Department of Defense
Agency Wide
CONSOLIDATED BALANCE SHEET
As of June 30, 2005 and 2004

		2005 Consolidated		2004 Consolidated
1. ASSETS (Note 2)				
A. Intragovernmental:				
1. Fund Balance with Treasury (Note 3)				
a. Entity	$	420,110,215,785.23	$	381,112,216,075.63
b. Non-Entity Seized Iraqi Cash		77,285,422.99		166,023,057.98
c. Non-Entity-Other		692,326,631.81		842,245,237.10
2. Investments (Note 4)		264,871,038,153.33		233,440,885,778.52
3. Accounts Receivable (Note 5)		1,289,004,365.86		1,072,085,996.80
4. Other Assets (Note 6)		1,351,991,758.14		290,103,481.63
5. Total Intragovernmental Assets	$	688,391,862,117.36	$	616,923,559,627.66
B. Cash and Other Monetary Assets (Note 7)	$	2,395,445,883.48	$	2,092,464,989.71
C. Accounts Receivable (Note 5)		7,908,636,176.61		7,198,014,487.03
D. Loans Receivable (Note 8)		71,816,614.89		67,063,289.18
E. Inventory and Related Property (Note 9)		213,025,885,858.22		216,219,163,241.15
F. General Property, Plant and Equipment (Note 10)		453,052,708,996.03		443,161,913,756.15
G. Investments (Note 4)		575,993,130.00		405,225,630.00
H. Other Assets (Note 6)		24,233,224,520.77		21,316,747,915.37
2. TOTAL ASSETS	$	1,389,655,573,297.36	$	1,307,384,152,936.25
3. LIABILITIES (Note 11)				
A. Intragovernmental:				
1. Accounts Payable (Note 12)	$	2,783,231,392.38	$	885,790,233.32
2. Debt (Note 13)		592,238,699.55		701,674,835.79
3. Other Liabilities (Note 15 & Note 16)		10,562,833,126.01		10,450,120,481.09
4. Total Intragovernmental Liabilities	$	13,938,303,217.94	$	12,037,585,550.20
B. Accounts Payable (Note 12)	$	26,803,086,930.93	$	24,967,790,883.46
C. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)		1,569,704,984,877.05		1,429,565,352,698.49
D. Environmental Liabilities (Note 14)		64,226,224,747.95		61,054,436,517.40
E. Loan Guarantee Liability (Note 8)		45,819,277.64		22,816,285.30
F. Other Liabilities (Note 15 & Note 16)		31,460,194,944.99		32,195,362,557.97
4. TOTAL LIABILITIES	$	1,706,178,613,996.50	$	1,559,843,344,492.82
5. NET POSITION				
A. Unexpended Appropriations	$	385,126,414,325.76	$	349,103,315,675.73
B. Cumulative Results of Operations		(701,649,455,024.90)		(601,562,507,232.30)
6. TOTAL NET POSITION	$	(316,523,040,699.14)	$	(252,459,191,556.57)
7. TOTAL LIABILITIES AND NET POSITION	$	1,389,655,573,297.36	$	1,307,384,152,936.25

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF NET COST

For the periods ended June 30, 2005 and 2004

	2005 Consolidated	2004 Consolidated
1. Program Costs		
A. Intragovernmental Gross Costs	$ 19,256,535,177.38	$ 9,983,451,342.14
B. (Less: Intragovernmental Earned Revenue)	(13,627,465,163.54)	(10,370,449,568.80)
C. Intragovernmental Net Costs	$ 5,629,070,013.84	$ (386,998,226.66)
D. Gross Costs With the Public	351,304,881,423.45	348,271,874,745.19
E. (Less: Earned Revenue From the Public)	(17,663,410,697.72)	(17,081,701,259.85)
F. Net Costs With the Public	$ 333,641,470,725.73	$ 331,190,173,485.34
G. Total Net Cost	$ 339,270,540,739.57	$ 330,803,175,258.68
2. Cost Not Assigned to Programs	0.00	8,847.45
3. (Less:Earned Revenue Not Attributable to Programs)	0.00	0.00
4. Net Cost of Operations	$ 339,270,540,739.57	$ 330,803,184,106.13

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended June 30, 2005 and 2004

	2005 Consolidated	2004 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
1. Beginning Balances	$ (745,441,240,189.41)	$ (621,610,712,064.01)
2. Prior period adjustments (+/-)		
2.A. Prior Period Adjustments - Restated (+/-)	0.00	9,860,431,817.84
2.B. Beginning Balance, Restated	(745,441,240,189.41)	(611,750,280,246.17)
2.C. Prior Period Adjustments - Not Restated (+/-)	0.00	(25,214,355,787.95)
3. Beginning Balances, as adjusted	(745,441,240,189.41)	(636,964,636,034.12)
4. Budgetary Financing Sources:		
4.A. Appropriations received	0.00	0.00
4.B. Appropriations transferred-in/out (+/-)	0.00	0.00
4.C. Other adjustments (rescissions, etc) (+/-)	0.00	7,740,561,000.00
4.D. Appropriations used	378,700,577,337.84	351,257,514,597.36
4.E. Nonexchange revenue	1,701,994,528.07	1,112,355,255.87
4.F. Donations and forfeitures of cash and cash equivalents	28,671,501.92	6,270,240.16
4.G. Transfers-in/out without reimbursement (+/-)	3,041,432,967.73	379,846,267.43
4.H. Other budgetary financing sources (+/-)	(3,923,603,517.97)	5,680,423,721.08
5. Other Financing Sources:		
5.A. Donations and forfeitures of property	385,009.85	265,900.19
5.B. Transfers-in/out without reimbursement (+/-)	(3,724,929.08)	(2,846,204,999.11)
5.C. Imputed financing from costs absorbed by others	3,344,717,876.03	3,052,437,077.85
5.D. Other (+/-)	171,875,129.69	(178,156,152.88)
6. Total Financing Sources	383,062,325,904.08	366,205,312,907.95
7. Net Cost of Operations (+/-)	339,270,540,739.57	330,803,184,106.13
8. Ending Balances	$ (701,649,455,024.90)	$ (601,562,507,232.30)

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended June 30, 2005 and 2004

	2005 Consolidated	2004 Consolidated
UNEXPENDED APPROPRIATIONS		
1. Beginning Balances	$ 243,813,788,091.23	$ 192,955,803,473.31
2. Prior period adjustments (+/-)		
2.A. Prior Period Adjustments - Restated (+/-)	0.00	0.00
2.B. Beginning Balance, Restated	243,813,788,091.23	192,955,803,473.31
2.C. Prior Period Adjustments - Not Restated (+/-)	0.00	25,913,749,160.94
3. Beginning Balances, as adjusted	243,813,788,091.23	218,869,552,634.25
4. Budgetary Financing Sources:		
4.A. Appropriations received	523,020,384,489.15	486,795,254,974.75
4.B. Appropriations transferred-in/out (+/-)	(655,603,492.00)	756,609,418.27
4.C. Other adjustments (rescissions, etc) (+/-)	(2,351,577,424.78)	(6,060,586,754.18)
4.D. Appropriations used	(378,700,577,337.84)	(351,257,514,597.36)
4.E. Nonexchange revenue	0.00	0.00
4.F. Donations and forfeitures of cash and cash equivalents	0.00	0.00
4.G. Transfers-in/out without reimbursement (+/-)	0.00	0.00
4.H. Other budgetary financing sources (+/-)	0.00	0.00
5. Other Financing Sources:		
5.A. Donations and forfeitures of property	0.00	0.00
5.B. Transfers-in/out without reimbursement (+/-)	0.00	0.00
5.C. Imputed financing from costs absorbed by others	0.00	0.00
5.D. Other (+/-)	0.00	0.00
6. Total Financing Sources	141,312,626,234.53	130,233,763,041.48
7. Net Cost of Operations (+/-)		
8. Ending Balances	$ 385,126,414,325.76	$ 349,103,315,675.73

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended June 30, 2005 and 2004

	2005 Combined	2004 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
1. Budget Authority:		
1a. Appropriations received	$ 593,364,602,316.64	$ 549,448,914,272.87
1b. Borrowing authority	0.00	134,899.00
1c. Contract authority	44,245,033,886.93	38,516,664,027.50
1d. Net transfers (+/-)	(386,450,252.39)	(794,995,123.29)
1e. Other	8,359,378,958.67	11,754,501,382.81
2. Unobligated balance:		
2a. Beginning of period	293,956,869,248.72	259,054,449,252.08
2b. Net transfers, actual (+/-)	368,170,819.80	506,980,211.63
2c. Anticipated Transfers balances	0.00	0.00
3. Spending authority from offsetting collections:		
3a. Earned	0.00	0.00
1. Collected	114,658,831,171.20	105,727,128,736.30
2. Receivable from Federal sources	97,159,952.50	(1,526,413,099.96)
3b. Change in unfilled customer orders	0.00	0.00
1. Advance received	1,146,315,974.30	638,929,484.70
2. Without advance from Federal sources	14,256,875,694.44	11,950,294,458.88
3c. Anticipated for the rest of year, without advances	9,250,757,004.18	9,957,950,471.19
3d. Previously unavailable	0.00	0.00
3e. Transfers from trust funds	0.00	0.00
3f. Subtotal	139,409,939,796.62	126,747,890,051.11
4. Recoveries of prior year obligations	31,817,215,588.08	24,625,606,545.41
5. Temporarily not available pursuant to Public Law	(10,000,000.00)	0.00
6. Permanently not available	(26,382,357,870.46)	(27,105,957,670.46)
7. Total Budgetary Resources	$ 1,084,742,402,492.61	$ 982,754,187,848.66

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended June 30, 2005 and 2004

	2005 Combined	2004 Combined
STATUS OF BUDGETARY RESOURCES		
8. Obligations incurred:		
8a. Direct	$ 452,944,542,620.42	$ 448,025,973,051.48
8b. Reimbursable	145,307,666,597.61	107,607,265,033.45
8c. Subtotal	598,252,209,218.03	555,633,238,084.93
9. Unobligated balance:		
9a. Apportioned	210,131,253,855.79	116,224,447,042.92
9b. Exempt from apportionment	204,781,712,235.08	200,643,877,537.45
9c. Other available	0.00	0.00
10. Unobligated Balances Not Available	71,577,227,183.71	110,252,625,183.36
11. Total, Status of Budgetary Resources	$ 1,084,742,402,492.61	$ 982,754,187,848.66
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
12. Obligated Balance, Net - beginning of period	$ 232,726,115,800.56	$ 213,901,595,026.07
13. Obligated Balance transferred, net (+/-)	0.00	(14,147,223.76)
14. Obligated Balance, Net - end of period:		
14a. Accounts receivable	(10,233,992,413.53)	(9,193,235,620.84)
14b. Unfilled customer order from Federal sources	(53,658,766,466.16)	(50,372,281,878.19)
14c. Undelivered orders	257,290,242,678.24	247,949,507,002.28
14d. Accounts payable	51,668,900,200.14	47,199,132,740.36
15. Outlays:		
15a. Disbursements	539,740,689,784.88	498,888,075,739.30
15b. Collections	(115,805,147,145.50)	(106,366,058,221.00)
15c. Subtotal	423,935,542,639.38	392,522,017,518.30
16. Less: Offsetting receipts	(50,820,675,118.15)	(43,024,229,124.38)
17. Net Outlays	$ 373,114,867,521.23	$ 349,497,788,393.92

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended June 30, 2005 and 2004

	2005 Combined	2004 Combined
NONBUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
1. Budget Authority:		
1a. Appropriations received	$ 0.00	$ 0.00
1b. Borrowing authority	51,047,630.00	95,961,092.88
1c. Contract authority	0.00	0.00
1d. Net transfers (+/-)	0.00	0.00
1e. Other	0.00	0.00
2. Unobligated balance:		
2a. Beginning of period	24,520,250.64	21,845,045.69
2b. Net transfers, actual (+/-)	0.00	0.00
2c. Anticipated Transfers balances	0.00	0.00
3. Spending authority from offsetting collections:		
3a. Earned	0.00	0.00
1. Collected	14,891,311.08	10,502,232.68
2. Receivable from Federal sources	0.00	(587,592.88)
3b. Change in unfilled customer orders	0.00	0.00
1. Advance received	0.00	0.00
2. Without advance from Federal sources	4,502,814.00	11,182,863.00
3c. Anticipated for the rest of year, without advances	2,143,941.92	0.00
3d. Previously unavailable	0.00	0.00
3e. Transfers from trust funds	0.00	0.00
3f. Subtotal	21,538,067.00	21,097,502.80
4. Recoveries of prior year obligations	0.00	0.00
5. Temporarily not available pursuant to Public Law	0.00	0.00
6. Permanently not available	(2,071,414.00)	24,149,203.50
7. Total Budgetary Resources	$ 95,034,533.64	$ 163,052,844.87

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended June 30, 2005 and 2004

	2005 Combined	2004 Combined
STATUS OF BUDGETARY RESOURCES		
8. Obligations incurred:		
8a. Direct	$ 55,861,077.00	$ 19,309,615.20
8b. Reimbursable	0.00	0.00
8c. Subtotal	55,861,077.00	19,309,615.20
9. Unobligated balance:		
9a. Apportioned	2,672,494.21	0.00
9b. Exempt from apportionment	0.00	0.00
9c. Other available	0.00	0.00
10. Unobligated Balances Not Available	36,500,962.43	143,743,229.67
11. Total, Status of Budgetary Resources	$ 95,034,533.64	$ 163,052,844.87
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
12. Obligated Balance, Net - beginning of period	$ 155,747,457.81	$ 29,895,366.06
13. Obligated Balance transferred, net (+/-)	0.00	0.00
14. Obligated Balance, Net - end of period:		
14a. Accounts receivable	0.00	0.00
14b. Unfilled customer order from Federal sources	(87,585,637.00)	(47,032,453.00)
14c. Undelivered orders	290,630,280.81	73,242,164.14
14d. Accounts payable	0.00	0.00
15. Outlays:		
15a. Disbursements	4,061,077.00	12,400,000.00
15b. Collections	(14,891,311.08)	(10,502,232.68)
15c. Subtotal	(10,830,234.08)	1,897,767.32
16. Less: Offsetting receipts	0.00	0.00
17. Net Outlays	$ (10,830,234.08)	$ 1,897,767.32

Department of Defense
Agency Wide
COMBINED STATEMENT OF FINANCING
For the periods ended June 30, 2005 and 2004

	2005 Combined	2004 Combined
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ 598,308,070,295.03	$ 555,652,547,700.13
2. Less: Spending authority from offsetting collections and recoveries (-)	(161,995,792,505.60)	(141,436,643,628.13)
3. Obligations net of offsetting collections and recoveries	436,312,277,789.43	414,215,904,072.00
4. Less: Offsetting receipts (-)	(50,820,675,118.15)	(43,024,229,124.38)
5. Net obligations	385,491,602,671.28	371,191,674,947.62
Other Resources		
6. Donations and forfeitures of property	385,009.85	265,900.19
7. Transfers in/out without reimbursement (+/-)	(3,724,929.08)	(2,846,204,999.11)
8. Imputed financing from costs absorbed by others	3,344,717,876.03	3,052,437,077.85
9. Other (+/-)	171,875,129.69	(178,156,152.88)
10. Net other resources used to finance activities	3,513,253,086.49	28,341,826.05
11. Total resources used to finance activities	389,004,855,757.77	371,220,016,773.67
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 (-)	(49,957,305,381.16)	(33,182,288,929.56)
12b. Unfilled Customer Orders	15,407,694,482.74	12,600,406,806.58
13. Resources that fund expenses recognized in prior periods	(3,174,513,747.58)	(4,660,740,262.83)
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	2,253,477,276.09	846,006,583.97
15. Resources that finance the acquisition of assets	(78,209,653,472.30)	(78,423,508,684.62)
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	(10,000,000.00)	(10,000,000.00)
16b. Other (+/-)	3,339,919.23	2,846,204,999.11
17. Total resources used to finance items not part of the net cost of operations	(113,686,960,922.98)	(99,983,919,487.35)
18. Total resources used to finance the net cost of operations	275,317,894,834.79	271,236,097,286.32

