United States Air Force
Annual Financial Statement
2006

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Financing the Fight

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SECRETARY OF THE AIR FORCE
WASHINGTON DC

November 2006

Message from the
Secretary of the Air Force

I am proud to report that in Fiscal Year 2006 the Airmen of the United States Air Force responded with distinction to the many challenges our nation faced. Whether in the Global War on Terrorism, in defending our homeland, in humanitarian and peacekeeping operations, or in ensuring the readiness of the world's greatest air, space, and cyberspace power, our nation's Airmen performed magnificently.

Our financial management team remains a key enabler of these Air Force efforts. As proud stewards of the country's resources, they are confidently entrusted with our Air Force finances. Those resources allow us to accomplish our mission - to deliver sovereign options for the defense of the United States of America and its global interests - to fly and fight in air, space and cyberspace.

Through Air Force Smart Operations for the Twenty-First Century, we have focused our efforts to more efficiently accomplish our mission, support our people, and modernize our force.

Our expeditionary fighting forces, centered on the Air and Space Expeditionary Force, provide the foundation for our operations. We continue to closely align the active duty Air Force, Air National Guard, and Air Force Reserve with Total Force initiatives to enhance our overall capability, and as recent developments illustrate, we are fully engaged as a Total Force in the Global War on Terrorism.

We have also remained focused on caring for and developing our Airmen - our most valuable resource. They face tremendous challenges, and in FY2006 we continued seeking ways to maintain and improve their training as well as personal and professional development.

Modernizing our aircraft inventory, which is the oldest in Air Force history, will allow our Service to maintain its technological advantage and build a portfolio of military capabilities needed to deliver sovereign options to the nation.

Our financial management team is also focused on transforming to deliver improved service, better information reliability, integration and visibility in our financial management processes. These financial statements illustrate the success of the Air Force over the past year, as well as specific financial management accomplishments. The publication of our financial statements complies with the requirement set out in the Chief Financial Officers Act, and this financial information addresses both our General Fund and Working Capital Fund activities.

The service of our financial managers remains nothing short of outstanding – "Financing the fight," while providing stellar contributions to America's air, space and cyberspace capability.

Michael W. Wynne

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

November 2006

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

I share the confidence and pride expressed by the Air Force Secretary in our financial management professionals. In Fiscal Year 2006, we continued our support to ongoing Global War on Terrorism operations throughout the world, responded to natural disasters, and continued to improve our financial processes, systems and personnel.

The FY2006 Air Force Financial Statement reflects the wise investment America has made in its Air Force. It includes a Management Discussion and Analysis section that more precisely illuminates Air Force efforts and contributions. It fulfills the requirements of the Chief Financial Officers Act, documents the expenditures devoted to our General Fund and Working Capital Fund, and reviews performance measures established as part of the Government Performance and Results Act.

Financial management plays a key role in fulfilling the Air Force mission, improving that support and conforming to the law is at the center of the Air Force financial management transformation. Our Financial Management Vision is to:

- Become a partner in strategic Air Force decisions.
- Recruit, prepare and retain a well-trained and highly educated provisional team for today and tomorrow.
- Make processes efficient and effective to produce accurate and relevant financial information.
- Reduce our cost structure by employing leading-edge technologies that continuously streamline financial management processes and increase capabilities.
- Provide our customers with world-class financial services.

Our financial management team members are accomplishing these goals while stressing accountability, visibility and the highest-quality management skills available anywhere. This remains our top priority.

We continue to make progress toward achieving financial information integrity. This year we begin validating individual lines on our financial statement. One of the critical steps in this effort will be to thoroughly evaluate the information comprising our Fund Balance with Treasury and our Cash and Other Monetary Assets entries as major steps toward a complete and accurate presentation of our financial information.

We will never forget that we are financing the world's finest air and space power and that we have the obligation to be good stewards of the resources entrusted to us. Air Force financial management professionals have met that obligation, and will continue to do so, as we proudly preserve–your strategic partners ...“financing the fight!”

Management Discussion and Analysis

Air Force in Action

The Air Force vision of "Lasting Heritage…Limitless Horizon" encapsulates how America's Airmen have created the world's—and history's—greatest air, space, and cyberspace power. In FY2006, this power was used around the globe to face, and prepare for, mission requirements across the full spectrum of conflict.

Our first priority is to maintain our national focus on winning the Global War on Terrorism (GWOT). In FY2006, the Air Force continues to be a part of a joint and coalition team with the Army, Navy, Marine Corps, Coast Guard, and our allies. Whether flying fighters, conducting space operations, operating unmanned aerial vehicles or maintaining vigilance over the Homeland, all of America's Airmen, no matter their specialty, contribute to this mission. They have performed tremendously, and in many cases heroically, in defending both our freedom and the freedom of others.

In defending our country, our Airmen continue countless hours of surveillance and remain on constant alert, ensuring that our airspace is protected while our people stand ready for whatever missions may come their way, including humanitarian relief and rescue operations.

To provide the foundation for these vital capabilities, the Secretary of the Air Force and the Chief of Staff of the Air Force have highlighted two additional USAF priorities. The first of these is Developing and Caring for Airmen. As the Air Force Posture Statement 2006 explains, "we must manage our force to ensure the Air Force is properly sized, shaped, and organized, to meet the global challenges of today and tomorrow." We are also undertaking innovative recruiting and retention efforts, military housing, and new management systems for personnel actions and civilian employment.

Another element of this foundation is Maintenance, Modernization, and Recapitalization of Air Force systems – essentially transforming the way we do business. In some cases, the Air Force is planning to use older aircraft with system upgrades to extend service life. Bearing in mind the Air Force is dealing with service life extensions, we are also moving to bring newer systems to the field, including the F-22A Raptor, unmanned aerial vehicles and intelligence, surveillance and reconnaissance aircraft.

In this report, you will also read how our financial management community supports Air Force missions and initiatives worldwide. All three goals – winning the GWOT, taking care of our people, and recapitalizing our force – are critical to maintaining Air Force capabilities in the service of the nation.

Looking into the future at how we will accomplish these three goals, we are taking a number of bold steps. In order to respond swiftly, flexibly and decisively to asymmetric, irregular, and emerging threats, we have embarked on a bold new initiative known as Air Force Smart Operations for the 21st Century (AFSO21). This will allow our Airmen to respond to everything from major conflicts to humanitarian relief. Our Airmen are doing this with remarkable success, despite dealing with the oldest inventory of aircraft in the storied history of both the Army Air Corps and the Air Force.

Underpinning all of this are our financial management professionals, both military and civilian. Their attention to detail, expertise, and professionalism ensures excellent Air Force stewardship of the nation's resources. They are indeed "Financing the Fight."

Air Force Organizations

The command line of the Air Force flows from the President to the Secretary of Defense and then to the Department of the Air Force. The Air Force is headed by the Secretary of the Air Force (SECAF), with the Chief of Staff reporting to the Secretary. Immediately subordinate to the departmental headquarters are the Major Air Commands, Field Operating Agencies (FOAs), Direct Reporting Units (DRUs), and the Auxiliary.

Major Command (MAJCOM)

Major Air Commands are divided primarily between two types: operational and support. Within the operational commands, the divisions are generally defined according to purpose or location (e.g., combat, movement of people and supplies, Pacific and European theaters). The support commands generally are organized according to function (e.g., logistic, support, or training) and are directly subordinate to Air Force Headquarters. The MAJCOMs are:

AIR COMBAT COMMAND (ACC)

Mission - Operate USAF bombers (active and Air National Guard and Air Force Reserve Command); USAF's CONUS-based fighter and attack, reconnaissance, battle management, and command and control aircraft and intelligence and surveillance systems. Provide combat airpower to America's warfighting commands (Central European, Northern, Pacific, and Southern).

Provide nuclear, conventional, and information operations forces to United States Strategic Command (STRATCOM). Provide air defense forces to North American Aerospace Defense Command (NORAD).

AIR EDUCATION AND TRAINING COMMAND (AETC)

Mission - Recruit, train, and educate professional, expeditionary-minded airmen to sustain the combat capability of America's Air Force. Conduct joint, readiness, and Air Force security assistance training.

AIR FORCE MATERIEL COMMAND (AFMC)

Mission - Deliver war-winning expeditionary capabilities to the warfighter through development and transition of technology, professional acquisition management, and world-class sustainment of all Air Force weapons systems.

AIR FORCE SPACE COMMAND (AFSPC)

Mission - Operate and test USAF ICBM forces for STRATCOM; missile warning radars, sensors, and satellites; national space-launch facilities and operational boosters; worldwide space surveillance radars and optical systems; worldwide space environment systems; and position, navigation, and timing systems.

AIR FORCE SPECIAL OPERATIONS COMMAND (AFSOC)

Mission - Serve as America's specialized airpower, providing combat search and rescue, and delivering special power anytime, anywhere. Also tasked with: shaping the battlefield; information operations; precision engagement;

mobility; agile combat support; aerospace interface; and recovery operations.

AIR MOBILITY COMMAND (AMC)

Mission - Provide rapid global mobility and sustainment through tactical and strategic airlift and aerial refueling for U.S. armed forces. Provide special duty and operational support aircraft and global humanitarian support.

PACIFIC AIR FORCES (PACAF)

Mission - Provide ready air and space power to promote U.S. interests in the Asia-Pacific region during peacetime, crisis, and war.

US AIR FORCES IN EUROPE (USAFE)

Mission - Provide the joint force commander rapidly deployable expeditionary aerospace forces. Plan, conduct, coordinate, and support air and space operations to achieve U.S. national and North Atlantic Treaty Organization (NATO) objectives based on U.S. European Command (EUCOM) taskings. Support U.S. military plans and operations in Europe, the Mediterranean, the Middle East, and Africa.

AIR RESERVE COMMAND (AFRC)

Mission - Support the active duty force. Serve in such missions as fighter, bomber, airlift, aerial port operations, aeromedical evacuation, aerial fire fighting, weather reconnaissance, space operations, airborne air control, flying training, flight testing, and aerial spraying. Provide support and disaster relief in the U.S., and support national counterdrug efforts.

AIR NATIONAL GUARD (ANG)

Mission - Provide combat capability to the warfighter and security for the homeland. Protect life and property and preserve peace, order, and public safety.

FIELD OPERATING AGENCY (FOA)

A FOA is a subdivision of the Air Force, directly subordinate to a Headquarters Air Force functional manager. An FOA performs field activities beyond the scope of any of the major commands. The activities are specialized or associated with an Air Force-wide mission and do not include functions performed in management headquarters, unless specifically directed by a Department of Defense (DoD) authority. Examples of the total thirty-two FOAs are the Air Force Audit Agency, Air Force Communications Agency, Air Force Cost Analysis Agency, Air Force Services Agency, and Air Force Weather Agency.

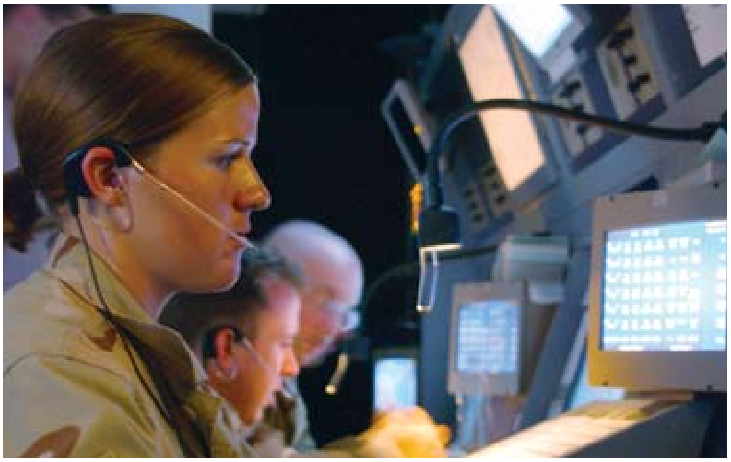
DIRECT REPORTING UNIT (DRU)

A DRU is a subdivision of the Air Force, directly subordinate to Headquarters Air Force. A DRU performs a mission that does not fit into any of the MAJCOMs. A DRU has many of the same administrative and organizational responsibilities as a MAJCOM. The five DRUs are the Air Force Academy, Air Force Studies and Analysis Agency, Air Force Doctrine Center, Air Force District of Washington, and Air Force Operational Test and Evaluation Center.

AUXILIARY

An Air Force auxiliary is an organization created by statute that the Secretary of the Air Force may use to fulfill the Air Force's noncombat programs and missions. The Civil Air Patrol (CAP) is the only U.S. Air Force auxiliary to date.

This Management Discussion and Analysis includes both the Air Force General Fund and Working



Capital Fund, descriptions of functional areas these funds support, and how they are used to further Air Force capabilities for the nation. The Air Force Financial Statement also satisfies provisions of the Chief Financial Officers (CFO) Act.

General Fund

Quality People/Force Shaping

The beginning of FY2006 saw the Air Force reach its goal of reducing manning below 360,000 in order to fall below authorized end-strength. Although the Air Force was below overall end-strength, the forces mix between officer and enlisted was unbalanced. Overage in officers resulted in the Air Force paying more in personnel costs than planned, which stretched an already thin budget.

To address these imbalances, the FY2006 Force Shaping Program involved a variety of programs to ensure the Air Force could make the required reductions while maintaining the right skills and experience mix to accomplish today's mission, as well as future missions.

The Air Force accessed approximately 31,000 enlisted personnel and 4,200 officers for FY2006. This was an increase of about 12,000 enlisted accessions and a decrease of more than 600 officer accessions over the previous year, as the Air Force worked to balance the force. It is critical to mission accomplishment to have the right person, in the right position, at the right time, which is achieved through balancing the force.

To reduce officer overages, the SECAF authorized the establishment of annual Force Shaping Boards (FSBs). The purpose of the FY2006 FSB was to reduce officer overages by identifying eligible officers for separation while, at the same time, balancing career fields and officer commissioned year-groups. Prior to establishment of the FSBs, eligible officers were offered voluntary options to transition to other forms of service, in and out of the Air Force. For example, officers could move from active duty to vacancies in the Reserve and Air National Guard under the PALACE CHASE program, and to the Army under the "Blue to Green" program. The Air Force also waived most active duty service commitments to allow personnel to separate early.

In addition to the FSB, the Air Force also provided incentives to those eligible to retire, such as reducing from three years to two years the time in grade required for colonels and lieutenant colonels to retire. A liberal separation policy was also instituted to encourage officers serving in overage skills to leave, by waiving active duty service commitments incurred for education, recent assignments, and other administrative actions. Officers (colonel and below) were also allowed to request retirement more than 12 months from their originally requested date. The FY2006 National Defense Authorization Act (NDAA) provided legislation allowing officers to retire with only 8 years of commissioned service instead of 10 years, provided they attained at least 20 years of active service. These programs allowed Airmen inclined to leave or retire to do so quickly and easily.

The Air Force also force shaped the enlisted force through the FY2006 Noncommissioned Officer Retraining Program (NCORP), which retrained 964 personnel from 30 overage Air Force Specialty Codes (AFSCs) into those with a shortage. The results equated to an overall achievement rate of 95 percent of the Air Staff's target goal – the best since the program's inception and an amazing improvement over the previous year's 69 percent achievement. The Career Job Reservation (CJR) program helped rebalance the junior enlisted force as they entered their second enlistment. All Airmen were required to obtain a CJR in one of the 146 AFSCs in order to re-enlist. In 17 AFSCs that had significant overages, CJRs were limited to the number needed to sustain the career fields at their optimal manning. Airmen from these AFSCs who did not obtain CJRs had the choice of applying to retrain into one of the shortage AFSCs or leaving the Air Force. Using this tool helped improve by 17 percent the imbalances in the 17 AFSCs where CJRs constrained the number of people entering a second enlistment.

The Air Force continues to judiciously control spending for Selective Reenlistment Bonuses (SRBs). SRBs are an additional financial incentive used to encourage enlisted Airmen in select AFSCs with between 17 months and 14 years of service to remain on active duty. The FY2006 NDAA set the maximum payment an Airman can receive for an enlistment through the SRB program to $90,000; however, the Air Force's retention rate has not demanded implementing this option. The maximum payment in the Air Force remains $60,000. SRBs are set by AFSC on a sliding scale. The average SRB payment to Airmen in FY2004 was $10,700. In FY2004, the Air Force removed 82 AFSCs from the list of those eligible for SRBs, leaving 62 AFSCs. In March 2005, that list was reduced further, leaving only 32 AFSCs with this financial incentive. This reduction saved the Air Force $102.7 million. In May 2006, the Air Force further revised the SRB List to include 37 AFSCs. Coupled with the savings/efficiencies gained from previous year's SRB reductions and the newly developed SRB modeling capabilities, the Air Force can more effectively target the SRBs to human capital capability shortages in our warfighting specialties.

Together these programs and policies helped shape the Air Force by improving imbalances between many enlisted AFSCs and retaining the right Airmen with the right skills. The Air Force will continue to devise programs to ensure the human capital is available to provide the needed mission capability.

Transforming Nonappropriated Fund (NAF) Business Operations

Air Force Services is transforming NAF business processes through Nonappropriated Funds Transformation (NAF-T), a four-phased, multi-year initiative to improve financial management capabilities and leverage technology to eliminate non-value added business processes.

Air Force Services is transforming NAF accounting and payroll processes through the continued building of a NAF Shared Services Center (SSC) in San Antonio, Texas. This follows the trend in the commercial sector where decentralized activities are moved to one location to achieve economies

of scale and increases in productivity. This initiative will have a positive impact on the management, control, and reporting of all Air Force NAF activities by streamlining the information flow and reducing operating costs in the worldwide $1.2 billion NAF operation.

Personnel Service Delivery

In remarks made on 10 September 2001, the Secretary of Defense declared war on the Pentagon's bureaucratic processes and challenged us all to "wage an all-out campaign to shift Pentagon resources from bureaucracy to the battlefield, from tail to the tooth." The Secretary went on to say: "To compete, we need to bring the Department of Defense the human resources practices that have already transformed the private sector." With that challenge, several initiatives were launched to "transform the way the Department works and what it works on."

To execute these new initiatives, the Deputy Chief of Staff for Manpower and Personnel established the Personnel Service Delivery (PSD) Transformation program in order to better serve the force. This program is a multi-year effort designed to dramatically transform the processes, organizations, and technology by which the Air Force delivers personnel services to the Total Force-Active Duty, Guard, Reserve, and civilians. The focus of the transformation is on the development and implementation of a new Service Delivery Model (SDM). This new model will improve the efficiency and quality of transaction and inquiry services through the re-engineering, centralization, and automation of processes. The SDM will also allow Personnel professionals to focus on providing an enhanced level of strategic advisory services to commanders and leaders within their respective organizations.

The PSD Transformation vision is to transform Air Force Personnel to focus on the strategic delivery of the right people, to the right place, at the right time. The end-state goal for the program is to transition the primary interface with customers, such that 85 percent of personnel transactions/inquiries are conducted through self-service (Web and interactive voice response), 10 percent through the contact center (phone, chat, email, etc.), and only 5 percent through face-to-face means. The PSD concept enabled the release of 1,500 authorizations, creating a $382.4 million savings between FY2006 and FY2010 that is being re-capitalized into the personnel transformation effort.

Operational Performance

The Air Force must retain, maintain, and operate around the world 24 hours a day, 7 days a week. This is how we accomplish air supremacy, protecting American ground commanders and troops from significant air threats. Americans fighting on the ground have not been significantly attacked by fixed-wing or rotary-wing aircraft in more than 50 years, but this is not something we can take for granted. A key part of this training and preparation is the President's Budget (PB) Air Force Flying Hour Program.

The Air Force Flying Hour Program was developed to provide training opportunities to prepare units to support their warfighting mission. Execution of the FY2005 PB Flying Hour Program was 100.5 percent. As of 31 August 2006, execution was 97.1 percent, and is projected to exceed the PB for the full year. Flying Hour Program execution addresses the execution of the Active Air Force Congressionally funded O&M hours. Incrementally funded contingency support hours, Transportation Working Capital Fund hours, foreign nation reimbursable training hours, Special Operations hours, and RDT&E hours are not included.

The execution of the Flying Hour Program can be impacted by contingency operations support, maintenance issues, aircraft flight operations suspensions, aircraft delivery delays, weapons system retirements, and approved program changes. Though the execution of the Flying Hour Program does not define unit readiness, it can be a forward indicator of possible readiness issues. The MAJCOMs determine the reasons for execution deviation and required courses of action. These evaluations provide insight to possible future-year requirements.

Weapon System Performance Metrics

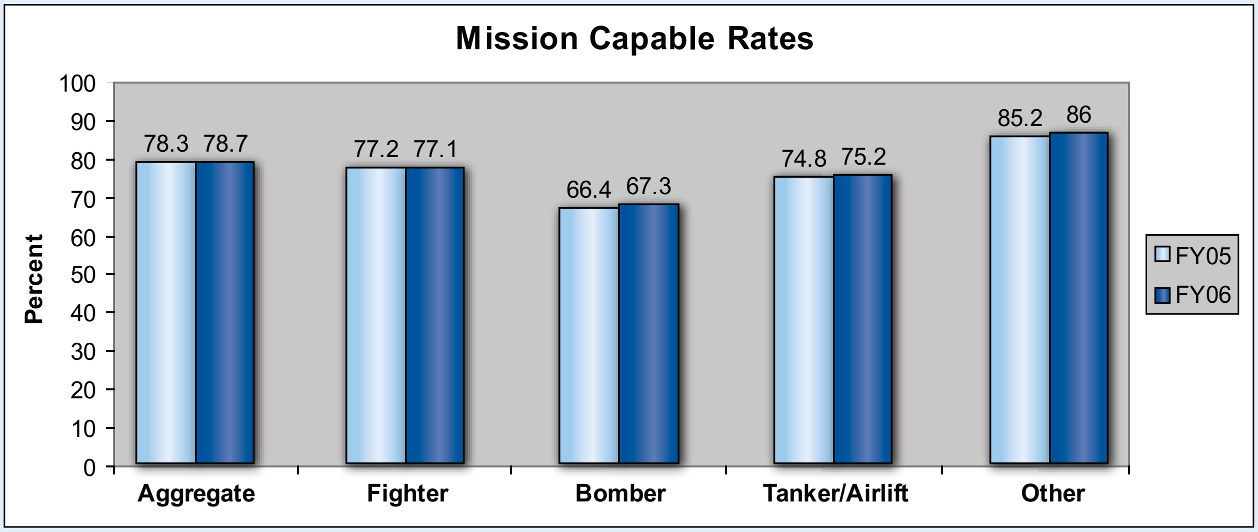
The Air Force uses a variety of metrics to gauge the performance of its weapon systems and organizations. They are the barometers for measuring the effectiveness of our organizational structures, our training, manpower and equipment levels, quality of spare parts, maintenance actions, and a variety of other indicators of our ability to provide mission-ready weapons systems to the warfighter. Chief among these performance metrics are Mission Capable rates, Non-Mission Capable rates, Cannibalization rates, and engine and supply measures.

Mission Capable Rates

Mission Capable (MC) rates are perhaps the best-known yardstick for measuring the readiness of Air Force aircraft. MC rates reflect the percentage of aircraft, by fleet, capable of performing at least one of their assigned missions. The FY2006 aggregate MC rate as of 31 July 2006 is 78.7 percent, an increase from the FY2005 rate of 78.3 percent, and is based on a combined MC rate of A/OA-10, B-1, B-2, B-52, C-130, C-141, C-5, C-17, E-3, E-8, F-15, F-15E, F-16, F-117, HC-130, KC-10, KC-135, HH-60, RC-135, RQ-1, T-1, T-6, T-37, T-38, and U-2 aircraft. MC rates categorized into Fighter, Bomber, Tanker/Airlift, and Other are drawn from the aggregate fleet above.

Non-Mission Capable Rates

Total Non-Mission Capable for Maintenance (TNMCM) rate is a measure of a maintenance organization's ability to fix aircraft quickly and accurately; Total Non-Mission Capable for Supply (TNMCS) measures spare parts availability.



Rates as of 31 July 06

The FY2006 aggregate fleet TNMCM rate, as of 31 July 2006, decreased from 18.1 percent to 17.9 percent. The FY2006 TNMCS rate as of 31 July 2006 decreased from 8.2 percent to 7.9 percent, representing the seventh consecutive year of improving supply rates, and the lowest TNMCS rate since FY1994.

Other Key Metrics

Air Force weapon system performance measures for FY2006 provide a snapshot of the tremendous efforts of the logistics community to provide and support combat-capable forces that are organized, trained and equipped to provide efficient and effective combat and combat support efforts across the full spectrum of military operations.

Cannibalization (CANN) rates reflect the number of cannibalization actions that occur per 100 sorties for a particular weapon system. The FY2006 aggregate rate of 3.6 CANNs per 100 sorties, as of 31 July 2006, is a decrease from the FY2005 rate of 4.2 and represents the lowest CANN rate since FY1994.

The Engine Non-Mission Capable-Supply (ENMCS) rate for all Air Force engines improved as the rate dropped to 3.6 percent, the lowest rate in the past eight years. Engine-time-on-wing (ETOW) rates have improved by slightly over one percent each year for Fighter, Bomber, and Tanker/Airlift fleets over the past two years. Investments in engine modifications, spare parts, and reliability-centered maintenance have continued to pay quality dividends for our engine fleet throughout FY2006.

Aircraft MC rates are but one indicator of enhanced weapon system readiness. Programmed depot maintenance and fleet modernization activities are critical to maintaining mission-ready aircraft. The Air Force strives to make continual improvements in business practices designed to increase the efficiency and effectiveness of our depot maintenance programs. As of 31 July 2006, the total number of aircraft in depot for FY2006 was 525, continuing the downward trend in depot-possessed aircraft.

Financial Management Transformation

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

Office, but retaining access to face-to-face support when needed.

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

The strategic goals outlined in the plan are:

1. Become a partner in strategic Air Force decisions.
2. Recruit, prepare, and retain a well-trained and highly educated professional team for today and tomorrow.
3. Make processes efficient and effective to produce accurate and relevant financial information complemented by sophisticated decision support.
4. Reduce our cost structure by employing leading-edge technologies that continuously streamline financial management processes and increase capabilities.
5. Provide our customers with world-class financial services.

To better achieve these goals, FM is transforming its services, systems, and people.

Services Transformation:

We will transition from primarily processing and responding to routine transactions and place more emphasis on analytical decision support activities while streamlining financial procedures.

Systems Transformation:

We will modernize systems to provide more robust capabilities that will reduce man-hours and costs of completing transactions.

People:

We will continue to develop our force through innovative training, self-study, and developmental assignments.

Transformation is our catalyst to achieving the FM vision. In 2006, through our FM operational framework, we enacted Six Lanes of Transformation:

- Financial Services Transformation will consolidate back-office travel and pay processing into a centralized Central Processing Center (CPC). The goal is to transition into a 3-tier customer service concept to include a 24x7 Call Center, online services, and face-to-face support, allowing customers to get financial help anytime, anywhere in the world. This Air Force Finance Services Center (AFFSC) will be operational in October 2008.
- Financial Advisor Transformation will provide enhanced analytical decision support and financial advice to commanders. This includes realigning resources to provide enhanced budget, cost, and accounting services to the unit. This improved trusted advisor role, referred to as the Financial Advisor, will debut in June 2007.
- Analytical Capability Transformation's vision of the Center of Expertise (CoE) is to provide expert, on-demand, specialized financial analysis support for decisions to Air Force installa-

tions and Major Commands. The types of analytic efforts that the CoE will provide include advice/analysis for resource allocation, economic analyses, business case analyses, as well as specialized analytical efforts (i.e., mission changes, support agreements, privatization, A-76, etc.).

- Combat Comptroller Transformation will determine how the 21st Century FM community prepares and deploys to support the warfighter. Deliverables include launch of a Community of Practice used to share deployment information to ensure we maintain a robust capability to meet our wartime requirements, as well as test and implement the E-44, a handheld tool used to automate processes in deployed environments.
- Education, Training, and Development Transformation created Web-based training guides to support the realignment of the budget and accounting liaison functions; developed an induction course for the CoE; and supported the other transformation lanes by providing the necessary training and ensuring FM professionals have the necessary skills to perform their duties in the transformed environment.
- Budget Operation Transformation will create a world-class enterprise in the Headquarters Air Force Budget operation by strategically allocating resources, re-engineering processes, and building continuous cultural improvements.

Transformation accomplishments in FY2006 included:

- The site selection for the AFFSC was approved and officially announced as Ellsworth AFB in South Dakota. The center will be home to shared services of more than 600 pay and travel professionals, and will service the Air Force warfighters' financial needs. It will open in October 2007.
- The accounting and budget functions were realigned at all active and reserve bases to provide one-stop shopping for all accounting, budgeting, and decision support for their customers and commanders.
- 18 April 2006 marked the grand opening of the FM Center of Expertise. At full capacity, the CoE will deliver support to installation and MAJCOM comptroller staff, and clear and unbiased analysis to installation and MAJCOM financial management customers, as well as expert training to improve analytical skills for making resource allocation decisions. The CoE will be fully operational in FY2007.
- The Combat Comptroller team has provided electronic tools and a website for one-stop shopping for all deployment needs. The Combat Comptroller Community of Practice was launched in late April 2006 and has already received more than 1,300 hits. The E-44 handheld device will be deployed in the fall of 2006 in an effort to make

financial transactions while deployed easier and more efficient.

- The Education, Training, and Development team held the First Decision Support Course in April 2006. Additionally, modern Web-based courses are being built to support the opening of the AFFSC.

Air Force Working Capital Fund Overview

Air Force Materiel Command (AFMC) supports Air Force warfighters and operations via major business areas that operate as revolving funds, i.e., providers charge users for the goods and services provided. AFMC accounts for more than 93 percent of Air Force Working Capital Fund (WCF) revenue and expense activity (excluding the Transportation WCF, which is managed by the United States Transportation Command). The AFMC-managed WCF consists of two functions: Supply Management and Depot Maintenance. These functions, referred to as activity groups, supply singular goods and services to the Air Force and Department of Defense (DoD) customers as well as customers outside the DoD (e.g., local and foreign governments). Supply Management provides managers expedited repair, replenishment, and inventory control for spare parts and associated logistics support services to fulfill Air Force needs during war and peacetime. Depot Maintenance provides economical and responsive repair, overhaul and modification of aircraft, missiles, engines, other major end items, and associated components. The Information Services business area was decapitalized beginning 1 October 2005 (FY2006) and became an appropriated activity that no longer operates under the WCF.

WCFs allow the Air Force to accomplish the following:

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

Supply Management Activity Group

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

SMAG consists of four divisions: Material Support Division (MSD), General Support Division (GSD), Medical/Dental Division, and United States Air Force Academy Cadet Issue Division. AFMC manages MSD and GSD. Headquarters United States Air Force manages the Medical/Dental

Division and Air Force Academy Cadet Issue Division.

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

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

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

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

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

Customers, Products, and Services

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

SMAG Transformation Initiatives

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

- Purchasing and Supply Chain Management (PSCM) - adapts commercial best practices to integrate purchasing and supply processes into a single, customer-centric, end-to-end process that provides the right item in the right quantity and quality, on time, and at a reasonable cost.

- Weapon System Supply Chain Management - a customer-facing proactive initiative that seeks to improve processes and leverage savings achieved by PSCM strategies, while retaining ultimate focus on specific platforms operated by thewarfighter.
- Logistics Enterprise Architecture - an initiative to develop a single authoritative strategic map of future logistics business practices, systems, and organizations. This single authoritative source defines operations and systems models, aligns business and IT initiatives, and provides a vehicle to ensure transformation coordination across the Air Force and outside the Air Force.
- Advanced Planning System - aims to improve the process of translating warfighter needs into executable logistics system support plans and schedules. By emphasizing collaboration with customers and suppliers, it seeks to optimize activities and resources across the Air Force supply chain.

Customer Support Performance Measures

Mission Capable (MICAP) and Customer Wait Time (CWT) measures allow managers to assess quality of spares support provided and plan corrective action when needed. MICAP is defined as the status of a weapon system as determined by its ability to accomplish its assigned mission. MICAP hours are accrued in a given month for items affecting mission capability that are on backorder to an AFMC source of supply. For every day during the month the requisition is unfilled, 24 hours are assigned to the requisition. CWT measures the average time elapsed between customer order and satisfaction of that order, including the wait time – expressed in days – between the retail supply issue or backorder from the source of supply and then subsequent delivery to the base customer. MICAP hours have improved significantly since 1999. MSD items accrued an average of five million monthly MICAP hours during calendar year 2000. That number dropped to 1.3 million hours for the 12-month period ending in April 2006. CWT is a newer metric but has also shown a significant improvement. The monthly average CWT during FY2004 was 7.4 days and has been six days through the first eight months of FY2006.

Financial Performance Measures

SMAG measures financial performance based on the Net Operating Result (NOR) for MSD and GSD.The NOR is the difference between revenue and expenses, i.e., a bottom-line profit and loss indicator. The NOR objective of an activity group is to break even over the budget cycle. Setting rates that effectively offset prior year net profit or loss and break

even for new activity in the rate-setting year accomplishes this objective. Revenues are amounts earned as a result of normal operations and usually result from sale of, or reimbursements for, goods and services provided to DoD activities, other federal government agencies and the public. Expenses are the use of resources during an accounting period in carrying out the DoD's mission. They occur from rendering services; acquiring, producing or delivering goods; or carrying out other mission-related activities. The result is being able to provide needed goods and services to customers and generating the revenue to sustain continued operations within the activity.

Depot Maintenance Activity Group

The Depot Maintenance Activity Group (DMAG) ensures successful management and execution of comprehensive depot maintenance programs for Air Force-managed equipment in accordance with existing Air Force guidance. In peacetime, DMAG enhances readiness by efficiently and economically repairing, overhauling, and modifying aircraft, engines, missiles, components and software to meet warfighter demands. During wartime or contingencies, the group shifts to surge repair operations and to realign capacity to support the warfighter's immediate needs.

Customers, Products and Services

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

DMAG has two principal objectives. The first objective is to provide organic depot repair capability for fielded and emerging weapon systems, so that warfighters have mission-essential equipment. Secondly, DMAG's intent is to ensure the ability to rapidly respond to those warfighter requirements driven by contingency operations.

To accomplish this, short- and long-term strategies must be used. The depot maintenance strategic plan guides the DMAG to have the right workload capacity and capability to meet depot maintenance in:
(a) peacetime support, (b) surge, and (c) core requirements. To better support the services that DMAG provides to its customers, an integrated suite of systems, Depot Maintenance Accounting and Production Systems (DMAPS), provides improved financial, production, and material functionality in support of the warfighter's needs for quality organic depot maintenance. This includes improved financial management support/ tools and reporting for organic depot maintenance activities, including substantial compliance with legislative requirements, such as the CFO Act.

DMAG supports a variety of customers including Air Force Major Commands, Air National Guard

(ANG), Air Force Reserve Command (AFRC), SMAG, Foreign Military Sales, and Non-DoD customers. Additionally, DMAG provides storage, reclamation, and regeneration for equipment not currently used by the military services. This work is done at the Aerospace Maintenance and Regeneration Center at Davis-Monthan AFB, Arizona. Contract depot maintenance is transitioning from the Air Force WCF to be financed directly by the using commands, SMAG, and other customers.

