United States Air Force

Annual Financial Statement

2005

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Annual Financial Statements

Financing the Fight

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SECRETARY OF THE AIR FORCE
WASHINGTON DC

October 2005

Message from the
Acting Secretary of the Air Force

I am pleased and proud to report that in Fiscal Year 2005 the Airmen of the United States Air Force responded with excellence to the many challenges our nation faces. Whether in the Global War on Terrorism, in defending our homeland, in humanitarian and peacekeeping operations, or in ensuring the readiness of the world's greatest air and space power, the nation's Airmen were magnificent.

FY2005 saw almost 31,000 Airmen deployed to Southwest Asia, where they continue to fly more than 200 sorties a day over Iraq and Afghanistan. Our Airmen are part of a cohesive team, integral to the joint and combined forces taking the fight to those who threaten democracy. In addition to Operations IRAQI FREEDOM and ENDURING FREEDOM, they also continue to protect the nation as part of Operation NOBLE EAGLE.

The nation can be equally proud of our Air Force response to other global events. Within hours of Southeast Asia's terrible tsunami, Air Force aircraft and Airmen were enroute to the region, with supplies and skilled expertise at the ready for delivery to the most hard hit and remote regions of Asia. Within days, our Airmen delivered over 120 tons of relief supplies using the full range of Air Force assets from heavy airlifters to agile helicopters.

In the first two weeks after hurricane Katrina devastated the Gulf Coast, the Air Force flew thousands of relief missions and guaranteed air access to New Orleans and Keesler AFB near Biloxi, MS. Air Force rescue missions saved thousands of stranded victims, evacuated thousands of the injured and even flew mosquito eradication missions to stem the spread of disease.

A key enabler of these Air Force efforts and services remains our financial management team, proud stewards of the country's resources, confidently entrusted with our Air Force finances. In addition to improving daily services to our Airmen, they continue implementing the FY05-10 Air Force Financial Management Strategic Plan. The Plan provides strategic vision, improved support to our warfighters, and better information reliability, integration and visibility in our financial management.

These financial statements illustrate the success of the Air Force over the past year, as well as specific financial management accomplishments. The publication of our financial statements complies with a requirement of the Chief Financial Officers Act, and the financial information addresses both our General Fund and Working Capital Fund activities.

The service of our financial managers has been nothing short of outstanding. Rest assured, their innovation, dedication and professionalism will remain the bedrock for Air Force capabilities long into the future. They are "financing the fight," and providing stellar contributions to America's air and space power.

Peter Geren

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

October 2005

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

I share with tremendous pride the sentiments expressed by the Secretary in our Air Force financial management professionals. In Fiscal Year 2005, we continued our support to ongoing Global War on Terrorism operations throughout the world and provided critical financial management contributions to Indian Ocean tsunami and Gulf Coast hurricane relief efforts. Indeed, our Air Force financial team was chosen to lead DoD's accounting effort for hurricane Katrina. We do all this--and more, while we continue to maintain top-quality financial services for our Airmen at home and around the globe.

Financial management plays a key role in fulfilling the Air Force mission. This in turn is made possible by the implementation of our Air Force Financial Management Strategic Plan. The Plan calls for five goals to bring the Financial Management Vision into clear focus:

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

Our financial management team members are accomplishing these goals that stress accountability, visibility and the highest-quality management skills available anywhere. This is our highest priority. We are financing the world's finest air and space power.

The FY2005 Air Force Financial Statement reflects the wise investment America has made in our Air Force. It includes a Management Discussion and Analysis section that more precisely illuminates Air Force efforts and contributions. It fulfills the requirements of the Chief Financial Officers Act, documents the expenditures devoted to our General Fund and Working Capital Fund, and reviews performance measures established as part of the Government Performance and Results Act.

America's Air Force has the obligation to be good stewards of the national resources entrusted us. Air Force financial management professionals have met that obligation, and will continue to do so, as we proudly persevere in "financing the fight!"


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Management Discussion and Analysis

Air Force in Action

America can be justly proud of the performance of the Air Force in FY2005. Air Force operations in IRAQI FREEDOM and ENDURING FREEDOM showed that America's airpower is capable 24/7 and worldwide. In continuing the global war on terror, America's Airmen continued to successfully fly over 200 sorties per day. Airmen also contributed on the ground, calling in air support and evacuating the wounded with bravery and professionalism.

Also as part of the global war on terror, Airmen continued to defend the homeland in Operation NOBLE EAGLE. This vigilant force, requiring readiness and extraordinary aviation response, stands ready as always to defend the skies of the United States. In FY2005, Airmen did indeed respond to potential threats. Fortunately, none of these threats came to fruition, but this effort serves as an example of coordination between all components of the Air Force—Active, Reserve and Air National Guard—and civilian authorities.

Combat and defensive operations were not the only contribution of the Air Force. As the Secretary of the Air Force has noted, in the wake of the tsunami in Southeast Asia, the Air Force responded with humanitarian aid within hours and delivered hundreds of tons of relief supplies within days. Thus the great capability America has given our dedicated Airmen was turned into lifesaving support for others.

Air Force humanitarian operations continued in both preparation for and in response to the Gulf hurricanes. Search and rescue, recovery, airlift, and aeromedical evacuation missions were generated from Air Force bases nationwide, flying in vital supplies. Airmen flew and supported more than 4,000 missions, rescued almost 5,000 victims and transported more than 3,000 patients in need of care. On the ground, Airmen not only operated off damaged runways and airfields, but also erected shelters to house relief personnel. As in Air Force support to tsunami victims, the Air Force worked as a joint team with

other services and federal assets in everything from elite helicopter-borne pararescue, to airlift, to civil engineering.

The Air Force also advanced America's air and space capabilities in FY2005. To name but a few examples: B-2 bomber crews not only supported ongoing operations, but demonstrated the ability to engage 80 targets in one pass; C-17 crews continued to show the ability to support operations from remote bases; in space, increased coordination led to better surveillance.

All of this was underpinned by Air Force financial management professionals. Guided by the Air Force Financial Management Strategic Plan, they have stressed three themes: Warfighter Support, Strategic Resourcing and Cost Management, and Information Reliability and Integration. They have been extraordinarily successful in fulfilling the needs of global Air Force operations and America's Airmen, and are indeed "Financing the Fight."

Air Force Organizations

In FY 2005, Air Force active duty members, the Air National Guardsmen, the Air Force Reserve, and Air Force civilians responded to unprecedented challenges with unprecedented performance. Calling upon the Air Force Core Values of "Integrity First—Service Before Self—Excellence In All That We Do," Air Force personnel proved time and time again that they comprise the preeminent air and space power on the planet.

The integrated components of our Air and Space Expeditionary Force were involved in operations including major theater war, homeland security, and humanitarian relief. Air Force personnel and organizations operated with outstanding effectiveness and efficiency, all while constantly preparing to face the challenges of the future.

Major Commands, Direct Reporting Units, Field Operating Agencies

The Air Force is organizationally aligned into nine Major Commands (MAJCOMs, including the Air Force Reserve and Air National Guard), with 13 Field Operating Agencies (FOAs), and four Direct Reporting Units (DRUs).

Major Command (MAJCOM)

A MAJCOM is a major subdivision of the Air Force, directly subordinate to Headquarters US Air Force. MAJCOM headquarters are management headquarters and thus have the full range of functional staff. Examples of MAJCOMs are Air Combat Command (ACC), Air Education and Training Command (AETC), and Air Force Materiel Command (AFMC).

Direct Reporting Unit (DRU)

A DRU is a subdivision of the Air Force, directly subordinate to the Chief of Staff, US Air Force. A DRU performs a mission that does not fit into any of the MAJCOMs. A DRU has many of the same administrative and organizational responsibilities as a MAJCOM. Examples of DRUs are the Air Force Academy (USAFA), the Air Force Studies and Analysis Agency (AFSAA), and the Air Force Operational Test and Evaluation Center (AFOTEC).

Field Operating Agency (FOA)

A FOA is a subdivision of the Air Force, directly subordinate to a Headquarters US Air Force functional manager. A FOA performs field activities beyond the scope of any of the major commands. The activities are specialized or associated with an Air Force-wide mission and do not include functions performed in management headquarters, unless specifically directed by a Department of Defense (DoD) authority. Examples of FOAs are the Air Force Intelligence Analysis Agency (AFIAA), the Air Reserve Personnel Center (ARPC), and the Air Force Services Agency (AFSA).

All of this leads us to proudly present both the Management Discussion and Analysis and the Air Force Financial Statement. This includes both the Air Force General Fund and Working Capital Fund, with details on Air Force stewardship of taxpayer dollars. This includes descriptions of the functional areas these funds support and how they are used to further Air Force capabilities for the nation. This Statement also satisfies provisions of the Chief Financial Officer Act.

General Fund

Quality People/Force Shaping

Throughout FY2005, Air Force personnel have worked to shape our human capital to meet new challenges. After the September 11 attack on our nation, the Air Force moved to a new post-Cold War plateau in manning. Following a brief period of maintaining people on active duty through Stop Loss actions, the Air Force retention among officers and enlisted members climbed higher than it had during the late 1990s. At the same time the Air Force was increasing the pace of deployments under the Air Expeditionary Force (AEF) construct to meet the daily challenges of the Global War on Terrorism (GWOT), we also began a long-term transformation to meet the challenges of applying air and space power in a post-modern world. Force shaping has been the most visible aspect of how the Air Force is reorganizing nearly half a million people to create the force our nation needs.

The Air Force began the fiscal year with a challenge: reduce end strength from 376,500 to fewer than 360,000 by the end of FY2005. Due to aggressive recruiting and retention programs in the late 1990s, and the uncertainty of the early months of the GWOT, the Air Force had more people on active duty than required by law. In addition, we had an imbalance in

skills. Several career fields were over-manned, while others suffered from shortages. The Air Force used a number of tools and programs to begin simultaneously reducing the number of people to meet the end-strength set by Congress and to shift our quality Air Force people to meet our needs.

First, the Air Force relied on voluntary separations through incentives to help reduce the overall number on active duty. For example, it made it easier for officers and enlisted members to move from active duty to the Reserve and Air National Guard under the PALACE CHASE program, and allowed them to move to the Army under the Blue to Green program. The Air Force also provided additional incentives to people eligible to retire, such as reducing from three years to two years the time in grade required for colonels and lieutenant colonels to retire. We also instituted a liberal policy to encourage officers and enlisted members who were not serving in shortage skills to leave if they wanted to. This was done by announcing a policy to waive active duty service commitments incurred for education, recent assignments, and other administrative actions. This allowed Airmen inclined to leave or retire to do so quickly and easily.

The Air Force used a few involuntary separations to meet authorized end-strength. These measures included speeding up the separation of Airmen who had refused Permanent Change of Station orders or required training/retraining, those involved in disciplinary action or coming to the end of an enlistment and those who had declined to re-enlist or extend their service. The Air Force also instituted a more restrictive policy for dealing with Airmen who were unable to complete training schools. Those who could qualify for training and where a genuine Air Force need existed were allowed to stay, while the rest were not allowed to remain as excess on active duty.

After greatly expanding the voluntary separation and retirement opportunities, the Air Force began to reduce the number of Airmen entering active duty. These reductions began in the previous fiscal year and became more pronounced during FY2005. Officer accessions were cut by 335 and enlisted accessions by 16,700. Together, these reductions prevented well over $1 billion of the Air Force budget from being spent to maintain excess personnel.

While the end-strength was coming down, the Air Force was also working to reshape many career fields to correct imbalances. The Career Job Reservation (CJR) program helped rebalance the junior enlisted force as they entered their second enlistment. All Airmen were required to obtain a CJR in one of the 146 Air Force Specialty Codes (AFSCs) in order to re-enlist. In 27 AFSCs that had significant overages, CJRs were limited to the number needed to sustain the career fields at their optimal manning. Airmen from these AFSCs who did not obtain CJRs

had the choice of applying for a CJR in one of the shortage AFSCs or leaving the Air Force. Using this tool helped improve by 17 percent the imbalances in the 27 AFSCs where CJRs constrained the number of people entering a second enlistment.

The Air Force was able to continue to reduce the number of AFSCs receiving Selective Reenlistment Bonuses (SRBs). SRBs are an additional financial incentive for enlisted Airmen with between 17 months and 14 years of service to remain on active duty. The maximum additional payment an Airman can receive for an enlistment through the SRB program is $60,000, but SRBs are set by AFSC on a sliding scale. The average SRB payment to Airmen in FY 2004 was $10,700. In 2004, the Air Force removed 82 AFSCs from the list of those eligible for SRBs, leaving 62 AFSCs eligible. In March 2005, that list was reduced further, leaving only 32 AFSCs with this additional financial incentive to serve. The reduction saved the Air Force $102.7 million.

Together these programs and policies helped the Air Force meet its target end-strength in the summer of 2005 and improve imbalances between many enlisted AFSCs. Unfortunately, it left the force with an overall shortage of enlisted personnel and an excess of officers. The Air Force will continue to devise programs and tools to correct this imbalance in the next fiscal year.

Operational Performance

Air Force Flying Hour Program

The Air Force Flying Hour Program is designed to prepare units to support warfighting commanders. The execution of the President's Budget (PB) Flying Hour Program is impacted by contingency operations support, maintenance issues, fact-of-life impacts, aircraft flight operations suspensions, aircraft delivery delays, weapons system retirements, and approved program changes. Though the execution of the Flying Hour Program does not define unit readiness, it can be a forward indicator of possible readiness issues.

The Major Commands (MAJCOMs) determine the reasons for execution deviation and required course of action. These evaluations provide insight to possible future year requirements.

As of 31 May 2005, the Air Force executed 67.0 percent of the PB Flying Hour Program and will fulfill the authorized amount for FY2005. Flying Hour Program execution hours include active Air Force Congressionally funded O&M hours. They do not include incrementally funded contingency support hours, Transportation Working Capital Fund hours, foreign nation reimbursable training hours, Special Operations hours, or Research, Development, Test, and Evaluation (RDT&E).

Weapon System Performance Metrics

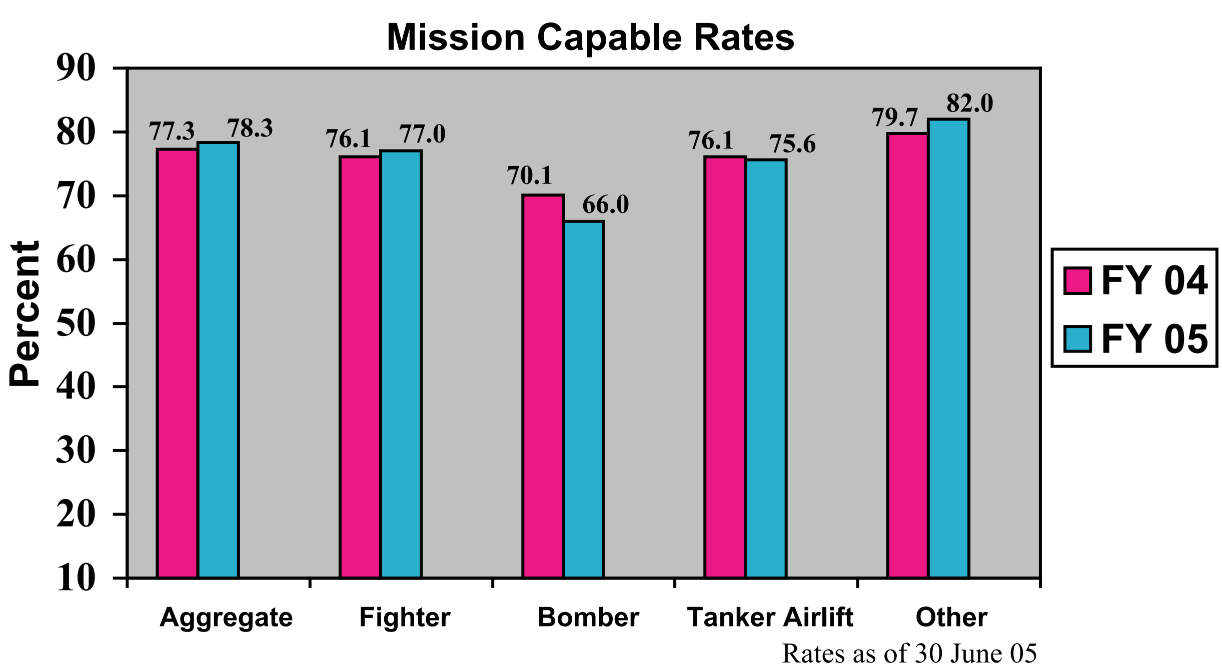
The Air Force uses a variety of metrics to gauge the performance of its weapon systems and organizations. They are barometers for measuring the effectiveness of our organizational structures, our training, manpower and equipment levels, quality of spare parts, maintenance actions, and a variety of other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

Mission Capable Rates

Mission Capable (MC) rates are perhaps the best known yardstick for measuring the readiness of Air Force aircraft. MC rates reflect the percentage of aircraft, by fleet, capable of performing at least one of their assigned missions. The FY2005 aggregate MC rate as of 30 June 05 is 78.3 percent, an increase from the FY2004 rate of 77.3 percent, and is based on a combined MC rate of A/O-10, B-1, B-2, B-52, C-130, C-141, C-5, C-17, E-3, E-8, F-15, F-15E, F-16, F-117, HC-130, KC-10, KC-135, HH-60, RC-135, RQ-1, T-1, T-6, T-37, T-38, and U-2 aircraft. MC rates categorized into Fighter, Bomber, Tanker/Airlift, and Other are drawn from the aggregate fleet above.

Non-Mission Capable Rates

Total Non-Mission Capable for Maintenance (TNMCM) is a measure of a maintenance organization's ability to fix aircraft quickly and accurately and Total Non-Mission Capable for Supply (TNMCS) measures spare parts availability. The FY2005 aggregate fleet TNMCM rate, as of 30 June 05, decreased from 18.9 percent to 18.2 percent. The FY2005 TNMCS rate as of 30 June 05 decreased from 8.9 percent to 8.2 percent representing the sixth consecutive year of improving supply rates, and the lowest TNMCS rate since FY1994.



Other Key Metrics

Air Force weapon system performance measures for FY2005 provide a snap-shot of the tremendous efforts of the logistics community to provide and support combat-capable forces that are organized, trained and equipped to provide efficient and effective combat and combat support efforts across the full spectrum of military operations.

Cannibalization (CANN) rates reflect the number of cannibalization actions that occur per 100 sorties for a particular weapon system. The FY2005 aggregate rate of 4.2 CANN's per 100 sorties, as of 30 June 05, is a decrease from the FY2004 rate of 4.6, and represents the lowest CANN rate since FY1994.

Engine Non-Mission Capable-Supply (ENMCS) rate for all Air Force engines improved as the rate dropped to 5 percent, the lowest rate in the past seven years. ENMCS for Fighter and Tanker/Airlift fleets improved over FY2004 rates, while Bomber fleet ENMCS increased. Engine-time-on-wing (ETOW) rates declined 1.2 percent for Fighter, Bomber, and Tanker/Airlift fleets. Investments in engine modifications, spare parts, and reliability centered maintenance has continued to pay *quality* dividends for our engine fleet throughout FY2005.

Aircraft MC rates are but one indicator of enhanced weapon system readiness. Programmed depot maintenance and fleet modernization activities are critical to maintaining mission-ready aircraft. The Air Force strives to make continual improvements in business practices designed to increase the efficiency and effectiveness of our depot maintenance programs. As of 31 May 05, the total number of aircraft in depot for FY2005 was 431, continuing the downward trend in depot-possessed aircraft.

Financing the Fight

Financial Management Transformation

Air Force Financial Management (FM) envisions an Air Force operating at peak effectiveness and efficiency with every dollar striking the correct balance among supporting the mission, maintaining the infrastructure, and taking care of our people. We will achieve that

vision by providing Air Force leaders with accurate, relevant, and timely information to make the right strategic choices while making existing operations more effective and efficient. In addition, we see Airmen resolving pay issues without a trip to the Finance Office, but retaining access to face-to-face support when needed.

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

The strategic goals outlined in the plan are:

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

Translating these goals into strategy led to three distinct strategic themes:

Warfighter Support: We will remain an expeditionary-focused workforce trained and prepared to support deployed forces.

Strategic Resourcing and Cost Management: We will link strategy to measurable improvements in effectiveness and efficiency.

Information Reliability and Integration: We will provide relevant, timely, accurate, and reliable information to support decision-making.

Transformation is our catalyst to achieving the FM vision. In 2005, through our FM operational framework, we've begun enacting our Six Lanes of Transformation:

- **Financial Services Transformation** aims to create a shared services organization with a Central Processing Center (CPC) to handle back-office customer support and a Contact Center to interface with our customers. The goal is to create a 3-tier customer service concept to include online services, a contact center, and face-to-face support.
- **Financial Advisor Transformation** will provide enhanced decision support and financial advice to commanders. This includes realigning resources to provide enhanced budget, cost, and accounting financial services to the unit and developing a new position, Enhanced Financial Advisor, to serve as the commander's right-hand person on all resource issues.
- **O&M Center of Expertise Transformation** establishes a Center of Expertise that can provide expert on-demand, specialized decision support and financial analysis for privatization, activity-based costing, and economic analysis. It returns an O&M cost capability to the base.
- **Combat Comptroller Transformation** enhances how the 21st century FM community prepares and deploys to support the warfighter.
- **Education, Training and Development Transformation** builds the right FM training construct for the future and supports all other lanes of transformation. The team is focused on enduring competencies needed in a post transformation environment and on time technical training for the effort's major phases.
- **Re-engineering the Air Force Budget processes** redesigns the current Air Staff O&M budget process within Air Force Financial Management.

Transformation accomplishments in FY2005 have included:

- Financial Services team produced the high-level design of the CPC. The Financial Advisor team realigned existing Accounting Liaison functions and personnel with base-level Financial Analysis to set the stage for the next step in their project, developing the Enhanced Financial Advisor.

- In October 2005, the O&M Center of Expertise team stood up the Air Force Center of Expertise with an initial cadre of experts.

- Combat Comptroller team has finished initial design work on the new Combat Comptroller Contingency Organization, which will consolidate numerous duties related to how FM meets its deployment obligations.

- Education, Training, and Development (Tools) team is exploring exciting collaborative opportunities to enhance deployable processes with Contracting personnel.

Our transformation efforts haven't stopped there:

- Financial Services team is currently working to determine who will deliver financial shared services (CPC and Contact Center) and how those services will be delivered in concert with Air Force Personnel offices. They have already developed a number of options and are zeroing in on the best.

- Financial Advisor team is building detailed job descriptions for Enhanced Financial Advisors.

- O&M Center of Expertise team will continue to increase the size and capability of their center during the next few years, reaching full operational capability in FY2008.

- Combat Comptroller team is currently examining a number of innovative initiatives and hardware to facilitate transformation, such as hand-held equipment to automate the time-consuming paper work frequently required in deployed environments.

Working Capital Fund

Air Force Materiel Command (AFMC) supports Air Force warfighters and operations via four major business areas that operate as revolving funds (i.e.,

providers charge users for the goods and services provided). AFMC accounts for more than 95 percent of Working Capital Fund (WCF) revenue and expense activity (excluding the Transportation Working Capital Fund, which is managed by the United States Transportation Command). The WCF consists of three functions: Supply Management, Depot Maintenance, and Information Services. These functions, referred to as activity groups, supply singular goods and services to Air Force and Department of Defense (DoD) customers. Supply Management provides managers expedited repair, replenishment, and inventory control for spare parts and associated logistics support services to fulfill Air Force needs during war and peacetime. Depot Maintenance provides economical and responsive repair, overhaul, and modification of aircraft, missiles, engines, other major end items, and their associated components. The Information Services business area provides for the maintenance and development of automated information systems for information-related activities of the Air Force and DoD, along with certain other government agencies.

WCFs allow the Air Force to accomplish the following:

- Ensure readiness through reduced support costs, stabilized rates, and customer service.

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

Supply Management Activity Group

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

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

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

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

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

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

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

Customers, Products, and Services

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

SMAG Transformation Initiative

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

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

- Weapon System Supply Chain Management (WS SCM) is a customer-facing initiative aimed at balancing Air Force and AFMC goals. It addresses process improvements and savings championed by PSCM strategies while retaining ultimate focus on the warfighter through rapid and proactive maneuvers to deliver weapon system support.

- Logistics Enterprise Architecture (LOGEA) is an initiative to develop a single authoritative strategic map of future Logistics business practices, systems, and organizations. It is a single authoritative source which defines operating and systems models, aligns business and IT initiatives, and provides a vehicle to ensure transformation coordination across the Air Force and outside the Air Force.

- Advanced Planning System (APS) is improving the process of translating warfighter needs into executable logistics system support plans and schedules. By emphasizing collaboration with customers and suppliers, it seeks to optimize activities and resources across the Air Force supply chain.

Customer Support Performance Measures

MICAP and Customer Wait Time (CWT) allow managers to assess quality of spares support provided and plan corrective action when needed. MICAP is defined as the status of a weapon system as determined by its ability to accomplish its assigned mission. MICAP hours are accrued in a given month for items affecting mission capability that are on backorder to an AFMC source of supply. For every day during the month the requisition is unfilled, 24 hours are assigned to the requisition. CWT measures the average time elapsed between customer order and satisfaction of that order, including the wait time between the retail supply issue or backorder from the source of supply, and the delivery to the base customer, expressed in days.

MICAP hours and CWT have improved significantly since 1999. These improvements continue to have a direct impact on the warfighter's ability to meet worldwide missions.

Financial Performance Measures

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

effectively offset the prior year net profit or loss accomplishes this objective. Revenues are amounts earned as a result of normal operations and usually result from sale of, or reimbursements for, goods and services provided to DoD activities, other federal government agencies and the public. Expenses are the use of resources during an accounting period in carrying out the DoD's mission. They occur from rendering services, delivering or producing goods, or carrying out other mission related activities.

Depot Maintenance Activity Group

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

Customers, Products and Services

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

The DMAG supports a variety of customers including the Air Force Major Commands, Air National Guard (ANG), Air Force Reserve Command (AFRC), SMAG, Foreign Military Sales, and non-DoD customers. Additionally, the DMAG provides storage, reclamation, and regeneration for equipment not currently used by the active forces of all military services. This work is done at the Aerospace Maintenance and Regeneration Center at Davis-Monthan AFB, Arizona. Contract depot maintenance is transitioning from the Air Force Working Capital Fund (WCF) to be financed directly by the using commands, the Supply Management Activity Group, and other customers. DMAG plans to stop accepting new contract orders for FY2007 and out. However, DMAG will fulfill all previous contracts.

The DMAG has two principal objectives. The first objective is to provide organic depot repair capability for fielded and emerging weapon systems, so that warfighters have mission-essential equipment. Secondly, DMAG's intent is to ensure the ability to rapidly respond to those warfighter requirements driven by contingency operations. To accomplish this, short- and long-term strategies must be used. The depot maintenance strategic plan guides the DMAG to have the right workload capacity and capability to meet depot maintenance; (a) peacetime support, (b) surge, and (c) core requirements. To better support the services that DMAG provides to its customers, an integrated suite of systems, Depot Maintenance Accounting and Production Systems (DMAPS), provides improved financial, production, and material functionality in support of the warfighter's needs for quality organic depot maintenance. This includes improved financial management support/tools and reporting for organic depot maintenance activities, to include substantial compliance with legislative requirements, such as the Chief Financial Officers (CFO) Act.

Transformation Initiatives

The future financial framework being developed through the Air Force logistics transformation effort envisions centrally managed provider (AFMC) and customer (MAJCOMs) funds, utilizing the WCF financing mechanism to enhance cost awareness and provide flexibility. On the provider side, the Material Support

Division (MSD) and DMAG financial management operations will be merged, focusing on cost and output. In this simplified structure, MSD and DMAG will no longer recursively pass costs between each other prior to establishing a price to the ultimate customer.

The Depot Maintenance Reengineering and Transformation (DMRT) initiatives include improvements to the budgeting process. This is to be accomplished in part by using predictive modeling and statistical techniques to develop portions of the budgets. The model will also consider a reduction of manual effort currently required to prepare the workload baseline for the budgets.

Customer Support Performance Measures

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

The Due Date Performance (ability of the depot to produce aircraft according to schedule) improved significantly compared to a year ago and reached 99.4 percent (7 percent above goal) in May of 2005. The depot performance of Air Logistics Centers (ALCs) continues to have a direct impact on the warfighter's ability to meet worldwide missions.

Financial Performance Measures

Financial Performance Indicators assess the financial performance of the DMAG. These indicators are designed to achieve accountability at the appropriate level and also measure compliance with DMAG budget objectives. The budget objectives are identified in each ALC's financial performance plan used to measure results during execution.

Information Services Activity Group

Information Services Activity Group (ISAG) was established to develop and maintain automated information systems for specific Air Force, DoD, and other government agencies and provides technological support, from development of leading-edge technologies to the maintenance and modification of older legacy systems.

Customers, Products, and Services

ISAG provides information products and services via two business lines—the Information Technology (IT) solutions line and the commercial information technology line.

The IT solutions business line develops, acquires, and sustains automated information systems in two target markets: 1) AFMC-level Supply Management and Depot Maintenance information systems, and 2) Air Force-wide, standardized support systems.

The commercial information technology business line provides computer hardware, software, peripheral equipment, and related services to the Department of the Air Force, DoD, and other agencies, and private parties through its Web-based "Virtual Superstore" called "AFWay."

ISAG Transformation Initiatives

In response to changes in Air Force structure and operations, technology, and customer needs, and to take better advantage of industry core competencies, the ISAG is reshaping itself to meet future information technology requirements for the warfighter.

AFMC has initiated an effort to decapitalize the activity by transferring the function to an appropriated environment in FY2006.

Financial Performance Measures

The current method of measuring ISAG performance is determined by the Net Operating Result (revenue minus expenses).