Department of Defense

Agency Wide

COMBINED STATEMENT OF FINANCING

For the periods ended June 30, 2005 and 2004

	2005 Combined	2004 Combined
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	701,290,224.39	552,299,707.03
20. Increase in environmental and disposal liability	1,026,802,239.00	765,881,663.61
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0.00	0.00
22. Increase in exchange revenue receivable from the public (-)	35,902,048.78	(11,185,256.61)
23. Other (+/-)	424,778,791.15	556,766,392.48
24. Total components of Net Cost of Operations that will require or generate resources in future periods	2,188,773,303.32	1,863,762,506.51
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	32,603,485,481.16	34,365,396,783.52
26. Revaluation of assets or liabilities (+/-)	169,420,459.51	(405,438,103.28)
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	(19,458,010,119.40)	(18,044,999,711.26)
27b. Cost of Goods Sold	34,387,602,834.87	36,661,518,882.73
27c. Operating Material & Supplies Used	(1,672,865,733.94)	3,024,959,720.30
27d. Other	15,734,239,679.26	2,101,886,741.29
28. Total components of Net Cost of Operations that will not require or generate resources	61,763,872,601.46	57,703,324,313.30
29. Total components of net cost of operations that will not require or generate resources in the current period	63,952,645,904.78	59,567,086,819.81
30. Net Cost of Operations	339,270,540,739.57	330,803,184,106.13

Department of Defense
Agency Wide
COMBINED STATEMENT OF CUSTODIAL ACTIVITY
For the periods ended June 30, 2005 and 2004

	2005 Combined	2004 Combined
1.SOURCE OF COLLECTIONS		
A. Deposits by Foreign Governments	$ 7,319,995,877.62	$ 7,965,659,052.26
B. Seized Iraqi Cash	700.00	117,962,889.58
C. Other Collections	0.00	0.00
D. Total Cash Collections	$ 7,319,996,577.62	$ 8,083,621,941.84
E. Accrual Adjustments (+/-)	$ 0.00	$ 190,527.71
F. Total Custodial Collections	$ 7,319,996,577.62	$ 8,083,812,469.55
2.DISPOSITION OF COLLECTIONS		
A. Disbursed on Behalf of Foreign Governments and International Organizations	$ 8,199,186,284.15	$ 7,472,775,834.36
B. Seized Assets Disbursed on behalf of Iraqi People	36,145,259.17	230,078,607.58
C. Increase (Decrease) in Amounts to be Transferred	(879,190,406.53)	639,964,038.27
D. Collections Used for Refunds and Other Payments	0.00	0.00
E. Retained by The Reporting Entity	0.00	0.00
F. Seized Assets Retained for Support of the Iraqi People	(36,144,559.17)	(112,115,718.00)
G. Total Disposition of Collections	$ 7,319,996,577.62	$ 8,230,702,762.21
3. NET CUSTODIAL COLLECTION ACTIVITY	$ 0.00	$ (146,890,292.66)

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the "Chief Financial Officers 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 Department in accordance with the "DoD Financial Management Regulation," Office of Management and Budget Bulletin No. 01-09 (Form and Content of Agency Financial Statements), and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the Department is responsible. Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified.

The Department is unable to fully implement all elements of GAAP and Office of Management and Budget Bulletin No. 01-09 due to limitations of its financial management processes and systems, and nonfinancial systems and processes that feed into the financial statements. The Department derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory systems and logistics 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 Department continues to implement process and system improvements addressing these limitations. The Department currently has eleven auditor identified financial statement material weaknesses: (1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Accounting Entries, (4) Fund Balance with Treasury, (5) Environmental Liabilities, (6) General Property, Plant and Equipment, (7) Government Property and material in Possession of Contractors, (8) Inventory, (9) Operating Materials and Supplies, (10) Statement of Net Cost, and (11) Statement of Financing.

1.B. Mission of the Reporting Entity

The National Security Act of 1947 established the Department of Defense. The Department's mission is to organize, train, and equip armed forces to deter aggression and, if necessary, defeat aggressors against the United States and its allies. Fiscal Year (FY) 2005 is the tenth year that the Department has prepared audited DoD Agencywide financial statements as required by the Chief Financial Officers Act and Government Management Reform Act. Auditors are required to audit the financial statements of the following stand-alone reporting entities: (1) Army General Fund, (2) Army Working Capital Fund, (3) Navy General Fund, (4) Navy Working Capital Fund, (5) Air Force General Fund, (6) Air Force Working Capital Fund, (7) Military Retirement Fund, (8) DoD Medicare-Eligible Retiree Health Care Fund, and (9) U.S. Army Corps of Engineers (Civil Works).

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

The Department requires the following Defense Agencies to prepare internal stand-alone auditable financial statements : (1) Defense Logistics Agency, (2) Defense Finance and Accounting Service, (3) Defense Information Systems Agency, (4) Defense Contract Audit Agency, (5) Defense Commissary Agency, (6) Defense Security Service, (7) Defense Threat Reduction Agency, (8) Defense Advanced

Research Projects Agency, (9) Chemical Biological and Defense Program, and (10) Missile Defense Agency.

1.C. Appropriations and Funds

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

General funds are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and military construction accounts.

Working capital funds (WCF) receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial startup. The WCF entities provide goods and services on a reimbursable basis. Reimbursable receipts fund ongoing operations and generally are available in their entirety for use without further congressional action.

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

Special fund accounts are used to process government receipts earmarked for a specific purpose.

Deposit funds are used to record amounts held temporarily until ownership is determined. The Department is acting as an agent or a custodian for funds awaiting distribution, for example payroll taxes.

1.D. Basis of Accounting

For FY 2005, the Department's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Department's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the Department'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 nonfinancial 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 the Department's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, the DoD's financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

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

1.E. Revenues and Other Financing Sources

The Department receives congressional appropriations as financing sources for general funds on either an annual or multi-year basis. When authorized, these appropriations are supplemented by revenues generated by sales of goods or services. The Department recognizes revenue as a result of costs incurred for goods and services provided to other federal agencies and the public. The Department recognizes revenue when earned within the constraints of current system capabilities. In some instances, revenue is recognized when bills are issued.

The Department does not include non-monetary support provided by U.S. allies for common defense and mutual security in amounts reported in its Statements of Net Cost and 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 Department's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. The Department'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 Department or between two or more federal agencies. However, the Department cannot accurately identify most of its intragovernmental transactions by customer because DoD's systems do not track buyer and seller data needed to match related transactions. Seller entities within the Department 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 agree with DoD seller-side balances. Intra-DoD intragovernmental balances are then eliminated. The Department is developing long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with the existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the Department 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 Policies Guide," provide guidance for reporting and reconciling intragovernmental balances. While the Department is unable to fully reconcile intragovernmental transactions with all federal partners, the department 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 Department'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.

The Department'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 of federal agencies. The

DoD's financial statements, therefore, do not report any portion of 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, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, the Department has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Payment is required in advance.

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

The Department'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 Department'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, and interagency transfers and deposits.

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

1.J. Foreign Currency

Cash is the total of cash resources under the control of the Department of Defense, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and non-purchased foreign currencies held in foreign currency fund accounts. The majority of cash and all foreign currency is classified as non-entity and, therefore, 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. Cash seized during Operation Iraqi Freedom is restricted for use to assist the Iraqi people and support the reconstruction of Iraq.

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

1.K. Accounts Receivable

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

DoD Components use a variety of techniques for estimating the Allowance for Uncollectible Accounts Receivable from the public. While the exact details differ among the Components, estimates are usually based on either a percentage of actual prior-year write-offs or a percentage of aged accounts receivable from the public.

1.L. Direct Loans and Loan Guarantees

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

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

The Department also operates a loan guarantee program designed to encourage commercial use of inactive government facilities. The revenue generated from property rental offsets the cost of maintaining these facilities.

1.M. Inventories and Related Property

Most of the Department'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 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 DoD Components have transitioned, and are continuing to transition, their inventory to the moving average cost method. Upon full implementation, the Department will be compliant with SFFAS No. 3. Approximately 35 percent of the Department's 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 non-compliant with SFFAS No. 3 and GAAP.

The Department manages only military or government-specific materiel under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DoD materiel management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The Department holds materiel based on military need and support for contingencies. Therefore, the Department 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) and stockpile materials. OM&S, including munitions not held for sale, are valued at standard purchase price. The Department 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 reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the Department uses the purchase method - that is, materials and supplies are expensed when purchased. For FY 2005, the Department expensed significant amounts using the purchase method either because the systems could not support the consumption method or because management deemed that the item was in the hands of the end user.

The Department 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 managed items, such as aircraft engines, are categorized as OM&S rather than military equipment by DoD activities.

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

Past audits identified uncertainties about the completeness and existence of the reported values of inventory. Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the Department. 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 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. Finally, work in process balances include costs related to the production or servicing of items, including direct materiel, 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 amounts paid to contractors under cost reimbursable contracts, including amounts withheld from payment to ensure performance, and amounts paid to other government plants for accrued costs of end items of materiel ordered but not delivered. Work in process includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services.

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

The Department reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment using the effective interest rate method or another method obtaining similar results. The Department'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.

The Department invests in both marketable and non-marketable securities. Marketable securities are investments trading on a public market. The two types of non-marketable securities are par value and market-based intragovernmental securities. The Bureau of Public Debt issues non-marketable par value intragovernmental securities. Non-marketable, market-based intragovernmental securities mimic marketable securities, but are not traded publicly.

The Department's Net Investments are supported by various Trust Funds in each of the reporting entities. These Trust Funds are comprised of the Military Retirement Trust Fund (MRF); Medicare-Eligible Retiree

Health Care Fund (MERHCF); Other Defense Organizations General Fund (ODO GF) trust funds; donations (Gift Funds); and the USACE South Dakota Terrestrial Habitat Restoration, Inland Waterways, and Harbor Maintenance Trust Fund accounts.

1.O. General Property, Plant and Equipment

The SFFAS No. 23 establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in Federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades for accounting periods beginning after September 30, 2002. The Department uses data from the Bureau of Economic Analysis to calculate a value for military equipment.

General Plant, Property and Equipment (PP&E) assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of $100,000, except for the USACE and WCF as discussed below. Also, DoD requires capitalization of improvement costs over the DoD capitalization threshold of $100,000 to General PP&E. The Department depreciates all General PP&E, other than land, on a straight-line basis.

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for FYs 1993, 1994, and 1995, respectively, and an estimated useful life of 2 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.

The USACE Civil Works General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost exceeds $25,000. One exception is all buildings and structures related to hydropower projects are capitalized regardless of cost. During 2003, the Corps increased its buildings and structures threshold from $0 to $25,000 for all Civil Works appropriations with the exception of Revolving Fund and Power Marketing Agency assets. All Civil Works buildings and structures currently capitalized under $25,000 (excluding Revolving Fund and Power Marketing Agency) were expensed in FY 2003 and removed from the Corps of Engineers Financial Management System. Beginning in FY 2004 all Civil Works Buildings and Structures under $25,000 are expensed except for Power Marketing Agency assets.

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

The Department is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Department reports only the government property in the possession of contractors that is maintained in the DoD's property systems.

To bring the DoD into fuller compliance with federal accounting standards, the Department has issued new property accountability and reporting regulations that require the DoD 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 Department records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. In addition, when the Department receives the related goods and services, it recognizes advances and prepayments as expenses.

1.Q. Leases

Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), the Department records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The Department records the amounts as the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. DoD as the lessee receives the use and possession of leased property, for example real estate or equipment, 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 Department in support of contingency operations are the largest components of operating leases. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Inter-service 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 Department expects to continue to reduce the level of owned assets while increasing the number of leased assets. The Department will strive to displace commercial leases with more economical GSA leases.

1.R. Other Assets

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

The Federal Acquisition Regulation allows the Department to make financing payments, under fixed price contracts. The Department reports these financing payments as "Other Assets" because the Department becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the Department is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the Department for the full amount of the advance.

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 DoD recognizes contingencies as liabilities when past events or exchange transactions occur, a future loss is probable and the loss amount can be reasonably estimated.

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

Other liabilities arise as a result of anticipated disposal costs for the Department's assets. This type of liability has two components: nonenvironmental and environmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon the Department's policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of the Federal Government." The Department recognizes nonenvironmental disposal liabilities for National Defense PP&E nuclear-powered assets when placed into service. Such amounts are developed in conjunction with, and not easily separately identifiable from, environmental disposal costs.

1.T. Accrued Leave

The Department 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 difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY1998, these results included the cumulative amount of donations and transfers of assets in and out without reimbursement.

1.V. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The Department purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. 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 to the U.S. for such capital investments.

1.W. Comparative Data

Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet or 10 percent from the previous period presented are generally explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

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

1.Y. Problem 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 payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities' outstanding accounts payable balance.

The Department of Defense policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. The majority of the DoD Components reported following this allocation procedure. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities.

Note 2. Nonentity Assets

As of June 30		2005		2004
1. Intragovernmental Assets				
A. Fund Balance with Treasury	$	769,612,054.80	$	1,008,268,295.08
B. Investments		0.00		0.00
C. Accounts Receivable		596,847.67		7,247,633.98
D. Other Assets		0.00		0.00
E. Total Intragovernmental Assets	$	770,208,902.47	$	1,015,515,929.06
2. Nonfederal Assets				
A. Cash and Other Monetary Assets	$	2,256,965,760.72	$	1,931,201,088.95
B. Accounts Receivable		4,768,136,092.99		4,922,634,588.43
C. Loans Receivable		0.00		0.00
D. Inventory & Related Property		0.00		0.00
E. General PP&E		0.00		0.00
F. Investments		0.00		0.00
G. Other Assets		157,033,789.61		148,714,790.88
H. Total Nonfederal Assets	$	7,182,135,643.32	$	7,002,550,468.26
3. Total Nonentity Assets	$	7,952,344,545.79	$	8,018,066,397.32
4. Total Entity Assets	$	1,381,703,228,751.57	$	1,299,366,086,538.93
5. Total Assets	$	1,389,655,573,297.40	$	1,307,384,152,936.30

Nonentity assets are assets for which the Department maintains stewardship accountability and responsibility to report, but are not available for the Department's operation.

Fluctuations:

Nonentity Fund Balance with Treasury (FBWT) decreased a net of $238.7 million (24 percent). The Foreign Military Sales (FMS) Fund Balance with Treasury decreased $1.4 billion due to FMS disbursements exceeding collections. The FMS Trust Fund receives funds in advance for foreign customers based on future requirement forecasts. These funds are disbursed as the work is performed. Timing differences between collections and disbursements occasionally occur when there is a decline in new contracts with the foreign customer and also when larger initial upfront payments have been collected and disbursements are starting to catch up to collections. This decrease was offset by an increase of $1.2 billion due to the reclassification of certain suspense accounts from nonentity to entity.

Nonentity intragovernmental accounts receivable decreased $6.6 million (92 percent). Erroneous balances were created during the implementation of the General Accounting and Finance System-Rehost (GAFS-R) in FY 2004 due to incorrect coding. During FY 2005, Air Force accounts receivables were reconciled and accurately recorded.

Intragovernmental Assets

Fund Balance with Treasury

The Nonentity Fund Balance with the Treasury is comprised of four elements: Iraqi Custodial Fund, Development

Fund for Iraq, FMS Trust Fund, deposit and specific suspense accounts. The Iraqi Custodial Fund represents Iraqi cash seized by coalition forces during Operation Iraqi Freedom. The Development Fund for Iraq contain funds transferred from the Interim Iraqi Government to the Multi-National Force-Iraq. These funds will be used to support the Iraqi people. Under authority of the Arms Export and Control Act, the FMS Trust Fund receives collections from foreign governments that are dedicated specifically to FMS purchases. The deposit and suspense accounts primarily represent various deposits and Thrift Saving Plan balances.

Accounts Receivable

This amount represents receivables from cancelled year appropriations. The receivables will be returned to the Treasury as miscellaneous receipts once collected.

Non-Federal Assets

Cash and Other Monetary Assets

Cash and other monetary assets consist of cash held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange missions. Foreign currency is valued using the Department of Treasury Prevailing Rate of Exchange.

Accounts Receivable

Receivables are primarily related to Navy General Fund advance payments made to contractors and the associated accrued interest, which remains in litigation. In addition, the United States Army Corps of Engineers reports that its non-federal nonentity accounts receivable include long-term receivables due from state and local municipalities for water storage contracts, hydraulic mining, and the leasing of land for flood control purposes. The balance of the amounts reported as nonentity non-federal accounts receivable represents accrued interest, penalties, fines and administrative fees receivable, accounts receivable due from active duty members, and accounts receivable due to cancelled year appropriations. The Department neither derives nor receives any benefit from these collections, but incurs the cost of administering them. The receivables will be returned to the Treasury as miscellaneous receipts once collected.

Other Assets

Other nonentity assets primarily represent advances to contractors by the Air Force General Fund.