Transformation Initiatives

Air Force Smart Operations for the 21st Century (AFSO21) is the overarching process improvement initiative now encompassing all transformation efforts. Process improvement activities have reduced flow days and backlogs, and avoided costs, thus increasing equipment availability to the warfighter and reducing operating costs in support of Expeditionary Logistics for the 21st Century (eLog21) goals. These ongoing efforts have been recognized throughout DoD and industry and will no doubt continue to be in the future.

Awards and recognitions include:

- 2005 Public Sector Shingo Prize for Excellence in Manufacturing
- Warner Robins ALC, the C-5 Planned Depot Maintenance, Gold “winner”
- Oklahoma City ALC, the KC-135 Planned Depot Maintenance, Silver “winner”
- Ogden ALC, the F-16 Common Configuration Implementation Program, Silver “winner”
- Ogden ALC, the F-16 Pylon Shop, Silver “winner”
- 2005 DoD Lean Recognition Award for Depot/Center Level Maintenance Organizational Excellence
- 2006 Franz Edelman Award for Achievement in Operations Research

Customer Support Performance Measures

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

The Due Date Performance (ability of the depot to produce aircraft on time and on schedule) is currently exceeding the new standard of 95 percent, holding at 98 percent as of May 2006. The depot performance of Air Logistics Centers (ALCs) continues to have a direct impact on the warfighter's ability to meet worldwide missions.

Financial Performance Measures

Financial performance measures assess the financial performance of the DMAG. These measures are designed to achieve accountability at the appropriate level and also measure compliance with DMAG budget objectives. Budget objectives are identified in each ALC’s

financial performance plan used to measure results during execution.

Cash Management

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

Effective cash management is directly dependent on the availability of accurate and timely data on cash levels and operational results.

Cash levels should be maintained to cover at least 7 to 10 days of operational costs, as well as cash adequate to meet six months of capital disbursements.

Cash management efforts continue to focus on analyzing data and developing tools to identify changes in cash and forecast future needs. Monthly, AFMC prepares a statement of sources and uses of cash, which is used to identify areas of increases and decreases, to monitor performance.

Financing the Fight

America's Airmen performed brilliantly in FY2006, delivering decisive air supremacy and combat power as well as much-needed humanitarian support. Our country can count on our Airmen to continue these and other missions into the future. Our Airmen, and indeed the country, deserve our best as we achieve the strategic vision, and attain transparency at all levels (financial, business practices, data, systems, and processes). We are your strategic partners, acknowledged leaders in the field of financial and management information, working together to meet the needs of our nation in time of war and in time of peace. Financial management will be a vital component of on-going operations, able to meet any need required, and the Air Force's financial management professionals will continue to support them with top-tier, world-class service - always there when needed, always ready to help finance the fight!

Fiscal Year 2006

Annual Financial Statements

Limitations to the Financial Statements

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

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

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

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

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

General Fund

Principal Statements

Consolidated Balance Sheet—General Fund

As of September 30, 2006 and 2005 ($ in Thousands)

	2006 Consolidated	2005 Consolidated Restated
1. ASSETS (Note 2)		
A. Intragovernmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	$ 68,767,178	$ 62,272,967
b. Nonentity Seized Iraqi Cash	0	0
c. Nonentity - Other	80,989	77,275
2. Investments (Note 4)	722	717
3. Accounts Receivable (Note 5)	665,672	653,589
4. Other Assets (Note 6)	454,968	427,989
5. Total Intragovernmental Assets	$ 69,969,529	$ 63,432,537
B. Cash and Other Monetary Assets (Note 7)	$ 114,779	$ 151,844
C. Accounts Receivable, Net (Note 5)	1,041,746	1,028,310
D. Loans Receivable (Note 8)	0	0
E. Inventory and Related Property, Net (Note 9)	48,584,335	47,169,013
F. General Property, Plant and Equipment, Net (Note 10)	141,861,111	142,955,380
G. Investments (Note 4)	0	0
H. Other Assets (Note 6)	11,379,126	11,179,041
2. TOTAL ASSETS	$ 272,950,626	$ 265,916,125
3. LIABILITIES (Note 11)		
A. Intragovernmental:		
1. Accounts Payable (Note 12)	$ 1,425,771	$ 1,651,904
2. Debt (Note 13)	0	0
3. Other Liabilities (Note 15 & 16)	2,258,259	1,589,867
4. Total Intragovernmental Liabilities	$ 3,684,030	$ 3,241,771
B. Accounts Payable (Note 12)	$ 4,269,732	$ 5,851,184
C. Military Retirement and Other Federal Employment Benefits (Note 17)	1,143,748	1,147,437
D. Environmental and Disposal Liabilities (Note 14)	6,554,952	7,126,178
E. Loan Guarantee Liability (Note 8)	0	0
F. Other Liabilities (Note 15 and Note 16)	6,253,108	4,179,504
4. TOTAL LIABILITIES	$ 21,905,570	$ 21,546,075
5. NET POSITION		
A. Unexpended Appropriations - Earmarked Funds (Note 23)	$ 0	$ 0
B. Unexpended Appropriations - Other Funds	70,186,333	63,716,637
C. Cumulative Results of Operations - Earmarked Funds	4,540	0
D. Cumulative Results of Operations - Other Funds	180,854,183	180,653,413
6. TOTAL NET POSITION	$ 251,045,056	$ 244,370,050
7. TOTAL LIABILITIES AND NET POSITION	$ 272,950,626	$ 265,916,125

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

Consolidated Statement of Net Cost—General Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	2006 Consolidated	2005 Consolidated
1. Program Costs		
A. Gross Costs	$ 142,378,997	$ 129,381,974
B. (Less: Earned Revenue)	-5,320,847	-5,087,578
C. Net Program Costs	$ 137,058,150	$ 124,294,397
2. Cost Not Assigned to Programs	0	0
3. (Less: Earned Revenue Not Attributable to Programs)	0	0
4. Net Cost of Operations	$ 137,058,150	$ 124,294,397

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

Consolidated Statement of Changes in Net Position—General Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	Earmarked Funds	All Other Funds	Eliminations	2006 Consolidated	2005 Consolidated
CUMULATIVE RESULTS OF OPERATIONS					
1. Beginning Balances	$ 5,451	$ 161,338,650	$ 0	$ 161,344,101	$ 168,982,135
2. Prior Period Adjustments:					
2a. Changes in accounting principles (+/-)	0	0	0	0	0
2b. Corrections of errors (+/-)	0	19,309,311	0	19,309,311	19,309,311
3. Beginning balances, as adjusted	5,451	180,647,961	0	180,653,412	188,291,446
4. Budgetary Financing Sources:	0	0	0	0	0
4a. Appropriations received	0	0	0	0	0
4b. Appropriations transferred-in/out (+/-)	0	0	0	0	0
4c. Other adjustments (rescissions, etc.) (+/-)	0	0	0	0	0
4d. Appropriations used	-1,251	132,720,187	0	132,718,936	114,969,992
4e. Nonexchange revenue	877	0	0	877	920
4f. Donations and forfeitures of cash and cash equivalents	1,779	0	0	1,779	1,860
4g. Transfers-in/out without reimbursement (+/-)	0	106,784	0	106,784	967,200
4h. Other budgetary financing sources (+/-)	0	0	0	0	0
5. Other Financing Sources:					
5a. Donations and forfeitures of property	0	0	0	0	0
5b. Transfers-in/out without reimbursement (+/-)	0	46,239	0	46,239	-25,648
5c. Imputed financing from costs absorbed by others	0	698,815	0	698,815	742,039
5d. Other (+/-)	0	3,690,030	0	3,690,030	0
6. Total Financing Sources	1,405	137,262,055	0	137,263,460	116,656,363
7. Net Cost of Operations (+/-)	2,316	137,055,834	0	137,058,150	124,294,396
8. Net Change	-911	206,221	0	205,310	-7,638,033
9. Ending Balances	4,540	180,854,182	0	180,858,722	180,653,413
UNEXPENDED APPROPRIATIONS					
1. Beginning Balances	$ -1,251	$ 63,717,889	$ 0	$ 63,716,638	$ 49,660,670
2. Prior Period Adjustments:					
2a. Changes in accounting principles (+/-)	0	0	0	0	0
2b. Corrections of errors (+/-)	0	0	0	0	0
3. Beginning balances, as adjusted	-1,251	63,717,889	0	63,716,638	49,660,670
4. Budgetary Financing Sources:					
4a. Appropriations received	0	139,764,959	0	139,764,959	128,888,188
4b. Appropriations transferred-in/out (+/-)	0	2,469,906	0	2,469,906	1,631,239
4c. Other adjustments (rescissions, etc) (+/-)	0	-3,046,233	0	-3,046,233	-1,493,468
4d. Appropriations used	1,251	-132,720,187	0	-132,718,936	-114,969,992
4e. Nonexchange revenue	0	0	0	0	0
4f. Donations and forfeitures of cash and cash equivalents	0	0	0	0	0
4g. Transfers-in/out without reimbursement (+/-)	0	0	0	0	0
4h. Other budgetary financing sources (+/-)	0	0	0	0	0
5. Other Financing Sources:					
5a. Donations and forfeitures of property	0	0	0	0	0
5b. Transfers-in/out without reimbursement (+/-)	0	0	0	0	0
5c. Imputed financing from costs absorbed by others	0	0	0	0	0
5d. Other (+/-)	0	0	0	0	0
6. Total Financing Sources	1,251	6,468,445	0	6,469,696	14,055,967
7. Net Cost of Operations (+/-)	0	0	0	0	0
8. Net Change	1,251	6,468,445	0	6,469,696	14,055,967
9. Ending Balances	$ 0	$ 70,186,334	0	$ 70,186,334	$ 63,716,637

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

Combined Statement of Budgetary Resources—General Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES:		
1. Unobligated balance, brought forward, October 1	$ 13,006,208	$ 9,043,364
2. Recoveries of prior year unpaid obligations	1,450,906	1,300,191
3. Budget authority		
3a. Appropriation	139,767,610	128,890,968
3b. Borrowing authority	0	0
3c. Contract authority	0	0
4. Spending authority from offsetting collections		
4a. Earned		
1. Collected	9,255,190	8,923,532
2. Change in receivables from Federal sources	-99,279	142,948
4b. Change in unfilled customer orders		
1. Advance received	-94,677	349,671
2. Without advance from Federal sources	-102,493	388,543
4c. Anticipated for rest of year, without advances	0	0
4d. Previously unavailable	0	0
4e. Expenditure transfers from trust funds	0	0
4f. Subtotal	148,726,351	138,695,662
5. Nonexpenditure transfers, net, anticipated and actual	2,576,690	2,598,439
6. Temporarily not available pursuant to Public Law	0	0
7. Permanently not available	-3,046,233	-1,493,468
8. Total Budgetary Resources	$ 162,713,922	$ 150,144,188
STATUS OF BUGETARY RESOURCES:		
9. Obligations incurred:		
9a. Direct	$ 136,439,546	$ 124,689,424
9b. Reimbursable	9,161,449	12,448,555
9c. Subtotal	145,600,995	137,137,979
10. Unobligated balance:		
10a. Apportioned	14,998,616	11,756,881
10b. Exempt from apportionment	3,174	3,218
10c. Subtotal	15,001,790	11,760,099
11. Unobligated balance not available	2,111,137	1,246,110
12. Total Status of Budgetary Resources	$ 162,713,922	$ 150,144,188
CHANGE IN OBLIGATED BALANCE:		
13. Obligated balance, Net		
13a. Unpaid obligations, brought forward, October 1	51,840,781	53,808,139
13b. Less: Uncollected customer payments from Federal sources, brought forward, October 1	$ -2,835,497	$ -2,304,006
13c. Total unpaid obligated balance	49,005,284	51,504,133
13d. Obligations incurred net (+/-)	$ 145,600,995	$ 137,137,979
14. Less: Gross outlays	-142,001,769	-137,805,147
15. Obligated balance transferred, net		
15a. Actual transfers, unpaid obligations (+/-)	0	0
15b. Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0
16. Total Unpaid obligated balance transferred, net	0	0
17. Less: Recoveries of prior year unpaid obligations, actual	-1,450,906	-1,300,191
Change in uncollected customer payments from Federal sources (+/-)	201,773	-531,490
18. Obligated balance, net, end of period		
18a. Unpaid obligations	53,989,101	51,840,781
18b. Less: Uncollected customer payments from Federal sources	-2,633,723	-2,835,497
18c. Total, unpaid obligated balance, net, end of period	51,355,378	49,005,284
NET OUTLAYS:		
19. Net Outlays:		
19a. Gross outlays	142,001,769	137,805,147
19b. Less: Offsetting collections	-9,160,512	-9,273,203
19c. Less: Distributed Offsetting receipts	-185,423	-123,202
20. Net Outlays	$ 132,655,834	$ 128,408,742

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

Consolidated Statement of Financing—General Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ 145,600,996	$ 137,137,979
2. Less: Spending authority from offsetting collections and recoveries	-10,409,644	-11,104,884
3. Obligations net of offsetting collections and recoveries	135,191,352	126,033,095
4. Less: Offsetting receipts	-185,423	-123,202
5. Net obligations	135,005,929	125,909,893
Other Resources		
6. Donations and forfeitures of property	0	0
7. Transfers in/out without reimbursement (+/-)	46,240	-25,648
8. Imputed financing from costs absorbed by others	698,814	742,039
9. Other (+/-)	3,690,030	0
10. Net other resources used to finance activities	4,435,084	716,391
11. Total resources used to finance activities	$ 139,441,013	$ 126,626,284
Resources Used to Finance Items not Part of the Net Cost of Operations		
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
12a. Undelivered Orders (-)	-2,386,909	-11,681,780
12b. Unfilled Customer Orders	-197,170	738,214
13. Resources that fund expenses recognized in prior periods	-898,944	-606,526
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	185,423	123,202
15. Resources that finance the acquisition of assets	-17,411,172	-18,029,608
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations		
16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget	0	0
16b. Other (+/-)	-3,736,270	25,648
17. Total resources used to finance items not part of the net cost of operations	$ -24,445,042	$ -29,430,850
18. Total resources used to finance the net cost of operations	$ 114,995,971	$ 97,195,434
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
19. Increase in annual leave liability	491,847	81,024
20. Increase in environmental and disposal liability	0	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
22. Increase in exchange revenue receivable from the public (-)	0	0
23. Other (+/-)	610,486	13,659
24. Total components of Net Cost of Operations that will require or generate resources in future periods	1,102,333	94,683
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	16,091,380	11,743,098
26. Revaluation of assets or liabilities (+/-)	569,339	787,835
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0	0
27b. Cost of Goods Sold	0	0
27c. Operating Material & Supplies Used	13,272,303	2,037,758
27d. Other	-8,973,176	12,435,587
28. Total components of Net Cost of Operations that will not require or generate resources	20,959,846	27,004,278
29. Total components of net cost of operations that will not require or generate resources in the current period	$ 22,062,179	$ 27,098,961
30. Net Cost of Operations	$ 137,058,150	$ 124,294,395

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

General Fund

Footnotes to the Principal Statements

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Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Air Force, as required by the "Chief Financial Officers Act of 1990," expanded by the "Government Management Reform Act of 1994," and other appropriate legislation. The financial statements have been prepared from the books and records of the Air Force in accordance with the "DoD Financial Management Regulation," Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the Air Force is responsible. Information relative to classified assets, programs, and operations is aggregated and reported in such a manner that it is not discernable.

The Air Force is unable to fully implement all elements of GAAP and the Office of Management and Budget Circular A-136, due to process and system limitations for both financial and non-financial management, which feeds into the financial statements. The Air Force derives its reported values and information for major asset and liability categories, largely from non-financial systems, such as inventory and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with GAAP.

The Air Force currently has two auditor identified financial statement material weaknesses: (1) financial and non-financial feeder systems do not contain an adequate audit trail and other systems controls for the proprietary and budgetary accounts, and (2) intragovernmental transaction cannot be accurately identified by the customer, which is required for eliminations when preparing consolidated financial statements. In addition, with the implementation of the Office of Management and Budget (OMB) Circular A-123, Management's Responsibility for Internal Controls, Appendix A, Internal Controls Over Financial Reporting (ICOFR), the Air Force identified two additional material weaknesses: (1) Military Equipment Valuation, the Air Force is unable to report the value of its current military equipment assets in a consistent and accurate manner on the financial statements, and (2) Real Property Valuation, the Air Force is unable to report the value of its current real property assets in a consistent and accurate manner on the financial statements. The Air Force also identified one reportable condition with the Environmental Liabilities reporting process. These findings are being addressed with corrective actions in the Financial Improvement Plan.

1.B. Mission of the Reporting Entity

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

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

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

Air Force Account Number	Title
57 * 0704	Military Family Housing (O&M and Construction), Air Force
57 * 0740	Military Family Housing (Construction), Air Force
57 * 0745	Military Family Housing (O&M), Air Force
57 * 0810	Environmental Restoration, Air Force
57 * 1007	Medicare Eligible Retiree Health fund Contributions, Air Force
57 * 1008	Medicare Eligible Retiree Health fund Contributions, Air Force Reserve
57 * 1009	Medicare Eligible Retiree Health fund Contributions, Air National Guard
57 * 3010	Aircraft Procurement, Air Force
57 * 3011	Procurement of Ammunition, Air Force
57 * 3020	Missile Procurement, Air Force
57 * 3080	Other Procurement, Air Force
57 * 3300	Military Construction, Air Force
57 * 3400	Operation and Maintenance (O&M), Air Force
57 * 3500	Military Personnel, Air Force
57 * 3600	Research, Development, Testing, and Evaluation (RDT&E), AF
57 * 3700	Personnel, Air Force Reserve
57 * 3730	Military Construction, Air Force Reserve
57 * 3740	Operation and Maintenance (O&M), Air Force Reserve
57 * 3830	Military Construction, Air National Guard
57 * 3840	Operation and Maintenance (O&M), Air National Guard
57 * 3850	Personnel, Air National Guard
57 X 5095	Wildlife Conservation, etc., Military Reservations, Air Force
57 X 8418	Air Force Cadet Fund
57 X 8928	Air Force General Gift Fund
57 * 3XXX (Incl Nonentity)	Budget Clearing Accounts
57 * 6XXX (Nonentity)	Deposit Fund Accounts
57 **** (Nonentity)	Receipt Accounts

1.C. Appropriations and Funds

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

- General funds are used for financial transactions funded by congressional appropriations, including personnel, operations and maintenance, research and development, procurement, and military construction accounts.
- Working capital fund (revolving fund) activities are reported in a separate set of audited financial statements and related footnotes.
- Trust funds contain the receipt and expenditure of funds held in trust by the Air Force for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.
- Special funds account for Air Force receipts reserved for specific purposes.

- Deposit funds are generally used to (1) account for unidentified remittances or (2) hold assets for which the Air Force is acting as an agent or a custodian or whose distribution is awaiting legal determination.
- Earmarked funds are financed by specifically identified revenues that are required by statute to be used for designated activities, benefits or purposes, and remain available over time. Earmarked funds also have a requirement to account for and report on the receipt, use, and retention of revenues and other financing sources that distinguish them from general revenues.

1.D. Basis of Accounting

For FY 2006, the Air Force's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Air Force's financial and non-financial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the Air Force's legacy systems were designed to record information on a budgetary basis.

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

In addition, the DoD identifies program costs based upon the major appropriation groups provided by Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the "Government Performance and Results Act (GPRA)." The DoD is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

The Air Force receives congressional appropriations as financing sources for general funds on either an annual or multi-year basis. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The Air Force recognizes revenue as a result of costs incurred or services provided to other Federal agencies and the public. Full cost pricing is the Air Force's standard policy for services provided as required by OMB Circular A-25. The Air Force recognizes revenue when earned within the constraints of current system capabilities. In other instances, revenue is recognized when bills are issued.

The Air Force does not include non-monetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and the Statement of Financing. The U.S. has cost sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because the Air Force's financial and non-financial 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, environmental liabilities, and unbilled revenue. The Air Force's expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses.

1.G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within the DoD or between two or more federal agencies. However, the Air Force cannot accurately identify most of its intragovernmental transactions by customer because the Air Force's systems do not track buyer and seller data needed to match related transactions. Seller entities within the DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. Intra-DoD intragovernmental balances are then eliminated. The Air Force properly eliminates the revenue results from intra-DoD sales of capitalized assets. The DoD is developing long-term system 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 effectively with existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the DoD and other federal agencies. The Treasury Financial Manual, Part 2 - Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" and the Treasury's "Federal Intragovernmental Transactions Accounting Policy Guide," provide guidance for reporting and reconciling intragovernmental balances. While the Air Force is unable to fully reconcile intragovernmental transactions with all federal partners, the Air Force is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DOL), and benefit program transactions with the Office of Personnel Management (OPM). The DoD's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

1.H. Transactions with Foreign Governments and International Organizations

Each year, the Air Force sells defense articles and services to foreign governments and international organizations under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, the DoD has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Payment is required in advance.

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

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

In addition, the DFAS sites and the USACE Finance Center submit appropriation reports to the Department of the Treasury on interagency transfers, collections received, and disbursements issued. The Department of the Treasury records this information to the applicable Fund Balance with Treasury (FBWT) account. Differences sometimes occur between the Air Force's recorded balance in the FBWT accounts and Treasury's FBWT accounts and are subsequently reconciled.

1.J. Foreign Currency

Cash is the total of cash resources under the control of the DoD, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and nonpurchased foreign currencies held in foreign currency fund accounts.

The majority of cash and all foreign currency is classified as nonentity and, therefore, is restricted. Amounts reported consist primarily of cash and foreign currency held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange missions.

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

1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable include accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies (per Code of Federal Regulations 4 CFR 101).

The allowance for Air Force entity receivables is computed each quarter based on the average percent of write-offs to outstanding public accounts receivable for the last five years. For closed years receivables and deferred debts in litigation, an allowance rate of 50% is used. Interest allowance is calculated using an average percent of write-offs to outstanding public accounts receivable over a five year period starting with FY 2001 data.

1.L. Direct Loans and Loan Guarantees

Not applicable.

1.M. Inventories and Related Property

Most of the Air Force's inventories are currently reported at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, the Air Force has transitioned, and is continuing to transition, the inventory to the moving average cost method. Approximately 32% of the Air Force inventory value is now being reported from systems that have transitioned to moving average cost functionality. However, since the on-hand balances which transitioned were not, for the most part, baselined to auditable historical cost, the reported values remain noncompliant with SFFAS 3 and GAAP.

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 DoD uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as ammunitions and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S.

The Air Force determined that the recurring high dollar value of OM&S in need of repair is material to the financial statements and requires a separate reporting category. Many high dollar items, such as aircraft engines, are categorized as OM&S rather than military equipment.

The Air Force recognizes condemned material as "Excess, Obsolete, and Unserviceable." The cost of disposal is greater than the potential scrap value; therefore, the net value of condemned material is zero. Potentially redistributed 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.

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

The Air Force reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts amortize into interest income over the term of the investment using the effective interest rate method or another method obtaining similar results. The Air Force's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities. Related earnings are allocated to appropriate Air Force activities to be used in accordance with the directions of the donor.

The Air Force invests in nonmarketable securities. The two types of nonmarketable securities are par value and market-based intragovernmental securities. The Bureau of Public Debt issues nonmarketable par value intragovernmental securities. Nonmarketable, market-based intragovernmental securities mimic marketable securities, but are not publicly traded.

1.O. General Property, Plant and Equipment

The Department is moving away from a standard capitalization threshold for all categories (e.g. real property, military equipment, etc.) of General Property Plant and Equipment (PP&E) to one that is specific for each individual category.

The capitalization threshold was revised from $100,000 to $20,000 for real property. The current $100,000 capitalization threshold remains unchanged for the remaining General PP&E categories.

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

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for fiscal years 1993, 1994, and 1995, respectively, and an estimated useful life of two or more years. General PP&E previously capitalized at amounts below $100,000 were written off from the General Fund financial statements in FY 1998.

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

The DoD is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Air Force reports only government property in the possession of contractors that is maintained in the Air Force's property systems. The DoD has issued new property accountability and reporting requirements that require Air Force Components to maintain, in their property systems, information on all property furnished to contractors. This action which should be implemented by the end of FY 2009 is structured to capture and report the information necessary for compliance with Federal accounting standards.

The SFFAS No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," establishes generally accepted accounting principles for valuing and reporting military equipment (e.g. ships, aircraft, combat vehicles, weapons) in federal financial statements. The Standard provided for the use of estimated historical cost for valuing military equipment if obtaining actual historical cost information is not practical. The Department used Bureau of Economic Analysis (BEA) to calculate the value of the military equipment for reporting periods from October 1, 2002 through March 31, 2006.

Effective 3rd Quarter, FY 2006, the Department replaced the BEA estimation methodology with an estimation methodology for military equipment based on Department internal records. The Department initially identified the universe of military equipment by accumulating information relating to program funding and associated military equipment, equipment useful life, program acquisitions and disposals to create a baseline. The military equipment baseline is updated using expenditure information, and information related to acquisition and disposals.

1.P. Advances and Prepayments

The Air Force records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. The Air Force recognizes advances and prepayments as expenses when it receives the related goods and services.

1.Q. Leases

Lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), the Air Force records the applicable asset and liability if the value equals or exceeds the current capitalization threshold.

The Air Force records the amounts as the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the governmental's incremental borrowing rate at the inception of the lease. The Air Force, as the lessee of real estate or equipment, will receive the use and possession of leased property from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are charged to expense over the lease term as it becomes payable.

Office space and leases entered into by the Air Force in support of contingency operations are the largest component of operating leases. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Interservice Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. Equipment leases have a variety of lease terms which are not expected to be renewed upon expiration. Other operating leases are generally one year leases. The Air Force expects to continue to reduce the level of owned assets while increasing the number of leased assets. The Air Force will strive to displace commercial leases with more economical GSA leases.

1.R. Other Assets

The Air Force conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the Air Force provides financing payments. One type of financing payment that the Air Force makes for real property is based upon a percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction-in-process and are reported on the General PP&E line on the Balance Sheet and in the related note.

Other assets include those assets, such as military and civil service employee pay advances, travel advances, and contract financing payments, that are not reported elsewhere on the Department's Balance Sheet.

Contract financing payments are defined in the Federal Acquisition Regulations (FAR), Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. These payments are designed to alleviate the potential financial burden on contractors performing on certain long-term contracts and facilitate competition for defense contracts. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts. Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisitions Regulations Supplement (DFARS) authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property and ships are reported as Construction in Progress in Note 10.

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The Air Force recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but where there is at least a reasonable possibility that a loss or additional loss will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The Air Force's loss contingencies arise as a result of pending or threatened litigation or claims; and assessments that occur due to events such as aircraft and vehicle accidents, medical malpractice, property or environmental damages, and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for the Air Force's assets. This type of liability has two components: non-environmental and environmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Non-environmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon the DoD's policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of Federal Government."

1.T. Accrued Leave

The Air Force reports as liabilities military leave and civilian earned leave except sick leave that has been accrued and not used as of the Balance Sheet date. Sick leave is expensed as taken. The liability reported at the end of the accounting period reflects current pay rates.

1.U. Net Position

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

Unexpended appropriations represent the amounts of authority that are not obligated and that have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative results of operations represent the net difference between expenses and losses and financing sources (including appropriations, revenue, and gains) since the inception of an activity. Beginning with FY 1998, the cumulative results also include donations and transfer in and out of assets without reimbursement.

1.V. Treaties for Use of Foreign Bases

The Air Force has the use of land, buildings, and other facilities that are located overseas and that have been obtained through various international treaties and agreements negotiated by the Department of State. The Air Force purchases overseas capital assets with appropriated funds, but the host country retains title to land and improvements. Generally, treaty terms allow the Air Force continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any non-retrievable capital assets. This takes place after negotiations between the U.S. and the host country have determined the amount to be paid the U.S. for such capital investments.

1.W. Comparative Data

Financial statement fluctuations greater than 2% of total assets on the Balance Sheet or 10% from the previous period presented are explained within the notes to the financial statements.

1.X. Unexpended Obligations

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

1.Y. Undistributed Disbursements and Collections

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

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities. The Air Force follows DoD policy.

Note 2. Nonentity Assets

As of September 30	2006		2005	
($ in thousands)				
1. Intragovernmental Assets				
A. Fund Balance with Treasury	$	80,989	$	77,276
B. Accounts Receivable		2,715		2,354
C. Total Intragovernmental Assets	$	83,704	$	79,630
2. Nonfederal Assets				
A. Cash and Other Monetary Assets	$	114,779	$	151,844
B. Accounts Receivable		568,289		128,943
C. Other Assets		196,826		156,872
D. Total Nonfederal Assets	$	879,894	$	437,659
3. Total Nonentity Assets	$	963,598	$	517,289
4. Total Entity Assets	$	271,987,028	$	265,398,836
5. Total Assets	$	272,950,626	$	265,916,125

Fluctuations

Total nonentity assets increased by $446.3 million (86%) primarily due to a $439.3 million increase in nonfederal accounts receivable. In the past, DFAS-DE erroneously reported public accounts receivable in receipt and deposit accounts as entity. DFAS-DE corrected the error during 3rd Quarter, FY 2006. These receivables are now correctly recorded as nonentity in accordance with the classification of accounts as entity versus nonentity in DoDFMR, Volume 6B, Attachment 20A.

Relevant Information for Comprehension

Nonentity assets are assets held by an entity but are not available for use in the operations of the entity. Nonfederal other assets are advances to contractors. The Nonentity Fund Balance with Treasury asset class represents amounts in Air Force's deposit fund and two suspense fund accounts (Uniformed Services Thrift Savings Plan Suspense and Thrift Savings Plan Suspense) that are not available for Air Force use. Nonentity Accounts Receivable, when collected, goes to the Department of the Treasury as miscellaneous receipts. The Nonentity

Nonfederal Accounts Receivable amount also includes interest receivables on aged debt. Nonentity Cash and Other Monetary Assets represent disbursing officers' cash and undeposited collections as reported on the Statement of Accountability. These assets are held by the Air Force disbursing officers as agents of the Treasury.

Other nonfederal assets consist of advances to contractors as part of the advance payment pool agreements with the Massachusetts Institute of Technology and other nonprofit institutions. These agreements are used for the financing of cost-type contracts with nonprofit educational or research institutions for experimental or research and development work when several contracts or a series of contracts require financing by advance payments.

Note 3. Fund Balance with Treasury

As of September 30	2006	2005
($ in thousands)		
1. Fund Balances		
A. Appropriated Funds	$ 68,762,362	$ 62,293,567
B. Revolving Funds	0	0
C. Trust Funds	3,944	4,134
D. Special Funds	872	789
E. Other Fund Types	80,989	51,752
F. Total Fund Balances	$ 68,848,167	$ 62,350,242
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 69,960,267	$ 63,268,814
B. Fund Balance per Air Force	-68,848,167	-62,350,242
3. Reconciling Amount	$ 1,112,100	$ 918,572

Fluctuations

Total fund balances increased $6.5 billion (10%) primarily due to a capital infusion in the amount of $9.6 billion received on June 15, 2006 from the supplemental appropriation act for defense to support Global War on Terrorism and Hurricane Recovery. Of the $9.6 billion, $5.0 billion was multi-year and operations and maintenance appropriations that could not be disbursed in the current fiscal year due to the late receipt of funding.

Reconciling Amount

The Air Force shows a reconciling amount of $1.1 billion with the Department of the Treasury which is comprised of:

- $929.9 million in withdrawal of the FBWT in the canceling appropriations at September 30, 2006. These funds are included in FBWT per Treasury but are not included in FBWT per Air Force.
- $170.1 million in withdrawal of the FBWT for unavailable receipt accounts at September 30, 2006. These funds are included in FBWT per Treasury but are not included in FBWT per Air Force.
- $16.8 million in allocation transfers from the Department of Agriculture and the Foreign Military Sales - Military Assistance Program. An allocation transfer occurs when the Treasury appropriates funds to one federal entity, which then transfers the authority to execute its funds to another federal entity. These funds are included in the fund balance with Treasury (FBWT) per Treasury, but are not included in the FBWT per Air Force.
- $4.7 million in allocation transfers to the Department of Transportation. These funds are included in FBWT per Air Force but are not included in FBWT per Treasury.

Status of Fund Balance with Treasury

As of September 30	2006		2005	
($ in thousands)				
1. Unobligated Balance				
A. Available	$	15,001,790	$	11,760,100
B. Unavailable		2,111,136		1,246,109
2. Obligated Balance not yet Disbursed	$	53,989,101	$	51,840,781
3. Non-Budgetary FBWT	$	380,571	$	339,456
4. Non-FBWT Budgetary Accounts	$	-2,634,431	$	-2,836,206
5. Total	$	68,848,167	$	62,350,240

Fluctuations

Total status of Fund Balance with Treasury increased $6.5 billion (10%) primarily due to a $3.2 billion increase in the unobligated balance available. This increase is due a capital infusion of $9.6 billion received on June 15, 2006 from the supplemental appropriation act for defense to support Global War on Terrorism and Hurricane Recovery. Most of the $2.8 billion of multi-year appropriations, included in the supplemental, were not obligated prior to the end of FY 2006. In addition, obligated balance not yet disbursed increased $2.2 billion as a result of the late receipt of the $9.6 billion supplemental. The late receipt resulted in Air Force obligating the single year appropriations during FY 2006 but was unable to disburse all of the obligations during the current fiscal year.

Relevant Information for Comprehension

The Status of Fund Balance with Treasury consists of unobligated and obligated balances. These balances reflect the budgetary authority remaining for disbursements against current or future obligations. In addition, the Status includes various accounts that affect either budgetary reporting or Fund Balance with Treasury, but not both.

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

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received or services that have not been performed.

Non-Budgetary Fund Balance with Treasury (FBWT) includes entity and nonentity Fund Balance with Treasury accounts which do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

Non-FBWT Budgetary Accounts include budgetary accounts that do not affect Fund Balance with Treasury, such as contract authority, borrowing authority, and investment accounts. This category reduces the Status of Fund Balance with Treasury.

Although funds have been appropriated, $2.1 billion of these funds are not available for obligation because the period for obligation established by law has lapsed.

Disclosures Related to Suspense/Budget Clearing Accounts

As of September 30 ($ in thousands)	2004	2005	2006	(Decrease)/Increase from FY 2005 - 2006
Account				
F3845 – Personal Property Proceeds	$ 0	$ 0	$ 0	$ 0
F3875 – Disbursing Officer Suspense	-357,705	336,053	362,040	25,987
F3880 – Lost or Cancelled Treasury Checks	-3,803	691	553	-138
F3882 – Uniformed Services Thrift Savings Plan Suspense	-20,956	25,523	30,802	5,279
F3885 – Interfund/IPAC Suspense	14,989	-74,564	-63,012	11,552
F3886 – Thrift Savings Plan Suspense	0	0	0	0
Total	$ -367,475	$ 287,703	$ 330,383	$ 42,680

Fluctuations

Total suspense/budget clearing accounts increased $42.7 million (15%) due to a $26.0 million increase in Disbursing Officer Suspense and an $11.6 million increase in Interfund/IPAC Suspense. The increase in the Disbursing Officer Suspense account is the result of an increase in federal income tax being withheld and not yet disbursed for civilian and military due to increases in Internal Revenue Service withholding rates during FY 2006. The change in the Interfund/IPAC Suspense account can be attributed to a decrease in the amount of intragovernmental payments and collections in suspense. In April 2006, the DFAS Transaction Interface Module was implemented (DTIM-IPAC). DTIM-IPAC has greatly reduced the time transactions remain in suspense thereby reducing the amount and dollar value of transactions that are in the Interfund/IPAC Suspense account.