Revenue is earned through the sale of direct billable labor hours at the ISAG composite rate; direct reimbursements for pass-through contract efforts and extraordinary expenses (e.g., mission-unique travel, equipment, and supplies); and the collection of commercial information technology surcharges.

Cost of operations (expenses) measures the resources consumed in filling customer orders. These costs include labor and non-labor expenses, both direct and overhead.

Cash Management

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

Effective cash management is directly dependent on the availability of accurate and timely data on cash levels and operational results. Cash levels should be maintained to cover at least seven to ten days of operational costs as well as cash adequate to meet six months of capital disbursements.

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

Financing the Future Fight

America's Airmen performed brilliantly in FY2005, delivering decisive air supremacy and combat power as well as much needed humanitarian support. Our country can count on our Airmen to continue these and other missions into the future. Our financial management professionals ensure responsible stewardship of our resources. They will be a vital component to both on-going operations and any need required.

Fiscal Year 2005
Annual Financial Statements

Limitations to the Financial Statements

The financial statements have been prepared to report the financial position and results of operations for the entity, pursuant to the requirements of the Title 31, United States Code, Section 3515(b). While the statements have been prepared from the books and records of the entity, in accordance with the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. To the extent possible, the financial statements have been prepared in accordance with federal accounting standards. At times, the Department is unable to implement all elements of the standards due to financial management systems limitations. The Department continues to implement system improvements to address these limitations. There are other instances when the Department's application of the accounting standards is different from the auditor's application of the standards. In those situations, the Department has reviewed the intent of the standard and applied it in a manner that management believes fulfills that intent. The statements should be read with the realization that they are for a component of the United States Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation that provides resources to do so. The Federal Accounting Standards Advisory Board (FASAB) amended the Statement of Federal Financial Accounting Standard No. 6 to require the capitalization and depreciation of military equipment (formerly known as National Defense Property, Plant and Equipment) for fiscal years (FY) 2004 and beyond, and encouraged early implementation. Accordingly, the Department began the process of developing and reporting values for these assets in notes to the Balance Sheet, beginning in FY 2003.

General Fund

Principal Statements

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Consolidated Balance Sheet—General Fund

As of September 30, 2005 and 2004 ($ in Thousands)

	2005 Consolidated	2004 Consolidated
1. ASSETS (Note 2)		
A. Intra-governmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	$ 62,272,967	$ 60,547,709
b. Non-Entity Seized Iraqi Cash	0	0
c. Non-Entity-Other	77,275	53,290
2. Investments (Note 4)	717	711
3. Accounts Receivable (Note 5)	653,589	689,871
4. Other Assets (Note 6)	427,989	443,939
5. Total Intra-governmental Assets	$ 63,432,537	$ 61,735,520
B. Cash and Other Monetary Assets (Note 7)	$ 151,844	$ 311,323
C. Accounts Receivable (Note 5)	1,028,310	978,883
D. Loans Receivable (Note 8)	0	0
E. Inventory and Related Property (Note 9)	47,169,013	51,340,248
F. General Property, Plant and Equipment (Note 10)	123,646,068	117,954,430
G. Investments (Note 4)	0	0
H. Other Assets (Note 6)	11,179,041	10,809,588
2. TOTAL ASSETS	$ 246,606,813	$ 243,129,992
3. LIABILITIES (Note 11)		
A. Intra-governmental:		
1. Accounts Payable (Note 12)	$ 1,651,904	$ 1,900,411
2. Debt (Note 13)	0	0
3. Other Liabilities (Note 15 & Note 16)	1,589,867	1,726,480
4. Total Intra-governmental Liabilities	$ 3,241,771	$ 3,626,891
B. Accounts Payable (Note 12)	$ 5,851,184	$ 7,707,163
C. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,147,437	1,163,442
D. Environmental Liabilities (Note 14)	5,781,322	7,387,187
E. Loan Guarantee Liability (Note 8)	0	0
F. Other Liabilities (Note 15 and Note 16)	4,179,504	4,602,505
4. TOTAL LIABILITIES	$ 20,201,218	$ 24,487,188
5. NET POSITION		
A. Unexpended Appropriations	$ 63,716,637	$ 49,660,670
B. Cumulative Results of Operations	162,688,958	168,982,134
6. TOTAL NET POSITION	$ 226,405,595	$ 218,642,804
7. TOTAL LIABILITIES AND NET POSITION	$ 246,606,813	$ 243,129,992

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

Consolidated Statement of Net Cost—General Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	2005 Consolidated	2004 Consolidated
1. Program Costs		
A. Intra-governmental Gross Costs	$ 29,845,743	$ 28,909,864
B. (Less: Intra-governmental Earned Revenue)	-4,207,648	-5,002,246
C. Intra-governmental Net Costs	$ 25,638,095	$ 23,907,618
D. Gross Costs With the Public	99,536,231	96,505,988
E. (Less: Earned Revenue From the Public)	-879,929	-1,724,336
F. Net Costs With the Public	$ 98,656,302	$ 94,781,652
G. Total Net Cost	$ 124,294,397	$ 118,689,270
2. Cost Not Assigned to Programs	0	0
3. (Less: Earned Revenue Not Attributable to Programs)	0	0
4. Net Cost of Operations	$ 124,294,397	$ 118,689,270

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

Consolidated Statement of Changes in Net Position—General Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	2005 Consolidated	2004 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
1. Beginning Balances	$ 168,982,134	$ 161,327,684
2. Adjustments (+/-)		
2a. Changes in Accounting Principles (+/-)	0	0
2b. Correction of Errors (+/-)	0	0
3. Beginning Balances, as adjusted	168,982,134	161,327,684
4. Budgetary Financing Sources:		
4a. Appropriations received	0	0
4b. Appropriations transferred-in/out (+/-)	0	0
4c. Other adjustments (rescissions, etc) (+/-)	0	0
4d. Appropriations used	114,969,992	124,686,986
4e. Nonexchange revenue	920	8,827
4f. Donations and forfeitures of cash and cash equivalents	1,860	2,171
4g. Transfers-in/out without reimbursement (+/-)	967,200	671,000
4h. Other budgetary financing sources (+/-)	0	0
5. Other Financing Sources:		
5a. Donations and forfeitures of property	0	0
5b. Transfers-in/out without reimbursement (+/-)	-25,648	311,130
5c. Imputed financing from costs absorbed by others	742,039	663,607
5d. Other (+/-)	0	0
6. Total Financing Sources	116,656,363	126,343,721
7. Net Cost of Operations (+/-)	124,294,397	118,689,270
8. Net Change	-7,638,034	7,654,451
9. Ending Balance	$ 161,344,100	$ 168,982,135
UNEXPENDED APPROPRIATIONS		
1. Beginning Balances	$ 49,660,670	$ 50,742,317
2. Prior period adjustments (+/-)		
2a. Changes in Accounting Principles (+/-)	0	0
2b. Correction of Errors (+/-)	0	0
3. Beginning Balances, as adjusted	49,660,670	50,742,317
4. Budgetary Financing Sources:		
4a. Appropriations received	128,888,188	125,480,665
4b. Appropriations transferred-in/out (+/-)	1,631,239	-454,456
4c. Other adjustments (rescissions, etc) (+/-)	-1,493,468	-1,420,870
4d. Appropriations used	-114,969,992	-124,686,986
4e. Nonexchange revenue	0	0
4f. Donations and forfeitures of cash and cash equivalents	0	0
4g. Transfers-in/out without reimbursement (+/-)	0	0
4h. Other budgetary financing sources (+/-)	0	0
5. Other Financing Sources:		
5a. Donations and forfeitures of property	0	0
5b. Transfers-in/out without reimbursement (+/-)	0	0
5c. Imputed financing from costs absorbed by others	0	0
5d. Other (+/-)	0	0
6. Total Financing Sources	14,055,967	-1,081,647
7. Net Cost of Operations (+/-)		
8. Net Change	14,055,967	-1,081,647
9. Ending Balance	$ 63,716,637	$ 49,660,670

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

Combined Statement of Budgetary Resources—General Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

		2005 Combined		2004 Combined
BUDGETARY FINANCING ACCOUNTS				
Budgetary Resources				
1. Budget Authority:				
1a. Appropriations received	$	128,890,968	$	125,483,786
1b. Borrowing authority		0		0
1c. Contract authority		0		0
1d. Net transfers (+/-)		638,153		-29,394
1e. Other		0		0
2. Unobligated balance:				
2a. Beginning of period		9,043,364		9,189,946
2b. Net transfers, actual (+/-)		1,960,286		245,938
2c. Anticipated Transfers Balances		0		0
3. Spending authority from offsetting collections:				
3a. Earned		0		0
1. Collected		8,923,532		8,117,605
2. Receivable from Federal sources		142,948		317,565
3b. Change in unfilled customer orders		0		0
1. Advance received		349,671		188,072
2. Without advance from Federal sources		388,543		-109,981
3c. Anticipated for the rest of year, without advances		0		0
3d. Previously unavailable		0		0
3e. Transfers for trust funds		0		0
3f. Subtotal		9,804,694		8,513,261
4. Recoveries of prior year obligations		1,300,191		1,431,079
5. Temporarily not available pursuant to Public Law		0		0
6. Permanently not available		-1,493,468		-1,437,653
7. Total Budgetary Resources	$	150,144,188	$	143,396,963
STATUS OF BUDGETARY RESOURCES				
8. Obligations incurred:				
8a. Direct	$	124,689,424	$	129,913,273
8b. Reimbursable		12,448,555		4,447,386
8c. Subtotal		137,137,979		134,360,659
9. Unobligated balance:				
9a. Apportioned		11,756,881		8,072,566
9b. Exempt from apportionment		3,218		2,709
9c. Other available		1		-1
10. Unobligated Balances Not Available		1,246,109		961,030
11. Total, Status of Budgetary Resources	$	150,144,188	$	143,396,963
Relationship of Obligations to Outlays:				
12. Obligated Balance, Net - beginning of period	$	51,504,133	$	50,541,583
13. Obligated Balance transferred, net (+/-)		0		0
14. Obligated Balance, Net - end of period:				
14a. Accounts receivable		-1,619,560		-1,476,612
14b. Unfilled customer order from Federal sources		-1,215,937		-827,393
14c. Undelivered orders		42,643,727		42,309,792
14d. Accounts payable		9,197,053		11,505,411
15. Outlays:				
15a. Disbursements		137,805,147		131,752,381
15b. Collections		-9,273,203		-8,305,678
15c. Subtotal		128,531,944		123,446,703
16. Less: Offsetting receipts		-123,202		-115,376
17. Net Outlays	$	128,408,742	$	123,331,327

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

Consolidated Statement of Financing—General Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	2005 Consolidated	2004 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ 137,137,979	$ 134,360,658
2. Less: Spending authority from offsetting collections and recoveries (-)	-11,104,884	-9,944,341
3. Obligations net of offsetting collections and recoveries	126,033,095	124,416,317
4. Less: Offsetting receipts (-)	-123,202	-115,376
5. Net obligations	125,909,893	124,300,941
Other Resources		
6. Donations and forfeitures of property	0	0
7. Transfers in/out without reimbursement (+/-)	-25,648	311,130
8. Imputed financing from costs absorbed by others	742,039	663,607
9. Other (+/-)	0	0
10. Net other resources used to finance activities	716,391	974,737
11. Total resources used to finance activities	126,626,284	125,275,678
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 (-)	-11,681,780	201,266
12b. Unfilled Customer Orders	738,214	78,091
13. Resources that fund expenses recognized in prior periods	-606,526	-896,088
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	123,202	115,376
15. Resources that finance the acquisition of assets	-18,029,608	-16,068,394
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations		
16a. Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0	0
16b. Other (+/-)	25,648	-311,130
17. Total resources used to finance items not part of the net cost of operations	-29,430,850	-16,880,879
18. Total resources used to finance the net cost of operations	97,195,434	108,394,799
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	81,024	137,700
20. Increase in environmental and disposal liability	0	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
22. Increase in exchange revenue receivable from the the public (-)	0	0
23. Other (+/-)	13,659	53,205
24. Total components of Net Cost of Operations that will require or generate resources in future periods	94,683	190,905
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	11,743,098	9,847,705
26. Revaluation of assets or liabilities (+/-)	787,835	-938,081
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0	0
27b. Cost of Goods Sold	0	0
27c. Operating Material & Supplies Used	2,037,758	3,919,002
27d. Other	12,435,587	-2,725,063
28. Total components of Net Cost of Operations that will not require or generate resources	27,004,278	10,103,563
29. Total components of net cost of operations that will not require or generate resources in the current period	27,098,961	10,294,468
30. Net Cost of Operations	$ 124,294,395	$ 118,689,267

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

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General Fund

Footnotes to the Principal Statements

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Note 1. Significant Accounting Policies

1.A. Basis of Presentation

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

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

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

1.B. Mission of the Reporting Entity

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

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

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

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

1.C. Appropriations and Funds

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

- General funds are used for financial transactions arising under congressional appropriations and include personnel, operation and maintenance, research and development, procurement, and construction accounts.
- Working Capital Fund (revolving fund) activities are reported in a separate set of audited financial statements and related footnotes.
- Trust funds represent the receipt and expenditure of funds held in trust by the Air Force for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.
- Special funds account for Air Force receipts earmarked for specific purposes.
- Deposit funds are generally used to (1) account for unidentified remittances, or (2) hold assets for which the Air Force is acting as an agent or a custodian or whose distribution is awaiting legal determination.

1.D. Basis of Accounting

The Air Force generally records transactions on a budgetary basis and not an accrual accounting basis as is required by Federal GAAP. For FY 2005, the Air Force's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Air Force's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of Federal GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by Federal GAAP.

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

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

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

1.E. Revenues and Other Financing Sources

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

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

1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses during the period in which they were incurred. However, because the Air Force's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, and environmental liabilities. Expenditures for capital and other long-term assets are not recognized as expenses in the Air Force's operations until depreciated, in the case of Property, Plant, and Equipment (PP&E), or consumed, in the case of Operating Materials and Supplies (OM&S). Net increases or decreases in unexpended appropriations are recognized as constituting a change in the net position. Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made.

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

1.G. Accounting for Intra-governmental Activities

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

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

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

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

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

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

1.H. Transactions with Foreign Governments and International Organizations

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

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

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

In addition, the DFAS sites and USACE Finance Center submit reports to the Department of the Treasury, providing information at the appropriation level on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in the Treasury's system. Differences between the Air Force's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled. Material disclosures are provided at Note 3. Also disclosed at Note 3 are differences between accounting offices' detail level records and Treasury's FBWT accounts, specifically, differences caused by in-transit disbursements and unmatched disbursements (where the specific disbursement has not been recorded in the appropriate accounting offices' detail level records).

1.J. Foreign Currency

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

1.K. Accounts Receivable

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

1.L. Loans Receivable

Not applicable

1.M. Inventories and Related Property

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

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

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

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

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

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

Investments in U.S. Treasury securities are reported at cost, determined as the net of unamortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment, using the effective interest rate method or other method if similar results are obtained. The Air Force's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, provision is not made for unrealized gains or losses on these securities. Related earnings are allocated to appropriate Air Force activities to be used in accordance with the directions of the donor. See Note 4 for material disclosures.

The Air Force invests in both marketable and nonmarketable securities. Marketable securities are investments trading on a public market. The two types of nonmarketable securities are par value and market-based intra-governmental securities. The Bureau of Public Debt issues nonmarketable, par value intra-governmental securities. Nonmarketable, market-based intra-governmental securities mimic marketable securities but are not traded publicly. See Note 4 for material disclosures.

1.O. General Property, Plant and Equipment

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

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

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

See Note 10 for material disclosures.

1.P. Advances and Prepayments

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

1.Q. Leases

Generally, lease payments are for the rental of equipment vehicles and operating facilities and are classified as either capital or operating leases. When a lease essentially is equivalent to an installment purchase of property (a capital lease), the Air Force records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The Air Force records the amounts as the lesser of the following two values: (1) the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor); or (2) the asset's fair value. The Air Force deems the use of estimates for these costs as adequate and appropriate due to the relatively low dollar value of capital leases. Imputed interest is necessary to reduce net minimum lease payments to present value calculated at the incremental borrowing rate at the inception of the leases. Leases that do not transfer substantially all of the benefits or risks of ownership are classified as operating leases and are expensed over the period of the lease.

1.R. Other Assets

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

Note 10, General PP&E, Net. In addition, based on the Federal Acquisition Regulation, the Air Force makes financing payments under fixed price contracts not based on percentage of completion. The Air Force reports these financing payments as advances or prepayments in the Other Assets line item. The Air Force treats these payments as advances or prepayments because the Air Force becomes liable only after the contractor delivers the goods. If the contractor does not deliver a satisfactory product, the Air Force is not obligated to reimburse the contractor, and the contractor is liable to repay the Air Force for the full amount of the advance.

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

1.S. Contingencies and Other Liabilities

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

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

1.T. Accrued Leave

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

1.U. Net Position

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

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

1.V. Treaties for Use of Foreign Bases

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

1.W. Comparative Data

The Financial Statements and accompanying Notes to the Financial Statements report the financial position and results of operations for FY 2005. Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet and/or greater than 10 percent between FY 2004 and FY 2005 are explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

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

1.Y. Undistributed Disbursements and Collections

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

Note 2. Nonentity Assets

As of September 30	2005	2004
(Amounts in thousands)		
1. Intra-governmental Assets		
A. Fund Balance with Treasury	$ 77,276	$ 53,290
B. Investments	0	0
C. Accounts Receivable	2,354	48,685
D. Other Assets	0	0
E. Total Intra-governmental Assets	$ 79,630	$ 101,975
2. Non-Federal Assets		
A. Cash and Other Monetary Assets	$ 151,844	$ 311,323
B. Accounts Receivable	128,943	238,159
C. Loans Receivable	0	0
D. Inventory & Related Property	0	0
E. General PP&E	0	0
F. Investments	0	0
G. Other Assets	156,872	559
H. Total Nonfederal Assets	$ 437,659	$ 550,041
3. Total Nonentity Assets	$ 517,289	$ 652,016
4. Total Entity Assets	$ 246,089,524	$ 242,477,977
5. Total Assets	$ 246,606,813	$ 243,129,993

Relevant Information for Comprehension

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

Fluctuations

The Nonentity Fund Balance with Treasury on line 1.A increased $23,986 thousand, or 45 percent due to revised guidance that clarifies what accounts should be reported as Nonentity Fund Balance with Treasury. This line now includes balances in deposit fund accounts, receipt accounts, and the Civilian Thrift Saving Plan (TSP) and Military TSP budget clearing accounts.

The decrease of Intra-governmental and Nonfederal Accounts Receivable is due to a management initiative in identifying invalid accounts receivable and subsequently taking the appropriate corrective action. The Air Force was also successful in collecting on a substantial amount of delinquent debts. The Intra-governmental Accounts Receivable on line 1.C. decreased $46,330 thousand, or 95 percent, and Non-Federal Assets Accounts Receivables on line 2.B. decreased $103,056 thousand, or 43 percent.

Total Cash and Other Monetary Assets decreased $159,479 thousand, or 51 percent, between FY 2004 and FY 2005. Of this decrease, $147,780 thousand can be attributed to changes in the reporting of Advances to

Contractors under University Pool Agreements. University Pool Agreements are agreements to provide advances for research and development conducted on behalf of the Air Force at major academic research institutions. In FY 2004, guidance instructed that these advances be reclassified to Cash and Other Monetary Assets from Other Assets. The guidance was subsequently rescinded, resulting in their reclassification from Cash and Other Monetary Assets back to Other Assets on the FY 2005 financial statements.

In addition, implementation of a new procedure using the International Treasury Service (ITS.gov) to pay foreign vendors drove a $5,275 thousand decrease in the Foreign Currency asset class. The Centralized Disbursing Directorate at DFAS-DE now sends U.S. dollars directly to the Bank of America in Germany for conversion to foreign currencies and for direct disbursement from the bank to foreign vendors. ITS.gov therefore bypasses the Air Force disbursing officers, whose need for foreign currency is thereby reduced.

Note 3. Fund Balance with Treasury

As of September 30	2005	2004
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	$ 62,293,567	$ 60,559,736
B. Revolving Funds	0	0
C. Trust Funds	4,134	9,212
D. Special Funds	789	0
E. Other Fund Types	51,752	32,051
F. Total Fund Balances	$ 62,350,242	$ 60,600,999
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 63,268,814	$ 61,497,801
B. Fund Balance per Air Force	62,350,242	60,600,999
3. Reconciling Amount	$ 918,572	$ 896,802

Reconciling Amount

Parent Child Allocations that are not included in Air Force balances total $15,893 thousand. Included in these are allocations from Foreign Military Sales Military Assistance Program and the Department of Agriculture. Included in Air Force balance and not in Treasury balance is $4,418 thousand for funds allocated to the Department of Transportation. This balance is reported on the Treasury Trial Balance 6654 for Treasury Index 69. In a parent/child relationship, the child reports the FBWT amount if the amount is material to the child. Included in the Treasury's Balance is a canceling accounts balance of $783,279 thousand and the Receipt accounts balances of $123,817 thousand that are not included in Air Force Fund Balance due to preclosing.

Fluctuations

The decrease of trust funds in the current year compared to the prior year is attributable to the completion of the new expansion wing at the Air Force Museum and fewer donations in the Gift Fund because of the completion. Although donations decreased, disbursements had a greater decrease, resulting in fewer funds within the gift fund.

The increase in special funds is due to the proper display of appropriation 5095, Fish and Wildlife, as a special fund. During FY 2004, these funds were included on line 1.C., Trust Funds.

The fluctuation in Other Fund Types is primarily attributed to increases in amounts withheld from Air Force personnel for Servicemen's Group Life Insurance Funds (SGLI) and proceeds from military airlift revenue traffic. Amounts in these deposit fund accounts will be disbursed to applicable third parties or in the case of the proceeds from revenue traffic reimbursed to appropriations.

Air Force Cadet Fund

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

Check Issue Discrepancy

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

Note Reference

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

Status of Fund Balance with Treasury		
As of September 30	2005	2004
(Amounts in thousands)		
1. Unobligated Balance		
A. Available	$ 11,760,100	$ 8,075,275
B. Unavailable	1,246,109	961,030
2. Obligated Balance not yet Disbursed	$ 51,840,781	$ 53,815,202
3. Non-Budgetary FBWT	$ 339,456	$ 53,290
4. Non-FBWT Budgetary Accounts	$ -2,836,206	$ -2,304,716
5. Total	$ 62,350,240	$ 60,600,081

Fluctuations

Increase in Unobligated Balance Unavailable is due to less unused reimbursable authority in the Research, Test, Development & Evaluation (RDT&E) appropriation in FY 2005.

From FY 2003 to FY 2004, the amount of reimbursable budget authority doubled from $2 billion to $4 billion to accommodate the amount of future planned reimbursable work performed primarily in the research laboratories and the classified programs. Although increased use of reimbursable budget authority occurred in FY 2004, a dramatic increase in usage didn't occur until FY 2005.

The difference between the total amount of the Status of Fund Balance with Treasury reflected here and Fund Balance with Treasury in part one of Note 3 is identified as the Discount on U.S. Treasury Securities issued by the Bureau of Public Debt. Further analysis is being done on a suggested mapping change that will resolve this reconciling amount.

Relevant Information for Comprehension

Unexpended Obligations reported as a component of Unexpended Appropriations include both Undelivered Orders-Unpaid and Undelivered Orders-Paid only for direct appropriated funds. This amount is distinct from Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Received line of the Statement of Financing, which includes the change during the fiscal year in Unexpended Obligations against Budget Authority from all sources.

Disclosures Related to Suspense/Budget Clearing Accounts As of September 30	2003	2004	2005	(Decrease)/ Increase from FY 2004 - 2005
(Amounts in thousands)				
Account				
F3875	$ -364,737	$ -357,705	$ 336,053	$ 693,758
F3880	-2,343	-3,803	691	4,494
F3882	-16,526	-20,956	25,523	46,479
F3885	8,785	14,989	-74,564	-89,553
F3886	0	0	0	0
Total	$ -374,821	$ -367,475	$ 287,703	$ 655,178

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

Suspense account F3882 is utilized to accommodate the Military Thrift Savings Plan (TSP). The National Finance Center posts amounts into each member's account, and they are consolidated and posted to the Treasury before the Air Force can post the amounts in the military accounting system in the following month. The $4,568 thousand increase is the result of increased participation in the TSP.

The increase (absolute value) in account F3885 IPAC is due to the inclusion in limit 007 of $(52,754) thousand and the remaining variance can be attributed to IPAC transactions received during the last business day of the month. When IPAC transactions are received, funds are placed in a suspense account until they can be researched and assigned a valid appropriation, which will fluctuate from one reporting period to another depending upon the amount processed to the Treasury at that time.

In the published reports for FY 2004, the balances for FY 2003 and FY 2004 are displayed incorrectly in the opposite sign in the table. For FY 2005, the table is reflected the same as the published report. FY 2005 column is reflected correctly.

Disclosures Related to Problem Disbursements and In-Transit Disbursements As of September 30	2003	2004	2005	(Decrease)/ Increase from 2004 - 2005
(Amounts in thousands)				
1. Total Problem Disbursements, Absolute Value				
A. Unmatched Disbursements (UMDS)	$ 7,813	$ 161,630	$ 272,972	$ 111,342
B. Negative Unliquidated Obligations (NULO)	12,436	$ 9,792	8,209	-1,583
2. Total In-transit Disbursements, Net	$ 1,111,274	$ 1,065,326	$ 776,544	$ -288,782

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

The Air Force had a $109,759 thousand increase in problem disbursements and a $288,782 thousand decrease in In-transit Disbursements. The Defense Finance and Accounting Service has efforts underway to improve the systems, to resolve all previous problem disbursements, and to process all In-transit Disbursements in a timely manner. The amount of Unmatched Disbursements (UMDs) over 180 days is $0.00, of Negative Unliquidated Disbursements (NULOs) is $0.00 and of In-transits is $17,955,733.29. The amount of UMDs over 120 days old is $0.00, for NULOs is $0.00, and for In-transits is $20,432,111.93. The current absolute value of In-transit disbursements is $1,029,617,356.16.

The increase in UMDs can be attributed to database mergers (San Antonio to Limestone in October 2004, and Omaha to Dayton in May 2005) and difficulties encountered with the merger of the Contract Procurement Accounting System (CPAS) and the General Accounting and Finance System (GAFS). Also, a substantial amount of problems were encountered when we implemented new business processes for handling disbursements. (e.g., corrupted data, duplicate data, missing data) All corrections are expected to be accomplished in the first quarter of FY 2006.

Note 4. Investments and Related Interest

As of September 30	2005					2004
	Par Value/Cost	Amortization Method	Unamortized (Premium/ Discount)	Investments, Net	Market Value Disclosure	Investments, Net
(Amounts in thousands)						
1. Intra-governmental Securities						
A. Non-Marketable, Market-Based	$ 710		$ 0	$ 710	$ 705	$ 711
B. Accrued Interest	7			7	7	0
C. Total Intra-governmental Securities	$ 717		$ 0	$ 717	$ 712	$ 711
2. Other Investments	$ 0		$ 0	$ 0	N/A	$ 0

Fluctuations

Accrued Interest for FY 2004 of $7.3 thousand was posted using an incorrect attribute that did not cross-walk to the Accrued Interest Line. It was incorrectly classified to accounts receivable.

Relevant Information for Comprehension

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

The Air Force Gift Fund was established to control and account for the disbursement and use of monies donated to the Air Force along with the interest received from the investment of such donations. The related earnings are allocated to appropriate Air Force activities to be used in accordance with the directions of the donor. These funds are recorded as Non-Marketable Market Based U.S. Treasury Securities, which are not traded on any security exchange but which mirror the prices of marketable securities with similar terms.

Note Reference

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

Note 5. Accounts Receivable

As of September 30	2005			2004
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intra-governmental Receivable s	$ 653,589	N/A	$ 653,589	$ 689,871
2. Non-Federal Receivables (From the Public)	$ 1,178,626	$ -150,316	$ 1,028,310	$ 978,883
3. Total Accounts Receivable	$ 1,832,215	$ -150,316	$ 1,681,899	$ 1,668,754

The total allowance method is determined at the Air Force departmental level. For closed years receivables and deferred debts in litigation, an allowance rate of 50 percent results in an estimated allowance of $68,966 thousand. Interest allowance of $332 thousand is calculated using an average percent of write offs to outstanding public accounts receivable over a five year period starting with FY 2000 data. In addition, the allowance for Air Force entity receivables is computed each year based on the average percent of write offs to outstanding public accounts receivable for the last five years. This results in an estimated allowance of $81,017 thousand.

Relevant Information for Comprehension

As presented on the Consolidated Balance Sheet, accounts receivable include reimbursements receivable and refunds receivable such as out of service debts (amounts owed by former service members), contractor debt, and unused travel tickets. It also includes net interest receivables per Department of Defense (DoD) Financial Management Regulation (FMR) Vol. 6B guidance. Canceled accounts receivable is reported as nonentity receivables because these amounts are deposited into a Treasury Department miscellaneous receipt account when collected. Reconciliation between Report on Receivables Due from the Public and the balance sheet was accomplished. The differences between the balance sheet (line 1.C.) and Treasury Report on Receivables (TROR)

Due from the Public (line 7) include the allowance for estimated uncollectible of $150,316 thousand, unsupported disbursements in transit in the amount of $1,938 thousand, and undistributed collections of $(9,280) thousand. Undistributed collections are prorated between public and intra-governmental receivables on the balance sheet based on the percentages of distributed receivables. This reconciliation is performed to ensure that the financial statements are in agreement with the public receivables reported to the Department of the Treasury.