Note 3. Fund Balance with Treasury

As of June 30	2005	2004
1. Fund Balances		
A. Appropriated Funds	$ 400,506,107,729.92	$ 362,298,717,052.26
B. Revolving Funds	9,225,238,254.27	9,698,105,816.47
C. Trust Funds	(176,492,074.62)	1,126,300,497.77
D. Special Funds	290,926,327.79	0.00
E. Other Fund Types	11,034,047,602.67	8,997,361,004.21
F. Total Fund Balances	$ 420,879,827,840.03	$ 382,120,484,370.71
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 421,672,115,714.66	$ 382,172,535,303.93
B. Fund Balance per DoD	420,879,827,840.03	382,120,484,370.71
3. Reconciling Amount	$ 792,287,874.63	$ 52,050,933.22

Reporting Entity (Amounts in millions)	Fund Balance with Treasury FY 2005	Fund Balance per Entity Books FY 2005	Reconciling Amount FY 2005	Reconciling Amount FY 2004
Navy GF	$ 120,803.1	$ 120,687.1	$ 116.0	$ 49.0
Air Force GF	96,628.6	96,615.7	12.9	
Army GF	130,629.5	130,652.3	(22.8)	
ODO GF	64,641.1	63,879.1	762.1	3.0
Corps of Engineers	4,153.2	4,229.0	(75.8)	
MERHCF	5.0	5.0		
MRF	21.0	21.0		
Air Force WCF	1,276.4	893.0	383.4	533.0
Army WCF	708.7	708.7		
ODO WCF	1,719.7	2,103.1	(383.4)	(533.0)
Navy WCF	1,085.8	1,085.8		
Total	**$ 421,672.1**	**$ 420,879.7**	**$ 792.4**	**$ 52.0**

Analysis of Reconciling Amounts

The Department of Defense (DoD) shows a reconciling net difference of $792.4 million with the Department of the Treasury, which is comprised of:

- $116.0 million, for the Navy General Fund, that is primarily due to $48.5 million in receipt account transactions unavailable to the Navy and $67.5 million in net transfer differences that represent nonexpenditure transfers recorded at the Treasury but not recorded on entity books;

- $12.9 million, for the Air Force General Fund, that is primarily due to a combination of $21.9 million in parent child allocations. The allocations from the Foreign Military Sales Military Assistance Program and the Department of Agriculture are for the Air Force. These allocations are included in the fund balance per Treasury for Air Force, but they are not found in the fund balance per Air Force. There is also an offset of $8.9 million in funds allocated to the Department of Transportation that are included in the fund balance per Air Force but not in the fund balance per Treasury for Air Force;

- ($22.8) million, for the Army General Fund, which is primarily due to a combination of $48.4 million in parent account allocations reported in the fund balance per Army but not in the fund balance per Treasury for Army offset by $71.2 million in child account allocations reported in the fund balance per Treasury for Army but not in the fund balance per Army;
- $762.1 million, for the Other Defense Organizations (ODO) General Fund, that primarily consists of the net of the reconciling difference for the DoD component level accounts offset by the aggregated negative reconciling difference of approximately 50 defense agencies and organizations;
- ($75.8) million, for the US Army Corps of Engineers (USACE), that primarily consists of approximately $75.5 million in parent account allocations for the reporting of trust funds (Inland Waterways and Harbor Maintenance) for the Bureau of Public Debt;
- $383.4 million, for the Air Force Working Capital Fund, that represents the Fund Balance with Treasury for the United States Transportation Command, which is reported to the Treasury as part of the Air Force Working Capital Fund. The accounting for these funds is actually performed within the entity books of the ODO Working Capital Fund. For financial reporting, the Fund Balance with Treasury for the ODO Working Capital Fund is adjusted downward to reconcile with the Air Force Working Capital Fund;
- ($383.4) million, for the ODO Working Capital Fund, which is due to the adjustment to the Fund Balance per Treasury for the ODO Working Capital Fund to reflect that the cash reporting to the Department of the Treasury for the United States Transportation Command is done through the Air Force Working Capital Fund.

4. Other Information Related to Fund Balance with Treasury

Total Fund Balance

Total Fund Balance with Treasury per DoD increased by approximately $38.8 billion (10 percent).

Appropriated Funds increased by approximately $38.2 billion (11 percent). This was primarily a result of increased budget authority in FY 2005 for the Army, Navy and Air Force General Funds. The Army General Fund increased approximately $22.2 billion, the Navy General Fund increased approximately $7.3 billion and the Air Force General Fund increased approximately $3.9 billion. The increases are primarily attributable to support for the Global War on Terrorism.

The Army received an FY 2005 supplemental appropriation of approximately $10.1 billion in support of the Global War on Terrorism and for Tsunami Relief. The Army also received approximately $7.0 billion in new funding for support of the Iraq and Afghanistan security forces. The balance of the increase is primarily attributable to additional funding for the Research, Development, Test and Evaluation and Military Construction appropriations.

The Navy increase of $7.3 billion reflects increased levels of funding to support the Global War on Terrorism and to improve the Navy's warfighter capabilities and modernization efforts. The Air Force increase of $3.9 billion reflects receipt of supplemental funding to support the Global War on Terrorism.

The Army General Fund includes approximately $34.8 million in Vested Iraqi Cash. This cash represents frozen Iraqi deposits in the United States and is vested in accordance with the International Emergency Economic Powers Act, Section 1701, and is used in support of the Iraqi people. The Army has collected $1.7 billion in Vested Iraqi Cash and has disbursed $1.7 billion benefiting the Iraqi people as follows:

	Disbursed ($ in millions)
Iraqi Salaries	$1,184.9
Repair/Reconstruction/Humanitarian Assistance	$ 147.6
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	$ 356.8
Total Disbursed	$1,689.3

The Revolving Funds decreased by approximately $472.9 million (5 percent). This change was primarily a result of decreases to the Defense Emergency Response Fund (DERF), offset by increases to the Navy Working Capital Fund and the Navy General Fund. The DERF decreased by $1.6 billion, primarily as the result of a correction. DERF includes both Appropriated and Revolving Fund components. In 3rd quarter, FY 2004 the Revolving Fund component was overstated, and the Appropriated Fund component was understated, by approximately $1.4 billion. A correction was made in the 4th quarter, FY 2004. The Navy Working Capital Fund increased approximately $558.2 million, primarily as the result of approved advance billings, receipt of supplemental appropriations in support of the Global War on Terrorism, increased fuel costs, and the billing of large work-in-process balances. The Navy General Fund increased approximately $480.1 million as a result of increased funding received by the National Defense Sealift Fund for construction of combat logistic ships and to cover increased stabilized rates for the Surge and Hospital Ship programs.

The Trust Funds decreased by approximately $1.3 billion (116 percent) due to a decrease of $1.4 billion in the Foreign Military Sales (FMS) Trust Fund. This balance reflects net disbursements exceeding net collections from FMS customers during the current fiscal year only. The FMS Trust Fund receives funds in advance for foreign customers based on initial deposit requirements. Collections are based on these deposits and billings that forecast future cash requirements. Disbursements are made to fulfill customer orders. The FMS decrease is primarily attributable to cash decreases in the Egypt, Japan, Korea and Taiwan programs.

Special Funds increased to approximately $290.9 million from zero. Special Funds is a new category of Fund Type disclosed in the note schedule above. Amounts reported in FY 2004 for these funds were reported in one of the other four categories.

The Other Fund Types increased by approximately $2.0 billion (23 percent) primarily as a result of the $1.1 billion increase in the Army General Fund’s Iraqi Relief and Reconstruction Fund. There was also an increase of approximately $684 million in the Navy General Fund primarily due to efforts in clearing negative balances in the Disbursing Officers and Interfund/IPAC suspense accounts.

The Army General Fund collected and disbursed funds for two custodial accounts – nonentity seized (Custodial) Iraqi cash and the Development Fund for Iraq (DFI). During FY 2003 and subsequently through the 3rd Quarter, FY 2005, the non-entity seized (Custodial) Iraqi cash had collections of $927.2 million and disbursements of $849.9 million resulting in the balance of $77.3 million (See Note 22). The Iraqi seized cash will be used in support of the Iraqi people. In addition, during FY 2005 the Army General Fund received deposits of $136.0 million from the Interim Iraqi Government into the DFI. These funds will be accounted for separately from the seized Iraqi cash.

Status of Fund Balance with Treasury

As of June 30		2005		2004
1. Unobligated Balance				
A. Available	$	397,653,840,077.98	$	358,295,349,004.06
B. Unavailable		71,372,243,636.20		47,351,633,359.05
2. Obligated Balance not yet Disbursed	$	(54,127,190,051.33)	$	(27,559,474,324.75)
3. Total	$	414,898,893,662.85	$	378,087,508,038.36

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.

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 and other authorizations (i.e. contract authority, restricted invested balances).

<u>Fluctuations and/or Abnormalities</u>

Status of Fund Balance with Treasury balances increased $36.8 billion (9 percent). The increase is attributable to a combination of a $39.4 billion increase in Unobligated Balance Available, a $24 billion increase of Unobligated Balance Unavailable, and a $26.6 billion decrease in Obligated Balance not yet Disbursed.

The increase of Unobligated Balance Available directly corresponds to an increase in appropriations received by the DoD in FY 2005. The increase of $24.0 billion (34 percent) in Unobligated Balance Unavailable was primarily due to the Medicare-Eligible Retiree Health Care Fund's (MERHCF) Unapportioned Authority increase of $21.5 billion.

Obligated Balance not yet Disbursed decreased by a net of $26.6 billion (49 percent). This decrease was primarily due to a decrease of approximately $20 billion in the MERHCF and a decrease of approximately $10 billion in the Military Retirement Fund (MRF). The restricted invested balances reported by the MERHCF and the MRF were offset by the increase in Unobligated Balance Unavailable.

For FY 2005 and subsequent reporting for both these financial statements and the accompanying budgetary data, the Office of Management and Budget has determined that amounts appropriated but not yet apportioned for current quarter use by the Department are to be reclassified as available vice unavailable. This will create significant but offsetting differences in the amounts classified as an Unobligated Balance during this initial year of change.

Disclosures Related to Suspense/Budget Clearing Accounts

As of June 30	2003	2004	2005	(Decrease)/ Increase from FY 2004 - 2005
Account				
F3875	$ 23,481,420.01	$ (47,912,981.28)	$ 181,791,781.39	$ 229,704,762.67
F3880	(34,904,347.37)	(28,236,327.97)	14,553,424.41	42,789,752.38
F3882	18,386,229.77	4,864,981.44	89,911,734.76	85,046,753.32
F3885	(806,939,604.87)	(539,752,327.48)	(508,570,219.37)	31,182,108.11
F3886	(3,013,427.01)	(9,006,743.72)	(109,967,095.95)	(100,960,352.23)
Total	$ (802,989,729.47)	$ (620,043,399.01)	$ (332,280,374.76)	$ 287,763,024.25

A description of the suspense and budget clearing accounts and their respective balances follows:

The F3885 suspense clearing account represents the primary source of the overall negative balance. Account F3885, which includes the Interfund/IPAC suspenses, reported a negative balance of approximately $508.6 million. Account F3875 reported a positive balance of approximately $181.8 million that represents the Disbursing Officer's (DO) suspense. Account F3886 has a negative balance of approximately $110.0 million represented by 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 reported a positive balance of approximately $14.6 million. This amount 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 reported a positive balance of approximately $89.9 million. This 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 same amounts in the military accounting systems in the following month.

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of June 30		2003		2004		2005		(Decrease)/ Increase from FY 2004 - 2005
1. Total Problem Disbursements, Absolute Value								
A. Unmatched Disbursements (UMDS)	$	1,238,200,000.00	$	2,097,400,000.00	$	3,868,920,017.98	$	1,771,520,017.98
B. Negative Unliquidated Obligations (NULO)		242,800,000.00		238,200,000.00		277,702,286.22		39,502,286.22
2. Total In-transit Disbursements, Net	$	5,470,900,000.00	$	5,627,000,000.00	$	9,695,230,719.35	$	4,068,230,719.35

The DoD reported $3.9 billion (absolute value) in Unmatched Disbursements (UMD), which is an increase of $1.8 billion. 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).

The DoD reported $277.7 million (absolute value) in Negative Unliquidated Obligations (NULOs), which is an increase of $39.5 million. A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These problem disbursements represent the absolute value of disbursements of DoD funds that have been reported by a disbursing station to the Department of the Treasury. However, these problem disbursements have not yet been precisely matched against the specific source obligation that gave rise to the disbursements. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The DoD reported $9.7 billion (net) for In-Transits, which is an increase of $4.1 billion. The In-Transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

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

Note 4. Investments and Related Interest

As of June 30	2005					2004
	Par Value/Cost	Amortization Method	Unamortized (Premium/ Discount)	Investments, Net	Market Value Disclosure	Investments, Net
1. Intragovernmental Securities						
A. Non-Marketable, Market-Based	$ 236,296,109,011.05		$ 25,173,466,712.73	$ 261,469,575,723.78	$ 271,418,980,456.94	$ 230,196,220,706.64
B. Accrued Interest	3,401,462,429.55			3,401,462,429.55	3,401,462,429.55	3,244,665,071.88
C. Total Intragovernmental Securities	$ 239,697,571,440.60		$ 25,173,466,712.73	$ 264,871,038,153.33	$ 274,820,442,886.49	$ 233,440,885,778.52
2. Other Investments	$ 575,993,130.00		0.00	$ 575,993,130.00	N/A	$ 405,225,630.00

The amortization method used for non-marketable, market-based securities is effective interest. Other Investments represent limited partnerships, entered into on behalf of the U.S. Government by the Army and Navy in support of the Military Housing Privatization Initiative authorized by Public Law 104-106, Stat. 186, on February 11, 1996. These investments do not require market value disclosure.

Intragovernmental Securities

Net Investments increased $31.4 billion (14 percent) in non-marketable, market-based securities. The increase is primarily due to positive cash flows of $20.8 billion for the Medicare-Eligible Retiree Health Care Fund, $10.1 billion for the Military Retirement Fund, and $.4 billion for the Inland Waterways, Harbor Maintenance, and South Dakota Terrestrial Wildlife Habitat Restoration Trust Funds.

Other Investments

Other Investments increased $170.8 million (42 percent) due to new investments in limited partnerships by the Army ($136.3.million) and Navy ($34.5 million) to support military housing. A summary of the Department's total investments in these limited partnerships follows.

INSTALLATION	Q3 FY 2004 BALANCE	MONTH INVESTED	NEW INVESTMENTS	MONTH INVESTED	Q3 FY 2005 TOTAL
Beaufort/Paris ISL/Quantico	$ 97,158	Oct-03			$ 97,158
Ft. Campbell, Kentucky *	52,205	Jan-04	7,900	Mar-05	60,105
Ft. Hood, Texas	52,000	Nov-01			52,000
Ft. Bragg, North Carolina	49,437	Dec-03			49,437
Ft. Stewart, Georgia	37,374	Feb-04			37,374
South Texas, Texas	29,400	Feb-02			29,400
New Orleans Naval Complex, Louisiana	23,100	Oct-01			23,100
San Diego, California	20,900	Jun-03			20,900
Everett NAS, Washington	12,176	Dec-00			12,176
Kingsville NAS, Texas	4,300	Dec-00			4,300
Ft. Hamilton, New York *	2,175	May-04			2,175
Ft. Detrick, Maryland *			1,285	Sep-04	1,285
Ft/. Polk, Louisiana *			53,655	Feb-05	53,655
Oahu, Hawaii**	25,000	May-04			25,000
Yuma Naval Air Station **			18,654	Dec-04	18,654
Pacific Northwest **			15,874	Mar-05	15,874
Ft. Sam Houston, Texas*			6,600	Jun-05	6,600
Ft. Eustis, Virginia*			14,800	Apr-05	14,800
Ft. Drum, New York*			52,000	Jun-05	52,000
TOTALS	$ 405,225		$ 170,768		$ 575,993

*Army Installations
**Navy Installations

Note 5. Accounts Receivable

As of June 30	2005			2004
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
1. Intragovernmental Receivables	$ 1,289,004,365.86	N/A	$ 1,289,004,365.86	$ 1,072,085,996.80
2. Nonfederal Receivables (From the Public)	$ 8,282,988,366.47	$ (374,352,189.86)	$ 7,908,636,176.61	$ 7,198,014,487.03
3. Total Accounts Receivable	$ 9,571,992,732.33	$ (374,352,189.86)	$ 9,197,640,542.47	$ 8,270,100,483.83

Fluctuations

Total accounts receivable, net, increased $927.5 million (11 percent).