Relevant Information for Comprehension

The F3845 suspense account represents the balance of proceeds from the sale of personal property.

The F3875 suspense clearing accounts represents the Disbursing Officer's (DO) suspense. Account F3885 represents the Interfund/IPAC suspense. Account F3886 represents the (payroll) Thrift Savings Plan suspense. These three suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation.

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

The F3882 suspense account was established for the Uniformed Services Thrift Savings Plan in FY 2002. The amounts in this account represent a timing difference between the posting of the Thrift Savings Plan deductions by the National Finance Center and the posting of these amounts in the military accounting systems in the following month.

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of September 30	2004	2005	2006	(Decrease)/Increase from FY 2005-2006
($ in thousands)				
1. Total Problem Disbursements, Absolute Value				
A. Unmatched Disbursements (UMDs)	$ 161,630	$ 272,972	$ 32,063	$ -240,909
B. Negative Unliquidated Obligations (NULO)	9,792	8,209	6,291	-1,918
2. Total In-transit Disbursements, Net	$ 1,065,326	$ 776,544	$ 611,372	$ -165,172

Fluctuations

The Air Force had a $242.8 million decrease in problem disbursements and a $165.2 million decrease in in-transits. The Defense Finance and Accounting Service has efforts underway to improve the systems, to resolve all previous problem disbursements, and to process all in-transits in a timely manner. The amount of unmatched disbursements (UMDs) over 180 days is $0, negative unliquidated disbursements (NULOs) is $0, and in-transits is $2.1 million. The amount of UMDs over 120 days old is $0, NULOs is $0 and in-transits is $3.0 million. The current absolute value of in-transits is $1.3 billion.

The decrease of $240.9 million (88%) in UMDs and the $1.9 million (23%) decrease in NULOs can be attributed to an increase in the rate of automated posting of disbursements since September 2005, utilizing the DFAS Transaction Interface Module.

The decrease in in-transits of $165.2 million (21%) can be attributed to a decrease in Interfund activity and a decrease in intraservice (Air Force for Air Force) disbursement activity 4th Quarter, FY 2006. Fluctuations are driven by the cyclical nature of Interfund and cross disbursement activities.

Relevant Information for Comprehension

The Air Force is reporting $1.5 million of in-transit disbursements pertaining to the International Military Education and Training (IMET) appropriation. The Air Force has no problem disbursements directly related to Foreign Military Sales.

There are no discrepancies between amounts reported in the problem disbursement metric furnished to DFAS Arlington and the schedule above.

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

A UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The in-transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

Note 4. Investments and Related Interest

As of September 30	2006				
	Cost	Amortization Method	Amortized (Premium)/Discount	Investments Net	Market Value Disclosure
($ in thousands)					
1. Intragovernmental Securities					
A. Nonmarketable, Market Based	$ 713		$ 1	$ 714	$ 712
B. Accrued Interest	8			8	8
C. Total Intragovernmental Securities	$ 721		$ 1	$ 722	$ 720
2. Other Investments					
A. Total Investments	$ 0		$ 0	$ 0	N/A

As of September 30	2005				
	Cost	Amortization Method	Amortized (Premium)/Discount	Investments Net	Market Value Disclosure
($ in thousands)					
1. Intragovernmental Securities					
A. Nonmarketable, Market Based	$ 710		$ 0	$ 710	$ 705
B. Accrued Interest	7			7	7
C. Total Intragovernmental Securities	$ 717		$ 0	$ 717	$ 712
2. Other Investments					
A. Total Investments	$ 0		$ 0	$ 0	N/A

Relevant Information for Comprehension

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to the Air Force as evidence of its receipts. Treasury securities are an asset to the Air Force and a liability to the U.S. Treasury. Because the Air Force and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Governmentwide financial statements. U.S. Treasury securities provide the Air Force with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the Air Force requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

Note 5. Accounts Receivable

As of September 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
($ in thousands)				
1. Intragovernmental Receivables	$ 665,672	N/A	$ 665,672	$ 653,589
2. Nonfederal Receivables (From the Public)	$ 1,189,271	$ -147,525	$ 1,041,746	$ 1,028,310
3. Total Accounts Receivable	$ 1,854,943	$ -147,525	$ 1,707,418	$ 1,681,899

Relevant Information for Comprehension

As presented on the Consolidated Balance Sheet, accounts receivable include reimbursements receivable and refunds receivable such as out-of-service debts (amounts owed by former service members) and contractor debts. It also includes net interest receivables per DoDFMR Vol. 6B guidance. Canceled accounts receivable are reported as nonentity receivables because these amounts are deposited into a Treasury Department miscellaneous receipt account when collected. Reconciliation between Treasury Report on Receivables (TROR) Due from the Public and the Balance Sheet was accomplished. This reconciliation is performed to ensure that the financial statements are in agreement with the receivable amount reported to the Department of the Treasury. The difference between accounts receivable on the Balance Sheet and TROR Due from the Public include the allowance for estimated uncollectible of $147.5 million, unsupported collections in transit in the amount of $1.1 million, and undistributed collections of $358.5 thousand. Undistributed collections are prorated between public and intragovernmental receivables based on a percentage calculated from receivable amounts represented on the Balance Sheet.

Aged Accounts Receivable

As of September 30	2006		2005	
	Intragovernmental	Nonfederal	Intragovernmental	Nonfederal
($ in thousands)				
CATEGORY				
Nondelinquent				
Current	$ 1,085,891	$ 193,635	$ 1,360,677	$ 247,651
Noncurrent	5,725	0	0	0
Delinquent				
1 to 30 days	$ 34,155	$ 6,010	$ 7,167	$ 6,242
31 to 60 days	122,543	4,677	5,836	3,369
61 to 90 days	28,469	6,744	22,661	7,735
91 to 180 days	64,611	21,217	14,723	7,214
181 days to 1 year	55,201	41,513	25,834	21,965
Greater than 1 year and less than or equal to 2 years	7,145	12,565	436	661,736
Greater than 2 years and less than or equal to 6 years	6,437	705,483	36	30,232
Greater than 6 years and less than or equal to 10 years	0	179,819	0	177,244
Greater than 10 years	0	17,702	0	17,115
Subtotal	$ 1,410,177	$ 1,189,365	$ 1,437,370	$ 1,180,503
Less Supported Undistributed Collections	-665	-94	-7,439	-1,841
Less Eliminations	-743,840	0	-776,342	0
Less Other	0	0	0	-36
Total	$ 665,672	$ 1,189,271	$ 653,589	$ 1,178,626

For nondelinquent, noncurrent accounts receivables, the Air Force currently has 26 claims in the amount of $5.7 million, which are currently being negotiated. These amounts are reported by the Air Force in the Operation and Maintenance appropriation classified program. As a result, additional information on these cases is not available. Throughout the year, follow-up is made by the Air Force on these cases.

Delinquent receivables as a result of transactions arising within DoD or other federal agencies are being collected through the Intergovernmental Payment and Collection System (IPAC) in accordance with trading partner agreements. For receivables without valid supporting documentation, DFAS-DE is working with the Air Force to obtain documentation to support an IPAC collection. If supporting documentation is not available, the original entry will be reversed.

DFAS-DE has a new initiative to develop a front end edit system to help validate reimbursable data before it is loaded into the accounting system. DFAS-DE is also strengthening guidance relative to the elimination of unsupported reimbursable transactions and is providing training to Air Force customers.

Demand letters are sent to nonfederal debtors once the payment becomes 30 days delinquent in accordance with the procedures outlined in the Concept of Operations for Managing Accounts Receivables. The delinquencies for the Air Force consist primarily of debts that have been turned over to the Contract Debt System (CDS) and the Defense Debt Management System (DDMS) for resolution.

Note 6. Other Assets

As of September 30	2006	2005
($ in thousands)		
1. Intragovernmental Other Assets		
A. Advances and Prepayments	$ 454,968	$ 427,989
B. Other Assets	0	0
C. Total Intragovernmental Other Assets	$ 454,968	$ 427,989
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	$ 11,098,138	$ 10,919,137
B. Other Assets (With the Public)	280,988	259,904
C. Total Nonfederal Other Assets	$ 11,379,126	$ 11,179,041
3. Total Other Assets	$ 11,834,094	$ 11,607,030

Relevant Information for Comprehension

Other Assets (With the Public) (line 2B) is comprised primarily of advances to contractors as part of advance payment pool agreements with the Massachusetts Institute of Technology and other nonprofit institutions and travel advances. The advance payment pool agreements are used for the financing of cost type contracts with nonprofit educational or research institutions for experimental or research and development work when several contracts or a series of contracts require financing by advance payments.

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Department that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Government. The government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the Department is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product.

The Contract Financing Payment balance of $11.1 billion is comprised of $9.9 billion in contract financing payments and an additional $1.2 billion in estimated future funded payments that will be paid to the contractor upon future delivery and Government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities).

Note 7. Cash and Other Monetary Assets

As of September 30	2006	2005
($ in thousands)		
1. Cash	$ 111,641	$ 148,938
2. Foreign Currency	3,138	2,906
3. Total Cash, Foreign Currency, & Other Monetary Assets	$ 114,779	$ 151,844

Fluctuations

Overall total cash, foreign currency, & other monetary assets (line 3) decreased by $37.1 million (24%) primarily due to a $37.3 million decrease in cash (line 1). The decrease is attributed to the increased utilization of the International Treasury Service (ITS.gov) for payments to foreign vendors in U.S. dollars. DFAS-DE sends U.S. dollars directly to the Federal Reserve Bank of New York. The Federal Reserve Bank disburses funds directly to foreign vendors resulting in a reduced need for U.S. dollars at Air Force disbursing locations. ITS.gov began a phased implementation during the 2nd Quarter, FY 2005.

Relevant Information for Comprehension

The amount reported as cash and foreign currency consists primarily of cash held by disbursing officers. The foreign currency amount reported is valued at the Department of Treasury's prevailing exchange rate, which is the most favorable rate available to the U.S. Government for foreign exchange transactions. Foreign currency is used to make disbursements and exchange U.S. dollars for military personnel.

Cash and foreign currency are nonentity assets and, as such, are considered restricted assets that are held by the Air Force but not available for use in its operations. These assets are held by the Air Force's disbursing officers as agents of the Treasury. The total balance of $114.8 million is restricted.

Note 8. Direct Loan and/or Loan Guarantee Programs

Direct Loan and/or Loan Guarantee Programs - The entity operates the following direct loan and/or Loan guarantee program(s):

- Military Housing Privatization Initiative
- Armament Retooling & Manufacturing Support Initiative

Note 9. Inventory and Related Property

As of September 30	2006	2005
($ in thousands)		
1. Inventory, Net	$ 0	$ 0
2. Operating Materials & Supplies, Net	48,584,335	47,169,013
3. Stockpile Materials, Net	0	0
4. Total	$ 48,584,335	$ 47,169,013

Operating Materials and Supplies, Net

As of September 30	2006			2005	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
($ in thousands)					
1. OM&S Categories					
A. Held for Use	$ 37,448,202	$ 0	$ 37,448,202	$ 36,317,706	SP, LAC
B. Held for Repair	11,136,133	0	11,136,133	10,851,307	SP, LAC
C. Excess, Obsolete, and Unserviceable	1,263,059	-1,263,059	0	0	NRV
D. Total	$ 49,847,394	$ -1,263,059	$ 48,584,335	$ 47,169,013	

Legend for Valuation Methods:

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

Information related to OM&S

General Composition of OM&S

Operating Materials and Supplies (OM&S) include weapon systems, spare and repair parts, ammunition, tactical missiles, centrally managed spare aircraft engines, and uninstalled cruise and intercontinental ballistic missile motors.

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

Some munitions included in OM&S are restricted to use. Restricted munitions are items that cannot be expected to meet performance requirements under all conditions. They are only used in emergency combat situations in which no other suitable munitions are immediately available.

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

The category Held for Use includes all materials available for issuance. OM&S classified as such is marked within each supply or inventory system with condition codes A-D.

The category "Held as Excess, Obsolete, and Unserviceable" includes all material that managers determine to be more costly to repair than to replace. Items retained for management purposes, which are beyond economic repair are coded "condemned." The net value of these items is zero and they are shown as Excess, Obsolete, and Unserviceable and assigned condition codes H, P, S, or V.

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

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

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

To date, the Air Force has partially implemented a moving average cost (MAC) valuation process within four systems in an effort to report the value of OM&S at historical cost, which is the DoD-approved costing methodology.

(Three of the four systems had its beginning balance validated). Most OM&S assets are in systems not yet converted to MAC and therefore are still valued at standard price with an allowance for Excess, Obsolete, and Unserviceable.

Under current DoD policy, no allowance is made for serviceable ready-to-issue items (category Held for Use). An allowance equal to 100% of standard price, however, is made for the category Excess, Obsolete, and Unserviceable. This allowance results in a net book value of zero, which is considered appropriate in the case of items coded as condemned that have no intrinsic value to the Air Force. The category Held for Repair represents suspended, unserviceable (but reparable) items which have a value to the Air Force but whose value is less than that of the Held for Use items and greater than that of the Excess, Obsolete and Unserviceable items. To date, the Office of the Secretary of Defense is currently developing guidance for computing an allowance for the Held for Repair category. As a result, Air Force continues to report Held for Repair at full standard price.

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

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

Operating Materials and Supplies (OM&S) Value

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

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

In general, the Air Force is using the consumption method of accounting for OM&S, since OM&S is defined in the SFFAS No. 3 as material that has not yet been issued to the end user. Once issued, the material is expensed. According to federal accounting standards, the consumption method of accounting should be used to account for OM&S unless (1) the amount of OM&S is not significant, (2) OM&S are in the hands of the end user for use in normal operations, or (3) it is cost beneficial to expense OM&S when purchased (purchase method).

Other Air Force Disclosures

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

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

Note 10. General PP&E, Net

As of September 30	2006					2005
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
($ in thousands)						
1. Major Asset Classes						
A. Land	N/A	N/A	$ 440,350	N/A	$ 440,350	$ 432,911
B. Buildings, Structures, and Facilities		20 or 40	46,075,786	$ -26,234,571	19,841,215	18,916,942
C. Leasehold Improvements	S/L	lease term	0	0	0	0
D. Software	S/L	2-5 or 10	794,601	-307,616	486,985	344,561
E. General Equipment	S/L	5 or 10	30,298,895	-23,829,906	6,468,989	6,808,603
F. Military Equipment	S/L	Various	235,060,495	-123,829,675	111,230,820	111,579,312
G. Assets Under Capital Lease	S/L	lease term	453,481	-328,319	125,162	151,598
H. Construction-in-Progress	N/A	N/A	3,267,590	N/A	3,267,590	4,721,453
I. Other			0	0	0	0
2. Total General PP&E			$ 316,391,198	$ -174,530,087	$ 141,861,111	$ 142,955,380

[1] Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

Relevant Information for Comprehension

The Air Force changed its method of valuing military equipment in 3rd Quarter, FY 2006. Previously, military equipment was valued using Bureau of Economic Analysis (BEA) data. Beginning 3rd Quarter, FY 2006, military equipment is valued based on internal records. The value of military equipment for the 4th Quarter, FY 2005 was restated from $92.3 billion to $111.6 billion for comparative purposes using the new valuation method. See Note 19 for further disclosures.

For 4th Quarter, FY 2006, military equipment is valued at $111.2 billion based on internal records. Under the previously used BEA valuation methodology, this equipment would have been valued at $95.0 billion.

There are restrictions on the Air Force's ability to dispose of real property (land and buildings) located outside the continental United States.

Other Air Force Disclosures

Included in the net book value of general equipment for 4th Quarter, FY 2006 reports, the Air Force used some FY 2002 ending data for Special Tools and Special Test Equipment (ST/STE) but did use actual data for the B-2 aircraft. The FY 2002 values were still being used for all other ST/STE because the two systems previously used to report ST/STE have been turned off and at least 80% of the dollar value is scheduled to be replaced by Air Force Equipment Management System (AFEMS) in FY 2007. The net book value of ST/STE for the 4th Quarter, FY 2006 remains unchanged at $170.3 million, which is immaterial to the balance of general equipment.

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

Heritage Assets

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

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

Buildings and Structures: The Air Force considers 4,548 buildings and structures on Air Force bases and sites to be heritage assets. In order to be considered a heritage asset, the building and/or facility must be listed, eligible, or potentially eligible for the National Register. These buildings and structures are maintained by each base's civil engineering group as part of their overall responsibility.

Museums: The Air Force Museum System consists of 14 museums with the major museum located at Wright-Patterson Air Force Base, Ohio. It houses the main collection of historical artifacts. 13 museums are considered Air Force Field Museums or Heritage Centers, which also contain items of historical interest, some of which are specific to the general locality. The 14th museum belongs to the Air National Guard. The Air Force also has several heritage centers that are no longer considered museums.

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

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

Archeological Sites: The Air Force has 1,514 archeological sites listed on or eligible for the National Register.

Assets Under Capital Lease

As of September 30	2006	2005
($ in thousands)		
1. Entity as Lessee, Assets Under Capital Lease		
A. Land and Buildings	$ 453,481	$ 453,481
B. Equipment	0	0
C. Accumulated Amortization	-328,319	-301,883
D. Total Capital Leases	$ 125,162	$ 151,598

Fluctuations

The total capital leases decrease of $26.4 million (17%) is due to the current year increase in accumulated amortization. The Air Force is not acquiring new capital leases; therefore, the change in amortization will continue to decrease the net value of assets under capital lease.

Relevant Information for Comprehension

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

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2006	2005
($ in thousands)		
1. Intragovernmental Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Debt	0	0
C. Other	971,752	491,562
D. Total Intragovernmental Liabilities	$ 971,752	$ 491,562
2. Nonfederal Liabilities		
A. Accounts Payable	$ 185,457	$ 232,672
B. Military Retirement and Other Federal Employment Benefits	1,123,322	1,147,437
C. Environmental Liabilities	5,787,360	6,376,345
D. Other Liabilities	3,494,673	2,835,261
E. Total Nonfederal Liabilities	$ 10,590,812	$ 10,591,715
3. Total Liabilities Not Covered by Budgetary Resources	$ 11,562,564	$ 11,083,277
4. Total Liabilities Covered by Budgetary Resources	$ 10,343,006	$ 10,462,797
5. Total Liabilities	$ 21,905,570	$ 21,546,074

Information Related to Liabilities Not Covered by Budgetary Resources: Other Liability Disclosures

Other Intragovernmental Liabilities Not Covered by Budgetary Resources consists of Federal Employees' Compensation Act (FECA) liability to the Department of Labor, unemployment compensation, and custodial liabilities.

Military Retirement and Other Federal Employment Benefits consist of actuarial FECA liability.

Other Nonfederal Liabilities Not Covered by Budgetary Resources consists of capital lease liabilities, contingent liabilities, and accrued annual leave liabilities for military and civilians.

Note 12. Accounts Payable

As of September 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
($ in thousands)				
1. Intragovernmental Payables	$ 1,425,771	N/A	$ 1,425,771	$ 1,651,905
2. Nonfederal Payables (to the Public)	$ 4,269,732	$ 0	$ 4,269,732	$ 5,851,184
3. Total	$ 5,695,503	$ 0	$ 5,695,503	$ 7,503,089

Fluctuations

Intragovernmental accounts payable decreased by $226.1 million (14%) primarily due to less business with the Department of Transportation, the General Service Administration, and the National Aeronautics and Space Administration. Air Force reported a $168.3 million net decrease in payables to the Department of Transportation, the General Service Administration, and the National Aeronautics and Space Administration from 4th Quarter, FY 2005 to 4th Quarter, FY 2006.

Nonfederal payables decreased by $1.6 billion (27%) primarily in aircraft procurement. In FY 2005, production of the F-22, C-17, C-130J, and Predator aircraft was increased to meet additional requirements. In FY 2006, production was reduced back to normal operating levels.

Note 13. Debt

Not applicable

Note 14. Environmental Liabilities and Disposal Liabilities

As of September 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
($ in thousands)				
1. Environmental Liabilities–Nonfederal				
A. Accrued Environmental Restoration Liabilities				
1. Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 397,341	$ 3,241,240	$ 3,638,581	$ 4,006,627
2. Active Installations—Military Munitions Response Program (MMRP)	15,545	1,378,160	1,393,705	1,344,856
3. Formerly Used Defense Sites—IRP and BD/DR	0	0	0	0
4. Formerly Used Defense Sites—MMRP	0	0	0	0
B. Other Accrued Environmental Liabilities—Active Installations				
1. Environmental Corrective Action	0	136,910	136,910	138,378
2. Environmental Closure Requirements	4,429	95,052	99,481	51,655
3. Environmental Response at Operational Ranges	0	0	0	0
4. Other	0	0	0	0
C. Base Realignment and Closure (BRAC)				
1. Installation Restoration Program	124,812	1,080,060	1,204,872	1,201,444
2. Military Munitions Response Program	0	0	0	0
3. Environmental Corrective Action / Closure Requirements	8,432	72,971	81,403	152,376
4. Other	0	0	0	230,842
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0	0	0	0
2. Nuclear Powered Submarines	0	0	0	0
3. Other Nuclear Powered Ships	0	0	0	0
4. Other National Defense Weapons Systems	0	0	0	0
5. Chemical Weapons Disposal Program	0	0	0	0
6. Other	0	0	0	0
2. Total Environmental Liabilities	$ 550,559	$ 6,004,393	$ 6,554,952	$ 7,126,178

Other Categories Disclosure

Others Category Disclosure Comparative Table		
($ in thousands)	**2006**	**2005**
Other Accrued Environmental Costs - Other		
Total	$0	$0
Base Realignment and Closure - Other		
Manpower services at BRAC installations and headquarters offices.	$0	$230,842
Total	$0	$230,842
Environmental Disposal for Weapons Systems Programs - Other	$0	$0
Total	$0	$0

The amount reported for Base Realignment and Closure (BRAC) - Other in FY 2005 was reclassified into the Installation Restoration Program (IRP) line for 4th Quarter, FY 2006 to better reflect the distribution of management and manpower estimates and to be consistent with DoD policy. All future management and manpower estimates will be reported in the IRP and Environmental Corrective Action/Closure Requirements lines.

Environmental Disclosures

As of September 30	2006		2005	
($ in thousands)				
A. Amount of operating and capital expenditures used to remediate legacy waste. Legacy wastes are the remediation efforts covered by IRP, MMRP, and BD/DR regardless of funding source.	$	357,074	$	374,635
B. The unrecognized portion of the estimated total cleanup costs associated with general property, plant, and equipment.	$	103,690	$	152,145
C. The estimated cleanup costs associated with general property, plant, and equipment placed into service during each fiscal year.	$	0	$	0
D. Changes in total cleanup costs due to changes in laws, regulations, and/or technology.	$	-44,891	$	40
E. Portion of the changes in estimated costs due to changes in laws and technology that is related to prior periods.	$	0	$	0

The unrecognized portion of the estimated total cleanup costs associated with general property, plant, and equipment decreased by $48.5 million (32%) due to the normal management lifecycle of landfills maintained by the Air Force. Closure liabilities are recognized by multiplying the percentage used of the total capacity of the landfills. Since Air Force has not placed any new landfills into service in FY 2006, the percentage and dollar amount of used and recognized increases and the percentage and dollar amount of unused and unrecognized decreases.

There are no values for the estimated cleanup costs associated with general property, plant, and equipment placed into service during each fiscal year since the Air Force has not placed any new assets with environmental closure requirements (i.e., landfills) into service in FY 2005 and FY 2006. As of FY 2005, the Air Force no longer recognizes the costs of closure for Underground Storage Tanks (USTs) and Treatment, Storage, and Disposal Facilities (TSDFs) as environmental liabilities. The Air Force does not plan to abandon these facilities and therefore has no liability to be recognized in the financial statements. The Resource Conservation and Recovery Act (RCRA) states that the cleanup of a UST facility takes place only when the tank is abandoned for 12 consecutive months.

The changes in total cleanup costs due to changes in laws, regulations, and/or technology decreased by $44.9 million (112,328%). The change represents an increased improvement in the method used to report information. The FY 2005 information was based on a manual data call. Air Force built an automated process to track and report FY 2006 information.

There is no value assigned to the changes in estimated costs due to changes in laws and technology related to prior periods for FY 2006. The data collected for total changes in cost estimates is due to changes in laws, regulations, and technologies were changes that occurred during FY 2006.

Other Information Related to Environmental Liabilities

Applicable Laws and Regulations of Cleanup Requirements

The Air Force is required to clean-up contamination resulting from past waste disposal practices, leaks, spills and other past activity, which has created a public health or environmental risk. The Air Force does this in coordination with regulatory agencies, and if applicable, with other responsible parties, and current property owners. The Air Force is also required to recognize closure and post-closure costs for its General Property, Plant and Equipment (PP&E) and environmental corrective action costs for current operations. The Air Force is responsible for tracking and reporting all required environmental information related to environmental restoration costs, other accrued environmental costs, disposal costs of weapons systems, and environmental costs related to BRAC actions that have taken place in prior years. Examples of relevant laws and regulations that are considered for discussion, as applicable, include, but are not limited to:

(a) Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)
(b) Clean Water Act
(c) Clean Air Act
(d) Resource Conversation and Recovery Act (RCRA)
(e) Toxic Substances Control Act (TSCA)
(f) Other

The two laws with the vast majority of cost estimates for active environmental cleanup are CERCLA and RCRA. The "Other" classification is reserved to capture all other laws and regulations that are considered for discussion. For example, when environmental cleanup requirements are subject to individual state and/or local laws and regulations, the "Other" classification is used in the Air Force management system as an attribute of the cleanup.

Methods for Assigning Total Cleanup Costs to Current Operating Periods

The Air Force uses engineering estimates and independently validated models to estimate environmental cleanup costs. The models are either contained within the Remedial Action Cost Engineering Requirements (RACER) application, or a historic comparable project, a specific bid, or an independent government cost estimate is referenced for the current project. The Air Force validates the models in accordance with DoD Instruction 5000.61 and primarily uses the models to estimate the cleanup costs based on data received during a preliminary assessment and initial site investigation. The Air Force primarily uses engineering estimates after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project. Once the environmental cleanup cost estimates are complete, the Air Force complies with accounting standards to assign costs to current operating periods. Because the Accrued Environmental Restoration Liabilities is accounted for as a totally self-contained program, all direct and indirect costs of the program are captured and reported.

The Air Force has already expensed the costs for cleanup associated with General PP&E placed into service prior to October 1, 1997, unless the costs are intended to be recovered through user charges. If the costs are recovered through user charges, then the Air Force expensed that portion of the asset that has passed since the General PP&E was placed into service and is systematically recognizing the remaining cost over the life of the assets. For General PP&E placed into service after September 30, 1997, the Air Force expenses the associated environmental costs systematically over the life of the asset. The Air Force expenses the full cost to cleanup contamination for Stewardship PP&E at the time the asset is placed into service. The Air Force uses the physical capacity for operating landfills method for systematic recognition.

Types of Environmental Liabilities Identified

The Air Force has cleanup requirements for the Defense Environmental Restoration Program (DERP) sites at active installations, BRAC installations, and sites at active installations that are not covered by the DERP. The Air Force is required to cleanup DERP and sites not covered by the DERP in coordination with regulatory agencies, other responsible parties, and current property owners.

The environmental cleanup of military ranges is governed by the Military Munitions Rule in 40 CFR 266.201. Environmental cleanup liabilities on ranges refer to munitions related activities. Environmental cleanup areas within a closed range are referred to as Munitions Response Areas (MRAs). As studies are done to find munitions-related contamination on closed ranges, the number of sites is expected to rise. As investigations progress, the number of sites will increase to reflect specific areas of pollution. The Air Force expects the number of sites reported to increase as pollution is discovered and sites are defined in areas less than the total boundary of the closed range.

The accounting standard requires full cost be recognized for closure requirements. The Air Force has closure requirements or disposal liabilities at active installations. Disposal liabilities are presented as an accrued amount for the life of the landfill. The total liability for FY 2006 is $202.0 million which includes:

$99.5 million recognized in the FY 2006 financial statements. The environmental closure liability for landfills is based on the proportion of the landfill used as of the reporting date. This estimate includes the cost of capping (closing) the landfill, as well as 30 years of monitoring required by federal regulations.

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

The Air Force is not aware of any pending changes to reported values of reported Environmental Liabilities. The Air Force does understand that the liabilities can change in the future due to changes in laws and regulations, changes in agreements with regulatory agencies, and advances in technology.

Level of Uncertainty Regarding the Accounting Estimates used to Calculate the Reported Environmental Liabilities

Environmental liabilities for the Air Force are based on accounting estimates which require certain judgments and assumptions to be made by management. The Air Force believes the estimates are reasonable based upon the information available at the time of their calculation. Actual results may vary materially from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. The liabilities can be further impacted if further investigation of the environmental sites discovers contamination different than known at the time of the estimates.

Air Force financial statements would be affected to the extent there are material differences between these estimates and actual results. There are areas in which management judgment in selecting any available alternative could produce a materially different result.

Included in the Accrued Environmental Restoration Liability for September 30, 2006, are 27 engineering sites that represent building demolition and debris removal totaling $56.5 million.

Other Disclosures

Other Accrued Environmental Liabilities - Environmental Corrective Actions

Because the Other Accrued, non-BRAC environmental cleanup activity is part of general funding achieved using Air Force Operation and Maintenance appropriated funds, there is no special accounting for the costs of the cleanup program. Therefore, the costs captured for the Other Accrued, non-BRAC environmental cleanup reflect only direct costs. Because this program was not tracked and appropriated specifically, there was no accounting specific to this program. It is believed that the current portion of the environmental cleanup liability in this area is relatively small and not material in the classification of liabilities.

Other Accrued Environmental Liabilities - Environmental Closure Requirements

Closure liabilities recognized by the Air Force cover only direct costs. No cost accounting exists to determine indirect closure costs. Costs incurred in periods greater than 30 years into the future are considered immaterial. The present value of such costs would be negligible in recognition of closure liabilities if such recognition were not on a current cost basis.

Reporting of landfill closure liability is not in conformance with the accounting standard. The standard would recognize all future costs regardless of timing. The Air Force recognizes only the initial closure. A landfill cap typically requires replacement every 30 to 40 years. An estimation of current costs based on all future costs, regardless of timing, would result in an infinite liability. The Air Force, therefore, reports only the cost of the initial cap required to close a landfill.

Environmental Restoration for Overseas Bases

In addition to the liabilities reported above, the Air Force has the potential to incur costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. The Air Force is unable to provide a reasonable estimate at this time because the extent of restoration required is not known.

Note 15. Other Liabilities

As of September 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
($ in thousands)				
1. Intragovernmental				
A. Advances from Others	$ 622,200	$ 0	$ 622,200	$ 573,687
B. Deposit Funds and Suspense Account Liabilities	299,582	0	299,582	167,899
C. Disbursing Officer Cash	311,604	0	311,604	304,148
D. Judgment Fund Liabilities	0	0	0	0
E. FECA Reimbursement to the Department of Labor	124,516	165,899	290,415	291,104
F. Other Liabilities	734,458	0	734,458	253,029
G. Total Intragovernmental Other Liabilities	$ 2,092,360	$ 165,899	$ 2,258,259	$ 1,589,867
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	$ 965,802	$ 0	$ 965,802	$ 877,966
B. Advances from Others	31,769	0	31,769	67,773
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	79,865	0	79,865	171,514
E. Temporary Early Retirement Authority	130	0	130	677
F. Non-environmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
G. Accrued Unfunded Annual Leave	2,839,835	0	2,839,835	2,351,814
H. Capital Lease Liability	0	188,119	188,119	265,543
I. Other Liabilities	1,524,515	623,073	2,147,588	444,217
J. Total Nonfederal Other Liabilities	$ 5,441,916	$ 811,192	$ 6,253,108	$ 4,179,504
3. Total Other Liabilities	$ 7,534,276	$ 977,091	$ 8,511,367	$ 5,769,371

Fluctuations

Total intragovernmental other liabilities increased $668.4 million (42%) primarily due to a $481.4 million increase in other liabilities. The increase is primarily due to custodial liabilities. In the past, DFAS-DE erroneously reported public accounts receivables in the receipt and deposit fund accounts as entity. DFAS-DE corrected the error during 3rd Quarter, FY 2006 in accordance with the classification of accounts as entity versus nonentity in DoDFMR, Volume 6B, Attachment 20A. The correct classification of a receivable as nonentity results in the recognition of a corresponding custodial liability.

Total nonfederal other liabilities increased $2.1 billion (50%) primarily due to a $1.7 billion increase in other liabilities. The increase is due to the new DoD reporting requirement to record the estimated future contract financing payment that will be paid to contractors upon delivery and Government acceptance of a satisfactory product. This new requirement was implemented in the 4th Quarter, FY 2006.

Relevant Information for Comprehension

The amount of Intragovernmental Other Liabilities represents government contributions for employee benefits, unemployment compensation, education benefits, and custodial liabilities.

The amount of Nonfederal Other Liabilities represents legal contingencies, employee benefits, and contract holdbacks.

The Air Force has no delinquent amounts due to Department of Labor for Federal Employees' Compensation Act (FECA).

Contingent Liabilities balance includes $1.2 billion in estimated future contract financing payments that will be paid to the contractor upon delivery and Government acceptance of a satisfactory product. In accordance with contract terms, specific rights to the contractor's work vests with the Government when a specific type of contract financing payments is made, thereby, protecting taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The Department is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance of a satisfactory product. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to the Department and the amount of potential future payments are estimable; the Department has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance of a satisfactory product.

The recorded estimated probable liability amount of $25.0 million is included in other liabilities nonfederal for open contractor claims greater than $100.0 thousand. At this junction, these claims are not in appeal or in litigation. In addition to the contractor claims under appeal and the open contractor claims for an amount greater than $100.0 thousand, the Air Force was party to numerous other contractor claims in amounts less than $100.0 thousand per claim. These claims are a routine part of the contracting business and are typically resolved through mutual agreement between the contracting officer and the contractor. Because of the routine nature of these claims, no requirement exists for a consolidated tracking mechanism to record the amount of each claim, the number of open claims, or the probability of the claim being settled in favor of the claimant. The potential liability arising from these claims in aggregate would not materially affect the operations or financial condition of the Air Force. A reasonably possible liability is estimated at $47.9 million and is not included in the reported amount and is disclosed in Note 16.

The total estimated probable liability for claims and litigation against the Air Force handled by the Civil Law and Litigation Directorate, as of September 30, 2006, was valued at $443.8 million and is included in other liabilities nonfederal. As of September 30, 2006, the Air Force was party to 19,254 claims and litigation actions. This liability dollar amount recorded in the financial statements is an estimate based on the weighted average payout rate for the previous three years. A reasonably possible liability is estimated at $204.9 million and is not included in the reported amount and disclosed in Note 16. Neither past payments nor the current contingent liability estimate provides a basis for accurately projecting the results of any individual lawsuit or claim. It is uncertain that claims will ever accrue to the Air Force. In addition, many claims and lawsuits, even if successful, will not be paid out of Air Force Funds.