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

Allocation of Undistributed Collections

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

Note Reference

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

Note 6. Other Assets

As of September 30	2005	2004
(Amounts in thousands)		
1. Intra-governmental Other Assets		
A. Advances and Prepayments	$ 427,989	$ 443,939
B. Total Intra-governmental Other Assets	$ 427,989	$ 443,939
2. Non-Federal Other Assets		
A. Outstanding Contract Financing Payments	$ 10,919,137	$ 10,705,720
B. Other Assets (With the Public)	259,904	103,868
C. Total Non-Federal Other Assets	$ 11,179,041	$ 10,809,588
3. Total Other Assets	$ 11,607,030	$ 11,253,527

Fluctuations

Other Assets with the Public, line 2.B., increased $156,036 thousand, or 150 percent, primarily due to the correct reporting of advances to contractors as shown on the SF 1219, Statement of Accountability, as Other Assets this fiscal year. In FY 2004, guidance instructed the reclassification of these advances from the Other Asset line on the Balance Sheet to the Cash and Other Monetary Asset line in order to show all SF 1219 data on one line. The guidance was issued prematurely and was later rescinded, resulting in advances to contractors being reclassified back to Other Assets in FY 2005.

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

Relevant Information for Comprehension

Other Assets

The amount of $259,904 thousand on line 2.B., Other Assets with the Public, is composed of $96,296 thousand in travel advances, $6,928 thousand in other advances to contractors, and $156,680 thousand in advances to contractors as reported on the SF 1219, Statement of Accountability.

Outstanding Contract Financing Payments

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

Note Reference

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

Note 7. Cash and Other Monetary Assets

	2005	2004
(Amounts in thousands)		
1. Cash	$ 148,938	$ 303,142
2. Foreign Currency (non-purchased)	2,906	8,181
3. Total Cash, Foreign Currency, & Other Monetary Assets	$ 151,844	$ 311,323

Fluctuations

Total Cash, Foreign Currency & Other Monetary Assets decreased $159,479 thousand, or 51 percent, between FY 2004 and FY 2005, caused by decreases in both the Cash and Foreign Currency asset classes.

The $154,204 thousand, or 51 percent, decrease in the Cash asset class can be attributed to changes in the reporting of Advances to Contractors under University Pool Agreements of $147,780 thousand. University Pool Agreements are agreements to provide advances for research and development conducted on behalf of the Air Force at major academic research institutions. In FY 2004, guidance instructed that these advances be reclassified to Cash and Other Monetary Assets from Other Assets. The guidance was subsequently rescinded, resulting in their reclassification from Cash and Other Monetary Assets back to Other Assets in the FY 2005 financial statements.

The implementation of a new procedure using the International Treasury Service (ITS.gov) to pay foreign vendors drove the $5,275 thousand decrease in the Foreign Currency asset class. The Centralized Disbursing Directorate at DFAS-DE now sends U.S. dollars directly to the Bank of America in Germany for conversion to foreign currencies and for direct disbursement from the bank to foreign vendors. ITS.gov therefore bypasses the Air Force disbursing officers, whose need for foreign currency is thereby reduced.

Relevant Information for Comprehension

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

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

Note Reference

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

Note 8. Direct Loan and/or Loan Guarantee Programs

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

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

Note 9. Inventory and Related Property

As of September 30	2005	2004
(Amounts in thousands)		
1. Inventory, Net	$ 0	$ 0
2. Operating Materials & Supplies, Net	47,169,013	51,340,248
3. Stockpile Materials, Net	0	0
4. Total	$ 47,169,013	$ 51,340,248

Operating Materials and Supplies, Net As of September 30	2005			2004	
	OM&S Gross Value	**Revaluation Allowance**	**OM&S, Net**	**OM&S, Net**	**Valuation Method**
(Amounts in thousands)					
1. OM&S Categories					
A. Held for Use	$ 36,317,706	$ 0	$ 36,317,706	$ 39,347,759	SP, LAC
B. Held for Repair	10,851,307	0	10,851,307	11,992,489	SP, LAC
C. Excess, Obsolete, and Unserviceable	1,100,179	-1,100,179	0	0	NRV
D. Total	$ 48,269,192	$ -1,100,179	$ 47,169,013	$ 51,340,248	

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

Fluctuations

Held for Repair decreased $1,141,183 thousand, or 10 percent, due to a reduction in Aircraft Engines and Munitions repairs and a policy change which resulted in Aircraft Electronics POD being reclassified from OM&S to General PP&E.

Information related to OM&S

General Composition of OM&S

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

Balances

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

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

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

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

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

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

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

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

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

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

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

Operating Materials and Supplies (OM&S) Value

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

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

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

Note Reference

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

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

Other Air Force Disclosures

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

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

Note 10. General Property, Plants, and Equipment (PP&E), Net

As of September 30	2005					2004
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in thousands)						
1. Major Asset Classes						
A. Land	N/A	N/A	$ 432,911	N/A	$ 432,911	$ 431,608
B. Buildings, Structures, and Facilities	S/L	20 Or 40	44,089,947	$ -25,173,005	18,916,942	18,166,918
C. Leasehold Improvements	S/L	lease term	0	0	0	0
D. Software	S/L	2-5 Or 10	484,668	-140,107	344,561	23,782
E. General Equipment	S/L	5 or 10	36,023,812	-29,215,209	6,808,603	6,744,374
F. Military Equipment	S/L	Various	313,670,000	-221,400,000	92,270,000	89,060,000
G. Assets Under Capital Lease	S/L	lease term	453,481	-301,883	151,598	163,059
H. Construction-in-Progress	N/A	N/A	4,721,453	N/A	4,721,453	3,364,351
I. Other			0	0	0	338
2. Total General PP&E			$ 399,876,272	$ -276,230,204	$ 123,646,068	$ 117,954,430

[1] Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

Fluctuations

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

The Construction-in-Progress (CIP) on line 1.H. increased $1,357,102 thousand, or 40 percent because the Treasury Index 97 funds were incorporated into the Air Force Construction-in-Progress total projects. The reporting of CIP has long been a problem, not only with Air Force but with all services. TI97 funds allocated to the Air Force and used on Air Force real property projects that benefit the AF must be reported on the Air Force financial statements (see DoD FMR Volume 4, Chapter 6, page 6-20).

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

The Other asset class on line 1.I. decreased by $338 thousand, or 100 percent. The Other category represents the timing factor inherent in timber harvesting. The timber markets, driven by supply and demand, are volatile and fluctuate. Timber sale contracts are awarded at irregular intervals, with some contracts held back until the market improves. Similarly, when buyers pay for just the timber they cut, they may hold off when markets are bad and cut more when markets are good. Weather conditions also influence the flow of timber and revenue.

Relevant Information for Comprehension

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

The value of the Bureau of Economic Analysis (BEA) data provided by the DoD to the Air Force for inclusion in the financial statements for the 4th Quarter, 2005 amounted to approximately $313,670,000 thousand less accumulated depreciation of $221,400,000 thousand for a net realized book value of $92,270,000 thousand.

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

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

Other Air Force Disclosures

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

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

For the 4th Quarter, FY 2005 reports, the Air Force used some FY 2002 ending data for (ST/STE) but did use actual data for the B2 aircraft. The FY 2002 values were still being used for all other (ST/STE) because the two systems previously used to report ST/STE have been turned off and are scheduled to be replaced by Air Force Equipment Management System (AFEMS) in FY 2005.

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

Note Reference

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

Assets Under Capital Lease As of September 30	2005	2004
(Amounts in thousands)		
1. Entity as Lessee, Assets Under Capital Lease		
A. Land and Buildings	$ 453,481	$ 408,540
B. Equipment	0	958
C. Other	0	0
D. Accumulated Amortization	-301,883	-246,439
E. Total Capital Leases	$ 151,598	$ 163,059

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

Fluctuations

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

The $958 thousand Equipment lease reflected on the FY 2004 statements is no longer held by the Air Force.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2005	2004
(Amounts in thousands)		
1. Intra-governmental Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Debt	0	0
C. Other	491,562	682,737
D. Total Intra-governmental Liabilities	$ 491,562	$ 682,737
2. Non-Federal Liabilities		
A. Accounts Payable	$ 232,672	$ 473,152
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,147,437	1,163,442
C. Environmental Liabilities	6,376,345	6,876,461
D. Loan Guarantee Liability	0	0
E. Other Liabilities	2,835,261	2,721,503
F. Total Non-Federal Liabilities	$ 10,591,715	$ 11,234,558
3. Total Liabilities Not Covered by Budgetary Resources	$ 11,083,277	$ 11,917,295
4. Total Liabilities Covered by Budgetary Resources	$ 10,462,797	$ 12,569,893
5. Total Liabilities	$ 21,546,074	$ 24,487,188

Fluctuations and Abnormalities

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

Information Related to Liabilities Not Covered by Budgetary Resources

Other Liability Disclosures

Other Intra-governmental Liabilities Not Covered by Budgetary Resources consists of $291,104 thousand in Federal Employees' Compensation Act (FECA) reimbursement to the Department of Labor, $32,812 thousand in unemployment compensation, and $167,646 thousand in custodial liabilities.

Other Nonfederal Liabilities Not Covered by Budgetary Resources consists of $222,570 thousand in capital lease liabilities, $260,566 thousand in contingent liabilities, $2,351,814 thousand in accrued annual leave liabilities for military and civilians, and $311 thousand in accrued interest liability.

Note Reference

For Additional Line Item discussion, see:

- Note 12, Accounts Payable
- Note 13, Debt
- Note 14, Environmental Liabilities and Disposal Liabilities
- Note 15, Other Liabilities
- Note 16, Commitments and Contingencies
- Note 17, Military Retirement Benefits and Other Employment Related Actuarial Liabilities

Note 12. Accounts Payable

As of September 30	2005			2004
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intra-governmental Payables	$ 1,651,904	$ N/A	$ 1,651,904	$ 1,900,411
2. Non-Federal Payables (to the Public)	5,851,184	0	5,851,184	7,707,163
3. Total	$ 7,503,088	$ 0	$ 7,503,088	$ 9,607,574

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

Fluctuations

Accounts Payable—Public decreased by $1,855,979 thousand, or 24 percent. This net decrease can be attributed to a $1,820,450 thousand increase in Aircraft Procurement - Air Force Materiel Command resulting from production increases for the F/A22, C-130J, Predator and final delivery of the Joint STARS aircraft; a $2,738,699 thousand decrease in classified Other Procurement—Air Force Special Programs; an increase of $41,434 thousand in classified Missile Procurement—Air Force Special Programs, and a decrease of $859,763 thousand attributable to an supplemental Elimination Adjusting Entry made in September 2004 whereas additional seller data was received after the initial Adjusting Entries were made which then made it necessary to effect an additional Elimination Adjusting Entry to bring into agreement the reported Air Force accounts payable with the accounts receivable reported by the sellers. There was also a decrease of $389,424 thousand in the Military Personnel—Air Force program entity due to a posting logic change that was implemented. Accrued Funded Payroll, Employer Contributions, and Other Post Employment Benefits are now cited (when applicable) instead of Accounts Payable. The remaining $270,023 thousand increase is shared by a number of other program entities.

Accounts Payable—Intra-governmental decreased by $248,506 thousand or 13 percent. The variance can be attributed to a $93,331 thousand decrease in liabilities to the Department of the Treasury; a $97,187 thousand decrease to the Army General Fund, and a decrease of $67,065 to the Department of Labor. The fluctuation associated with Intra-governmental accounts payable is impacted by the elimination process that requires the accrual of accounts payable to agree with Air Force trading partner seller data. Also, the recording of accounts payable based on actual seller side data provided by the agency or using an estimation technique for those agencies that did not provide actuals contributes to the fluctuation as well. The estimation technique was implemented in the 4th Quarter FY 2004 and continues to be refined.

Judgment Fund liabilities for the 4th Quarter FY 2005 total $14,530 thousand as of September 30, 2005. This is a result of contractor claims under the Contract Disputes Act in the amount of $13,192 thousand for Air Force contracts that have been adjudicated in favor of the contractor by a court or a board. Initially, Treasury pays the monetary awards to the contractor. The Air Force must subsequently reimburse the Treasury's Judgment Fund for the amount that was paid to the contractors. Also included is approximately $1,338 thousand owed for Judgment Fund liabilities that resulted because of the Notification of reimbursements to Treasury's Judgment Fund, and because of judgments amounts resulting from the Federal Employee Antidiscrimination and Retaliatory Act of 2002. These amounts can change daily and can fluctuate substantially due to new billings by the Treasury, and to payments made to the Treasury by DFAS and the U.S. Army Corps of Engineers on behalf of the Air Force.

Intra-governmental Eliminations

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

Comparison prior to eliminations:

	Sep 2005	**Sep 2004**	**$ Change**
Intra-governmental accounts payable	$ 811,280	$ 427,882	$ 383,398
Accruals to match seller data	1,615,885	2,034,148	-418,263
	2,427,165	2,462,030	-34,865
Less: Intra-Air Force eliminations	775,261	561,620	213,641
Total	$ 1,651,904	$ 1,900,410	$ 248,506

(All data in thousands)

Allocation of Undistributed Disbursements

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

Note Reference

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

Note 13. Debt

Not applicable

Note Reference

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

Note 14. Environmental Liabilities and Disposal Liabilities

As of September 30	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
1. Environmental Liabilities – Non Federal				
A. Accrued Environmental Restoration (DERP funded) Costs:				
1. Active Installations--Environmental Restoration (ER)	$ 387,680	$ 3,618,947	$ 4,006,627	$ 4,225,215
2. Active Installations--ER for Closed Ranges	15,000	1,329,856	1,344,856	1,344,856
3. Formerly Used Defense Sites (FUDS) -- ER	0	0	0	0
4. FUDS--ER for Transferred Ranges	0	0	0	0
B. Other Accrued Environmental Costs (Non-DERP funds)				
1. Active Installations--Environmental Corrective Action	0	138,378	138,378	182,385
2. Active Installations--Environmental Closure Requirements	2,354	49,301	51,655	112,283
3. Active Installations--Environ. Response at Active Ranges	0	0	0	0
4. Other	0	0	0	0
C. Base Realignment and Closure (BRAC)				
1. BRAC Installations--Environmental Restoration (ER)	60,688	1,140,756	1,201,444	1,379,647
2. BRAC Installations--ER for Transferring Ranges	0	0	0	0
3. BRAC Installations--Environmental Corrective Action	7,697	144,679	152,376	142,801
4. Other	11,660	219,182	230,842	0
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0	0	0	0
2. Nuclear Powered Submarines	0	0	0	0
3. Other Nuclear Powered Ships	0	0	0	0
4. Other National Defense Weapons Systems	0	0	0	0
5. Chemical Weapons Disposal Program	0	0	0	0
6. Other	0	0	0	0
2. Total Environmental Liabilities:	$ 485,079	$ 6,641,099	$ 7,126,178	$ 7,387,187

Fluctuations

Other Accrued Environmental Costs (Non-DERP funds) Active Installations - Environmental Corrective Action decreased $44,007 thousand, or 24 percent. RCRA corrective actions are defined by the Environmental Protection Agency as Solid Waste Management Units (SWMU). SWMUs are not determined in a scientific manner and may arise from any indication of potential pollution. Therefore, there are a high number of SWMUs. Limited initial investigation generally leads to the conclusion that there is no significant pollution at the SWMU. The amount of the liability fluctuates greatly from year-to-year as further investigation results in significant changes in cost estimates. These changes result from the additional information gained in each step of the cleanup process and the relatively few sites that actually require significant cleanup costs.

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

Base Realignment and Closure (BRAC) Installations—Environmental Restoration decreased $178,203 thousand, or 13 percent. The decrease is due to cleanup work performed, expensed, and paid during the reporting period as well as revaluations attributed primarily to the adjustment of Chanute Air Force Base's Last Remedial Action In Place (LRIP) date from FY 2007 to FY 2009. This adjustment was the result of the Air Force Real Property Agency's (AFRPA's) bottoms-up review and subsequent budget scrubs. In FY 2004, with LRIP projected for FY 2007, Chanute based its environmental assumptions on fast-track cleanup efforts and programmed massive dig and haul efforts and Engineering Evaluation Cost Analysis (EECA) to meet the September 30, 2007 LRIP date. With the FY 2009 LRIP, many fast track requirements were eliminated or scopes significantly reduced, which affected Cost-To-Complete (CTC) projections. In addition to the LRIP date change, Chanute's current Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) status—the Remedial Investigation phase—has produced more accurate data during FY 2005 which in turn has allowed the BRAC Environmental Coordinator to make better assumptions to more clearly define the environmental requirements for Chanute. The data supports significantly less remedial action than was previously assumed by operating location. Many of the environmental sites can be recommended in Record of Decision documents for Long-Term Monitoring with Land Use Control/Institutional Controls cost rather than dig and haul and/or active systems, which have greatly reduced out-year costs.

Base Realignment and Closure (BRAC)—Other increased $230,842 thousand, or 100 percent. The increase is due to improved identification of costs resulting in the addition of this line item. The increase includes cost for manpower services at BRAC installations and headquarters offices for services performed by Global Engineering Integration and Technical Assistance (GEITA) for $57,711 thousand, or 25 percent of the total. This contractual support provides program level support for management oversight services at various BRAC installations. This supports the strategy development and execution for environmental and property transfer programs. This support allows the installations to remain on track working towards the Defense Planning Goals which includes: property transfer, Remedial Actions In Place (RIP), Last RIP (LRIP), Operating Properly and Successfully (OPS), Response Complete (RC) and ultimately, Site Closure (SC). Also, the Air Force Center for Environmental Excellence (AFCEE) comprised $115,421 thousand, or 50 percent, of the total cost. AFCEE provides technical, management, contract and administrative manpower assistance to manage and execute BRAC projects and other closure related matters for closure bases. The Program Managers are the heart of program execution and single point of contact for all activities cradle-to-grave. Programs Managers frequently require technical consultation from staff members who are experts in toxicology, risk assessment, engineering, chemistry, and hydrogeology. Contracting personnel provide the necessary contracting expertise to conduct acquisition planning, develop contracting strategies, execute contract awards, and administer those contracts. Administrative personnel are required to adequately leverage the myriad of technical and project management correspondence, reports, visitors, and callers to relieve staff from clerical duties.

In addition, various mandated direct costs comprise $57,710 thousand, or 25 percent, of the total. These costs include the cost for Technical Assistance for Public Participation (TAPP) grants which allow community members to obtain objective, independent scientific and engineering support concerning the restoration process through the issuance of government purchase orders to small businesses. Also, included are costs for the Agency for Toxic Substances and Disease Registry (ATSDR), which is mandated under CERCLA Section 104(i) to evaluate all federal facilities on or proposed to the Environmental Protection Agency's (EPA's) National Priorities List (NPL) for public health concerns. In addition, under the EPA's Fast Track Cleanup, an agreement was made between service components and DoD to provide funds to the Deputy Under Secretary of Defense (Installation and Environment) in support of the BRAC Fast Track Program. They provide assistance in setting up BRAC Environmental Coordinator/BRAC Cleanup Teams (BEC/BCT) workshops to develop BRAC environmental policies and issue Defense Planning Guidance and Goals. Also, direct costs are included for the Defense/State

Memorandum of Agreement (DSMOA) program which was established by DoD to enhance state and territorial involvement in the cleanup of active and closing DoD installations and at Formerly Used Defense Sites (FUDS). This program provides funds to federal organizations and state regulatory programs that mandate funding in order to support AFRPA.

General Disclosures

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

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

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

Non-DERP, non-BRAC environmental cleanup liabilities represent corrective actions generally required under RCRA law. These environmental cleanup liabilities are estimated in the same manner as DERP environmental cleanup liabilities. The change in non-DERP, non-BRAC environmental cleanup liabilities during a reporting period is comprised of revaluations of the cost-to-complete for engineering sites that existed at the beginning of the period plus the cost-to-complete for new engineering sites added during the reporting period less amounts expensed during the period. Because the non-DERP, non-BRAC environmental cleanup activity is part of general funding achieved using Air Force Operation and Maintenance appropriated funds, there is no special accounting for the costs of the cleanup program per se. Therefore, the costs captured for the non-DERP, non-BRAC environmental cleanup reflect only direct costs. Because this program was not tracked and appropriated specifically, there was no accounting specific to this program. Expense codes for this program were established in 1999 and implemented in FY 2000. Therefore, the expense portion of the estimate has no significant history. Because of the lack of expense history for the program, there is no reliable data for estimating the current portion of the non-DERP, non-BRAC environmental cleanup liability. It is believed that the current portion of the environmental cleanup liability in this area is relatively small and not material in the classification of liabilities. Because the non-DERP, non-BRAC environmental cleanup liabilities are only estimated between 1 July and 1 September of each year, there is no significant change other than at fiscal yearend for non-DERP, non-BRAC environmental liabilities. On less than an annual basis the only change to the liability estimate in this area is the amount recorded as expensed during the reporting period.

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

The DERP environmental liability represents an addition of $132,200 thousand due to new engineering sites added during the year, $374,600 thousand in expenses during the year, and $118,600 thousand in revaluations of engineering sites that existed at the end of fiscal year 2004. Revaluations result as better information is obtained and cost estimates are revised accordingly.

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

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

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

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

The sum of the sites' costs-to-complete cleanup becomes the environmental cleanup liability for closed ranges. The environmental cleanup for closed ranges is in its infancy, and the total liability is expected to increase significantly over the coming years as investigations progress. Current policy is to investigate all closed ranges by the end of 2007.

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

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

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

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

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

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

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

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

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

The Air Force Real Property Agency (AFRPA) estimates a $1,584,662 thousand total environmental liability as of September 30, 2005. This amount includes all cleanup requirements to meet applicable laws and regulatory requirements and to transfer property. However, this amount does not include Land Use Control/Institutional Control costs beyond system operations associated with property transfer. Cost estimates are assigned to current operating periods using RACER.

Reporting of Estimates

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

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

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

Note Reference

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

Note 15. Other Liabilities

As of September 30	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
1. Intra-governmental				
A. Advances from Others	$ 573,687	$ 0	$ 573,687	$ 664,325
B. Deposit Funds and Suspense Account Liabilities	167,899	0	167,899	23,508
C. Disbursing Officer Cash	304,148	0	304,148	311,323
D. Judgment Fund Liabilities	0	0	0	101,779
E. FECA Reimbursement to the Department of Labor	129,229	161,875	291,104	304,421
F. Other Liabilities	252,150	879	253,029	321,124
G. Total Intra-governmental Other Liabilities	$ 1,427,113	$ 162,754	$ 1,589,867	$ 1,726,480
2. Non-Federal				
A. Accrued Funded Payroll and Benefits	$ 877,966	$ 0	$ 877,966	$ 1,589,124
B. Advances from Others	67,773	0	67,773	71,763
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	171,514	0	171,514	30,199
E. Temporary Early Retirement Authority	414	263	677	1,503
F. Nonenvironmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	91,980
(3) Conventional Munitions Disposal	0	0	0	0
(4) Other	0	0	0	0
G. Accrued Unfunded Annual Leave	2,351,814	0	2,351,814	2,272,599
H. Capital Lease Liability	165,960	99,583	265,543	235,637
I. Other Liabilities	183,650	260,567	444,217	309,700
J. Total Non-Federal Other Liabilities	$ 3,819,091	$ 360,413	$ 4,179,504	$ 4,602,505
3. Total Other Liabilities	$ 5,246,204	$ 523,167	$ 5,769,371	$ 6,328,985

Intra-government Fluctuations

The $90,637 thousand decrease in Advances from Others on Line 1.A. is due to the timing of the receipt and execution of orders mainly in the Research, Development, Test and Evaluation (RDT&E) classified program, causing variations.

Balances in Intra-governmental Deposit Funds and Suspense Account Liabilities (Line 1.B, above) increased in FY 2005 by $144,391 thousand or 23 percent. This increase was driven by a change in Treasury guidelines (Treasury Bulletin No. 2005-06: "Yearend Closing"). In FY 2004, Treasury required that certain suspense account balances have a zero balance at the end of the fiscal year. Treasury now allows agencies to carry forward a balance into the upcoming fiscal year in all suspense accounts.

The decrease in Judgment Fund Liabilities is a result of guidance received from Treasury requiring information to be included in Accounts Payable, Footnote 12.

The decrease in Other Liabilities is primarily due to a management initiative in identifying invalid accounts receivable and subsequently taking the appropriate corrective action. The offset for closed year receivables is Custodial Liabilities, which are part of Other Liabilities

Other Liabilities

The amount of $258,436 thousand represents $54,997 thousand in government contributions for employee benefits, $32,812 thousand in unfunded unemployment compensation liabilities, $879 thousand in funded unemployment compensation liabilities, $168,141 thousand in custodial liabilities, and $1,607 thousand in DoD education benefit liabilities.

Non-Federal Fluctuations

The decrease in Accrued Funded Payroll and Benefits is due to the military payroll. During FY 2004, the military pay date occurred in October, whereas during FY 05, the pay date occurred in September.

Nonfederal Deposit Funds and Suspense Accounts (Line 2.D. above) increased in FY 2005 by $141,359 thousand or 82 percent. See the explanation for Intra-governmental Deposit Fund and Suspense Account Liabilities (Line 1.B.), above.

The Temporary Early Retirement Authority (TERA) liabilities decrease of $826 thousand or 55 percent is due to the expiration of the authority in FY 2001. The liability will continue to decrease as expenditures are made because the program was terminated resulting in no new liabilities.

Nonenvironmental Disposal Liabilities – Excess/Obsolete Structures decreased $91,980 thousand or 100 percent due to the completion of Defense Reform Initiative Directive (DRID) 36. The liability was originally established to meet reporting requirements for DRID 36 which provided facility demolition goals for the Air Force beginning in FY 1998. DRID 36 directed that increased funding be used to eliminate these structures by FY 2003. Currently, there are no established facility demolition goals for the Air Force.

Other Liabilities increases by a total of $134,517 thousand or 44 percent. The major contributor of this is attributed to the win/loss settlement of case(s) and the associated dollar value reported as Contingent Liabilities. In addition, there was a posting logic change implemented in the Military Personnel program for Air Force active, reserve and guard. Accrued Funded Payroll, Employer Contribution, and Other Post Employment benefits are now reported (when applicable) and cross walked to Other Liabilities.

Other Liabilities

The amount of $440,650 thousand represents legal contingencies of $261,913 thousand and accrued interest liability of $311 thousand and employee benefits in the amount of $178,426 thousand.

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

The total estimated probable liability for claims and litigation against the Air Force handled by the Civil Law and Litigation Directorate, as of Sept 30, 2005, was valued at $218,171 thousand and has been included in the accompanying financial statements. As of Sept 30, 2005, the Air Force was party to 21,733 claims and litigation actions. This liability dollar amount recorded in the financial statements is an estimate based on the weighted average payout rate for the previous three years. A reasonably possible liability is estimated at $101,756 thousand and is not included in the reported amount. Neither past payments nor the current contingent liability estimate provides a basis for accurately projecting the results of any individual lawsuit or claim. It is uncertain that claims will ever accrue to the Air Force. In addition, many claims and lawsuits, even if successful, will not be paid out of Air Force Funds.

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

Other Disclosures

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

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

Capital Lease Liability As of September 30	2005				2004
	Asset Category				
	Land and Buildings	Equipment	Other	Total	Total
(Amounts in thousands)					
1. Future Payments Due					
A. 2006	$ 42,973	$ 0	$ 0	$ 42,973	$ 45,433
B. 2007	39,878	0	0	39,878	45,152
C. 2008	38,594	0	0	38,594	42,056
D. 2009	38,478	0	0	38,478	38,978
E. 2010	38,478	0	0	38,478	38,502
F. After 5 Years	128,881	0	0	128,881	115,278
G. Total Future Lease Payments Due	$ 327,282	$ 0	$ 0	$ 327,282	$ 325,399
H. Less: Imputed Interest Executory Costs	61,738	0	0	61,738	89,761
I. Net Capital Lease Liability	$ 265,544	$ 0	$ 0	$ 265,544	$ 235,638
2. Capital Lease Liabilities Covered by Budgetary Resources				$ 42,973	$ 188,413
3. Capital Lease Liabilities Not Covered by Budgetary Resources				$ 222,570	$ 47,224

The Air Force is the lessee in ten capital leases. These leases are for military family housing acquired through the Section 801 Family Housing Program. All leases originating prior to FY 1992 are funded on a fiscal year basis.

Six of the current military family housing leases were awarded before FY 1992. In addition, the Air Force has adjusted their records to account for the termination and conveyance of one lease as of October 30, 2004.

Fluctuations

The decrease in Capital Lease Liability in the amount of $29,907 thousand is the result of a change in methodology for the use of interest rates that applies to the individual leases. The Air Force previously used the interest rate provided with each of the eleven capital leases. This interest rate did not accurately provide the cost of money to compute fair market value. The current interest rate used reflects the appropriate government rate that best reflects the governments cost of borrowing, using the historical rates from the Federal Reserve. The new change was coordinated between the Air Force and OSD.

For FY 2004, the amount in Line 2 and Line 3 are reversed. However, the fluctuation in Capital Lease Liability covered by budgetary and not covered by budgetary resources is due to a more accurate reporting of Capital Leases.