Intragovernmental receivables increased $217.0 million (20 percent), which is primarily attributable to the U.S. Army Corps of Engineers (USACE). The majority of this increase, $157.4 million, is due to the support USACE provided for the hurricane relief efforts in Florida on behalf of the Federal Emergency Management Agency (FEMA). This support originally began in 4th Quarter FY 2004 and has continued through 3rd Quarter FY 2005. The USACE also recorded receivables for transfers from the Departments of Interior and Transportation for $24.5 million and $44.9 million, respectively, in excess of amounts reported in 3rd Quarter FY 2004. The Department of Interior transfer pertains to coastal wetland projects in the New Orleans District. The transfer from the Department of Transportation relates to inland waterway navigation projects.

Nonfederal accounts receivable increased $710.6 million (10 percent). This is primarily due to increases in the Navy General Fund ($242.9 million) and the Air Force Working Capital Fund ($99.0 million). The Navy increase is attributable to a reduction to the allowance for estimated uncollectibles after conducting an extensive analysis on the accounts receivable. The Air Force increase is due to the reclassification of Foreign Military Sales receivables that were previously reported as other assets. The additional increases are attributable to reclassifying receivables from intragovernmental to public and adjustments to reconcile to the Fund Balance with Treasury.

Note 6. Other Assets

As of June 30		2005		2004
1. Intragovernmental Other Assets				
A. Advances and Prepayments	$	1,351,991,758.14	$	290,103,481.63
B. Total Intragovernmental Other Assets	$	1,351,991,758.14	$	290,103,481.63
2. Nonfederal Other Assets				
A. Outstanding Contract Financing Payments	$	21,548,807,381.18	$	18,327,486,553.08
B. Other Assets (With the Public)		2,684,417,139.59		2,989,261,362.29
C. Total Nonfederal Other Assets	$	24,233,224,520.77	$	21,316,747,915.37
3. Total Other Assets	$	25,585,216,278.91	$	21,606,851,397.00

Fluctuations

Intragovernmental Other Assets

Advances and Prepayments increased $1.1 billion (366 percent). The increase is primarily attributed to the General Funds of the Army, Navy, and Air Force which experienced increases of $551.4 million, $313.6 million, and $232.2 million, respectively. This results from improved visibility of government advances with other non-DoD agencies that are procuring goods and services for the Department of Defense. For example, we advanced funds to the Department of Interior to purchase information technology services. This account balance is based on accruals or estimation techniques.

Nonfederal Other Assets

Outstanding Contract Financing Payments increased $3.2 billion (18 percent). The Navy General Fund reported an increase of $2.6 billion due to payments in the Aircraft Procurement program, mainly for the acquisition of the V-22 Osprey and F/A-18 Hornet. The remainder of this increase relates to Weapons Procurement and the need to replenish stocks of weapons and ammunitions.

Nonfederal Other Assets decreased $304.9 million (10 percent). The Air Force Working Capital reported a decrease of $325.4 million. Of that amount, $121.6 million represents a reduction to Foreign Military Sales that had been reported as Other Assets in prior periods that is being reclassified as Nonfederal Accounts Receivable (Note 5) effective with the current reporting period. An additional decrease of $203.9 million represents returns to vendors pending credit. This resulted from a program that was developed to write off unsupported balances greater than 210 days old. The Navy Working Capital Fund decreased $151 million.

Note 7. Cash and Other Monetary Assets

As of June 30	2005	2004
1. Cash	$ 1,827,463,011.34	$ 1,743,560,228.65
2. Foreign Currency (non-purchased)	567,982,872.14	348,904,761.06
3. Total Cash, Foreign Currency, & Other Monetary Assets	$ 2,395,445,883.48	$ 2,092,464,989.71

Fluctuations and/or Abnormalities

Cash increased by $83.9 million (5 percent) and foreign currency increased by $219.1 million (63 percent), resulting in a total increase of $303.0 million (14 percent) in Cash, Foreign Currency, and Other Monetary Assets. The increase in cash and foreign currency is primarily due to support for the Army's forward deployed tactical units and the Marine Corps' deployment and mission requirements associated with Operations Iraqi and Enduring Freedom, and the Global War on Terror.

Other Information

The majority of cash and all foreign currency are classified as nonentity and their use is, therefore, restricted. Approximately $1.7 billion in cash and $568 million in foreign currency are restricted.

Note 8.	Direct Loan and/or Loan Guarantee Programs

As of June 30

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

The Federal Credit Reform Act (FCRA) of 1990 governs all amended direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees.

Direct loans are reported at the net present value of the following projected cash flows:

- Loan disbursements;
- Repayments of principal; and
- Payments of interest and other payments over the life of the loan after adjusting for estimated defaults, prepayments, fees, penalties and other recoveries.

Loan guarantee liabilities are reported at the net present value. The cost of the loan guarantee is the net present value of the following estimated projected cash flows:

- Payments by the Department to cover defaults and delinquencies, interest subsidies, or other payments; offset by
- Payments to the Department including origination and other fees, penalties, and recoveries.

<u>Military Housing Privatization Initiative</u>

The Military Housing Privatization Initiative (MHPI) includes both Direct Loan and Loan Guarantee Programs. The Department obtains private sector capital to leverage government dollars. The Department provides protection against specific risks, such as base closure or member deployment, for the private sector partner. The Loan Guarantee Program is authorized by the National Defense Authorization Act for FY 1996, Public Law (P.L.) 104-106 Statute 186, Section 2801.

<u>Armament Retooling and Manufacturing Support Initiative</u>

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

Direct Loans Obligated After FY 1991

As of June 30	2005	2004
Loan Programs		
Military Housing Privatization Initiative		
A. Loans Receivable Gross	$ 141,430,018.16	$ 141,473,212.28
B. Interest Receivable	1,108,387.00	0.00
C. Foreclosed Property	0.00	0.00
D. Allowance for Subsidy Cost (Present Value)	(70,721,790.27)	(74,409,923.10)
E. Value of Assets Related to Direct Loans	$ 71,816,614.89	$ 67,063,289.18
Total Loans Receivable	$ 71,816,614.89	$ 67,063,289.18

Subsidy costs are recognized when direct loans are disbursed to borrowers and are re-estimated each year as of the date of the financial statements. Interest receivables related to direct loans were not previously reported. The allowance for subsidy cost is the difference between the outstanding principal of the loans and the present value of their net cash flows. The decrease in the allowance for subsidy is the result of FY 2004 subsidy reestimates, subsidy amortization and an adjustment to FY 2004 subsidy expense. Interest subsidy amortization is the net of interest revenue and interest expense. The subsidy amortization represents the difference between net borrowing from Treasury and gross loans receivable.

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

	(in millions)
Dyess Air Force Base, Texas	$ 28.8
Elmendorf Air Force Base, Alaska	48.0
Lackland Air Force Base, Texas	10.4
Warner Robins Air Force Base, Georgia	22.3
Camp Pendleton Marine Corps Base, California	29.4
Kingsville Air Force Base, Texas	2.5
Total Loan Receivable Gross	$ **141.4**

Total Amount of Direct Loans Disbursed

As of June 30	2005	2004
Direct Loan Programs		
Military Housing Privatization Initiative	$ 0.00	$ 12,396,000.00
Total	$ 0.00	$ 12,396,000.00

The Department disbursed no new direct loans in the current fiscal year. The demand for direct loans by private developers varies from year to year depending upon the progression of planned construction and renovation, and upon economic factors unrelated to the operations of the Department of Defense.

Subsidy Expense for Post-1991 Direct Loans

As of June 30

2005	Interest Differential	Defaults	Fees	Other	Total
1. New Direct Loans Disbursed: Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2004	Interest Differential	Defaults	Fees	Other	Total
2. New Direct Loans Disbursed: Military Housing Privatization Initiative	$ 7,227,282.64	$ 538,503.48	$ 0.00	$ 0.00	$ 7,765,786.12

2005	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
3. Direct Loan Modifications and Reestimates: Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2004	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
4. Direct Loan Modifications and Reestimates: Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

	2005	2004
5. Total Direct Loan Subsidy Expense: Military Housing Privatization Initiative	$ 0.00	$ 7,765,786.12

The interest rate and default cost values represent the amounts for the loans disbursed in FY 2005. These rates are established for each individual loan. Interest rate re-estimates for subsidy cost is an adjustment to subsidy cost from the assumed interest rates used in the budget preparations to the interest rates that are applicable to the periods in which the loans are disbursed. Technical/default re-estimate is an adjustment to subsidy cost based on the latest projections of defaults, delinquencies, recoveries, prepayments or other cash flow components.

The Department disbursed no new direct loans in current fiscal year.

Subsidy Rate for Direct Loans

As of June 30	Interest Differential	Defaults	Fees	Other	Total
Military Housing Privatization Initiative	24.17%	9.78%	0.00%	0.00%	33.95%

Subsidy rates pertain to the loan agreements contracted during the current fiscal year. The subsidy expense for new loans disbursed in the current year could result from disbursement of loans from both current and prior-year loan agreements.

The subsidy for FY 2005 is included in the FY 2006 Presidential Budget Federal Credit Supplement.

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

As of June 30	2005	2004
1. Beginning Balance of the Subsidy Cost Allowance	$ 70,721,790.27	$ 65,118,683.98
2. Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component		
A. Interest Rate Differential Costs	$ 0.00	$ 7,227,282.64
B. Default Costs (Net of Recoveries)	0.00	538,503.48
C. Fees and Other Collections	0.00	0.00
D. Other Subsidy Costs	0.00	0.00
E. Total of the above Subsidy Expense Components	$ 0.00	$ 7,765,786.12
3. Adjustments		
A. Loan Modifications	$ 0.00	$ 0.00
B. Fees Received	0.00	0.00
C. Foreclosed Property Acquired	0.00	0.00
D. Loans Written Off	0.00	0.00
E. Subsidy Allowance Amortization	0.00	0.00
F. Other	0.00	0.00
G. Total of the above Adjustment Components	$ 0.00	$ 0.00
4. Ending Balance of the Subsidy Cost Allowance before Re-estimates	$ 70,721,790.27	$ 72,884,470.10
5. Add or Subtract Subsidy Re-estimates by Component		
A. Interest Rate Re-estimate	$ 0.00	$ (185,332.00)
B. Technical/default Re-estimate	0.00	1,710,785.00
C. Total of the above Re-estimate Components	$ 0.00	$ 1,525,453.00
6. Ending Balance of the Subsidy Cost Allowance	$ 70,721,790.27	$ 74,409,923.10

Defaulted Guaranteed Loans from Post-1991 Guarantees

The Department had no defaulted guaranteed loans as of June 30, 2005.

Guaranteed Loans Outstanding

As of June 30	Outstanding Principal, Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
Guaranteed Loans Outstanding		
1. Military Housing Privatization Initiative	$ 552,365,000.00	$ 552,365,000.00
2. Armament Retooling & Manufacturing Support Initiative	$ 27,561,517.03	$ 24,701,455.66
3. Total	$ 579,926,517.03	$ 577,066,455.66
2005		
New Guaranteed Loans Disbursed		
1. Military Housing Privatization Initiative	$ 165,000,000.00	$ 165,000,000.00
2. Armament Retooling & Manufacturing Support Initiative	$ 739,852.83	$ 628,874.91
3. Total	$ 165,739,852.83	$ 165,628,874.91

The Guaranteed Loans Outstanding for the MHPI program as of the end of June 30, 2005 consists of the following:

Loan Guarantees	(in millions) FY 05
Robins Air Force Base, Georgia	$ 25.6
Fort Carson, Colorado	145.4
Kirtland Air Force Base, New Mexico	74.0
Wright Patterson Air Force Base, Ohio	65.0
Elmendorf Air Force Base, Alaska	48.0
Lackland Air Force Base, Texas	29.4
Fort Polk, Louisiana	165.0
Total Guaranteed Loans Outstanding	S 552.4

Liability for Post-1991 Loan Guarantees, Present Value

As of June 30		2005		2004
Loan Guarantee Program				
1. Military Housing Privatization Initiative	$	33,466,807.32	$	21,543,648.98
2. Armament Retooling & Manufacturing Support Initiative		12,352,470.32		1,272,636.32
3. Total	$	45,819,277.64	$	22,816,285.30

<u>MHPI</u>
The $11.9 million (55 percent) increase is attributable to the subsidy expense for the new guarantee loans issued for Fort Polk, and FY 2004 downward technical re-estimate and subsidy amortization. For additional information, see the Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees. There was one new guaranteed loan added in FY 2005.

<u>ARMS</u>

Total loan guarantee liabilities increased by $11.1 million (871 percent) due to upward technical re-estimate and subsidy amortization of $11.1 million in FY 2004. There were no new guaranteed loans added in FY 2005.

Subsidy Expense for Post-1991 Loan Guarantees

As of June 30

2005	Interest Differential	Defaults	Fees	Other	Total
1. New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	$ 0.00	$ 10,345,500.00	$ 0.00	$ 0.00	$ 10,345,500.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0.00	0.00
Total	$ 0.00	$ 10,345,500.00	$ 0.00	$ 0.00	$ 10,345,500.00

2004	Interest Differential	Defaults	Fees	Other	Total
2. New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0.00	0.00
Total	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2005	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
3. Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0.00	0.00
Total	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2004	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
4. Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.00	$ (479,310.00)	$ (2,543,706.00)	$ 0.00	$ (3,023,016.00)
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0.00	0.00
Total	$ 0.00	$ (479,310.00)	$ (2,543,706.00)	$ 0.00	$ (3,023,016.00)

	2005	2004
5. Total Loan Guarantee:		
Military Housing Privatization Initiative	$ 10,345,500.00	$ (3,023,016.00)
Armament Retooling & Manufacturing Support Initiative	0.00	0.00
Total	$ 10,345,500.00	$ (3,023,016.00)

<u>MHPI</u>

The increase in the reporting of Interest Rate Differential Costs and Default Costs is proportional to the number of guaranteed loans.

<u>ARMS</u>

ARMS had no new guaranteed loans in FY 2005.

Subsidy Rate for Loan Guarantees

	Interest Supplements	Defaults	Fees and other Collections	Other	Total
Loan Guarantees:					
1. Military Housing Privatization Initiative	0.00%	9.65%	0.00%	0.00%	9.65%
2. Armament Retooling & Manufacturing Support Initiative	0.00%	3.75%	-1.79%	0.00%	1.96%

The subsidy rates disclosed pertain only to loan agreements made during the current fiscal year. The subsidy expense for new loans reported in the current year result from disbursements of loans from both current year loan agreements and prior year(s) loan agreements.

The subsidy for FY 2005 is included in the FY 2006 Presidential Budget Federal Credit Supplement published at the end of FY 2005.

Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees

As of June 30		2005		2004
1. Beginning Balance of the Loan Guarantee Liability	$	34,360,030.64	$	25,839,301.30
2. Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component				
A. Interest Supplement Costs	$	0.00	$	0.00
B. Default Costs (Net of Recoveries)		10,345,500.00		0.00
C. Fees and Other Collections		0.00		0.00
D. Other Subsidy Costs		0.00		0.00
E. Total of the above Subsidy Expense Components	$	10,345,500.00	$	0.00
3. Adjustments				
A. Loan Guarantee Modifications	$	0.00	$	0.00
B. Fees Received		59,500.00		0.00
C. Interest Supplements Paid		0.00		0.00
D. Foreclosed Property and Loans Acquired		0.00		0.00
E. Claim Payments to Lenders		0.00		0.00
F. Interest Accumulation on the Liability Balance		1,054,247.00		0.00
G. Other		0.00		0.00
H. Total of the above Adjustments	$	1,113,747.00	$	0.00
4. Ending Balance of the Loan Guarantee Liability before Re-estimates	$	45,819,277.64	$	25,839,301.30
5. Add or Subtract Subsidy Re-estimates by Component				
A. Interest Rate Re-estimate		0.00		(479,310.00)
B. Technical/default Re-estimate		0.00		(2,543,706.00)
C. Total of the above Re-estimate Components	$	0.00	$	(3,023,016.00)
6. Ending Balance of the Loan Guarantee Liability	$	45,819,277.64	$	22,816,285.30

Administrative Expense

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

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

Note 9. Inventory and Related Property

As of June 30		2005		2004
1. Inventory, Net	$	68,301,968,905.11	$	72,826,504,686.19
2. Operating Materials & Supplies, Net		143,388,653,874.58		141,809,659,624.00
3. Stockpile Materials, Net		1,335,263,078.53		1,582,998,930.96
4. Total	$	213,025,885,858.22	$	216,219,163,241.15

Inventory, Net

As of June 30

	2005			2004	
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	Valuation Method
1. Inventory Categories					
A. Available and Purchased for Resale	$ 80,924,834,188.60	$ (36,131,642,833.73)	44,793,191,354.87	$ 46,852,895,377.18	LAC,MAC
B. Held for Repair	28,628,433,448.25	(5,912,329,666.86)	22,716,103,781.39	24,790,056,009.06	LAC,MAC
C. Excess, Obsolete, and Unserviceable	5,362,496,737.77	(5,362,496,737.77)	0.00	0.00	NRV
D. Raw Materials	22,772,920.09	0.00	22,772,920.09	25,795,289.13	MAC,SP,LAC
E. Work in Process	769,900,848.76	0.00	769,900,848.76	1,157,758,010.82	AC
F. Total	$ 115,708,438,143.47	$ (47,406,469,238.36)	68,301,968,905.11	$ 72,826,504,686.19	

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

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

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

General Composition of Inventory

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

- Held for sale, or held for repair for eventual sale;
- In the process of production for sale; or
- To be consumed in the production of goods for sale or in the provision of service for a fee.