As of September 30, 2006, the Air Force was party to 77 contract appeals before the Armed Services Board of Contract Appeals (ASBCA). The probable amount of loss from contractor claims of $154.2 million is included in other liabilities nonfederal. The contractor claims involve unique circumstances, which are considered by the ASBCA in formulating decisions on the cases. Such claims are funded primarily from Air Force appropriations. A reasonably possible liability is estimated at $486.6 million and is not included in the reported amount and disclosed in Note 16.

Capital Lease Liability

As of September 30	2006				2005
	Asset Category				
	Land and Buildings	Equipment	Other	Total	Total
($ in thousands)					
1. Future Payments Due					
A. 2006	$ 0	$ 0	$ 0	$ 0	$ 42,973
B. 2007	39,878	0	0	39,878	39,878
C. 2008	38,594	0	0	38,594	38,594
D. 2009	38,478	0	0	38,478	38,478
E. 2010	38,478	0	0	38,478	38,478
F. 2011	36,786	0	0	36,786	0
G. After 5 Years	43,520	0	0	43,520	128,881
H. Total Future Lease Payments Due	$ 235,734	$ 0	$ 0	$ 235,734	$ 327,282
I. Less: Imputed Interest Executory Costs	47,615	0	0	47,615	61,738
J. Net Capital Lease Liability	$ 188,119	$ 0	$ 0	$ 188,119	$ 265,544
2. Capital Lease Liabilities Covered by Budgetary Resources				$ 158,472	$ 42,973
3. Capital Lease Liabilities Not Covered by Budgetary Resources				$ 29,647	$ 222,570

Note 16. Commitments and Contingencies

Relevant Information for Comprehension

The Air Force is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests. The Air Force has accrued contingent liabilities for legal actions where the Air Force Office of the General Counsel considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. The Air Force records Judgment Fund liabilities in Note 12 "Accounts Payable."

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

	($ in Millions)
Contractual Actions:	
Contractor Claims	$ 47.9
Appeals before Armed Services Board of Contract Appeals (ASBCA)	486.6
Claims and Litigation from Civil Law	204.9
Total	$ 739.4

The amounts disclosed for litigations claims and assessments are fully supportable and agree with the Air Force's legal representation letters and management summary schedule.

The amount of undelivered orders for open contracts citing cancelled appropriations which remain unfilled or unreconciled for which the Air Force may incur a contractual commitment for payment is $1.4 billion.

The Air Force is not aware of any amounts for contractual arrangements such as fixed price contracts with escalation, price redetermination, or incentive clauses; contract authorizing variations in quantities; and contracts where allowable interest may become payable based on contractors' claims under "Dispute" clause contained in contracts.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2006				2005
	Present Value of Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liability	Present Value of Benefits
($ in thousands)					
1. Pension and Health Actuarial Benefits					
A. Military Retirement Pensions	$ 0		$ 0	$ 0	$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Military Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Actuarial Benefits	$ 0		$ 0	$ 0	$ 0
2. Other Actuarial Benefits					
A. FECA	$ 1,123,323		$ 0	$ 1,123,323	$ 1,147,437
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. Total Other Actuarial Benefits	$ 1,123,323		$ 0	$ 1,123,323	$ 1,147,437
3. Other Federal Employment Benefits	$ 20,425		$ -20,425	$ 0	$ 0
4. Total Military Retirement and Other Federal Employment Benefits:	$ 1,143,748		$ -20,425	$ 1,123,323	$ 1,147,437

Relevant Information for Comprehension

Federal Employees' Compensation Act (FECA)

The Air Force's actuarial liability for workers' compensation benefits is developed and provided by the Department of Labor (DOL) at the end of each fiscal year. The total liability for 4th Quarter, FY 2006 is $1.1 billion, which is a change of $24.1 million (2%) in comparison to 4th Quarter, FY 2005, and includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but unreported claims.

The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the Office of Management and Budget's (OMB's) economic assumptions for 10-year U.S. Treasury notes and bonds. Interest rate assumptions utilized for discounting are as follows:

2006

5.170% in Year 1

5.313% in Year 2 and thereafter

To adjust 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) 2006 were also used to adjust the methodology's historical payments to current year constant dollars.

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

	2006	**2007**	**2008**	**2009**	**2010+**
COLA	3.50%	3.13%	2.40%	2.40%	2.43%
CPIM	4.00%	4.01%	4.01%	4.01%	4.09%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid loses per case (a measure of case-severity) in CBY 2006 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the 2006 projection to the average pattern for the projections of the most recent three years.

Other Federal Employment Benefits

Other Federal Employment Benefits represent liabilities for Servicemembers' Group Life Insurance (SGLI) and death gratuities payable to the beneficiaries of military members.

Note 18. General Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue

As of September 30		2006		2005
($ in thousands)				
1. Intragovernmental Costs	$	30,656,499	$	29,845,742
2. Public Costs		111,722,498		99,536,232
3. Total Costs	$	142,378,997	$	129,381,974
4. Intragovernmental Earned Revenue	$	-4,493,654	$	-4,207,648
5. Public Earned Revenue		-827,193		-879,930
6. Total Earned Revenue	$	-5,320,847	$	-5,087,578
7. Net Cost of Operations	$	137,058,150	$	124,294,396

Fluctuations

Total costs increased $13.0 billion (10%) primarily due to a $12.2 billion increase in public costs. The increase resulted from the additional expenses in FY 2006 to address the hurricanes in the Gulf of Mexico and the Global War on Terrorism (GWOT).

Relevant Information for Comprehension

The Air Force recorded a prior period adjustment due to a change in the methodology for reporting of military equipment. The FY 2005 restatement impacts the value of general property, plant, and equipment and associated accumulated depreciation reported on the balance sheet. The Department has determined that developing the prior year value for the depreciation expense is cost-prohibitive, and thus has elected not to restate the Statement of Net Cost.

Intragovernmental costs and revenue are related to transactions made between two reporting entities within the Federal Government.

Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

The Statement of Net Cost is unique because its principles are driven on understanding the net cost of programs and/or organizations that the Federal Government supports through appropriations or by 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.

The amounts presented in this statement are based on obligations and disbursements and, thus, may not report actual accrued costs in all cases and may not meet accounting standards. As such, the information presented is based on budgetary obligations, disbursements, and collection transactions, as well as non-financial feeder systems, adjusted to record known accruals for major items such as payroll expenses, accounts payable, and environmental liabilities.

The cost of acquiring, constructing, improving, reconstructing, or renovating heritage assets is $2.3 million in FY 2006.

Note 19. Disclosures Related to the Statement of Changes in Net Position

As of September 30	2006		2005	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
($ in thousands)				
1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance				
A. Changes in Accounting Standards	$ 0	$ 0	$ 0	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	19,309,311	0	19,309,311	0
C. Total Prior Period Adjustments	$ 19,309,311	$ 0	$ 19,309,311	$ 0
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	$ 230,498	$ 0	$ 236,321	$ 0
B. Civilian Health	454,584	0	427,569	0
C. Civilian Life Insurance	1,481	0	1,398	0
D. Judgment Fund	12,252	0	76,751	0
E. Intra-Entity	0	0	0	0
F. Total Imputed Financing	$ 698,815	$ 0	$ 742,039	$ 0

Abnormalities

The Statement of Changes in Net Position includes the following abnormal balances:

Cumulative Results of Operations

Appropriations used - Earmarked Funds $-1,251,498

Unexpended Appropriations

Appropriations used - Earmarked Funds $1,251,498

DFAS-DE caused the abnormal balances by establishing incorrect posting logic for the US Standard General Ledger (USSGL) in the General Accounting and Finance System - Rehost (GAFS-R). Prior to the 4th Quarter, FY 2005, GAFS-R erroneously updated unexpended appropriations used and expended appropriations for the earmarked funds. DFAS-DE corrected the posting logic in the 4th Quarter, FY 2005, but did not reverse the previous fiscal years transactions until 1st Quarter, FY 2006. In FY 2007, these balances will be corrected and no longer reported on the Statement of Net Position.

Relevant Information for Comprehension

Errors and Omissions in Prior Year Accounting Reports

The Air Force recorded a $19.3 billion prior period adjustment due to a change in the methodology for reporting of military equipment, resulting in a $19.3 billion restatement for FY 2005. The FY 2005 restatement impacts the value of general property, plant, and equipment and associated accumulated depreciation reported on the Balance Sheet. The Department has determined that developing the prior year value for the depreciation expense is cost-prohibitive, and thus has elected not to restate the Statement of Net Cost.

In accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 23, Eliminating the Category National Defense Property, Plant, and Equipment, the Department reported military equipment values in the financial statements beginning in FY 2003. As an interim measure, while the Department worked to develop its military equipment baseline from internal records, the military equipment values reported were based on information obtained from the Bureau of Economic Analysis (BEA).

Effective 3rd Quarter, FY 2006, the Department replaced the BEA estimation methodology with a valuation based on internal Departmental records. During the process of establishing a baseline, we discovered that the BEA estimates had failed to consider disposals, thresholds, and construction in process. While an estimation methodology is acceptable per SFFAS 23, due to the nature of the BEA omissions, we consider that the method we previously used was not compliant with Generally Accepted Accounting Principles (GAAP), and thus have treated the adjustment as correction of a material error.

Imputed Financing

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

For the Judgment Fund, the Air Force recognizes liabilities and expenses when unfavorable litigation outcomes are probable and the amounts can be estimated. The Treasury provides the dollar amount of the imputed financing. The Treasury based the imputed financing on the amount the Judgment Fund is expected to pay for settlements.

Appropriations Received

Appropriations Received on the Statement of Change in Net Position does not agree with Appropriations Received on the Statement of Budgetary Resources due to differences between proprietary and budgetary accounting concepts and reporting requirements. This difference totals $2.7 million.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2006	2005
($ in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 56,974,233	$ 54,587,501
2. Available Borrowing and Contract Authority at the End of the Period	0	0

Apportionment Categories

Funds are apportioned by three categories: (1) category A is apportioned at the quarterly level, (2) category B is apportioned by activity or project, and (3) exempt are funds not subject to apportionment. The amount of direct obligations incurred and apportioned under category A is $78.9 billion, category B is $57.6 billion, and exempt is $1.8 million. For reimbursable obligations incurred and apportioned, category A is $5.9 billion, category B is $3.3 billion, and exempt is $11.8 million.

Relevant Information for Comprehension

Intra-entity transactions have not been eliminated because the financial statements are presented as combined and combining. Permanent indefinite appropriations are the Wildlife Conservation Fund [16 USC 670 (b)] and the Department of the Air Force General Gift Fund [10 USC 2601 (b)]. Reference Note 23 for additional information. There are no legal arrangements affecting the use of unobligated balances of budget authority. Capital infusion in the amount of $13.9 billion was received during FY 2006 from the Supplemental Appropriation Act for Defense - The Global War on Terror and Hurricane Recovery (P.L. 109-234).

Note 21. Disclosures Related to the Statement of Financing

The objective of the Statement of Financing is to reconcile the difference between budgetary obligations and the net cost of operations reported.

Due to limitations in the Department of the Air Force's financial systems, budgetary data is not in agreement with proprietary expenses and assets capitalized. Differences between budgetary and proprietary data constitute a previously identified deficiency.

No adjustment was made to bring the Statement of Financing into balance with the Statement of Net Cost.

The following Statement of Financing lines are presented as combined instead of consolidated due to intraagency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

Other Resources, Other consists of other gains and losses to adjust intragovernmental transfers in. Other resources or adjustments to net obligated resources that do not affect net cost of operations, Other consists of net transfers in and transfers out without reimbursement and other gains and losses to adjust intragovernmental transfers in. Components Requiring or Generating Resources in Future Period, Other consists of increases to future funded expenses. Components Not Requiring or Generating Resources, Other consists of cost capitalization offset and other expenses not requiring budgetary resources.

The Air Force's allocation transfers do not create a reconciling item on the transferor's or recipient's Statement of Financing.

Components requiring or generating resources in future periods are costs not funded in the period the costs are incurred. The expense and the corresponding liability are recognized in the current period but the budgetary resource will not be provided until a subsequent period. The amount of liabilities not covered by budgetary resources for 4th Quarter, FY 2006 is $11.6 billion. In general, the changes in liabilities not covered by budgetary resources as shown on the Balance Sheet are reflected on the Statement of Financing. Differences are a result of custodial liabilities, unfunded capital lease liabilities, and environmental liabilities covered by unobligated budgetary resources.

Note 22. Disclosures Related to the Statement of Custodial Activity

Not applicable.

Note 23. Earmarked Funds

BALANCE SHEET As of September 30	MRF	MERHCF	Other Earmarked Funds	Eliminations	Total
($ in thousands)					
ASSETS					
Fund Balance with Treasury	$ 0	$ 0	$ 4,816	$ 0	$ 4,816
Investments	0	0	722	0	722
Accounts and Interest Receivable	0	0	284	0	284
Other Assets	0	0	6	0	6
Total Assets	$ 0	$ 0	$ 5,828	$ 0	$ 5,828
LIABILITIES and NET POSITION As of September 30					
Military Retirement Benefits and Other Federal Employment Benefits	$ 0	$ 0	$ 0	$ 0	$ 0
Other Liabilities	0	0	1,288	-1,288	0
Unexpended Appropriations	0	0	0	0	0
Cumulative Results of Operations	0	0	4,540	0	4,540
Total Liabilities and Net Position	$ 0	$ 0	$ 5,828	$ -1,288	$ 4,540
STATEMENT OF NET COST As of September 30					
Program Costs	$ 0	$ 0	$ 14,835	$ 0	$ 14,835
Less Earned Revenue	0	0	-12,519	0	-12,519
Net Program Costs	$ 0	$ 0	$ 2,316	$ 0	$ 2,316
Less Earned Revenues Not Attributable to Programs	0	0	0	0	0
Net Cost of Operations	$ 0	$ 0	$ 2,316	$ 0	$ 2,316
STATEMENT OF CHANGES IN NET POSITION As of September 30					
Net Position Beginning of the Period	$ 0	$ 0	$ 4,200	$ 0	$ 4,200
Net Cost of Operations	0	0	2,316	0	2,316
Budgetary Financing Sources	0	0	2,656	0	2,656
Other Financing Sources	0	0	0	0	0
Change in Net Position	$ 0	$ 0	$ 340	$ 0	$ 340
Net Position End of Period	$ 0	$ 0	$ 4,540	$ 0	$ 4,540

Department of the Air Force General Gift Fund (10 USC 2601 (b)

The Department of the Air Force General Gift Fund accepts, holds, and administers any gift, device, or bequest of real or personal property, made on the condition that it is used for the benefit (or in connection with the establishment, maintenance, or operation) of a school, hospital, library, museum, or cemetery under the Air Force's jurisdiction. The fund is available to such institutions or organizations - subject to the terms of the gift, device, or bequest.

Conditional gifts are invested in U.S. Treasury securities, and any interest earned on these securities is added back into the fund.

Wildlife Conservation Fund (16 USC 670 (b))

The Wildlife Conservation Fund provides for (1) the conservation and rehabilitation of natural resources on military installations; (2) the sustainable multipurpose use of the resources which include hunting, fishing, trapping, and nonconsumptive uses; and (3) the public access to military installations to facilitate its use - subject to safety requirements and military security. The fund is available to carry out these programs and other such expenses that may be necessary for the purpose of the cited statute.

Consisting of both appropriated and nonappropriated funding, this fund gives installation commanders the authority to collect fees from the sale of hunting and fishing permits.

Air Force Cadet Fund (37 USC 725 (s))

The Air Force Cadet Fund is maintained for the benefit of Air Force Academy cadets. Disbursements are made for the personal services of cadets such as laundry, arts, and athletics while collections are received from the same cadets at least equal to any disbursements made.

Relevant Information for Comprehension

No legislation exists that significantly changes the purpose of an earmarked fund or redirects a material portion of the accumulated balance of an earmarked fund.

The Total Earmarked Funds column is shown as consolidated. All intra-DoD activity between earmarked funds and non-earmarked funds has been eliminated from this column, which causes assets to not equal liabilities and net position.

Note 24. Other Disclosures

As of September 30	2006 Asset Category			
	Land and Buildings	Equipment	Other	Total
($ in thousands)				
1. ENTITY AS LEASEE-Operating Leases				
Future Payments Due				
Fiscal Year				
2007	$ 65,538	$ 0	$ 123,726	$ 189,264
2008	60,167	0	127,437	187,604
2009	56,064	0	131,260	187,324
2010	51,000	0	135,198	186,198
2011	72,078	0	139,254	211,332
After 5 Years	66,960	0	143,432	210,392
Total Future Lease Payments Due	$ 371,807	$ 0	$ 800,307	$ 1,172,114

Relevant Information for Comprehension

Leases in the land and buildings category include costs for operating leased housing facilities in the U.S. and overseas for the active Air Force.

The Air Force has no leases in the equipment category and does not anticipate any in the future.

Other leases consist of vehicle leases. The Air Force leases vehicles in three major geographic regions (stateside, Europe, and Southwest Asia) and from two types of lessors, the General Service Administration (GSA) and commercial lessors.

General Fund

Consolidating and Combining Statements

Consolidating Balance Sheet—General Fund

As of September 30, 2006 and 2005 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard
1. ASSETS (Note 2)			
A. Intragovernmental:			
1. Fund Balance with Treasury (Note 3)			
a. Entity	$ 65,780,012	$ 958,933	$ 2,028,233
b. Nonentity Seized Iraqi Cash	0	0	0
c. Nonentity - Other	80,989	0	0
2. Investments (Note 4)	722	0	0
3. Accounts Receivable (Note 5)	1,128,138	111,283	170,092
4. Other Assets (Note 6)	38	0	0
5. Total Intragovernmental Assets	$ 66,989,899	$ 1,070,216	$ 2,198,325
B. Cash and Other Monetary Assets (Note 7)	$ 114,779	$ 0	$ 0
C. Accounts Receivable, Net (Note 5)	1,015,683	9,425	16,638
D. Loans Receivable (Note 8)	0	0	0
E. Inventory and Related Property, Net (Note 9)	47,147,046	98,984	1,338,305
F. General Property, Plant and Equipment, Net (Note 10)	137,923,115	946,193	2,991,803
G. Investments (Note 4)	0	0	0
H. Other Assets (Note 6)	11,351,763	6,269	21,094
2. TOTAL ASSETS	$ 264,542,285	$ 2,131,087	$ 6,566,165
3. LIABILITIES (Note 11)			
A. Intragovernmental:			
1. Accounts Payable (Note 12)	$ 702,167	$ 26,230	$ 73,024
2. Debt (Note 13)	0	0	0
3. Other Liabilities (Note 15 & 16)	2,638,269	1,372	923
4. Total Intragovernmental Liabilities	$ 3,340,436	$ 27,602	$ 73,947
B. Accounts Payable (Note 12)	$ 4,042,852	$ 79,033	$ 108,840
C. Military Retirement and Other Federal Employment Benefits (Note 17)	826,321	118,222	199,205
D. Environmental and Disposal Liabilities (Note 14)	6,554,952	0	0
E. Loan Guarantee Liability (Note 8)	0	0	0
F. Other Liabilities (Note 15 and Note 16)	5,955,603	115,611	181,894
4. TOTAL LIABILITIES	$ 20,720,164	$ 340,468	$ 563,886
5. NET POSITION			
A. Unexpended Appropriations - Earmarked Funds (Note 23)	$ 0	$ 0	$ 0
B. Unexpended Appropriations - Other Funds	67,980,181	880,943	1,895,172
C. Cumulative Results of Operations - Earmarked Funds	4,540	0	0
D. Cumulative Results of Operations - Other Funds	175,837,400	909,676	4,107,107
6. TOTAL NET POSITION	$ 243,822,121	$ 1,790,619	$ 6,002,279
7. TOTAL LIABILITIES AND NET POSITION	$ 264,542,285	$ 2,131,087	$ 6,566,165

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

Component Level	Combined Total	Eliminations	2006 Consolidated	2005 Consolidated Restated
$ 0	$ 68,767,178	$ 0	$ 68,767,178	$ 62,272,967
0	0	0	0	0
0	80,989	0	80,989	77,275
0	722	0	722	717
-743,841	665,672	0	665,672	653,589
454,930	454,968	0	454,968	427,989
$ -288,911	$ 69,969,529	$ 0	$ 69,969,529	$ 63,432,537
$ 0	$ 114,779	$ 0	$ 114,779	$ 151,844
0	1,041,746	0	1,041,746	1,028,310
0	0	0	0	0
0	48,584,335	0	48,584,335	47,169,013
0	141,861,111	0	141,861,111	142,955,380
0	0	0	0	0
0	11,379,126	0	11,379,126	11,179,041
$ -288,911	$ 272,950,626	$ 0	$ 272,950,626	$ 265,916,125
$ 624,350	$ 1,425,771	$ 0	$ 1,425,771	$ 1,651,904
0	0	0	0	0
-382,305	2,258,259	0	2,258,259	1,589,867
$ 242,045	$ 3,684,030	$ 0	$ 3,684,030	$ 3,241,771
$ 39,007	$ 4,269,732	$ 0	$ 4,269,732	$ 5,851,184
0	1,143,748	0	1,143,748	1,147,437
0	6,554,952	0	6,554,952	7,126,178
0	0	0	0	0
0	6,253,108	0	6,253,108	4,179,504
$ 281,052	$ 21,905,570	$ 0	$ 21,905,570	$ 21,546,075
$ 0	$ 0	$ 0	$ 0	$ 0
-569,963	70,186,333	0	70,186,333	63,716,637
0	4,540	0	4,540	0
0	180,854,183	0	180,854,183	180,653,413
$ -569,963	$ 251,045,056	$ 0	$ 251,045,056	$ 244,370,050
$ -288,911	$ 272,950,626	$ 0	$ 272,950,626	$ 265,916,125

Consolidating Statement of Net Cost—General Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard
1. Program Costs			
A. Military Personnel			
1. Gross Costs	$ 27,251,264	$ 1,487,489	$ 2,885,836
2. (Less: Earned Revenue)	-313,642	-5,980	-33,030
3. Net Program Costs	$ 26,937,622	$ 1,481,509	$ 2,852,806
B. Operation and Maintenance			
1. Gross Costs	$ 43,289,289	$ 3,264,430	$ 6,671,632
2. (Less: Earned Revenue)	-4,243,713	-365,940	-839,532
3. Net Program Costs	$ 39,045,576	$ 2,898,490	$ 5,832,100
C. Procurement			
1. Gross Costs	$ 34,227,618	$ 0	$ 0
2. (Less: Earned Revenue)	-307,269	0	0
3. Net Program Costs	$ 33,920,349	$ 0	$ 0
D. Research, Development, Test & Evaluation			
1. Gross Costs	$ 23,881,915	$ 0	$ 0
2. (Less: Earned Revenue)	-3,062,745	0	0
3. Net Program Costs	$ 20,819,170	$ 0	$ 0
E. Military Construction/Family Housing			
1. Gross Costs	$ 2,714,499	$ 107,946	$ 214,321
2. (Less: Earned Revenue)	-467	0	0
3. Net Program Costs	$ 2,714,032	$ 107,946	$ 214,321
F. Other			
1. Gross Costs	$ 409,131	$ 0	$ 0
2. (Less: Earned Revenue)	-12,737	0	0
3. Net Program Costs	$ 396,394	$ 0	$ 0
G. Total Program Costs			
1. Gross Costs	$ 131,773,716	$ 4,859,865	$ 9,771,789
2. (Less: Earned Revenue)	-7,940,573	-371,920	-872,562
3. Net Program Costs	$ 123,833,143	$ 4,487,945	$ 8,899,227
2. Cost Not Assigned to Programs	0	0	0
3. (Less: Earned Revenue Not Attributable to Programs)	0	0	0
4. Net Cost of Operations	$ 123,833,143	$ 4,487,945	$ 8,899,227

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

Component Level	Combined Total	Eliminations	2006 Consolidated	2005 Consolidated
	$ 31,624,589	$ 0	$ 31,624,589	$ 30,439,626
	-352,652	0	-352,652	-412,333
	$ 31,271,937	$ 0	$ 31,271,937	$ 30,027,293
	$ 53,225,351	$ 0	$ 53,225,351	$ 51,130,908
	-5,449,185	0	-5,449,185	-4,979,392
	$ 47,776,166	$ 0	$ 47,776,166	$ 46,151,516
	$ 34,227,618	$ 0	$ 34,227,618	$ 30,102,668
	-307,269	0	-307,269	-409,050
	$ 33,920,349	$ 0	$ 33,920,349	$ 29,693,618
	$ 23,881,915	$ 0	$ 23,881,915	$ 23,481,095
	-3,062,745	0	-3,062,745	-3,335,195
	$ 20,819,170	$ 0	$ 20,819,170	$ 20,145,900
	$ 3,036,766	$ 0	$ 3,036,766	$ 196,667
	-467	0	-467	1,168
	$ 3,036,299	$ 0	$ 3,036,299	$ 197,835
$ -4,026,373	$ -3,617,242	$ 0	$ -3,617,242	$ -5,968,990
3,864,208	3,851,471	0	3,851,471	4,047,225
$ -162,165	$ 234,229	$ 0	$ 234,229	$ -1,921,765
$ -4,026,373	$ 142,378,997	$ 0	$ 142,378,997	$ 129,381,974
3,864,208	-5,320,847	0	-5,320,847	-5,087,577
$ -162,165	$ 137,058,150	$ 0	$ 137,058,150	$ 124,294,397
0	0	0	0	0
0	0	0	0	0
$ -162,165	$ 137,058,150	$ 0	$ 137,058,150	$ 124,294,397

Combining Statement of Budgetary Resources—General Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	Air Force Active	Air Force Reserve
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES:		
1. Unobligated balance, brought forward, October 1	$ 12,315,048	$ 223,806
2. Recoveries of prior year unpaid obligations	1,278,697	103,489
3. Budget authority		
3a. Appropriation	127,698,816	4,187,758
3b. Borrowing authority	0	0
3c. Contract authority	0	0
4. Spending authority from offsetting collections		
4a. Earned		
1. Collected	8,064,516	307,942
2. Change in receivables from Federal sources	-153,113	64,003
4b. Change in unfilled customer orders		
1. Advance received	-94,677	0
2. Without advance from Federal sources	-101,970	125
4c. Anticipated for rest of year, without advances	0	0
4d. Previously unavailable	0	0
4e. Expenditure transfers from trust funds	0	0
4f. Subtotal	135,413,572	4,559,828
5. Nonexpenditure transfers, net, anticipated and actual	2,302,571	-37,205
6. Temporarily not available pursuant to Public Law	0	0
7. Permanently not available	-2,800,010	-89,081
8. Total Budgetary Resources	$ 148,509,878	$ 4,760,837
STATUS OF BUDGETARY RESOURCES:		
9. Obligations incurred:		
9a. Direct	$ 124,191,781	$ 4,161,954
9b. Reimbursable	7,874,286	408,314
9c. Subtotal	132,066,067	4,570,268
10. Unobligated balance:		
10a. Apportioned	14,791,609	48,988
10b. Exempt from apportionment	3,174	0
10c. Subtotal	14,794,783	48,988
11. Unobligated balance not available	1,649,028	141,581
12. Total Status of Budgetary Resources	$ 148,509,878	$ 4,760,837
CHANGE IN OBLIGATED BALANCE:		
13. Obligated balance, Net		
13a. Unpaid obligations, brought forward, October 1	49,444,390	879,413
13b. Less: Uncollected customer payments from Federal sources, brought forward, October 1	$ -2,592,595	$ -52,108
13c. Total unpaid obligated balance	46,851,795	827,305
13d. Obligations incurred net (+/-)	$ 132,066,066	$ 4,570,268
14. Less: Gross outlays	-128,856,921	-4,461,592
15. Obligated balance transferred, net		
15a. Actual transfers, unpaid obligations (+/-)	0	0
15b. Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0
16. Total Unpaid obligated balance transferred, net	0	0
17. Less: Recoveries of prior year unpaid obligations, actual	-1,278,697	-103,489
Change in uncollected customer payments from Federal sources (+/-)	255,083	-64,127
18. Obligated balance, net, end of period		
18a. Unpaid obligations	51,374,838	884,600
18b. Less: Uncollected customer payments from Federal sources	-2,337,512	-116,235
18c. Total, unpaid obligated balance, net, end of period	49,037,326	768,365
NET OUTLAYS:		
19. Net Outlays:		
19a. Gross outlays	128,856,921	4,461,592
19b. Less: Offsetting collections	-7,969,838	-307,942
19c. Less: Distributed Offsetting receipts	-185,423	0
20. Net Outlays	$ 120,701,660	$ 4,153,650

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

Air National Guard	Component Level	2006 Combined	2005 Combined
$ 467,354	$ 0	$ 13,006,208	$ 9,043,364
68,720	0	1,450,906	1,300,191
7,881,036	0	139,767,610	128,890,968
0	0	0	0
0	0	0	0
882,732	0	9,255,190	8,923,532
-10,169	0	-99,279	142,948
0	0	-94,677	349,671
-648	0	-102,493	388,543
0	0	0	0
0	0	0	0
0	0	0	0
8,752,951	0	148,726,351	138,695,662
311,324	0	2,576,690	2,598,439
0	0	0	0
-157,142	0	-3,046,233	-1,493,468
$ 9,443,207	$ 0	$ 162,713,922	$ 150,144,188
$ 8,085,811	$ 0	$ 136,439,546	$ 124,689,424
878,849	0	9,161,449	12,448,555
8,964,660	0	145,600,995	137,137,979
158,019	0	14,998,616	11,756,881
0	0	3,174	3,218
158,019	0	15,001,790	11,760,099
320,528	0	2,111,137	1,246,110
$ 9,443,207	$ 0	$ 162,713,922	$ 150,144,188
1,516,978	0	51,840,781	53,808,139
$ -190,794	$ 0	$ -2,835,497	$ -2,304,006
1,326,184	0	49,005,284	51,504,133
$ 8,964,661	$ 0	$ 145,600,995	$ 137,137,979
-8,683,256	0	-142,001,769	-137,805,147
0	0	0	0
0	0	0	0
0	0	0	0
-68,720	0	-1,450,906	-1,300,191
10,817	0	201,773	-531,490
1,729,663	0	53,989,101	51,840,781
-179,976	0	-2,633,723	-2,835,497
1,549,687	0	51,355,378	49,005,284
8,683,256	0	142,001,769	137,805,147
-882,732	0	-9,160,512	-9,273,203
0	0	-185,423	-123,202
$ 7,800,524	$ 0	$ 132,655,834	$ 128,408,742

Consolidating Statement of Financing—General Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
1. Obligations incurred	$ 132,066,067	$ 4,570,268	$ 8,964,661
2. Less: Spending authority from offsetting collections and recoveries (-)	-8,993,450	-475,559	-940,635
3. Obligations net of offsetting collections and recoveries	123,072,617	4,094,709	8,024,026
4. Less: Offsetting receipts (-)	-185,423	0	0
5. Net obligations	122,887,194	4,094,709	8,024,026
Other Resources			
6. Donations and forfeitures of property	0	0	0
7. Transfers in/out without reimbursement (+/-)	3,833,935	49,264	-146,929
8. Imputed financing from costs absorbed by others	698,814	0	0
9. Other (+/-)	0	0	0
10. Net other resources used to finance activities	4,532,749	49,264	-146,929
11. Total resources used to finance activities	$ 127,419,943	$ 4,143,973	$ 7,877,097
Resources Used to Finance Items not Part of the Net Cost of Operations			
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
12a. Undelivered Orders (-)	-2,011,669	-6,994	-206,081
12b. Unfilled Customer Orders	-196,647	125	-648
13. Resources that fund expenses recognized in prior periods	-884,679	-4,340	-9,925
14. Budgetary offsetting collections and receipts that do not affect	185,423	0	0
15. Resources that finance the acquisition of assets	-17,216,050	-15,022	-180,100
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations			
16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget	0	0	0
16b. Other (+/-)	-3,833,935	-49,264	146,929
17. Total resources used to finance items not part of the net cost of operations	$ -23,957,557	$ -75,495	$ -249,825
18. Total resources used to finance the net cost of operations	$ 103,462,386	$ 4,068,478	$ 7,627,272
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:			
Components Requiring or Generating Resources in Future Period:			
19. Increase in annual leave liability	491,847	0	0
20. Increase in environmental and disposal liability	0	0	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0	0
22. Increase in exchange revenue receivable from the public (-)	0	0	0
23. Other (+/-)	610,250	236	0
24. Total components of Net Cost of Operations that will require or generate resources in future periods	1,102,097	236	0
Components not Requiring or Generating Resources:			
25. Depreciation and amortization	15,792,824	46,327	252,229
26. Revaluation of assets or liabilities (+/-)	431,256	24,483	113,600
27. Other (+/-)			
27a. Trust Fund Exchange Revenue	0	0	0
27b. Cost of Goods Sold	0	0	0
27c. Operating Material & Supplies Used	13,184,372	10,511	77,420
27d. Other	-10,139,794	337,911	828,707
28. Total components of Net Cost of Operations that will not require or generate resources	19,268,658	419,232	1,271,956
29. Total components of net cost of operations that will not require or generate resources in the current period	$ 20,370,755	$ 419,468	$ 1,271,956
30. Net Cost of Operations	$ 123,833,141	$ 4,487,946	$ 8,899,228

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

Component Level	Combined Total	Eliminations	2006 Consolidated	2005 Consolidated
$ 0	$ 145,600,996	$ 0	$ 145,600,996	$ 137,137,979
0	-10,409,644	0	-10,409,644	-11,104,884
0	135,191,352	0	135,191,352	126,033,095
0	-185,423	0	-185,423	-123,202
0	135,005,929	0	135,005,929	125,909,894
0	0	0	0	0
-3,690,030	46,240	0	46,240	-25,648
0	698,814	0	698,814	742,039
3,690,030	3,690,030	0	3,690,030	0
0	4,435,084	0	4,435,084	716,391
$ 0	$ 139,441,013	$ 0	$ 139,441,013	$ 126,626,284
-162,165	-2,386,909	0	-2,386,909	-11,681,780
0	-197,170	0	-197,170	738,214
0	-898,944	0	-898,944	-606,526
0	185,423	0	185,423	123,202
0	-17,411,172	0	-17,411,172	-18,029,608
0	0	0	0	0
0	-3,736,270	0	-3,736,270	25,648
$ -162,165	$ -24,445,042	$ 0	$ -24,445,042	$ -29,430,850
$ -162,165	$ 114,995,971	$ 0	$ 114,995,971	$ 97,195,434
0	491,847	0	491,847	81,024
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	610,486	0	610,486	13,659
0	1,102,333	0	1,102,333	94,683
0	16,091,380	0	16,091,380	11,743,098
0	569,339	0	569,339	787,835
0	0	0	0	0
0	0	0	0	0
0	13,272,303	0	13,272,303	2,037,758
0	-8,973,176	0	-8,973,176	12,435,587
0	20,959,846	0	20,959,846	27,004,278
$ 0	$ 22,062,179	$ 0	$ 22,062,179	$ 27,098,961
$ -162,165	$ 137,058,150	$ 0	$ 137,058,150	$ 124,294,395

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General Fund

Required Supplementary Stewardship Information

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NON-FEDERAL PHYSICAL PROPERTY
Yearly Investment in State and Local Governments
For Fiscal Years 2002 through 2006
($ in Millions)

Categories	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Funded Assets:					
National Defense Mission Related	$21.30	$11.31	$18.30	$8.30	$8.50
Total	$21.30	$11.31	$18.30	$8.30	$8.50

Narrative Statement

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

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

INVESTMENTS IN RESEARCH AND DEVELOPMENT
Yearly Investment in Research and Development
For Fiscal Years 2002 through 2006
($ in Millions)

Categories	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
1. Basic Research	$205	$220	$209	$287	$334
2. Applied Research	658	735	805	805	939
3. Development					
Advanced Technology Development	559	545	681	966	901
Advanced Component Development And Prototypes	4,640	4,385	1,426	1,897	1,985
System Development and Demonstration	3,509	4,341	4,390	4,179	4,172
Research, Development, Test and Evaluation Management Support	824	880	890	824	1,271
Operational Systems Development	7,103	7,571	10,361	10,083	9,622
4. Totals	$17,498	$18,677	$18,762	$19,041	$19,224

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

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

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

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

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

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

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

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

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

Basic Research - A team of Air Force-supported basic researchers has discovered a new diagnostic technique called Radar Resonant Enhanced Multi-Photo Ionization (Radar REMPI) for measuring plasmas and hypersonic flows. The technique is based on scattering microwave radiation from a small laser-induced ionization region in a flowing gas, combusting zone or plasma, and is capable of measuring at any point of the hypersonic flow without causing any intrusion on the flow that could negatively impact the accuracy of the measurements. The research conducted by the team is both computational and experimental and involves working at hypersonic speeds. Better understanding of hypersonic flows is critical for designing more efficient high-speed vehicles.