Note 16. Commitments and Contingencies

Relevant Information for Comprehension

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

Contractual Actions:		
Contractor Claims		$ 8,386 Thousand
Appeals before Armed Services Board of Contract Appeals		308,076 Thousand
(ASBCA)		$ 316,462 Thousand
Claims and Litigation from Civil Law		$ 101,756 Thousand
	Total	**$ 418,218 Thousand**

Note Reference

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

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

As of September 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
(Amounts in thousands)					
1. Pension and Health Benefits					
A. Military Retirement Pensions	$ 0		$ 0	$ 0	$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Benefits	$ 0		$ 0	$ 0	$ 0
2. Other					
A. FECA	$ 1,147,437		$ 0	$ 1,147,437	$ 1,163,442
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. *[Enter Program Name}*	0		0	0	0
E. Total Other	$ 1,147,437		$ 0	$ 1,147,437	$ 1,163,442
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$ 1,147,437		$ 0	$ 1,147,437	$ 1,163,442

Actuarial Cost Method Used:
Assumptions:
Market Value of Investments in Market-based and Marketable Securities:

Military Retirement Pensions—Assumptions:

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

Military Retirement Health Benefits—Assumptions:

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

Federal Employees' Compensation Act (FECA)—Assumptions and Actuarial Cost Method Used:

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

Interest rate assumptions utilized for discounting were as follows:

2005

4.528% in Year 1

5.020% in Year 2 and thereafter

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

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

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

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

Note Reference

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

Note 18. Disclosures Related to the Statement of Net Cost

Statement of Net Cost fluctuations

Intra-governmental Earned Revenue decreased $794,599 thousand, or 16 percent, in FY 2005, driven mainly by an increase in Intra-Air Force transactions. Intra-Air Force transactions are removed from the revenue generated by all government sources by matching seller-side transactions to buyer-side transactions and eliminating those transactions which are between two Air Force entities. Total revenue from all governmental sources increased $667,523 thousand in FY 2005 over FY 2004. Intra-Air Force transactions for the same time period increased $1,462,122 thousand, leaving a decrease in revenue generated by Air Force transactions with non-Air Force governmental entities of $794,599 thousand. Driving this decrease were reductions in Air Force receipts for classified projects involving Aircraft Procurement, Research, Development, Test & Evaluation (RDT&E), and Operations & Maintenance(O&M).

Earned Revenue From the Public decreased $844,406 thousand, or 49 percent, in FY 2005. Earned Revenue From the Public was overstated in FY 2004 and the first three quarters of FY 2005 due to an Air Force Equipment Management System (AFEMS) problem that incorrectly posted suspended transactions to Other Gains when they should have been posted to Other Expenses not Requiring Budgetary Resources. The error was discovered in late FY 2005, and $439,364 thousand in FY 2005 Other Gains were reclassified from Other Gains to Other Expenses not Requiring Budgetary Resources. Corrections to AFEMS posting logic are in process. System problems in FY 2005 posted negative accounts receivable to intra-governmental revenue. The error was discovered and corrections made, and accounts receivable balances with trading partners were reclassified from public revenue to intra-governmental revenue in FY 2005, yielding a decrease of $36,806 thousand in public revenue. Additional decreases in public revenue can be attributed to actual decreases in revenue from the public for personnel costs associated with foreign military sales ($63,714 thousand) and non-medical reimbursements from consumers ($147,780 thousand).

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

As of September 30	2005 Cumulative Results of	2005 Unexpended Appropriations	2004 Cumulative Results of	2004 Unexpended Appropriations
(Amounts in thousands)				
1. Prior Period Adjustments Increases (Decreases) to Net Position				
A. Changes in Accounting Standards	$ 0	$ 0	$ 0	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	0	0	0	0
C. Other Prior Period Adjustments	0	0	0	0
D. Total Prior Period Adjustments	$ 0	$ 0	$ 0	$ 0
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	$ 236,321	$ 0	$ 244,900	$ 0
B. Civilian Health	427,569	0	393,519	0
C. Civilian Life Insurance	1,398	0	1,316	0
D. Judgment Fund	76,751	0	23,872	0
E. Intra-Entity	0	0	0	0
F. Total Imputed Financing	$ 742,039	$ 0	$ 663,607	$ 0

Relevant Information for Comprehension

Imputed Financing

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

The total Civilian Retirement imputed financing of $236,322 thousand is comprised of $207,471 thousand for the CSRS and $28,851 thousand for the FERS.

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

Note Reference

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

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2005	2004
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 54,587,501	$ 42,905,248
2. Available Borrowing and Contract Authority at the End of the Period	0	0

Other Information Related to the Statement of Budgetary Resources

The amount of direct obligations incurred and apportioned under category A is $70,014,669 thousand, category B is $54,673,386 thousand, and exempt is $1,370 thousand. For reimbursable obligations incurred and apportioned, category A is $8,543,615 thousand, category B is $3,904,940 thousand, and exempt is $0.

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

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

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

Note 21. Disclosures Related to the Statement of Financing

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

Note 1A and Note 1F provide additional detail.

Other Information Related to the Statement of Financing

Components Requiring or Generating Resources in Future Period, Other consists of $13,659 thousand in closed year liabilities. Components Not Requiring or Generating Resources, Other consists of $171,533 thousand in bad debt expense, $15,178,363 thousand in Other Expenses not Requiring Budgetary Resources, and $(2,914,308) thousand in Cost Capitalization Offset.

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

Intra-entity transactions have not been eliminated because the statements are presented as combined and combining.

Note 22. Disclosures Related to the Statement of Custodial Activity

Not applicable

Note 23. Other Disclosures

As of September 30	2005							
(Amounts in thousands)								
1. ENTITY AS LESSEE-Operating Leases		Land and Buildings		Equipment		Other		Total
Future Payments Due								
Fiscal Year								
2006	$	80,301	$	0	$	133,321	$	213,622
2007		76,877		0		135,987		212,864
2008		100,960		0		138,716		239,676
2009		116,387		0		141,391		257,778
2010		117,543		0		144,319		261,862
After 5 Years		126,286		0		147,197		273,483
Total Future Lease Payments Due	$	618,354	$	0	$	840,931	$	1,459,285

Fluctuations

In FY 2005, projections made in FY 2004 for future land and building leases were revised. This led to a $24,885 thousand, or 31%, increase in projected building lease costs for FY 2006. This increase was driven by added lease costs of $10,700 thousand for new leases (375 additional leased units by U.S. Air Force—Europe and 13 additional leased units for trainers and recruiters at Air Education & Training Command in 2005). Increases in projections for FY 2007, FY 2008, FY 2009 and FY 2010 are also due to 1325 projected new leases of family housing units for USAF—Europe.

The bulk of the remaining $14,185 thousand FY 2005 increase was caused by anticipated unfavorable changes in the exchange rate between the U.S. dollar and European currencies. Foreign exchange rate calculations made by the Department of Defense, Office of the Secretary of Defense for Acquisition, Technology and Logistics—Housing Directorate account for the bulk of these changes. Working in conjunction with its military counterparts, the 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. The new exchange rates were also used to project FY 2006 through FY 2010 lease expenses for Buildings and Land.

The Air Force has no leases in the Equipment Category and does not anticipate any in the future.

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

Overall lease costs for Other leases in FY 2005 rose $30,400 thousand over FY 2004 costs. Two causes drove this increase: an increase in the number of new vehicle leases and increased fuel costs charged on both new and existing leases.

New vehicle leases increased in every region in FY 2005, contributing $14,600 thousand to the total increase in Other operating lease expenses. Projections made in FY 2005 for future vehicle lease costs include these new leases. Increases in FY 2005 contributed to increased projected vehicle lease costs for FY 2006, FY 2007, FY 2008 and FY 2009 of $16,203 thousand, $16,527 thousand, $16,857 thousand and $17,123 thousand, respectively.

The General Services Administration (GSA) implemented a fuel surcharge of 1.5 cents per mile traveled on its leased vehicles in FY 2005; Defense Energy Support Center (DESC) has likewise raised fuel costs per gallon by approximately 25% worldwide. Increased fuel costs added $1,400 thousand to total Other lease costs in FY 2005. These fuel expense increases are also factored into projected leases costs for subsequent years.

In addition, factors unique to each geographic region added to actual costs in FY 2005, and to the projected costs in subsequent years for Other leases. The causes of rising vehicle leases by geographic region are:

Stateside, the Air Force is moving towards GSA leased vehicles within light, medium and heavy duty class vehicles at stateside bases. Moving towards GSA leased vehicles enables the Air Force to obtain alternative fuel vehicles that satisfy petroleum conservation requirements mandated by the Energy Policy and Conservation Act (EPACT) of 1992/2005 and Executive Order 13149. Air Force is now leasing 1,802 more GSA vehicles over the same period last year. These additional leases contributed $7,400 thousand to the overall increase in FY 2005.

The number of commercial vehicle leases in Europe has increased as well. New European leases contributed $3,188 thousand to the overall increase.

The Air Force realized an overall increase of $4,000 thousand in commercial vehicle leases in SWA in FY 2005. Commercial leases for comparable vehicles can cost as much as 10 times more in SWA than stateside. Vehicle leases in SWA therefore account for a disproportionate amount (nearly one third) of Air Force Other lease costs worldwide.

Fluctuations in commercial lease cost data for Other leases also reflect cumbersome data collection at deployment locations in SWA. Late in FY 2005, units at deployed locations began implementing uniform procedures established by the HQ Air Combat Command and Transportation Division. As a result, Vehicle Maintenance Managers now receive improved training in leased vehicle procurement, accountability and standardized data reporting prior to deployment to SWA. This additional training is helping to reduce data reporting errors, and summary statements are now provided whenever significant fluctuations occur.

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General Fund

Consolidating and Combining Statements

Consolidating Balance Sheet—General Fund

As of September 30, 2005 and 2004 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard
ASSETS (Note 2)			
Intra-governmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 59,428,317	$ 1,051,111	$ 1,793,539
Non-Entity Seized Iraqi Cash	0	0	0
Non-Entity-Other	77,275	0	0
Investments (Note 4)	717	0	0
Accounts Receivable (Note 5)	1,206,890	47,391	175,650
Other Assets (Note 6)	31	0	0
Total Intra-governmental Assets	$ 60,713,230	$ 1,098,502	$ 1,969,189
Cash and Other Monetary Assets (Note 7)	$ 151,844	$ 0	$ 0
Accounts Receivable (Note 5)	998,501	8,718	21,091
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property (Note 9)	44,108,240	442,477	2,618,296
General Property, Plant and Equipment (Note 10)	119,735,929	958,811	2,951,328
Investments (Note 4)	0	0	0
Other Assets (Note 6)	11,154,741	5,717	18,583
TOTAL ASSETS	$ 236,862,485	$ 2,514,225	$ 7,578,487
LIABILITIES (Note 11)			
Intra-governmental:			
Accounts Payable (Note 12)	$ 703,276	$ 31,505	$ 74,770
Debt (Note 13)	0	0	0
Other Liabilities (Note 15 & Note 16)	2,080,613	2,182	938
Total Intra-governmental Liabilities	$ 2,783,889	$ 33,687	$ 75,708
Accounts Payable (Note 12)	$ 5,620,700	$ 72,861	$ 122,366
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	823,713	120,179	203,545
Environmental Liabilities (Note 14)	5,781,322	0	0
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	3,896,185	119,668	163,651
TOTAL LIABILITIES	$ 18,905,809	$ 346,395	$ 565,270
NET POSITION			
Unexpended Appropriations	$ 61,864,263	$ 907,247	$ 1,677,255
Cumulative Results of Operations	156,092,413	1,260,583	5,335,962
TOTAL NET POSITION	$ 217,956,676	$ 2,167,830	$ 7,013,217
TOTAL LIABILITIES AND NET POSITION	$ 236,862,485	$ 2,514,225	$ 7,578,487

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

Component Level	Combined Total	Eliminations	2005 Consolidated	2004 Consolidated
$ 0	$ 62,272,967	$ 0	$ 62,272,967	$ 60,547,709
0	0	0	0	0
0	77,275	0	77,275	53,290
0	717	0	717	711
-776,342	653,589	0	653,589	689,871
427,958	427,989	0	427,989	443,939
$ -348,384	$ 63,432,537	$ 0	$ 63,432,537	$ 61,735,520
$ 0	$ 151,844	$ 0	$ 151,844	$ 311,323
0	1,028,310	0	1,028,310	978,883
0	0	0	0	0
0	47,169,013	0	47,169,013	51,340,248
0	123,646,068	0	123,646,068	117,954,430
0	0	0	0	0
0	11,179,041	0	11,179,041	10,809,588
$ -348,384	$ 246,606,813	$ 0	$ 246,606,813	$ 243,129,992
$ 842,353	$ 1,651,904	$ 0	$ 1,651,904	$ 1,900,411
0	0	0	0	0
-493,866	1,589,867	0	1,589,867	1,726,480
$ 348,487	$ 3,241,771	$ 0	$ 3,241,771	$ 3,626,891
$ 35,257	$ 5,851,184	$ 0	$ 5,851,184	$ 7,707,163
0	1,147,437	0	1,147,437	1,163,442
0	5,781,322	0	5,781,322	7,387,187
0	0	0	0	0
0	4,179,504	0	4,179,504	4,602,505
$ 383,744	$ 20,201,218	$ 0	$ 20,201,218	$ 24,487,188
$ -732,128	$ 63,716,637	$ 0	$ 63,716,637	$ 49,660,670
0	162,688,958	0	162,688,958	168,982,134
$ -732,128	$ 226,405,595	$ 0	$ 226,405,595	$ 218,642,804
$ -348,384	$ 246,606,813	$ 0	$ 246,606,813	$ 243,129,992

Consolidating Statement of Net Cost—General Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard
Program Costs			
A. Military Personnel	0		
Intra-governmental Gross Costs	$ -2,370	$ 55,752	$ 295,858
(Less: Intra-governmental Earned Revenue)	-275,622	-4,927	-18,871
Intra-governmental Net Costs	$ -277,992	$ 50,825	$ 276,987
Gross Costs With the Public	26,533,041	1,328,708	2,228,638
(Less: Earned Revenue From the Public)	-102,980	12	-9,944
Net Costs With the Public	$ 26,430,061	$ 1,328,720	$ 2,218,694
Total Net Cost	$ 26,152,069	$ 1,379,545	$ 2,495,681
B. Operation and Maintenance	0		
Intra-governmental Gross Costs	$ 16,530,530	$ 742,927	$ 1,947,990
(Less: Intra-governmental Earned Revenue)	-3,512,031	-296,275	-588,762
Intra-governmental Net Costs	$ 13,018,499	$ 446,652	$ 1,359,228
Gross Costs With the Public	23,951,923	2,251,507	5,706,030
(Less: Earned Revenue From the Public)	-502,991	-1,800	-77,534
Net Costs With the Public	$ 23,448,932	$ 2,249,707	$ 5,628,496
Total Net Cost	$ 36,467,431	$ 2,696,359	$ 6,987,724
C. Procurement	0		
Intra-governmental Gross Costs	$ 17,606,563	$ 0	$ 0
(Less: Intra-governmental Earned Revenue)	-316,706	0	0
Intra-governmental Net Costs	$ 17,289,857	$ 0	$ 0
Gross Costs With the Public	12,496,105	0	0
(Less: Earned Revenue From the Public)	-92,344	0	0
Net Costs With the Public	$ 12,403,761	$ 0	$ 0
Total Net Cost	$ 29,693,618	$ 0	$ 0
D. Research, Development, Test & Evaluation	0		
Intra-governmental Gross Costs	$ 9,218,480	$ 0	$ 0
(Less: Intra-governmental Earned Revenue)	-3,174,483	0	0
Intra-governmental Net Costs	$ 6,043,997	$ 0	$ 0
Gross Costs With the Public	14,262,616	0	0
(Less: Earned Revenue From the Public)	-160,712	0	0
Net Costs With the Public	$ 14,101,904	$ 0	$ 0
Total Net Cost	$ 20,145,901	$ 0	$ 0
E. Military Construction/Family Housing	0		
Intra-governmental Gross Costs	$ 272,226	$ 163	$ -7,524
(Less: Intra-governmental Earned Revenue)	1,168	0	0
Intra-governmental Net Costs	$ 273,394	$ 163	$ -7,524
Gross Costs With the Public	-276,055	-10,215	218,070
(Less: Earned Revenue From the Public)	0	0	0
Net Costs With the Public	$ -276,055	$ -10,215	$ 218,070
Total Net Cost	$ -2,661	$ -10,052	$ 210,546
F. Other	0		
Intra-governmental Gross Costs	$ 13,069	$ 0	$ 0
(Less: Intra-governmental Earned Revenue)	0	0	0
Intra-governmental Net Costs	$ 13,069	$ 0	$ 0
Gross Costs With the Public	-393,961	0	0
(Less: Earned Revenue From the Public)	-12,817	0	0
Net Costs With the Public	$ -406,778	$ 0	$ 0
Total Net Cost	$ -393,709	$ 0	$ 0
G. Total Program Costs	0		
Intra-governmental Gross Costs	$ 43,638,498	$ 798,842	$ 2,236,324
(Less: Intra-governmental Earned Revenue)	-7,277,674	-301,202	-607,633
Intra-governmental Net Costs	$ 36,360,824	$ 497,640	$ 1,628,691
Gross Costs With the Public	76,573,669	3,570,000	8,152,738
(Less: Earned Revenue From the Public)	-871,844	-1,788	-87,478
Net Costs With the Public	$ 75,701,825	$ 3,568,212	$ 8,065,260
Total Net Cost	$ 112,062,649	$ 4,065,852	$ 9,693,951
Cost Not Assigned to Programs	0	0	0
(Less:Earned Revenue Not Attributable to Programs)	0	0	0
Net Cost of Operations	$ 112,062,649	$ 4,065,852	$ 9,693,951

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

Component Level	Combined Total	Eliminations	2005 Consolidated	2004 Consolidated
	$ 349,240	$ 0	$ 349,240	$ 319,206
	-299,420	0	-299,420	-315,349
	$ 49,820	$ 0	$ 49,820	$ 3,857
	30,090,387	0	30,090,387	29,708,361
	-112,912	0	-112,912	-106,551
	$ 29,977,475	$ 0	$ 29,977,475	$ 29,601,810
	$ 30,027,295	$ 0	$ 30,027,295	$ 29,605,667
	$ 19,221,447	$ 0	$ 19,221,447	$ 16,886,951
	-4,397,068	0	-4,397,068	-4,385,376
	$ 14,824,379	$ 0	$ 14,824,379	$ 12,501,575
	31,909,460	0	31,909,460	28,465,443
	-582,325	0	-582,325	-644,464
	$ 31,327,135	$ 0	$ 31,327,135	$ 27,820,979
	$ 46,151,514	$ 0	$ 46,151,514	$ 40,322,554
	$ 17,606,563	$ 0	$ 17,606,563	$ 652,495
	-316,706	0	-316,706	-265,408
	$ 17,289,857	$ 0	$ 17,289,857	$ 387,087
	12,496,105	0	12,496,105	27,231,988
	-92,344	0	-92,344	-401,470
	$ 12,403,761	$ 0	$ 12,403,761	$ 26,830,518
	$ 29,693,618	$ 0	$ 29,693,618	$ 27,217,605
	$ 9,218,480	$ 0	$ 9,218,480	$ 791,689
	-3,174,483	0	-3,174,483	-2,553,633
	$ 6,043,997	$ 0	$ 6,043,997	$ -1,761,944
	14,262,616	0	14,262,616	20,987,117
	-160,712	0	-160,712	-174,458
	$ 14,101,904	$ 0	$ 14,101,904	$ 20,812,659
	$ 20,145,901	$ 0	$ 20,145,901	$ 19,050,715
	$ 264,865	$ 0	$ 264,865	$ 200,852
	1,168	0	1,168	781
	$ 266,033	$ 0	$ 266,033	$ 201,633
	-68,200	0	-68,200	585,403
	0	0	0	0
	$ -68,200	$ 0	$ -68,200	$ 585,403
	$ 197,833	$ 0	$ 197,833	$ 787,036
$ -16,827,921	$ -16,814,852	$ 0	$ -16,814,852	$ 10,058,671
3,978,861	3,978,861	0	3,978,861	2,516,739
$ -12,849,060	$ -12,835,991	$ 0	$ -12,835,991	$ 12,575,410
11,239,824	10,845,863	0	10,845,863	-10,472,324
81,181	68,364	0	68,364	-397,393
$ 11,321,005	$ 10,914,227	$ 0	$ 10,914,227	$ -10,869,717
$ -1,528,055	$ -1,921,764	$ 0	$ -1,921,764	$ 1,705,693
$ -16,827,921	$ 29,845,743	$ 0	$ 29,845,743	$ 28,909,864
3,978,861	-4,207,648	0	-4,207,648	-5,002,246
$ -12,849,060	$ 25,638,095	$ 0	$ 25,638,095	$ 23,907,618
11,239,824	99,536,231	0	99,536,231	96,505,988
81,181	-879,929	0	-879,929	-1,724,336
$ 11,321,005	$ 98,656,302	$ 0	$ 98,656,302	$ 94,781,652
$ -1,528,055	$ 124,294,397	$ 0	$ 124,294,397	$ 118,689,270
0	0	0	0	0
0	0	0	0	0
$ -1,528,055	$ 124,294,397	$ 0	$ 124,294,397	$ 118,689,270

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

Consolidating Statement of Changes in Net Position—General Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 159,814,485	$ 1,604,932	$ 7,562,717
Adjustments (+/-)			
Changes in Accounting Principles (+/-)	0	0	0
Correction of Errors (+/-)	0	0	0
Beginning Balances, as adjusted	159,814,485	1,604,932	7,562,717
Budgetary Financing Sources:			
Appropriations received	0	0	0
Appropriations transferred-in/out (+/-)	0	0	0
Other adjustments (rescissions, etc.) (+/-)	0	0	0
Appropriations used	105,465,154	3,699,577	7,489,194
Nonexchange revenue	920	0	0
Donations and forfeitures of cash and cash equivalents	1,860	0	0
Transfers-in/out without reimbursement (+/-)	967,200	0	0
Other budgetary financing sources (+/-)	0	0	0
Other Financing Sources:			
Donations and forfeitures of property	0	0	0
Transfers-in/out without reimbursement (+/-)	-181,453	21,925	-21,997
Imputed financing from costs absorbed by others	742,039	0	0
Other (+/-)	0	0	0
Total Financing Sources	106,995,720	3,721,502	7,467,197
Net Cost of Operations (+/-)	112,062,649	4,065,852	9,693,951
Net Change	-5,066,929	-344,350	-2,226,754
Ending Balance	$ 154,747,556	$ 1,260,582	$ 5,335,963
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ 49,486,289	$ 803,393	$ 1,787,049
Prior period adjustments (+/-)			
Changes in Accounting Principles (+/-)	0	0	0
Correction of Errors (+/-)	0	0	0
Beginning Balances, as adjusted	49,486,289	803,393	1,787,049
Budgetary Financing Sources:			
Appropriations received	117,808,827	3,821,047	7,258,314
Appropriations transferred-in/out (+/-)	1,478,871	11,026	141,342
Other adjustments (rescissions, etc) (+/-)	-1,444,570	-28,642	-20,256
Appropriations used	-105,465,154	-3,699,577	-7,489,194
Nonexchange revenue	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0
Transfers-in/out without reimbursement (+/-)	0	0	0
Other budgetary financing sources (+/-)	0	0	0
Other Financing Sources:			
Donations and forfeitures of property	0	0	0
Transfers-in/out without reimbursement (+/-)	0	0	0
Imputed financing from costs absorbed by others	0	0	0
Other (+/-)	0	0	0
Total Financing Sources	12,377,974	103,854	-109,794
Net Cost of Operations (+/-)			
Net Change	12,377,974	103,854	-109,794
Ending Balance	$ 61,864,263	$ 907,247	$ 1,677,255

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

Component Level	Combined Total	Eliminations	2005 Consolidated	2004 Consolidated
$ 0	$ 168,982,134	$ 0	$ 168,982,134	$ 161,327,684
0	0	0	0	0
0	0	0	0	0
0	168,982,134	0	168,982,134	161,327,684
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
-1,683,933	114,969,992	0	114,969,992	124,686,986
0	920	0	920	8,827
0	1,860	0	1,860	2,171
0	967,200	0	967,200	671,000
0	0	0	0	0
0	0	0	0	0
155,877	-25,648	0	-25,648	311,130
0	742,039	0	742,039	663,607
0	0	0	0	0
-1,528,056	116,656,363	0	116,656,363	126,343,721
-1,528,055	124,294,397	0	124,294,397	118,689,270
-1	-7,638,034	0	-7,638,034	7,654,451
$ -1	$ 161,344,100	$ 0	$ 161,344,100	$ 168,982,135
$ -2,416,061	$ 49,660,670	$ 0	$ 49,660,670	$ 50,742,317
0	0	0	0	0
0	0	0	0	0
-2,416,061	49,660,670	0	49,660,670	50,742,317
0	128,888,188	0	128,888,188	125,480,665
0	1,631,239	0	1,631,239	-454,456
0	-1,493,468	0	-1,493,468	-1,420,870
1,683,933	-114,969,992	0	-114,969,992	-124,686,986
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
1,683,933	14,055,967	0	14,055,967	-1,081,647
1,683,933	14,055,967	0	14,055,967	-1,081,647
$ -732,128	$ 63,716,637	$ 0	$ 63,716,637	$ 49,660,670

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

Combining Statement of Budgetary Resources—General Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	Air Force Active	Air Force Reserve
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 117,811,607	$ 3,821,047
Borrowing authority	0	0
Contract authority	0	0
Net transfers (+/-)	409,785	31,026
Other	0	0
Unobligated balance:		
Beginning of period	8,586,693	123,021
Net transfers, actual (+/-)	2,036,286	-20,000
Anticipated Transfers Balances	0	0
Spending authority from offsetting collections:		
Earned	0	0
Collected	7,863,996	367,750
Receivable from Federal sources	207,029	-64,747
Change in unfilled customer orders	0	0
Advance received	349,671	0
Without advance from Federal sources	386,137	1,881
Anticipated for the rest of year, without advances	0	0
Previously unavailable	0	0
Transfers for trust funds	0	0
Subtotal	8,806,833	304,884
Recoveries of prior year obligations	1,029,817	86,331
Temporarily not available pursuant to Public Law	0	0
Permanently not available	-1,444,570	-28,642
Total Budgetary Resources	$ 137,236,451	$ 4,317,667
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 113,497,488	$ 3,787,130
Reimbursable	11,423,914	306,731
Subtotal	124,921,402	4,093,861
Unobligated balance:		4,093,861
Apportioned	11,526,850	79,393
Exempt from apportionment	3,218	0
Other available	1	0
Unobligated Balances Not Available	784,980	144,413
Total, Status of Budgetary Resources	$ 137,236,451	$ 4,317,667
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	$ 49,104,743	$ 786,248
Obligated Balance transferred, net (+/-)	0	0
Obligated Balance, Net - end of period:		
Accounts receivable	-1,379,402	-50,176
Unfilled customer order from Federal sources	-1,213,193	-1,932
Undelivered orders	42,425,919	679,671
Accounts payable	7,018,470	199,742
Outlays:		
Disbursements	125,551,368	4,029,339
Collections	-8,213,667	-367,750
Subtotal	117,337,701	3,661,589
Less: Offsetting receipts	-123,202	0
Net Outlays	$ 117,214,499	$ 3,661,589

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

Air National Guard	Component Level	2005 Combined	2004 Combined
$ 7,258,314	$ 0	$ 128,890,968	$ 125,483,786
0	0	0	0
0	0	0	0
197,342	0	638,153	-29,394
0	0	0	0
333,650	0	9,043,364	9,189,946
-56,000	0	1,960,286	245,938
0	0	0	0
0	0	0	0
691,786	0	8,923,532	8,117,605
666	0	142,948	317,565
0	0	0	0
0	0	349,671	188,072
525	0	388,543	-109,981
0	0	0	0
0	0	0	0
0	0	0	0
692,977	0	9,804,694	8,513,261
184,043	0	1,300,191	1,431,079
0	0	0	0
-20,256	0	-1,493,468	-1,437,653
$ 8,590,070	$ 0	$ 150,144,188	$ 143,396,963
$ 7,404,806	$ 0	$ 124,689,424	$ 129,913,273
717,910	0	12,448,555	4,447,386
8,122,716	0	137,137,979	134,360,659
150,638	0	11,756,881	8,072,566
0	0	3,218	2,709
0	0	1	-1
316,716	0	1,246,109	961,030
$ 8,590,070	$ 0	$ 150,144,188	$ 143,396,963
$ 1,613,142	$ 0	$ 51,504,133	$ 50,541,583
0	0	0	0
-189,982	0	-1,619,560	-1,476,612
-812	0	-1,215,937	-827,393
1,192,089	-1,653,952	42,643,727	42,309,792
324,889	1,653,952	9,197,053	11,505,411
8,224,440	0	137,805,147	131,752,381
-691,786	0	-9,273,203	-8,305,678
7,532,654	0	128,531,944	123,446,703
0	0	-123,202	-115,376
$ 7,532,654	$ 0	$ 128,408,742	$ 123,331,327

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

Combining Statement of Financing—General Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	Air Force Active	Air Force Reserve
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 124,921,402	$ 4,093,861
Less: Spending authority from offsetting collections and recoveries (-)	-9,836,649	-391,215
Obligations net of offsetting collections and recoveries	115,084,753	3,702,646
Less: Offsetting receipts (-)	-123,202	0
Net obligations	114,961,551	3,702,646
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	-181,453	21,925
Imputed financing from costs absorbed by others	742,039	0
Other (+/-)	0	0
Net other resources used to finance activities	560,586	21,925
Total resources used to finance activities	115,522,137	3,724,571
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered Orders (-)	-10,235,882	-4,938
Unfilled Customer Orders	735,808	1,881
Resources that fund expenses recognized in prior periods	-594,728	-8,661
Budgetary offsetting collections and receipts that do not affect net cost of operations	123,202	0
Resources that finance the acquisition of assets	-17,776,704	-45,012
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0	0
Other (+/-)	181,453	-21,925
Total resources used to finance items not part of the net cost of operations	-27,566,851	-78,655
Total resources used to finance the net cost of operations	87,955,286	3,645,916
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:		
Increase in annual leave liability	80,366	0
Increase in environmental and disposal liability	0	0
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
Increase in exchange revenue receivable from the the public (-)	0	0
Other (+/-)	13,612	29
Total components of Net Cost of Operations that will require or generate resources in future periods	93,978	29
Components not Requiring or Generating Resources:		
Depreciation and amortization	11,442,702	45,136
Revaluation of assets or liabilities (+/-)	621,661	4,631
Other (+/-)		
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	0	0
Operating Material & Supplies Used	1,949,358	9,863
Other	9,999,663	360,276
Total components of Net Cost of Operations that will not require or generate resources	24,013,384	419,906
Total components of net cost of operations that will not require or generate resources in the current period	24,107,362	419,935
Net Cost of Operations	$ 112,062,648	$ 4,065,851

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

Air National Guard	Component Level	2005 Consolidated	2004 Consolidated
$ 8,122,716	$ 0	$ 137,137,979	$ 134,360,658
-877,020	0	-11,104,884	-9,944,341
7,245,696	0	126,033,095	124,416,317
0	0	-123,202	-115,376
7,245,696	0	125,909,893	124,300,941
0	0	0	0
-21,997	155,877	-25,648	311,130
0	0	742,039	663,607
0	0	0	0
-21,997	155,877	716,391	974,737
7,223,699	155,877	126,626,284	125,275,678
242,973	-1,683,933	-11,681,780	201,266
525	0	738,214	78,091
-3,137	0	-606,526	-896,088
0	0	123,202	115,376
-207,892	0	-18,029,608	-16,068,394
0	0	0	0
21,997	-155,877	25,648	-311,130
54,466	-1,839,810	-29,430,850	-16,880,879
7,278,165	-1,683,933	97,195,434	108,394,799
658	0	81,024	137,700
0	0	0	0
0	0	0	0
0	0	0	0
18	0	13,659	53,205
676	0	94,683	190,905
255,260	0	11,743,098	9,847,705
5,666	155,877	787,835	-938,081
0	0	0	0
0	0	0	0
78,537	0	2,037,758	3,919,002
2,075,648	0	12,435,587	-2,725,063
2,415,111	155,877	27,004,278	10,103,563
2,415,787	155,877	27,098,961	10,294,468
$ 9,693,952	$ -1,528,056	$ 124,294,395	$ 118,689,267

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

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General Fund

Required Supplementary Stewardship Information

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NATIONAL DEFENSE PROPERTY, PLANT AND EQUIPMENT

The Federal Accounting Standards Advisory Board (FASAB) revised the Statement of Federal Financial Accounting Standards No. 6 to require the capitalization and Depreciation of military equipment (formerly National Defense Property, Plant and Equipment/ND PP&E) for fiscal years (FY) 2004 and beyond and encouraged early implementation.