Fluctuations

Inventory Available and Purchased for Resale decreased $2.1 billion (5 percent) due to two events affecting the Air Force Working Capital Fund: (1) a decrease of $4.2 billion related to price corrections for in-transit inventory, and (2) a change in requirements for inventory balances in support of the war efforts. The decreases are offset by a Defense Logistics Agency $1.8 billion increase due to rebuilding inventory levels to support Operations Enduring Freedom and Iraqi Freedom.

Inventory Held for Repair decreased $2.1 billion (9 percent) due primarily to a $2.7 billion decrease in Navy Working Capital Fund resulting from a reconciliation of the depot level reparable carcass liability and inventory in-transit accounts. The decrease was offset by a $1.2 billion increase in Army Working Capital resulting from an increase in volume of returned items needing repair in support of Operations Enduring Freedom, Iraqi Freedom and Noble Eagle.

Raw Materials decreased $3 million (12 percent) primarily due to increased issuances of raw materials at Tobyhanna Army Depot.

Work in Process decreased $387.9 million (34 percent) due to the closeout of the Conventional Ammunition Working Capital Fund and the continued phase out of the Contract Depot Maintenance Activity Group operations. In addition, the Aviation Depots' Component program is in the process of implementing new revenue recognition procedures to recognize revenue as a percentage of work completed.

Operating Materials and Supplies, Net

As of June 30	2005 OM&S Gross Value	2005 Revaluation Allowance	2005 OM&S, Net	2004 OM&S, Net	Valuation Method
1. OM&S Categories					
A. Held for Use	$ 127,676,056,799.08	$ 0.00	$ 127,676,056,799.08	$ 125,765,322,823.02	SP, LAC
B. Held for Repair	17,222,061,903.55	(1,509,464,828.05)	15,712,597,075.50	16,044,336,800.98	SP, LAC
C. Excess, Obsolete, and Unserviceable	3,636,718,301.15	(3,636,718,301.15)	0.00	0.00	NRV
D. Total	$ 148,534,837,003.78	$ (5,146,183,129.20)	$ 143,388,653,874.58	$ 141,809,659,624.00	

Legend for Valuation Methods:

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

General Composition of Operating Materials and Supplies

Operating Materials and Supplies include spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally managed aircraft engines held for consumption by General Funds. Generally, there are no restrictions on the use or disposition of operating materials and supplies.

Stockpile Materials, Net

As of June 30	2005			2004	
	Stockpile Materials Amount	Allowance for Gains (Losses)	Stockpile Materials, Net	Stockpile Materials, Net	Valuation Method
1. Stockpile Materials Categories					
A. Held for Sale	$ 1,241,177,309.58	$ 0.00	$ 1,241,177,309.58	$ 1,437,664,442.83	AC, LCM
B. Held in Reserve for Future Sale	94,085,768.95	0.00	94,085,768.95	145,334,488.13	AC, LCM
C. Total	$ 1,335,263,078.53	$ 0.00	$ 1,335,263,078.53	$ 1,582,998,930.96	

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

General Composition of Stockpile Materials

Stockpile materials are strategic and critical materials held due to statutory requirements, for use in national defense, conservation or national emergencies. All materials held by the National Defense Stockpile (NDS) are classified as Material Held in Reserve until Congressional action declares the materials are no longer required to be stockpiled, and are available for sale on the open market. When NDS receives authorization to offer materials for sale, NDS removes the materials from Material Held in Reserve and reclassifies them as Materials Held for Sale. Disposals cannot be made from the stockpile except under the following situations: (1) necessary upgrading, refining, or processing; (2) necessary rotation to prevent deterioration; (3) determination as excess with potential financial loss if retained, and (4) as authorized by law. The estimated market price of the stockpile materials held for sale is $1.5 billion.

Fluctuations:

Materials Held for Sale decreased $196.5 million (14 percent) due to the Defense National Stockpile Center's (DNSC) aggressive disposal program to meet inventory reduction targets. The type and quantity of each commodity chosen for sale in a fiscal year is based on statutory sales authority and on the Annual Material Plan (AMP). This plan has been approved by the Market Impact Committee and submitted to Congress in accordance with section 11(b) of the Strategic and Critical Materials Stockpiling Act (50 U.S.C. 98h-2(b)). As a result, significant commodities to include lead, zinc, and titanium were sold to the public.

Materials Held in Reserve for Future Sale decreased $51.2 million (35 percent) due to a DNSC correction of a systems programming error in FY 2005.

Note 10. General PP&E, Net

As of June 30	2005					2004
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
1. Major Asset Classes						
A. Land	N/A	N/A	$ 10,372,724,621.71	N/A	$ 10,372,724,621.71	$ 9,696,244,226.54
B. Buildings, Structures, and Facilities	S/L	20 Or 40	160,174,034,598.46	$ (93,169,567,273.95)	67,004,467,324.51	70,634,097,906.77
C. Leasehold Improvements	S/L	lease term	259,662,548.67	(113,775,118.67)	145,887,430.00	43,732,378.54
D. Software	S/L	2-5 Or 10	6,392,830,970.36	(3,964,132,692.40)	2,428,698,277.96	2,336,628,297.77
E. General Equipment	S/L	5 or 10	62,035,433,585.08	(45,036,829,556.56)	16,998,604,028.52	14,065,072,617.16
F. Military Equipment	S/L	Various	1,185,940,000,000.00	(850,290,000,000.00)	335,650,000,000.00	324,620,000,000.00
G. Assets Under Capital Lease	S/L	lease term	636,352,021.45	(442,033,815.77)	194,318,205.68	232,575,076.41
H. Construction-in-Progress	N/A	N/A	20,180,421,862.98	N/A	20,180,421,862.98	21,441,570,229.34
I. Other			80,627,935.38	(3,040,690.71)	77,587,244.67	91,993,023.62
2. Total General PP&E			$ 1,446,072,088,144.10	$ (993,019,379,148.06)	$ 453,052,708,996.03	$ 443,161,913,756.15

[1] Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

Fluctuations:

General Property, Plant and Equipment (PP&E) increased $9.8 billion (2 percent).

Assets Under Capital Lease

As of June 30		2005		2004
1. Entity as Lessee, Assets Under Capital Lease				
A. Land and Buildings	$	625,335,565.05	$	576,203,434.43
B. Equipment		11,016,456.40		1,163,847.69
C. Other		0.00		0.00
D. Accumulated Amortization		(442,033,815.77)		(344,792,205.71)
E. Total Capital Leases	$	194,318,205.68	$	232,575,076.41

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

Note 11. Liabilities Not Covered by Budgetary Resources

As of June 30	2005	2004
1. Intragovernmental Liabilities		
A. Accounts Payable	$ 0.00	$ 6,200,345.01
B. Debt	14,432,825.53	16,445,632.04
C. Other	6,904,849,907.85	4,935,101,114.18
D. Total Intragovernmental Liabilities	$ 6,919,282,733.38	$ 4,957,747,091.23
2. Nonfederal Liabilities		
A. Accounts Payable	$ 322,897,132.97	$ 464,751,959.28
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,306,831,113,096.68	1,194,625,068,131.51
C. Environmental Liabilities	61,605,379,145.95	56,702,115,636.41
D. Loan Guarantee Liability	0.00	0.00
E. Other Liabilities	12,986,458,284.14	13,429,781,776.35
F. Total Nonfederal Liabilities	$ 1,381,745,847,659.70	$ 1,265,221,717,503.60
3. Total Liabilities Not Covered by Budgetary Resources	$ 1,388,665,130,393.10	$ 1,270,179,464,594.80
4. Total Liabilities Covered by Budgetary Resources	$ 317,513,483,603.38	$ 289,663,879,898.04
5. Total Liabilities	$ 1,706,178,613,996.50	$ 1,559,843,344,492.80

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

Fluctuations

Intragovernmental Accounts Payable

Intragovernmental Accounts Payable decreased from $6.2 million to $0. In the 3rd Quarter, FY 2004, several activities recognized federal accounts payable from canceled appropriations. These canceled year accounts payable have now been resolved or settled.

Intragovernmental Debt

Debt decreased $2.0 million (12 percent) as a result of debt reduction payments by the US Army Corps of Engineers (USACE) and US Transportation Command (TRANSCOM) of $0.8 million and $1.2 million, respectively. The USACE debt payment is made in quarterly installments on a loan for capital improvements to the Washington Aqueduct. The remaining USACE-unfunded debt is $14.4 million. The $1.2 million payment was the final payment for a Military Sealift Command (MSC) loan from the Federal Financing Bank. MSC, which is a TRANSCOM element, made the final loan payment in July 2004.

Intragovernmental – Other

Intragovernmental Liabilities - Other increased $2.0 billion (40 percent). The U.S. Army Corps of Engineers increased because its Uncollected Custodial Liability was reported with Liabilities Not Covered by Budgetary Resources. The liability was previously reported with Liabilities Covered by Budgetary Resources. This became effective the 4th quarter FY 2004. The USACE's reclassification was $1.8 billion.

Nonfederal Accounts Payable

Nonfederal Accounts Payable decreased $141.9 million (31 percent). This decrease was due to a concentrated effort by the Air Force in the 3rd Quarter, FY 2005 to clean up unsupported accounts payable in cancelled appropriations.

Military Retirement Benefits and Other Employment-Related Actuarial Liabilities

The reported Actuarial Liability is changed once a year at Fiscal Year End. The unfunded liability for Military Retirement and Other Employment-Related Actuarial Liabilities increased $112.2 billion. The variance is attributable to an increase of $140.1 billion in the actuarial liability that is partially offset by an increase of $27.8 billion in the value of assets available to pay benefits. The most significant increases were in military retirement pensions and military retirement health benefits, which increased $92.6 billion and $27.9 billion, respectively.

Environmental Liabilities

Environmental Liabilities increased $4.9 billion (9 percent). The fluctuation is due mainly to the completion of the Army inventory for closed ranges resulting in 100 percent reporting of site level data ($3.6 billion) and increases in the labor rates and cost of materials for the disposal of Navy’s nuclear-powered ships and submarines ($929.2 million).

Note 12. Accounts Payable

As of June 30	2005			2004
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
1. Intragovernmental Payables	$ 2,783,231,392.38	$ N/A	$ 2,783,231,392.38	$ 885,790,233.32
2. Non-Federal Payables (to the Public)	26,800,893,846.02	2,193,084.91	26,803,086,930.93	24,967,790,883.46
3. Total	$ 29,584,125,238.40	$ 2,193,084.91	$ 29,586,318,323.31	$ 25,853,581,116.78

Fluctuations

Total accounts payable increased $3.7 billion (14 percent).

Intragovernmental Accounts Payable

Intragovernmental accounts payable increased $1.9 billion (214 percent). During 4th Quarter FY 2004, the Department of Defense began using a new method to better estimate the amount of business conducted with other Federal agencies for goods and services provided but not yet paid for. In addition to this change in methodologies, during the 1st Quarter, FY 2005, the Judgment Fund Liability of $154.4 million previously recorded as Other Liabilities, was reclassified to Accounts Payable. These new processes and reclassifications resulted in increases to intragovernmental accounts payable for the General Funds of the Navy, $866.3 million; Army, $714.6 million; and Air Force, $164.9 million.

Nonfederal Payables

Nonfederal accounts payable increased $1.8 billion (7 percent).

Note 13. Debt

As of June 30	2005						2004	
		Beginning Balance		Net Borrowings		Ending Balance		Ending Balance
1. Agency Debt								
A. Debt to the Treasury	$	85,469,146.90	$	2,859,450.39	$	88,328,597.29	$	84,476,417.78
B. Debt to the Federal Financing Bank		506,277,717.36		(2,367,615.10)		503,910,102.26		617,198,418.01
C. Total Agency Debt	$	591,746,864.26	$	491,835.29	$	592,238,699.55	$	701,674,835.79
2. Total Debt	$	591,746,864.26	$	491,835.29	$	592,238,699.55	$	701,674,835.79

Debt to the Treasury

Debt owed to the Treasury increased $3.8 million (4.6 percent), due to a $4.6 million (6.7 percent) increase in Military Housing Privatization Initiative (MHPI) offset by a $0.8 million (5.0 percent) decrease for the US Army Corps of Engineers.

MHPI owed $73.5 million to the Treasury of the United States (TUS), which is directly related to the loan subsidy cost payments from the Family Housing Improvement Fund. This amount reflects the debt to the treasury funds borrowed from the TUS, interest owed and the principal payments from borrowers, borrower fees, interest earned from TUS and proceeds from the sale of collateral. Funds in this account are used for direct loans to borrowers, repayment of the principal and interest on funds borrowed from the TUS, payments of negative subsidy cost and payments of downward re-estimates of the subsidy costs.

During fiscal years 1997, 1998, and 1999, the Corps of Engineers executed three promissory notes totaling $75 million with the Department of the Treasury. Funds provided were used for capital improvements to the Washington Aqueduct. Arlington County, the city of Falls Church, Virginia, and the District of Columbia provide funding to repay the debt. Cumulative actual drawdown of the funds has been made from the Treasury in the amount of $74.9 million. There were no drawdowns of funds from the Treasury, for the 3rd Quarter, FY 2005.

Debt to the Federal Financing Bank

Debt owed to the Federal Financing Bank (FFB) decreased $113.2 million (18 percent). Intra-governmental Debt for Navy decreased $112.0 million (18 percent), primarily due to the reduction of outstanding principal amount reported for the Maritme Prepositioning Ships (MPS) loans.