The Air Force supported basic researchers have successfully proved experimentally the existence of a class of materials (metamaterials) that possess a negative refractive index that was predicted theoretically in 1968. All known materials have positive refractive index: however according to the experimental results, it is possible to make an artificial metamaterial that has a negative refractive index, without violating the laws of Physics. The experiment was conducted in a microwave wavelength region, but notionally, an electromagnetic wave (such as a beam of light) will be bent in the opposite way in a metamaterial, for an example. This scientific discovery could potentially lead to a higher-resolution imaging and smaller and lighter electromagnetic devises for military sensing and communication.

Applied Research - An Air Force Research Laboratory (AFRL) bio-sensor, consisting of aptamers combined with metallic nanoparticles and fluorescing quantum dots, was demonstrated for detection and identification of biological threat agents.

Researchers at the AFRL demonstrated a Logistics Fuel Processor (LFP). The processor would permit the user of a reliable and easily operated fuel cell power system as an alternative to current Mobile Electric Power (MEP) units for ground based power applications.

Air Force is investing in concept studies and technologies to suppress enemy activity in high threat areas with air-delivered, network centric, persistent munitions capable of defeating the entire spectrum of ground mobile targets.

Developed the first-ever broadband, laser-based proactive infrared countermeasure (PIRCM) system; integrating complex self-protection functions into a single set of electro-optical (EO) sensors. This PIRCM system can detect, identify, locate, target and counter threats from EO/infrared sensors and missile seekers prior to missile launch or sensor activation.

The Air Force is developing information technologies to support the Air, Space, and Cyberspace forces of the future. Development of the Commander's Predictive Environment is underway, whose goal is to explore and develop capabilities that will enable commanders to anticipate and shape the battlespace. This environment is designed to anticipate the strengths, capabilities and vulnerabilities of the adversary and neutrals, as well as, the Blue Forces. Utilizing these attributes, possible courses of action (COAs) are developed with the goal of determining plausible "future states" to which a Commander can then select to shape and control the battlespace.

Developed Accelerated Insertion of Materials techniques to investigate the plastic deformation of metallic crystals at a nanometer scale. This work is building towards the capability to accelerate production of new designer metals, which contain unique material properties (high strength, higher temperature, increased durability, etc.) for critical Air Force needs.

Advanced Technology Development - Demonstrated a suspended two telescope relay mirror system by redirecting a beam from a ground-based laser illuminating the first telescope to a distant target by aiming the first telescope at the ground based laser and the second at the target. This technology can significantly increase the range of high energy lasers by reducing the path through the atmosphere, and also allows non-line-of-sight targeting.

Completed development of first ever immersive and distributed environment for joint terminal attack and control training and rehearsal. The distributed environment is a benchmark for meeting Joint Operational Requirements Document (JORD) requirements for mission area training across Services.

The Air Force Research Laboratory in cooperation with industry have successfully developed and demonstrated a durable composite C-17 main landing gear (MLG) door. As a result of the Composites Affordability Initiative (CAI) C-17 technology transition demonstration program, the MLG door features stitched preforms, vacuum assisted resin transfer molding and an improved design.

The Air Force Research Laboratory is developing and testing low collateral damage munitions for engaging and prosecuting targets in urban environments. Technologies developed in this activity will benefit Focused Lethality Multiphase Blast Explosive MBX (JCTD).

The Air Force successfully completed demonstration of a lightweight, low profile, low-cost, X-band Active Electronically Steered Array (AESA). The AESA integrates Synthetic Aperture Radar (SAR) and Ground Moving

Target Indicator (GMT) functions while providing night/all-weather situational awareness and highly accurate targeting data to decrease the timeline in acquiring time critical targets.

The Air Force Research Laboratory demonstrated a new concept, called the Master Caution Panel (MCP). This program continuously monitors status of critical Air and Space Operations Center (AOC) information systems, correlates system failures against the battle rhythm of the AOC and user needs, and provides the "right info" to the "right person" at the "right time" enabling rapid understanding of any impact to the AOC mission. These tests were highly successful and MCP has been integrated into the AOCs Theater Battle Management Core Systems.

One revolutionary area of research ongoing in the Air Force Research Laboratory focuses on the X-51A, a hypersonic test platform that strives to demonstrate the HyTech hydrocarbon-fueled scramjet in flight using waverider airframe technologies from the Defense Advanced Research Projects Agency Affordable Rapid Response Missile Demonstrator (ARRMD) program. The program will use an existing ATACMS booster to accelerate the air vehicle from B-52 launch (40,000 ft. at Mach 0.8) to Mach 4.5 to Mach 5 at which time the flight vehicle will separate from the booster and the scramjet engine will then start and accelerate the vehicle to between Mach 6.5 and Mach 7. This game-changing technology looks to propel the Air Force to all new heights, potentially providing new methods for space access and improving our rapid response capabilities. Test flights are scheduled to begin in FY 2009.

As part of efforts to reduce the U.S. military's reliance on foreign energy sources, the Air Force conducted its first-ever flight test of an alternative jet fuel on September 19, 2006, at Edwards AFB, California. During the mission, two of the eight engines of a B-52H Stratofortress bomber aircraft successfully ran on a fuel comprised of a 50-50 blend of conventional oil-based jet fuel and a Fischer-Tropsch fuel derived from natural gas. The aircraft's six remaining engines burned traditional JP-8 jet fuel during the flight. This Fischer-Tropsch experiment is part of the Pentagon's Assured Fuel Initiative that seeks to convert coal, of which the United States has in abundant reserves, into liquid fuel (Defense Daily, June 8, 2006). The fuel derived from refining natural gas under the Fischer-Tropsch process, which is named after its German inventors of the 1920s.

The Air Force developed improved turbine engine life-management tools that integrate state-of-the-art material analysis, enhanced non-destructive evaluation, and data management as a comprehensive life management system. Component cost avoidance is estimated to exceed $300 million for the F100/F110 engine series alone (extends life for 8000 to 12000 TACs).

The Air Force's Advanced Technology Development program demonstrates, in a realistic operational environment, integrated sets of technology to prove military worth and utility. AFRL demonstrated a 330 Gigahertz detector that operates at frequencies billions of times faster than the blink of an eye. This technology will be used to produce compact solid-state circuits operating at Terahertz frequencies. Likely technology application would be to enable a new generation of sensors to enhance homeland security. The Air Force also completed the final transition of the very successful Laser Infrared Countermeasures Fly-out Experiment demonstration with a final risk reduction live fire missile test at Tonopah National Test Range, Nevada. This test showed conclusively that Closed Loop Infrared Countermeasures jamming techniques provide a robust capability against a wide variety of infrared missiles, including proliferated Man Portable Air Defense Systems.

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

The Joint Unmanned Combat air Systems (J-UCAS) program was terminated in December 2005. The two J-UCAS X-45A aircraft flew a total of 64 flights and performed limited demonstrations of precision weapon drops, multi-ship coordinated flight, and collaborative targeting technologies, illustrating the potential for future unmanned combat air systems development programs. The Air force continued to advocate the AFRL Automated Air Refueling (AAR) program. On August 16, 2006 the AFRL AAR program achieved a historic milestone by demonstrating the ability of a Learjet (surrogate unmanned air system) to automatically maintain precision position keeping behind a KC-135 through all of the aerial refueling positions including the contact position.

The SPIRITT Advanced Technology Demonstration (ATD) will develop a day, high altitude, hyperspectral imaging reconnaissance sensor testbed to address U-2/Global Hawk limitations in detecting and identifying camouflaged, concealed, and other difficult targets. The SPIRITT ATD developed an HIS sensor integrated with a high resolution daytime imaging sensor and successfully flight tested the system on a NASA WB-57 aircraft against simulated targets in CONUS as well as in an engineering demonstration capacity on a high-visibility OCONUS deployment. The sensor system supported a real-time on-board processing capability for rapid precision targeting. It also supported full data recording for longer term Measurement and Signature Intelligence (MASINT) exploitation for intelligence community target of interest.

The Air Force continues development of technologies to protect US Space assets from the continued worldwide development, deployment, and employment of foreign space and counterspace systems.

Demonstration and Validation (Advanced Component Development and Prototypes) - The Air Force's Advanced Component Development and Prototypes (ACD&EP) programs are comprised of system specific advanced technology integration efforts accomplished in an operational environment to help expedite transition from the effort: In FY 2004 the Air Force successfully demonstrated Fighter Aircraft Command and Control Enhancement (FACE). FACE provides an improved, beyond-line-of-sight (BLOS) command and control link with fighter aircraft by integrating Iridium telephone communications equipment with existing aircraft communications equipment. BLOS capability has traditionally been provided by low-density, high-demand airborne platforms acting as communications relays. FACE provides relief for these overworked assets, while allowing combatant commanders to maintain positive control of the battle space. FACE, which has been approved for deployment to Afghanistan through the Air Force's Rapid Response Process, has the potential for extensive use in virtually any Area of Responsibility, including Homeland Defense.

In FY 2005, two small responsive launch vehicles were matured to Critical Design Review (CDR) and beyond capability, with the Space-X launch Vehicle conducting a series of demonstration flights to mature components hardware and system integrity. An initial launch was conducted, unsuccessfully, in March 2006. A Return-to-Flight demonstration is planned for November 2006. The launch of Tactical Satellite-1 (TACSAT-1) is also scheduled to occur on a Space-X Falcon-1 vehicle in April 2007. The hypersonic test vehicle effort continues to mature constituent hypersonic technologies in the areas of aerodynamic, thermal protection, communications, and guidance, navigation and accuracy, moving towards two flight demonstrations, which are scheduled in FY 2009. The goal of this technology demonstration program is to demonstrate and validate key technologies leading to residual capability and follow-on operational systems.

In FY 2005, the Air Force restructured and refocused the Space Radar (SR) program (formerly Space Base Radar) to address congressional concerns with technical risk, affordability, and DoD-Intelligence Community (IC) integration. In January 2005, the Secretary of Defense (SECDEF) and the Director of Central intelligence (DCI) signed a joint memo designating the SR program as the single space radar capability for the nation. The Undersecretary of the Air Force appointed a two-star general as SR System Program Director (SPD) and Program Executive Officer (PEO), and moved the SR Integrated Program Office (IPO) from Los Angeles, CA to Chantilly, VA in order to foster greater synergy with the IC. The SR program implemented a demonstration framework approach to system development. This approach will further technology maturity risk reduction and CONOPS experimentation through a mix of space, air, and land-based demonstration activities that will maximize existing assets. The SR program will provide day/night, all-weather global surface moving target indications (MTI), synthetic aperture radar (SAR) and high-resolution terrain information (HRTI) capabilities from a space-based platform. Initial launch capability is planned for FY 2015.

System Development and Demonstration - The Air Force's System Development & Demonstration (SDD) efforts are development projects which have not received approval for full-production. In FY 2006, the F-22 Raptor program closed out Engineering and Manufacturing Development (EMD) and is now in Full Rate Production. The Air Combat Command at Langley AFB, Virginia, achieved Initial Operational Capability (IOC) in December 2005. In closing out EMD in June 2006, the F-22 program completed the full-scale airframe structural fatigue testing and analysis, completed support and test of the flight test engines, and completed integration of the Operational Flight Program (OFP) software in the Avionics Integration lab for future software development and support efforts. The successful conclusion of EMD laid the foundation for future F-22 Raptor enhancements under the current incremental modernization strategy.

The F-35 Joint Strike Fighter (JSF) program is developing a family of strike fighter aircraft for the Air Force, Navy, Marine Corps and our allies, with maximum commonality among the variants to minimize life cycle costs. The Air Force Conventional Takeoff and Landing (CTOL) variant will be a multi-role, primary air-to-ground aircraft to replace the F-16 and A-10 and complement the F-22. While the F-22 will establish air dominance, the F-35---with its combination of stealth, large internal payloads and multi-spectral avionics---will provide persistent stealth and precision engagement to the future battlespace. The F-35 is in the 5th year of a 12-year System Development and Demonstration (SDD) effort. Significant program accomplishments in FY 2006 include:

- Assembly, power on, and first engine run of the first CTOL aircraft
- Completed Critical Design Reviews (CDRs) for CTOL and Short Takeoff and Vertical landing (STOVL variants
- Awarded long lead contracts for Low Rate initial Production (LRIP) Lot 1 (f CTOL aircraft) in April 2006 to Lockheed Martin ($94M) and Pratt & Whitney ($23M)
- Began component assembly of 5 STOVLs and 2 additional CTOLs

The Multi-Platform - Radar Technology Insertion Program is being developed for the Global Hawk and E-10 programs as an interoperable platform-independent Ground Moving Target Indicator (GMTI), Synthetic Aperture Radar (SAR) imaging, and Air Moving Target Indicator (AMTI) system-of-systems capable of providing dynamic support to operations. MP-RTIP development is on cost and on schedule, while continuing to build upon previous years' achievements by completing a Design Readiness Review in preparation for System Demonstration. As of September 2006, MP-RTIP has completed developmental fabrication of three Global Hawk radar developmental units and completed three of sixteen aperture components, with six other in various stages of build, on the first E-10 developmental units. The Global Hawk MP-RTIP variant achieved successful first flight in September 2006 beginning developmental testing onboard a Proteus test vehicle and remains on track to begin Global Hawk testing in 2008 with production deliveries projected for 2010. Additionally, the E-10 MP-RTIP promises will enhance the mission areas of air and surface surveillance and tracking with faster revisit rates, increased resolution, simultaneous tracking and SAR imaging, as well as, cruise missile defense capability on the E-10A variant. The program's continued schedule delivery for the Global Hawk program ensures next generation radar technology on time to the Warfighter.

The Theater Battle Management Core System (TBMCS) develops force-level and wing-level command, control, and intelligence systems to support the operational functions of the joint Forces Air Component Commander. TBMCS has been designated the Joint System of Record for Air Tasking Order/Airspace Control Order generation within the Department of Defense. The system has shown its flexibility by successful employments in support of the Global War on Terror (OIF, OEF, ONE) as well as in support of humanitarian relief efforts (Tsunami Relief, and hurricanes Katrina and Rita Relief). TBMCS generated over 65,000 sorties for OIF/OEF in FY 2006 alone and over 409,000 sorties total since the start of these operations. TBMCS Spiral 1.1.3 successfully passed test and was released to the field, providing numerous system improvements such as greater and faster access to air battle management information.

In FY 2006, in an effort to reduce overall program risk, the Department of Defense restructured the TSAT program to block delivery approach. This strategy reduces the risk in the product development phase by implementing a more incremental fielding approach that reduces the complexity/capacity of the two driving technologies (i.e., lasercom and next-generation processor router) on the first two satellites (Block A). Capacities for the remaining three satellites (Block B) are higher, resulting in a constellation that meets all Key Performance Parameter requirements. Additionally, the program is funded at a higher cost confidence level (CL) vice prior 50/50% cost CL. The TSAT program is conducting rigorous risk reduction and system definition activities during the competitive development phase. The program completed two key risk reduction milestones during late 2005 and early 2006. These successful laser communication and advanced processor demonstrations involved multiple agencies and contractor teams. The first milestone involved competing teams, one led by Lockheed Martin/Northrop Grumman and the other Boeing/Ball Aerospace. The teams completed the second of three planned laser Communication (or 'lasercom') tests using an independent Government testbed, referred to as the Optical Standards Validation Suite (OSVS), located at MIT Lincoln Laboratory (MIT/LL). At the same time, competing teams, one led by Lockheed martin/Northrop Grumman and the other by Boeing/Harris, completed the first of three planned interoperability demonstrations between their TSAT next generation satellite processor/router (NGPR) equipment and MIT/LL's TSAT reference ground terminal. The TSAT program is making excellent progress and is on track to demonstrate key technology maturity and integration milestones. In January 2006, the single TSAT Mission Operations System (ITMOS) contract was awarded. Awarding the TMOS contract decreases TSAT program risk by providing an integrating construct for network architecture and design and allows the contractor to begin work on formal network interface definitions and specifications. The ultimate goal is a FY 2014 first launch of TSAT.

The Air Force has developed and deployed to CENTCOM a prototype designed to detect and report interference on satellite communications channels. The prototype was successfully demonstrated during Joint Expeditionary Force Experiment 2004 (JEFX 04). Operational lessons learned from this prototype are being incorporated into a formal acquisition program called Rapid Attack Identification Detection Reporting System (RAIDRS). This is a defensive counterspace program. The first spiral of RAIDRS will provide: Detection, Characterization, Geolocation, and Reporting of SATCOM Electromagnetic Interference (EMI) for designated channels in the C, X, and Ku frequency bands.

Research, Development, Test and Evaluation Management Support - The Air Force's Research, Development, Test and Evaluation (RDT&E) Management Support efforts include projects directed toward support of installation or operations required for general research and development use. Included would be test ranges, military construction, maintenance support of laboratories, operation and maintenance of test aircraft and ships, and studies and analyses in support of the research and development program. Example of Air Force RDT&E management support is: The Major Test and Evaluation Investment program, which funds the planning, improvements and modernization for three national asset test centers having over $10 billion of unique test facilities/capabilities operated and maintained by the Air Force for the Department of Defense (DoD) test and evaluation missions, and available to others having a requirement for their unique capabilities. The test capabilities and facilities are operated and maintained by the Air Force for the DoD test and evaluation missions, and are available to others having a requirement for their unique capabilities. Many efforts are contained within the AF I&M program, but two examples are the Scene Characterization & Reconstruction for Advanced Munitions (SCRAM), at the AAC Eglin AFB, replaces and/or upgrades multi-spectral measurement system sensors and provides higher spatial and spectral resolution in the UV, visual, IR, MMW, and RF bands. SCRAM also enables high-speed data acquisition and recording needed to support these advanced capability sensor. SCRAM enhances the distributed test connectivity between ground-test and open-air-ranges and assist in the development of realistic and dynamic weapons systems simulation. In addition, the Modeling & Simulation Test & Evaluation Resources (MASTER) program, at AFFTC Edwards AFB and AEDC Arnold AFB, provides a collaborative capability with respect to database information storage and retrieval. These capabilities provide engineering data connectivity with respect to modeling & simulation, ground-test and flight-test environment conditions.

Operational Systems Development - The Air Force's operational system efforts include projects in support of development acquisition programs or upgrades in System Demonstration and Development (SDD). The F-22 Raptor program is in full rate production on the world's only 5th generation production line and it will maintain its role as the key enabler of joint air dominance through an incremental modernization program funded through Operational Systems Development activities. The development program will enhance the air vehicle, engine, and training systems to improve F-22A weapons, communications, and Intelligence Surveillance Reconnaissance (ISR) capabilities to further enhance Global Strike capabilities. Increment 2 represents the first upgrade over IOC capabilities and FY 2006 activities included start of Increment 2 flight test of avionics improvements in displays and chaff processing, expanded datalink testing between multiple flights of aircraft, and planning activities for flight test of JDAM in an expanded envelope. Increment 3 activities included completion of a Preliminary Design Review (RPDR) for Increment 3.1 which will focus on dramatically improving the F-22A Raptor's Air-To-Ground attack capabilities with 4th generation synthetic aperture radar and a new weapon (the Small Diameter Bomb). Finally, a system Design Review (SDR) for the Enhanced Stores management System (ESMS) was completed in FY 2006 which lays the foundation for integration of advanced weapons in future Increments.

The advanced Medium Range Air-to-Air Missile (AMRAAM) Phase 3 (AIM-120C-7 effort completed System Demonstrations and Development (SDD) in May 2004 and has begun Operation Test (OT). Production units for this variant began in the 4th Quarter FY 2004 and will complete in the 2nd Quarter FY 2009. The AIM-120C-7 provides a major upgrade over the AIM-120C-6 guidance section, particularly the use of circular processor cards over previously used rectangular cards. These cards provide significant space savings within the missile for added capability in addition to providing greater processing power.

AMRAAM Phase 4 (AIM-120D) builds on the AIM-120C-7 capability and is progressing. This new AIM-120D missile will add a GPS/INU and a 2-way Data Link to enhance accuracy and control, and thus, increasing weapon effectiveness. In addition, the AIM-120D will have increased range and third party targeting which expands the HOBS launch envelope. The SDD contract was awarded in December 2003 and initial systems integration testing of the Proof of Design (POD) missile began in September 2005. Nine POD missiles have been produced to date. These are active in laboratory, ground and flight testing.

The Joint Direct Attack Munition Program completed the SAASM/Anti-Jam 27 month effort that commenced in FY 2003. SAASM/AJ capability decreases vulnerability to crypto compromise and spoofing as well as enhanced anti-jam performance. All JDAMS delivered in Lot 9 (starting in FY 2006) and beyond will be SAASM capable. The 9,000 JDAMs delivered in Lot 9 will also be AJ capable. Future AJ quantities will be determined by ACC and AF/XOR.

The Small Diameter Bomb I (SDB I) program will increase the number of kills per platform or sortie (x4) while achieving required effects by improving accuracy and reducing collateral damage over current inventory weapons. SDB I is an incremental development weapon program that entered low rate initial production in FY 2005. The first Increment of SDB I will attack fixed and stationary targets using anti-jam/SAASM Inertial Navigation System (INS)/Global Positioning Satellite (GPS) aided by a very wide area differential GPS solution and standoff capability. The program has successfully completed the IOT&E phase of twenty f Seamless Verification in July 2006. The program met Required Assets Available (RAA) in time to not only meet RAA requirements, but also a real-world operational deployment. The SDB will provide transformational capability to the Air Force by increasing loadout per weapon station on multiple platforms, reducing sorties and minimizing collateral damage.

The Joint Surveillance Target Attack Radar system (Joint STARS) Interim Capability for Airborne Networking (ICAN) program provides a low-cost interim Internet Protocol net-centric capability on joint STARS. A product of Northrop Grumman and the Air Force Research Laboratory, ICAN uses COTS software to tie into existing Joint STARS radios and antennas. ICAN enables SIPRNet connectivity to airborne and fixed/mobile users for collaboration via standard test chat as well as email and web-browser functionality. The fleet modifications were first implemented on deployed aircraft and in-theater ground stations, with IOC declared on March 30, 2006. Installs have continued on the rest of the fleet and are projected to be completed by March 2007.

ICAN on Joint STARS aircraft allows command and control of surveillance operations and time sensitive targeting in support of ground forces engaging enemy units. By enabling participation in secured text chat sessions, ICAN allows Joint STARS operators to rapidly collaborate with reconnaissance platform operators, strike aircraft pilots, and ground force combatants. Joint STARS operators exploit ICAN's large footprint to track the movements of enemy units in concert with other sensors. When the enemy stops moving, Joint STARS operators use ICAN to rapidly direct shooters to locate and destroy their targets. ICAN has become an integral tool for synchronizing the effects of airpower and ground forces to achieve warfighter objectives.

The Air Force Space program achieved four successful launches of military satellites, utilizing Titan, Atlas, and Delta to launch NROL-23, NROL-16, GPS IIR-13, DSP-22 and GPS IIR-14.

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

In FY 2004, the Air Force conducted a successful Preliminary Design Review for the Space Based Space Surveillance (SBSS) pathfinder satellite. The SBSS pathfinder program will design, build, launch and operate this single satellite with a visible sensor payload, as well as build and operate a ground segment to support initial satellite operations. The SBSS Pathfinder will detect and track objects in Earth's orbit, contributing to timely space situation awareness, and is scheduled to launch in late 2009.

In FY 2006, the Air Force successfully completed the source selection and contract award for a Non-developmental Item (NDI) Ground Multi-band Terminal (GMT). GMT provides the warfighter a wideband tactical terminal to support full spectrum operations from humanitarian/disaster relief to Major Theater War (MTW) by delivering Air Tasking Order (ATO), unmanned aerial vehicle video, voice, intelligence, command and control and other data products. Each GMT provides wideband SATCOM connectivity up to 104 Mbps via 4 bands (Ka, Ku, X and C) over military Wideband Gapfiller Satellite (WGS) and commercial SATCOM systems. The Air Force procured 2 terminals in FY 2006 to use for testing and will award a full rate production contract in FY 2007. The Air Force will procure a total of 141 GMT terminals. These terminals will replace existing 20+ year old wideband SATCOM terminals and reduce the airlift footprint by 75%.

In FY 2005, the Air Force conducted a successful Preliminary Design Review for the Space Based Space Surveillance (SBSS) Block 10 system. The SBSS Block 10 program will design, build, launch and operate a satellite system with a visible sensor payload, as well as build and operate a ground segment to support initial satellite operations. The SBSS Pathfinder will detect and track objects in Earth's orbit, contributing to timely space situation awareness, and is scheduled to launch in late 2009. Technical progress continued in FY 2006 with testing and refinement of the change-coupled devices, mirrors, ground system software, and other pathfinder system components.

The first Counter Communications System was delivered to the Air Force Space command (AFSPC) in December 2003 and AFSPC declared initial capability on September 24, 2004, after two additional systems were delivered. AFSPC continues development of strap on capability via Pods. Additional capability against future technology developments will be delivered with block 20. The Counter Communications System is operated by the 76th Space Control Squadron at Peterson AFB, Colorado, and is a transportable ground-based system that denies adversary satellite communications through reversible, not-destructive methods.

We successfully completed initial operational test and evaluation on the Safety Enhanced Reentry Vehicle (SERV) program. Also, the rest of the SERV flight test program (1 flight) was finished. The SERV program allows the Minuteman III system to use the Mk21 reentry vehicle, originally developed for the recently retired Peacekeeper missile. The Mk21 has the most modern safety features of any such weapon in the DoD inventory.

General Fund

Required Supplementary Information

Disaggregated Statement of Budgetary Resources—General Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	Other	Research, Development, Test & Evaluation	Operation and Maintenance
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES:			
1. Unobligated balance, brought forward, October 1	$ 3,837	$ 2,741,912	$ 1,099,819
2. Recoveries of prior year unpaid obligations	0	221,255	684,917
3. Budget authority			
3a. Appropriation	409,112	22,407,229	46,808,346
3b. Borrowing authority	0	0	0
3c. Contract authority	0	0	0
4. Spending authority from offsetting collections			
4a. Earned			
1. Collected	12,758	3,164,551	5,383,335
2. Change in receivables from Federal sources	-21	-101,806	58,849
4b. Change in unfilled customer orders			
1. Advance received	0	-84,490	-40,502
2. Without Advance from Federal sources	0	-107,194	14,202
4c. Anticipated for rest of year, without advances	0	0	0
4d. Previously unavailable	0	0	0
4e. Expenditure transfers from trust funds	0	0	0
4f. Subtotal	421,849	25,278,290	52,224,230
5. Non-expenditure transfers, net, anticipated and actual	-401,461	244,066	1,174,277
6. Temporarily not available pursuant to Public Law	0	0	0
7. Permanently not available	-5,000	-501,171	-973,798
8. Total Budgetary Resources	$ 19,225	$ 27,984,352	$ 54,209,445
STATUS OF BUDGETARY RESOURCES:			
9. Obligations incurred:			
9a. Direct	$ 2,608	$ 21,385,080	$ 47,384,824
9b. Reimbursable	12,519	2,940,679	5,520,594
9c. Subtotal	15,127	24,325,759	52,905,418
10. Unobligated balance:			
10a. Apportioned	925	3,314,921	306,495
10b. Exempt from apportionment	3,174	0	0
10c. Subtotal	4,099	3,314,921	306,495
11. Unobligated balance not available	0	343,672	997,530
12. Total Status of Budgetary Resources	$ 19,226	$ 27,984,352	$ 54,209,443
CHANGE IN OBLIGATED BALANCE:			
13. Obligated balance, Net			
13a. Unpaid obligations, brought forward, October 1	1,813	7,883,106	17,592,744
13b. Less: Uncollected customer payments from Federal sources, brought forward, October 1	$ -21	$ -974,712	$ -1,585,971
13c. Total unpaid obligated balance	1,792	6,908,394	16,006,773
13d. Obligations incurred net (+/-)	$ 15,127	$ 24,325,758	$ 52,905,419
14. Less: Gross outlays	-15,297	-23,949,855	-50,787,686
15. Obligated balance transferred, net			
15a. Actual transfers, unpaid obligations (+/-)	0	0	0
15b. Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0	0
16. Total Unpaid obligated balance transferred, net	0	0	0
17. Less: Recoveries of prior year unpaid obligations, actual	0	-221,255	-684,917
Change in uncollected customer payments from Federal sources (+/-)	21	209,000	-73,050
18. Obligated balance, net, end of period			
18a. Unpaid obligations	1,643	8,037,755	19,025,559
18b. Less: Uncollected customer payments from Federal sources	0	-765,712	-1,659,021
18c. Total, unpaid obligated balance, net, end of period	1,643	7,272,043	17,366,538
NET OUTLAYS:			
19. Net Outlays:			
19a. Gross outlays	15,297	23,949,855	50,787,686
19b. Less: Offsetting collections	-12,758	-3,080,061	-5,342,833
19c. Less: Distributed Offsetting receipts	-185,423	0	0
20. Net Outlays	$ -182,884	$ 20,869,794	$ 45,444,853

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

Procurement	Military Personnel	Military Construction/ Family Housing	2006 Combined	2005 Combined
$ 7,285,635	$ 403,345	$ 1,471,659	$ 13,006,208	$ 9,043,364
367,105	174,573	3,056	1,450,906	1,300,191
35,518,858	31,315,236	3,308,829	139,767,610	128,890,968
0	0	0	0	0
0	0	0	0	0
279,125	414,953	468	9,255,190	8,923,532
5,971	-62,272	0	-99,279	142,948
30,784	0	-468	-94,677	349,671
-9,499	-3	0	-102,493	388,543
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
35,825,239	31,667,914	3,308,829	148,726,351	138,695,662
1,088,747	474,174	-3,113	2,576,690	2,598,439
0	0	0	0	0
-943,251	-445,485	-177,527	-3,046,233	-1,493,468
$ 43,623,475	$ 32,274,521	$ 4,602,904	$ 162,713,922	$ 150,144,188
$ 33,475,546	$ 31,500,600	$ 2,690,889	$ 136,439,546	$ 124,689,424
334,790	352,867	0	9,161,449	12,448,555
33,810,336	31,853,467	2,690,889	145,600,995	137,137,979
9,378,822	99,975	1,897,479	14,998,616	11,756,881
0	0	0	3,174	3,218
9,378,822	99,975	1,897,479	15,001,790	11,760,099
434,317	321,080	14,537	2,111,137	1,246,110
$ 43,623,475	$ 32,274,522	$ 4,602,905	$ 162,713,922	$ 150,144,188
23,239,976	807,544	2,315,598	51,840,781	53,808,139
$ -235,478	$ -39,316	$ 0	$ -2,835,497	$ -2,304,006
23,004,498	768,228	2,315,598	49,005,284	51,504,133
$ 33,810,336	$ 31,853,467	$ 2,690,889	$ 145,600,995	$ 137,137,979
-33,790,912	-31,657,215	-1,800,804	-142,001,769	-137,805,147
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
-367,105	-174,573	-3,056	-1,450,906	-1,300,191
3,528	62,275	0	201,773	-531,490
22,892,295	829,223	3,202,626	53,989,101	51,840,781
-231,950	22,959	0	-2,633,723	-2,835,497
22,660,345	852,182	3,202,626	51,355,378	49,005,284
33,790,912	31,657,215	1,800,804	142,001,769	137,805,147
-309,908	-414,953	0	-9,160,512	-9,273,203
0	0	0	-185,423	-123,202
$ 33,481,004	$ 31,242,262	$ 1,800,804	$ 132,655,834	$ 128,408,742

HERITAGE ASSETS
As of September 30, 2006

	Measurement Quantities	As of 10/1/2005	Additions	Deletions	As of 9/30/2006
Museums	Each	19	0	5	14
Monuments & Memorials	Each	244	0	0	244
Cemeteries	Sites	39	0	0	39
Archeological Sites	Sites	1,685	0	171	1,514
Buildings & Structures	Each	6,153	0	1,605	4,548
Major Collections	Each	4	0	0	4

Narrative Statement:

1. Museums

The National Museum of the United States Air Force (NMUSAF), located at Wright-Patterson Air Force Base, Ohio, is the services' single, authorized national museum. This museum has a professionally-qualified staff and is responsible to the Secretary of the Air Force for the management and stewardship of the historical collection. The NMUSAF houses the main collection of historical artifacts that are registered as historical property of the USAF Museum System. The other 12 reported museums are defined as Air Force Field Museums and are operated by their respective major commands (MAJCOMs). While they are responsible for Air Force Historical Property on loan from the NMUSAF, they have been limited in both their scope and capabilities.

The MAJCOMs also operate at various base locations small heritage centers and historical exhibits, which are limited in capabilities and are neither manned nor resourced at professional museum levels. These five activities are no longer defined as museums by the NMUSAF or by their respective MAJCOMs.

The Air National Guard continues to report one old munitions storage vault, dating back to the Horse Artillery days as their only museum. This storage vault is the only building remaining of a number that use to be at this location. All Air Force and Air National Guard museums are reported in acceptable condition.

2. Monuments and Memorials

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

3. Cemeteries

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

4. Archeological Sites

As of 30 September 2006, the Air Force has (as reported in the FY 2005 Annual Report to Congress on Federal Archaeological Activity, submitted 30 March 2006) 1,514 archeological sites listed on or eligible for the National Register. The Air Force has 10,015 recorded but unevaluated (AKA "potentially eligible") archeological sites, and 4,593 sites, considered not eligible for the Register. A total of 16,122 archeological sites have been reported so far from Air Force lands. Eligible and listed sites (AKA "heritage assets") are maintained in an acceptable condition on Air Force installations.

The table shows a total of 171 archaeological sites were removed from the heritage asset list between FY 2005 and FY 2006, even though the number of archaeological sites increased by 958 (15,164 in FY 2005 to 16,122 in FY 2006). The reduction in eligible sites is a result of (a) more accurate reporting by installations after the FY 2005 audit; (b) corrections of site number data reported by a few installations in previous Annual reports; (c) the destruction of several dozen sites after thorough Section 106 review by construction and other Air Force ground-disturbing projects; (d) determination that some previously considered-eligible sites were no longer eligible; and (e) the consolidation of previously separated, but adjacent sites into fewer larger sites (primarily at Tyndall and Lackland AFBs) during reevaluation projects.