HERITAGE ASSETS

For Fiscal Year Ended September 2005

	Measurement Quantities	As Of 10/1/2004	Additions	Deletions	As Of 9/30/2005
Museums	Each	19	0	0	19
Monuments & Memorials	Each	244	0	0	244
Cemeteries	Sites	39	0	0	39
Archeological Sites	Sites	1,685	168	168	1,685
Buildings & Structures	Each	5,968	193	8	6,153
Major Collections	Each	4	0	0	4

Narrative Statement:

1. Museums

The Air Force Museum, located at Wright-Patterson Air Force Base, Ohio, houses the main collection of historical artifacts that are registered as historical property in the USAF Museum System. The other 17 Air Force museums are considered Air Force Field Museums or Heritage Centers, which also contain items of historical interest; some however, are specific to the general locality. The 19th museum belonging to the Air National Guard, in good condition with significant architectural characteristic, was erroneously not reported in FY 04.

All museums and Heritage Centers are reported in acceptable condition.

2. Monuments and Memorials

The memorials and monuments reported above, except for 28, are all located at the Air Force Academy in the Air Gardens and Honor Court. Most of these monuments and memorials honor specific individuals or cadet wings for various accomplishments. The remaining 28 Air Force memorials, all with costs that exceed $100,000, are located on various Air Force bases throughout the United States. All are reported in acceptable condition. There are 120 memorials and monuments belonging to the Air National Guard, which were erroneously omitted from the FY04 Report, all in good condition.

The Air Force made an adjustment to the beginning balance of 91 monuments and memorials do to an oversight of not including the Air National Guard in previous reporting periods.

3. Cemeteries

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

4. Archeological Sites

As of 30 September 2005, the Air Force has (as reported in the FY04 Annual Report to Congress on Federal Archaeological Activity, submitted 30 March 05) 1,685 archeological sites listed on or eligible for the National

Register. The Air Force has 9,292 recorded but unevaluated (AKA "potentially eligible") archeological sites, and 4,327 sites, considered not eligible for the Register. A total of 15,304 archeological sites have been reported so far from Air Force lands. Eligible site and unevaluated sites (both herein considered heritage assets) are maintained in an acceptable condition.

Changes in site numbers from those reported last year are the result of several factors: (1) Each year the Air Force performs additional surveys of un-inventoried lands, in accordance with Sections 106 and 110 of the National Historical Reservation Act. The average number of acres surveyed each year is around 100,000. These surveys yield about 600 newly reported archaeological sites per year. (2) Relatively few (or sometimes none) of these newly reported sites are evaluated for eligibility during their discovery year. The Air Force programs evaluations of a significant portion of the backlog of "potentially eligible" sites every year, so the number of unevaluated sites diminishes, and the number of eligible and ineligible sites increase. (3) By coincidence, the number of sites considered eligible increased by the same amount of eligible sites removed from the Air Force eligible inventory by data recovery, development, re-valuation, and closure of transfer. For that reason, the number of eligible sites listed in the FY 05 report is the same: 1685.

5. Buildings and Structures

As of 30 September 2005 (as reported in the FY04 Annual Report to Congress on Federal Archaeological Activities, submitted 30 March 2005), the Air Force considers 6,153 buildings and structures as heritage assets (listed, eligible, and potentially eligible buildings/structures). Most are considered Multi-use Heritage Assets, and as such, are reported as general Property, Plant, and Equipment on the balance sheet. These buildings and structures are maintained by each base civil engineering group and are considered to be in good condition. A discrepancy was discovered in the FY 04 RSSI data reported: Instead of the 4,074 reported buildings and structures last year, the actual total should have been 5,968. The error was due to a categorical omission of data set. So the increase in historical buildings and structures between FY 04 and FY 05 is only 193 (with 8 buildings reported as disposed). Most of the 193 newly counted buildings and structures are those turning 50 years of age in FY 05 that have not yet been fully evaluated, but are considered "potentially eligible" for the national Register.

6. Major Collections

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

STEWARDSHIP LAND
For Fiscal Year Ended September 2005
(Acres in Thousands)

(a) Land Use	(b) As of 10/1/2004	(c) Additions	(d) Deletions	(e) As of 9/30/2004
1. Mission	7,728	0	0	7,728
2. Parks & Historic Sites	0	0	0	0
Totals	7,728	0	0	7,728

The Air Force has approximately 7,728,000 acres of mission-essential Stewardship land under their administration. Lands purchased by the Air Force with the intent to construct buildings or facilities are considered general PP&E and are reported on the balance sheet. All stewardship lands, as reported, are in acceptable condition, based on designated use.

NONFEDERAL PHYSICAL PROPERTY
Yearly Investment in State and Local Governments
For Fiscal Years 2001 through 2005
($ in Millions)

Categories	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Funded Assets:					
National Defense Mission Related	$20.20	$21.30	$11.31	$18.30	$8.30
Total	$20.20	$21.30	$11.31	$18.30	$8.30

Narrative Statement:

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

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

INVESTMENTS IN RESEARCH AND DEVELOPMENT
Yearly Investment in Research and Development
For Fiscal Years 2001 through 2005
($ in Millions)

Categories	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
1. Basic Research	$207	$205	$220	$209	$287
2. Applied Research	582	658	735	805	805
3. Development					
Advanced Technology Development	560	559	545	681	966
Advanced Component Development and Prototypes	5,209	4,640	4,385	1,426	1,897
System Development and Demonstration	3,358	3,509	4,341	4,390	4,179
Research, Development, Test and Evaluation Management Support	777	824	880	890	824
Operational Systems Development	6,872	7,103	7,571	10,361	10,083
Totals	$17,565	$17,498	$18,677	$18,762	$19,041

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

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

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

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

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

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

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

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

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

Basic Research—The Air Force supported basic researchers have developed a method to produce gallium nitride material for use in improved semiconductor devices. This advance could enable improved electronics that can perform in harsh environments. Possible applications include: remote-sensing platforms; displays and indicators based on light-emitting diodes; laser diodes for optical data storage; and sensor and detector surveillance systems, such as the solar-blind shield and biological agent detectors.

Air Force supported basic researchers have discovered a new method of improving digital signal processing through holography. These holographic systems are able to record fast events that occur on the nanosecond timescale. This advance could lead to significant improvements in our capability to track and identify enemy aircraft and missile threats.

Applied Research—The Air Force's Applied Research program is developing technologies to support the air and space force of the future. Development of electronic components and subsystems for use in shallow-depth phased-array radar antennas for persistent intelligence, surveillance, and reconnaissance and time-sensitive strike capabilities. Such phased-array antennas, at 1/5 the cost of conventional antennas, could have direct application to advanced unmanned aerial vehicles and fighter aircraft. Wireless Intrusion Detection System sensors for information assurance were designed, developed, and field-tested. This program opens door for secure operation of military wireless networks based on this widely available and cost-effective technology.

Advanced Technology Development—The Air Force's Advanced Technology Development program demonstrates, in a realistic operational environment, integrated sets of technology to prove military worth and utility. The first example was the AF and the Defense Advanced Research Projects Agency conducted a successful jettison release of a weapon from a Boeing X-45A Joint Unmanned Combat Air System (J-UCAS) over the Precision Impact Range Area (PIRA) at Edwards Air Force Base, CA. It is an aviation-first for a UAV to release from an internal weapons bay. Secondly, AFRL also demonstrated a 330 Gigahertz detector that operates at frequencies billions of times faster than the blink of an eye. This technology will be used to produce compact solid-state circuits operating at Terahertz frequencies. Likely technology application would be to enable a new generation of sensors to enhance homeland security. Completed the final transition of the very successful Laser Infrared Countermeasures Fly-out Experiment demonstration with a final risk reduction live fire missile test at Tonopah National Test Range, Nevada. This test showed conclusively that Closed Loop Infrared Countermeasures jamming techniques provide a robust capability against a wide variety of infrared missiles, including proliferated Man Portable Air Defense Systems.

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

Demonstration and Validation (Advanced Component Development and Prototypes)—The Air Force's Advanced Component Development and Prototypes (ACD&EP) programs are comprised of system specific advanced technology integration efforts accomplished in an operational environment to help expedite transition from the effort: In FY04 the Air Force successfully demonstrated Fighter Aircraft Command and Control Enhancement (FACE). FACE provides an improved, beyond-line-of-sight (BLOS) command and control link with fighter aircraft by integrating Iridium telephone communications equipment with existing aircraft communications equipment. BLOS capability has traditionally been provided by low-density, high-demand airborne platforms acting as communications relays. FACE provides relief for these overworked assets, while allowing combatant commanders to maintain positive control of the battle space. FACE, which has been approved for deployment to Afghanistan through the Air Force's Rapid Response Process, has the potential for extensive use in virtually any Area of Responsibility, including Homeland Defense.

In FY04, the joint DARPA/Air Force program office awarded Falcon contracts (other transaction agreements administered by DARPA) for the development and demonstration of key technologies. The small responsive launch vehicle portion (four contracts) is proceeding toward a FY05 down select (to one or more contractors) with a launch no later than FY07 while the hypersonic test vehicle portion (one contract) is also working toward a FY07 launch. The ultimate goal of this technology demonstration program is to demonstrate and validate key technologies leading to residual capability and follow-on operational systems.

In FY05, the Air Force restructured and refocused the Space Radar (SR) program (formerly Space Base Radar) to address congressional concerns with technical risk, affordability, and DoD-Intelligence Community (IC) integration. In January 2005, the Secretary of Defense (SECDEF) and the Director of Central intelligence (DCI) singed a joint memo designating the SR program as the single space radar capability for the nation. The Undersecretary of the Air Force appointed a two-star general as SR System Program Director (SPD) and Program Executive Officer (PEO), and moved the SR Integrated Program Office (IPO) from Los Angeles, CA to Chantilly, VA in order to foster greater synergy with the IC. The SR program implemented a demonstration framework approach to system development. This approach will further technology maturity risk reduction and CONOPS experimentation through a mix of space, air, and land-based demonstration activities that will maximize existing assets. The SR program will provide day/night, all-weather global surface moving target indications (MTI), synthetic aperture radar (SAR) and high-resolution terrain information (HRTI) capabilities from a space-based platform. Initial launch capability is planned for FY 15.

Engineering and Manufacturing Development—The Air Force's System Demonstration and Engineering Development (SD&ED) efforts are development projects which have not received approval for full-production. The F/A-22 Raptor program is closing out Engineering and Manufacturing Development (EMD) and is now in Full Rate Production (FRP) following a successful Initial Operational Test and Evaluation (IOT&E) and Defense Acquisition Board (DAB) approval. The F/A-22 Raptor is the key enabler of joint air dominance. The Raptor is a transformational combat aircraft ready to counter persistent and emerging national security challenges for decades. Its capabilities create desired effects when, where, and for the duration they are needed. The Raptor is the best value for the money today, and the only fighter produced today that will defeat the threats of tomorrow. The air force accepted the 50th F/A-22 on 5 October 05. The Air combat command stationed at Langley AFB, Virginia, expects to achieve Initial Operational Capability (IOC) during December 05. Significant program accomplishments in fiscal year 2005 include:

- DAB approval to commerce FRP March 2005
- Delivery of first operational aircraft to the 27th Fighter Wing During May 2005
- Commencement of Follow-on Test and Evaluation (FOT&E) during August 2005
- The exceeding of over 3,400 flight test missions, logging in over 7,500 hours on the EMD aircraft fleet

The F-35 Joint Strike Fighter (JSF) program is developing a family of strike fighter aircraft for the Air Force, Navy, Marine Corps and our allies, with maximum commonality among the variants to minimize life cycle costs. The Air Force Conventional Takeoff and Landing (CTOL) variant will be a multi-role, primary air-to-ground aircraft to replace the F-16 and A-10 and complement the F/A-22. While the F/A-22 will establish air dominance, the F-35---with its combination of stealth, large internal payloads and multi-spectral avionics---will provide persistent stealth and precision engagement to the future battlespace. The F-35 has been in System Development and Demonstration (SDD) since 2001. In May 2005, the USD(AT&L) formally approved a program restructure to address design maturity issues. The F-35 is still projected to meet or exceed all Key Performance Parameters. Significant program accomplishments in fiscal year 2005 include:

- Assembly and power on of the first CTOL aircraft
- $2.4B contract awarded to General Electric/Rolls Royce Fighter Engine Team for F136 Engine SDD
- Began assembly of first Short Takeoff and Vertical landing (STOVL) aircraft

The last block of the B-1 Conventional Mission Upgrade Program (CMUP) completed development and entered full rate production. The B-1 successfully fielded JSOW and JASSM capability, achieving Required Assets Available (RAS) in October 2004; the user declared Initial Operating Capability (IOC) for JASSM on the B-1 in August 2005; and the Block E computer deliveries continued under an accelerated schedule, with new computers installed in 54 of the 67 B-1 aircraft as of September 2005. Since production is almost complete, the B-1 CMUP program was removed from OSD oversight.

The Multi-Platform – Radar Technology Insertion Program is being developed for the Global Hawk and E-10 programs as an interoperable platform-independent Ground Moving Target indicator (GMTI), Synthetic Aperture Radar (SAR) imaging, and Air Moving Target Indicator (AMTI) system-of-systems capable of providing dynamic support to operations. The MP-RTIP development is on cost and on schedule, building upon the FY 04 achievements of a Final Design Review and successful lab demonstration of a Global hawk-size radar. MP-RTIP has begun developmental fabrication for both the Global Hawk and the E-10 radars. The Global Hawk developmental testing remains on track to begin in 2007 with production deliveries projected for 2010. Additionally, the E-10 MP-RTIP variant is on schedule for a first flight demonstration in 2010. The capability that MP-RTIP promises will enhance the mission areas of air and surface surveillance and tracking with faster revisit rates, increased resolution, simultaneous tracking and SAR imaging, as well as, cruise missile defense capability. The program's continued schedule delivery for the Global Hawk program ensures next generation radar technology on time to the Warfighter.

The Theater Battle Management Core Systems (TBMCS) develops force-level and wing-level command, control, and intelligence systems to support the operational functions of the Joint Forces Air Component Commander. TBMCS has been designated the Joint System of Record for Air Tasking Order/Airspace Control Order generation within the Department of Defense. The system has shown its flexibility by successful employments in support of the Global War on Terror (OIF, OEF, ONE) as well as in support of humanitarian relief efforts (Tsunami Relief, and Hurricanes Katrina and Rita Relief). TBMCS generated over 83,000 sorties for OIF/OEF in FY04 and over 77,000 sorties in FY05. TBMCS Version 1.1.3 successfully passed test and was released to the field, providing numerous system improvements.

In FY04, the Air Force awarded contracts for Transformational Satellite Communications System (TSAT) space segment development and continued technology development for the next-generation communication satellite. The TSAT program will develop key technologies such as laser communications, internet-like communications protocols, and methods of dynamically allocating communications capability among users. The program made tremendous progress in FY 05. Key TSAT technologies were demonstrated during key risk reduction testing, and both contractors completed a successful interim Space Segment design review. As a result, sufficient risk has been retired for four of the seven key technical challenges to advance them to Technology Readiness Level (TRL) 6. A Request For Proposal for the TSAT Network and Mission Operations contract was released and a single contract is to be awarded in early FY 06. The ultimate goal is a FY 14 first launch of TSAT.

The Counter Communications Systems first system was delivered in December 2003. Air Force Space Command declared initial capability on Sept. 24, 2004, after the final two systems were delivered. The Counter Communications Systems (CCS) is operated by the 76th Space Control Squadron at Peterson AFB, Co., and is a transportable ground-based system that denies adversary satellite communications through reversible, non-destructive methods.

Research, Development, Test and Evaluation Management Support—The Air Force's Research, Development, Test and Evaluation (RDT&E) Management Support efforts include projects directed toward support of installation or operations required for general research and development use. Included would be test ranges, military construction, maintenance support of laboratories, operation and maintenance of test aircraft and ships, and studies and analyses in support of the research and development program. Example of Air Force RDT&E management support is: The Major Test and Evaluation Investment program, which funds the planning, improvements and modernization for three national asset test centers having over $10 billion of unique test facilities/capabilities operated and maintained by the Air Force for the Department of Defense (DoD) test and evaluation missions, and available to others having a requirement for their unique capabilities. The test capabilities and facilities are operated and maintained by the Air Force for the DoD test and evaluation missions, and are available to others having a requirement for their unique capabilities. Many efforts are contained within this program, but two examples are the Propulsion Wind Tunnel Upgrade at Arnold Engineering Development Center. This effort replaces outdated data acquisition, processing, and control systems and drive motors. A second example is the Threat Simulator Development program, which supports many of the AF Electronic Warfare Test Processes. Current projects focus on improved Low Radar Cross Section threat modeling and simulation, and enhanced infrared and radio frequency countermeasures testing.

Operational Systems Development — The Air Force's operational system efforts include projects in support of development acquisition programs or upgrades in System Demonstration and Development (SDD). Examples of operational systems development are: The AIM-9X Short Range Missile (SRM) completed Milestone III in May

2004, and Full-Rate Production was approved with the first full-rate production lot (Lot 5) awarded in first quarter of Fiscal year 2005. Lot 6 will be awarded in First Quarter FY 2006 and platform integration efforts for the F-16 and F-18E/F remain on track.

The Phase 3 (AIM-120C-7) effort completed System Demonstration and Development (SDD) in May 2004 and has begun Operational Test (OT). Production units for this variant began in the fourth quarter FY 2004 and will complete in the fourth quarter FY 2007. The AIM-120C-7 provides a major upgrade over the AIM-120C-6 guidance section, particularly the use of circular processor cards over previously used rectangular cards. These cards provide significant space savings within the missile for added capability in addition to providing greater processing power.

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

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

The JDAM program also started developing the JDAM supplement to the Universal Armament Interface (UAI) interface control document (ICD). JDAM's UAI ICD will be ready for integration on the F-15E's Suite 6 Operational Flight Program (OFP). UAI will reduce the complexity, schedule and cost of the weapon-aircraft integration process, decoupling weapon integration from aircraft OFP cycles.

The Small Diameter Bomb I (SDB I) program will increase the number of kills per platform or sortie (x4) while achieving required effects by improving accuracy and reducing collateral damage over current inventory weapons. SDB I is an incremental development weapon program that entered a 36-month System Development and Demonstration (SDD) of its first increment in FY04. The first Increment of SDB I will attack fixed and stationary targets using anti-jam/SAASM Inertial Navigation System (INS)/Global Positioning Satellite (GPS) aided by a very wide area differential GPS solution and standoff capability. The program has successfully completed 29 free flight events and entered the IOT&E phase of Seamless Verification in Oct 2005. The program completed a successful MS C decision in April 05 with Required Assets Available (RAA) scheduled for September 2006. The SDB will provide transformational capability to the Air Force by increasing loadout per weapon station on multiple platforms, reducing sorties and minimizing collateral damage.

The predator program successfully completed development and testing of Multiple Aircraft Control (MAC) Ground Control Stations (GCS). The MAC capability will allow a single pilot to control up to four Predators simultaneously from a single GSC. The first MAC GCS is scheduled to be available for operations late in CY 05.

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

The Air Force continues to develop the Family of Advanced Beyond Line of Sight Terminals (FAB-T) to provide robust, secure, strategic and tactical global communications for nuclear and conventional forces. This family of terminals will provide transformational communications via connectivity to Advanced EHF satellites (AEHF), Wideband Gapfiller Satellites (WGS), and the future Transformational Satellite Communications System (TSAT). Future increments of this terminal will provide laser communications in conjunction with optical capabilities on

TSAT to deliver data in excess of one GB per second, as well as a new multi-band antenna that will enable aircraft to have simultaneous connectivity to multiple satellites via a phased array construct. This capability will allow the Air Force to reduce the costs of integrating multiple antennas to communicate with different satellite constellations.

In FY04, the Air Force conducted a successful Preliminary Design Review for the Space Based Space Surveillance (SBSS) pathfinder satellite. The SBSS pathfinder program will design, build, launch and operate this single satellite with a visible sensor payload, as well as build and operate a ground segment to support initial satellite operations. The SBSS Pathfinder will detect and track objects in Earth orbit, contributing to timely space situation awareness, and is scheduled to launch in late 2009.

In FY05, the Air Force awarded a contract to begin architecture development for the Orbital Deep Space Imager (ODSI). In FY 05, three concept study contracts were awarded to further define the ODSI system. The ODSI program will deploy a satellite constellation for characterization of objects in deep space in support of overall battlespace awareness. The first ODSI launch is scheduled for FY13.

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

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General Fund

Required Supplementary Information

Disaggregated Statement of Budgetary Resources—General Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	Other	Research, Development, Test & Evaluation	Operation and Maintenance
BUDGETARY RESOURCES			
1. Budget Authority:			
1a. Appropriations received	$ 400,148.00	$ 21,029,922.00	$ 40,070,798.00
1b. Borrowing authority	0	0	0
1c. Contract authority	0	0	0
1d. Net transfers (+/-)	-396,384.00	-316,894.00	657,368.00
1e. Other	0	0	0
2. Unobligated balance:			
2a. Beginning of period	3,224.00	1,998,848.00	1,394,749.00
2b. Net transfers, actual (+/-)	0	51,366.00	1,017,182.00
2c. Anticipated Transfers Balances	0	0	0
3. Spending authority from offsetting collections:			
3a. Earned	0	0	0
1. Collected	12,799.00	3,251,279.00	4,908,057.00
2. Receivable from Federal sources	18	83,152.00	67,108.00
3b. Change in unfilled customer orders	0	0	0
1. Advance received	0	129,002.00	179,530.00
2. Without advance from Federal sources	0	292,629.00	47,970.00
3c. Anticipated for the rest of year without advances	0	0	0
3d. Transfers from trust funds	0	0	0
3e. Subtotal	0	0	0
4. Recoveries of prior year obligations	0	101,851.00	747,049.00
5. Temporarily not available pursuant to Public Law	0	0	0
6. Permanently not available	-984	-345,781.00	-455,689.00
7. Total Budgetary Resources	$ 18,821.00	$ 26,275,374.00	$ 48,634,122.00
STATUS OF BUDGETARY RESOURCES			
8. Obligations incurred:	$		
8a. Direct	2,167.00	19,969,969.00	42,232,853.00
8b. Reimbursable	12,817.00	3,563,491.00	5,301,449.00
8c. Subtotal	14,984.00	23,533,460.00	47,534,302.00
9. Unobligated balance:			
9a. Apportioned apportionment	619	3,004,781.00	109,810.00
9b. Exempt from	3,218.00	0	0
9c. Other available	0	0	0
10. Unobligated Balances Not Available	0	-262,869.00	990,008.00
11. Total, Status of Budgetary Resources	$ 18,821.00	$ 26,275,372.00	$ 48,634,120.00
12. Obligated Balance, Beginning of period	$ 7,295.00	$ 7,873,000.00	$ 16,814,207.00
13. Obligated Balance transferred, net (+/-)	0	0	0
14. Obligated Balance, Net - end of period:			
14a. Accounts receivable	-21	-306,141.00	-1,233,620.00
14b. Unfilled customer order from Federal sources	0	-668,570.00	-352,350.00
14c. Undelivered orders	-1,653,633.00	6,865,398.00	15,042,094.00
14d. Accounts payable	1,655,446.00	1,017,709.00	2,550,650.00
15. Outlays:			
15a. Disbursements	20,469.00	24,020,435.00	47,479,609.00
15b. Collections	-12,799.00	-3,380,281.00	-5,087,587.00
15c. Subtotal	7,670.00	20,640,154.00	42,392,022.00
16. Less: Offsetting receipts	-123,202.00	0	0
17. Net Outlays	$ -115,532.00	$ 20,640,154.00	$ 42,392,022.00

Procurement	Military Personnel	Military Construction/ Family Housing	2005 Combined	2004 Combined
$ 35,420,540.00	$ 29,748,267.00	$ 2,221,293.00	$ 128,890,968.00	$ 125,483,786.00
0	0	0	0	0
0	0	0	0	0
79,150.00	595,812.00	19,101.00	638,153.00	-29,394.00
0	0	0	0	0
4,190,942.00	438,056.00	1,017,546.00	9,043,364.00	9,189,946.00
934,644.00	29,670.00	-72,576.00	1,960,286.00	245,938.00
0	0	0	0	0
0	0	0	0	0
348,393.00	404,173.00	-1,168.00	8,923,532.00	8,117,605.00
-15,504.00	8,175.00	0	142,948.00	317,565.00
0	0	0	0	0
39,970.00	0	1,168.00	349,671.00	188,072.00
47,939.00	5	0	388,543.00	-109,981.00
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
159,945.00	283,903.00	7,443.00	1,300,191.00	1,431,079.00
0	0	0	0	0
-524,296.00	-93,554.00	-73,164.00	-1,493,468.00	-1,437,653.00
$ 40,681,723.00	$ 31,414,507.00	$ 3,119,643.00	$ 150,144,188.00	$ 143,396,963.00
33,054,632.00	27,781,820.00	1,647,983.00	124,689,424.00	129,913,273.00
341,456.00	3,229,342.00	0	12,448,555.00	4,447,386.00
33,396,088.00	31,011,162.00	1,647,983.00	137,137,979.00	134,360,659.00
7,108,817.00	69,381.00	1,463,473.00	11,756,881.00	8,072,566.00
0	0	0	3,218.00	2,709.00
0	0	0	1	-1
176,818.00	333,964.00	8,187.00	1,246,109.00	961,030.00
$ 40,681,723.00	$ 31,414,507.00	$ 3,119,643.00	$ 150,144,188.00	$ 143,396,963.00
$ 22,352,881.00	$ 1,806,465.00	$ 2,650,285.00	$ 51,504,133.00	$ 50,541,583.00
0	0	0	0	0
-40,468.00	-39,309.00	0	-1,619,560.00	-1,476,612.00
-195,009.00	-6	0	-1,215,937.00	-827,393.00
20,097,550.00	36,878.00	2,255,441.00	42,643,727.00	42,309,792.00
3,142,426.00	770,666.00	60,157.00	9,197,053.00	11,505,411.00
32,552,090.00	31,757,316.00	1,975,227.00	137,805,147.00	131,752,381.00
-388,363.00	-404,173.00	0	-9,273,203.00	-8,305,678.00
32,163,727.00	31,353,143.00	1,975,227.00	128,531,944.00	123,446,703.00
0	0	0	-123,202.00	-115,376.00
$ 32,163,727.00	$ 31,353,143.00	$ 1,975,227.00	$ 128,408,742.00	$ 123,331,327.00

General Property, Plant, and Equipment
Real Property Deferred Annual Sustainment and RestorationTables

As of September 30, 2005 ($ in thousands)

	Annual Sustainment FY 2005			
Property Type	1. Required	2. Appropriated	3. Executed	4. Difference
Buildings, Structures, and Utilities	2,540,229	2,369,899	1,949,650	$590,579

Notes:

1. FY05 O&M Sustainment figures include subsidies and MILPERS contribution (49% of MILPAY).

2. FY05 O&M Sustainment Required is based on Facilities Sustainment Model (FSM 5.1) per business rule direction of OSD (AT&L).

3. FY05 O&M Sustainment Appropriated amount is the FY05 PB plus/minus Congressional marks.

4. FY05 O&M Sustainment Actuals were pulled from the CRIS database. The numbers are not certified DFAS numbers and are subject to change. Certifed numbers for FY05 obligations are not expected until late Oct/early Nov 05.

