   |
| <b>2. Nonfederal</b>                                |                            |                      |                            |                            |
| A. Accrued Funded Payroll and Benefits              | \$ 84,350,411.36           | \$ 0.00              | \$ 84,350,411.36           | \$ 95,600,810.86           |
| B. Advances from Others                             | 7,881,586.46               | 0.00                 | 7,881,586.46               | 18,354,805.85              |
| C. Deferred Credits                                 | 0.00                       | 0.00                 | 0.00                       | 0.00                       |
| D. Deposit Funds and Suspend Accounts               | 54,760,242.28              | 0.00                 | 54,760,242.28              | 15,578,059.59              |
| E. Temporary Early Retirement Authority             | 0.00                       | 0.00                 | 0.00                       | 0.00                       |
| 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                       | 0.00                       |
| (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                    | 0.00                       | 0.00                 | 0.00                       | 0.00                       |
| H. Capital Lease Liability                          | 0.00                       | 0.00                 | 0.00                       | 0.00                       |
| I. Other Liabilities                                | 1,125,761,274.02           | 0.00                 | 1,125,761,274.02           | 1,354,310,618.76           |
| <b>J. Total Nonfederal Other Liabilities</b>        | <b>\$ 1,272,753,514.12</b> | <b>\$ 0.00</b>       | <b>\$ 1,272,753,514.12</b> | <b>\$ 1,483,844,295.06</b> |
| <b>3. Total Other Liabilities</b>                   | <b>\$ 1,432,713,465.06</b> | <b>\$ 0.00</b>       | <b>\$ 1,432,713,465.06</b> | <b>\$ 1,739,914,466.78</b> |

## Fluctuations and Abnormalities

Line 1.A – The Intragovernmental advances from others decreased \$86.3 million (36 percent) due to the decrease in the Depot Maintenance Activity Group (DMAG) Contract progress billings. Contract DMAG is phasing out of the Working Capital Fund (WCF).

Line 1.F – The Intragovernmental other liabilities decrease of \$9.7 million (66 percent) represents employee benefits that are payable to the Office of Personnel Management (OPM). Liabilities fluctuate based on staffing levels and participation in benefit programs by employees. The amounts in this account are calculated for the WCF by OPM and provided by a data call. This year the employee benefits decreased because fewer accrued days were used in the FY 2006 calculation done by OPM than in FY 2005.

Line 2.A – The decrease of accrued funded payroll and benefits of \$11.2 million (12 percent) was due to four events. The first event, an increase of \$9.7 million, was caused by decrease given in Line 1.F above. The second event, a decrease of \$15.0 million, was caused by an erroneous journal voucher processed in FY 2005 that overstated the accrued funded payroll and benefits account. The amount in FY 2006 reflects normal activity. The third event, a decrease of \$1.8 million, was caused by the removal of the Information System Activity Group (ISAG) as a WCF, which resulted in a decrease of payroll costs. The fourth event, a decrease of \$2.6 million, was caused by an incorrect abnormal balance for the Supply Management Activity Group (SMAG) in FY 2006. A reconciliation was not performed resulting in an abnormal balance amount being recorded in the general ledger account. If the reconciliation had been performed the amount would have been a normal balance and a variance would not have resulted.

Line 2.B – The decrease of advances from others of \$10.5 million (57 percent) was in the DMAG business area. This decrease is largely due to the resolution of the problem with the billing of public workload that resulted in FY04 with the implementation of the Defense Industrial Fund Financial Management System (DIFMS). DIFMS was not designed to bill private party billings at a fixed price, thus resulting in an increase in the advances account throughout all of FY 2004. A release was installed to correct the report during the first quarter of FY 2005 and current private party bills can now be processed. The release, however, did not provide functionality to process the older contracts and a backlog continued to exist in the account throughout the first two quarters of FY 2005. This backlog has been steadily worked off and the account is now at a normal balance.

Line 2.D – The increase of \$39.1 million (252 percent) was due to an amount of unsupported undistributed for AF component in FY 2006. In FY 2005, the amount was incorrectly classified as other liabilities.