5. Buildings and Structures

As of 28 September 2006, the Air Force considers 4,548 buildings and structures as heritage assets (listed and eligible buildings/structures). Most are considered Multi-use Heritage Assets, and as such, are reported as general property, plant, and equipment on the Balance Sheet. These buildings and structures are maintained by each base civil engineering group and are considered to be in good condition.

The decrease from last year's report total by 1,605 buildings is due to several factors, including: (a) more accurate reporting in FY 2006 because of the FY 2005 audit; (b) refining the definition of heritage assets in regard to historic buildings and structures ("heritage asset" is not commonly used for historic properties in the Air Force Cultural Resources management community, and the definitions do not overlap completely). Unlike previous additions of this report, only buildings/structures listed on or determined eligible for listing on the National Register are considered as heritage assets. In past reports, installations included data on those buildings/structures considered "potentially eligible" (not yet evaluated) as heritage assets because they must be managed as eligible until evaluated; (c) because the Air Force has developed much better data on historical housing than we've had in the past, and solved several past problems, such as occasionally counting out-buildings (e.g. garages) as separate assets instead of part of the historic house itself (primarily because garages and carports often have separate building numbers on installations), and differentiating between "units" and "buildings" where confusion arose for multi-dwelling buildings (e.g. duplexes/multiplexes); (d) completing evaluations of many buildings in the National Historic Preservation Act 50+ year old category that were considered likely eligible, but which evaluation showed were not eligible; (e) many Capehart-Wherry Era housing units have been demolished or marked for demolition under the Advisory Council for Historic Preservation Program Comment signed in August 2006 (some buildings that were previously considered eligible); and (f) many installations have privatized their military housing, resulting in some historic assets being removed from the Air Force inventory.

6. Major Collections

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

STEWARDSHIP LAND
As of September 30, 2006
(Acres in Thousands)

(a) Land Use	(b) As of 10/1/2005	(c) Additions	(d) Deletions	(e) As of 9/30/2006
1. Mission	7,709	0	4	7,705
2. Parks & Historic Sites	0	0	0	0
Totals	7,709	0	0	7,705

The Air Force has approximately 7,705,000 acres of mission-essential Stewardship Land under their administration. The beginning balance was (FY 2005 Ending Balance) was adjusted by 19,000 acres due to an unsupported previous year's balance that has remained on the above schedule since FY 2002. During this period of time, various transactions have occurred that decreased the number of acres by approximately 19,000 acres. Lands purchased by the Air Force with the intent to construct buildings or facilities are considered general plant, property, and equipment (PP&E) and are reported on the balance sheet. All stewardship lands, as reported, are in acceptable condition, based on designated use.

GENERAL PROPERTY, PLANT, AND EQUIPMENT
REAL PROPERTY DEFERRED ANNUAL SUSTAINMENT AND RESTORATION TABLES
As of September 30, 2006 ($ in thousands)

	Annual Sustainment FY 2006			
Property Type	1. Required	2. Appropriated	3. Executed	4. Difference
Buildings, Structures and Utilities	2,440,231	2,294,138	1,949,749	490,482

Notes:

1. FY 2006 O&M Sustainment Required is based on Facilities Sustainment Model (FSM 6.1) per business rule direction of OSD (AT&L).

2. FY 2006 O&M Sustainment Appropriated amount is the FY 2006 PB plus subsidies and MILPERS contribution (49% of MILPAY), does not include Supplemental funding for Contingencies and Storms, and include post-PB Congressional Marks.

3. FY 2006 O&M Sustainment Actuals are from the CRIS database, DBT perspective, 30 September 2006. The numbers are not certified DFAS numbers and are subject to change. Certified numbers for FY 2006 obligations are not expected until late October/early November 2006.

4. FY 2006 O&M Sustainment Difference is the sustainment required, minus the Actual, which equals our deferred facility maintenance submission.

5. Military Family Housing (MFH) annual sustainment requirements are based upon data reflected in the 2002 Family Housing Master Plan. These requirements are further refined based upon a combination of historical expenditures for day-to-day maintenance and condition assessment surveys for MFH real property maintenance by contract, and take into account programmatic changes such as housing privatization initiatives.

6. RDT&E Sustainment appropriated and actual obligated includes Congressional Marks and does not include Emergency Hurricane supplemental funding.

	Annual Deferred Sustainment Trend			
Property Type	FY 2003	FY 2004	FY 2005	FY 2006
Buildings, Structures and Utilities	417,112	550,966	590,579	490,482

Notes:

1. RDT&E Sustainment funding obligations and expenditures are not available prior to FY 2004; appropriation/program element structure did not facilitate an accurate determination of this number.

MILITARY EQUIPMENT
DEFERRED MAINTENANCE AMOUNTS
Deferred Maintenance Amounts

As of September 30, 2006 ($ in thousands)	
(a)	(b)
Major Type	
1. Aircraft	$30,894
2. Engines	25,769
3. Missiles	
4. Software	97,011
5. Other Major End Items	4,241
6. Non-MSD Exchangeables	980
7. Area Base Maintenance	
8. Storage	
Total	$158,895

The figures presented are actual deferred maintenance amounts for FY 2006.

The figures include Active Air Force, Air National Guard and the Air Force Reserve.

Required Supplemental Information - Part A **AT57 - Air Force General Fund** **Schedule, Part A DoD Intragovernmental Asset Balances.** ($ in Thousands)	Treasury Index:	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Executive Office of the President	11		$77			
Department of Agriculture	12		$807			
Department of Commerce	13		$295			$10,447
Department of the Interior	14		$4,326			$117,384
Department of Justice	15		$4,575			$6,224
Department of Labor	16		$43			
Navy General Fund	17		$44,066			
United States Postal Service	18		$260			
Department of State	19		$25,992			
Department of the Treasury	20	$68,848,167	$834		$722	
Army General Fund	21		$20,239			$660
Office of Personnel Management	24		$111			$57,778
Social Security Administration	28		$1			
Library of Congress	3		$7			
Nuclear Regulatory Commission	31		$111			
Department of Veterans Affairs	36		$511			$273
Government Printing Office	4		$0			
General Service Administration	47		$425			$2,954
National Science Foundation	49		$636			$5,411
General Accounting Office	5		$4			
Central Intelligence Agency	56		$289			
Environmental Protection Agency	68		$37			$9,880
Department of Transportation	69		$286			$1,296
Homeland Security	70		$41,997			$15,552
Agency for International Development	72		$5,606			
Small Business Administration	73					$162
Department of Health and Human Services	75		$40			
National Aeronautics and Space Administration	80		$11,295			$15,327
National Archives and Records Administration	88		$25			
Department of Energy	89		$9,876			$4,412
Department of Education	91		$40			
US Army Corps of Engineers	96		$32			
Other Defense Organizations General Funds	97		$103,344			$0
Other Defense Organizations Working Capital Funds	97-4930		$320,047			$46,720
Army Working Capital Fund	97-4930.001		$6			
Navy Working Capital Fund	97-4930.002		$1,219			$3
Air Force Working Capital Fund	97-4930.003		$68,208			$160,484

Required Supplemental Information - Part B **AT57 - Air Force General Fund** **Schedule, Part B DoD Intragovernmental entity liabilities.** ($ in Thousands)	**Treasury Index:**	**Accounts Payable**	**Debts/Borrowings From Other Agencies**	**Other**
Department of Agriculture	12	$330		
Department of Commerce	13	$2,031		$19
Department of the Interior	14	$4,560		
Department of Justice	15	$2,598		$8,639
Department of Labor	16			$318,407
Navy General Fund	17	$13,973		$184,167
United States Postal Service	18	$8,717		$1
Department of State	19	$1,641		
Department of the Treasury	20	$3,027		$209
Army General Fund	21	$34,964		$56,502
Office of Personnel Management	24			$52,959
Federal Communications Commission	27	$143		
Social Security Administration	28	$2		
Nuclear Regulatory Commission	31	$60		
Department of Veterans Affairs	36	$8,621		
General Service Administration	47	$176,672		$24
National Science Foundation	49	$1,902		
Tennessee Valley Authority	64	$3,065		
Environmental Protection Agency	68	$2,022		
Department of Transportation	69	$6,771		$0
Homeland Security	70	$15,670		
Agency for International Development	72	$76		
Small Business Administration	73	$216		
Department of Health and Human Services	75	$430		
National Aeronautics and Space Administration	80	$36,346		$14
Department of Energy	89	$26,889		$2,460
Department of Education	91	$83		
US Army Corps of Engineers	96	$941		
Other Defense Organizations General Funds	97	$11,606		$363,639
Other Defense Organizations Working Capital Funds	97-4930	$707,244		$5,361
Army Working Capital Fund	97-4930.001	$5,039		
Navy Working Capital Fund	97-4930.002	$22,079		
Air Force Working Capital Fund	97-4930.003	$328,052		$451
The General Fund of the Treasury	99			$1,265,409

Required Supplemental Information - Part C AT57 - Air Force General Fund Schedule, Part C DoD Intragovernmental revenue and related costs. ($ in Thousands)	Treasury Index:	Earned Revenue
Department of Agriculture	12	$2,559
Department of Commerce	13	$899
Department of the Interior	14	$3,888
Department of Justice	15	$34,192
Department of Labor	16	$105
Navy General Fund	17	$152,921
United States Postal Service	18	$5,554
Department of State	19	$44,015
Department of the Treasury	20	$31,866
Army General Fund	21	$147,417
Office of Personnel Management	24	$189
Library of Congress	3	$47
Nuclear Regulatory Commission	31	$187
Department of Veterans Affairs	36	$971
Government Printing Office	4	$2
General Service Administration	47	$1,526
National Science Foundation	49	$57,639
General Accounting Office	5	$31
Central Intelligence Agency	56	$848
Environmental Protection Agency	68	$197
Department of Transportation	69	$3,284
Homeland Security	70	$108,489
Agency for International Development	72	$16,334
Department of Health and Human Services	75	$25
National Aeronautics and Space Administration	80	$71,223
National Archives and Records Administration	88	$500
Department of Energy	89	$39,629
Department of Education	91	$201
US Army Corps of Engineers	96	$1,702
Other Defense Organizations General Funds	97	$1,661,075
Other Defense Organizations Working Capital Funds	97-4930	$1,475,013
Army Working Capital Fund	97-4930.001	$0
Navy Working Capital Fund	97-4930.002	$17,396
Air Force Working Capital Fund	97-4930.003	$355,614
Military Retirement Fund	97-8097	$0
DoD Medicare-Eligible Retiree Health Care Fund		$201,012

Required Supplemental Information - Part E AT57 - Air Force General Fund ($ in Thousands)	Treasury Index:	Transfers In	Transfers Out
Navy General Fund	17		$123
Army General Fund	21		$26,738
US Army Corps of Engineers	96		$0
Other Defense Organizations General Funds	97	$72,335	$0
Other Defense Organizations Working Capital Funds	97-4930	$766	
Air Force Working Capital Fund	97-4930.003	$106,784	

General Fund

Audit Opinion

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

November 8, 2006

MEMORANDUM FOR PRINCIPAL DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT)

SUBJECT: Independent Auditor's Report on the Fiscal Year 2006 Air Force General Fund Financial Statements (Report No. D-2007-014)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Air Force General Fund Consolidated Balance Sheet as of September 30, 2006 and 2005, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing for the fiscal years then ended. The financial statements are the responsibility of Air Force management. The Air Force is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Fiscal Year 2006 Air Force General Fund Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

Disclaimer of Opinion on the Financial Statements

The Principal Assistant Deputy Secretary of the Air Force (Financial Management) acknowledged to us that the FY 2006 Air Force General Fund Financial Statements would not substantially conform to generally accepted accounting principles because deficiencies in Air Force financial management and feeder systems limit its ability to present information accurately and in conformance with generally accepted accounting principles as of September 30, 2006. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Air Force has also acknowledged, and prior audits have identified, the material weaknesses listed in the Summary of Internal Control. These material weaknesses affect the reliability of certain information contained in the United States Air Force Annual Financial Statement 2006—much of which is taken from the same data sources as the basic financial statements.[1] Therefore, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

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

Summary of Internal Control

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

- Financial Management Systems
- Operating Materials and Supplies
- General Property, Plant, and Equipment
- Government-Furnished Material to Contractors
- Environmental Liabilities
- Intragovernmental Eliminations
- Accounting Entries
- Statement of Net Cost
- Statement of Financing

Material weaknesses are reportable conditions in which internal controls do not reduce (to a relatively low level) the risk of misstatements that are material to the financial statements and that might not be timely detected by employees while performing their normal assigned functions. Our internal control work (conducted during prior audits) would not necessarily disclose all reportable conditions. See the Attachment for additional details on material internal control weaknesses.

Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged, and prior audits confirm, that instances of noncompliance continue to exist. The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged to us that Air Force financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether Air Force complied with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

Management Responsibility

Management is responsible for:

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

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

Attachment:
As stated

Report on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing and maintaining effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; the requirements of applicable laws and regulations are met; and assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses and reportable conditions that could adversely affect a favorable opinion on internal control.

Material Weaknesses. Management acknowledged that previously identified reportable conditions, all of which are material, continue to exist.

Financial Management Systems. Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," requires financial management system controls are adequate to ensure transactions are executed in accordance with budgetary and financial laws and other requirements, are consistent with the purposes authorized, and are recorded in accordance with Federal accounting standards. The Statement also requires that financial management system control ensures assets are properly safeguarded to deter fraud, waste, and abuse, and performance measurement information is adequately supported. The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged that many Air Force financial management systems do not substantially comply with Federal financial management system requirements. Air Force financial management and feeder systems were not designed to collect and record financial information based on a full accrual accounting basis. Until these systems are updated to collect and report financial information in compliance with generally accepted accounting principles, Air Force financial reporting will be based on budgetary transactions and nonfinancial feeder systems.

Operating Materials and Supplies. The Air Force is required by the Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," to use historical cost to value its operating materials and supplies inventory. The Statement also requires that operating materials and supplies be expensed when the items are consumed. The Air Force has acknowledged that significant amounts of operating materials and supplies are valued using standard prices and the consumption method is not always used to recognize the related expense. Accordingly, management is not certain the operating materials and supplies balances reported in its financial statements are accurate.

General Property, Plant, and Equipment. The Air Force is required by Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," to record general property, plant, and equipment using acquisition cost, capitalize improvement costs, and recognize depreciation expense. However, Air Force has acknowledged that despite its implementation of a new system to improve its controls over recording real property, construction-in-progress, and related expenses, its controls need additional improvement for its financial reporting to become compliant.

Attachment

Government-Furnished and Contractor-Acquired Material. Statement of Federal Financial Accounting Standards No. 11, "Amendments to Accounting for Property, Plant, and Equipment," requires that property and equipment in the possession of a contractor for use in accomplishing a contract be considered Government property. Government property should be accounted for based on the nature of the item, regardless of who has possession. The Air Force has acknowledged that its Balance Sheet does not include the cost of all Government-furnished material in the hands of contractors where such value exceeds the capitalization threshold. As a result, the value of Air Force property and material in the possession of contractors is not reliably reported.

Environmental Liabilities. The Air Force is not currently able to support its environmental cleanup cost estimates as recorded in the Air Force Real Property Agency management information system. This system provides the information reported on its Balance Sheet and its related footnote. The reported amounts may not be reliable.

Intragovernmental Transaction Accounting. Air Force accountants cannot always identify intragovernmental trading partners when recording transactions. Thus, the Air Force cannot properly eliminate all transactions among its internal organizational elements. In addition, the Air Force cannot reconcile intragovernmental accounts receivable, accounts payable, and revenues for transactions between its DoD and other Federal trading partners. This may prevent the Air Force from properly eliminating all of its intragovernmental transactions.

Other Accounting Entries. The Air Force acknowledged that it continues to enter material amounts of accounting adjustments that are not adequately supported. The lack of adequate supporting documentation for adjustments may prevent the related financial statement amounts from being audited.

Statement of Net Cost. Statement of Federal Financial Accounting Concepts No. 2, "Entity and Display," requires the Statement of Net Cost present gross and net cost information for major organizations and programs that can be related to their outputs and outcomes. The Air Force acknowledged the amounts reported in its Statement of Net Cost are accumulated by major appropriation groups funded by Congress and not by major organizations and programs as required. In addition, the Air Force does not accumulate cost information in accordance with Statement of Federal Financial Standards No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government." The amounts presented for General Funds are based on budgetary obligations, disbursements, and collections with adjustments only for major items of known accruals and imputed expenses. Thus, the Statement of Net Cost may not report all actual costs.

Statement of Financing. Statement of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting," states the Statement of Financing should reconcile resources obligated during the period to the net cost of operations. However, the Air Force acknowledged that it is unable to reconcile budgetary obligations to net costs. Specifically, budgetary data are not in agreement with proprietary expenses. The Air Force has disclosed in Note 21 to the financial statements it has not adjusted the Statements of Financing and Net Cost to be in agreement. In addition, it has disclosed in Note 21 that certain lines on the statement are presented on a combined basis instead of a consolidated basis as required by Office of Management and Budget Circular A-136, "Financial Reporting Requirements."

Attachment

Other Reportable Conditions. During FY 2006, our financial-related audits noted certain reportable conditions related to Accounts Payable. Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government," states that "a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future." Our audit of DoD-Wide accounting systems and processes for accounts payable indicates that the Air Force uses estimates of accounts payable amounts that do not always accurately reflect the liabilities associated with the actual receipt of goods and services in the appropriate time period. In addition, its Accounts Payable balance includes long-overdue payables related to closed appropriations that have not been reviewed for propriety.

Compliance with Laws and Regulations

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

Statutory Financial Management Systems Reporting Requirements. The Air Force is required to comply with the following financial management systems reporting requirements.

- Section 3512, title 31, United States Code, incorporates the reporting requirements of the Federal Managers Financial Integrity Act of 1982 and requires the Air Force to evaluate its systems and to annually report whether those systems are in compliance with requirements prescribed by the Comptroller General.

- The Federal Financial Management Improvement Act of 1996 requires the Air Force to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. This law also requires the Air Force to develop a remediation plan when its financial management systems do not comply with Federal financial management systems requirements. The remediation plan must include remedies, costs, and milestones.

For FY 2006, the Air Force did not fully comply with the statutory reporting requirements identified in these provisions. Specifically, it acknowledged that many of its critical financial management and feeder systems did not comply substantially with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2006. In an attempt to remedy these long-standing financial management system deficiencies, the Air Force is participating in implementing the DoD-Wide Business Enterprise Architecture. Until the Business Enterprise Architecture is fully developed and implemented, the Air Force will not be able to fully comply with statutory requirements.

Audit Disclosures

The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged to us on February 28, 2006, that the Air Force financial management systems cannot provide adequate evidence supporting various material amounts on the financial statements. Therefore, we did not perform detailed testing related to previous identified material weaknesses. In addition, we did not perform audit work related to provisions of the laws and regulations identified in Office of Management and Budget Bulletin No. 06-03, "Audit Requirements for Federal Financial Statements," August 23, 2006, Appendix E, "General Laws."

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

Working Capital Fund

Principal Statements

Consolidated Balance Sheet—Working Capital Fund

As of September 30, 2006 and 2005 ($ in Thousands)

	2006 Consolidated	2005 Consolidated
1. ASSETS (Note 2)		
A. Intragovernmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	$ 1,357,976	$ 1,164,223
b. Nonentity Seized Iraqi Cash	0	0
c. Nonentity-Other	0	0
2. Investments (Note 4)	0	0
3. Accounts Receivable (Note 5)	420,073	510,560
4. Other Assets (Note 6)	5,218	48,515
5. Total Intragovernmental Assets	$ 1,783,267	$ 1,723,298
B. Cash and Other Monetary Assets (Note 7)	$ 0	$ 0
C. Accounts Receivable, Net (Note 5)	232,314	219,929
D. Loans Receivable (Note 8)	0	0
E. Inventory and Related Property, Net (Note 9)	34,530,876	32,701,689
F. General Property, Plant and Equipment, Net (Note 10)	1,169,165	1,205,556
G. Investments (Note 4)	0	0
H. Other Assets (Note 6)	541,143	440,337
2. TOTAL ASSETS	$ 38,256,765	$ 36,290,809
3. LIABILITIES (Note 11)		
A. Intragovernmental:		
1. Accounts Payable (Note 12)	$ 171,623	$ 199,650
2. Debt (Note 13)	0	0
3. Other Liabilities (Note 15 & 16)	174,216	146,538
4. Total Intragovernmental Liabilities	$ 345,839	$ 346,188
B. Accounts Payable (Note 12)	$ 494,347	$ 546,739
C. Military Retirement and Other Federal Employment Benefits (Note 17)	227,035	233,713
D. Environmental and Disposal Liabilities (Note 14)	0	0
E. Loan Guarantee Liability (Note 8)	0	0
F. Other Liabilities (Note 15 and Note 16)	1,197,430	1,389,331
4. TOTAL LIABILITIES	$ 2,264,651	$ 2,515,971
5. NET POSITION		
A. Unexpended Appropriations - Earmarked Funds (Note 23)	0	0
B. Unexpended Appropriations - Other Funds	0	0
C. Cumulative Results of Operations - Earmarked Funds	0	0
D. Cumulative Results of Operations - Other Funds	35,992,114	33,774,838
6. TOTAL NET POSITION	$ 35,992,114	$ 33,774,838
7. TOTAL LIABILITIES AND NET POSITION	$ 38,256,765	$ 36,290,809

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

Consolidated Statement of Net Cost—Working Capital Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	2006 Consolidated	2005 Consolidated
1. Program Costs		
A. Gross Costs	$ 8,671,960	$ 10,514,194
B. (Less: Earned Revenue)	-10,783,023	-11,414,946
C. Net Program Costs	$ -2,111,063	$ -900,752
2. Cost Not Assigned to Programs	0	0
3. (Less: Earned Revenue Not Attributable to Programs)	0	0
4. Net Cost of Operations	$ -2,111,063	$ -900,752

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

Consolidated Statement of Changes in Net Position—Working Capital Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	Earmarked Funds	All Other Funds	Eliminations	2006 Consolidated	2005 Consolidated
CUMULATIVE RESULTS OF OPERATIONS					
1. Beginning Balances	$ 0	$ 33,774,838	$ 0	$ 33,774,838	$ 21,890,390
2. Prior Period Adjustments:					
2a. Changes in accounting principles (+/-)	0	0	0	0	3,632,598
2b. Corrections of errors (+/-)	0	0	0	0	7,256,576
3. Beginning balances, as adjusted	0	33,774,838	0	33,774,838	32,779,564
4. Budgetary Financing Sources:	0	0	0	0	0
4a. Appropriations received	0	0	0	0	0
4b. Appropriations transferred-in/out (+/-)	0	0	0	0	0
4c. Other adjustments (rescissions, etc.) (+/-)	0	0	0	0	0
4d. Appropriations used	0	48,389	0	48,389	0
4e. Nonexchange revenue	0	0	0	0	0
4f. Donations and forfeitures of cash and cash equivalents	0	0	0	0	0
4g. Transfers-in/out without reimbursement (+/-)	0	-106,784	0	-106,784	-73,911
4h. Other budgetary financing sources (+/-)	0	0	0	0	0
5. Other Financing Sources:					
5a. Donations and forfeitures of property	0	0	0	0	0
5b. Transfers-in/out without reimbursement (+/-)	0	0	0	0	0
5c. Imputed financing from costs absorbed by others	0	164,609	0	164,609	168,434
5d. Other (+/-)	0	0	0	0	0
6. Total Financing Sources	0	106,214	0	106,214	94,523
7. Net Cost of Operations (+/-)	0	-2,111,062	0	-2,111,062	-900,751
8. Net Change	0	2,217,276	0	2,217,276	995,274
9. Ending Balances	$ 0	$ 35,992,114	$ 0	$ 35,992,114	$ 33,774,838
UNEXPENDED APPROPRIATIONS					
1. Beginning Balances	$ 0	$ 0	$ 0	$ 0	$ 0
2. Prior Period Adjustments:					
2a. Changes in accounting principles (+/-)	0	0	0	0	0
2b. Corrections of errors (+/-)	0	0	0	0	0
3. Beginning balances, as adjusted	0	0	0	0	0
4. Budgetary Financing Sources:					
4a. Appropriations received	0	48,577	0	48,577	0
4b. Appropriations transferred-in/out (+/-)	0	0	0	0	0
4c. Other adjustments (rescissions, etc) (+/-)	0	-188	0	-188	0
4d. Appropriations used	0	-48,389	0	-48,389	0
4e. Nonexchange revenue	0	0	0	0	0
4f. Donations and forfeitures of cash and cash equivalents	0	0	0	0	0
4g. Transfers-in/out without reimbursement (+/-)	0	0	0	0	0
4h. Other budgetary financing sources (+/-)	0	0	0	0	0
5. Other Financing Sources:					
5a. Donations and forfeitures of property	0	0	0	0	0
5b. Transfers-in/out without reimbursement (+/-)	0	0	0	0	0
5c. Imputed financing from costs absorbed by others	0	0	0	0	0
5d. Other (+/-)	0	0	0	0	0
6. Total Financing Sources	0	0	0	0	0
7. Net Cost of Operations (+/-)	0	0	0	0	0
8. Net Change	0	0	0	0	0
9. Ending Balances	$ 0	$ 0	$ 0	$ 0	$ 0

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

Combined Statement of Budgetary Resources—Working Capital Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES:		
1. Unobligated balance, brought forward, October 1	$ 292,678	$ 134,440
2. Recoveries of prior year unpaid obligations	79,238	4
3. Budget authority		
3a. Appropriation	48,577	0
3b. Borrowing authority	0	0
3c. Contract authority	9,857,832	9,744,293
4. Spending authority from offsetting collections		
4a. Earned		
1. Collected	15,953,188	16,559,412
2. Change in receivables from Federal sources	-43,158	50,393
4b. Change in unfilled customer orders		
1. Advance received	10,419	-121,421
2. Without advance from Federal sources	-936,323	692,744
4c. Anticipated for rest of year, without advances	0	0
4d. Previously unavailable	0	0
4e. Expenditure transfers from trust funds	0	0
4f. Subtotal	24,890,535	26,925,421
5. Non-expenditure transfers, net, anticipated and actual	-106,784	-73,911
6. Temporarily not available pursuant to Public Law	0	0
7. Permanently not available	-8,457,316	-10,801,211
8. Total Budgetary Resources	$ 16,698,351	$ 16,184,743
Status of Budgetary Resources:		
9. Obligations incurred:		
9a. Direct	$ 0	$ 0
9b. Reimbursable	15,773,214	15,892,064
9c. Subtotal	15,773,214	15,892,064
10. Unobligated balance:		
10a. Apportioned	925,137	292,678
10b. Exempt from apportionment	0	0
10c. Subtotal	925,137	292,678
11. Unobligated balance not available	0	1
12. Total Status of Budgetary Resources	$ 16,698,351	$ 16,184,743
CHANGE IN OBLIGATED BALANCE:		
13. Obligated balance, Net		
13a. Unpaid obligations, brought forward, October 1	8,621,328	8,980,235
13b. Less: Uncollected customer payments from Federal sources, brought forward, October 1	$ -4,967,392	$ -4,224,253
13c. Total unpaid obligated balance	3,653,936	4,755,982
13d. Obligations incurred net (+/-)	$ 15,773,214	$ 15,892,064
14. Less: Gross outlays	-15,711,459	-16,250,968
15. Obligated balance transferred, net		
15a. Actual transfers, unpaid obligations (+/-)	0	0
15b. Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0
16. Total Unpaid obligated balance transferred, net	0	0
17. Less: Recoveries of prior year unpaid obligations, actual	-79,238	-4
Change in uncollected customer payments from Federal sources (+/-)	979,482	-743,137
18. Obligated balance, net, end of period		
18a. Unpaid obligations	8,603,843	8,621,328
18b. Less: Uncollected customer payments from Federal sources	-3,987,910	-4,967,392
18c. Total, unpaid obligated balance, net, end of period	4,615,933	3,653,936
NET OUTLAYS:		
19. Net Outlays:		
19a. Gross outlays	15,711,459	16,250,968
19b. Less: Offsetting collections	-15,963,606	-16,437,991
19c. Less: Distributed Offsetting receipts	0	0
20. Net Outlays	$ -252,147	$ -187,023

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

Consolidated Statement of Financing—Working Capital Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ 15,773,214	$ 15,892,064
2. Less: Spending authority from offsetting collections and recoveries	-15,063,364	-17,181,132
3. Obligations net of offsetting collections and recoveries	709,850	-1,289,068
4. Less: Offsetting receipts	0	0
5. Net obligations	709,850	-1,289,068
Other Resources		
6. Donations and forfeitures of property	0	0
7. Transfers in/out without reimbursement (+/-)	0	0
8. Imputed financing from costs absorbed by others	164,609	168,434
9. Other (+/-)	0	0
10. Net other resources used to finance activities	164,609	168,434
11. Total resources used to finance activities	$ 874,459	$ -1,120,634
Resources Used to Finance Items not Part of the Net Cost of Operations		
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
12a. Undelivered Orders (-)	-214,214	180,293
12b. Unfilled Customer Orders	-925,904	571,323
13. Resources that fund expenses recognized in prior periods	-7,923	-5,775
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	0	0
15. Resources that finance the acquisition of assets	-4,988,458	-5,376,780
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations		
16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget	0	0
16b. Other (+/-)	0	0
17. Total resources used to finance items not part of the net cost of operations	$ -6,136,499	$ -4,630,939
18. Total resources used to finance the net cost of operations	$ -5,262,040	$ -5,751,573
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
19. Increase in annual leave liability	0	0
20. Increase in environmental and disposal liability	0	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
22. Increase in exchange revenue receivable from the public (-)	6	0
23. Other (+/-)	1,244	5,961
24. Total components of Net Cost of Operations that will require or generate resources in future periods	1,250	5,961
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	166,193	190,703
26. Revaluation of assets or liabilities (+/-)	849,401	3,193
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0	0
27b. Cost of Goods Sold	5,130,847	5,026,640
27c. Operating Material & Supplies Used	0	416,094
27d. Other	-2,996,714	-791,770
28. Total components of Net Cost of Operations that will not require or generate resources	3,149,727	4,844,860
29. Total components of net cost of operations that will not require or generate resources in the current period	$ 3,150,977	$ 4,850,821
30. Net Cost of Operations	$ -2,111,063	$ -900,752

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

Working Capital Fund

Footnotes to the Principal Statements

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and operating results 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 AFWCF in accordance with the "Department of Defense Financial Management Regulation (DoDFMR)," the Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which AFWCF is responsible. The AFWCF's financial statements are in addition to the monthly 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 fully implement all elements of GAAP and OMB Circular A-136, due to limitations of using non-financial feeder systems and processes that feed into the financial statements. The AFWCF derives its reported values and information for major asset and liability categories largely from non-financial feeder systems, such as inventory systems and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations, rather than preparing financial statements in accordance with GAAP. The AFWCF currently has several material departures from GAAP. The five primary auditor-identified financial statement material weaknesses are: (1) financial and non-financial feeder systems do not contain an adequate audit trail for the proprietary and budgetary accounts; (2) the Defense Finance and Accounting Service (DFAS) cannot accurately identify all intergovernmental transactions by customer, which is required for eliminations when preparing consolidated financial statements; (3) operating materials and supplies are not reflected at historical cost; (4) the problem disbursement and in-transit disbursements that have been reported by a disbursing station to the Department of Treasury have not been precisely matched against specific source obligations; this condition adversely affects the Balance Sheet line item for fund balance with treasury, and (5) adjustments for undistributed disbursements and collections are not supported at the detail level, which precludes expressing an opinion on accounts payable and accounts receivable.

The AFWCF continues to implement process and system improvements addressing these limitations, many of which are detailed below.

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 Department of Defense (DoD) and made the Air Force a department within DoD. The overall mission of 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 deliver sovereign options for the defense of the United States of America and its global interest to fly and fight in air, space, and cyberspace. Our priorities are: 1) win the Global War on Terror; 2) develop and care for our airmen, and 3) modernize and recapitalize our aircraft and equipment.

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

1.C. Appropriations and Funds

The Air Force receives its appropriations and funds as general, working capital (revolving funds), trust, special and deposit funds. The Air Force uses these appropriations and funds to execute mission requirements and report on resource usage.

Working Capital Funds (WCF) receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and uses those capital resources to finance the initial startup. The WCF activities provide goods and services to customers on a reimbursable basis. Reimbursable receipts fund ongoing operations and 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.

The FY 2006 AFWCF operations consist of two major activity groups: Supply Management and Depot Maintenance. Prior to FY 2006, there was a third activity group called Information Services Activity Group (ISAG). ISAG was removed from the Air Force Working Capital Fund at the end of FY 2005. In FY 2006, the remaining unfilled customer orders and balance sheet accounts are being liquidated in preparation for account closure in FY 2007.

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 supply inventories. The majority of Air Force supply requirements are financed and managed within the 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 replenishing inventories with funds received from sales to customers.

There are four active business activities in the Supply Management Activity Group (SMAG): 1) Materiel Support Division (MSD); 2) General Support Division (GSD); 3) Medical-Dental Division, and 4) Air Force Academy Division. The Fuels Division and Troop Support Division were closed prior to FY 2001. The residual accounts for these two divisions are in the process of being closed by end of FY 2007.

A brief description is provided below for the four active business activities.

Wholesale Supply

- MSD manages over 130 thousand depot-level repairables and consumable items, for which the Air Force is the Inventory Control Point, which are used to maintain weapon systems.

Retail Supply

- GSD manages over 1.5 million different supply items, which support field and depot maintenance of aircraft, ground and airborne communication and electronic systems.
- Medical-Dental manages over seven thousand different items, which are used to support medical and dental supply requirements
- Air Force Academy finances the purchase of uniforms and uniform accessories for sale to cadets.

Depot Maintenance

The Air Force Depot Maintenance Activity Group (DMAG) repairs systems and spare parts that ensure readiness in peacetime and provide sustainment to combat forces in wartime. In peacetime, the Air Force enhances readiness by efficiently and economically repairing, overhauling, and modifying aircraft, engines, missiles, depot-level reparables, and software to meet customer demands. Depots have unique skills and equipment required to support and overhaul both new, complex components as well as aging weapon systems. An extremely important facet of the depots is that during wartime or contingencies, the Air Force can surge repair operations and realign capacity to support the war-fighters' immediate needs. This is achieved by employing the unique strengths of organic (in-house) and contracted (contract) repair resources.

Air Force Working Capital Fund Component

The purpose of the Air Force Component Activity is to provide an activity within 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. The Component account's primary activities involve fund balance transactions and are minimal in both number of transaction and dollar values.

Additional Defense Finance and Accounting Service (DFAS)-Arlington memorandums provided specific and detailed instructions and procedures to maintain accountability for fund balance with treasury.

Business Operations

Operations of the activities within the AFWCF are based on policies and procedures that include funds management. The AFWCF receives two fund types: operating authority and capital authority. These two fund types are received on a funding document.

(1) Operating Authority:
Funding is used for the daily recurring business operating expenses incurred to produce the service or supply items being demanded.