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

	Annual Deferred Sustainment Trend			
Property Type	FY 2002	FY 2003	FY 2004	FY 2005
Buildings, Structures, and Utillities	808,628	417,112	550,609	590,579

Notes

RDT&E Sustainment funding obligations and expenditures are not available prior to FY04; appropriation/program element structure did not facilitate an accurate determination of this number.

Military Equipment
Deferred Maintenance Amounts

As of September 30, 2005 ($ in thousands)

Military Equipment
Deferred Maintenance Amounts

As of September 30, 2005 (Amounts in Thousands)	
(a)	(b)
Major Type	
1. Aircraft	$70,980
2. Engines	$21,580
3. Missiles	$2,400
4. Software	$44,800
5. Other Major End Items	$17,500
6. Non-MSD Exchangeables	
7. Area Base Maintenance	
8. Storage	
Total	$157,260

The figures presented are actual deferred maintenance amounts for FY05. The figures include Active Air Force, Air National Guard and the Air Force Reserve.

Required Supplemental Information - Part A AT57 - Air Force General Fund Schedule, Part A DoD Intra-governmental Asset Balances	Treasury Index:	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Executive Office of the President	11		$2.00			
Department of Agriculture	12		$2,219.00			
Department of Commerce	13		$553.00			$10,745.00
Department of the Interior	14		$1,831.00			$124,048.00
Department of Justice	15		$3,859.00			$780.00
Department of Labor	16		$12.00			
Navy General Fund	17		$43,215.00			
United States Postal Service	18		$153.00			
Department of State	19		$19,873.00			
Department of the Treasury	20	$62,350,242.00	$3,386.00		$717.00	$0.00
Army General Fund	21		$26,277.00			$2,249.00
Office of Personnel Management	24		$6.00			$52,822.00
Social Security Administration	28		$1.00			
Library of Congress	3		$4.00			
Nuclear Regulatory Commission	31		$7.00			
Department of Veterans Affairs	36		$217.00			
Government Printing Office	4		$0.00			
General Service Administration	47		$888.00			$2,339.00
National Science Foundation	49		$12,594.00			$1,413.00
General Accounting Office	5		$2.00			
Central Intelligence Agency	56		$202.00			
Environmental Protection Agency	68		$82.00			$9,701.00
Department of Transportation	69		$23,437.00			$1,484.00
Homeland Security	70		$8,939.00			($122.00)
Agency for International Development	72		$659.00			
Small Business Administration	73					$109.00
Department of Health and Human Services	75		$158.00			
National Aeronautics and Space Administration	80		$11,098.00			$45,692.00
National Archives and Records Administration	88		$25.00			
Department of Energy	89		$7,117.00			$4,480.00
Department of Education	91		$41.00			
US Army Corps of Engineers	96		$102.00			
Other Defense Organizations General Funds	97		$109,542.00			$91.00
Other Defense Organizations Working Capital Funds	97-4930		$293,245.00			$38,044.00
Army Working Capital Fund	97-4930.001		$421.00			
Navy Working Capital Fund	97-4930.002		$1,029.00			$3.00
Air Force Working Capital Fund	97-4930.003		$82,392.00			$134,111.00

Required Supplemental Information - Part B Schedule, Part B DoD Intra-governmental entity liabilities.	Treasury Index:	Accounts Payable	Debts/ Borrowings From Other Agencies	Other
Department of Agriculture	12	$225.00		
Department of Commerce	13	$3,491.00		$19.00
Department of the Interior	14	$3,099.00		$1.00
Department of Justice	15	$2,523.00		$8,105.00
Department of Labor	16			$324,795.00
Navy General Fund	17	$25,208.00		$101,858.00
Department of State	19	$5,626.00		
Department of the Treasury	20	$14,530.00		$124.00
Army General Fund	21	$58,326.00		$15,778.00
Office of Personnel Management	24	$0.00		$50,083.00
Federal Communications Commission	27	$140.00		
Social Security Administration	28	$2.00		
Nuclear Regulatory Commission	31	$66.00		
Department of Veterans Affairs	36	$8,928.00		
General Service Administration	47	$269,895.00		$24.00
National Science Foundation	49	$3,085.00		
Tennessee Valley Authority	64	$2,475.00		
Environmental Protection Agency	68	$12.00		
Department of Transportation	69	$42,551.00		$351.00
Homeland Security	70	$14,526.00		
Agency for International Development	72	$11,760.00		
Department of Health and Human Services	75	$268.00		$0.00
National Aeronautics and Space Administration	80	$75,970.00		$8.00
Department of Energy	89	$27,052.00		$3,110.00
US Army Corps of Engineers	96	$1,035.00		
Other Defense Organizations General Funds	97	$61,219.00		$397,780.00
Other Defense Organizations Working Capital Funds	97-4930	$586,952.00		$62.00
Army Working Capital Fund	97-4930.001	$5,609.00		
Navy Working Capital Fund	97-4930.002	$15,615.00		
Air Force Working Capital Fund	97-4930.003	$411,716.00		$48,076.00
The General Fund of the Treasury	99			$639,694.00

Required Supplemental Information - Part C AT57 - Air Force General Fund Schedule, Part C DoD Intra-governmental revenue and related costs.	Treasury Index:	Earned Revenue
Executive Office of the President	11	$8,787.00
Department of Agriculture	12	$2,008.00
Department of Commerce	13	$565.00
Department of the Interior	14	$308.00
Department of Justice	15	$13,434.00
Department of Labor	16	$268.00
Navy General Fund	17	$283,057.00
United States Postal Service	18	$580.00
Department of State	19	$29,538.00
Department of the Treasury	20	$41,685.00
Army General Fund	21	$179,263.00
Office of Personnel Management	24	$7.00
Library of Congress	3	$33.00
Nuclear Regulatory Commission	31	$7.00
Department of Veterans Affairs	36	$829.00
Government Printing Office	4	$2.00
General Service Administration	47	$1,991.00
National Science Foundation	49	$61,202.00
General Accounting Office	5	$21.00
Central Intelligence Agency	56	$1,315.00
Environmental Protection Agency	68	$710.00
Department of Transportation	69	$29,372.00
Homeland Security	70	$60,648.00
Agency for International Development	72	$62,130.00
Department of Health and Human Services	75	$254.00
National Aeronautics and Space Administration	80	$72,188.00
National Archives and Records Administration	88	$25.00
Department of Energy	89	$25,459.00
Department of Education	91	$157.00
US Army Corps of Engineers	96	$4,095.00
Other Defense Organizations General Funds	97	$1,486,905.00
Other Defense Organizations Working Capital Funds	97-4930	$1,259,887.00
Army Working Capital Fund	97-4930.001	$1,808.00
Navy Working Capital Fund	97-4930.002	$19,011.00
Air Force Working Capital Fund	97-4930.003	$331,083.00
Military Retirement Fund	97-8097	$0.00
DoD Medicare-Eligible Retiree Health Care Fund		$181,752.00

Required Supplemental Information - Part E AT57 - Air Force General Fund ($Amounts in Thousands)	Treasury Index:	Transfers In	Transfers Out
Navy General Fund	17		$21.00
Army General Fund	21		$36,234.00
Other Defense Organizations General Funds	97	$145,255.00	$135,630.00
Other Defense Organizations Working Capital Funds	97-4930	$968,182.00	

General Fund

Audit Opinion

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

November 8, 2005

MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Fiscal Year 2005 Air Force General Fund Financial Statements (Report No. D-2006-018)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Air Force General Fund Consolidated Balance Sheet as of September 30, 2005 and 2004, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing for the fiscal years then ended. The financial statements are the responsibility of Air Force management. The Air Force is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Fiscal Year 2005 financial statements of the Air Force General Fund because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us that previously identified material weaknesses in internal control and instances of noncompliance with laws and regulations continue to affect the current period. Management acknowledged that, as a result of those conditions, the financial data reported in the financial statements were unreliable. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Air Force has also acknowledged the material weaknesses listed in the Summary of Internal Control. These material weaknesses also affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the principal financial statements.[1] Therefore, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

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

Summary of Internal Control

In planning our audit, we considered Air Force internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance. However, previously identified reportable conditions,[2] all of which are material, continue to exist in the following areas.

- Financial Management Systems
- Operating Materials and Supplies
- Environmental Liabilities
- Statement of Net Cost
- Statement of Financing
- Intragovernmental Transactions
- Other Accounting Entries

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

Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged that instances of noncompliance continue to exist. The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us that critical financial management feeder systems of the Air Force do not comply substantially with the Federal Financial Management Improvement Act of 1996. Therefore, we did not determine whether the Air Force was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

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[2] Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

Management Responsibility

Management is responsible for:

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

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

Attachment:
As stated

Report on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting.

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

Financial Management Systems. The Air Force financial management systems do not substantially comply with Federal financial management systems requirements.

The Air Force had not implemented the U.S. Government Standard General Ledger at the transaction level. For details, see Note 1.D. to the financial statements.

The Air Force is unable to implement fully all elements of generally accepted accounting principles and Office of Management and Budget Bulletin No. 01-09, "Form and Content of Agency Financial Statements," because of limitations in financial management processes and systems, including nonfinancial feeder systems and processes. For details, see Note 1.A. to the financial statements.

The Air Force generally records transactions on a cash (budgetary) basis and not on an accrual basis as required by generally accepted accounting principles. The amounts presented in the Consolidated Statement of Net Cost are based on budgetary obligations, and disbursements and collections, which are adjusted to record known accruals for major items and known imputed expenses. For details, see Note 1.D. to the financial statements.

Operating Materials and Supplies. The Air Force does not record operating materials and supplies balances derived from logistics systems at historical cost in conformance with Statement of Federal Financial Accounting Standard No. 3, "Accounting for Inventory and Related Property." Furthermore, the Air Force does not strictly follow the consumption method in accounting for operating materials and supplies. In addition, the operating materials and supplies amount on the Balance Sheet does not include all contractor-controlled, Government-furnished material in the financial records. For details, see Note 9. to the financial statements.

Environmental Liabilities. The Air Force could not support environmental cleanup cost estimates used for year-end financial reporting. For details, see Note 14. to the financial statements.

Statement of Net Cost. The Air Force does not accumulate cost information as required by generally accepted accounting principles. The Air Force identifies costs in the Consolidated Statement of Net Cost based on the major appropriation groups funded by Congress instead of being based on major programs and activities as set forth in Statement of Federal Financial

Attachment

Accounting Standard No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government." For details, see Note 1.D. to the financial statements.

Statement of Financing. The objective of the Statement of Financing is to reconcile the difference between budgetary obligations and the net cost of operations reported. It is presented as combined statements rather than consolidated statements because intragovernmental transactions were not eliminated. Because of limitations in the Air Force financial system, budgetary data are not in agreement with proprietary expenses and assets capitalized. For details, see Note 21. to the financial statements.

Intragovernmental Transactions. The Air Force cannot accurately identify all intragovernmental transactions by customer and cannot be assured that transactions occurring between entities within DoD, or between two or more Federal agencies, are eliminated.

The Air Force was unable to reconcile intragovernmental accounts receivable or accounts payable balances, or reconcile intragovernmental revenue balances with its trading partners. For details, see Notes 5., 12., and 19. to the financial statements.

Other Accounting Entries. The Air Force continues to enter a material number of unsupported accounting entries because financial and non-financial feeder systems continue to lack sufficient customer-identification information to accurately process eliminations. For details, see Note 1.A. to the financial statements.

These financial management deficiencies are indications of material weaknesses in internal control that may adversely affect any decision by the Air Force that is based, in whole or in part, on information that is inaccurate because of these deficiencies. Financial information reported by the Air Force also may contain misstatements resulting from these deficiencies.

Compliance with Laws and Regulations

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

The Air Force is required by the Federal Financial Management Improvement Act of 1996 to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. The Air Force acknowledged that many of its critical financial management feeder systems do not comply substantially with Federal financial management systems requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not perform tests of compliance for these requirements.

Attachment

Audit Disclosures

The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us on February 14, 2005, that Air Force financial management systems do not comply substantially with Federal financial management systems requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. These deficiencies in Air Force critical financial feeder systems limited its ability to present information accurately and in conformance with generally accepted accounting principles.

In addition, we did not perform audit work related to provisions of the laws and regulations identified in Office of Management and Budget Bulletin Number 01-02, "Audit Requirements for Federal Financial Statements," October 16, 2000, Appendix C, "General Laws."

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

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Working Capital Fund

Principal Statements

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Consolidated Balance Sheet—Working Capital Fund

As of September 30, 2005 and 2004 ($ in Thousands)

		2005 Consolidated		2004 Consolidated
1. ASSETS (Note 2)				
A. Intra-governmental:				
1. Fund Balance with Treasury (Note 3)				
a. Entity	$	1,164,223	$	1,051,110
b. Non-Entity Seized Iraqi Cash		0		0
c. Non-Entity-Other		0		0
2. Investments (Note 4)		0		0
3. Accounts Receivable (Note 5)		510,560		576,396
4. Other Assets (Note 6)		48,515		10
5. Total Intra-governmental Assets	$	1,723,298	$	1,627,516
B. Cash and Other Monetary Assets (Note 7)	$	0	$	0
C. Accounts Receivable (Note 5)		219,929		103,111
D. Loans Receivable (Note 8)		0		0
E. Inventory and Related Property (Note 9)		32,701,689		28,311,805
F. General Property, Plant and Equipment (Note 10)		1,205,556		1,197,683
G. Investments (Note 4)		0		0
H. Other Assets (Note 6)		440,337		788,966
2. TOTAL ASSETS	$	36,290,809	$	32,029,081
3. LIABILITIES (Note 11)				
A. Intra-governmental:				
1. Accounts Payable (Note 12)	$	199,650	$	256,763
2. Debt (Note 13)		0		0
3. Other Liabilities (Note 15 & Note 16)		146,538		243,131
4. Total Intra-governmental Liabilities	$	346,188	$	499,894
B. Accounts Payable (Note 12)	$	546,739	$	497,471
C. Military Retirement Benefits and Other Employment-Related		233,713		238,729
D. Actuarial Liabilities (Note 17)				
E. Environmental Liabilities (Note 14)		0		0
F. Loan Guarantee Liability (Note 8)		0		0
G. Other Liabilities (Note 15 and Note 16)		1,389,331		1,616,321
TOTAL LIABILITIES	$	2,515,971	$	2,852,415
4. NET POSITION				
A. Unexpended Appropriations	$	0	$	0
B. Cumulative Results of Operations		33,774,838		29,176,666
6. TOTAL NET POSITION	$	33,774,838	$	29,176,666
7. TOTAL LIABILITIES AND NET POSITION	$	36,290,809	$	32,029,081

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

Consolidated Statement of Net Cost—Working Capital Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	2005 Consolidated	2004 Consolidated
1. Program Costs		
A. Intra-governmental Gross Costs	$ 5,312,719	$ 5,399,793
B. (Less: Intra-governmental Earned Revenue)	-10,643,244	-11,888,462
C. Intragovernmental Net Costs	$ -5,330,525	$ -6,488,669
D. Gross Costs With the Public	5,201,476	8,674,787
E. (Less: Earned Revenue From the Public)	-771,703	-891,419
F. Net Costs With the Public	$ 4,429,773	$ 7,783,368
G. Total Net Cost	$ -900,752	$ 1,294,699
2. Cost Not Assigned to Programs	0	0
3. (Less: Earned Revenue Not Attributable to Programs)	0	0
4. Net Cost of Operations	$ -900,752	$ 1,294,699

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

Consolidated Statement of Changes in Net Position—Working Capital Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	2005 Consolidated	2004 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
1. Beginning Balances	$ 21,890,389	$ 11,537,088
2. Adjustments (+/-)		
2a. Changes in Accounting Principles (+/-)	3,632,598	699,393
2b. Correction of Errors (+/-)	7,256,576	18,656,733
3. Beginning Balances, as adjusted	32,779,563	30,893,214
4. Budgetary Financing Sources:	0	0
4a. Appropriations received	0	0
4b. Appropriations transferred-in/out (+/-)	0	0
4c. Other adjustments (rescissions, etc) (+/-)	0	0
4d. Appropriations used	0	0
4e. Nonexchange revenue	0	0
4f. Donations and forfeitures of cash and cash equivalents	0	0
4g. Transfers-in/out without reimbursement (+/-)	-73,911	-580,900
4h. Other budgetary financing sources (+/-)	0	0
5. Other Financing Sources:	0	0
5a. Donations and forfeitures of property	0	0
5b. Transfers-in/out without reimbursement (+/-)	0	34
5c. Imputed financing from costs absorbed by others	168,434	159,017
5d. Other (+/-)	0	0
6. Total Financing Sources	94,523	-421,849
7. Net Cost of Operations (+/-)	-900,752	1,294,699
8. Net Change	995,275	-1,716,548
9. Ending Balance	$ 33,774,838	$ 29,176,666

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

Combined Statement of Budgetary Resources—Working Capital Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	2005 Combined	2004 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
1. Budget Authority:		
1a. Appropriations received	$ 0	$ 0
1b. Borrowing authority	0	0
1c. Contract authority	9,744,293	684,378
1d. Net transfers (+/-)	0	0
1e. Other	0	0
2. Unobligated balance:		
2a. Beginning of period	134,440	607,130
2b. Net transfers, actual (+/-)	-73,911	-580,900
2c. Anticipated Transfers Balances	0	0
3. Spending authority from offsetting collections:		
3a. Earned	0	0
1. Collected	16,559,412	17,824,823
2. Receivable from Federal sources	50,393	-186,398
3b. Change in unfilled customer orders	0	0
1. Advance received	-121,421	-173,221
2. Without advance from Federal sources	692,744	-733,915
3c. Anticipated for the rest of year, without advances	0	0
3d. Previously unavailable	0	0
3e. Transfers for trust funds	0	0
3f. Subtotal	17,181,128	16,731,289
4. Recoveries of prior year obligations	4	3,180
5. Temporarily not available pursuant to Public Law	0	0
6. Permanently not available	-10,801,211	-36,669
7. Total Budgetary Resources	$ 16,184,743	$ 17,408,408
STATUS OF BUDGETARY RESOURCES		
8. Obligations incurred:		
8a. Direct	$ 0	$ 2,027
8b. Reimbursable	15,892,064	17,271,941
8c. Subtotal	15,892,064	17,273,968
9. Unobligated balance:		
9a. Apportioned	292,678	134,440
9b. Exempt from apportionment	0	0
9c. Other available	1	0
10. Unobligated Balances Not Available	0	0
11. Total, Status of Budgetary Resources Relationship of Obligations to Outlays:	$ 16,184,743	$ 17,408,408
12. Obligated Balance, Net - beginning of period	$ 4,755,983	$ 3,317,312
13. Obligated Balance transferred, net (+/-)	0	0
14. Obligated Balance, Net - end of period:		
14a. Accounts receivable	-1,009,179	-958,783
14b. Unfilled customer order from Federal sources	-3,958,214	-3,265,470
14c. Undelivered orders	6,461,705	6,610,227
14d. Accounts payable	2,159,623	2,370,008
15. Outlays:		
15a. Disbursements	16,250,968	16,752,435
15b. Collections	-16,437,991	-17,651,602
15c. Subtotal	-187,023	-899,167
16. Less: Offsetting receipts	0	0
17. Net Outlays	$ -187,023	$ -899,167

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

Combined Statement of Financing—Working Capital Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	2005 Consolidated	2004 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ 15,892,064	$ 17,273,968
2. Less: Spending authority from offsetting collections and recoveries (-)	-17,181,132	-16,734,469
3. Obligations net of offsetting collections and recoveries	-1,289,068	539,499
4. Less: Offsetting receipts (-)	0	0
5. Net obligations	-1,289,068	539,499
Other Resources		
6. Donations and forfeitures of property	0	0
7. Transfers in/out without reimbursement (+/-)	0	34
8. Imputed financing from costs absorbed by others	168,434	159,017
9. Other (+/-)	0	0
10. Net other resources used to finance activities	168,434	159,051
11. Total resources used to finance activities	-1,120,634	698,550
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 (-)	180,293	-951,116
12b. Unfilled Customer Orders	571,323	-907,137
13. Resources that fund expenses recognized in prior periods	-5,775	-36,403
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	0	0
15. Resources that finance the acquisition of assets	-5,376,780	-2,686,199
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations		
16a. Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0	0
16b. Other (+/-)	0	-34
17. Total resources used to finance items not part of the net cost of operations	-4,630,939	-4,580,889
18. Total resources used to finance the net cost of operations	-5,751,573	-3,882,339
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
19. Increase in annual leave liability	0	0
20. Increase in environmental and disposal liability	0	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
22. Increase in exchange revenue receivable from the the public (-)	0	0
23. Other (+/-)	5,961	0
24. Total components of Net Cost of Operations that will require or generate resources in future periods	5,961	0
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	190,703	259,260
26. Revaluation of assets or liabilities (+/-)	3,193	-5,660,357
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0	0
27b. Cost of Goods Sold	5,026,638	5,866,527
27c. Operating Material & Supplies Used	416,094	325,585
27d. Other	-791,768	4,386,023
28. Total components of Net Cost of Operations that will not require or generate resources	4,844,860	5,177,038
29. Total components of net cost of operations that will not require or generate resources in the current period	4,850,821	5,177,038
30. Net Cost of Operations	$ -900,752	$ 1,294,699

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

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Working Capital Fund

Footnotes to the Principal Statements

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

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

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

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

1.B. Mission of the Reporting Entity

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

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

1.C. Appropriations and Funds

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

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

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

Supply Management

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

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

Depot Maintenance

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

Transportation

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

Air Force Working Capital Fund Component

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

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

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

(1) Funding Authority:

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

(2) Minor Construction Funding:

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

(3) Software Development Costs:

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

(4) Capital Budgeting:

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

(5) Asset Capitalization and Depreciation:

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

(6) Rates and Prices:

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

The FY 2005, AFWCF operations encompassed three activity groups: Supply Management, Depot Maintenance, and Information Services. These activity groups use their resources to finance the initial cost of products or services for activities of the United States Government, primarily those of the DoD. Work is generated by the acceptance of customer orders from ordering activities.

1.D. Basis of Accounting

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

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

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

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

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

Material disclosures are provided at Note 10.

1.E. Revenues and Other Financing Sources

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

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

Supply Management

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

Depot Maintenance

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

Revenue recognition for Contract DMAG is based on the number of units produced times the Unit Sales Price (USP) and does not recognize Incremental Revenue Recognition (IRR) at this time.

Information Services

The Information Services Activity Group (ISAG), as a service type organization, recognizes revenue in one of two ways based on the service level agreement between the customer and the provider. ISAG uses either the completed contract method or the percentage of completion method.

1.F. Recognition of Expenses

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

1.G. Accounting for Intra-governmental Activities

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

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

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

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

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

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

1.H. Transactions with Foreign Governments and International Organizations

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

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

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

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

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

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

1.J. Foreign Currency

Not applicable.

1.K. Accounts Receivable

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

Material disclosures are provided at Note 5.

1.L. Loans Receivable

Not applicable.

1.M. Inventories and Related Property

Inventory for the AFWCF is held in SMAG except for work-in-process inventory, which is in the Depot Management Activity Group. Prior to fiscal year 2004, the majority of the SMAG inventory was reported at approximate historical cost based on Latest Acquisition Cost (LAC), adjusted for holding gains and losses. During fiscal years 2004 and 2005, a major portion of the Supply Management Activity Group inventory changed from the LAC method to the Moving Average Cost (MAC) method of valuation. This allowed SMAG to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property" for that percentage of the inventory. The conversion to MAC included programming changes for the SMAG accounting system to convert from the Air Force General Ledger (AFGL) to the USSGL for supply accounting.

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

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

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

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

Not applicable.

1.O. General Property, Plant and Equipment

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

Prior to FY 1996, General PP&E with an acquisition cost of $15,000, $25,000, and $50,000 for FYs 1993, 1994, and 1995 respectively, and an estimated useful life of 2 or more years was capitalized. These assets remain capitalized and are reported on WCF financial statements. General PP&E previously capitalized at amounts below $100,000 were written off General Fund financial statements in FY 1998.

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

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

Material disclosures are provided at Note 10.

1.P. Advances and Prepayments

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

1.Q. Leases

Not applicable.

1.R. Other Assets

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

1.S. Contingencies and Other Liabilities

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

1.T. Accrued Leave

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

1.U. Net Position

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

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

1.V. Treaties for Use of Foreign Bases

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

1.W. Comparative Data

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

1.X. Unexpended Obligations

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

1.Y. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. 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 and collections are recorded in other liabilities.

Note 2. Nonentity Assets

As of September 30	2005	2004
(Amounts in thousands)		
1. Intra-governmental Assets		
A. Fund Balance with Treasury	$ 0	$ 0
B. Investments	0	0
C. Accounts Receivable	0	0
D. Other Assets	0	0
E. Total Intra-governmental Assets	$ 0	$ 0
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	$ 0	$ 0
B. Accounts Receivable	0	0
C. Loans Receivable	0	0
D. Inventory & Related Property	0	0
E. General PP&E	0	0
F. Investments	0	0
G. Other Assets	0	0
H. Total Nonfederal Assets	$ 0	$ 0
3. Total Nonentity Assets	$ 0	$ 0
4. Total Entity Assets	$ 36,290,809	$ 32,029,081
5. Total Assets	$ 36,290,809	$ 32,029,081

Asset accounts are categorized as either entity or nonentity. Entity accounts consist of resources that are available for use in the operations of the entity. The Air Force is authorized to decide how to use resources in entity accounts. The Air Force may be legally obligated to use these resources to meet entity obligations. Nonentity accounts, on the other hand, consist of assets that are held by an entity but are not available for use in the operations of the entity.

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

Note 3. Fund Balance with Treasury

As of September 30	2005	2004
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	$ 0	$ 0
B. Revolving Funds	1,164,223	1,051,111
C. Trust Funds	0	0
D. Special Funds	0	0
E. Other Fund Types	0	0
F. Total Fund Balances	$ 1,164,223	$ 1,051,111
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 1,038,596	$ 1,703,858
B. Fund Balance per AFWCF	1,164,223	1,051,111
3. Reconciling Amount	$ -125,627	$ 652,747

The reconciling amount on line 3 above represents $(125.6) million for the United States Transportation Command (USTC), which is reported at the Department of the Treasury as part of the Air Force Working Capital Fund (AFWCF). However, for the purposes of Audited Financial Statements (AFS), USTC is included with the Other Defense Organizations (ODO) reporting, which is separate from the AFWCF. Therefore, USTC cash is not included on the AFWCF AFS statements.

Fluctuations and Abnormalities

Fund Balance with Treasury increased $113.1 million (11 percent) in FY 2005. The increase can be attributed to three primary factors. First, the Information Services Activity Group (ISAG) and the Depot Maintenance Activity Group (DMAG) both had increases in their respective fund balances from the prior year primarily attributed to favorable financial performance. Net operation results for ISAG and DMAG before eliminations and mandated Audited Financial Statement adjustments, which do not impact cash flow, totaled $84.3 million, which is a source of cash inflow. Secondly, DMAG experienced favorable balance sheet performance. DMAG collected an additional $92.8 million in accounts receivable over the prior year, increased their accounts payable $20.9 million, and disbursed $55.5 million less under the Capital Purchase Program then planned. Overall, the increases from these items total $253.5 million, which was offset by a Congressional mandated cash transfer to the Army in the amount of $155.0 million, resulting in a net increase of $98.5 million. The remaining $14.6 million increase can be attributed to normal business fluctuations in the remaining business areas.

Note Reference

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

Status of Fund Balance with Treasury As of September 30 (Amounts in thousands)	2005	2004
1. Unobligated Balance		
A. Available	$ 292,679	$ 134,439
B. Unavailable	0	0
2. Obligated Balance not yet Disbursed	$ 8,621,328	$ 8,980,235
3. Non-Budgetary FBWT	$ 0	$ 0
4. Non-FBWT Budgetary Accounts	$ -7,749,784	$ -8,063,563
5. Total	$ 1,164,223	$ 1,051,111

The amounts reported in this schedule represent the budgetary resources associated with cash.

Disclosures Related to Problem Disbursements and In-Transit Disbursements As of September 30 (Amounts in thousands)	2003	2004	2005	(Decrease)/ Increase from 2004 - 2005
1. Total Problem Disbursements, Absolute Value				
A. Unmatched Disbursements (UMDS)	$ 2,813	$ 4,713	$ 60,443	$ 55,730
B. Negative Unliquidated Obligations (NULO)	6,498	4,255	2,405	-1,850
2. Total In-transit Disbursements, Net	$ 464,049	$ 415,522	$ 347,157	$ -68,365

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

Due to the accelerated reporting requirements the 2004 column represents August 2004 amounts. The 2003 and 2005 columns are both September balances.

The AFWCF has a $55.7 million increase in problem disbursements and a $68.4 million decrease in In-transit disbursements. The amount of Unmatched Disbursements (UMDs) over 180 days old is $0.00, for Negative Unliquidated Obligations (NULOs) is $0.00, and for In-transit is $3.6 million. The amount of UMDs over 120 days old is $0.00, for NULO is $0.00, and for In-transit is $7.9 million. The current absolute value of In-transit disbursements is $433.0 million.

The increase in UMDs can be attributed to database mergers (San Antonio to Limestone in October 2004, and Omaha to Dayton in May 2005) and difficulties encountered with the merger of the Contract Procurement Accounting System (CPAS) and the General Accounting and Finance System (GAFS). Also, a substantial amount of problems were encountered when we implemented new business processes for handling disbursements. All corrections are expected to be accomplished by the first quarter of FY 2006. The decrease in NULOS and In-transit Disbursements is due to a concentrated effort to resolve problems and the corresponding posting of transactions.

Note 4. Investments and Related Interest

Not Applicable.