Note 14. Environmental Liabilities and Disposal Liabilities

As of June 30	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
1. Environmental Liabilities – Non Federal				
A. Accrued Environmental Restoration (DERP funded) Costs:				
1. Active Installations--Environmental Restoration (ER)	$ 1,333,352,945.63	$ 8,861,009,114.07	$ 10,194,362,059.70	$ 10,525,208,304.40
2. Active Installations--ER for Closed Ranges	53,056,000.00	7,342,378,000.00	7,395,434,000.00	4,526,740,100.00
3. Formerly Used Defense Sites (FUDS) -- ER	220,317,000.00	3,977,640,000.00	4,197,957,000.00	4,141,912,000.00
4. FUDS--ER for Transferred Ranges	97,022,000.00	13,810,031,000.00	13,907,053,000.00	13,611,181,000.00
B. Other Accrued Environmental Costs (Non-DERP funds)				
1. Active Installations--Environmental Corrective Action	62,560,937.17	500,527,297.75	563,088,234.92	576,332,993.66
2. Active Installations--Environmental Closure Requirements	15,999,000.00	162,499,000.00	178,498,000.00	117,669,200.00
3. Active Installations--Environ.Response at Active Ranges	62,500,000.00	217,132,000.00	279,632,000.00	267,632,000.00
4. Other	57,935.00	7,973,332.00	8,031,267.00	9,342,609.00
C. Base Realignment and Closure (BRAC)				
1. BRAC Installations--Environmental Restoration (ER)	339,978,597.00	2,644,644,291.29	2,984,622,888.29	3,592,788,000.01
2. BRAC Installations--ER for Transferring Ranges	8,797,000.00	537,094,000.00	545,891,000.00	554,537,000.00
3. BRAC Installations--Environmental Corrective Action	7,708,712.21	148,141,872.58	155,850,584.79	179,118,301.08
4. Other	167,924,000.00	0.00	167,924,000.00	211,364,000.00
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0.00	6,426,100,000.00	6,426,100,000.00	5,693,000,000.00
2. Nuclear Powered Submarines	0.00	5,819,300,000.00	5,819,300,000.00	5,172,400,000.00
3. Other Nuclear Powered Ships	0.00	223,900,000.00	223,900,000.00	287,500,000.00
4. Other National Defense Weapons Systems	5,026,000.00	202,128,316.25	207,154,316.25	314,604,009.25
5. Chemical Weapons Disposal Program	767,094,000.00	10,065,620,000.00	10,832,714,000.00	11,123,042,000.00
6. Other	69,557,393.00	69,155,004.00	138,712,397.00	150,065,000.00
2. Total Environmental Liabilities:	$ 3,210,951,520.01	$ 61,015,273,227.94	$ 64,226,224,747.95	$ 61,054,436,517.40

Service Component – Environmental Restoration (Cleanup) Liabilities and Environmental Disposal Liabilities (Amounts in millions)	Army	Navy	Air Force	ODO	Total
1. Environmental Liabilities-Nonfederal					
A. Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) funded) Costs:					
1. Active Installations-Environmental Restoration (ER)	$ 3,258.8	$ 2,732.3	$ 3,952.7	$ 250.6	10,194.4
2. Active Installations--ER for Closed Ranges	5,494.1	556.5	1,344.9		7,395.5
3. Formerly Used Defense Sites (FUDS) –ER	4,197.9				4,197.9
4. FUDS--ER for Transferred Ranges	13,907.0				13,907.0
B. Other Accrued Environmental Costs (Non-DERP funds)					
1. Active Installations--Environmental Corrective Action	259.1		173.7	130.3	563.1
2. Active Installations--Environmental Closure Requirements	51.2		112.3	15.0	178.5
3. Active Installations--Environ. Response at Active Ranges	267.6			12.0	279.6
4. Other				8.1	8.1
C. Base Realignment and Closure (BRAC)					
1. BRAC Installations--Environmental Restoration (ER)	597.3	1,096.1	1,264.5	26.7	2,984.6
2. BRAC Installations--ER for Transferring Ranges	480.1	65.8			545.9
3. BRAC Installations--Environmental Corrective Action	25.0		130.8		155.8
4. Other	167.9				167.9
D. Environmental Disposal for Weapon Systems Programs					
1. Nuclear Powered Aircraft Carriers		6,426.1			6,426.1
2. Nuclear Powered Submarines		5,819.3			5,819.3
3. Other Nuclear Powered Ships		223.9			223.9
4. Other National Defense Weapon Systems		207.1			207.1
5. Chemical Weapons Disposal Program	10,832.7				10,832.7
6. Other				138.8	138.8
2. Total Nonfederal Environmental Liabilities:	39,538.7	17,127.1	6,978.9	581.5	**64,226.2**

Others Category Disclosure Comparative Table

Types	June 30, 2005 ($ in Millions)
Other Accrued Environmental Costs (Non-DERP funds)	
DoD Component Level Accounts	$ 0.4
Defense Commissary Agency	$ 7.7
Total	**$ 8.1**
Base Realignment and Closure	
Army's Prior BRAC Unliquidated Obligations that cannot be identified to a specific program	**$ 167.9**
Environmental Disposal for Weapons Systems Programs-Other	
National Defense Stockpile –Other Defense Organizations (ODO)	**$ 138.8**

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

The Department uses engineering estimates and independently validated models to estimate environmental liabilities. The models are contained within the Remedial Action Cost Engineering Requirements (RACER) and the Department of the Navy Normalization of Data System (NORM). The Department validates the models in accordance with DoD Instruction 5000.61 and primarily uses the models to estimate the liabilities based on data received during a preliminary assessment and initial site investigation. The Department primarily uses engineering estimates after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project.

The DoD has clean up requirements for the Defense Environmental Restoration Program (DERP) sites at active installations, BRAC installations, Formerly Used Defense Sites (FUDS), non-DERP sites at active installations, weapon systems programs, and chemical weapons disposal programs. The DoD follows the Comprehensive Environmental Response, Compensation Liability Act (CERCLA) and the Superfund Amendment and Reauthorization Act (SARA) to clean up DERP-eligible contamination. Non-DERP eligible contamination clean up is performed in accordance with the Resource Conservation and Recovery Act (RCRA). The CERCLA and RCRA require DoD to clean up contamination in coordination with regulatory agencies, current property owners of property damaged by the Department, and third parties that have a partial responsibility for the environmental restoration. Failure to comply with agreements and legal mandates can put DoD at risk of incurring fines and penalties.

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

The Chemical Weapons Disposal Program is based on the FY 1986 National Defense Authorization Act (PL 99-145, as amended by subsequent acts) that directed the DoD to destroy the unitary chemical stockpile by April 29, 2004. The current guidelines for destruction are based on the Chemical Weapons Convention (CWC) treaty. The United States ratified the treaty in April 1997 that required the stockpile of chemical weapons to be destroyed by April 2007, according to the terms outlined. The Army, as Executive Agent within the DoD, provides policy, direction, and oversight for both the Chemical Stockpile Program and the Non-Stockpile Chemical Materiel Project. As such, the Army is responsible for the safe and economical disposal of the U.S. stockpile of lethal and incapacitating chemical warfare agents and munitions.

The estimated total clean up cost for the current operating period is assigned based on the amount of the current year appropriation and unliquidated obligations that will be expended within 12 months from the Balance Sheet date. The non-current clean up cost is the portion of the clean up cost that will be expended more than 12 months from the Balance Sheet date.

The DoD has not identified any unrecognized portion of the estimated total clean up cost associated with General PP&E. The Department requires the unrecognized clean up cost associated with PP&E to be disclosed and is working with the Military Departments to ensure this policy is properly implemented.

The Department had changes in estimates resulting from overlooked or previously unknown contaminants, better site characterization with sampling, and re-estimation based on different assumptions, lessons-learned, and advances in technology. Environmental liabilities can also change in the future due to changes in laws and regulations, and changes in agreements with regulatory agencies.

The Active Installations – Environmental Restoration (ER) for Closed Ranges increased by $2.9 billion (63 percent). The Army reported an increase of $2.4 billion due to the completion of estimating the liabilities in the 4th Quarter, FY 2004 for the sites identified in its universe. Although the Army has completed its estimates for each site, the estimate is based on site level data and the estimates may change as they get closer to program execution. The Air Force also reported an increase of $506.7 million that resulted from the identification of 32 additional sites.

The Active Installations-Environmental Closure Requirements increased $60.8 million (52 percent). The Air Force reported an increase of $45.9 million that is attributable to the identification of additional landfill sites, and a change in the amortization calculation that systematically recognizes the liability estimates over the life of an asset, rather than assessing the liability in the year of disposal.

Other Accrued Environmental Costs (Non-DERP funds) – Other decreased $1.2 million (14 percent). The decrease is primarily attributable to a reduction of Defense Commissary facilities requiring clean-up.

The Base Realignment and Closure (BRAC) Installations – Environmental Restoration (ER) decreased $608.2 million (17 percent). The net decrease is primarily due to a $532.5 million decrease reported by the Air Force, a $159.6 million decrease reported by the Navy, and a $78.6 million increase reported by the Army. The decrease reported by the Air Force resulted from implementation of a new cost estimating and reporting policy that limits the liability to 25 years of remediation action operations along with five years of long term monitoring. The remaining decrease reported by the Navy was due to $119.5 million in completion of site cleanups and $40.1 million in Cost to Complete revaluations of BRAC sites during the current quarter. The increase reported by the Army is due to the increased remediation efforts required and is based on better site characterization.

The BRAC Installations-Environmental Corrective Action decreased $23.3 million (13 percent). The variance is primarily due to a decrease in Army cost estimates that reflect changes in required cleanup actions at a site.

Base Realignment and Closure (BRAC) – Other decreased $43.5 million (21 percent). The decrease is attributable to the Army disbursing funds on environmental projects.

Nuclear Powered Aircraft Carriers increased $733.1 million (13 percent) and Nuclear Powered Submarines increased $646.9 million (13 percent). The Navy Working Capital Fund (NWCF) manages the disposal of these assets and the increases are attributable to a 13.0 percent increase in the NWCF for FY 2005. The NWCF increases are attributed to an increase in the labor rates and an increase in the cost of materials used in performing the disposal. The source for increasing the labor rates and cost of material is the annual escalation guidance.

Other Nuclear Powered Ships decreased $63.6 million (22 percent). The decrease is attributable to adjustments made in the liability estimates and overall execution of the ship disposal program. As the Navy executes its program, it annually adjusts liability estimates based on actual execution of previous annual programs.

Other National Defense Weapons Systems decreased $107.5 million (34 percent). The decrease is primarily attributable to a decrease in the liability estimate for the Air Force and the Navy of $50.6 million and $40.9 million, respectively. The Air Force previously reported a liability for disposal of conventional munitions; however, the Army is the Department's executive agent for the conventional weapons disposal. The Army reports this liability on its financial statements. The Navy had two contributing contingencies: (1) a decrease in estimates resulting from the annual review and validation of the estimates, and (2) an overall decrease resulting from the program execution liability of the Trident Missile Motors Disposal Program.

Note 15. Other Liabilities

As of June 30	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
1. Intragovernmental				
A. Advances from Others	$ 477,910,798.19	$ 0.00	$ 477,910,798.19	$ 398,243,557.28
B. Deposit Funds and Suspense Account Liabilities	333,212,912.57	0.00	333,212,912.57	327,505,787.21
C. Disbursing Officer Cash	2,397,777,996.58	0.00	2,397,777,996.58	2,076,305,421.10
D. Judgment Fund Liabilities	152,665,321.95	0.00	152,665,321.95	413,717,133.38
E. FECA Reimbursement to the Department of Labor	613,220,043.35	661,483,565.84	1,274,703,609.19	1,276,752,494.32
F. Other Liabilities	4,299,086,919.16	1,627,475,568.37	5,926,562,487.53	5,957,596,087.80
G. Total Intragovernmental Other Liabilities	$ 8,273,873,991.80	$ 2,288,959,134.21	$ 10,562,833,126.01	$ 10,450,120,481.09
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	$ 10,554,490,608.22	$ 1,290,604,909.00	$ 11,845,095,517.22	$ 9,097,399,748.18
B. Advances from Others	1,731,683,413.35	0.00	1,731,683,413.35	1,702,555,909.27
C. Deferred Credits	4,916,423.41	0.00	4,916,423.41	7,362,894.96
D. Deposit Funds and Suspense Accounts	566,793,044.16	35,579,926.13	602,372,970.29	310,583,080.39
E. Temporary Early Retirement Authority	364,277.56	263,000.00	627,277.56	2,102,706.59
F. Nonenvironmental Disposal Liabilities				
(1) National Defense PP&E (Nonnuclear)	7,200,000.00	506,059,589.81	513,259,589.81	563,421,145.81
(2) Excess/Obsolete Structures	53,581,000.00	235,897,000.00	289,478,000.00	672,575,500.00
(3) Conventional Munitions Disposal	0.00	1,250,307,433.32	1,250,307,433.32	1,192,860,894.00
(4) Other	82,011.60	0.00	82,011.60	(486,192.06)
G. Accrued Unfunded Annual Leave	8,722,225,529.32	0.00	8,722,225,529.32	8,177,712,944.88
H. Capital Lease Liability	53,317,871.65	218,256,216.00	271,574,087.65	326,157,133.90
I. Other Liabilities	5,322,708,933.29	905,863,758.17	6,228,572,691.46	10,143,116,792.05
J. Total Nonfederal Other Liabilities	$ 27,017,363,112.56	$ 4,442,831,832.43	$ 31,460,194,944.99	$ 32,195,362,557.97
3. Total Other Liabilities	$ 35,291,237,104.36	$ 6,731,790,966.64	$ 42,023,028,071.00	$ 42,645,483,039.06

Other Intragovernmental Liabilities include employee entitlements (life insurance, health benefits, retirement, voluntary separation incentives, unemployment and education benefits), contract liabilities pending litigation, custodial liabilities for interest, penalties, fines and administrative fees due to Treasury, accounts receivable from cancelled appropriations, and future revenues from long-term water storage contracts.

Other Nonfederal Liabilities include custodial liabilities for foreign military sales, Iraqi Seized Cash, and Iraqi Developmental Fund and contingent liabilities for items held for repair. Also included are employee contributions to employee benefit plans, contract payment holdbacks, and progress payments.

Capital Lease Liability

As of June 30	2005				2004
	Asset Category				
	Land and Buildings	Equipment	Other	Total	Total
1. Future Payments Due					
A. 2005	$ 71,108,692.57	$ 280,145.00	$ 0.00	$ 71,388,837.57	$ 71,711,706.43
B. 2006	60,041,331.79	1,149,952.00	0.00	61,191,283.79	66,259,692.32
C. 2007	47,482,178.53	4,034,951.00	0.00	51,517,129.53	63,160,637.19
D. 2008	43,853,305.76	93,058.00	0.00	43,946,363.76	50,584,885.57
E. 2009	43,853,305.76	0.00	0.00	43,853,305.76	44,353,046.76
F. After 5 Years	85,394,190.08	0.00	0.00	85,394,190.08	178,995,651.54
G. Total Future Lease Payments Due	$ 351,733,004.49	$ 5,558,106.00	$ 0.00	$ 357,291,110.49	$ 475,065,619.81
H. Less: Imputed Interest Executory Costs	85,287,663.46	429,359.38	0.00	85,717,022.84	148,908,485.53
I. Net Capital Lease Liability	$ 266,445,341.03	$ 5,128,746.62	$ 0.00	$ 271,574,087.65	$ 326,157,134.28
2. Capital Lease Liabilities Covered by Budgetary Resources				$ 200,944,431.30	$ 207,451,586.91
3. Capital Lease Liabilities Not Covered by Budgetary Resources				$ 70,629,656.35	$ 118,705,547.36

For the Department of Defense, all leases prior to FY 1992 are funded on an annual basis and subject to the availability of funds. Noncurrent amounts for these leases are shown as not covered by budgetary resources.

Leases originating after FY 1992 are required to be fully funded in the year of their inception. Therefore, budgetary resources show the present value of those lease payments as covered by budgetary resources.

Note 16. Commitments and Contingencies

Legal Contingencies

The Department is a party in various administrative proceedings and legal actions, which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. Others may be payable from the Department's resources, either directly or by reimbursement to the Judgment Fund. Based on information currently available, however, it is management's opinion that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on the Department.

The Department is aggressively contesting the claimed liability of the Government in each litigation, claim, or assessment. Except as indicated below, the Department is unable to predict the likely outcome or the amount of liability because most of the litigation, claims, or assessments are in the preliminary stage. As of September 30, 2004, the Department reported one case with a probable loss to the Government. However, the status regarding this case appears that the United States may not have to pay damages.

Other Commitments and Contingencies

In addition, the Department has other possible contingent liabilities primarily consisting of the Chemical Demilitarization Non-Stock Disposal of $9.2 billion (the estimated cost of destroying buried chemical munitions). These liabilities are not accrued in the Department's financial statements because the likelihood of expenditure of resources is not probable.

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

As of June 30	2005				2004
	Actuarial Present Value of Projected Plan Benefits	Assume Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
1. Pension and Health Benefits					
A. Military Retirement Pensions	$ 834,582,098,074.36	6.25%	$ (200,278,400,924.64)	$ 634,303,697,149.72	$ 541,149,500,600.33
B. Military Retirement Health Benefits	221,242,011,000.00	6.25%	0.00	221,242,011,000.00	206,839,265,000.00
C. Medicare-Eligible Retiree Benefits	504,073,807,000.00	6.25%	(60,686,155,426.23)	443,387,651,573.77	438,093,152,525.88
D. Total Pension and Health Benefits	$ 1,559,897,916,074.40		$ (260,964,556,350.87)	$ 1,298,933,359,723.50	$ 1,186,081,918,126.20
2. Other					
A. FECA	$ 6,959,028,620.69		$ 0.00	$ 6,959,028,620.69	$ 7,596,102,000.02
B. Voluntary Separation Incentive Programs	1,593,549,446.00	4.0%	(775,682,833.94)	817,866,612.06	860,456,299.40
C. DoD Education Benefits Fund	1,254,490,736.00	5.3%	(1,133,632,595.56)	120,858,140.44	86,591,705.88
D. Total Other	$ 9,807,068,802.69		$ (1,909,315,429.50)	$ 7,897,753,373.19	$ 8,543,150,005.30
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$ 1,569,704,984,877.10		$ (262,873,871,780.37)	$ 1,306,831,113,096.70	$ 1,194,625,068,131.50

Fluctuations

The unfunded liability for Military Retirement and Other Employment Related Actuarial Liabilities increased $112.2 billion (9.5 percent) and is attributable to an increase of $140.1 billion (10 percent) in the actuarial liability that is offset by an increase of $27.9 billion in the value of assets available to pay benefits.