### Information Related to Other Liabilities (Line 2.I)

| (In thousands)  | FY2006    | FY 2005   |
|---|-----------|-----------|
| Misc Liabilities  | 308       | 0         |
| DMAG – WIP Accrued Expenses                                     | 1,095,036 | 1,274,876 |
| SMAG – Future Purchase - Foreign Military Sales                 | 28,377    | 29,049    |
| SMAG – Other Accrued Liabilities                                | 2,040     | 14,835    |
| Component – Reclass of Abnormal Non-Federal Accounts Receivable | 0         | 35,551    |
|   |           |           |
| Total   | 1,125,761 | 1,354,311 |

Line 2.I – The decrease of \$228.5 million (17 percent) in Other Liabilities is as follows:

DMAG work in process accrued expenses has a decrease of \$179.8 million. The decrease is a result of the removal Contract DMAG from the Working Capital Funds, which has resulted in a decline in material, labor, and overhead cost accruals.

SMAG future purchase – foreign military sales consist of money that various countries have deposited with the SMAG as a buy-in on future purchases they plan to make under the foreign military sales program. These funds are considered a liability as the funds are returned if the countries do not make future purchases. Revenue is not recognized on these transactions until the purchase takes place. The decrease of \$672.0 thousand in this account is caused by some foreign governments canceling agreements.

SMAG – Other Accrued Liabilities had a decrease of \$12.8 million which is primarily due to the cleanup of invalid transactions reported in liability accounts.

Component other liability decreased \$35.6 million as this amount represented unsupported undistributed collections which are now reported on Line 2.D.

#### 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.

## Capital Lease Liability

| As of December 31  | 2006               |           |         |         | 2005    |         |
|--|--------------------|-----------|---------|---------|---------|---------|
|  | Asset Category     |           |         |         |         |         |
|  | Land and Buildings | Equipment | Other   | Total   | Total   |         |
| <b>1. Future Payments Due</b>  |                    |           |         |         |         |         |
| A. 2006  | \$ 0.00            | \$ 0.00   | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| B. 2007  | 0.00               | 0.00      | 0.00    | 0.00    | 0.00    | 0.00    |
| C. 2008  | 0.00               | 0.00      | 0.00    | 0.00    | 0.00    | 0.00    |
| D. 2009  | 0.00               | 0.00      | 0.00    | 0.00    | 0.00    | 0.00    |
| E. 2010  | 0.00               | 0.00      | 0.00    | 0.00    | 0.00    | 0.00    |
| F. After 5 Years   | 0.00               | 0.00      | 0.00    | 0.00    | 0.00    | 0.00    |
| G. Total Future Lease Payments Due                                     | \$ 0.00            | \$ 0.00   | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| H. Less: Imputed Interest Executory Costs                              | 0.00               | 0.00      | 0.00    | 0.00    | 0.00    | 0.00    |
| I. Net Capital Lease Liability   | \$ 0.00            | \$ 0.00   | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| <b>2. Capital Lease Liabilities Covered by Budgetary Resources</b>     |                    |           |         | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| <b>3. Capital Lease Liabilities Not Covered by Budgetary Resources</b> |                    |           |         | \$ 0.00 | \$ 0.00 | \$ 0.00 |

|                 |                                      |
|-----------------|--------------------------------------|
| <b>Note 16.</b> | <b>Commitments and Contingencies</b> |
|-----------------|--------------------------------------|

Not Applicable.



|                 |  |
|-----------------|--|
| <b>Note 17.</b> | <b>Military Retirement Benefits and Other Employment Related Actuarial Liabilities</b> |
|-----------------|--|

| As of December 31  | 2006  |                                   |   | 2005                         |                                 |
|--|---|-----------------------------------|---|------------------------------|---------------------------------|
|  | Actuarial Present Value of<br>Projected Plan Benefits | Assume<br>Interest<br>Rate<br>(%) | (Less: Assets Available to<br>Pay Benefits) | Unfunded Actuarial Liability | Unfunded Actuarial<br>Liability |
| <b>1. Pension and Health Benefits</b>  |   |                                   |   |                              |                                 |
| 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                         |
| <b>2. Other</b>  |   |                                   |   |                              |                                 |
| A. FECA  | \$ 233,713,461.91                                     |                                   | \$ 0.00                                     | \$ 233,713,461.91            | \$ 238,729,115.79               |
| 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   | \$ 233,713,461.91                                     |                                   | \$ 0.00                                     | \$ 233,713,461.91            | \$ 238,729,115.79               |
| <b>3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:</b> | <b>\$ 233,713,461.91</b>                              |                                   | <b>\$ 0.00</b>                              | <b>\$ 233,713,461.91</b>     | <b>\$ 238,729,115.79</b>        |

Actuarial Cost Method Used:

Assumptions:

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

Military Retirements Pensions

Not applicable

Military Retirement Health Benefits

Not applicable

Federal Employees Compensation Act (FECA)

The Air Force Working Capital Fund's (AFWCF) actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the AFWCF at the end of each fiscal year. The FECA is not related to and should not be misinterpreted to represent the Federal Unemployment Compensation Act. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the Office of Management and Budget's (OMB's) economic assumptions for 10-year U.S. Treasury notes and bonds. Cost-of-living adjustments and medical inflation factors are also applied to the calculation of projected future benefits.