Note 5. Accounts Receivable

As of September 30	2005			2004
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intra-governmental Receivables	$ 510,560	N/A	$ 510,560	$ 576,396
2. Non-federal Receivables (From the Public)	$ 219,929	$ 0	$ 219,929	$ 103,111
3. Total Accounts Receivable	$ 730,489	$ 0	$ 730,489	$ 679,507

Fluctuations

Federal receivables decreased $65.8 million (11 percent). The amount consists primarily of a decrease in Depot Maintenance Activity Group (DMAG). The decrease in DMAG is caused by a decrease in revenues, which would lead to a subsequent decrease in outstanding invoices. See Note 18 for more information on the cause of the revenue decrease.

Non-federal receivables increased $116.8 million (113 percent). The amount consists primarily of an increase of $115.4 million in the Supply Management Activity Group (SMAG). The increase was attributed to a change in classification of receivables from Foreign Military Sales that were previously recorded as other assets. This change occurred in the 3rd Qtr, FY 2005 reports.

Information Related to Accounts Receivables

Allowance Method

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

Allocation of Undistributed Collections

The Department of Defense (DoD) policy is to allocate supported undistributed collections between federal and non-federal categories based on the percentage of federal and non-federal accounts receivable. Unsupported undistributed collections are recorded in USSGL account 2400, Liability For Deposit Funds, Clearing Accounts, and Undeposited Collections. The Air Force Working Capital Fund (AFWCF) followed this allocation procedure, applying $608.7 thousand in undistributed collections to accounts receivable and recording $54.8 million of unsupported undistributed to USSGL account 2400.

Elimination Adjustments

Accounts receivable within the AFWCF have been eliminated for statement presentation purposes. The total value of the receivables that were eliminated on these financial statements is $332.4 million.

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

Receivables over 180 Days

The Air Force has $4.5 million intra-government receivables and $16.1 million non-federal receivables over 180 days. Processes have been implemented to closely monitor the delinquent receivables and to refer them to the appropriate entity for resolution.

Note Reference

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

Note 6. Other Assets

As of September 30	2005	2004
(Amounts in thousands)		
1. Intra-governmental Other Assets		
A. Advances and Prepayments	$ 48,515	$ 10
B. Total Intragovernmental Other Assets	$ 48,515	$ 10
2. Non-federal Other Assets		
A. Outstanding Contract Financing Payments	$ 0	$ 0
B. Other Assets (With the Public)	440,337	788,966
C. Total Nonfederal Other Assets	$ 440,337	$ 788,966
3. Total Other Assets	$ 488,852	$ 788,976

Fluctuations and Abnormalities

Intra-governmental other assets (Line 1)

The $48.5 million (486,139 percent) increase to intra-governmental other assets is primarily due to an advance to the Air Force General Funds in the amount of $47.9 million for miscellaneous contractual services to the depots. The remaining advances are being reported by other defense organizations.

Non-federal other assets (Line 2)

Non-Federal Other Assets decreased $348.6 million (44 percent) and can be attributed to the decrease in the Supply Management Activity Group (SMAG). SMAG had decreases in both the "Other" and the Advances section of the Other Asset Line. Additional details of how the variance breaks out can be found in the table below.

In the assets other than advances section, there was a decrease of $279.3 million, which can be attributed to two events. First, there was a $163.9 million decrease in the vendors pending credit account in the Materiel Support Division. Based on the recommendations of a prior audit, a program was developed to identify and systematically prepare journal vouchers to write off unsupported balances greater than 210 day old. The journal vouchers were processed in October 2004 and May 2005. The second event can be found in the SMAG assets for foreign military sales, which had a decrease of $115.4 million. As was discussed in Note 5, this account is now being reported as a component of accounts receivable.

In the advances section, there was a decrease of $63.8 million which can also be attributed to two events. First, the "Inventory Intransit from Vendor" account in the Material Support Division (MSD) decreased $35.3 million. This decrease was the result of a journal voucher (JV) processed in FY05 to correct the balance in this account. For several months, a program that removes the Wholesale Intransit Inventory as it is received was not run, thus, causing the account to be overstated at the end of FY 2004. Once the issue was identified, a journal voucher was processed to correct for this error. The program continues to run each month to ensure the proper entries are made and the account balance is accurate. Second, the "Inventory Intransit from Vendor" account in the General Support Division (GSD) decreased $8.8 million and is currently in an abnormal balance. This decrease was the result of a systemic issue within the Financial Inventory Accounting and Billing System (FIABS). Erroneous amounts were used to reduce the account when the monthly systemic programs were executed. The cause of the glitch has not yet been identified; however, the issue is currently being worked by the appropriate DFAS personnel for resolution. The remaining decrease in the account is the normal business fluctuation in advances in the remaining categories of advance accounts.

Note Reference

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

Non-Federal Other Assets (in Thousands)

Types of Asset	**2005**	**2004**
Advances		
SMAG - Advances and Prepayments to Contractors	$317,655	$374,443
DMAG - Advances and Prepayments to Contractors	0	7,044
Total Advances	**$317,655**	**$381,487**
Other Assets		
SMAG - Air Force assets—other DoD foreign military sales (depot)	0	115,434
SMAG - Other assets returns to vendors pending credit	122,167	286,109
DMAG - Unallocated labor and materials	515	5,937
Total Other Assets	**122,682**	**407,480**
Total Non-Federal Other Assets	**$440,337**	**$788,966**

Note 7. Cash and Other Monetary Assets

Definitions

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

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

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

Note 8. Direct Loan and/or Loan Guarantee Programs

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

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

Not applicable.

Note 9. Inventory and Related Property

As of September 30	2005	2004
(Amounts in thousands)		
1. Inventory, Net	$ 32,319,057	$ 27,779,167
2. Operating Materials & Supplies, Net	382,632	532,638
3. Stockpile Materials, Net	0	0
4. Total	$ 32,701,689	$ 28,311,805

Inventory, Net As of September 30	2005			2004	
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	Valuation Method
(Amounts in thousands)					
1. Inventory Categories					
A. Available and Purchased for Resale	$ 22,717,224	$ -15,016	$ 22,702,208	$ 17,978,646	LAC,MAC
B. Held for Repair	13,445,847	-4,073,414	9,372,433	9,330,509	LAC,MAC
C. Excess, Obsolete, and Unserviceable	775,072	-775,072	0	0	NRV
D. Raw Materials	0	0	0	0	MAC,SP,LAC
E. Work in Process	244,416	0	244,416	470,012	AC
F. Total	$ 37,182,559	$ -4,863,502	$ 32,319,057	$ 27,779,167	

Legend for Valuation Methods:

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

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

1) Distributions without reimbursement are made when authorized by Department of Defense (DoD) directives.

2) War Reserve Material includes fuels and subsistence items that are considered restricted.

3) Inventory, with the exception of safety stocks, may be sold to foreign, state and local governments, private parties, and contractors in accordance with current policies and guidance or at the direction of the President.

Definitions

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

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

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

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

Fluctuations

Inventory increased $4.5 billion (16 percent) due to the following factors.

Inventory Available and Purchased for Resale values for the Supply Management Activity Group (SMAG) had an increase of $4.7 billion. The increase is a result of an inventory valuation change from Latest Acquisition Cost to Moving Average Cost. In FY 2005, the allowance account of $11.3 billion was removed for the Material Support Division. For comparative statement purposes, the Inventory Available and Purchased for Resale balance for FY 2004 was restated by $7.2 billion, which represents the portion of the prior period adjustment related to errors. The remaining $4.1billion, which represents the portion of the prior period adjustment related to a standard change in accounting procedure, was not restated. Therefore the inventory balance in FY 2004 is less than FY 2005.

Work in Process (WIP) had a decrease of $225.6 million in the Depot Maintenance Activity Group (DMAG). This decrease can be attributed to two events. The first event is the continuing phase out of Contract Depot Maintenance Activity Group (CDMAG) operations from the Working Capital Fund. This phase-out caused the $168.2 million WIP decrease in CDMAG. The second event, a $57.4 million decrease in Organic WIP, was due to less work being inducted into the WIP then what had been completed, coupled with the clean-up effort of some of the old customer orders that still had open WIP balances.

General Composition of Inventory

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

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

Note Reference

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

Operating Materials and Supplies, Net As of September 30	2005			2004	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in thousands)					
1. OM&S Categories					
A. Held for Use	$ 382,632	$ 0	$ 382,632	$ 532,638	SP, LAC
B. Held for Repair	0	0	0	0	SP, LAC
C. Excess, Obsolete, and Unserviceable	0	0	0	0	NRV
D. Total	$ 382,632	$ 0	$ 382,632	$ 532,638	

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

Fluctuations

The $150.0 million decrease (28 percent) in the OM&S category held for use (Line 1A) can be attributed to two events. A $76.9 million decrease resulted from the continuing phase out of Contract DMAG operations. In addition, a $51.0 million decrease occurred in Organic DMAG operations, which is attributed to the clean-up effort of on hand supplies, coupled with a credit return of shop materials returned to the supplier by the Warner Robins Air Logistic Center.

General Composition of Operating Materials and Supplies

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

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

Note Reference

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

Stockpile Materials, Net

Not Applicable.

Note 10. General PP&E, Net

(Amounts in thousands)	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	$ 0	N/A	$ 0	$ 0
B. Buildings, Structures, and Facilities	S/L	20 Or 40	905,184	$ -591,229	313,955	249,229
C. Leasehold Improvements	S/L	lease term	0	0	0	0
D. Software	S/L	2-5 Or 10	1,025,075	-683,000	342,075	369,465
E. General Equipment	S/L	5 or 10	2,053,877	-1,542,561	511,316	551,426
F. Military Equipment	S/L	Various	0	0	0	0
G. Assets Under Capital Lease	S/L	lease term	0	0	0	0
H. Construction-in-Progress	N/A	N/A	38,210	N/A	38,210	27,563
I. Other			0	0	0	0
2. Total General PP&E			$ 4,022,346	$ -2,816,790	$ 1,205,556	$ 1,197,683

[1] Note 15 for additional information on Capital

Legend for Valuation Methods:

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

Information Related to General PP&E, Net

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

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

The value of Air Force General PP&E real property in the possession of contractors is included in the value reported above for the Major Asset Classes of Land and Buildings, Structures, and Facilities. The value of General PP&E personal property (Major Asset Classes of Software and Equipment) does not include all of the General PP&E in the possession of contractors that is above the Department of Defense (DoD) capitalization threshold.

The net book amount of such property is immaterial in relation to the total General PP&E net book value. In accordance with a strategy approved by the Office of Management and Budget, the Government Accountability Office, and the Inspector General, DoD, the Department is developing new policies and a contractor-reporting process to capture General PP&E information for future reporting purposes in compliance with generally accepted accounting practices.

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

Note Reference

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

Assets Under Capital Lease

Not Applicable.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2005	2004
(Amounts in thousands)		
1. Intra-governmental Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Debt	0	0
C. Other	0	0
D. Total Intra-governmental Liabilities	$ 0	$ 0
2. Non-Federal Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	233,713	238,729
C. Environmental Liabilities	0	0
D. Loan Guarantee Liability	0	0
E. Other Liabilities	0	0
F. Total Non-Federal Liabilities	$ 233,713	$ 238,729
3. Total Liabilities Not Covered by Budgetary Resources	$ 233,713	$ 238,729
4. Total Liabilities Covered by Budgetary Resources	$ 2,282,258	$ 2,613,686
5. Total Liabilities	$ 2,515,971	$ 2,852,415

Definitions

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

- New budget authority
- Spending authority from offsetting collections (credited to an appropriation or fund account)
- Recoveries of unexpired budget authority through downward adjustments of prior-year obligations

- Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior-year balances during the year
- Borrowing authority or permanent indefinite appropriations that have been enacted and signed into law as of the balance sheet date, provided that the Office of Management and Budget (OMB) can apportion the resources without first meeting a contingency or without additional action by the Congress.

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

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

Note Reference

For additional line item discussion, see:

Note 8, Direct Loans and/or Loan Guarantee Programs

Note 12, Accounts Payable

Note 13, Liabilities Not Covered and Covered by Budgetary Resources

Note 14, Environmental Restoration Liabilities and Environmental Disposal Liabilities

Note 15, Other Liabilities

Note 16, Commitments and Contingencies

Note 17, Military Retirement Benefits and Other Employment Related

Note 12. Accounts Payable

As of September 30	2005			2004
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intra-governmental Payables	$ 199,650	$ N/A	$ 199,650	$ 256,763
2. Non-Federal Payables (to the Public)	546,739	0	546,739	497,471
3. Total	$ 746,389	$ 0	$ 746,389	$ 754,234

Definition

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

Fluctuations and Abnormalities

Intra-governmental payables decreased by $57.1 million (22 percent). The primary cause was a decrease of $60.6 million in the General Support Division (GSD). In FY 2004 unpaid bills for Defense Logistics Agency increased at the end of the year causing an increase in accounts payable as well. The unpaid bills were paid in the first month of FY 2005. The account balance has returned to a normal balance and maintained a normal balance throughout the remainder of FY 2005.

Non-Federal payables increased $49.2 million (10 percent). The primary cause was an increase in unmatched disbursements caused by difficulties encountered with the merger of the Contract Procurement Accounting System (CPAS) and the General Accounting and Finance System (GAFS). Information regarding unmatched disbursements is discussed in Note 3.

Undistributed Disbursements

Undistributed disbursements consist of the difference between (1) disbursements/collections recorded at the transaction level to a specific obligation, payable, or receivable in the activity field records, and (2) those disbursements/collections reported by the U.S. Treasury via the reconciled DD1329 and DD1400. The total undistributed disbursement amounts displayed in this note should agree with the undistributed amounts reported on accounting reports (SF 133/(M) 1002/(M) 1307). In-transit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to each entity's outstanding accounts payable balance at year-end. Accounts payable were adjusted downward in the amount of $408.3 million for these payments.

Allocation of Undistributed Disbursements

The Department of Defense (DoD) policy is to allocate supported undistributed disbursements between intra-governmental and non-federal categories based on the percentage of intra-governmental and non-federal accounts payable. Unsupported undistributed disbursements should be recorded in U.S. Standard General Ledger account (USSGLA) 2120, Disbursements in Transit. The AFWCF followed this allocation policy reporting $184.6 million in USSGLA 2120.

Intra-governmental Eliminations

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

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

Note Reference

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

Note 13. Debt

Not applicable.

Note 14. Environmental Liabilities and Disposal Liabilities

Not applicable.

Note 15. Other Liabilities

As of September 30	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
1. Intra-governmental				
A. Advances from Others	$ 136,241	$ 0	$ 136,241	$ 234,529
B. Deposit Funds and Suspense Account Liabilities	0	0	0	0
C. Disbursing Officer Cash	0	0	0	0
D. Judgment Fund Liabilities	0	0	0	0
E. FECA Reimbursement to the Department of Labor	0	0	0	0
F. Other Liabilities	10,297	0	10,297	8,602
G. Total Intra-governmental Other Liabilities	$ 146,538	$ 0	$ 146,538	$ 243,131
2. Non-Federal				
A. Accrued Funded Payroll and Benefits	$ 129,479	$ 0	$ 129,479	$ 135,633
B. Advances from Others	8,570	0	8,570	15,256
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	54,771	0	54,771	18,913
E. Temporary Early Retirement Authority	0	0	0	0
F. Nonenvironmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
(4) Other	0	0	0	0
G. Accrued Unfunded Annual Leave	0	0	0	0
H. Capital Lease Liability	0	0	0	0
I. Other Liabilities	1,196,511	0	1,196,511	1,446,519
J. Total Non-Federal Other Liabilities	$ 1,389,331	$ 0	$ 1,389,331	$ 1,616,321
3. Total Other Liabilities	$ 1,535,869	$ 0	$ 1,535,869	$ 1,859,452

Fluctuations and Abnormalities

Line 1.A – The Intra-governmental advances from others decreased $98.3M (42 percent) due to the decrease in the Depot Maintenance Activity Group (DMAG) Contract progress billings. Contract DMAG is phasing out of the Working Capital Fund (WCF).

Line 1.F – The Intra-governmental other liabilities increase of $1.7M (20 percent) represents employee benefits that are payable to the Office of Personnel Management (OPM). Liabilities fluctuate based on staffing levels and participation in benefit programs by employees. Health insurance premiums and contribution limits for employees to the Thrift Savings Plan both increased, which is reflected in the overall increase in employee benefit liabilities.

Line 2.B – The decrease of advances from others of $6.7M (44 percent) was in the DMAG business area. This decrease is largely due to the resolution of the problem with the billing of public workload that resulted in FY04 with the implementation of the Defense Industrial Fund Financial Management System (DIFMS). DIFMS was not designed to bill private party billings at a fixed price, thus resulting in an increase in the advances account throughout all of FY 2004. A release was installed to correct the report during the first quarter of FY 2005 and current private party bills can now be processed. The release, however, did not provide functionality to process the older contracts and a backlog continued to exist in the account throughout the first two quarters of FY 2005. This backlog has been steadily worked off and the account is now at a normal balance.

Line 2.D – The increase of $35.9M (190 percent) was due to an amount of unsupported undistributed for AF component in FY 2005 that was classified as supported in FY 2004.

Information Related to Other Liabilities (Line 2.I)

(In thousands)	FY2005	FY 2004
Misc Liabilities	500	0
DMAG – WIP Accrued Expenses	1,161,308	1,377,793
SMAG – Future Purchase - Foreign Military Sales	28,377	29,049
SMAG – Other Accrued Liabilities	6,326	4,140
Component – Reclass of Abnormal Non-Federal Accounts Receivable	$ 0	$ 35,537
Total	$ 1,196,511	$ 1,446,519

DMAG work in process accrued expenses continue to decrease as a result of the removal Contract DMAG from the Working Capital Funds, which has resulted in a decline in material, labor, and overhead cost accruals.

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

The Component other liability is related to an abnormal non-federal accounts receivable amount. The amount was abnormal because of Unsupported Undistributed Collections that were moved to Component as part of the undistributed stabilization effort. In FY2005, the amount was reported on Line 2.D with total unsupported collections.

Note Reference

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

Note 16. Commitments and Contingencies

Not applicable.

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

As of September 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
(Amounts in thousands)					
1. Pension and Health Benefits					
A. Military Retirement Pensions	$ 0		$ 0	$ 0	$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Benefits	$ 0		$ 0	$ 0	$ 0
2. Other					
A. FECA	$ 233,713		$ 0	$ 233,713	$ 238,729
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. *[Enter Program Name}*	0		0	0	0
E. Total Other	$ 233,713		$ 0	$ 233,713	$ 238,729
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$ 233,713		$ 0	$ 233,713	$ 238,729

Actuarial Cost Method Used:
Assumptions:
Market Value of Investments in Market-based and Marketable Securities:

Military Retirements Pensions

Not applicable

Military Retirement Health Benefits

Not applicable

Federal Employees Compensation Act (FECA)

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

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

Interest rate assumptions utilized for discounting were as follows:

2001	2002	2003	2004	2005
5.21% in year 1	5.20% in year 1	3.84% in year 1	4.883% in year 1	4.528% in year 1
5.21% in year 2	5.20% in year 2	4.35% in year 2	5.235% in year 2	5.020% in year 2
And thereafter	And thereafter	And thereafter	And thereafter	And thereafter

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

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

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

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

Note Reference

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

Note 18. Disclosures Related to the Statement of Net Cost

Fluctuations and Abnormalities

Intra-governmental Earned Revenue

Intra-governmental earned revenue had a decrease of $1.2 billion (10 percent). The majority of the decrease was in the Supply Management Activity Group (SMAG), which had a decrease of $968.8 million. Two events caused the SMAG decrease. The Material Support Division (MSD) had a decrease of $507.7 million which was caused by backorders of spare engines. In FY 2004 there was a significant quantity of backordered spare engines and the Air Force focused on filling these backorders, which resulted in a reduction of most of the backlog by the end of FY 2004. This reduction in backlog resulted in a one time spike in net sales. With only a minimal level of backorders existing, FY 2005 net sales for spare engines have returned to normal recurring demands. For the General Support Division (GSD), a decrease of $105.1 million is attributed to a reduction in current program requirement levels which are lower than the prior year. Budget estimates have been updated to reflect this trend. The remaining decrease of $356.0 million (represents three percent of the total AFWCF revenue) is a result of normal operations. The Depot Maintenance Activity Group (DMAG) had a decrease of $313.3 million which can be attributed to two events. The first event was a planned budget decrease in FY 2005. The FY 2005 revenue budget was over $200 million less then the actual revenue earned in FY 2004. FY 2005 actual revenue was within 1% of the budget. The second event was due to more accurate classification of revenues between intra-governmental and nonfederal. In FY 2004, allocated information was used to classify revenues and in FY 2005, allocation was not used as actual data was reported.

Earned Revenue from the Public

Nonfederal earned revenue had a decrease of $119.7 million (13 percent), which was primarily caused by the decrease of $236.8 million in SMAG, offset by the $117.2 million increase in DMAG. Two events caused the SMAG decrease. First, MSD had a decrease of $163.3 million which was caused by the non reimbursement of the Readiness Spares Packages (RSP) in FY 2005. RSP kits are parts packages that are purchased in order to ensure that parts are available when needed. MSD was reimbursed for their RSP purchases and the reimbursement was booked as revenues in FY 2004; however, MSD was not reimbursed for their RSP kits in FY 2005. In addition upon researching the decrease it was discovered that these revenues were incorrectly reported as public in FY 2004. For FY 2005 these amounts were zero therefore the error did not impact the FY 2005 financial statements. The second event was the $65.4 million decrease in GSD revenue. The GSD decrease is attributed to a return to current program requirement levels which are lower than the prior year. Budget estimates have been updated to reflect this trend. The DMAG increase of $117.2 million can be attributed to more accurate classification of revenues between intra-governmental and nonfederal. In FY 2004, allocated information was used to classify revenues and in FY 2005, allocation was not used as actual data was reported.

Gross Costs with the Public

Gross cost with the public had a decrease of $3.5 billion (40 percent). The primary cause of this decrease was a change in accounting procedures which required a prior period adjustment to inventory values as discussed in Note 9. A portion of the prior period adjustment relating to standard price changes was not restated, totaling $3.6 billion. If this amount had been recorded in accordance with current procedures, prior year expenses would be decreased by the amount. Further disclosures of the prior period adjustments are disclosed in Note 19.

Information Related to the Statement of Net Cost (SoNC)

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

Working Capital Funds

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

Intra-governmental Operating Expenses

The AFWCF's operating expenses were adjusted based on a comparison between the AFWCF's accounts payable and the DoD summary-level seller accounts receivables. An adjustment was posted to accounts payable and operating expenses to reflect unrecognized accounts payable and operating expenses. The operating expenses of the AFWCF were adjusted upward in the amount of $168.2 million

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

As of September 30	2005 Cumulative Results of Operations	2005 Unexpended Appropriations	2004 Cumulative Results of Operations	2004 Unexpended Appropriations
(Amounts in thousands)				
1. Prior Period Adjustments Increases (Decreases) to Net Position				
A. Changes in Accounting Standards	$ 3,632,598	$ 0	$ 699,393	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	7,256,576	0	18,656,732	0
C. Other Prior Period Adjustments	0	0	0	0
D. Total Prior Period Adjustments	$ 10,889,174	$ 0	$ 19,356,125	$ 0
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	$ 62,192	$ 0	$ 63,443	$ 0
B. Civilian Health	105,973	0	95,320	0
C. Civilian Life Insurance	269	0	255	0
D. Judgment Fund	0	0	0	0
E. Intra-Entity	0	0	0	0
F. Total Imputed Financing	$ 168,434	$ 0	$ 159,018	$ 0

Information Related to the Statement of Changes in Net Position

Prior Period Adjustments

The Material Support Division (MSD) inventory valued at Latest Acquisition Cost (LAC) in Standard Base Supply System (SBSS) was converted to Moving Average Cost historical cost basis valuation on October 1, 2004. Historical cost does not require an allowance for gains and losses. The conversion created a prior period adjustment in fiscal year 2005 of approximately $10.8 billion for the elimination of the allowance for gains and losses, the establishment of an allowance for repairs and the revaluation of inventory. Of this amount, $3.6 billion represents standard price changes, which is classified as a change in standard and not restated, $7.3 billion was attributed to correction of errors and restated in prior year, and $29.7 million was attributed to a correction of error that was not restated. The table below provides detail by USSGL of the prior period adjustment.

USSGL	Description	Debit	Credit
1529	Inventory - Allowance Available and Purchased for Resale	$4,019,352,856.89	
7400	Prior Period Adjustment – Not Restated – Changes		$4,019,352,856.89
Eliminate Allowance related to price gains and losses			
7210	Losses on Disposition of Assets	$442,693,990.47	
7400	Prior Period Adjustment – Not Restated – Changes		$442,693,990.47
Eliminate value of initial increase in inventory from LAC to MAC			
7400	Prior Period Adjustment – Not Restated – Changes	$829,448,586.05	
7290	Other Losses		$829,448,586.05
Eliminate value of initial decrease in inventory from LAC to MAC			
7400	**Prior Period Adjustment – Not Restated – Changes Total**		**$3,632,598,261.31**
7400	Prior Period Adjustment – Not Restated – Errors	$29,700,432.94	
6790	Other Expenses Not Requiring Budgetary Resources		$29,700,432.94
Eliminate the value of the initial establishment of the allowance for repair			
7400	**Prior Period Adjustment – Not Restated – Errors Total**	**$29,700,432.94**	
1529	Inventory - Allowance Available and Purchased for Resale	$1,554,025,803.22	
7401	Prior Period Adjustment – Restated – Errors		$1,554,025,803.22
Value of Realization from Inventory Worksheet			
1529	Inventory - Allowance Available and Purchased for Resale	$5,732,250,672.69	
7401	Prior Period Adjustment – Restated – Errors		$5,732,250,672.69
Restate prior year inventory balance upon changing from LAC to MAC and eliminating the allowance account			
7401	**Prior Period Adjustment – Restated-Errors Total**		**$7,286,276,475.91**

In FY 2004, three prior adjustments were processed for MSD and GSD inventory valued at LAC. The $699.4 million on Line 1.A. represents standard prices changes related to the conversion of GSD inventory. The correction of errors amount on Line 1.B. equates to $10.9 billion for MSD and $465.3 million for GSD. In addition, the FY 2004 amount reflects the restatement of $7.3 billion for the FY 2005 restated amount.

Imputed Financing

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

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2005	2004
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 6,937,550	$ 7,117,842
2. Available Borrowing and Contract Authority at the End of the Period	2,782,392	3,839,310

Information Related to the Statement of Budgetary Resources

Intra-entity Transactions

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

Apportionment Categories

Office of Management and Budget Bulletin No. 01-09, section 9.27, specifically requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B, and exempt from apportionment. This disclosure should agree with the aggregate of the related information as included in each reporting entity's SF 133 and lines 8A and 8B in the SBR. There are no Category A direct or reimbursable obligations. Category B reimbursable obligations total $15.9 billion. There are no category B direct or exempt obligations.

Undelivered Orders

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

Spending Authority from Offsetting Collections

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

Note 21. Disclosures Related to the Statement of Financing

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

Note 1.A. and Note 1.F. provide additional detail.

Other Information Related to the Statement of Financing

Budgetary data is not in agreement with Proprietary Expenses and Assets Capitalized. This causes a difference in Net Cost between the Statement of Net Cost (SoNC) and the Statement of Financing. Line 15 on the Statement of Financing, "Resources that finance the acquisition of assets," is adjusted in order to align the amount of net cost on the Statement of Financing with the amount reported on the (SoNC). Line 15 was adjusted by an absolute value of $862.2 million to balance the report. The adjustment will be researched to determine the cause of the increase over prior reporting periods.

Note 22. Disclosures Related to the Statement of Custodial Activity

Not applicable.

Note 23. Other Disclosures

Not applicable.