Military Retirement

The increase in the actuarial liability is primarily the result of an amendment to the MRF Plan established by the National Defense Authorization Act for FY 2004 for new concurrent receipt benefits.

The Military Retirement System is a single-employer, defined benefit plan. Administrative costs of the Fund are not ascertainable. Projected revenues into the Fund, authorized by PL 98-94, come from three sources: Interest earnings on Fund assets, monthly DoD contributions, and annual contributions from the Treasury Department. The monthly DoD contributions are determined as a percentage (approved by the DoD Retirement Board of Actuaries) of basic pay. The contribution from Treasury is paid into the Fund at the beginning of each fiscal year, and represents the amortization of the unfunded liability for service performed prior to October 1, 1984, as well as the amortization of actuarial gains and losses that have arisen since then. Effective FY 2005, Treasury began making an annual contribution to the Fund that represents the normal cost amount for the new concurrent receipt provisions of the 2004 National Defense Authorization Act. The Board determines Treasury's contribution and the Secretary of Defense directs the Secretary of Treasury to make the payment.

The long-term economic assumptions for each valuation are set by the DoD Retirement Board of Actuaries. The long-term assumptions for the FY 2003 valuation were 6.25 percent interest, 3.0 percent Consumer Price Index, and 3.75 percent salary increase. The long-term economic assumptions did not change for the FY 2004 valuation. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience. Because of reporting deadlines, the FY 2004 actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year valuation results as reported in the DoD office of Actuary Valuation of the Military Retirement System. In calculating the FY 2004 roll-forward amount, the following assumptions were used:

	Inflation	Salary	Interest
Fiscal Year 2004	2.1 percent (actual)	3.7 percent (actual)	6.25 percent
Fiscal Year 2005	2.4 percent (estimated)	3.5 percent (estimated)	6.25 percent
Long-Term	3.0 percent	3.75 percent	6.25 percent

For purposes of the Fund's financial reporting, this roll-forward process is applied annually.

Actuarial Cost Method Used: Aggregate entry-age normal method.
Market Value of Investments in Market-Based and Marketable Securities: $209.8 billion

	(Amounts in millions)
	FY 2004
Actuarial Liability as of 9/30/03	$736,061.6
Expected Normal Cost for FY 04	12,857.2
Plan Amendment Liability	81,062.7
Assumption Change Liability	(32.5)
Expected Benefit Payments for FY 04	(36,623.5)
Interest Cost for FY 04	45,272.4
Actuarial (gains)/losses due to changes in trend assumptions	(4,015.8)
Actuarial Liability as of 09/30/04	$834,582.1
Change in Actuarial Liability	$98,520.5

Military Retirement Health Benefits (MRHB)

The unfunded actuarial liability for the Military Retirement Health Benefits increased $14.4 billion (7 percent) and is attributable to an increase in the overall actuarial liability.

Change in Defense Health Program MRHB Actuarial Liability

	(Amounts in millions)
Actuarial Liability as of 09/30/03 (DoD pre-Medicare + all uniformed services Medicare cost-basis effect)	$206,839.4
Expected Normal Cost for FY04	7,421.8
Expected Benefit Payments for FY04	(6,939.3)
Interest Cost for FY04	12,942.3
Actuarial (gains)/losses due to other factors	11,564.9
Actuarial (gains)/losses due to changes in trend assumptions	(10,587.1)
Actuarial Liability as of 09/30/04 (DoD pre-Medicare + all uniformed services Medicare cost-basis effect)	$221,242.0
Change in Actuarial Liability	$14,402.6

Assumptions in Calculation of DHP Liability:
Interest Rate: 6.25%

Medical Trend

Medicare Inpatient:	5.1% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Outpatient:	6.8% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Direct Care):	9.7% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Purchased Care):	14.6% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Non-Medicare Inpatient:	5.9% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Non-Medicare Outpatient:	8.4% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Non-Medicare Prescriptions:	11.3% from FY03 to FY04, ultimate rate of 6.25% in 2028.

Other Information

The DHP liability includes pre-Medicare liabilities for the Department of Defense, plus a cost-basis effect related to the direct care portion of Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2004 liability was:

	(Amounts in millions)
DoD	$220,865.0
Coast Guard	334.0
Public Health Service	40.0
NOAA	3.0
Total	$221,242.0

Liabilities for direct care in the Military Retirement Health Benefits are valued at a higher cost basis as established by the Government Accountability Office (GAO). As a result, the Medicare portion of the Military Retirement Health Benefits liability is approximately $16.9 billion higher than the corresponding liability for the MERHCF. This $16.9 billion amount is included in the DHP liability.

Actuarial gains/losses due to other factors include new population data, other actuarial experience being different from assumed, and actuarial assumption changes other than the change in trend assumptions.

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

Medicare-Eligible Retiree Benefits

The unfunded actuarial liability increased $5.3 billion (1 percent). The increase is attributable to an increase of $27.9 billion in the actuarial liability that is offset by the increase of $22.6 billion in the value of assets available to pay benefits.

Changes in MERHCF Actuarial Liability

	(Amounts in millions)
Actuarial Liability as of 09/30/03 (all uniformed services Medicare)	$476,170.3
Expected Normal Cost for FY04	10,187.8
Expected Benefit Payments for FY04	(5,911.8)
Interest Cost for FY04	29,892.2
Actuarial (gains)/losses due to other factors	(1,430.6)
Actuarial (gains)/losses due to changes in trend assumptions	(4,834.1)
Actuarial Liability as of 09/30/04 (all uniformed services Medicare)	$504,073.8
Change in Actuarial Liability	$27,903.5

Assumptions in Calculation of MERHCF Liability
Interest Rate: 6.25%

Medical Trend

Medicare Inpatient:	5.1% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Outpatient:	6.8% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Direct Care):	9.7% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Purchased Care):	14.6% from FY03 to FY04, ultimate rate of 6.25% in 2028.

The MERHCF liability includes Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2004, liability was:

	(Amounts in millions)
DoD	$493,717.0
Coast Guard	9,263.7
Public Health Service	1,024.9
NOAA	68.2
Total	$ 504,073.8

FY 2003 Service contributions to the MERHCF were:

	(Amounts in millions)
DoD	$7,918.8
Coast Guard	192.3
Public Health Service	27.4
NOAA	1.2
Total	$ 8,139.7

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

Projected revenues into the Medicare Eligible Retiree Health Care Fund, authorized by Chapter 56 of Title 10, United States Code, come from three sources: interest earnings on Fund assets, monthly Uniformed Services contributions, and annual contributions from the Treasury Department. The monthly contributions are determined as a per-capita amount (approved by the DoD Medicare Eligible Retiree Health Care Board of Actuaries) times end strength. The contribution from Treasury is paid into the Fund at the beginning of each fiscal year and represents the amortization of the unfunded liability for service performed prior to October 1, 2002, as well as the amortization of actuarial gains and losses that have arisen since then. The Board determines Treasury's contribution, and the Secretary of Defense directs the Secretary of Treasury to make the payment.

The actuarial liability reported above does not include $838.3 million in incurred but not reported liabilities. These liabilities are disclosed in the Liabilities Not Covered and Covered by Budgetary Resources note, and the Other Liabilities note.

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

Actuarial Cost Method Used for MERHCF Liability: Aggregate Entry-Age Normal
Market Value of Investments in Market-Based and Marketable Securities: $60.3 billion

Federal Employees Compensation Act (FECA)

The unfunded liability for FECA decreased 8 percent.

Assumptions

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

Year 1	3.84%
Year 2	4.35%
Year 3 and thereafter	4.35%

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

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

CBY	COLA	CPIM
2004	2.30%	3.21%
2005	2.00%	3.54%
2006	1.83%	3.64%
2007	1.97%	3.80%
2008+	2.17%	3.92%

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

Voluntary Separation Incentive Programs (VSI)

The unfunded actuarial liability decreased $42.6 million (5 percent) as a result of a decrease of $96.4 million in the actuarial liability, and a decrease of $53.8 million in the value of assets available to pay benefits.

The VSI program was established by Public Law 102-190. The intent of this program is to reduce the number of military personnel on active duty. This plan was offered to personnel with a minimum of six years of service who do not qualify for retirement. The incentive payments are spread over a period equivalent to twice the years of active service. The annual payment is based on 2.5 percent of the person's basic pay at the time they leave service multiplied by the number of years of service. The September 30, 2004, VSI Actuarial Present Value of Projected Plan Benefits (Actuarial Liability) was calculated at an assumed annual interest rate of 4 percent.

Since the VSI program is discontinued for new takers, each year the Actuarial Liability is expected to decrease with benefit outlays, and increase with interest cost. In the absence of (1) actuarial gains and losses, and (2) assumption changes, a decrease of $91.2 million in the Actuarial Liability was expected during FY 2004. The September 30, 2004, Actuarial Liability includes changes due to experience, which resulted in a net gain of $5.3 million. This reflects the new population on which the September 30, 2004, Actuarial Liability is based, as well as other economic experience being different than assumed.

The Present Value of Projected Plan Benefits (Actuarial Liability) for the VSI Fund, as of September 30, 2004, is $1.6 billion. It has been calculated as in prior years; namely, as the present value, as of September 30, 2004, of all remaining VSI payments.

Market Value of Investments in Market-based and Marketable Securities: $677.4 million.

DoD Education Benefits Fund

The increase in the DoD Education Benefits unfunded actuarial liability is the combined result of an increase of $46.3 million in the actuarial present value of the plan benefits, and an increase of $12.1 million in the value of the assets available to pay benefits. The modified estimate of the present value of benefits (PVB) for the DoD Education includes more complete experience. The increase in the actuarial liability is the result of an increase of $64 million due to an additional year of new entrants and calculating the present value of the stream of projected future benefits as of a year later, and a PVB decrease of $18 million related to a higher interest rate assumption (5.3 percent versus 4.4 percent).

The Education Benefits Fund was established by Public Law 98-525. The program is designed to accumulate funds for the Educational Assistance program to promote the recruitment and retention of members for the All-Volunteer Forces program and the Total Force Concept of the Armed Forces and aid in the readjustment of members of the Armed Forces to civilian life after separation from military service.

Market Value of Investments in Market-based and Marketable Securities: $999.8 million.

Note 18. Disclosures Related to the Statement of Net Cost

General Disclosures Related to the Statement of Net Cost

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.

For General Funds, the amounts presented in the Statement of Net Cost (SoNC) are based on obligations and disbursements and therefore may not, in all cases, accrue actual costs. While the Department's Working Capital Funds (WCFs) generally record transactions on an accrual basis, the systems do not always capture actual costs in a timely manner. As such, information presented in the SoNC 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.

Fluctuations

Intragovernmental Gross Costs

Intragovernmental Gross Costs increased $9.3 billion (93 percent). This increase is primarily attributed to 1) increased expenditures in FY 2005 required to support contingency operations, antiterrorism base operations, and force protection requirements; and 2) adjustments to match trading partner seller side revenues.

Intragovernmental Earned Revenue

Intragovernmental Earned Revenue increased $3.3 billion (31 percent) which is primarily comprised of the following:

The Medicare-Eligible Retiree Health Care Fund increased $1.1 billion and the Military Retirement Fund increased $901.0 million as the result of increased interest on investments.

The US Army Corps of Engineers (USACE) increased $711.0 million due to reimbursable work performed for Federal Emergency Management Agency (FEMA) on the hurricane relief effort in Florida. The USACE received funding authority from FEMA to perform numerous missions to support those affected by the four hurricanes that struck Florida in the fall of 2004.

Gross Cost and Earned Revenue by Budget Functional Classification

As of June 30	2005			2004
	Gross Cost	(Less: Earned Revenue)	Net Cost	Net Cost
Budget Functional Classification				
1. Department of Defense Military (051)	$ 330,519,009,846.67	$ (19,626,920,131.21)	$ 310,892,089,715.46	$ 306,423,736,671.48
2. Water Resources by U.S. Army Corps of Engineers (301)	6,700,608,357.90	(1,396,871,702.71)	5,303,736,655.19	4,514,141,584.88
3. Pollution Control and Abatement by US. Army Corps of Engineers (304)	92,468,153.20	0.00	92,468,153.20	85,228,488.64
4. Federal Employees Retirement and Disability, Department of Defense Military Retirement Fund (602)	29,183,682,350.78	(8,372,291,681.10)	20,811,390,669.68	20,222,134,621.41
5. Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund (702)	242,474,873.39	(25,724,911.07)	216,749,962.32	204,911,059.59
6. Medicare Eligible Retiree Health Care Fund (551)	3,823,173,018.89	(1,869,067,435.17)	1,954,105,583.72	(646,968,319.87)
7. Total	$ 370,561,416,600.83	$ (31,290,875,861.26)	$ 339,270,540,739.57	$ 330,803,184,106.13

Gross Cost to Generate Intragovernmental Revenue and Earned Revenue (Transactions with Other Federal—Non-DoD—Entities) by Budget Functional Classification

As of June 30	2005			2004
	Gross Cost to Generate Intragovernmental Revenue	(Less: Earned Revenue)	Net Cost	Net Cost
1. Department of Defense Military (051)	$ 18,358,598,689.74	$ (2,250,197,358.31)	$ 16,108,401,331.43	$ 7,401,593,134.52
2. Water Resources by U.S. Army Corps of Engineers (301)	653,845,620.25	(1,110,296,743.05)	(456,451,122.80)	245,596,182.48
3. Pollution Control and Abatement by US. Army Corps of Engineers (304)	1,728,959.16	0.00	1,728,959.16	2,014,777.83
4. Federal Employees Retirement and Disability Department of Defense Military Retirement Trust Fund (602)	0.00	(8,372,291,681.10)	(8,372,291,681.10)	(7,470,650,548.84)
5. Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund (702)	242,361,908.23	(25,611,945.91)	216,749,962.32	204,911,059.59
6. Medicare Eligible Retiree Health Care Fund (551)	0.00	(1,869,067,435.17)	(1,869,067,435.17)	(770,462,832.24)
7. Total	$ 19,256,535,177.38	$ (13,627,465,163.54)	$ 5,629,070,013.84	$ (386,998,226.66)

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

As of June 30	2005 Cumulative Results of Operations	2005 Unexpended Appropriations	2004 Cumulative Results of Operations	2004 Unexpended Appropriations
1. Prior Period Adjustments Increases (Decreases) to Net Position				
A. Changes in Accounting Standards	$ 0.00	$ 0.00	$ 0.00	$ 0.00
B. Errors and Omissions in Prior Year Accounting Reports	0.00	0.00	11,604,540,255.62	25,913,749,160.94
C. Other Prior Period Adjustments	0.00	0.00	(26,958,464,225.73)	0.00
D. Total Prior Period Adjustments	$ 0.00	$ 0.00	$ (15,353,923,970.11)	$ 25,913,749,160.94
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	$ 1,169,986,665.60	$ 0.00	$ 1,225,360,063.39	$ 0.00
B. Civilian Health	1,828,648,806.32	0.00	1,685,112,180.50	0.00
C. Civilian Life Insurance	17,010,564.06	0.00	15,917,339.85	0.00
D. Judgment Fund	329,071,840.05	0.00	126,047,494.11	0.00
E. Intra-Entity	0.00	0.00	0.00	0.00
F. Total Imputed Financing	$ 3,344,717,876.03	$ 0.00	$ 3,052,437,077.85	$ 0.00

Imputed Financing

The amounts the Department of Defense remits 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 (FEHB) program, and the Federal Employees' Group Life Insurance (FEGLI) 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 employees and the Agency's contributions for them. The OPM provides cost factors for the computation of imputed financing costs, and their inclusion in the Department's financial statements.

Fluctuations

Cumulative Results of Operations

Other Adjustments decreased $7.7 billion due to the correct reporting of funds transferred to the Army from the Executive Office of the President for the Army Iraqi Relief and Reconstruction Fund. These transfers are correctly reported as Budgetary Financing Sources, Transfers-in/out Without Reimbursement. At 3rd quarter FY 2004, these transfers were incorrectly reported as Other Financing Sources. This reporting error was corrected at 4th quarter FY 2004.

Budgetary Financing Sources, Nonexchange Revenue increased $589.6 million. The increase is primarily due to the collection of taxes and interest for the Harbor Maintenance Trust Fund and Inland Waterways Trust Fund.

Donations and forfeitures of cash and cash equivalents increased by $22.5 million. The increase is attributable to donations made to the Navy and Other Defense Organizations.