(2) Capital Program Authority:
Funding is used to procure investment items. These items are classified into four categories: 1) Equipment; 2) Software; 3) Hardware, and 4) Minor Construction. Procured items must be greater than $100,000 and provide more than one year of service. These items are currently depreciated over the expected life of the asset.

All AFWCF groups establish rates and prices for full cost recovery. If an operating loss or gain is incurred, the activity will make the appropriate adjustment in following year prices to recoup the loss or return the gain to their customers.

1.D. Basis of Accounting

For FY 2006, AFWCF's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of AFWCF's financial and non-financial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of AFWCF's legacy systems were designed to record information on a proprietary basis.

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

In addition, AFWCF identifies program costs based upon the major appropriation groups provided by Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act (GPRA). The AFWCF is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

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

Supply Management

Supply Management activities recognize revenue from the sale of inventory items and receipt of direct reimbursement for the purchase of customer requested initial and readiness spares. Revenue from the sale of inventory is recognized at the time of sale. Revenue from the receipt of direct reimbursements is recognized upon receipt from the General Fund.

Depot Maintenance

Depot Maintenance (Organic) activities recognize revenue according to the percentage of completion method. Depot Maintenance (Contract) activities recognize revenue based on the number of units produced times the Unit Sales Price (USP) which is recognized upon completion of the repair. Due to the anticipated closure of contract activity in FY 2010, it is not cost-effective to implement system modifications to support the percentage of completion method.

The AFWCF does not include non-monetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and the Statement of Financing. The U.S. has cost sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

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 non-financial 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, environmental liabilities, and unbilled revenue. The Air Force expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses.

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. 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); Secretary of the Air Force, Deputy Assistant Secretary Budget (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.

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 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, civilian employees covered by FERS and military personnel covered by MRS receive 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 OPM in the Statement of Net Cost, and recognizes corresponding imputed revenue in the Statement of Changes in Net Position.

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DoD or between two or more federal agencies. However, AFWCF cannot accurately identify most of its intragovernmental transactions by customer because the Air Force's systems do not track buyer and seller data needed to match related transactions. Seller entities within DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances, intra-DoD balances are then eliminated. The AFWCF properly eliminates the revenue results from intra-DoD sales of capitalized assets. The DoD is developing long-term system improvements that will include sufficient process checks and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between DoD and other federal agencies. The Treasury Financial Manual, Part 2 - Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" and the Treasury's "Federal Intragovernmental Transactions Accounting Policy Guide," provide guidance for reporting and reconciling intragovernmental balances. While AFWCF is unable to fully reconcile intragovernmental transactions with all federal partners, AFWCF is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DOL), and benefit program transactions with the Office of Personnel Management (OPM).

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

Financing for the construction of DoD facilities is obtained through 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.

1.H. Transactions with Foreign Governments and International Organizations

Each year, AFWCF sells spare parts and maintenance services to foreign governments and international organizations under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, the DoD has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Payment is required in advance.

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

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

In addition, the DFAS sites and 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 records this information to the applicable fund balance with treasury (FBWT) account. Differences between AFWCF's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled.

1.J. Foreign Currency

Not applicable.

1.K. Accounts Receivable

As presented on the Balance Sheet, accounts receivable includes accounts receivable, claims receivable, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies (per Code of Federal Regulations 4 CFR 101).

The AFWCF maintains an aging schedule of receivables. Aging allows for the management of collection action. The receivables are considered delinquent if not received within 30 days from date of invoice or notice of payment due, unless different terms are specified by contract or other agreements. Interest, penalty and administrative charges are calculated on delinquent accounts from the public in accordance with 31 USC 3717. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type.

1.L. Direct Loans and Loan Guarantees

Not applicable.

1.M. Inventories and Related Property

Inventory for AFWCF is all held in SMAG except for work-in-process inventory, which is in the Depot Management Activity Group. Prior to FY 2004, SMAG inventory was reported at approximate historical cost based on Latest Acquisition Cost (LAC), adjusted for holding gains and losses. During FY 2004 and 2005, 99% of SMAG 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-DE prepared an inventory worksheet monthly for each fund code within 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. 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 MAC for SMAG inventories in FY 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, to account for spares requiring repair.

The AFWCF manages only military or government specific materiel under normal conditions. Items commonly used that are available from the commercial sector are not managed in AFWCF materiel management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The AFWCF holds materiel based on military need and support for contingencies. Therefore, DoD does not attempt to account separately for "inventory held for sale" and "inventory held in reserve for future sale" based on SFFAS No. 3 definitions.

Related property includes operating materials and supplies (OM&S). The OM&S are valued at standard purchase price. The DoD uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, AFWCF uses the purchase method. Under this method, materials and supplies are expensed when purchased. The AFWCF expenses significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user.

The AFWCF determined that the recurring high dollar value of OM&S in need of repair is material to the financial statements and requires a separate reporting category. Many high-dollar items, such as aircraft engines, are categorized as OM&S rather than military equipment.

The AFWCF recognizes condemned material as "Excess, Obsolete, and Unserviceable." The cost of disposal is greater than the potential scrap value; therefore, the net value of condemned material is zero. Potentially redistributed 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.

Past audits identified uncertainties about completeness and existence of reported values of inventory. Inventory available and purchased for resale includes consumable spare and reparable items owned and managed by AFWCF. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. It is more economical to repair than to procure these inventory items. Because AFWCF often relies on weapon systems and machinery that are no longer in production, AFWCF supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential in maintaining a ready, mobile, and armed military force. 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. Depot maintenance work in process includes labor, applied overhead, and supplies used in the delivery of maintenance services.

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

Not applicable.

1.O. General Property, Plant and Equipment

The Department is moving away from a standard capitalization threshold for all categories (e.g. real property, military equipment, etc.) of General Property, Plant and Equipment (PP&E) to one that is specific for each individual category. The Under Secretary of Defense Comptroller issued a memorandum dated March 13, 2006 regarding a "Capitalization Threshold Policy for Real Property". This memorandum revised the Department's capitalization threshold from $100,000 to $20,000 in order to meet the Department's audit readiness objective to capitalize 99% of all real property expenses. All entities are required to update records and fully implement the new policy no later than March 31, 2008. The AFWCF is in the process of implementing this revised policy. The 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 the acquisition cost equals or exceeds DoD capitalization threshold of $100,000. DoD also requires capitalization of improvements over DoD capitalization threshold of $100,000 for PP&E. The DoD depreciates all PP&E, other than land, on a straight-line basis. 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.

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for FY 1993, 1994, and 1995, respectively, and an estimated useful life of two or more years. General PP&E previously capitalized at amounts below $100,000 were written off General Fund financial statements in FY 1998. No adjustment was made for WCF assets. These assets remain capitalized and reported on WCF financial statements.

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

The DoD is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Air Force reports only government property in the possession of contractors that is maintained in the Air Force's property systems. The DoD has issued new property accountability and reporting requirements that require Air Force components to maintain, in their property systems, information on all property furnished to contractors. This action and other DoD-proposed actions are structured to capture and report the information necessary for compliance with Federal accounting standards.

1.P. Advances and Prepayments

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

1.Q. Leases

Not applicable.

1.R. Other Assets

Other assets includes those assets, such as military and civil service employee pay advances, travel advances, and contract financing payments, that are not reported elsewhere on the Department's Balance Sheet.

Contract financing payments are defined in the Federal Acquisition Regulations (FAR), Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. These payments are designed to alleviate the potential financial burden on contractors performing on certain long-term contracts and facilitate competition for defense contracts. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts. Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisitions Regulations Supplement (DFARS) authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property and ships are reported as Construction in Progress in Note 10.

The Federal Acquisition Regulation allows the AFWCF to make financing payments under fixed price contracts. The AFWCF reports these financing payments as "Other Assets" because 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, AFWCF is not obligated to reimburse the contractor for its costs and the contractor is liable to repay 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," as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The AFWCF recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The AFWCF's loss contingencies arise as a result of pending or threatened litigation or claims and assessments that occur due to events such as aircraft, ship, and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

1.T. Accrued Leave

The AFWCF reports as liabilities civilian annual leave and military leave that has been accrued and not used as of the Balance Sheet date. The liability reported at the end of the accounting period 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 that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative Results of Operations represent the net difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, the cumulative results also include donations and transfer in and out of assets without reimbursement.

1.V. Treaties for Use of Foreign Bases

The AFWCF has the use of the land, building, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The AFWCF purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow AFWCF continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any non-retrievable capital assets. This takes place after negotiations between the U.S. and the host country have determined the amount to be paid the U.S. for such capital investments.

1.W. Comparative Data

Financial statement fluctuations greater than 2% of total assets on the Balance Sheet or 10% from the previous period presented are explained within the notes to the financial statements.

1.X. Unexpended Obligations

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

1.Y. Undistributed Disbursements and Collections

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

The DoD policy is to allocate supported undistributed disbursements and collections between federal and non-federal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities. The AFWCF follows this procedure.

Note 2. Nonentity Assets

As of September 30	2006	2005
($ in thousands)		
1. Intragovernmental Assets		
A. Fund Balance with Treasury	$ 0	$ 0
B. Accounts Receivable	0	0
C. Total Intragovernmental Assets	$ 0	$ 0
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	$ 0	$ 0
B. Accounts Receivable	0	0
C. Other Assets	0	0
D. Total Nonfederal Assets	$ 0	$ 0
3. Total Nonentity Assets	$ 0	$ 0
4. Total Entity Assets	$ 38,256,765	$ 36,290,809
5. Total Assets	$ 38,256,765	$ 36,290,809

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 that are not available for use in the operations of the entity.

The Air Force Working Capital Fund has no Nonentity Assets.

Note 3. Fund Balance with Treasury

As of September 30		2006		2005
($ in thousands)				
1. Fund Balances				
A. Appropriated Funds	$	0	$	0
B. Revolving Funds		1,357,976		1,164,223
C. Trust Funds		0		0
D. Special Funds		0		0
E. Other Fund Types		0		0
F. Total Fund Balances	$	1,357,976	$	1,164,223
2. Fund Balances Per Treasury Versus Agency				
A. Fund Balance per Treasury	$	1,380,931	$	1,038,596
B. Fund Balance per AFWCF		1,357,976		1,164,223
3. Reconciling Amount	$	22,955	$	-125,627

The reconciling amount on line 3 above represents $23.0 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

The $193.8 million (17%) increase in the Fund Balance with Treasury (FBWT) is primarily due to a $181.0 million increase in the Organic Depot Maintenance Activity Group (DMAG). All three of the Air Logistic Centers (ALC) contributed to this increase and the details are as follows:

Organic DMAG at Warner Robins Air Logistic Center had a $84.7 million increase in FBWT due to a 4% increase in customer orders during FY 2006.

Organic DMAG at Oklahoma City Air Logistic Center had a $56.5 million increase in FBWT due to decreased material consumption during FY 2006. Material costs were substantially below forecast due to decreased material being used in engine repair activities.

Organic DMAG at Ogden Air Logistic Center had a $39.8 million increase in FBWT due to changes in workload during FY 2006. This change in workload caused a decrease in the material required for missile repair.

Status of Fund Balance with Treasury

As of September 30		2006		2005
($ in thousands)				
1. Unobligated Balance				
A. Available	$	925,139	$	292,680
B. Unavailable		0		0
2. Obligated Balance not yet Disbursed	$	8,603,843	$	8,621,327
3. Non-budgetary FBWT	$	0	$	0
4. Non-FBWT Budgetary Accounts	$	-8,171,006	$	-7,749,784
5. Total	$	1,357,976	$	1,164,223

Fluctuations

The $632.5 million (316%) increase in the Available Unobligated Balance is a result of DMAG operations which generated resources in excess of the liabilities. The cash increase was described above. In addition, Contract DMAG had a concerted effort to clean up accrued liabilities, further improving the available resource balance.

The $193.8 million (17%) increase in the total Status of Fund Balance with Treasury is the result of an increase in resources in DMAG. This increase can be attributed to the increase in cash discussed above.

Status of Fund Balance with Treasury consists of unobligated and obligated balances. These balances reflect the budgetary authority remaining for disbursements against current or future obligations. In addition, the status includes various accounts that affect either budgetary reporting or Fund Balance with Treasury, but not both.

Unobligated Balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated Balance is classified as available or unavailable and is associated with appropriations expiring at fiscal year end that remain available only for obligation adjustments until the account is closed. There are no restrictions on the Unobligated Balance.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received or services that have not been performed.

Non-Budgetary Fund Balance with Treasury (FBWT) includes entity and nonentity Fund Balance with Treasury accounts which do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

Non-FBWT Budgetary Accounts include budgetary accounts that do not affect Fund Balance with Treasury, such as contract authority, borrowing authority and investment accounts. This category reduces the Status of Fund Balance with Treasury.

Disclosures Related to Suspense/Budget Clearing Accounts

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 - 2006
($ in thousands)				
Account				
F3845 – Personal Property Proceeds	$ 0	$ 0	$ 0	$ 0
F3875 – Disbursing Officer Suspense	0	0	0	0
F3880 – Lost or Cancelled Treasury Checks	0	0	0	0
F3882 – Uniformed Services Thrift Savings Plan Suspense	0	0	0	0
F3885 – Interfund/IPAC Suspense	0	0	0	0
F3886 – Thrift Savings Plan Suspense	0	0	0	0
Total	$ 0	$ 0	$ 0	$ 0

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 to 2006
($ in thousands)				
1. Total Problem Disbursements, Absolute Value				
A. Unmatched Disbursements (UMDs)	$ 4,713	$ 60,443	$ 8,377	$ -52,066
B. Negative Unliquidated Obligations (NULO)	4,255	2,405	717	-1,688
2. Total In-transit Disbursements, Net	$ 415,522	$ 346,640	$ 189,863	$ -156,777

A UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The In-transit Disbursements, Net represent the net value of disbursements and collections made by a DOD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

Fluctuations

The AFWCF had a $53.8 million decrease in problem disbursements and a $156.8 million decrease in in-transits. The decrease in in-transits of $156.8 million can be attributed to an accounting station merger which reduced intraservice (Air Force to Air Force) disbursement activity.

The decrease of $52.1 million in UMDs and the $1.7 million in NULOs can be attributed to a 25% increase in the rate of automated posting of disbursements since May 2005 when various system enhancements (e.g. DFAS Transaction Interface Module) were implemented. During implementation phase in FY 2005, a backlog developed compared to FY 2004.

The AFWCF has no problem disbursements related to Foreign Military Sales. In addition, there are no discrepancies between the amounts reported and the problem disbursement metric.

Note 4. Investments and Related Interest

Not Applicable.

Note 5. Accounts Receivable

As of September 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
($ in thousands)				
1. Intragovernmental Receivables	$ 420,073	N/A	$ 420,073	$ 510,560
2. Nonfederal Receivables (From the Public)	$ 232,314	$ 0	$ 232,314	$ 219,929
3. Total Accounts Receivable	$ 652,387	$ 0	$ 652,387	$ 730,489

Fluctuations

The Air Force Working Capital Fund (AFWCF) had a $90.5 million (18%) decrease in Intragovernmental Receivables. Of the decrease, $65.4 million is due to Information Services Activity Group discontinuing operations in September 2005. During FY 2006, remaining unfilled customer orders and balance sheet accounts are being liquidated in preparation for account closure in FY 2007.

Information Related to Accounts Receivables

Allocation of Undistributed Collections

The Department of Defense (DoD) policy is to allocate supported undistributed collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts receivable. Unsupported undistributed collections are recorded in United States Standard General Ledger (USSGL) account 2400, Liability For Deposit Funds, Clearing Accounts, and Undeposited Collections. The AFWCF followed this allocation procedure, applying $467.3 thousand in undistributed collections to accounts receivable and recording $805.7 thousand of unsupported undistributed to USSGL account 2400.

Elimination Adjustments

Accounts receivable within the AFWCF have been eliminated for statement presentation purposes. The total value of the receivables that were eliminated on these financial statements is $312.6 million.

Aged Accounts Receivable

As of September 30	2006		2005	
	Intra-governmental	Nonfederal	Intra-governmental	Nonfederal
($ in thousands)				
CATEGORY				
Nondelinquent				
Current	$ 727,179	$ 220,312	$ 838,289	$ 205,913
Noncurrent	0	0	138	0
Delinquent				
1 to 30 days	$ 624	$ 436	$ -797	$ 372
31 to 60 days	2,353	264	343	366
61 to 90 days	2,323	936	-304	181
91 to 180 days	-521	718	741	556
181 days to 1 year	129	3,656	-44	9,116
Greater than 1 year and less than or equal to 2 years	1,023	5,274	4,556	2,224
Greater than 2 years and less than or equal to 6 years	13	651	6	799
Greater than 6 years and less than or equal to 10 years	0	125	0	131
Greater than 10 years	0	3	0	3
Subtotal	$ 733,123	$ 232,375	$ 842,928	$ 219,661
Less Supported Undistributed Collections	-467	0	332	277
Less Eliminations	-312,643	0	-332,709	0
Less Other	60	-61	9	-9
Total	$ 420,073	$ 232,314	$ 510,560	$ 219,929

The AFWCF currently has no nondelinquent receivables over 30 days. The FY 2005 noncurrent amount was reported in error and should have been included with delinquent receivables.

Delinquent accounts receivables are referred to either Columbus Contract Debt Collection Office or the Defense Debt Management System at the Defense Finance and Accounting Service - Denver for collection action.

All abnormal amounts in the above schedule are due to accounting posting errors in accounts receivable subsidiary ledgers. All prior year errors have been corrected and the $520.5 thousand in the 91-180 day category was corrected in October 2006.

The "Other" Line represents intragovernmental receivables that were incorrectly reported on the monthly report on receivables as public.

Note 6. Other Assets

As of September 30		2006		2005
($ in thousands)				
1. Intragovernmental Other Assets				
A. Advances and Prepayments	$	5,218	$	48,515
B. Other Assets		0		0
C. Total Intragovernmental Other Assets	$	5,218	$	48,515
2. Nonfederal Other Assets				
A. Outstanding Contract Financing Payments	$	177,481	$	0
B. Other Assets (With the Public)		363,662		440,337
C. Total Nonfederal Other Assets	$	541,143	$	440,337
3. Total Other Assets	$	546,361	$	488,852

Fluctuations and Abnormalities

Intragovernmental other assets

The $43.3 million (89%) decrease to Intragovernmental Other Assets is primarily due to an advance that was recorded in error in September 2005. The Air Force General Fund recorded an advance from Depot Maintenance Activity Group (DMAG) for $47.9 million. The correction was processed and the advance was reversed in the Air Force Working Capital Fund (AFWCF) in October 2005.

Nonfederal other assets

Nonfederal Other Assets increased $100.8 million (23%). Outstanding Contract Financing Payments increased $177.5 million which was offset by a decrease in Other Assets (With the Public) of $76.6 million.

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Department that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Government. The government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the Department is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product.

Outstanding Contract Financing Payments increased $177.5 million. The contract financing payment balance of $177.5 million is comprised of $139.8 million in contract financing payments and an additional $37.7 million in estimated future funded payments that will be paid to the contractor upon future delivery and Government acceptance of a satisfactory product (See additional discussion in Note 15, Other Liabilities).

The increase of $139.8 million is due to a reclassification of other assets that occurred for the first time in the 2nd Quarter, FY 2006. A portion of the AFWCF advances were determined to be financing payments on long term contracts. For reporting periods prior to 2nd Quarter, 2006 they were reflected as Other Assets (With the Public). The $37.7 million increase in estimated future funded payments is due to guidance issued in the 4th Quarter 2006, by the Office of the Under Secretary of Defense, Comptroller to recognize a contingent liability for the estimated future contract financing payments that will be paid to the contractor upon delivery and Government acceptance of a satisfactory product. Based on the new requirement, there was no accrual for FY 2005.

Other Assets (With the Public) had a decrease of $76.6 million, which is the result of three events. The composition of Other Assets (With the Public) is reflected in the schedule below.

Line 2.B. Nonfederal Other Assets - Other Assets (With the Public)

Types of Asset As of September 30 ($ in thousands)	2006	2005
Advances -		
SMAG - Advances and Prepayments to Contractors	$214,798	$149,759
SMAG – Contract Financing Payments	0	167,896
Total Advances	**214,798**	**317,655**
Other Assets -		
SMAG - Other assets returns to vendors pending credit	147,218	122,167
DMAG – Unallocated labor and materials	1,646	515
Total Other Assets	**148,864**	**122,682**
Total Nonfederal Other Assets	**$363,662**	**$440,337**

The first event is an increase of $65.0 million in the Supply Management Activity Group (SMAG) advances to contractors for intransit inventory. This increase is the result of a systematic issue within the Financial Inventory Accounting and Billing System (FIABS). When FIABS was converted to Standard General Ledger Programming in October of 2003, intransit inventory was split so that the portion of inventory that had already been billed but not received was recorded as an advance to contractors. The advances values have been slowly increasing since October 2004, and it is believed that the system is not computing and updating the billed not received values correctly. To properly identify the valid amounts, hard copy source documents are being reconciled with an expected completion date of 1st Quarter, FY 2007.

The second event is the reclassification of contract financing payments as discussed in the table on page 1, Line 2A under Non Federal Other Assets. This reclassification resulted in a decrease of $167.9 million, which was the 4th Quarter, FY 2005 outstanding advances amounts.

The third event is an increase of $25.1 million in SMAG returns awaiting the vendor to process a credit. The main contributor to this increase was shipments not credited for the Material Support Division in the amount of $27.7 million. Prior to FY 2006 these could not be validated due to the limited availability of transaction level detail. In 1st Quarter, FY 2006 a reconciliation/validation tool was implemented resulting in accurate balances in FY 2006.

Note 7. Cash and Other Monetary Assets

Not Applicable.

Note 8. Direct Loan and/or Loan Guarantee Programs

Direct Loan and/or Loan Guarantee Programs - The entity operates the following direct loan and/or Loan guarantee program(s):

Military Housing Privatization Initiative
Armament Retooling & Manufacturing Support Initiative

Note 9. Inventory and Related Property

As of September 30		2006		2005
($ in thousands)				
1. Inventory, Net	$	34,170,548	$	32,319,057
2. Operating Materials & Supplies, Net		360,328		382,632
3. Stockpile Materials, Net		0		0
4. Total	$	34,530,876	$	32,701,689

Inventory, Net

As of September 30		2006 Inventory, Gross Value		2006 Revaluation Allowance		2006 Inventory, Net		2005 Inventory, Net	Valuation Method
($ in thousands)									
1. Inventory Categories									
A. Available and Purchased for Resale	$	23,973,248	$	-9,942	$	23,963,306	$	22,702,208	LAC, MAC
B. Held for Repair		14,131,014		-4,222,717		9,908,297		9,372,433	LAC, MAC
C. Excess, Obsolete, and Unserviceable		826,866		-826,866		0		0	NRV
D. Raw Materials		0		0		0		0	MAC, SP, LAC
E. Work in Process		298,945		0		298,945		244,416	AC
F. Total	$	39,230,073	$	-5,059,525	$	34,170,548	$	32,319,057	

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

Fluctuations

Net Inventory increased $1.9 billion (6%) primarily due to a $1.0 billion increase in the Material Support Division (MSD) and a $673.6 million increase in the General Support Division (GSD) within the Supply Management Activity Group.

Available and purchase for resale increased $1.3 billion primarily due to MSD physical inventory counts and GSD reconciling inventory transfers between storage facilities. During 2006, physical inventory counts and inspections identified $410 million of MSD inventory not recorded in accounting records. Due to a significant decrease in GSD's inventory value when compared to FY 2004, a reconciliation of inventory transfers between storage facilities was conducted in FY 2006. The analysis determined inventory transfers were being adjusted incorrectly resulting in $660 million of inventory not being recorded. In August 2006, the reconciliation was completed and a journal voucher was processed to correct the value of GSD inventory.

Held for repair increased $535.9 million due to MSD physical inventory counts and spare parts being pulled from retired aircraft in FY 2006. The physical inventory counts and inspections identified $295 million of inventory not recorded in accounting records. Parts reclamation was conducted on retired C-5 aircraft, effectively returning $236 million of parts to inventory.

The Depot Maintenance Activity Group (DMAG) increased $54.5 million in Work in Progress (WIP). In FY 2006, Contract DMAG had a $44 million increase in WIP due to ongoing reconciliation efforts to accurately reflect account balances in preparation for Contract DMAG closure in FY 2010.

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.

General Composition of Inventory

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

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

Operating Materials and Supplies, Net

As of September 30	2006			2005	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
($ in thousands)					
1. OM&S Categories					
A. Held for Use	$ 360,328	$ 0	$ 360,328	$ 382,632	SP, LAC
B. Held for Repair	0	0	0	0	SP, LAC
C. Excess, Obsolete, and Unserviceable	0	0	0	0	NRV
D. Total	$ 360,328	$ 0	$ 360,328	$ 382,632	

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

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.

There are no restrictions on the use of OM&S.

Stockpile Materials, Net

As of September 30	2006			2005	
	Stockpile Materials Amount	Allowance for Gains (Losses)	Stockpile Materials, Net	Stockpile Materials, Net	Valuation Method
($ in thousands)					
1. Stockpile Materials Categories					
A. Held for Sale	$ 0	$ 0	$ 0	$ 0	AC, LCM
B. Held in Reserve for Future Sale	0	0	0	0	AC, LCM
C. Total	$ 0	$ 0	$ 0	$ 0	

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

The Air Force Working Capital Fund has no Stockpile Materials.

Note 10. General PP&E, Net

As of September 30	2006					2005
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
($ in thousands)						
1. Major Asset Classes						
A. Land	N/A	N/A	$ 0	N/A	$ 0	$ 0
B. Buildings, Structures, and Facilities	S/L	20 or 40	896,080	$ -577,350	318,730	313,956
C. Leasehold Improvements	S/L	lease term	0	0	0	0
D. Software	S/L	2-5 or 10	1,045,037	-739,755	305,282	342,075
E. General Equipment	S/L	5 or 10	2,081,890	-1,579,536	502,354	511,315
F. Military Equipment	S/L	Various	0	0	0	0
G. Assets Under Capital Lease	S/L	lease term	0	0	0	0
H. Construction-in-Progress	N/A	N/A	42,799	N/A	42,799	38,210
I. Other			0	0	0	0
2. Total General PP&E			$ 4,065,806	$ -2,896,641	$ 1,169,165	$ 1,205,556

[1] 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), equipment reported by the Air Force Equipment Management System (AFEMS) and Information Processing Management System (IPMS) have not been validated and reconciled. The Depot Maintenance Air Logistic Centers (ALC) and Aerospace Maintenance and Regeneration Center (AMARC) use ACES to capture the costs of real property based on preponderance of use for each building. The ALC's and AMARC 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.

The value of Air Force General PP&E 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 (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 DoD Inspector General, DoD 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).

There are no restrictions on the use or convertibility of General PP&E.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2006	2005
($ in thousands)		
1. Intragovernmental Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Debt	0	0
C. Other	0	0
D. Total Intragovernmental Liabilities	$ 0	$ 0
2. Nonfederal Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Military Retirement and Other Federal Employment Benefits	227,035	233,713
C. Environmental Liabilities	0	0
D. Other Liabilities	0	0
E. Total Nonfederal Liabilities	$ 227,035	$ 233,713
3. Total Liabilities Not Covered by Budgetary Resources	$ 227,035	$ 233,713
4. Total Liabilities Covered by Budgetary Resources	$ 2,037,616	$ 2,282,258
5. Total Liabilities	$ 2,264,651	$ 2,515,971

Information Related to Liabilities Not Covered by Budgetary Resources

Line 2.B. represents the Actuarial Federal Employee Compensation future liabilities as provided annually by the Department of Labor.

Note 12. Accounts Payable

As of September 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
($ in thousands)				
1. Intragovernmental Payables	$ 171,623	$ N/A	$ 171,623	$ 199,650
2. Nonfederal Payables (to the Public)	494,347	0	494,347	546,739
3. Total	$ 665,970	$ 0	$ 665,970	$ 746,389

Fluctuations and Abnormalities

Intragovernmental payables decreased by $28.0 million (14%). This decrease is primarily due to a $27.1 million decrease in Contract Depot Maintenance Activity Group (CDMAG) at Ogden Air Logistic Center (OO-ALC). This decrease is due to an adjustment processed in July of 2006 to correct an erroneous account balance. During FY 2006, OO-ALC began an effort to reconcile the accounts payable subsidiary ledger to the trial balance. The analysis specifically identified $34.0 million in month end disbursement reconciliation adjustments that were processed in FY 2005 that erroneously reduced an other liability account in lieu of accounts payable. An adjustment was processed in July of 2006 to correct the error, resulting in an overall decrease in Ogden's Intragovernmental Accounts Payable.

Public payables decreased $52.4 million (10%), which was primarily due to three events.

The first event was a $153.6 million decrease in the Information Services Activity Group (ISAG). At the end of FY 2005, ISAG discontinued activity operations. During FY 2006, remaining unfilled customer orders and balance sheet accounts are being liquidated in preparation for account closure in FY 2007.

The second event was a $125.4 million increase due to the write-off of unsupported undistributed disbursements in September 2006 based upon the Office of Secretary of Defense Comptroller guidance directing stabilized unsupported amounts should be written off. Undistributed disbursements are treated as an offset to accounts payable.

The third event was a $21.2 million decrease in public payables in the General Support Division (GSD) which was caused by an adjustment processed in July of 2006. In a review of the nonfederal payables, it was determined that transactions for the Defense Logistic Centers had erroneously updated the nonfederal accounts payable in lieu of the intragovernmental accounts payable. These erroneous transactions were properly recorded in intragovernmental payables in July of 2006, resulting in the decrease in nonfederal 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. 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 $166.9 million for these payments.

Allocation of Undistributed Disbursements

The Department of Defense (DoD) policy is to allocate supported undistributed disbursements between intragovernmental and nonfederal categories based on the percentage of intragovernmental and nonfederal 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 $14.5 million in USSGLA 2120.

Note 13. Debt

Not Applicable.

Note 14. Environmental Liabilities and Disposal Liabilities

Not Applicable.

Note 15. Other Liabilities

As of September 30	2006						2005	
	Current Liability		Noncurrent Liability		Total		Total	
($ in thousands)								
1. Intragovernmental								
A. Advances from Others	$	163,617	$	0	$	163,617	$	136,241
B. Deposit Funds and Suspense Account Liabilities		0		0		0		0
C. Disbursing Officer Cash		0		0		0		0
D. Judgment Fund Liabilities		0		0		0		0
E. FECA Reimbursement to the Department of Labor		0		0		0		0
F. Other Liabilities		10,599		0		10,599		10,297
G. Total Intragovernmental Other Liabilities	$	174,216	$	0	$	174,216	$	146,538
2. Nonfederal								
A. Accrued Funded Payroll and Benefits	$	147,711	$	0	$	147,711	$	129,479
B. Advances from Others		5,215		0		5,215		8,570
C. Deferred Credits		0		0		0		0
D. Deposit Funds and Suspense Accounts		806		0		806		54,771
E. Temporary Early Retirement Authority		0		0		0		0
F. Non-environmental Disposal Liabilities								
(1) Military Equipment (Nonnuclear)		0		0		0		0
(2) Excess/Obsolete Structures		0		0		0		0
(3) Conventional Munitions Disposal		0		0		0		0
G. Accrued Unfunded Annual Leave		0		0		0		0
H. Capital Lease Liability		0		0		0		0
I. Other Liabilities		1,006,017		37,681		1,043,698		1,196,511
J. Total Nonfederal Other Liabilities	$	1,159,749	$	37,681	$	1,197,430	$	1,389,331
3. Total Other Liabilities	$	1,333,965	$	37,681	$	1,371,646	$	1,535,869

Fluctuations and Abnormalities

Intragovernmental Other Liabilities increased $27.7 million (19%) due to the following events:

The Intragovernmental Advances from Others increased $27.4 million (20%) which is caused by a $28.0 million increase in the Depot Maintenance Activity Group (DMAG). In FY 2006 progress billings increased $15.1 million at Oklahoma City and $14.5 million at the Ogden Air Logistic Centers as a result of increased customer orders within their respective Contract DMAG programs.

Nonfederal Other Liabilities decreased $191.9 million (14%) due to the following events:

Accrued Funded Payroll and Benefits increased $18.2 million (14%) due to increases in DMAG benefits in FY 2006. Benefits are increasing due to increased contributions to Federal Employee Retirement System (FERS) and Thrift Saving Plan. This trend is expected to continue as Civil Service Retirement System workers retire and are replaced with employees enrolled in FERS.

Advances from Others decreased $3.4 million (39%) due to the continued reduction in the backlog of DMAG advances. The backlog occurred in FY 2004 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 systems release was installed to correct the report during the first quarter of FY 2005 so current private party bills could be processed. However, the release did not provide functionality to process the older contracts and a backlog continued to exist in the account throughout FY 2005. This backlog has been steadily worked off and the account is now at a normal balance.

Deposits Funds and Suspense Accounts decreased $54.0 million (99%) was due to write-off of unsupported undistributed collections in September 2006 based upon the Office of the Secretary of Defense Comptroller guidance directing stabilized unsupported amounts should be written off.

Other Liabilities decreased $152.8 million (13%) as follows:

Information Related to Other Liabilities

As of September 30 ($ in thousands)	FY 2006	FY 2005
Misc. Liabilities	$ 239	$ 500
DMAG – WIP Accrued Expenses	967,461	1,161,308
SMAG – Future Purchase - Foreign Military Sales	28,376	28,377
SMAG – Other Accrued Liabilities	9,941	6,326
MOCAS/Contract Financing Payments	37,681	0
Total	$ 1,043,698	$ 1,196,511

The DMAG accrued expenses decreased $193.8 million. In FY 2006 Contract DMAG had a net change of $202.6 million in accrued expenses due to the reconciliation of production complete contracts. This reconciliation effort will continue to decrease accrued liabilities in preparation for Contract DMAG closure in FY 2010.

The Supply Management Activity Group (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 Mechanization of Contract Administration Services (MOCAS)/Contract Financing Payments include $37.7 million in estimated future contract financing payments that will be paid to the contractor upon delivery and Government acceptance of a satisfactory product. In accordance with contract terms, specific rights to the contractor's work vests with the Government when a specific type of contract financing payments is made, thereby protecting taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The Department is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance of a satisfactory product. Since it is probable that the contractor will complete its efforts and deliver a satisfactory product to the Department and the amount of potential future payment are estimable; the Department has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance of a satisfactory product.

Note 16. Commitments and Contingencies

Not Applicable.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2006				2005
	Present Value of Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liability	Present Value of Benefits
($ in thousands)					
1. Pension and Health Actuarial Benefits					
A. Military Retirement Pensions	$ 0		$ 0	$ 0	$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Military Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Actuarial Benefits	$ 0		$ 0	$ 0	$ 0
2. Other Actuarial Benefits					
A. FECA	$ 227,035		$ 0	$ 227,035	$ 233,713
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. Total Other Actuarial Benefits	$ 227,035		$ 0	$ 227,035	$ 233,713
3. Other Federal Employment Benefits	$ 0		$ 0	$ 0	$ 0
4. Total Military Retirement and Other Federal Employment Benefits:	$ 227,035		$ 0	$ 227,035	$ 233,713

Military Retirement Pensions

The Air Force Working Capital has no Military Retirement Pensions.