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Working Capital Fund

Consolidating and Combining Statements

Consolidating Balance Sheet—Working Capital Fund

As of September 30, 2005 and 2004 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
1. ASSETS (Note 2)			
A. Intra-governmental:			
1. Fund Balance with Treasury (Note 3)			
a. Entity	$ 623,824	$ 476,882	$ 38,195
b. Non-Entity Seized Iraqi Cash	0	0	0
c. Non-Entity-Other	0	0	0
2. Investments (Note 4)	0	0	0
3. Accounts Receivable (Note 5)	308,008	422,459	77,137
4. Other Assets (Note 6)	47,936	98,600	16
5. Total Intra-governmental Assets	$ 979,768	$ 997,941	$ 115,348
B. Cash and Other Monetary Assets (Note 7)	$ 0	$ 0	$ 0
C. Accounts Receivable (Note 5)	36,093	183,551	8
D. Loans Receivable (Note 8)	0	0	0
E. Inventory and Related Property (Note 9)	627,048	32,074,641	0
F. General Property, Plant and Equipment (Note 10)	1,053,914	122,299	29,336
G. Investments (Note 4)	0	0	0
H. Other Assets (Note 6)	516	439,821	0
2. TOTAL ASSETS	$ 2,697,339	$ 33,818,253	$ 144,692
3. LIABILITIES (Note 11)			
A. Intra-governmental:			
1. Accounts Payable (Note 12)	$ 260,118	$ 235,695	$ 881
2. Debt (Note 13)	0	0	0
3. Other Liabilities (Note 15 & Note 16)	243,164	1,000	411
4. Total Intra-governmental Liabilities	$ 503,282	$ 236,695	$ 1,292
B. Accounts Payable (Note 12)	$ 1,158	$ 498,481	$ 156,739
C. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	202,565	23,216	7,932
D. Environmental Liabilities (Note 14)	0	0	0
E. Loan Guarantee Liability (Note 8)	0	0	0
F. Other Liabilities (Note 15 and Note 16)	1,283,805	59,936	10,335
4. TOTAL LIABILITIES	$ 1,990,810	$ 818,328	$ 176,298
5. NET POSITION	0	0	0
A. Unexpended Appropriations	$ 0	$ 0	$ 0
B. Cumulative Results of Operations	706,529	32,999,925	-31,606
6. TOTAL NET POSITION	$ 706,529	$ 32,999,925	$ -31,606
7. TOTAL LIABILITIES AND NET POSITION	$ 2,697,339	$ 33,818,253	$ 144,692

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

Transportation	Component Level	Combined Total	Eliminations	2005 Consolidated	2004 Consolidated
$ 10,137	$ 15,185	$ 1,164,223	$ 0	$ 1,164,223	$ 1,051,110
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	807,604	297,044	510,560	576,396
0	0	146,552	98,037	48,515	10
$ 10,137	$ 15,185	$ 2,118,379	$ 395,081	$ 1,723,298	$ 1,627,516
$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
277	0	219,929	0	219,929	103,111
0	0	0	0	0	0
0	0	32,701,689	0	32,701,689	28,311,805
7	0	1,205,556	0	1,205,556	1,197,683
0	0	0	0	0	0
0	0	440,337	0	440,337	788,966
$ 10,421	$ 15,185	$ 36,685,890	$ 395,081	$ 36,290,809	$ 32,029,081
$ 0	$ 0	$ 496,694	$ 297,044	$ 199,650	$ 256,763
0	0	0	0	0	0
0	0	244,575	98,037	146,538	243,131
$ 0	$ 0	$ 741,269	$ 395,081	$ 346,188	$ 499,894
$ 1,685	$ -111,324	$ 546,739	$ 0	$ 546,739	$ 497,471
0	0	233,713	0	233,713	238,729
0	0	0	0	0	0
0	0	0	0	0	0
-340	35,595	1,389,331	0	1,389,331	1,616,321
$ 1,345	$ -75,729	$ 2,911,052	$ 395,081	$ 2,515,971	$ 2,852,415
0	0	0	0	0	0
$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
9,076	90,914	33,774,838	0	33,774,838	29,176,666
$ 9,076	$ 90,914	$ 33,774,838	$ 0	$ 33,774,838	$ 29,176,666
$ 10,421	$ 15,185	$ 36,685,890	$ 395,081	$ 36,290,809	$ 32,029,081

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

Consolidating Statement of Net Cost—Working Capital Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	Combined Total	Eliminations	2005 Consolidated	2004 Consolidated
Program Costs				
B. Component Level				
Intra-governmental Gross Costs	$ 0	$ 0	$ 0	$ 10,166
(Less: Intra-governmental Earned Revenue)	0	0	0	0
Intra-governmental Net Costs	$ 0	$ 0	$ 0	$ 10,166
Gross Costs With the Public	-10,166	0	-10,166	0
(Less: Earned Revenue From the Public)	0	0	0	0
Net Costs With the Public	$ -10,166	$ 0	$ -10,166	$ 0
Total Net Cost	$ -10,166	$ 0	$ -10,166	$ 10,166
C. Depot Maintenance				
Intra-governmental Gross Costs	$ 3,586,771	$ 2,423,153	$ 1,163,618	$ 615,753
(Less: Intra-governmental Earned Revenue)	-6,187,933	-2,640,520	-3,547,413	-3,860,743
Intra-governmental Net Costs	$ -2,601,162	$ -217,367	$ -2,383,795	$ -3,244,990
Gross Costs With the Public	2,883,343	0	2,883,343	3,940,937
(Less: Earned Revenue From the Public)	-285,280	0	-285,280	-168,063
Net Costs With the Public	$ 2,598,063	$ 0	$ 2,598,063	$ 3,772,874
Total Net Cost	$ -3,099	$ -217,367	$ 214,268	$ 527,884
D. Information Services				
Intra-governmental Gross Costs	$ 58,243	$ 12	$ 58,231	$ 59,444
(Less: Intra-governmental Earned Revenue)	-733,469	-128,620	-604,849	-567,884
Intra-governmental Net Costs	$ -675,226	$ -128,608	$ -546,618	$ -508,440
Gross Costs With the Public	667,961	0	667,961	670,818
(Less: Earned Revenue From the Public)	-3,339	0	-3,339	-2,865
Net Costs With the Public	$ 664,622	$ 0	$ 664,622	$ 667,953
Total Net Cost	$ -10,604	$ -128,608	$ 118,004	$ 159,513
E. Supply Management				
Intra-governmental Gross Costs	$ 6,850,471	$ 2,759,601	$ 4,090,870	$ 4,714,430
(Less: Intra-governmental Earned Revenue)	-8,904,608	-2,413,626	-6,490,982	-7,459,835
Intra-governmental Net Costs	$ -2,054,137	$ 345,975	$ -2,400,112	$ -2,745,405
Gross Costs With the Public	1,660,261	0	1,660,261	4,063,032
(Less: Earned Revenue From the Public)	-483,084	0	-483,084	-719,910
Net Costs With the Public	$ 1,177,177	$ 0	$ 1,177,177	$ 3,343,122
Total Net Cost	$ -876,960	$ 345,975	$ -1,222,935	$ 597,717
F. Transportation				
Intra-governmental Gross Costs	$ 0	$ 0	$ 0	$ 0
(Less: Intra-governmental Earned Revenue)	0	0	0	0
Intra-governmental Net Costs	$ 0	$ 0	$ 0	$ 0
Gross Costs With the Public	77	0	77	0
(Less: Earned Revenue From the Public)	0	0	0	-581
Net Costs With the Public	$ 77	$ 0	$ 77	$ -581
Total Net Cost	$ 77	$ 0	$ 77	$ -581
G. Total Program Costs				
Intra-governmental Gross Costs	$ 10,495,485	$ 5,182,766	$ 5,312,719	$ 5,399,793
(Less: Intra-governmental Earned Revenue)	-15,826,010	-5,182,766	-10,643,244	-11,888,462
Intra-governmental Net Costs	$ -5,330,525	$ 0	$ -5,330,525	$ -6,488,669
Gross Costs With the Public	5,201,476	0	5,201,476	8,674,787
(Less: Earned Revenue From the Public)	-771,703	0	-771,703	-891,419
Net Costs With the Public	$ 4,429,773	$ 0	$ 4,429,773	$ 7,783,368
Total Net Cost	$ -900,752	$ 0	$ -900,752	$ 1,294,699
Cost Not Assigned to Programs	0	0	0	0
(Less:Earned Revenue Not Attributable to Programs)	0	0	0	0
Net Cost of Operations	$ -900,752	$ 0	$ -900,752	$ 1,294,699

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

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Consolidating Statement of Changes in Net Position—Working Capital Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
CUMULATIVE RESULTS OF OPERATIONS			
1. Beginning Balances	$ 716,058	$ 21,134,398	$ -49,968
2. Adjustments (+/-)	0	0	0
2a. Changes in Accounting Principles (+/-)	0	3,632,598	0
2b. Correction of Errors (+/-)	0	7,256,576	0
3. Beginning Balances, as adjusted	716,058	32,023,572	-49,968
4. Budgetary Financing Sources:			
4a. Appropriations received	0	0	0
4b. Appropriations transferred-in/out (+/-)	0	0	0
4c. Other adjustments (rescissions, etc) (+/-)	0	0	0
4d. Appropriations used	0	0	0
4e. Nonexchange revenue	0	0	0
4f. Donations and forfeitures of cash and cash equivalents	0	0	0
4g. Transfers-in/out without reimbursement (+/-)	-155,000	81,089	0
4h. Other budgetary financing sources (+/-)	0	0	0
5. Other Financing Sources:			
5a. Donations and forfeitures of property	0	0	0
5b. Transfers-in/out without reimbursement (+/-)	0	0	0
5c. Imputed financing from costs absorbed by others	142,373	18,303	7,758
5d. Other (+/-)	0	0	0
6. Total Financing Sources	-12,627	99,392	7,758
7. Net Cost of Operations (+/-)	-3,099	-876,960	-10,604
8. Net Change	-9,528	976,352	18,362
9. Ending Balance	$ 706,530	$ 32,999,924	$ -31,606
UNEXPENDED APPROPRIATIONS			
1. Beginning Balances	$ 0	$ 0	$ 0
2. Prior period adjustments (+/-)			
2a. Changes in Accounting Principles (+/-)	0	0	0
2b. Correction of Errors (+/-)	0	0	0
3. Beginning Balances, as adjusted	0	0	0
4. Budgetary Financing Sources:			
4a. Appropriations received	0	0	0
4b. Appropriations transferred-in/out (+/-)	0	0	0
4c. Other adjustments (rescissions, etc) (+/-)	0	0	0
4d. Appropriations used	0	0	0
4e. Nonexchange revenue	0	0	0
4f. Donations and forfeitures of cash and cash equivalents	0	0	0
4g. Transfers-in/out without reimbursement (+/-)	0	0	0
4h. Other budgetary financing sources (+/-)	0	0	0
5. Other Financing Sources:			
5a. Donations and forfeitures of property	0	0	0
5b. Transfers-in/out without reimbursement (+/-)	0	0	0
5c. Imputed financing from costs absorbed by others	0	0	0
5d. Other (+/-)	0	0	0
6. Total Financing Sources	0	0	0
7. Net Cost of Operations (+/-)			
8. Net Change	0	0	0
9. Ending Balance	$ 0	$ 0	$ 0

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

Transportation	Component Level	Combined Total	Eliminations	2005 Consolidated	2004 Consolidated
$ 9,153	$ 80,748	$ 21,890,389	$ 0	$ 21,890,389	$ 11,537,088
0	0	0	0	0	0
0	0	3,632,598	0	3,632,598	699,393
0	0	7,256,576	0	7,256,576	18,656,733
9,153	80,748	32,779,563	0	32,779,563	30,893,214
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	-73,911	0	-73,911	-580,900
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	34
0	0	168,434	0	168,434	159,017
0	0	0	0	0	0
0	0	94,523	0	94,523	-421,849
77	-10,166	-900,752	0	-900,752	1,294,699
-77	10,166	995,275	0	995,275	-1,716,548
$ 9,076	$ 90,914	$ 33,774,838	$ 0	$ 33,774,838	$ 29,176,666
$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
$ 0	$ 0	$ 0	$ 0	$ 0	$ 0

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

Combining Statement of Budgetary Resources—Working Capital Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
1. Budget Authority:			
1a. Appropriations received	$ 0	$ 0	$ 0
1b. Borrowing authority	0	0	0
1c. Contract authority	71,246	9,671,556	1,491
1d. Net transfers (+/-)	0	0	0
1e. Other	0	0	0
2. Unobligated balance:			
2a. Beginning of period	87,989	-57,606	3,997
2b. Net transfers, actual (+/-)	-155,000	81,089	0
2c. Anticipated Transfers Balances	0	0	0
3. Spending authority from offsetting collections:			
3a. Earned	0	0	0
1. Collected	6,473,199	9,365,795	720,359
2. Receivable from Federal sources	-84,665	114,626	20,491
3b. Change in unfilled customer orders	0	0	0
1. Advance received	-121,421	0	0
2. Without advance from Federal sources	-75,839	786,229	-17,646
3c. Anticipated for the rest of year, without advances	0	0	0
3d. Previously unavailable	0	0	0
3e. Transfers for trust funds	0	0	0
3f. Subtotal	6,191,274	10,266,650	723,204
4. Recoveries of prior year obligations	0	4	0
5. Temporarily not available pursuant to Public Law	0	0	0
6. Permanently not available	-434,683	-10,348,877	-17,651
7. Total Budgetary Resources	$ 5,760,826	$ 9,612,816	$ 711,041
STATUS OF BUDGETARY RESOURCES			
8. Obligations incurred:			
8a. Direct	$ 0	$ 0	$ 0
8b. Reimbursable	5,448,028	9,674,370	769,589
8c. Subtotal	5,448,028	9,674,370	769,589
9. Unobligated balance:			
9a. Apportioned	312,798	-61,554	-58,548
9b. Exempt from apportionment	0	0	0
9c. Other available	0	0	0
10. Unobligated Balances Not Available	0	0	0
11. Total, Status of Budgetary Resources	$ 5,760,826	$ 9,612,816	$ 711,041
Relationship of Obligations to Outlays:			
12. Obligated Balance, Net - beginning of period	$ 603,274	$ 4,203,791	$ 32,221
13. Obligated Balance transferred, net (+/-)	0	0	0
14. Obligated Balance, Net - end of period:			
14a. Accounts receivable	-380,677	-586,336	-77,144
14b. Unfilled customer order from Federal sources	-1,988,813	-1,720,404	-248,997
14c. Undelivered orders	889,591	5,327,888	244,226
14d. Accounts payable	1,581,220	519,676	168,366
15. Outlays:			
15a. Disbursements	6,110,484	9,436,477	712,514
15b. Collections	-6,351,778	-9,365,795	-720,359
15c. Subtotal	-241,294	70,682	-7,845
16. Less: Offsetting receipts	0	0	0
17. Net Outlays	$ -241,294	$ 70,682	$ -7,845

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

	Transportation	Component Level	2005 Combined	2004 Combined
	$ 0	$ 0	$ 0	$ 0
	0	0	0	0
	0	0	9,744,293	684,378
	0	0	0	0
	0	0	0	0
	9,146	90,914	134,440	607,130
	0	0	-73,911	-580,900
	0	0	0	0
	0	0	0	0
	0	59	16,559,412	17,824,823
	0	-59	50,393	-186,398
	0	0	0	0
	0	0	-121,421	-173,221
	0	0	692,744	-733,915
	0	0	0	0
	0	0	0	0
	0	0	0	0
	0	0	17,181,128	16,731,289
	0	0	4	3,180
	0	0	0	0
	0	0	-10,801,211	-36,669
	$ 9,146	$ 90,914	$ 16,184,743	$ 17,408,408
	$ 0	$ 0	$ 0	$ 2,027
	77	0	15,892,064	17,271,941
	77	0	15,892,064	17,273,968
	9,068	90,914	292,678	134,440
	0	0	0	0
	1	0	1	0
	0	0	0	0
	$ 9,146	$ 90,914	$ 16,184,743	$ 17,408,408
	$ 1,077	$ -84,380	$ 4,755,983	$ 3,317,312
	0	0	0	0
	-617	35,595	-1,009,179	-958,783
	0	0	-3,958,214	-3,265,470
	0	0	6,461,705	6,610,227
	1,685	-111,324	2,159,623	2,370,008
	86	-8,593	16,250,968	16,752,435
	0	-59	-16,437,991	-17,651,602
	86	-8,652	-187,023	-899,167
	0	0	0	0
	$ 86	$ -8,652	$ -187,023	$ -899,167

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

Consolidating Statement of Financing—Working Capital Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
1. Obligations incurred	$ 5,448,028	$ 9,674,370	$ 769,589
2. Less: Spending authority from offsetting collections and recoveries (-)	-6,191,274	-10,266,654	-723,204
3. Obligations net of offsetting collections and recoveries	-743,246	-592,284	46,385
4. Less: Offsetting receipts (-)	0	0	0
5. Net obligations	-743,246	-592,284	46,385
Other Resources			
6. Donations and forfeitures of property	0	0	0
7. Transfers in/out without reimbursement (+/-)	0	0	0
8. Imputed financing from costs absorbed by others	142,373	18,303	7,758
9. Other (+/-)	0	0	0
10. Net other resources used to finance activities	142,373	18,303	7,758
11. Total resources used to finance activities Resources Used to Finance Items not Part of the Net Cost of Operations	-600,873	-573,981	54,143
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 (-)	435,035	-208,236	-46,506
12b. Unfilled Customer Orders	-197,260	786,229	-17,646
13. Resources that fund expenses recognized in prior periods	-4,098	0	-1,677
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	0	0	0
15. Resources that finance the acquisition of assets	-253,098	-5,108,841	-4,675
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations			
16a. Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0	0	0
16b. Other (+/-)	0	0	0
17. Total resources used to finance items not part of the net net cost of operations	-19,421	-4,530,848	-70,504
18. Total resources used to finance the net cost of operations	-620,294	-5,104,829	-16,361
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:			
Components Requiring or Generating Resources in Future Period:			
19. Increase in annual leave liability	0	0	0
20. Increase in environmental and disposal liability	0	0	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0	0
22. Increase in exchange revenue receivable from the the public (-)	0	0	0
23. Other (+/-)	0	5,961	0
24. Total components of Net Cost of Operations that will require or generate resources in future periods	0	5,961	0
Components not Requiring or Generating Resources:			
25. Depreciation and amortization	134,880	50,066	5,757
26. Revaluation of assets or liabilities (+/-)	3,216	-23	0
27. Other (+/-)	0	0	0
27a. Trust Fund Exchange Revenue	0	0	0
27b. Cost of Goods Sold	5,026,640	0	0
27c. Operating Material & Supplies Used	416,094	0	0
27d. Other	-4,963,634	4,171,866	0
28. Total components of Net Cost of Operations that will not require or generate resources	617,196	4,221,909	5,757
29. Total components of net cost of operations that will not require or generate resources in the current period	617,196	4,227,870	5,757
30. Net Cost of Operations	$ -3,098	$ -876,959	$ -10,604

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

Transportation	Component Level	2005 Combined	2004 Combined
$ 77	$ 0	$ 15,892,064	$ 17,273,968
0	0	-17,181,132	-16,734,469
77	0	-1,289,068	539,499
0	0	0	0
77	0	-1,289,068	539,499
0	0	0	0
0	0	0	34
0	0	168,434	159,017
0	0	0	0
0	0	168,434	159,051
77	0	-1,120,634	698,550
0	0	180,293	-951,116
0	0	571,323	-907,137
0	0	-5,775	-36,403
0	0	0	0
0	-10,166	-5,376,780	-2,686,199
0	0	0	0
0	0	0	-34
0	-10,166	-4,630,939	-4,580,889
77	-10,166	-5,751,573	-3,882,339
0	0	0	0
0	0	0	0
0	0	0	0
0	0	0	0
0	0	5,961	0
0	0	5,961	0
0	0	190,703	259,260
0	0	3,193	-5,660,357
0	0	0	0
0	0	0	0
0	-2	5,026,638	5,866,527
0	0	416,094	325,585
0	0	-791,768	4,386,023
0	-2	4,844,860	5,177,038
0	-2	4,850,821	5,177,038
$ 77	$ -10,168	$ -900,752	$ 1,294,699

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

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Working Capital Fund

Required Supplementary Information

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Disaggregated Statement of Budgetary Resources—Working Capital Fund

For the years ended September 30, 2005 and 2004 ($ in Thousands)

	Working Capital Funds	2005 Combined	2004 Combined
BUDGETARY RESOURCES			
1. Budget Authority:			
1a. Appropriations received	$ 0	$ 0	$ 0
1b. Borrowing authority	0	0	0
1c. Contract authority	9,744,293	9,744,293	684,378
1d. Net transfers (+/-)	0	0	0
1e. Other	0	0	0
2. Unobligated balance:			
2a. Beginning of period	134,439	134,440	607,130
2b. Net transfers, actual (+/-)	-73,911	-73,911	-580,900
2c. Anticipated Transfers Balances	0	0	0
3. Spending authority from offsetting collections:			
3a. Earned	0	0	0
1. Collected	16,559,411	16,559,412	17,824,823
2. Receivable from Federal sources	50,394	50,393	-186,398
3b. Change in unfilled customer orders	0	0	0
1. Advance received	-121,421	-121,421	-173,221
2. Without advance from Federal sources	692,744	692,744	-733,915
3c. Anticipated for the rest of year, without advances	0	0	0
3d. Transfers from trust funds	0	0	0
3e. Subtotal	0	0	0
4. Recoveries of prior year obligations	4	4	3,180
5. Temporarily not available pursuant to Public Law	0	0	0
6. Permanently not available	-10,801,211	-10,801,211	-36,669
7. Total Budgetary Resources	$ 16,184,742	$ 16,184,743	$ 17,408,408
STATUS OF BUDGETARY RESOURCES			
8. Obligations incurred:	$		
8a. Direct	0	0	2,027
8b. Reimbursable	15,892,064	15,892,064	17,271,941
8c. Subtotal	15,892,064	15,892,064	17,273,968
9. Unobligated balance:			
9a. Apportioned	292,679	292,678	134,440
9b. Exempt from apportionment	0	0	0
9c. Other available	0	1	0
10. Unobligated Balances Not Available	0	0	0
11. Total, Status of Budgetary Resources	$ 16,184,743	$ 16,184,743	$ 17,408,408
Relationship of Obligations to Outlays:			
12. Obligated Balance, Net - beginning of period	$ 4,755,982	$ 4,755,983	$ 3,317,312
13. Obligated Balance transferred, net (+/-)	0	0	0
14. Obligated Balance, Net - end of period:			
14a. Accounts receivable	-1,009,178	-1,009,179	-958,783
14b. Unfilled customer order from Federal sources	-3,958,214	-3,958,214	-3,265,470
14c. Undelivered orders	6,461,706	6,461,705	6,610,227
14d. Accounts payable	2,159,621	2,159,623	2,370,008
15. Outlays:			
15a. Disbursements	16,250,968	16,250,968	16,752,435
15b. Collections	-16,437,991	-16,437,991	-17,651,602
15c. Subtotal	-187,023	-187,023	-899,167
16. Less: Offsetting receipts	0	0	0
17. Net Outlays	$ -187,023	$ -187,023	$ -899,167

Required Supplemental Information - Part A AT97 - Air Force Working Capital Fund Schedule, Part A DoD Intra-governmental Asset Balances	Treasury Index:	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Department of Agriculture	12		$8.00			
Department of the Interior	14		$4.00			
Department of Justice	15		$476.00			
Navy General Fund	17		$3,941.00			
Department of State	19		$16.00			
Department of the Treasury	20	$1,164,223.00				
Army General Fund	21		$1,347.00			
General Service Administration	47		$2,634.00			
General Accounting Office	5		$13.00			
Air Force General Fund	57		$411,716.00			$48,076.00
Homeland Security	70		$2,107.00			
National Aeronautics and Space Administration	80		$1,205.00			
Department of Energy	89		$120.00			
US Army Corps of Engineers	96		$34.00			
Other Defense Organizations General Funds	97		$39,672.00			
Other Defense Organizations Working Capital Funds	97-4930		$39,802.00			$439.00
Army Working Capital Fund	97-4930.001		$3,059.00			
Navy Working Capital Fund	97-4930.002		$4,405.00			

Required Supplemental Information - Part B AT97 - Air Force Working Capital Fund Schedule, Part B DoD Intra-governmental entity liabilities.	Treasury Index:	Accounts Payable	Debts/Borrowings From Other Agencies	Other
Navy General Fund	17	$634.00		$1,572.00
Army General Fund	21	$1,220.00		
Office of Personnel Management	24			$10,297.00
Air Force General Fund	57	$82,392.00		$134,111.00
Homeland Security	70			$408.00
Other Defense Organizations General Funds	97	$122.00		
Other Defense Organizations Working Capital Funds	97-4930	$110,118.00		$149.00
Army Working Capital Fund	97-4930.001	$2,884.00		
Navy Working Capital Fund	97-4930.002	$2,279.00		

Required Supplemental Information - Part C AT97 - Air Force Working Capital Fund Schedule, Part C DoD Intra-governmental revenue and related costs	Treasury Index:	Earned Revenue
Department of Agriculture	12	$15.00
Department of Commerce	13	$0.00
Department of the Interior	14	$75.00
Department of Justice	15	$3,139.00
Navy General Fund	17	$71,663.00
Department of State	19	$171.00
Department of the Treasury	20	$15.00
Army General Fund	21	$28,995.00
General Service Administration	47	$51.00
National Science Foundation	49	$6.00
General Accounting Office	5	$7.00
Air Force General Fund	57	$8,620,533.00
Department of Transportation	69	$57.00
Homeland Security	70	$8,462.00
Small Business Administration	73	$0.00
National Aeronautics and Space Administration	80	$2,341.00
Department of Energy	89	$6.00
US Army Corps of Engineers	96	$79.00
Other Defense Organizations General Funds	97	$1,227,126.00
Other Defense Organizations Working Capital Funds	97-4930	$473,044.00
Army Working Capital Fund	97-4930.001	$21,271.00
Navy Working Capital Fund	97-4930.002	$177,449.00

Required Supplemental Information - Part E AT97 - Air Force Working Capital Fund ($Amounts in Thousands)	Treasury Index:	Transfers In	Transfers Out
Army General Fund	21		$155,000.00
Other Defense Organizations Working Capital Funds	97-4930	$81,089.00	

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Working Capital Fund

Audit Opinion

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

November 8, 2005

MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Fiscal Year 2005 Air Force Working Capital Fund Financial Statements (Report No. D-2006-019)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Air Force Working Capital Fund Consolidated Balance Sheet as of September 30, 2005 and 2004, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing for the fiscal years then ended. The financial statements are the responsibility of Air Force management. The Air Force is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Fiscal Year 2005 financial statements of the Air Force Working Capital Fund because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us that previously identified material weaknesses in internal control and instances of noncompliance with laws and regulations continue to affect the current period. Management acknowledged that, as a result of those conditions, the financial data reported in the financial statements were unreliable. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Air Force has also acknowledged the material weaknesses listed in the Summary of Internal Control. These material weaknesses also affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the principal financial statements.[1] Therefore, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

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

Summary of Internal Control

In planning our audit, we considered Air Force internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance. However, previously identified reportable conditions,[2] all of which are material, continue to exist in the following areas.

- Financial Management Systems
- Operating Materials and Supplies
- In-Transit Inventory
- General Property, Plant, and Equipment
- Statement of Net Cost
- Statement of Financing
- Intragovernmental Transactions
- Other Accounting Entries
- Policies and Practices

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

Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged that instances of noncompliance continue to exist. The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us that critical financial management feeder systems of the Air Force do not comply substantially with the Federal Financial Management Improvement Act of 1996. Therefore, we did not determine whether the Air Force was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

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[2] Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

Management Responsibility

Management is responsible for:

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

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

Attachment:
As stated

Report on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting.

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

Financial Management Systems. The Air Force financial management systems do not substantially comply with Federal financial management systems requirements.

The Air Force has not fully implemented the U.S. Government Standard General Ledger at the transaction level. For details, see Note 1.D. to the financial statements. The Air Force is unable to implement fully all elements of generally accepted accounting principles and the Office of Management and Budget Bulletin No. 01-09, "Form and Content of Agency Financial Statements," because of limitations in financial management processes and systems. For details, see Note 1.A. to the financial statements.

Air Force systems are not transaction driven for budgetary accounts. Therefore, in some cases proprietary and statistical accounts are used to develop the Report on Budget Execution and Budgetary Resources (SF-133) and Statement of Budgetary Resources for reporting budgetary data. For details, see Note 1.C. to the financial statements.

Operating Materials and Supplies. Cost of goods sold and work-in-process are not recorded in accordance with Statement of Federal Financial Accounting Standard No. 3, "Accounting for Inventory and Related Property." Further, uncertainties remain regarding the existence and completeness of the quantities used to derive the balances reported in the financial statements for operating materials and supplies.

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

General Property, Plant, and Equipment. General Property, Plant, and Equipment values cannot be verified in accordance with Statement of Federal Financial Accounting Standard No. 6, "Accounting for Property, Plant, and Equipment." For details, see Note 10. to the financial statements. In addition, the General Property, Plant, and Equipment line item on the Balance Sheet does not include all Government-furnished equipment (with values exceeding the capitalization threshold) in the hands of contractors. The Air Force is developing policies and a contractor reporting system so that the Air Force can report appropriate values. For details, see Note 1.O. to the financial statements.

Attachment

Statement of Net Cost. The Air Force does not accumulate cost information as required by generally accepted accounting principles. The Air Force identifies cost in the Consolidated Statement of Net Cost based on the major appropriation groups funded by Congress instead of being based on major programs and activities as set forth in Statement of Federal Financial Accounting Standard No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government." For details, see Note 1.D. to the financial statements.

Statement of Financing. The Air Force cannot reconcile budgetary data with proprietary expenses and assets capitalized without making unsupported adjustments to resolve differences. For details, see Note 21. to the financial statements.

Intragovernmental Transactions. The Air Force cannot accurately identify all intragovernmental transactions by customer. Seller entities within the DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have been adjusted to recognize unrecorded costs and accounts payable. DoD intragovernmental balances were then eliminated. For details, see Note 1.G. to the financial statements.

The Air Force cannot reconcile intragovernmental accounts receivable or accounts payable balances, or reconcile intragovernmental revenue balances with its trading partners.

Other Accounting Entries. The Air Force continues to enter a material number of unsupported accounting entries because financial and nonfinancial feeder systems continue to lack sufficient customer identification information to accurately process eliminations. For details, see Note 1.A. to the financial statements.

Policies and Practices. Air Force resource managers do not always maintain adequate documentation or use transaction subsidiary ledgers and special journals to support recorded trial balance accounts. Air Force and Defense Finance and Accounting Service personnel do not perform reconciliation and systems validations to verify the accuracy of accounts receivable from foreign military sales, progress payments to contractors, and accounts payable from the Materiel Support Division.

These financial management deficiencies are indications of material weaknesses in internal control that may adversely affect any decision by the Air Force that is based, in whole or in part, on information that is inaccurate because of these deficiencies. Financial information reported by the Air Force also may contain misstatements resulting from these deficiencies.

Compliance with Laws and Regulations

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

Attachment

The Air Force is required by the Federal Financial Management Improvement Act of 1996 to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. The Air Force acknowledged that its critical financial management feeder systems do not comply substantially with Federal financial management systems requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not perform tests of compliance for these requirements.

Audit Disclosures

The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us on February 14, 2005, that Air Force financial management systems do not comply substantially with Federal financial management systems requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. These deficiencies in Air Force critical financial feeder systems limited its ability to present information accurately and in conformance with generally accepted accounting principles.

In addition, we did not perform audit work related to the provisions of the laws and regulations identified in Office of Management and Budget Bulletin Number 01-02, "Audit Requirements for Federal Financial Statements," October 16, 2000, Appendix C, "General Laws."

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

Attachment

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