The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the OMB's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

| <u>2001</u>     | <u>2002</u>     | <u>2003</u>     | <u>2004</u>      | <u>2005</u>      |
|-----------------|-----------------|-----------------|------------------|------------------|
| 5.21% in year 1 | 5.20% in year 1 | 3.84% in year 1 | 4.883% in year 1 | 4.528% in year 1 |
| 5.21% in year 2 | 5.20% in year 2 | 4.35% in year 2 | 5.235% in year 2 | 5.020% in year 2 |
| And thereafter  | And thereafter  | And thereafter  | And thereafter   | 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 charge back years (CBY) were as follows:

| <b>CBY</b> | <b>COLA</b> | <b>CPIM</b> |
|------------|-------------|-------------|
| 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 ensure that the estimates were reliable. The analysis was based on two tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments, and (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year calculated for the current projection to the liability-payment ratio calculated for the prior projection.

#### Note Reference

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

|                 |   |
|-----------------|---|
| <b>Note 18.</b> | <b>General Disclosures Related to the Statement of Net Cost</b> |
|-----------------|---|

| Intragovernmental Costs and Exchange Revenue |      |      |
|--|------|------|
| As of December 31                            | 2006 | 2005 |

| As of December 31                   | 2006                         | 2005                         |
|-------------------------------------|------------------------------|------------------------------|
| 1. Intragovernmental Costs          | \$ 1,142,874,562.21          | \$ 1,196,156,294.17          |
| 2. Public Costs                     | 1,178,335,757.38             | 2,061,500,727.57             |
| <b>3. Total Costs</b>               | <b>\$ 2,321,210,319.59</b>   | <b>\$ 3,257,657,021.74</b>   |
| 4. Intragovernmental Earned Revenue | \$ (2,424,653,362.37)        | \$ (2,480,643,523.41)        |
| 5. Public Earned Revenue            | (828,712,629.13)             | (394,746,497.79)             |
| <b>6. Total Earned Revenue</b>      | <b>\$ (3,253,365,991.50)</b> | <b>\$ (2,875,390,021.20)</b> |
| <b>7. Net Cost of Operations</b>    | <b>\$ (932,155,671.91)</b>   | <b>\$ 382,267,000.54</b>     |

General Disclosures related to Statement of Net Cost

Fluctuations and Abnormalities

Gross Costs

Gross Costs had a decrease of \$936.4 million (29 percent). The majority of the decrease was in Public Costs, which had a decrease of \$883 million. The primary cause of this decrease was due to inventory valuation transactions which required a loss to be recorded in FY 2005 of \$870.5 million. The inventory valuation transactions in FY 2006 resulted in net gains, therefore the transactions are included with revenues.

Earned Revenue

Earned Revenue had an increase of \$377.9 million (14 percent). Public Earned revenue had an increase of \$434.0 million. Two offsetting events caused the increase. The first event of a decrease of \$295.5 million was due to errors in classifying intragovernmental and public revenues for the Depot Maintenance Activity Group (DMAG) in the 1<sup>st</sup> Qtr of FY 2005. During that period, new revenue accounts were added to the DMAG accounting system which record government and public transactions in the same general ledger account. As a result, the public revenues had an increase of \$295.5 million in FY 2005. In the 2<sup>nd</sup> Qtr FY 2005 a process was developed to manually compile the government and public values in these accounts and journal vouchers were processed so that revenues are properly reflected. The second event was due to the inventory valuation transactions. In FY 2006, adjustments resulted in gains totaling \$708.1 million, which are reflected in revenue.