Budgetary Financing Sources, Transfers-in/out Without Reimbursement increased $2.7 billion primarily due to the transfer-in of funds from the Executive Office of the President for the Iraqi Relief and Reconstruction Fund.

Budgetary Financing Sources, Other Budgetary Financing Sources decreased $9.6 billion. The decrease is primarily due to adjustments to bring the proprietary accounts into agreement with the budgetary accounts. Due to system deficiencies, there are unreconciled differences between the budgetary and proprietary trial balances. The net of these adjustments are reflected in Other Budgetary Financing Sources on the Statement of Changes in Net Position.

Other Financing Sources, Transfers-in/out Without Reimbursement decreased by $2.8 billion. The variance is attributable to a transfer in of an actuarial liability from the U.S. Coast Guard that was recognized by the Medicare-Eligible Retiree Health Care Fund in 1st Quarter, FY 2004.

Other Financing Sources, Other increased by $350.0 million largely due to the gain recognized from the revaluation of fuels inventory by the Defense Logistics Agency.

Unexpended Appropriations

The $36.2 billion increase in appropriations received results primarily from:

- An increase of approximately $24.3 billion in appropriations received in the FY 2005 Appropriations Act.
- A net increase in supplemental appropriations received of $9.7 billion in FY 2005 as compared to FY 2004. During 3rd quarter 2005, the Department received $75.9 billion in supplemental appropriations to support the Global War on Terror and the tsunami relief effort.

Other Disclosures

There is a difference of $70.3 billion between Appropriations Received that are reported on the Statement of Changes in Net Position ($523.0 billion) and Appropriations Received in the Statement of Budgetary Resources ($593.3 billion). Trust Funds are reported in the Statement of Budgetary Resources but not in the Statement of Changes in Net Position.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of June 30	2005	2004
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 282,692,247,902.18	$ 252,503,360,288.21
2. Available Borrowing and Contract Authority at the End of the Period	46,818,705,494.60	39,046,761,276.29

The Net Amount of Budgetary Resources Obligated for Undelivered Orders increased $30.1 billion (12 percent). The Army General Fund and Army Working Capital Fund accounted for the majority of this increase. The large increase for Army General Fund is primarily due to the increase in appropriations received for the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief. Undelivered Orders increased significantly for Army Working Capital Fund due to the increased demand in support of the contingency missions Operations Enduring Freedom, Iraqi Freedom, and Noble Eagle.

Available Borrowing and Contract Authority at the end of the period increased $7.8 billion (20 percent). The Defense Logistics Agency and the Air Force Working Capital Funds account for this increase. This fluctuation was primarily attributable to increased reimbursable activity in support of the following contingency missions: Operations Enduring Freedom, Iraqi Freedom, and Noble Eagle and to the increased authority available to incur obligations for Foreign Military Sales administrative expenses.

The Budgetary Financing, Budgetary Resources section of Statement of Budgetary Resources (SBR) reflects an increase of $101.9 billion (10 percent). The changes were primarily due to increased funding provided for Operations Enduring Freedom, Iraqi Freedom, Noble Eagle, the Global War on Terror, and Tsunami Relief.

The Nonbudgetary Financing section of the SBR reflects a decrease of $68.1 million (42 percent). This section of the SBR reports activity for the Military Housing Privatization Initiative (MHPI). The fluctuation was primarily due to decreased borrowing authority and decreased loan activity in the MHPI.

Permanent Indefinite Appropriations

The Department of Defense received the following permanent indefinite appropriations:

- Department of the Army General Gift Fund (10 USC 2601(b)(1))
- Department of the Navy General Gift Fund (10 USC 2601(b)(2))
- Department of the Air Force General Gift Fund (10 USC 2601 (b)(3))
- Foreign National Employees Separation Pay Account, Defense (10 USC 1581)
- United States Naval Academy Gift and Museum Fund (10 USC 6973-4)
- Ship Stores Profits, Navy (10 USC 7220, 31 USC 1321)
- Midshipmen's Store (10 USC 2665)
- Burdensharing Contributions Account (10 USC 2350j)
- Forest Program (10 USC 2665)
- Department of Defense Base Closure Account (BRAC 10 USC 2687 note)
- Medicare Eligible Retiree Health Care Fund (10 USC 1111)
- Military Retirement Fund (10 USC 1461)
- Education Benefits Fund (10 USC 2006)
- Reserve Mobilization Income Insurance Fund (RII) (10 USC 12528)
- Host Nation Support for U.S. Relocation Activities (10 USC 2350k)
- National Defense Sealift Fund (10 USC 2218)
- Environmental Restoration, Navy (10 USC 2702)
- Hydraulic Mining Debris Reservoir (33 USC 683)
- Maintenance and Operation of Dams and Other Improvements of Navigable Waters (16 USC 810(a))
- Payments to States (33 USC 701c-3)
- Wildlife Conservation (16 USC 670-670f)
- Ainsworth Bequest (IAW 31 USC 1321)

Reconciliation Differences

There is a difference of $25.4 billion between undelivered orders (UDOs) reported on line 1 in the table above ($282.7 billion) and the amount of UDOs on the SBR ($257.3 billion). This difference is primarily attributable to the process of reporting UDOs with advances. Line 1 reports UDOs with advances, but the SBR does not. Both lines include upward and downward adjustments of prior-year UDOs. In addition, the SBR reports transferred obligations for UDOs without advances, but line 1 in the table above does not.

There is a difference of $2.6 billion between the contract and borrowing authority reported on line 2 in the table above ($46.8 billion) and the amount reported for Available Borrowing and Contract Authority on the SBR ($44.2 billion). Line 2 reports current-year activity as well as carry-forward amounts for both categories of authority. The SBR only reports current-year activity for these categories.

The Department of Treasury issues annual warrants to pay amortized payments for the unfunded actuarial liabilities of the Military Retirement Fund (MRF). This amount is credited and expended from the Other Defense Organizations - General Funds to the MRF in accordance with the Office of Management and Budget (OMB) guidance. As a result, unfunded actuarial liabilities are duplicated within the DoD financial statements. The OMB is aware and approves of this duplicate reporting.

The Medicare-Eligible Retiree Health Care Fund, MRF, Education Benefits Fund, and the Voluntary Separation Incentive Program report Appropriations Received for contributions paid by the Army, Navy, and Air Force. These Military Departments also include these amounts in Appropriations Received. As a result, these amounts are duplicated within the DoD financial statements.

Intraentity Transactions

The SBR includes intraentity transactions because the statements are presented as combined and combining.

Direct Obligations – Apportionment Categories

Reporting Entity	Category A ($millions)	Category B ($millions)	Exempt from Apportionment ($millions)	Totals ($million)
Army General Fund	$135,773.5	$688.4		$136,461.9
Navy General Fund - see disclosure	110,112.4			110,112.4
Air Force General Fund	31,654.1	40,230.5	$1.2	71,885.8
US Army Corps of Engineers	4,212.9		20.4	4,233.3
Military Retirement Fund	29,186.7			29,186.7
Medicare-Eligible Retiree Health Care Fund	5,425.8			5,425.8
Other Defense Organizations – General Fund	94,200.2	609.6		94,809.7
Other Defense Organizations – Working Capital Fund	884.8			884.8
Totals	$411,450.4	$41,528.5	$21.6	$453,000.4

Reimbursable Obligations – Apportionment Categories

Reporting Entity	Category A ($millions)	Category B ($millions)	Exempt from Apportionment ($millions)	Totals ($millions)
Army General Fund		$13,978.1		$13,978.1
Navy General Fund - see disclosure	$9,726.5			9,726.5
Air Force General Fund	25,236.0	3,074.2		28,310.2
Army Working Capital Fund		9,215.3	$3,657.8	12,873.1
Navy Working Capital Fund		17,616.1		17,616.1
Air Force Working Capital Fund		11,319.4		11,319.4
US Army Corps of Engineers	4,737.0		1.0	4,738.0
Other Defense Organizations – General Fund	5,027.9			5,027.9
Other Defense Organizations – Working Capital Fund	41,718.2			41,718.2
Totals	$86,445.6	$55,203.1	$3,658.8	$145,307.5

Due to system limitations, the Navy General Fund could not categorize obligations. Therefore, all of Navy's direct and reimbursable obligations are reported in the above table as Category "A."

NOTE:
1. Category "A" relates to appropriations for a specific period of time (e.g., Military Personnel appropriation).
2. Category "B" relates to appropriations for a specific project (e.g., Military Construction appropriation).

Note 21. Disclosures Related to the Statement of Financing

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

Resources That Finance the Acquisition of Assets	$ 9,796.8 million
Other Components Not Requiring or Generating Resources	$ 410.7 million
Revaluation of Assets or Liabilities	$ 355.7 million
Statement of Net Cost*	$ 2.8 million

*The U.S. Army Corps of Engineers adjusted the Statement of Net Cost instead of the Statement of Financing.

The Statement of Financing is a combined statement, budgetary accounts cannot be eliminated.

Offsetting Receipts increased $7.8 billion due primarily to increases in contributions to the Military Retirement Fund and the Medicare-Eligible Retiree Health Care Fund.

Transfers In/Out Without Reimbursement decreased by $2.8 billion due primarily to the reduction of transfers in from other federal agencies. In FY 2004, the U.S. Coast Guard transferred $2.8 billion to the Medicare-Eligible Retiree Health Care Fund, which completed the U.S. Coast Guard liability transfer. There were no Coast Guard transfers in FY 2005. This $2.8 billion transaction also impacts Resources That Fund Expenses Recognized in Prior Period and Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations – Other. The latter is primarily an offset to Transfers-In/Out without Reimbursement.

Imputed Financing from Costs Absorbed by Others increased $883.2 million due primarily to an increase in the cost factor for health care computed by the Office of Personnel Management.

Other Resources – Other decreased by $350.0 million primarily due to an Army Working Capital Fund correction to report inventory gains and losses as part of Revaluation of Assets or Liabilities and a Defense Logistics Agency change in accounting for non-exchange transactions.

Resources That Fund Expenses Recognized in Prior Period relates to the reduction in the estimates for unfunded liabilities. The $1.5 billion decrease in unfunded liabilities is due primarily to the reduction in environmental liabilities by the Air Force and the Army. For further disclosure on environmental liabilities see Note 14.

Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations increased by $1.4 billion due primarily to a change in reporting procedures. Previously, offsetting receipts for special funds were recorded as non-exchange revenue as required by Treasury.

Components Requiring Resources in Future Periods – Other consists of unfunded expenses relating to contingent liabilities, actuarial and other unfunded employment-related liabilities. The cumulative total of unfunded expenses from all fiscal years is reported as "Liabilities Not Covered by Budgetary Resources" in Note 11.

Components Not Requiring Resources in Future Periods – Other consists of expenses not requiring budgetary resources reported by the Department of the Army for the Iraqi Relief and Reconstruction Fund; adjustments to bring the Statement of Financing into balance with the Statement of Net Cost; Navy's efforts to normalize levels and continue support of the war on terrorism, price adjustment, and gains and losses in physical inventory, which caused a $3.5 billion decrease in operating materials and supplies used; and depreciation expense related to assets transferred from operating materials and supplies inventory to property, plant and equipment, and other corrections made by Air Force, which caused a $13.3 billion increase in "Other."

Note 22. Disclosures Related to the Statement of Custodial Activity

The Statement of Custodial Activity displays current year collections and disbursements for three custodial accounts: Foreign Military Sales, Development Fund for Iraq, and Seized Assets. Funds held in a custodial activity are only used for the stated purposes and are not available for the Department's use.

Foreign Military Sales (FMS)

Current year Deposits by Foreign Governments into the FMS Trust Fund are $7.2 billion and disbursements on Behalf of Foreign Governments and International Organizations equal $8.1 billion.

Under authority of the Arms Export and Control Act, the FMS Trust Fund receives collections from foreign governments that are dedicated specifically to FMS purchases. Funds collected into the Trust Fund are in advance of the performance of services or sale of articles. These advance collections constitute a fiduciary relationship with the countries.

FMS neither recognizes nor reports revenue. The only exception is cost clearing accounts, which are reflected in all other principle financial statements. Since various DoD Components actually perform the services and sell the articles, recognition of revenue and expense occurs in the financial statements of the applicable DoD Components.

Development Fund for Iraq (DFI)

The DFI is for urgent humanitarian assistance, reconstruction, and other projects carried out for the benefit of the Iraqi people. Current year deposits from the Interim Iraqi Government transferred to the Multi-National Force-Iraq are $136.0 million and there have been $61.8 million in disbursements.

(Amounts in millions)	**During FY 2005**	**Cumulative from Inception**
Source of Collections		
Deposits By Foreign Governments	136.0	136.0
Disposition of Collections		
Electric Sector	11.8	11.8
Water Resources and Sanitation	2.1	2.1
Transportation and Telecommunications	3.1	3.1
Roads, Bridges and Construction	.9	.9
Health Care	2.2	2.2
Private Sector Development	.4	.4
Education, Refugees, Human Rights, and Governance	41.3	41.3
Total Disbursed on Behalf of Foreign Governments	61.8	61.8
Retained for Future Support of Foreign Governments (see note)	74.2	74.2
Total Disposition of Collections	$136.0	$136.0
Net Custodial Collection Activity	$ 0	$ 0

Note – Reported on Statement of Custodial Activity under Disposition of Collections, Increase (Decrease) in Amounts to be Transferred.

Seized Assets

During Operation Iraqi Freedom, the U.S. Government seized assets from the former Iraqi Government that are used in support of the Iraqi people. As of June 30, 2005, $77.4 million of seized monetary assets remain to be disbursed in support of the Iraqi people as shown in the table below.

	(Amount in millions) During FY 2005	Cumulative from Inception
Source of Collections		
Seized Iraqi Cash	$ 0.0	$ 927.2
Disposition of Collections		
Iraqi Salaries	$ 0.0	$ 30.8
Repair/Reconstruction/Humanitarian Assistance	35.4	479.0
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	.7	264.7
Fuel/Supplies	0	75.3
Total Disbursed on Behalf of Iraqi People	$ 36.1	$ 849.8
Retained for Future Support of the Iraqi People	(36.1)	77.4
Total Disposition of Collections	$ 0.0	$ 927.2
Net Custodial Collection Activity	$ 0.0	$ 0.0

Other Disclosures

The Statement of Custodial Activity should balance to zero, but did not in 3th Quarter FY 2004 primarily due to a report mapping error that was corrected before 4th Quarter FY 2004.

Note 23. Other Disclosures

As of June 30	2005			
1. ENTITY AS LESSEE- Operating Leases				
Future Payments Due	Land and Buildings	Equipment	Other	Total
Fiscal Year				
2005	$ 122,188,930.92	$ 41,702.22	$ 130,279,920.00	$ 252,510,553.14
2006	181,981,655.48	0.00	132,880,708.00	314,862,363.48
2007	175,128,537.91	0.00	135,538,322.00	310,666,859.91
2008	193,540,406.31	0.00	138,249,089.00	331,789,495.31
2009	208,412,140.02	0.00	141,014,071.00	349,426,211.02
After 5 Years	179,911,372.49	0.00	143,834,352.00	323,745,724.49
Total Future Lease Payments Due	$ 1,061,163,043.13	$ 41,702.22	$ 821,796,462.00	$ 1,883,001,207.35

This note has been modified this quarter. It now displays the remaining period of the current fiscal year as a Future Payment Due and it no longer presents the Prior Fiscal Year's projected lease payments to the corresponding Current Fiscal Year. In accomplishing these changes, the data presented does not have prior year data for comparison.

Land and Buildings:

Air Force leases of Land and Buildings, which totaled $74.1 million, comprised 60 percent of this category.

The Air Force leased an additional 375 housing units at U.S. Air Force – Europe and 13 housing units for trainers and recruiters at the Air Education and Training Command. Working in conjunction with its military counterparts, the Department of Defense, Office of the Secretary of Defense for Acquisition, Technology and Logistics – Housing Directorate revised (for the first time since 1988) factors used to calculate foreign currency exchange per U.S.C. Title X, Sec. 2828: Domestic and Foreign Leases. Due to anticipated unfavorable changes in the exchange rates between the US dollar and foreign currencies, the Air Force expects increases in fiscal years 2006 through 2009.

The Department of Navy comprises 16 percent of the value of Land and Building leases totaling $19.5 million.

The Defense Finance and Accounting Service (DFAS) comprises 6 percent, $7.2 million, of the total Land and Building leases. All DFAS leases are operating leases for rent, where DFAS is the lessee.

The remainder of the Operating Leases represents the renting of office space for the rest of the Department of Defense.

Other

The Air Force General Fund comprises the majority of the overall lease costs for Other Leases, $130.3 million.