Military Retirement Health Benefits

The Air Force Working Capital Fund has no Military Retirement Health Benefits

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, 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. The projected annual benefit payments have been discounted to present value using the Office of Management and Budget's (OMB's) economic assumptions for 10-year 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 benefits 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:

2006
5.170% in Year 1
5.313% in Year 2
And thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2006 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:

CBY	COLA	CPIM
2006	3.50%	4.00%
2007	3.13%	4.01%
2008	2.40%	4.01%
2009	2.40%	4.013%
2010+	2.43%	4.09%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid loses per case (a measure of case-severity) in CBY 2006 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the 2006 projection to the average pattern for the projections of the most recent three years.

Note 18. General Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue

As of September 30	2006	2005
($ in thousands)		
1. Intragovernmental Costs	$ 4,748,892	$ 5,312,717
2. Public Costs	3,923,068	5,201,477
3. Total Costs	$ 8,671,960	$ 10,514,194
4. Intragovernmental Earned Revenue	$ -10,105,650	$ -10,643,243
5. Public Earned Revenue	-677,373	-771,703
6. Total Earned Revenue	$ -10,783,023	$ -11,414,946
7. Net Cost of Operations	$ -2,111,063	$ -900,752

Fluctuations and Abnormalities

Gross Costs

Gross Costs had a decrease of $1.8 billion (18%).

Intragovernmental Costs decreased by $563.8 million due to the following events.

$141.3 million decrease is attributed to an error in the revenues reported by the Army Working Capital Fund in FY 2005. During the last two quarters of FY 2005, Tobyhanna Army Depot implemented a new accounting system and they believe the numbers provided were overstated due to system implementation problems. The FY 2006 amounts provided were verified by the Tobyhanna Army Depot as correct.

$39.1 million decrease in the Information Services Activity Group (ISAG) was due to the removal of ISAG from the Air Force Working Capital Fund (AFWCF) at the end of FY 2005. In FY 2006, no new customer orders were started. Remaining unfilled customer orders and balance sheet accounts are being liquidated in preparation for account closure in FY 2007.

The remaining decrease of $383.4 million is primarily due to a reduction in revenues reported by the Defense Logistics Agency (DLA). AFWCF purchases, both inventory and services such as transportation, storage and warehouse issues/receipts from DLA. Due to trading partner eliminations, AFWCF is required to balance with DLA's revenue. In comparison to FY 2005, The Air Force has purchased the same level of services and inventory for resale in FY 2006. After a review of the FY 2006 business events, AFWCF does not agree with DLA's reported revenue reduction and a reconciliation will be performed in the 1st quarter of FY 2007.

Public Costs had a $1.3 billion decrease primarily due to a $636.5 million decrease in the General Support Division (GSD) and $522.4 million decrease in the ISAG.

The GSD decrease is due to a $660 million reported net gain under Public Costs. In FY 2006, an accounting adjustment was processed to correct erroneous inventory transfers processed in FY 2005. Due to significant inventory decreases in comparison to the FY 2004 inventory value, GSD conducted a reconciliation of inventory transfers between storage facilities in FY 2006. The analysis determined inventory transfers were being adjusted incorrectly resulting in $660 million of inventory not being recorded. In August 2006, the reconciliation was completed and a journal voucher was processed to correct the value of GSD inventory. Gains are processed as an offset within the loss account within the Supply Management Activity Group, thus are included in Gross Costs.

The ISAG decrease was due to the removal of ISAG from the AFWCF as discussed above.

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.

While the 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 non-financial feeder systems.

Intragovernmental costs and revenue are related to transactions made between two reporting entities within the Federal Government. Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

Note 19. Disclosures Related to the Statement of Changes in Net Position

As of September 30	2006		2005	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
($ in thousands)				
1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance				
A. Changes in Accounting Standards	$ 0	$ 0	$ 3,632,598	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	0	0	7,256,576	0
C. Total Prior Period Adjustments	$ 0	$ 0	$ 10,889,174	$ 0
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	$ 55,234	$ 0	$ 62,192	$ 0
B. Civilian Health	109,111	0	105,973	0
C. Civilian Life Insurance	264	0	269	0
D. Judgment Fund	0	0	0	0
E. Intraentity	0	0	0	0
F. Total Imputed Financing	$ 164,609	$ 0	$ 168,434	$ 0

Information Related to the Statement of Changes in Net Position

Prior Period Adjustments

The prior period adjustment during FY 2005 was due to the change in the Material Support Division inventory valuation methodology. The Latest Acquisition Cost in the Standard Base Supply System was converted to Moving Average Cost historical cost basis valuation which does not require an allowance for gains and losses. The conversion created a prior period adjustment of approximately $10.8 billion for the elimination of the allowance for gains and losses, the establishment of an allowance for repairs and the revaluation of the inventory.

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. OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for computation of imputed financing cost. DFAS provides the costs to OUSD (Personnel and Readiness) for validation. Approved imputed costs are provided to the reporting components for inclusion in their financial statements.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2006	2005
($ in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 7,151,764	$ 6,937,550
2. Available Borrowing and Contract Authority at the End of the Period	4,183,095	2,782,392

Information Related to the Statement of Budgetary Resources

Intra-entity Transactions

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

Apportionment Categories

Office of Management and Budget Circular A-136, 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 in the SBR, lines 8A and 8B. There are no Category A direct or reimbursable obligations. Category B reimbursable obligations total $15.8 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.

Appropriations Received

The Medical Dental Division of Supply Management received a Congressional appropriation of $43.3 million in February 2006 to maintain War Readiness Materials. Of this amount, $43.3 million has been obligated as of September 30, 2006.

Note 21. Disclosures Related to the Statement of Financing

The objective of the Statement of Financing is to reconcile the difference between budgetary obligations and the net cost of operations reported. Due to the Department of the Air Force's financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. Differences between budgetary and proprietary data constitutes a previously identified deficiency.

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. "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). This adjustment was $148.3 million, absolute value.

The following Statement of Financing lines are presented as combined instead of consolidated due to interagency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

Other "Resources Used to Finance Items not Part of the Net Cost of Operations" includes asset transfers out from the Air Force Working Capital Fund (AFWCF). At the end of FY 2005, ISAG discontinued activity operations. During FY 2006, remaining unfilled customer orders and balance sheet accounts are being liquidated in preparation for account closure in FY 2007. In FY 2006, the Information Services Activity Group transferred general equipment to the Air Force General Funds. "Other" resources that do not affect net cost consists of applied overhead and adjustments to inventory held for repair valuation accounts.

Amounts reported for "Exchange revenue receivable from public" represent a change in public receivables, which does not have a relationship to liabilities not covered by budgetary resources.

The value for "Other" reported under "Components Requiring or Generating Resources in Future Period" is the amount for Federal Employees Compensation Act.

The value for "Other" reported under "Components Not Requiring or Generating Resources in Future Period" are applied overhead, bad debt expense and expenses not requiring budgetary resources.

Note 22. Disclosures Related to the Statement of Custodial Activity

Not Applicable.

Note 23. Earmarked Funds

Not Applicable.

Note 24. Other Disclosures

Not Applicable.

Working Capital Fund

Consolidating and Combining Statements

Consolidating Balance Sheet—Working Capital Fund

As of September 30, 2006 and 2005 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
1. ASSETS (Note 2)			
A. Intragovernmental:			
1. Fund Balance with Treasury (Note 3)			
a. Entity	$ 795,976	$ 562,841	$ -15,781
b. Nonentity Seized Iraqi Cash	0	0	0
c. Nonentity-Other	0	0	0
2. Investments (Note 4)	0	0	0
3. Accounts Receivable (Note 5)	326,882	400,078	-7,367
4. Other Assets (Note 6)	5,186	81,352	25
5. Total Intragovernmental Assets	$ 1,128,044	$ 1,044,271	$ -23,123
B. Cash and Other Monetary Assets (Note 7)	$ 0	$ 0	$ 0
C. Accounts Receivable, Net (Note 5)	12,042	220,264	8
D. Loans Receivable (Note 8)	0	0	0
E. Inventory and Related Property, Net (Note 9)	659,272	33,871,604	0
F. General Property, Plant and Equipment, Net (Note 10)	1,035,725	112,945	20,495
G. Investments (Note 4)	0	0	0
H. Other Assets (Note 6)	27,273	513,870	0
2. TOTAL ASSETS	$ 2,862,356	$ 35,762,954	$ -2,620
3. LIABILITIES (Note 11)			
A. Intragovernmental:			
1. Accounts Payable (Note 12)	$ 247,946	$ 223,092	$ 104
2. Debt (Note 13)	0	0	0
3. Other Liabilities (Note 15 & 16)	254,462	1,099	0
4. Total Intragovernmental Liabilities	$ 502,408	$ 224,191	$ 104
B. Accounts Payable (Note 12)	$ 48,203	$ 428,942	$ 3,122
C. Military Retirement and Other Federal Employment Benefits (Note 17)	203,425	23,601	9
D. Environmental and Disposal Liabilities (Note 14)	0	0	0
E. Loan Guarantee Liability (Note 8)	0	0	0
F. Other Liabilities (Note 15 and Note 16)	1,113,355	82,955	261
4. TOTAL LIABILITIES	$ 1,867,391	$ 759,689	$ 3,496
5. NET POSITION			
A. Unexpended Appropriations - Earmarked Funds (Note 23)	$ 0	$ 0	$ 0
B. Unexpended Appropriations - Other Funds	0	0	0
C. Cumulative Results of Operations - Earmarked Funds	0	0	0
D. Cumulative Results of Operations - Other Funds	994,965	35,003,265	-6,116
6. TOTAL NET POSITION	$ 994,965	$ 35,003,265	$ -6,116
7. TOTAL LIABILITIES AND NET POSITION	$ 2,862,356	$ 35,762,954	$ -2,620

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

Component Level	Combined Total	Eliminations	2006 Consolidated	2005 Consolidated
$ 14,940	$ 1,357,976	$ 0	$ 1,357,976	$ 1,164,223
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
-1	719,592	299,519	420,073	510,560
0	86,563	81,345	5,218	48,515
$ 14,939	$ 2,164,131	$ 380,864	$ 1,783,267	$ 1,723,298
$ 0	$ 0	$ 0	$ 0	$ 0
0	232,314	0	232,314	219,929
0	0	0	0	0
0	34,530,876	0	34,530,876	32,701,689
0	1,169,165	0	1,169,165	1,205,556
0	0	0	0	0
0	541,143	0	541,143	440,337
$ 14,939	$ 38,637,629	$ 380,864	$ 38,256,765	$ 36,290,809
$ 0	$ 471,142	$ 299,519	$ 171,623	$ 199,650
0	0	0	0	0
0	255,561	81,345	174,216	146,538
$ 0	$ 726,703	$ 380,864	$ 345,839	$ 346,188
$ 14,080	$ 494,347	$ 0	$ 494,347	$ 546,739
0	227,035	0	227,035	233,713
0	0	0	0	0
0	0	0	0	0
859	1,197,430	0	1,197,430	1,389,331
$ 14,939	$ 2,645,515	$ 380,864	$ 2,264,651	$ 2,515,971
$ 0	$ 0	$ 0	$ 0	$ 0
0	0	0	0	0
0	0	0	0	0
0	35,992,114	0	35,992,114	33,774,838
$ 0	$ 35,992,114	$ 0	$ 35,992,114	$ 33,774,838
$ 14,939	$ 38,637,629	$ 380,864	$ 38,256,765	$ 36,290,809

Consolidating Statement of Net Cost—Working Capital Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	Combined Total	Eliminations	2006 Consolidated	2005 Consolidated
1. Program Costs				
A. Component Level				
1. Gross Costs	$ 0	$ 0	$ 0	$ -10,166
2. (Less: Earned Revenue)	90,914	0	90,914	0
3. Net Program Costs	$ 90,914	$ 0	$ 90,914	$ -10,166
B. Depot Maintenance				
1. Gross Costs	$ 6,090,124	$ 2,384,852	$ 3,705,272	$ 4,046,962
2. (Less: Earned Revenue)	-6,292,446	-2,643,203	-3,649,243	-3,832,693
3. Net Program Costs	$ -202,322	$ -258,351	$ 56,029	$ 214,269
C. Information Services				
1. Gross Costs	$ 164,747	$ 2	$ 164,745	$ 726,191
2. (Less: Earned Revenue)	-177,882	-38,979	-138,903	-608,187
3. Net Program Costs	$ -13,135	$ -38,977	$ 25,842	$ 118,004
D. Supply Management				
1. Gross Costs	$ 7,482,364	$ 2,680,471	$ 4,801,893	$ 5,751,130
2. (Less: Earned Revenue)	-9,467,887	-2,383,143	-7,084,744	-6,974,066
3. Net Program Costs	$ -1,985,523	$ 297,328	$ -2,282,851	$ -1,222,936
E. Transportation				
1. Gross Costs	$ 50	$ 0	$ 50	$ 77
2. (Less: Earned Revenue)	-1,047	0	-1,047	0
3. Net Program Costs	$ -997	$ 0	$ -997	$ 77
F. Total Program Costs				
1. Gross Costs	$ 13,737,285	$ 5,065,325	$ 8,671,960	$ 10,514,194
2. (Less: Earned Revenue)	-15,848,348	-5,065,325	-10,783,023	-11,414,946
3. Net Program Costs	$ -2,111,063	$ 0	$ -2,111,063	$ -900,752
2. Cost Not Assigned to Programs	0	0	0	0
3. (Less: Earned Revenue Not Attributable to Programs)	0	0	0	0
4. Net Cost of Operations	$ -2,111,063	$ 0	$ -2,111,063	$ -900,752

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

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Combining Statement of Budgetary Resources—Working Capital Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES:			
1. Unobligated balance, brought forward, October 1	$ 312,798	$ -61,554	$ -58,548
2. Recoveries of prior year unpaid obligations	0	2,397	75,221
3. Budget authority			
3a. Appropriation	1,000	47,577	0
3b. Borrowing authority	0	0	0
3c. Contract authority	226,498	9,631,334	0
4. Spending authority from offsetting collections			
4a. Earned			
1. Collected	6,252,321	9,438,497	262,384
2. Change in receivables from Federal sources	-26,793	34,018	-84,502
4b. Change in unfilled customer orders			
1. Advance received	10,419	0	0
2. Without advance from Federal sources	83,995	-790,879	-229,439
4c. Anticipated for rest of year, without advances	0	0	0
4d. Previously unavailable	0	0	0
4e. Expenditure transfers from trust funds	0	0	0
4f. Subtotal	6,547,440	18,360,547	-51,557
5. Nonexpenditure transfers, net, anticipated and actual	-60,000	-49,054	12,342
6. Temporarily not available pursuant to Public Law	0	0	0
7. Permanently not available	205,170	-8,672,778	10,292
8. Total Budgetary Resources	$ 7,005,408	$ 9,579,558	$ -12,250
STATUS OF BUDGETARY RESOURCES:			
9. Obligations incurred:			
9a. Direct	$ 0	$ 0	$ 0
9b. Reimbursable	6,077,689	9,569,890	0
9c. Subtotal	6,077,689	9,569,890	0
10. Unobligated balance:			
10a. Apportioned	927,719	9,668	-12,250
10b. Exempt from apportionment	0	0	0
10c. Subtotal	927,719	9,668	-12,250
11. Unobligated balance not available	0	0	0
12. Total Status of Budgetary Resources	$ 7,005,408	$ 9,579,558	$ -12,250
CHANGE IN OBLIGATED BALANCE:			
13. Obligated balance, Net			
13a. Unpaid obligations, brought forward, October 1	2,470,811	5,847,564	412,592
13b. Less: Uncollected customer payments from Federal sources, brought forward, October 1	$ -2,369,490	$ -2,306,740	$ -326,140
13c. Total unpaid obligated balance	101,321	3,540,824	86,452
13d. Obligations incurred net (+/-)	$ 6,077,689	$ 9,569,890	$ 0
14. Less: Gross outlays	-6,031,588	-9,350,873	-328,704
15. Obligated balance transferred, net			
15a. Actual transfers, unpaid obligations (+/-)	0	0	0
15b. Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0	0
16. Total Unpaid obligated balance transferred, net	0	0	0
17. Less: Recoveries of prior year unpaid obligations, actual	0	-2,397	-75,221
Change in uncollected customer payments from Federal sources (+/-)	-57,202	756,861	313,942
			313,942
18. Obligated balance, net, end of period			
18a. Unpaid obligations	2,516,913	6,064,183	8,667
18b. Less: Uncollected customer payments from Federal sources	-2,426,693	-1,549,878	-12,198
18c. Total, unpaid obligated balance, net, end of period	90,220	4,514,305	-3,531
NET OUTLAYS:			
19. Net Outlays:			
19a. Gross outlays	6,031,588	9,350,873	328,704
19b. Less: Offsetting collections	-6,262,739	-9,438,497	-262,385
19c. Less: Distributed Offsetting receipts	0	0	0
20. Net Outlays	$ -231,151	$ -87,624	$ 66,319

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

Transportation	Component Level	2006 Combined	2005 Combined
$ 9,068	$ 90,914	$ 292,678	$ 134,440
1,620	0	79,238	4
0	0	48,577	0
0	0	0	0
0	0	9,857,832	9,744,293
1	-15	15,953,188	16,559,412
-617	34,736	-43,158	50,393
0	0	10,419	-121,421
0	0	-936,323	692,744
0	0	0	0
0	0	0	0
0	0	0	0
-616	34,721	24,890,535	26,925,421
-10,072	0	-106,784	-73,911
0	0	0	0
0	0	-8,457,316	-10,801,211
$ 0	$ 125,635	$ 16,698,351	$ 16,184,743
$ 0	$ 0	$ 0	$ 0
0	125,635	15,773,214	15,892,064
0	125,635	15,773,214	15,892,064
0	0	925,137	292,678
0	0	0	0
0	0	925,137	292,678
0	0	0	1
$ 0	$ 125,635	$ 16,698,351	$ 16,184,743
1,685	-111,324	8,621,328	8,980,235
$ -617	$ 35,595	$ -4,967,392	$ -4,224,253
1,068	-75,729	3,653,936	4,755,982
$ 0	$ 125,635	$ 15,773,214	$ 15,892,064
-64	-230	-15,711,459	-16,250,968
0	0	0	0
0	0	0	0
0	0	0	0
-1,620	0	-79,238	-4
617	-34,736	979,482	-743,137
0	14,080	8,603,843	8,621,328
0	859	-3,987,910	-4,967,392
0	14,939	4,615,933	3,653,936
64	230	15,711,459	16,250,968
0	15	-15,963,606	-16,437,991
0	0	0	0
$ 64	$ 245	$ -252,147	$ -187,023

Consolidating Statement of Financing—Working Capital Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services	Transportation
Resources Used to Finance Activities:				
Budgetary Resources Obligated				
1. Obligations incurred	$ 6,077,689	$ 9,569,890	$ 0	$ 0
2. Less: Spending authority from offsetting collections and recoveries	-6,319,942	-8,684,033	-23,664	-1,004
3. Obligations net of offsetting collections and recoveries	-242,253	885,857	-23,664	-1,004
4. Less: Offsetting receipts (-)	0	0	0	0
5. Net obligations	-242,253	885,857	-23,664	-1,004
Other Resources				
6. Donations and forfeitures of property	0	0	0	0
7. Transfers in/out without reimbursement (+/-)	0	0	0	0
8. Imputed financing from costs absorbed by others	145,114	19,482	13	0
9. Other (+/-)	0	0	0	0
10. Net other resources used to finance activities	145,114	19,482	13	0
11. Total resources used to finance activities	$ -97,139	$ 905,339	$ -23,651	$ -1,004
Resources Used to Finance Items not Part of the Net Cost of Operations				
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided				
12a. Undelivered Orders (-)	-193,259	-259,993	239,038	0
12b. Unfilled Customer Orders	94,414	-790,879	-229,439	0
13. Resources that fund expenses recognized in prior periods	0	0	-7,923	0
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	0	0	0	0
15. Resources that finance the acquisition of assets	-139,491	-4,854,112	5,145	0
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations				
16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget	0	0	0	0
16b. Other (+/-)	0	0	0	0
17. Total resources used to finance items not part of the net cost of operations	$ -238,336	$ -5,904,984	$ 6,821	$ 0
18. Total resources used to finance the net cost of operations	$ -335,475	$ -4,999,645	$ -16,830	$ -1,004
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:				
Components Requiring or Generating Resources in Future Period:				
19. Increase in annual leave liability	0	0	0	0
20. Increase in environmental and disposal liability	0	0	0	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0	0	0
22. Increase in exchange revenue receivable from the public (-)	6	0	0	0
23. Other (+/-)	859	385	0	0
24. Total components of Net Cost of Operations that will require or generate resources in future periods	$ 865	$ 385	$ 0	$ 0
Components not Requiring or Generating Resources:				
25. Depreciation and amortization	123,024	43,169	0	0
26. Revaluation of assets or liabilities (+/-)	21,367	824,330	3,697	7
27. Other (+/-)				
27a. Trust Fund Exchange Revenue	0	0	0	0
27b. Cost of Goods Sold	5,130,847	0	0	0
27c. Operating Material & Supplies Used	0	0	0	0
27d. Other	-5,142,950	2,146,238	0	0
28. Total components of Net Cost of Operations that will not require or generate resources	132,288	3,013,737	3,697	7
29. Total components of net cost of operations that will not require or generate resources in the current period	$ 133,153	$ 3,014,122	$ 3,697	$ 7
30. Net Cost of Operations	$ -202,322	$ -1,985,523	$ -13,133	$ -997

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

Component Level	Combined Total	2006 Consolidated	2005 Consolidated
$ 125,635	$ 15,773,214	$ 15,773,214	$ 15,892,064
-34,721	-15,063,364	-15,063,364	-17,181,132
90,914	709,850	709,850	-1,289,068
0	0	0	0
90,914	709,850	709,850	-1,289,068
0	0	0	0
0	0	0	0
0	164,609	164,609	168,434
0	0	0	0
0	164,609	164,609	168,434
$ 90,914	$ 874,459	$ 874,459	$ -1,120,634
0	-214,214	-214,214	180,293
0	-925,904	-925,904	571,323
0	-7,923	-7,923	-5,775
0	0	0	0
0	-4,988,458	-4,988,458	-5,376,780
0	0	0	0
0	0	0	0
$ 0	$ -6,136,499	$ -6,136,499	$ -4,630,939
$ 90,914	$ -5,262,040	$ -5,262,040	$ -5,751,573
0	0	0	0
0	0	0	0
0	0	0	0
0	6	6	0
0	1,244	1,244	5,961
$ 0	$ 1,250	$ 1,250	$ 5,961
0	166,193	166,193	190,703
0	849,401	849,401	3,193
0	0	0	0
0	5,130,847	5,130,847	5,026,640
0	0	0	416,094
-2	-2,996,714	-2,996,714	-791,770
-2	3,149,727	3,149,727	4,844,860
$ -2	$ 3,150,977	$ 3,150,977	$ 4,850,821
$ 90,912	$ -2,111,063	$ -2,111,063	$ -900,752

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Working Capital Fund

Required Supplementary Information

Disaggregated Statement of Budgetary Resources—Working Capital Fund

For the periods ended September 30, 2006 and 2005 ($ in Thousands)

	Working Capital Funds	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES:			
1. Unobligated balance, brought forward, October 1	$ 292,679	$ 292,678	$ 134,440
2. Recoveries of prior year unpaid obligations	79,239	79,238	4
3. Budget authority			
3a. Appropriation	48,577	48,577	0
3b. Borrowing authority	0	0	0
3c. Contract authority	9,857,832	9,857,832	9,744,293
4. Spending authority from offsetting collections			
4a. Earned			
1. Collected	15,953,188	15,953,188	16,559,412
2. Change in receivables from Federal sources	-43,158	-43,158	50,393
4b. Change in unfilled customer orders			
1. Advance received	10,419	10,419	-121,421
2. Without Advance from Federal sources	-936,323	-936,323	692,744
4c. Anticipated for rest of year, without advances	0	0	0
4d. Previously unavailable	0	0	0
4e. Expenditure transfers from trust funds	0	0	0
4f. Subtotal	24,890,535	24,890,535	26,925,421
5. Nonexpenditure transfers, net, anticipated and actual	-106,784	-106,784	-73,911
6. Temporarily not available pursuant to Public Law	0	0	0
7. Permanently not available	-8,457,316	-8,457,316	-10,801,211
8. Total Budgetary Resources	$ 16,698,353	$ 16,698,351	$ 16,184,743
STATUS OF BUDGETARY RESOURCES:			
9. Obligations incurred:			
9a. Direct	$ 0	$ 0	$ 0
9b. Reimbursable	15,773,214	15,773,214	15,892,064
9c. Subtotal	15,773,214	15,773,214	15,892,064
10. Unobligated balance:			
10a. Apportioned	925,138	925,137	292,678
10b. Exempt from apportionment	0	0	0
10c. Subtotal	925,138	925,137	292,678
11. Unobligated balance not available	0	0	1
12. Total Status of Budgetary Resources	$ 16,698,352	$ 16,698,351	$ 16,184,743
CHANGE IN OBLIGATED BALANCE:			
13. Obligated balance, Net			
13a. Unpaid obligations, brought forward, October 1	8,621,327	8,621,328	8,980,235
13b. Less: Uncollected customer payments from Federal sources, brought forward, October 1	$ -4,967,391	$ -4,967,392	$ -4,224,253
13c. Total unpaid obligated balance	3,653,936	3,653,936	4,755,982
13d. Obligations incurred net (+/-)	$ 15,773,214	$ 15,773,214	$ 15,892,064
14. Less: Gross outlays	-15,711,459	-15,711,459	-16,250,968
15. Obligated balance transferred, net			
15a. Actual transfers, unpaid obligations (+/-)	0	0	0
15b. Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0	0
16. Total Unpaid obligated balance transferred, net	0	0	0
17. Less: Recoveries of prior year unpaid obligations, actual	-79,239	-79,238	-4
Change in uncollected customer payments from Federal sources (+/-)	979,481	979,482	-743,137
18. Obligated balance, net, end of period			
18a. Unpaid obligations	8,603,843	8,603,843	8,621,328
18b. Less: Uncollected customer payments (-) from Federal sources (-)	-3,987,910	-3,987,910	-4,967,392
18c. Total, unpaid obligated balance, net, end of period	4,615,933	4,615,933	3,653,936
NET OUTLAYS:			
19. Net Outlays:			
19a. Gross outlays	15,711,459	15,711,459	16,250,968
19b. Less: Offsetting collections	-15,963,607	-15,963,606	-16,437,991
19c. Less: Distributed Offsetting receipts	0	0	0
20. Net Outlays	$ -252,148	$ -252,147	$ -187,023

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

Required Supplemental Information - Part A AT97 - Air Force Working Capital Fund Schedule, Part A DoD Intragovernmental Asset Balances. ($ in Thousands)	Treasury Index:	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Department of Agriculture	12		$89			
Department of Justice	15		$861			
Navy General Fund	17		$5,802			
Department of State	19		$8			
Department of the Treasury	20	$1,357,975	$0			
Army General Fund	21		$1,387			
General Service Administration	47		$2,437			
General Accounting Office	5		$6			
Air Force General Fund	57		$328,052			$451
Homeland Security	70		$1,258			
National Aeronautics and Space Administration	80		$292			
Other Defense Organizations General Funds	97		$45,652			
Other Defense Organizations Working Capital Funds	97-4930		$27,882			$4,768
Army Working Capital Fund	97-4930.001		$3,081			
Navy Working Capital Fund	97-4930.002		$3,269			

Required Supplemental Information - Part B AT97 - Air Force Working Capital Fund Schedule, Part B DoD Intragovernmental entity liabilities. ($ in Thousands)	Treasury Index:	Accounts Payable	Debts/Borrowings From Other Agencies	Other
Navy General Fund	17	$502		
Army General Fund	21	$564		$202
Office of Personnel Management	24			$10,599
Air Force General Fund	57	$68,208		$160,484
Homeland Security	70			$966
Other Defense Organizations General Funds	97	$1		
Other Defense Organizations Working Capital Funds	97-4930	$99,794		$1,965
Army Working Capital Fund	97-4930.001	$419		
Navy Working Capital Fund	97-4930.002	$2,135		

Required Supplemental Information - Part C **AT97 - Air Force Working Capital Fund** **Schedule, Part C DoD Intragovernmental revenue and related costs.** ($ in Thousands)	**Treasury Index:**	**Earned Revenue**
Department of Agriculture	12	$495
Department of the Interior	14	$1
Department of Justice	15	$4,313
Navy General Fund	17	$70,262
Department of State	19	$102
Department of the Treasury	20	$0
Army General Fund	21	$25,342
General Service Administration	47	$83
National Science Foundation	49	$13
General Accounting Office	5	$8
Air Force General Fund	57	$8,236,112
Homeland Security	70	$8,859
National Aeronautics and Space Administration	80	$719
Other Defense Organizations General Funds	97	$1,267,624
Other Defense Organizations Working Capital Funds	97-4930	$381,644
Army Working Capital Fund	97-4930.001	$0
Navy Working Capital Fund	97-4930.002	$84,767

Required Supplemental Information - Part E **AT97 - Air Force Working Capital Fund** ($ in Thousands)	**Treasury Index:**	**Transfers In**	**Transfers Out**
Air Force General Fund	57		$106,784

Working Capital Fund

Audit Opinion

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

November 8, 2006

MEMORANDUM FOR PRINCIPAL DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT)

SUBJECT: Independent Auditor's Report on the Fiscal Year 2006 Air Force Working Capital Fund Financial Statements (Report No. D-2007-015)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Air Force Working Capital Fund Consolidated Balance Sheet as of September 30, 2006 and 2005, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing for the fiscal years then ended. The financial statements are the responsibility of Air Force management. The Air Force is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Air Force Working Capital Fund FY 2006 Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

Disclaimer of Opinion on the Financial Statements

The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged to us that the FY 2006 Air Force Working Capital Fund Financial Statements would not substantially conform to generally accepted accounting principles because deficiencies in Air Force financial management and feeder systems limit its ability to present information accurately and in conformance with generally accepted accounting principles as of September 30, 2006. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Air Force has also acknowledged, and prior audits have identified, the material weaknesses listed in the Summary of Internal Control. These material weaknesses affect the reliability of certain information contained in the United States Air Force Annual Financial Statement 2006—much of which is taken from the same data sources as the financial statements.[1] Therefore, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

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

Summary of Internal Control

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

- Financial Management Systems
- Operating Materials and Supplies
- General Property, Plant, and Equipment
- In-Transit Inventory
- Subsidiary Ledgers and Special Journals
- Intragovernmental Eliminations
- Other Accounting Entries

Material weaknesses are reportable conditions in which internal controls do not reduce (to a relatively low level) the risk of misstatements that are material to the financial statements and that might not be timely detected by employees while performing their normal assigned functions. Our internal control work (conducted during prior audits) would not necessarily disclose all reportable conditions. See the Attachment for additional details on material internal control weaknesses.

Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged, and prior audits confirm, that instances of noncompliance continue to exist. The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged to us that Air Force financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether Air Force complied with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

Management Responsibility

Management is responsible for:

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

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

Attachment:
As stated

Report on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing and maintaining effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; the requirements of applicable laws and regulations are met; and assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses and reportable conditions that could adversely affect a favorable opinion on internal control.

Material Weaknesses. Management acknowledged that many of the previously identified reportable conditions, all of which are material, continue to exist.

Financial Management Systems. Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," requires financial management system controls are adequate to ensure transactions are executed in accordance with budgetary and financial laws and other requirements, are consistent with the purposes authorized, and are recorded in accordance with Federal accounting standards. Statement of Federal Financial Accounting Concepts No. 1 also requires that financial management system controls ensure that assets are properly safeguarded to deter fraud, waste, and abuse, and that performance measurement information is adequately supported. The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged that many Air Force financial management systems do not substantially comply with Federal financial management system requirements. Air Force financial management and feeder systems were not designed to collect and record financial information based on a full accrual accounting basis. Until these systems are updated to collect and report financial information in compliance with generally accepted accounting principles, Air Force financial reporting will be based on budgetary transactions and nonfinancial feeder systems.

Operating Materials and Supplies. The Air Force is required by the Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," to use historical cost to value its Operating Materials and Supplies inventory. Statement of Federal Financial Accounting Standards No. 3 also states that Operating Materials and Supplies must be expensed when the items are consumed. Cost of goods sold and work in process are not recorded in accordance with Statement of Federal Financial Accounting Standards No. 3, Accounting for Inventory and Related Property. Accordingly, management is not certain the operating materials and supplies balances reported in its financial statements are accurate.

General Property, Plant, and Equipment. The Air Force is required by Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment" to record General Property, Plant, and Equipment using acquisition cost, capitalize improvement costs, and recognize depreciation expense. However, General Property, Plant, and Equipment values cannot be verified in accordance with Statement of Federal Financial Accounting

Attachment

Standards No. 6. In addition, the General Property, Plant, and Equipment line item on the Balance Sheet does not include all Government-furnished equipment (with values exceeding the capitalization threshold) in the hands of contractors.

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

Subsidiary Ledgers and Special Journals. Air Force Working Capital Fund resource managers do not always maintain adequate documentation or use transaction subsidiary ledgers and special journals to support recorded trial balance accounts. Air Force and Defense Finance and Accounting Service personnel do not perform reconciliations and system validations to verify the accuracy of accounts receivable from foreign military sales, progress payments to contractors, and accounts payable from the Materiel Support Division.

Intragovernmental Transaction Accounting. The Air Force cannot accurately identify all intragovernmental transactions by customer. Seller entities within DoD provide 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 are adjusted to recognize unrecorded costs and accounts payable. DoD intragovernmental balances are then eliminated.

Other Accounting Entries. The Air Force acknowledged that it continues to enter material transactions that are not properly recorded in the accounting records supporting the financial statements or disclosed in the notes to those statements.

Compliance with Laws and Regulations

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

Statutory Financial Management Systems Reporting Requirements. The Air Force is required to comply with the following financial management systems reporting requirements.

- Section 3512, title 31, United States Code, incorporates the reporting requirements of the Federal Managers' Financial Integrity Act of 1982 and requires the Air Force to evaluate its systems and to annually report whether those systems are in compliance with requirements prescribed by the Comptroller General.

- The Federal Financial Management Improvement Act (the Act) of 1996 requires the Air Force to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. The Act also requires the Air Force to develop a remediation plan when its financial management systems do not comply with Federal financial management systems requirements. The remediation plan must include remedies, costs, and milestones.

For FY 2006, the Air Force did not fully comply with the statutory requirements identified in these provisions. Specifically, it acknowledged that many of its critical financial management and feeder systems did not comply substantially with Federal financial management system requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2006. In an attempt to remedy these long-standing financial management system deficiencies, the Air Force is participating in the DoD-Wide development and implementation of the DoD-Wide Business Enterprise Architecture. Until the Business Enterprise Architecture is fully developed and implemented, the Air Force will not be able to fully comply with statutory requirements. Accordingly, we did not perform tests of compliance for these requirements.

Audit Disclosures

The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged to us on February 28, 2006, that the Air Force financial management systems cannot provide adequate evidence supporting various material amounts on the financial statements. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to provisions of the laws and regulations identified in Office of Management and Budget Bulletin No. 06-03, "Audit Requirements for Federal Financial Statements," August 23, 2006, Appendix E, "General Laws."

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

Attachment

The United States Air Force Annual Financial Statement is available for viewing on the Air Force portal at: https://www.my.af.mil.