## Information Related to the Statement of Net Cost (SoNC)

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

### Working Capital Funds

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

|                 |  |
|-----------------|--|
| <b>Note 19.</b> | <b>Disclosures Related to the Statement of Changes in Net Position</b> |
|-----------------|--|

| As of December 31  | 2006                                |                              | 2005                                |                              |
|--|-------------------------------------|------------------------------|-------------------------------------|------------------------------|
|  | Cumulative Results<br>of Operations | Unexpended<br>Appropriations | Cumulative Results<br>of Operations | Unexpended<br>Appropriations |
| <b>1. Prior Period Adjustments</b>                             |                                     |                              |                                     |                              |
| <b>Increases (Decreases) to Net Position Beginning Balance</b> |                                     |                              |                                     |                              |
| 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                         |
| <b>C. Total Prior Period Adjustments</b>                       | <b>\$ 0.00</b>                      | <b>\$ 0.00</b>               | <b>\$ 0.00</b>                      | <b>\$ 0.00</b>               |
| <b>2. Imputed Financing</b>                                    |                                     |                              |                                     |                              |
| A. Civilian CSRS/FERS Retirement                               | \$ 12,918,497.95                    | \$ 0.00                      | \$ 14,497,177.29                    | \$ 0.00                      |
| B. Civilian Health   | 26,202,358.00                       | 0.00                         | 26,007,382.50                       | 0.00                         |
| C. Civilian Life Insurance                                     | 59,194.25                           | 0.00                         | 60,922.33                           | 0.00                         |
| D. Judgment Fund   | 0.00                                | 0.00                         | 0.00                                | 0.00                         |
| E. IntraEntity   | 0.00                                | 0.00                         | 0.00                                | 0.00                         |
| <b>F. Total Imputed Financing</b>                              | <b>\$ 39,180,050.20</b>             | <b>\$ 0.00</b>               | <b>\$ 40,565,482.12</b>             | <b>\$ 0.00</b>               |

Information Related to the Statement of Changes in Net Position

Imputed Financing

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

|                 |  |
|-----------------|--|
| <b>Note 20.</b> | <b>Disclosures Related to the Statement of Budgetary Resources</b> |
|-----------------|--|

| As of December 31  | 2006                | 2005                |
|--|---------------------|---------------------|
| 1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period | \$ 6,914,827,965.40 | \$ 7,256,533,494.09 |
| 2. Available Borrowing and Contract Authority at the End of the Period                         | 11,853,261,513.39   | 14,138,788,316.84   |

### Information Related to the Statement of Budgetary Resources

#### Intra-entity Transactions

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

#### Apportionment Categories

Office of Management and Budget Bulletin No. 01-09, section 9.27, specifically requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B, and exempt from apportionment. This disclosure should agree with the aggregate of the related information as included in each reporting entity's SF 133 and lines 8A and 8B in the SBR. There are no Category A direct or reimbursable obligations. Category B reimbursable obligations total \$3.8 billion. There are no category B direct or exempt obligations.

#### Undelivered Orders

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

#### Spending Authority from Offsetting Collections

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

|                 |  |
|-----------------|--|
| <b>Note 21.</b> | <b>Disclosures Related to the Statement of Financing</b> |
|-----------------|--|

The objective of the Statement of Financing is to reconcile the difference between budgetary obligations and the net cost of operations reported. It is presented as combined or combining statements rather than consolidated statements due to intragovernmental transactions not being eliminated. Due to limitations in the Department of the Air Force's financial system, budgetary data is not in agreement with proprietary expenses and assets capitalized. Differences between budgetary and proprietary data constitutes a previously identified deficiency.

Note 1A and Note 1F provide additional detail.

Other Information Related to the Statement of Financing

Budgetary data is not in agreement with Proprietary Expenses and Assets Capitalized. This causes a difference in Net Cost between the Statement of Net Cost (SoNC) and the Statement of Financing. Line 15 on the Statement of Financing, "Resources that finance the acquisition of assets," is adjusted in order to align the amount of net cost on the Statement of Financing with the amount reported on the (SoNC). Line 15 was adjusted by an absolute value of \$66.8 million to balance the report. The adjustment will be researched to determine the cause of the increase over prior reporting periods.

|                 |   |
|-----------------|---|
| <b>Note 22.</b> | <b>Disclosures Related to the Statement of Custodial Activity</b> |
|-----------------|---|

Not Applicable.



|                 |                        |
|-----------------|------------------------|
| <b>Note 23.</b> | <b>Earmarked Funds</b> |
|-----------------|------------------------|

|                      |  |  |  |  |
|----------------------|--|--|--|--|
| <b>BALANCE SHEET</b> |  |  |  |  |
|----------------------|--|--|--|--|

As of December 31

|                                  | MRF            | MERHCF         | Other Earmarked Funds | Total Earmarked Funds |
|----------------------------------|----------------|----------------|-----------------------|-----------------------|
| <b>ASSETS</b>                    |                |                |                       |                       |
| Fund balance with Treasury       | \$ 0.00        | \$ 0.00        | \$ 0.00               | \$ 0.00               |
| Investments                      | 0.00           | 0.00           | 0.00                  | 0.00                  |
| Accounts and Interest Receivable | 0.00           | 0.00           | 0.00                  | 0.00                  |
| Other Assets                     | 0.00           | 0.00           | 0.00                  | 0.00                  |
| <b>Total Assets</b>              | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b>        | <b>\$ 0.00</b>        |

|                                     |  |  |  |  |
|-------------------------------------|--|--|--|--|
| <b>LIABILITIES and NET POSITION</b> |  |  |  |  |
|-------------------------------------|--|--|--|--|

|   |                |                |                |                |
|---|----------------|----------------|----------------|----------------|
| Military Retirement Benefits and Other Employment Related Actuarial Liabilities | \$ 0.00        | \$ 0.00        | \$ 0.00        | \$ 0.00        |
| Other Liabilities   | 0.00           | 0.00           | 0.00           | 0.00           |
| Unexpended Appropriations   | 0.00           | 0.00           | 0.00           | 0.00           |
| Cumulative Results of Operations  | 0.00           | 0.00           | 0.00           | 0.00           |
| <b>Total Liabilities and Net Position</b>                                       | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> |

|                              |  |  |  |  |
|------------------------------|--|--|--|--|
| <b>STATEMENT OF NET COST</b> |  |  |  |  |
|------------------------------|--|--|--|--|

As of December 31

|   |                |                |                |                |
|---|----------------|----------------|----------------|----------------|
| Program Costs                                     | \$ 0.00        | \$ 0.00        | \$ 0.00        | \$ 0.00        |
| Less Earned Revenue                               | 0.00           | 0.00           | 0.00           | 0.00           |
| <b>Net Program Costs</b>                          | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> |
| Less Earned Revenues Not Attributable to Programs | 0.00           | 0.00           | 0.00           | 0.00           |
| <b>Net Cost of Operations</b>                     | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> |

|   |  |  |  |  |
|---|--|--|--|--|
| <b>STATEMENT OF CHANGES IN NET POSITION</b> |  |  |  |  |
|---|--|--|--|--|

As of December 31

|                                      |                |                |                |                |
|--------------------------------------|----------------|----------------|----------------|----------------|
| Net Position Beginning of the Period | \$ 0.00        | \$ 0.00        | \$ 0.00        | \$ 0.00        |
| Net Cost of Operations               | 0.00           | 0.00           | 0.00           | 0.00           |
| Other Nonexchange Revenue            | 0.00           | 0.00           | 0.00           | 0.00           |
| <b>Change in Net Position</b>        | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> |
| <b>Net Position End of Period</b>    | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> | <b>\$ 0.00</b> |

|                 |                          |
|-----------------|--------------------------|
| <b>Note 24.</b> | <b>Other Disclosures</b> |
|-----------------|--------------------------|

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

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

Future Payments Due  
Fiscal Year

|               |    |      |    |      |    |      |    |      |
|---------------|----|------|----|------|----|------|----|------|
| 2006          | \$ | 0.00 | \$ | 0.00 | \$ | 0.00 | \$ | 0.00 |
| 2007          |    | 0.00 |    | 0.00 |    | 0.00 |    | 0.00 |
| 2008          |    | 0.00 |    | 0.00 |    | 0.00 |    | 0.00 |
| 2009          |    | 0.00 |    | 0.00 |    | 0.00 |    | 0.00 |
| 2010          |    | 0.00 |    | 0.00 |    | 0.00 |    | 0.00 |
| After 5 Years |    | 0.00 |    | 0.00 |    | 0.00 |    | 0.00 |

**Total Future Lease  
Payments Due**

|  |    |      |    |      |    |      |    |      |
|--|----|------|----|------|----|------|----|------|
|  | \$ | 0.00 | \$ | 0.00 | \$ | 0.00 | \$ | 0.00 |
|--|----|------|----|------|----|------|----|------|

Not applicable.